Lee Hsien Loong: Financial sector - liberalisation and growth

Address by Mr Lee Hsien Loong, Deputy Prime Minister of Singapore and Chairman of the Monetary Authority of Singapore, at the Association of Banks in Singapore's 31st Annual Dinner, Singapore, 17 June 2004.

*   *   *

In 1997, MAS launched a comprehensive review of Singapore's financial sector. The Asian crisis unfolded soon after, but we decided to press on. Over the next few years, we fundamentally changed our regulatory approach, from one-size-fits-all prescriptive regulation towards a more risk-focussed supervisory approach. We liberalised the industry, allowing freer competition, more play of market forces, and greater risk taking by institutions. We actively promoted activities in which we had competitive advantages.

Our efforts are bearing fruit. In the last seven years, the financial industry has changed dramatically. Tonight, let me review the state of the industry, and discuss some key challenges and opportunities going forward.

Overview of changes in the financial sector

Singapore's financial sector held up well against the full impact of the Asian Financial Crisis, and more recently the SARS outbreak. Despite the turbulent environment, it has steadily grown and matured. Our financial system is robust, and our legal, supervisory and institutional framework is sound, as the IMF's recent Financial System Stability Assessment of Singapore affirmed. Today, 700 local and foreign financial institutions are in Singapore. They offer a comprehensive range of world-class financial services and with 5% of our workforce, contribute 12% of Singapore's GDP.

In banking, seven local banking groups have consolidated into three stronger groups. Foreign shareholding limits on locally-incorporated banks have been removed, allowing them to tap the equity market more flexibly, and if they desire, to form strategic partnerships with foreign banks. Six banks with regional and international standing and the potential to contribute to our financial sector have been awarded Qualifying Full Bank (QFB) licences. This has intensified competition in retail banking and widened consumer choices. Foreign banks also continue to be active players in the wholesale banking market and in wealth management. International banks are using Singapore as their base to service corporations and high net worth individuals (HNWIs) in the region.

In insurance, a formerly closed industry has been substantially deregulated. We have enhanced disclosure requirements of products, tightened up sales practices and raised the overall professionalism of insurance advisers.

The financial advisory industry has also seen substantial growth. A diversity of firms and business models now cater to different market segments. Service and conduct standards of financial advisers have gone up.

The wealth management industry has grown dramatically. Annual growth rates in private banking assets under management (AUM) average almost 20%. In 2003, institutional AUM grew by 35% year-on-year to S$ 465 billion. A majority of these assets are internationally sourced. Close to 1,000 investment professionals, comprising portfolio managers, analysts, asset allocators and economists now work in this high value-added sector. Fund managers have been extending their value chain of activities here. Apart from portfolio management and marketing activities, companies now carry out middle-office functions such as regional trading and research. Others have centralised regional back office operations in Singapore, making full use of our efficient infrastructure, conducive business environment and stable political climate.

MAS also made a major effort to develop Singapore's capital markets. A cornerstone of this effort was the easing of restrictions on the lending of the Singapore dollar (S$) to non-residents. Originally, banks required MAS' permission for any form of lending to non-residents above S$ 5 million. This blanket restriction effectively discouraged S$ speculation, but it also stifled the growth of capital markets. Starting in 1998, we progressively refined the restrictions to focus more sharply on lending for the purpose of S$ speculation. We lifted restrictions on the trading of S$ derivatives like futures, options and cross-currency swaps. We allowed non-residents to raise S$ funds through debt and equity issuance. Eventually the policy changed so substantially that it was no longer apt to describe it as the non-internationalisation of the S$. So in May this year we renamed it the policy on the lending of S$ to non-resident financial institutions.

Consequently, our capital markets have broadened and deepened. The debt market has matured significantly, and now provides a cost-effective alternative funding source to a diverse range of local and foreign borrowers. The SGS yield curve has been extended from 7 to 15 years. Some statutory boards have even issued bonds up to 20 years in tenor. The corporate debt market has quadrupled since end-1996 with S$ 103 billion of corporate debt securities outstanding as at end-2003. Debt issuance has increased substantially from only S$ 5.4 billion at end-1996 to S$ 67 billion in 2003, a compounded annual growth of 43%.

The profile of debt issuers has also changed. Statutory boards used to dominate, but now form only 3% of total issuance. Instead, the debt market has a stable base of large corporates and financial institutions issuing bonds well over S$ 1 billion in issue size. This has increased liquidity in the secondary market. Large international issuers such as IFC, Freddie Mac, Fannie Mae and ADB, which can tap any market in the world, have chosen to raise funds in Singapore.

Treasury markets have also stayed buoyant, as Singapore remains one of the established leading global FX trading centres. The creation and hedging of structured products have boosted turnover in derivative markets. Singapore now ranks 6th globally, in OTC FX and interest rate derivatives.

Reforms were also introduced to deregulate the stockbroking industry. The industry has consolidated, operating more leanly on much lower commissions. The bigger local players have expanded their product range and also expanded overseas. More foreign players have entered the market. Overall, investors have benefited from lower trading costs.

SGX became the first demutualised, integrated stock and derivatives exchange in the Asia-Pacific in December 1999. It is now well placed to grow its business, and respond to developments in regional capital markets. More foreign companies are choosing to list in Singapore. To date, there have been 47 listings by Chinese companies, and a few Indian listings are in the pipeline. SGX has also actively pursued alliances with other exchanges. Its first securities co-trading linkage with the Australia Stock Exchange allowed investors in the two countries to trade in each other’s market directly. SGX is also exploring linkages with ASEAN securities markets. If this succeeds it will benefit the region as a whole.

We have also grown as a processing centre. Large financial institutions have centralised their regional and global processing operations in Singapore. These house high value-added, mission-critical systems as well as back-office processing activities.

In brief, our financial sector has become more dynamic and vibrant. Many persons and institutions have participated in this process. Their support, hard work and spirit of enterprise made this possible. I thank them all.

Developments in the banking sector

Let me now focus on the banking sector.

The Asian Financial Crisis underscored the importance of sound, resilient financial systems underpinned by strong domestic banks. The lessons of the Crisis played a major part in re-shaping the banking industry. Meanwhile, global trends such as consolidation among the major international banks, technology advances and globalisation of financial markets continued apace. A new financial landscape was emerging.

MAS-initiated reforms

Banking was the most critical and complex part of the MAS reforms. We started from a strong position, with sound and well supervised local banks, although they operated in a tightly regulated and protected environment. Our challenge was to free up this industry so that it could continue to develop and grow, without compromising stability and soundness in a changing landscape. Strong and well-managed local banks, with a significant share of the home market, were and are critical to the resilience and stability of our financial system. However, we could no longer maintain this by restricting access to the domestic market. We needed to permit more competition, but in phases, to allow the local banks to adjust and compete effectively.

MAS therefore introduced a five-year programme to liberalise access to Singapore's domestic banking market. We made the first moves in 1999. As we lightened our regulatory touch, we also worked with banks to set guidelines for best practices and give banks greater room for enterprise and innovation.

Stronger banking industry

Today, Singapore's banking sector is more open and dynamic. This has come about without sacrificing strength and stability. Individual banks and the industry as a whole have risen to the challenge. Existing players have upgraded and strengthened themselves. Banks have maintained high prudential standards, become more efficient and improved their service quality and product ranges.

The foreign banks have contributed to the vibrancy of the Singapore banking scene. Competition has led to the development of a rich array of innovative products and more discriminating pricing models. Customer service as a whole has improved. Foreign banks have continued to expand their operations here, and many have made Singapore a regional or even global platform for important banking services.

The local banks have strengthened their capabilities and expanded their range of business activities. They have built up their management teams, and made significant infrastructural investments to enhance their operational effectiveness. Fees and commissions have risen as a proportion of operating income. Banks are offering new business services, while continuing to provide affordable banking facilities to the average Singaporean. They have held their own despite the increased competition. For instance, their market share of resident non-bank deposits (both ACU and DBU) has declined only marginally from 62% to 59% over the last five years.

The local banks have also improved their business and risk management capabilities. The recent change in MAS' capital adequacy requirements is in recognition of local banks' efforts to upgrade their risk management capabilities, and should allow them to manage their capital more flexibly.

With greater financial strength from the mergers and increased competition at home, local banks have begun to venture abroad and develop a regional footprint through overseas acquisitions.

Banking liberalisation

When MAS embarked on the liberalisation measures, we sought to anticipate changes and trends that we were convinced were already underway. Events since then showed that we moved none too soon. Technological advances have continued unabated. The Internet for instance has proven to be an efficient and widely used alternative distribution and marketing channel, and has helped create new business models. Worldwide, major banks continue to consolidate, though the process is not yet complete, especially in Europe.

We also anticipated needing to open up our banking sector because we intended to negotiate FTAs with major trading partners. Since our goods sector was already almost completely open, our partners would surely make requests in services, and especially financial services. Therefore our local banks had to be ready. The banks would have preferred that we slow down the pace, but we had an overriding need to conclude a wide network of FTAs, including one with the US. The banking reforms enabled us to do this. Now that we have done so, we are reassured that our banks are holding their own, and can take the increased competition in their stride.

Adjustments to liberalisation measures

It is now three years since the last package of banking liberalisation measures in 2001. Having assessed the state of the industry, MAS has decided to take a few further steps to liberalise the banking industry. These are incremental adjustments to the earlier major liberalisation packages:

a. Firstly, from 1 January 2005, QFBs will be permitted to establish up to 25 service locations from the existing 15. The 25 locations can either be brick-and-mortar branches or offsite ATM locations. With 6 QFBs permitted to share ATMs amongst themselves, this could result in a QFB shared ATM network of about 150 locations across Singapore. This provides QFBs with significant scope for expanding their presence in the domestic market.

b. Secondly, MAS is prepared to grant a limited number of new Wholesale Bank (WB) licences to applicants that meet our admission requirements.

c. Finally, QFBs will with immediate effect be allowed to negotiate with the local banks on a commercial basis to let their credit card holders obtain cash advances through the local banks' ATM networks.

Singapore now has one of the most liberal banking environments in Asia. However, over time, as the industry changes, we must be ready to liberalise further. MAS will reassess the environment before deciding on any further measures.

While it is still too early to make a final judgment, banking liberalisation has so far achieved its aim of bringing about greater competition. It has fostered the consolidation of the local banks, which might otherwise have taken much longer. The overall market shares of local and foreign banks have not changed drastically, but there has been an all-round qualitative improvement which has enhanced the vibrancy of Singapore's financial sector.

The liberalisation measures and reforms of the last few years have set the financial sector on a firm foundation. However, we cannot afford to rest on our laurels. Challenges as well as opportunities exist for both the banking industry and the financial sector as a whole. We must identify and respond to them, in order to keep the financial sector dynamic and competitive.

Challenges for banks

For banks, I will focus on two main challenges. Firstly, banks need to continue to maintain high prudential standards so as to remain sound institutions. Next, they have to develop new strategies to continue growing strong, viable businesses.

Sound institutions

MAS does not seek to prevent institutions from taking risks. It is the business of financial institutions to take on and intermediate risks. But if risks are not well managed or events turn out unfavourably, institutions can incur substantial losses. No amount of regulation or supervision can completely prevent losses. On the other hand, over-regulation would curb innovation and enterprise. This was a key message in MAS' Monograph on the Objectives and Principles of Financial Supervision in Singapore.

Financial institutions therefore need to build their capacity to identify, monitor, and control the risks that they take. Banks should benchmark their risk management against international best practices. Risk management should be an integral part of their operations, and should keep pace with their business profile and with industry developments. The banking sector as a whole has done well in this respect, and we expect to see this continue.

One major change in the way banks manage risks will be triggered by the new Basel Accord. Implementing Basle II will be a complex exercise but will spur banks to enhance their risk management practices. Banks need to develop robust systems and processes to make the new capital adequacy rules work. While cost will inevitably be an important consideration, this should be weighed against the significant benefits and operational savings from the more accurate allocation of capital to risk. MAS will work closely with the local banks to implement the new Accord.

Business and strategic considerations

Next, banks have to decide how to grow and position their businesses over the longer term, especially the local banks. Maintaining margins and cutting costs is necessary in the short term, but beyond that, banks need longer term strategies for staying viable and competitive.

After a period of domestic consolidation, the local banks have made several regional acquisitions, but they still remain small by international standards. Competition will intensify, within the domestic market because of liberalisation, and internationally because globalisation is continuing. The local banks may well find that in order to hold their own and be viable, they need to grow bigger.

Possibilities for domestic growth are limited other than through further consolidation. But the region offers considerable opportunities. Asia is poised for sustained growth, having emerged from the Crisis as one of the most promising regions in the world. Countries have gone through a period of structural reforms and transformed their financial sectors. Now they are progressively opening up their economies to greater foreign participation. This is attracting interest from major regional and global players.

Our local banks cannot ignore this game. They need to consider their options carefully. Is the way forward to remain a niche player, sizeable in the domestic market, but small by international standards? Or must they achieve greater scale by expanding into the region? If so, what strategy will minimise the risks and maximise the benefits of operating in different countries? How can they build strong management teams, to execute a sound strategy well? Each bank must answer these questions for itself. Their long term profitability and viability depends on their finding the right answers.

Challenges for the financial sector

Let me move on to some of the opportunities and challenges for the financial sector. I will discuss three issues - developing the wealth management industry, growing our capital markets, and increasing our human capital.

Wealth management

The Asia-Pacific is the fastest growing market for private banking in the world. Rapid development is producing large numbers of wealthy individuals, and huge amounts of private wealth to be managed. Asian savers and investors are increasingly sophisticated and are seeking best of breed products and managers. Non-Asian clients are increasingly demanding geographical diversification for their assets. Institutional assets in Asia will also grow progressively as countries reform pensions, and deregulation frees up assets from insurance companies and other corporates for professional management.

These factors favour Singapore as an Asian centre, because of our sound economic and political environment, conducive legal and tax policies, reputation for integrity, and strict enforcement against crime and money laundering. Singapore is already an established centre for managing Asian investments of global clients, and global investments of Asian clients. The strong growth potential of wealth management makes it an industry where Singapore is well placed to become a global player.

The large increase in the number of HNWIs globally has also boosted demand for estate and trust planning. We are reviewing and modernizing the Singapore Trustees Act. MAS is also reviewing the Trust Companies Act, and will take over the regulation of trust companies. These steps will enhance Singapore’s position as an international trust domicile and widen the suite of wealth management services available here. We also need to build a larger pool of wealth management skills, and continue to increase the range of product offerings for wealth management clients.

Capital markets

Since the Crisis, countries in Asia have recognized the importance of developing their bond markets. While individual countries have made significant progress, their markets remain fragmented and small by international standards. We need closer co-operation among the capital markets in Asia, in order to integrate the markets and collectively increase their depth and liquidity. This will allow us to effectively recycle some of Asia’s huge reserves and attract more international investors to the region.

Regional governments have therefore taken several initiatives to foster a regional capital market, covering both fixed income and equity. These address both supply and demand side issues, such as easing constraints to cross border activity, forging alliances and linkages among the exchanges, as well as establishing a regional infrastructure. Challenges still remain. For example, we have to work out and implement efficient solutions across countries that have different start points, practices and regulatory frameworks. But it is encouraging that governments are more seized with this problem, and more ready to collaborate with one another, than ever before.

Singapore has taken the lead in several of the regional initiatives. Financial institutions here should also take part actively. This is the time to engage regulators and government officials in the region, to enter their growing markets and position yourselves for the business opportunities that the initiatives create.

As a leading foreign exchange centre with a critical mass of global fixed income and equities expertise, Singapore can service international investors operating in Asia. Our market is well placed to facilitate the hedging activities that are essential for risk management and improving market efficiency.

These will complement the domestic markets in the countries of the region. Our strong legal system and the availability of international legal expertise and product structuring teams equip us to structure complex cross-border transactions. The growing wealth management industry will also generate a steady source of funds for regional investment products.

Human capital

A major issue that concerns all parts of the financial sector is human capital. A distinguishing characteristic of a successful financial centre is that it attracts talented and dynamic professionals from a broad range of disciplines and experiences. They make the financial centre what it is. Deepening and broadening our talent pool will be a continuing challenge for the financial sector and for MAS.

MAS and industry players have taken steps together to address this. The Institute of Banking and Finance had been re-organised to better meet the needs of the industry as a financial training intermediary. It will also serve as a platform for the industry to provide regular feedback on manpower needs and issues.

The industry has established the Financial Industry Competency Standards Committee, which will develop internationally aligned competency benchmarks for the whole financial industry. MAS is also working with specific industries to address their human resource needs through a manpower conversion scheme. This scheme will help mobilize, train and channel resources to support growth areas quickly.

MAS will work with financial institutions to build and upgrade talent in the financial sector workforce. Singapore has always welcomed talented individuals to live and work here. They have contributed much to the vibrancy of our financial sector. Singapore must remain open to talent and continue to be a conducive environment to work and live in, so that we can continue to attract talent here, and also retain able Singaporeans.

Conclusion

MAS is committed to the vision of Singapore as a leading global financial sector, one which is competitive, fosters enterprise and innovation, and maintains high regulatory standards. We have made steady progress toward this goal and must continue to do so. We must never become complacent and satisfied with the status quo, or else we will soon be overtaken and left behind.

MAS will strive to create an environment where market forces, enterprise and innovation can thrive. We will stay abreast of market developments, and be sensitive to the needs of the industry, without compromising on supervisory standards. Our experience has shown that the two are not incompatible; indeed listening to industry players, without being overwhelmed by them, helps us to become better regulators and supervisors.

I am grateful for the full support and cooperation which the industry has extended to MAS, and to me personally, over the years. I am also grateful to the staff of MAS, whose professionalism, dedication and hard work have enabled us to reorientate our approach and transform the financial sector smoothly and safely. MAS and the industry will need to continue to work together to realise the vision of a more dynamic, competitive and vibrant financial sector in Singapore. That is the ultimate test of the success of our efforts to grow the sector, and make Singapore a key financial hub in Asia.