Koh Yong Guan: Regulatory approaches in global capital markets

Keynote address by Mr Koh Yong Guan, Managing Director of the Monetary Authority of Singapore, at the MAS Capital Markets Seminar 2002, Singapore, 2 May 2002.

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MAS Capital Markets Seminar

Ladies and Gentlemen

Good morning and a warm welcome to the MAS Capital Markets Seminar. For participants from abroad, I wish you a pleasant and rewarding time in Singapore.

We have chosen "Evolving Regulatory Approaches" as the theme to underscore the importance for regulators to keep pace with developments in the global capital markets.

Advances in technology have enabled instantaneous and seamless access into diverse capital markets. At the same time, consolidation of specialist financial institutions into financial conglomerates with cross-border presence has redefined traditional notions of market boundaries. The consequent growth in cross-border transactions poses regulatory challenges to national regulators supervising global market players.

As we have seen in recent months, a single event in one market can create significant ripple effects elsewhere. These developments have not been lost on regulators. Having no less than 12 countries represented here today bears testimony to the importance attached to learning from fellow regulators. One key reason for organising the capital market seminar is to facilitate the exchange of views and sharing of ideas. The occasion also provides an opportunity for regulators to get to know one another better.

We hope that the interaction through presentations and panel discussions will provide ample opportunities for participants to share the experiences and challenges in their home markets. To provide a global perspective, we are honoured to have distinguished speakers from the US Securities and Exchange Commission, the UK Financial Services Authority, and the Australian Securities and Investments Commission. The presentations by leading industry practitioners will add an important market dimension.

To start off the programme this morning, let me put to you three broad propositions which regulators should reconcile with, in keeping with the demands of global capital markets:

(a) First, the need for cross-jurisdiction regulatory collaboration;

(b) Second, a growing impetus for international standards; and

(c) Third, how can regulators and regulations respond and facilitate capital markets' continued innovation and growth.

The need for regulatory collaboration

The importance of cross-border regulatory cooperation is evident from the cross-border element in the regulator's job. Local investors buy financial products overseas while foreign funds own substantial stakes in locally-listed stocks. Capital market intermediaries compete vigorously to add value, servicing global orders. Even markets now seek direct presence, in the form of trading terminals, in different jurisdictions.

Increasingly, cross-border operations are no longer conducted predominantly via telephone or fax wires, but by proprietary networks capable of channeling orders and funds across the globe almost instantaneously. Such proprietary systems combined with the reach of the internet has pooled isolated pockets of liquidity into a single global market.

With the aid of international rating agencies and global issue managers, corporate entities on their part are raising funds wherever it is priced most cheaply and available with minimal hassle. On the demand side, investors recognize the importance of global liquidity and market diversification. By taking advantage of the financial links provided by intermediaries, retail investors have become empowered to actively manage a global portfolio of investments.

In this environment, no single national regulator can afford to focus just on activities taking place in its domestic markets. To achieve the objectives of investor protection and systemic stability, cross-border regulatory cooperation is imperative. The Sep 11 incident demonstrates the degree to which financial markets are interwoven and illustrates the need for such collaboration. All of you will recall that the event resulted not just in the closure of US markets for 4 working days, but also justified the temporary closure of several markets in Asia, while delaying trading hours in others. The reality was that regulators the world over found themselves having to assess the situation, update one another, and decide on actions to be taken in their respective markets.

Systemic risk has also increased with the trend towards commoditisation, ie volume business at competitive costs. The concentration of volumes into key nodes such as large global custodians represents exposure by market participants to entities located in other jurisdictions. Meanwhile, cross-border capital flows have significantly increased the magnitude by which markets adjust to shocks as evidenced in the Asian crisis. The same systems that allow international trades to be conducted from a hub are also conduits by which volatility is transmitted globally.

For the risk to be satisfactorily managed, collaboration is necessary. Regulatory collaboration can take many forms. It begins from interaction on occasions such as this, which represents an opportunity to compare notes, discuss issues and exchange views. Such informal but regular contact should not be discounted. Indeed, I understand from my colleagues that a series of telephone conversations and e-mails with regulatory counterparts elsewhere in the aftermath of Sep 11 contributed considerably to a quick appreciation of the type, and magnitude, of issues that could be expected. This contributed to the avoidance of instability in individual markets. Looking back, we can all agree the markets stood up remarkably well.

International meetings and joint forums such as IOSCO are a further step towards setting the foundation for more structured lines of communication amongst regulators. Participation in IOSCO taskforces requires resources but helps to develop better appreciation of characteristics unique in other markets, and alternative approaches to addressing regulatory concerns. It is in recognition of this that MAS has devoted resources to active participation in IOSCO's committees and working groups.

We have also found the Memorandum of Understanding ("MOU") to be a useful instrument for setting out mutually agreed procedures by which regulators may exchange information and provide mutual assistance. Since the mid-1990s, MAS has entered into a number of such MOUs to ensure that the level of regulatory collaboration keeps pace with the capital market linkages that are in place. A formal arrangement enshrined in an MOU may not be necessary in all cases, but are helpful amongst jurisdictions with substantive capital market linkages or trading arrangements in place.

Impetus for international standards

The second proposition is the growing impetus for international standards. In this regard, IOSCO has taken the lead in putting forward a set of principles which its members subscribe to. Some of the principles are necessarily pitched at a broad level, to allow members to agree on key areas which regulators should focus their attention.

The challenge ahead is to continue working systematically on the principles to further cross-reference against quantifiable standards. There are several reasons why such international standards are important.

Danger of a weak link in the system

The first is that interconnected markets means that transactions involving intermediaries or markets in different jurisdictions are always exposed to the weakest link. As an example, a localised weak link in clearing and custody networks used for cross-border transactions that buckles under stress will have far reaching repercussions on the smooth functioning of counterparties and markets in other jurisdictions.

Benchmarking

The second reason is that, whereas regulations are developed for local usage, international standards are invariably developed under the close scrutiny of different regulators, and are derived after rigorous debate and sometimes protracted fine-tuning. The end product is usually of laudable standards and serves as a good yardstick for domestic practices to be benchmarked against.

Investor protection

The third reason is that a common set of standards facilitates sound regulatory oversight that is based on consistent treatment of cross-border markets and activities. With regulators using the same standards in assessing systems, products and practices, market players that deal with foreign institutions or instruments can take comfort that those institutions and products are regulated based on similar high standards.

Efficiency & cost savings

And the fourth reason is that the establishment of a set of standards that is subscribed to internationally has the effect of aligning the regulatory practices in different jurisdictions. This allows international financial institutions operating in different markets with similar features and rules drawn up according to international standards, to benefit from lower compliance costs. Given a choice, from the business proposition point of view, few fund managers, issuers or financial advisers would wish to expend resources on compliance systems to keep track of different requirements and procedures in different markets.

Much work is already underway to develop international standards on specific subjects. Within IOSCO, MAS is a participant of various of its working groups including the Internet Project Team and the Implementation Committee which, as its name suggests, has been tasked to implement the 30 IOSCO principles of securities regulation. Apart from IOSCO, a number of other fora has also proposed recommendations in their respective areas. These include the Basle Committee's work on a set of globally accepted principles of risk-based capital among banks; the Group of 30's work in the area of standardising OTC documentation; and a collaborative effort by the Bank for International Settlements and IOSCO on recommended standards for securities settlement systems.

Indirectly giving impetus to international best practices is the IMF and World Bank's Financial Sector Assessment Programme ("FSAP"). Under this initiative, assessors will collaborate with regulators in participating jurisdictions to benchmark financial systems and practices against global standards.

MAS is convinced that these efforts represent considerable value-add to the global regulatory environment and has participated in support of these initiatives. We will be undertaking an FSAP this year. As an international financial center, we are also committed to contributing to international financial stability as a member of the Financial Stability Forum, and have found our involvement in various of its working groups to be invaluable. The establishment of international standards and best practices as the way forward will become even more compelling as globalisation continues, and regulators should be prepared to stay engaged with the process.

In doing so, it should be recognised that initiatives to draw up international standards in themselves also add value by prompting regulators to re-examine existing regulation and review the policy rationale behind them. This is useful in bringing dated practices back into line with international best practices. Improvements to comply with globally accepted principles will benefit the market's growth and in the long term attract participants with strong internal controls.

Call for responsive regulation

My third point concerns the role of regulators and regulations. Markets are calling and indeed demanding for regulation to be more responsive to the needs of innovation and growth. If globalisation has changed the international outlook of markets, the blurring of sectoral boundaries has transformed financial markets from within.

With the mergers and acquisitions of the 1990s in the financial industry, cross-selling has become prominent today with banks seeking to distribute investment and insurance products while stockbrokers offer cash management and checking accounts. Insurance corporations on their part have concentrated efforts to promote investment-linked policies. The trend is in part demand-driven with customers seeking a one-stop financial house that provides convenient and integrated approach to money management. Notwithstanding the global economic downturn which has checked M&A activities, market players have not let up efforts to gain a competitive edge by consolidating their positions through alliances.

The regulatory response to this has been a trend towards more integrated supervision. This allows regulators to supervise the range of activities more efficiently by taking a holistic view of the financial services market. The UK FSA is one example of integrated supervision under one roof while Australia's Securities and Investments Commission and the Australian Prudential Regulation Authority have ambits that cut across different industries.

As product lines converge, regulators in setting the rules have to be careful not to inadvertently pick and choose the winning models. Put another way, similar activities that involve identical risk issues should be regulated on an equal basis to avoid tilting the playing field. Failure to do so will result in regulatory arbitrage and cause activities to migrate towards looser controls.

In Singapore, the regulators for banking, securities and insurance activities are consolidated in MAS. Specific to the capital market, we have integrated our legislation for the securities and futures industries, and harmonised our regulation of the financial advisory business to support the cross-selling of products. What is critical however, is not how regulatory responsibility is divided or consolidated into one or more agencies. The overriding objective is equitable treatment and consistency in the approach to the measurement and management of risk.

Capital requirements illustrate this most clearly. Most regulatory models have moved away from setting fixed minimum capital for regulated activities. In banks as for capital market intermediaries, regulators are adopting and refining the risk based regulatory approach. Where risks take on a similar profile therefore, the capital charges should be aligned based on a consistent principle. This is so even as the risk management regime in the banking, securities and insurance sectors retains some distinctive features that recognises the differences in these businesses.

Legislative initiatives in Singapore

In Singapore, at the heart of the regulatory framework for the capital markets is the Securities and Futures Act ("SFA") which was enacted in September last year. The SFA is an omnibus Act that sets out the regulatory framework for the capital market. It seeks to cover in a single rulebook the range of capital market activities undertaken in Singapore, for the convenience of market participants.

The SFA introduces a single licensing regime covering the various activities in securities and futures, fund management and corporate finance advice under a modular approach. This is a shift away from folding all capital market activities into the categories of dealing in securities, and provision of investment advice. In its place, the new licensing framework is designed to accommodate individual slices of the capital market value chain.

To complement the modular licensing of intermediaries, MAS has announced the introduction of a risk based capital framework which will take effect later this year. Under the framework, capital market licence holders need only maintain capital sufficient to the business risks they undertake, according to their respective operations.

Complementing the SFA is the Financial Advisors Act which governs the provision of investment advice and the sale of collective investment products across all financial institutions. This will include banks, insurance companies, capital market intermediaries as well as independent financial advisers. A common code of conduct and business practices will be promulgated under the FA Act, and will set minimum standards for all investment advisers.

Conclusion

In concluding, there is little doubt that the new financial landscape both domestically and internationally has thrown up challenges and opportunities for regulators and market players alike. It is a time of change and renewal as the tried and tested means of doing things come under scrutiny as markets continually innovate. The challenge for us as regulators is to put in place a regulatory framework and operate the system flexibly to meet the market demand for innovation and dynamism, without compromising the safety and soundness of the system.

I hope to have given you some food for thought that will spark off questions and discussion over the next few days. It remains for me to encourage all of you to make the most of this opportunity and give voice to your views in the course of the seminar. I have no doubt that you will have much to share and learn from the speakers, and from one another's experiences. I wish you a lively and useful Seminar.

Thank you.