Lim Hng Kiang: The Singapore financial services sector

Address by Mr Lim Hng Kiang, Deputy Chairman of the Monetary Authority of Singapore and Minister for Trade and Industry, at the ABS Annual Dinner, Singapore, 29 June 2007.

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Chairman, ABS
Council Members of ABS
Ladies and gentlemen

It is good to be here tonight. The ABS Dinner is an excellent opportunity for the Singapore financial services community to get together, catch up and look ahead.

State of the Singapore financial sector

2006 has been a good year for Singapore. The financial services sector has done particularly well. All in, financial services grew 9.2% in 2006, outperforming Singapore's overall GDP growth of 7.9%. This momentum has carried into this year. 2007 first quarter growth for the financial services sector came in at 13% on a year-on-year basis.

Growth has been broad-based, with brokerage, treasury and advisory-related services being the largest contributors. Volumes in the Singapore foreign exchange market have also grown steadily. The equity markets have been hot. Volume of securities traded has gone up sharply.

The local debt market has also registered good growth in 2006. In the latest Annual Corporate Debt Review for 2006 which MAS released today, the total market capitalization of the Singapore bond market has reached S$243 billion.

Indeed, the Government's efforts to grow the Singapore Government Securities (SGS) market have produced results. Since 1996, outstanding SGS has grown from S$20.5 billion to S$85.8 billion in December 2006. This year we issued the first 20-year SGS. The 20-year SGS has extended the benchmark yield curve as a price discovery mechanism and liquid hedging instrument for the broader Singapore debt market.

The corporate debt market has also seen good growth. As at the end of last year, outstanding corporate debt securities were up 14% from a year earlier. This represents an increase of more than 6 times in size since 1996 to S$157 billion.

Another encouraging development has been an increase in the diversity of issuers. We have seen more real-estate borrowers and foreign issuers tapping the SGD bond market. Almost one-fourth of SGD-denominated bond issuance, or S$6 billion, was made up by foreign entity issuers. We have issuers from the US, Europe and more recently from Korea, Latin America and the Middle East.

In line with the growing sophistication of the investor base, the asset securitization market in Singapore has also taken off. For 2006, ABS issuance amounted to more than S$19 billion. There is also an influx of more structured products into our market such as convertibles and synthetic Collateralized Debt Obligations.

Turning to wealth management, Assets Under Management (AUM) has continued to grow strongly. 2005 was the fifth consecutive year of double-digit growth for Singapore, with AUM increasing 26%. This trend has continued in 2006, evidenced by the expanding wealth management community in Singapore. This underscores Singapore's emergence as a wealth management center. Singapore is strategically placed to capitalize on the significant wealth building up in Asia. At the same time, increasing interest from international investors to diversify a greater proportion of their portfolios to Asian assets has created business opportunities for fund managers based in Asia, including Singapore.

The local banks too registered good financial performance last year. Altogether, their profit grew by over 40%. Their return on equity also improved by 2-3% points compared to the year before. At the same time, the local banks have also shown improved financial health. Asset quality has improved further. Classified loans represented 1.6% of total loans in 2006 compared to 2.2% in 2005. The local banks remain well capitalized, meeting MAS' regulatory requirements and in comparison with peer banks internationally.

Taken together, these developments bode well for Singapore's efforts to develop itself as an international financial center. Barring any unforeseen shocks, 2007 looks to be another good year for the financial services sector.

Navigating the risks ahead

That said I would be remiss if I did not point out some of the risks on the horizon.

For now, the global environment appears benign with rosy prospects for growth worldwide. Nevertheless, various uncertainties could quickly unsettle this. For one, it is unclear how the mounting global imbalances between the East Asian countries and the developed countries will resolve. A sharp and abrupt adjustment would affect the global economy. It also remains unclear how long the golden era of good growth coupled with low inflation will continue. Already, fears of inflation have resurfaced. To complicate matters, we must not forget the geopolitical risks in the Middle East, terrorism and other surprises.

This year, we have already had several reminders of the risks in the system. The Chinese stock market has experienced a few incidents of volatility following expectations of and actual government action. It remains vulnerable to further corrections. In the US, the sub-prime market has imploded. More recently, US treasuries have come under severe selling pressure, causing interest rates to rise and generating unease in stock markets.

Nevertheless, the financial system has been resilient so far. Have we learnt our lessons from past crises and are now better prepared? Or are we just plain lucky? Whichever the answer, we should remain vigilant.

As bankers, you will be familiar with the saying that bad loans are made in good times. This saying is particularly worth repeating when the environment appears rosy and serves as a reminder that vigilance is our constant responsibility. With this in mind, MAS initiated a survey of risk managers and traders, many of whom are based in Singapore, about their key risk concerns. This poll was conducted between April and June this year. A roundtable discussion was also held with risk managers. Let me now share with you some of the findings from this survey.

The feedback received was open and honest and many views were shared. Most respondents believed that asset prices were frothy and that a big shock could happen. Some speculated that this could happen before the end of 2008. In this age of increased connectivity and correlation of markets, respondents felt that a shock event such as a terrorist attack, pandemic or geopolitical instability could cause market disruptions.

Respondents also highlighted the current liquidity in the financial markets. They observed that speculative liquidity was circulating in the financial system. This has led to historically unprecedented pricing and terms. When referring to the new players in the financial markets, respondents spoke of hedge funds and private equity in the same breath as "highly leveraged", "covenant-lite structures" and "large speculative positions". In the current low interest rate environment, many yield-hungry investors have become hedge providers for institutions. Respondents expressed concern about the systemic risks such providers posed and their default risk in a severe market correction.

In summary, the responses to the survey indicated that there seems to be a heightened level of risk in the macroeconomic and financial environment. Nevertheless, these responses are encouraging from another perspective. They indicate that financial institutions are aware of this heightened level of risk. With acceptance comes preparedness for the risks that may materialize in future.

It is important for banks not to become complacent. As banks pursue the many opportunities that lie ahead, we must not let our guard down. Banks must not be lulled into a false sense of security by the external environment's bullishness and resilience to shocks so far. We must not allow ourselves to get over-confident with our knowledge and analyses of the risks out there. Risks may deviate from expectations. Situations may take unexpected turns. In the face of such uncertainties, being prepared and ready is always a good proposition.

Reputation risk and fair dealing with consumers

Moving on from macroeconomic and financial risks to something closer to home, there is another risk which banks should remain mindful of. Unlike the other risks I had raised earlier, this is a risk which is fully within your bank's domain. This is reputation risk.

You all appreciate the value of a good reputation in doing business. A good reputation takes years to build. It can also be damaged within a short period of time through incidents that undermine consumer confidence and that are not managed properly.

You have read the newspaper articles in recent months concerning public unhappiness and questions about the transparency and fairness of practices concerning multiple home loan board rates and promotional fixed deposit rates. You might have asked yourself why these issues should concern you as they may not pose any significant impact on the financial standings of your banks.

While of limited short term bottom-line impact, these issues can affect the longer term reputation of and consumer confidence in your banks. The internet has empowered consumers with unprecedented reach. A disgruntled customer can post his or her unhappiness on a forum or blog and quickly reach a wide audience. It has become more important for banks to incorporate good and fair consumer outcomes as integral parts of the way they do business. Banks should pay attention to consumer feedback for early warnings of potentially larger issues and proactively take steps to address emerging customer concerns early.

The ABS Code of Consumer Banking Practice is premised on four key principles – fairness, transparency, accountability and reliability. These principles are a good foundation for building a trusting and open relationship between customers and their banks. As members of ABS, we encourage you to uphold and observe these principles. You are best placed to raise standards through market discipline, industry codes and guidelines.

Together, ABS and banks can do more in monitoring consumer feedback on industry practices and taking steps to manage consumers' concerns at an earlier stage before they become broader public issues. For example, ABS could initiate measures to identify emerging issues, conduct research to better understand consumers' concerns and work with member banks to address them. Individual banks could also do more by reviewing their customers' feedback, sharing their observations on concerns regarding industry practices and working with ABS to manage these issues.

MAS will continue to share with the industry our observations from feedback received from members of the public. We will also continue to work with the industry to encourage best practices by banks, with the aim of achieving good consumer outcomes. This more collaborative and consultative approach, we believe, is more desirable than formal and often more prescriptive regulation.

Conclusion

The Singapore financial services sector looks set for another year of good growth. However, as we look forward to the opportunities before us, we must be aware of the risks that lie ahead. As benign as the environment may seem, banks must not become complacent. Banks should be prepared for whatever surprises lie ahead.

At the same time, banks must also safeguard their reputations. More can be done and we look forward to seeing ABS working with industry in bringing about good and fair consumer outcomes.

On this note, let me wish everyone a good year ahead and a pleasant evening. Thank you.