Tharman Shanmugaratnam: Update on the Singaporean economy

Statement by Mr Tharman Shanmugaratnam, Managing Director of the Monetary Authority of Singapore, delivered at the MAS Annual Report 2000/2001 media conference in Singapore on 12 July 2001.

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1 Introduction

MAS has had an eventful year, shaping monetary policy in a challenging and uncertain environment and continuing to liberalise and enhance standards in the financial sector.

2 Monetary policy

In January this year, MAS decided to maintain the existing exchange rate policy stance of allowing a modest appreciation of the trade-weighted Singapore dollar within an unchanged policy band. This policy was aimed at capping medium-term inflationary pressures, while continuing to be supportive of economic activity as growth came off its cyclical high and moderated to a slower pace.

Economic activity slowed much more in the first half of 2001 than was expected, causing market sentiment to shift against the Singapore dollar. Strong demand for US dollars to fund merger and acquisition activities by domestic corporates, and a strengthening of the US dollar against the major currencies, exerted further downward pressure on the Singapore dollar. The S$NEER weakened over the period, from the top of the policy band at the start of the year to the lower half of the band at end June. This trend was consistent with the change in underlying economic and market conditions.

Against the backdrop of a weaker external economic environment and a more protracted global electronics downturn, near term growth prospects for the Singapore economy have turned significantly weaker while inflationary pressures are subsiding. The slowdown reflects a decline in demand, not an erosion of competitiveness. There is no reason for any persistent weakening of the Singapore dollar.

MAS has therefore shifted to a neutral exchange rate policy stance, with a policy band centred on a zero percent appreciation of the S$NEER. MAS will continue to guide the S$NEER within this exchange rate band, and stands ready to intervene to dampen excessive volatility should this become necessary.

3 Financial sector supervision and development

MAS' financial sector policies seek to promote a sound and resilient financial system while facilitating innovation, dynamism and competition. Recent and ongoing initiatives by the MAS have focused on:

- harmonising regulation across the financial sector;
- liberalising access to the domestic industry;
- promoting corporate governance and market discipline;
- implementing a risk-focused supervisory framework; and
- developing talent in the financial sector.

Harmonising regulation

Convergence of financial activities and consolidation of financial institutions have made a more harmonised and integrated approach to regulation more urgent. Consistent regulatory treatment for similar products and activities will help level the playing field; it will also lower compliance costs by streamlining relevant regulations and reporting requirements across activities. As an integrated regulator, MAS has made significant progress in harmonising regulation. Recent and ongoing efforts have focused on the areas of licensing and capital adequacy.

On *licensing*, there have been two major initiatives: the new Securities and Futures Act (SFA) and the new Financial Advisers Act (FAA). Public consultation documents and draft legislation of the SFA and

FAA were released in March 2001. The Bills will be tabled in Parliament soon and are expected to be enacted by the end of this year.

The SFA rationalises and consolidates into a single comprehensive legislation the Securities Industry Act, Futures Trading Act, and provisions in the Companies Act related to capital raising. It introduces a single, modular licensing regime for securities and futures intermediaries, which will enhance competition and lower compliance costs. The new legislation will also reflect initiatives that take into account industry developments brought on by globalisation and technological advancements.

The FAA provides a single licensing regime and a more flexible and integrated regulatory framework for entities engaging in financial advisory activities for all investment products, and facilitates the setting of consistent professional standards across the industry. Similarly, consistent business conduct standards will govern the sale of unit trusts and life insurance across financial institutions licensed by MAS.

With the proposed streamlining in licensing, financial institutions and market participants will no longer need different licences to undertake different classes of financial activities. However, they have to abide by common regulatory standards relevant to the financial activity they engage in, including activities where they are exempted from holding licences.

On *capital adequacy*, MAS is putting in place across the financial sector a risk-based framework based on common principles and objectives. The existing capital frameworks for insurance companies, securities dealers, and futures brokers, are being revised, so as to move towards a risk-based approach, not dissimilar to banking.

In insurance, industry working groups are looking into the valuation and solvency framework for both life and general insurance business. In securities and futures, MAS has been working with the Singapore Exchange to establish a risk-based capital adequacy framework for licensed securities dealers and futures brokers. This framework will allow the brokers to better manage the risks they face, in the light of market and product developments. The new framework is expected to be introduced in the second half of 2001, and will take into account comments and findings from two rounds of consultation with the industry.

In banking, where risk-based capital standards already exist, MAS welcomes the key thrusts of the proposed New Basel Capital Accord. It has been working closely with the local banks to develop their capabilities and resources, so as to implement the internal ratings based approach.

Liberalising access

Liberalisation efforts have kept pace. A more open and competitive environment will spur innovation and enterprise in the financial centre as well as provide Singaporeans with quality financial services.

The insurance industry is completely open. The securities industry has been substantially liberalised and will be completely open from January 2002, when remaining trading restrictions on new members admitted to the Singapore Exchange will be removed. In banking, MAS has announced its second liberalisation package which will free up the wholesale market and considerably enhance competition in the retail market.

Promoting corporate governance and market discipline

Sound corporate governance and effective market discipline will complement MAS' prudential oversight, in fostering the safety and soundness of financial institutions. MAS has taken several initiatives to improve corporate governance and information disclosure.

The Banking Act has been amended to give legislative effect to the policy requiring separation of financial and non-financial activities in Singapore banks and the unwinding of cross-shareholdings. This will limit the contagion risks to the banks, enhance market discipline, increase transparency and ensure that bank managements focus their attention on the core banking business.

Local banks, in consultation with MAS, are adopting corporate governance standards that will, in areas such as the independence of the Board and Board committees, go beyond the recommendations of the Corporate Governance Committee. For financial year 2000, local banks improved their disclosure of directors' remuneration, related party transactions, and risk management practices. They will disclose further details on these areas next year, putting them on par with their international counterparts in terms of public disclosure.

Implementing risk-focused supervisory framework

Recent regulatory reforms by MAS have also been motivated by the shift away from a "one-size-fits-all" regulation to a more risk-focused approach. MAS is now developing a new risk-focused liquidity supervision framework that will set a bank's liquidity requirement in line with its liquidity risk profile and liquidity risk management capabilities. This shift away from a "one-size-fits-all" minimum liquidity requirement would be in line with international best practices for liquidity risk management. The new framework will be announced in the second half of this year. Its implementation will be phased out to minimise potential disruptions to financial markets.

As business models and technologies continue to evolve, MAS has kept close touch with market participants and discussed with them the possible risk implications of new activities. We have avoided pre-empting market developments with premature regulation. Regulation has to be responsive but it cannot prejudge how the market will develop and business strategies will crystallise.

MAS has issued regulatory guidelines on the provision of financial services through new delivery channels. Examples include the policy statement on capital treatment of internet-only banks; guidelines on technology risk management for all institutions engaging in internet banking; and sound practice guidelines on internet securities trading. The proposed SFA will introduce an authorisation regime to cater to new trading systems, often referred to as Alternative Trading Systems, so as to increase the scope of products available to investors.

Developing talent

Attracting and developing talent, both Singaporean and foreign, is critical to fostering innovation and a vibrant financial centre. In January this year, MAS announced that a Financial Network for Excellence in Training (f-NExT) would be established to encourage greater collaborative efforts in enhancing workforce capabilities within the financial sector. The Institute of Banking and Finance (IBF) will take on a new role as the central executive arm of f-NExT. f-NExT will assess the training needs of the financial sector holistically, and identify gaps in skills requirements. f-NExT will also strive to attract world-class training providers to set up in Singapore. Reputable training providers will be encouraged to set up more training centres to meet the industry's demands for specialised courses. IBF will gradually phase out training courses which overlap with programmes offered by other training providers.

4 International profile

As a leading financial centre, Singapore has a stake in a sound and stable international financial system. MAS is actively involved in the Financial Stability Forum (FSF), and initiatives undertaken by the Bank for International Settlements (BIS) to strengthen national and cross border supervisory standards and capital adequacy of banks, market surveillance, and payments and settlement systems. MAS participates actively at the International Organisation of Securities Commissions (IOSCO), contributing to its work in developing principles and guidelines, which serve as global best practice standards. MAS is also an Executive Committee member of the International Association of Insurance Supervisors (IAIS), which is the global standards-setting body for insurance supervision.

Singapore is actively involved in regional financial fora, including ASEAN, APEC, the South East Asia Central Bank (SEACEN) Governors, and the Manila Framework Group. MAS is also engaged in expanded technical assistance to central banks and regulators in the Asia-Pacific over the past year, including training programmes on macroeconomic management and financial supervision.

As part of Singapore's efforts to forge bilateral free trade agreements with strategic partners, MAS has engaged in talks on financial services liberalisation and cooperation, including with Australia, Canada, the European Free Trade Association, Japan, Mexico and the US.

5 MAS annual accounts

Assets & liabilities

On MAS' annual accounts, total assets increased by $15.2 billion to $130 billion as at 31 March 2001. The main components of the increase were due to a $12.1 billion increase in foreign assets and a $3.3

billion increase in our holdings of Singapore Government Securities (SGS). As in the last financial year, the increase in SGS holdings reflected MAS' strategy of building up SGS to engage in more repurchase agreement (repo) transactions for our money market operations.

On the liabilities side, there was an increase of $14.7 billion in Government deposits with MAS, reflecting mainly increased issuance of SGS through the Authority.

Income & expenditure statement

For the financial year ended 31 March 2001, MAS registered profits of $2.1 billion compared to $3.6 billion in the previous year. The decrease resulted from translation effects arising from the strength of the Singapore Dollar against major currencies other than US Dollar over the financial year as a whole.

6 The organisation

MAS has strengthened its corporate planning process. We formed several cross-specialisation teams comprising more than 60 staff to evaluate developments and challenges both in the external environment and within the organisation. MAS' corporate priorities for the year have been developed on the basis of these external and internal environment scans. These include programmes to enhance Singapore's position as a world class financial centre and to create flexible and forward-looking organisational practices for a more cohesive and dynamic MAS.