Heng Swee Keat: International reform agenda – Singapore's challenges

Opening keynote address by Mr Heng Swee Keat, Managing Director of the Monetary Authority of Singapore (MAS), at the Asian Banker Summit, Singapore, 19 April 2010.

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Introduction

1. Good morning. It gives me great pleasure to join you today at this 11th Asian Banker Summit.

2. The inaugural Asian Banker Summit was held in Singapore about 10 years ago. At that time, Asia was staging a strong recovery from the financial crisis which shook the region in 1997. Today, we find ourselves at a similar inflection point.

Emerging from the crisis

3. The worst of the global financial crisis appears to be over. Global financial conditions have since improved markedly and prospects for the world economy have brightened. Asia ex-Japan is leading the recovery, with its GDP already surpassing the pre-crisis level by nearly 8%. For the whole of 2010, the region is expected to grow by 8% over the previous year. The Singapore economy has rebounded strongly and is expected to grow by 7–9% this year.

4. While the immediate outlook is positive, we need to remain vigilant. The structural headwinds to growth in advanced economies remain. The transition from government-led stimulus to sustained private-sector driven growth may be more difficult in those economies which face rising sovereign debt levels. As global liquidity conditions are normalised – following the unprecedented easing of interest rates by major central banks – financial markets could experience bouts of volatility as a range of asset classes are repriced and this could impact negatively on various interest-sensitive industries.

5. In addition, the reform of the global financial system has to be carefully thought through, calibrated and sequenced. It is important that regulatory reforms do not become politicised, with a rush to adopt simple rules that seem to solve the problems. Specific measures, each of which is sensible, may collectively create unintended outcomes and stymie the nascent economic recovery. In this regard, the Basel Committee's Quantitative Impact Studies will provide an important basis for us to take a more holistic view of the required changes.

6. So far, most of the discussions have been framed around the theme of "how do we prevent a similar crisis from happening again." Clearly, we must look back and learn from the crisis. But we must not fight the last war. We must also look forward. In the years ahead, significant restructuring of the global economy is necessary. Hence, I believe a more fundamental question to frame the discussion is: "Given the economic changes and challenges ahead, how do we make the global financial system more resilient and at the same time supports economic restructuring and sustainable global growth?"

7. It is therefore critical to get the nexus between the financial system and the real economy right. In this regard, Asia's needs are likely to be different from those in the advanced economies. Economies in rapid transition need responsive banking and capital markets. Bankers need to appreciate the changing needs of the economy, build new capabilities and develop new products and services, to support the needs of companies, large and small, in both mature and new industries. The financial industry needs to build up capabilities to understand the requirements of new industries in the technology and services arena, and to efficiently fund long term infrastructure needs. To sustain Asia's growth

trajectory, we need to further develop and deepen national financial systems and regional financial integration. MAS is studying several ideas in these areas, and we look forward to working with our counterparts in the region and with the industry to advance this.

8. Let me now share the measures that MAS is taking to respond to the challenges from the international reform agenda and the evolving new financial landscape. Our measures are based on three key pillars.

Sensible rules

9. The first pillar is establishing sensible rules. MAS seeks to establish sound rules of a high standard that allows well-managed risk taking and innovation, and which emphasises the stable and sustainable development of the financial services sector. The effectiveness of a regulatory framework is not determined by whether it is stringent enough to prevent any kind of shortcoming or failure of any firm. Neither is it determined by how dynamic and innovative the financial services sector is. A regulatory framework focused on stringency alone would impose undue costs and constrain innovation without the assurance that it would be effective. A regulatory framework focused on dynamism alone may not offer sufficient protection to investors, depositors and customers, and may experience more disruptive consequences in a crisis.

10. MAS' approach to rule-making is outcome-focused. This recognises that the design of regulation should take into account market realities so that unnecessary disruption to well-functioning markets is minimised. For example, in current proposals for a new liquidity framework for banks, having too narrow a definition of acceptable liquid assets is likely to adversely affect the operations of banks in countries without an active sovereign debt issuance programme. We believe that there is a good case for high quality, widely circulated non-sovereign debt to be included as acceptable liquid assets, without undermining the prudential intent of the new liquidity rules. In this regard, the results of the Quantitative Impact Study conducted by the Basel Committee will have to be studied carefully in finalising the list of eligible liquid assets.

11. Having outcome-focused rule-making also means that where appropriate, MAS may seek to reign in potential risk-spots through more prescriptive rules, even if such rules are not commonly accepted international best practices. A good example would be the macro-prudential rules in some Asian countries, including Singapore, to cap loan-to-value ratios for mortgages, which are not common in the US and Europe. In Singapore, we have also disallowed innovative financing schemes for mortgages. Drawing such "bright lines" in regulation – simple, clear "out-of-bound" markers – has been very useful in targeting excessive build-up of risks in certain situations.

12. Our approach to rule-making has to strike the right balance of having a financial system that is both sound and progressive, so that it can fulfill its function as a conduit of capital and a facilitator of trade and economic activity. MAS will shortly publish a monograph on our approach to effective regulation.

Effective supervision

13. The second pillar is effective supervision. Globally, there has been much discussion on having better rules, but not enough on strengthening day-to-day micro prudential supervision.

14. An eminent ex-central banker once likened this financial crisis to a massive accident on the highway. To prevent future accidents, if we assess that all drivers are irresponsible, we would have to drastically reduce the overall speed limit. But if we assess that we could also do a better job to take errant drivers to task early, we would have to also focus on strengthening the effectiveness of enforcement. We can then afford to be more measured

and targeted in our rule-making. I believe reinforcing sensible rules with good supervisory judgements achieves a better outcome than acting on just one or the other.

15. However, effective supervision is not easy. The spectrum of supervisory issues will continue to expand and evolve. The economic and financial landscapes are changing rapidly, and interactions remain complex even as we seek to simplify the system.

16. Globally, financial supervisors are responding to this challenge in two ways.

17. First, many countries are now considering changes to the institutional structure of their supervisory authorities in the aftermath of the crisis. In this regard, MAS is rather unique in combining financial sector regulation and supervision, central banking and development responsibilities under one agency. This structure has served us well. Building on this, MAS recently implemented a revised organisation structure. Aimed at broadening and deepening our management bench, this structure would also serve to enhance our ability to respond more effectively to supervisory challenges ahead, and to derive greater synergies from the combined structure.

18. Second, many financial supervisors are stepping up their investment in building up and enhancing their supervisory resources and capabilities. The crisis has underscored the need for financial supervisory authorities to have adequate and well-trained staff, so as to cope with the demands of supervising financial institutions in a fast-moving, complex and challenging operating environment. To maintain a high degree of confidence in the quality of supervision, we recently set up the MAS Academy and devote considerable resources into training and developing our central banking and supervisory staff.

Working in partnership with industry: shared outcomes and responsibility

19. However, sensible rules and effective supervision are not enough. We need a third pillar of partnership, where authorities and financial institutions each take on specific responsibilities to develop a shared ownership of supervisory outcomes. Indeed, the design of regulation and the supervisory approach taken should allow for financial institutions to take on responsibility in contributing towards desired supervisory outcomes where appropriate. Let me highlight two of these areas, namely the industry's role in improving corporate governance and in capability building.

Corporate governance

20. One lesson from the recent crisis is that good corporate governance matters. The failure by Boards to exercise effective risk management oversight had damaging consequences for many institutions. Boards play a vital role in safeguarding the safety and soundness of their institutions by setting the risk appetite, remuneration policies and strategic direction, amongst others. For directors to discharge their responsibilities, they have to have the requisite knowledge, skills and experience.

21. MAS will place increasing emphasis on the quality of the board of directors of financial institutions. Among the proposals to enhance our Corporate Governance Framework for locally incorporated banks and significant life insurers is the requirement for financial institutions to assess the current skills of their Boards on an ongoing basis, and to establish a continuing development programme for all their directors. Given the important role that the banking industry plays in our economy, MAS is also considering developing a mandatory training programme for bank directors.

22. But let me add that rules, and mechanical compliance with rules, can only go so far in encouraging good corporate governance in organisations. What matters most is for Board and management members to embrace not just the letter of the rules but the spirit of the rules, to take ownership of outcomes, and to internalise the essence of these rules in the ethos and practices of the organisation. Corporate governance in our financial institutions

have improved over the years. We must continue this partnership between the authorities and the corporate sector to seek continual improvements in corporate governance which will underpin Singapore's reputation as a trusted financial and business hub.

Capability building

23. The other area for collaborative partnership is in building up the capabilities of financial industry professionals. Asia's financial services industry is likely to grow rapidly. If this is not underpinned by an equally rapid growth of capabilities, whether it is in the front office or the mid-back office, we risk a major disruption ahead. It is essential that we act premptively to address this.

24. MAS has been working closely with the industry and with organisations such as the Institute of Banking and Finance (IBF) and the Workforce Development Agency (WDA) to increase the supply of skilled talent and to build professional capacity. It is heartening to see that the industry-led initiative in developing the Financial Industry Competency Standards or FICS for short is gaining traction, and despite the financial crisis, investment in training has not become an easy target for cost-cutting measures.

25. Such efforts should continue apace. Now that financial conditions have improved and firms are hiring again, financial institutions must invest in recruiting and developing their own staff. Taking the easy option of poaching staff from competitors to meet business expansion will undermine the collective strength of the industry in the long term, with adverse consequences on growth prospects for the industry as a whole.

26. To complement industry efforts in capability building, MAS would be prepared to consider regulatory initiatives to bring about a better-trained and more competent financial sector workforce. In the area of consumer banking, for example, some industry players have suggested the idea of a national examination to test the competencies of relationship managers serving customers in this segment. This could include topics such as ethics and conduct, so as to further promote fair dealing outcomes between industry players and end-consumers. MAS is now studying the idea and will work with the industry to develop this further.

Conclusion

27. Let me now conclude. Asia's financial systems and institutions are facing considerably less pressure for financial restructuring and regulatory reform in the current crisis. While Asia has not emerged unscathed, significant structural changes made after the Asian Financial Crisis have enabled the region's financial systems to weather this crisis relatively well.

28. But there is no room for complacency. Even as we recognise the need to continue development of our financial markets, considerable risks and policy challenges still remain for the region. MAS will continue with our three pillar approach of sensible rule-making, effective supervision and partnership to achieve the desired outcome.

29. We should take advantage of the global reform agenda to strengthen our regulatory and supervisory regimes, consistent with international standards and best practices, but at the same time, doing it in a manner that is sensitive to our regional environment and needs. I am confident that with financial supervisors and the industry working together in partnership, we can further enhance the resilience of our financial system to better serve the economic aspirations of Asians going forward. I wish you a fruitful conference. Thank you.