Ravi Menon: Singapore's financial centre in the new landscape

Keynote address by Mr Ravi Menon, Managing Director of the Monetary Authority of Singapore, at the Investment Management Association of Singapore's (IMAS) 14th Annual Conference, Singapore, 13 March 2013.

*   *   *

Mr Lester Gray, Chairman of IMAS,

Distinguished speakers, ladies and gentlemen, good morning.

A new financial landscape

Four years since Lehman Brothers collapsed, a new financial landscape is emerging. While the contours of this new landscape are still forming, three driving forces are discernible: financial deleveraging, regulatory reforms, and the rise of Asia

Driving forces

First, the global financial industry is deleveraging. Banks around the world are consolidating their balance sheets and tightening underwriting standards, even forgoing certain types of lending altogether. Many have resorted to shedding assets, especially assets in those countries where the banks do not enjoy a large market share.

- According to BIS data, globally, banks' foreign claims fell by about 15% from early 2008 to 2012.
- For European banks, the decline was twice as steep, at about 30%.

Second, the global financial crisis has spurred financial regulatory reforms on a scale that we have never seen before.

- Basel III will raise the quantity and quality of capital that banks must hold, increase the liquidity buffers they must keep, and limit the amount of leverage they can take on.
- Solvency II will raise requirements on capital adequacy and risk management for European insurance companies, and shape the development of risk-based capital frameworks for insurers in other jurisdictions.
- New capital markets regulation will transform the over-the-counter (OTC) derivatives trading business, with mandatory reporting, central clearing, and margin requirements for non-centrally-cleared contracts.
- Additional capital charges and closer supervisory intensity will be applied on the so-called G-SIBs, or global systemically important banks, as part of efforts to address the "too-big-to-fail" problem.

Some regulatory initiatives will impinge directly on the structure of financial institutions. Many jurisdictions are pushing for local incorporation of institutions, especially if they are systemically important. In America and Europe, regulators are reviewing various proposals for separating or insulating retail banking from riskier activities.

Third, the centre of gravity of financial activity is shifting towards Asia.

- The IMF forecasts that, in the next five years, emerging Asia will grow by about 7% per annum, nearly three times faster than the 2.5% forecast for the advanced economies.

The financing needs of companies and individuals in Asia will grow in tandem. Infrastructure investment needs alone will amount to a staggering 8 trillion US Dollars over the next decade. There is opportunity to mobilise Asia's large pool of savings to meet these financing needs. But this transmission is not working as well as it should, because financial markets in Asia are still under-developed and fragmented. The region remains heavily reliant on bank lending, and capital markets are not deep enough.

- According to McKinsey, bank loans were more than a third of Asian banking and capital markets, compared to just 10% in the US.
- Debt capital markets are particularly under-represented, contributing only 20–30% of financing in Asia, compared to 65% in the US and 55% in Europe.

A "new normal" in global finance?

How will the global financial landscape change in response to these three driving forces? It will be hard to say but let me hazard some guesses.

First, if the reforms are well implemented, we should see a material reduction of risk in the financial sector and improved financial stability. I do not think we will see an end to financial crises as such, but financial systems should become more resilient. This, in and of itself, will enhance economic welfare substantially.

Second, financial institutions will be forced to rationalise their business models and streamline their operations to better optimise capital, reduce compliance costs, and enhance efficiency.

Third, global financial institutions will expand their Asian footprint. They will establish more Asia-focused teams and functions. Many of these firms will make a second home in Asia. But Asia is a diverse and non-homogenous market. Global financial institutions will hub in more than one location.

The structure of global banks is likely to change significantly. Banks' profits and return on equity will come under pressure. The risk-return profiles of virtually all banking products will be re-ordered. The new liquidity rules will make deposits a strategic source of funding. Retail banking stands a good chance of reclaiming its role as the bedrock of banking.

Insurance companies, facing higher capital requirements and ageing demographics, will be under pressure to boost returns on investment and enhance asset-liability management. Many of them will be motivated to access new and under-penetrated markets, and seek higher yielding investments within the constraints of regulations and their mandates.

Exchanges will continue to consolidate and adopt a "multi-asset class" approach. Companies will explore other avenues for raising capital, including private placements. There will be more standardised derivative products and new types of market infrastructure: central counterparties for clearing, trade repositories for reporting, and swap execution facilities for trading. High-volume, low-margin platforms will likely become more competitive.

A big unknown is the future of long-term finance.

- First, banks are likely to play a reduced role in providing long-term financing, especially for infrastructure. Basel III will raise the cost of issuing long-term corporate and project finance loans above the cost of issuing mortgages and short-term loans.
- Second, insurance companies may be discouraged from investing in long term assets, as a possible consequence of Solvency II.
- Third, institutional investors such as pension funds and endowments often face restrictions on portfolio allocation that discourage them from providing long-term financing.

- Fourth, the range of instruments that allow long-term investment is limited: in many countries, bond, equity and securitisation markets that provide alternative avenues for long-term finance are underdeveloped.

If finance is to play its role as an enabler of economic growth, it will be important to develop new avenues for long-term funding.

Singapore's value proposition as a financial centre

MAS has been closely studying these trends in global finance and finetuning its strategies to develop Singapore as a premier financial centre. The emerging financial landscape plays to Singapore's strengths.

Singapore's value proposition in this new landscape rests on four pillars:

- smart regulation;
- diverse ecosystem;
- pan-Asian focus; and
- deep talent pool.

I will take stock of Singapore's strengths in each of these four areas and outline how we have refreshed our strategies and approaches.

Smart regulation

First, smart regulation. Since the global financial crisis, a higher premium has been placed on well-regulated financial centres like Singapore, which set high standards but implement them in a way that makes business sense.

MAS has always required banks to meet high prudential standards, exceeding international norms in several areas. During the global financial crisis, this ensured that adequate safeguards were in place and confidence sustained. Post-crisis, our banks are well-placed to meet the new global capital and liquidity standards. Maintaining high standards is compatible with fostering a vibrant financial centre. They provide confidence for financial institutions and customers to do business here.

MAS pays close attention to the design of financial regulation to ensure that they are risk-based and not more burdensome than necessary to meet regulatory objectives.

- An example is the Financial Holding Companies (FHCs) Bill that is currently before Parliament.
- MAS will not regulate all FHCs. The Bill will give MAS the flexibility on whether or not to regulate a particular FHC, taking into consideration, for instance, whether the FHC's subsidiaries are important to Singapore's financial system.

MAS consults the industry and other stakeholders when introducing significant new regulation. The exception of course is where the issue is market sensitive. We consult at an early stage on the broad policy proposals as well as in the later stages of detailed rule-making. We carefully consider all feedback on the impact of new regulation and implementation issues, and adjust the proposals where appropriate. This helps MAS to calibrate the rules in a way that is appropriate for our market.

- Take for example, the recent proposed changes to the regulatory capital framework for holders of capital markets services licenses. MAS briefed the industry, consulted extensively, and conducted quantitative impact studies.
- In response to feedback, MAS has decided to provide a longer transition period of two years for industry to comply with the new rules.

- MAS will also revise its calibration of the operational risk capital charge.
- Final details of the regulatory capital framework will be announced by June this year.

Diverse ecosystem

The second pillar: Singapore has a diverse financial ecosystem. The various parts of the financial sector not only serve important functions in their own right, but are mutually reinforcing.

- The World Economic Forum has ranked Singapore 2nd worldwide for financial market development – a testament to the depth and breadth of Singapore's financial sector.

A full-fledged financial centre

Singapore provides a broad and integrated suite of financial services.

We are an important regional funding centre.

- The Asian Dollar Market, with its total asset size of more than 1 trillion US dollars, has played a key role in serving the financing and treasury needs of individuals, corporates, and institutions in Singapore and the region.

We are the premier asset management centre in Asia, acting as gateway to the world for Asian investors and for the world to tap Asian investments.

- Assets under management by Singapore-based managers have more than quadrupled over the last decade to reach 1 trillion US dollars in 2011.

We are the leading insurance centre in Asia.

- Singapore plays host to about 190 insurance institutions meeting the protection needs of the economy and society across the region.
- The industry has built up expertise in complex and specialist risks – including marine, energy, aviation and credit and political risks.

We have one of the most developed bond markets in Asia.

- Singapore's total market capitalisation has grown by over 150% in the last decade, to 270 billion US dollars in 2011.

We are the fourth largest foreign exchange trading centre in the world.

- FX and FX derivatives turnover in Singapore has more than tripled in the last decade, with an average daily traded volume of about 360 billion US dollars.

We are Asia's leading commodity derivatives trading hub.

- Most of the major global banks have their regional hubs in Singapore.
- According to some estimates, Singapore accounts for more than half of Asia's OTC commodity derivatives trades.

To succeed in the new financial landscape, Singapore must comprehensively support Asia's long-term financing needs. Let me highlight two strategic areas where we will harness our diverse financial ecosystem: debt capital market and infrastructure financing.

Debt capital market

In a world of deleveraging and higher regulatory constraints on banks, it is now more urgent than ever to develop strong capital markets to complement bank lending and help to provide a better match for longer term funding requirements.

The fundamentals for a strong debt capital market are in place.

- The Singapore bond market is fully accessible to all issuers and investors globally with no capital controls, hedging restrictions, or withholding taxes.
- There is diversity of issuers – financial institutions, corporations and government agencies.
- There is variety in instruments issued, including structured and securitised debt.

Last year, I announced three initiatives to further improve the efficiency and liquidity of the Singapore Dollar bond markets. We have made good progress since.

The provision of swap liquidity to primary dealer banks handling Singapore Dollar debt issuance for corporations is fully operational. MAS is now able to support swap transactions at market-determined rates.

The Singapore Dollar corporate bond securities lending facility will become operational by June this year. The facility will provide market makers an avenue to borrow securities and make prices more freely.

The price discovery initiative to provide end-of-day prices for Singapore Dollar corporate bonds was completed in June last year. This price transparency has already spurred industry-led efforts to create a Singapore Dollar corporate bond index which market participants could use as a benchmark for investment management. MAS supports these efforts.

Infrastructure finance

A relatively new thrust in our financial sector strategy is infrastructure finance. Infrastructure is a sector ripe with opportunity. However, private sector participation has so far been muted due to the shortage of “bankable” projects and risks that the private sector alone is not equipped to mitigate. The financing gap will be compounded by new regulations restricting bank lending, which is still the primary form of infrastructure financing in Asia.

Singapore is working in partnership with a diverse group of stakeholders, to help address these challenges.

- We are working with the World Bank to identify and develop bankable projects in Asia. The World Bank’s investment arm, the IFC, will be setting up in Singapore its first Asset Management Company office outside Washington DC, to co-invest in regional infrastructure projects.
- Last year, Temasek Holdings partnered Singapore-based banks to establish Clifford Capital, which aims to plug financing gaps faced by Singapore-based companies involved in long-tenor, cross-border infrastructure projects.
- MAS is exploring with industry players how capital market solutions can encourage investor interest through project bonds, infrastructure debt funds, and project loan securitisation.

Pan-Asian focus

A third pillar of Singapore’s value proposition as a financial centre is its pan-Asian focus. With strong links to all the key Asian economies, Singapore is a natural gateway for international firms looking to access Asia, and for Asian businesses to access the world. There are three new areas of opportunity that play to Singapore’s pan-Asian focus: ASEAN connectivity, OTC derivatives infrastructure, and offshore RMB business.

ASEAN connectivity

First, ASEAN connectivity. Singapore, in partnership with our ASEAN neighbours, is actively pursuing greater harmonisation and integration across the region's financial markets.

- We are trying to harmonise rules and regulations and develop integrated trading, clearing and settlement infrastructure.
- For example, ASEAN regulators are currently working on a framework to facilitate cross-border offerings of collective investment schemes. This initiative aims to promote greater flow of capital across the region and enhance investor choice.
- The stock exchanges of Singapore, Malaysia and Thailand have linked up through a common trading platform, the ASEAN Trading Link. This platform provides investors a single entry-point access to the three largest equity markets in ASEAN.

There is still some way to go to achieve seamless participation across the region's financial markets. But these initiatives are a good start.

OTC derivatives infrastructure

Second, OTC derivatives infrastructure. Earlier, I spoke of global regulatory reforms driving a revolution in the derivatives market. This has brought about new market infrastructure developments, and Singapore has made significant strides in two key areas.

The first area is clearing.

- SGX AsiaClear, Asia's first OTC clearing facility, was established as early as 2006.
- As counterparty to both buyers and sellers, AsiaClear mitigates counterparty credit risk in OTC transactions.
- AsiaClear's value to the trading community extends to record and statement services, position netting, and cost savings for customers posting margins.
- Today, SGX AsiaClear is the region's leading multi-asset OTC clearing house, with volumes exceeding 300 billion US dollars to-date.

The second area is trade reporting.

- Just in December 2012, the Depository Trust & Clearing Corporation's (DTCC) Global Trade Repository established its Asia-Pacific global data centre in Singapore.
- The Singapore location is part of its global trio of data centres, designed to support DTCC's global trade repository services around the clock.
- DTCC's initiative will fill a key post-trade market infrastructure gap in Singapore and the Asia Pacific region.
- The industry will benefit from reduced connectivity costs and the greater convenience of reporting to a Singapore-based infrastructure.

These developments not only align us with global regulatory reforms, they allow us to strengthen our role as a derivatives and risk management hub in Asia.

Offshore RMB

The third area of opportunity that plays to Singapore's pan-Asian strength is offshore RMB business. The RMB's role in facilitating intra-regional trade and investment will only grow in the coming years. Singapore is in a strong position to facilitate greater RMB-denominated trade and investment in the ASEAN region.

We are deepening liquidity, establishing key infrastructure, and working with industry to expand the range of RMB products and services in Singapore.

- In February this year, the Industrial and Commercial Bank of China's Singapore branch was designated Singapore's RMB clearing bank.
- Just five days ago, MAS and the People's Bank of China signed an enhanced bilateral currency swap agreement. This will enable MAS to provide RMB liquidity to banks in Singapore where needed.

Deep talent pool

The fourth and final pillar supporting Singapore's financial centre is our deep talent pool. Over the years, we have invested heavily in building up the competencies of our financial sector workforce, providing training grants across a broad range of programmes under the Financial Sector Development Fund (FSDF). Perhaps the most important of these programmes is the Financial Industry Competency Standards (FICS), a structured competency framework that is job-specific and practice-oriented.

Looking ahead, to foster and sustain a strong financial sector workforce, MAS will take a dual approach. We will groom a first-rate Singaporean talent base, while continuing to secure highly-skilled global professionals.

MAS is stepping up efforts to build a strong core of Singaporean specialists and leaders in finance. We are working with the major financial institutions here, on several fronts:

- to nurture young Singaporeans at the entry level with opportunities to be mentored by senior leaders and to broaden their horizons across various functional roles;
- to give Singaporeans the opportunity to deepen specialist skills by expanding our Finance Scholarship Programme; and
- to help mid-career Singaporeans take on international postings that will help prepare them for leadership positions.

At the same time, to stay relevant in the more complex financial landscape of tomorrow, Singapore must remain open to diverse talent and expertise.

The financial sector offers Singaporeans great opportunity for well-paying, high value-added jobs. We need to ensure entrants to the sector have the necessary foundational skills and incumbents keep their skills relevant and updated through continuous professional development. The Institute of Banking and Finance will be sharpening the FICS programme to support this.

Conclusion

Let me conclude. The global financial industry is undergoing great change. What kind of financial centre do we want to be? If I had to choose three words, I would say robust, trusted, and purposeful

- *robust*, in the sense of building resilience against shocks and managing risks prudently;
- *trusted*, in the sense of staying clean and imbibing a culture of fair dealing with all stakeholders; and
- *purposeful*, in the sense of generating real value, creating opportunities for people, and serving the economic needs of Singapore and the region.

This vision cannot be realised by MAS alone. It is through active partnership with the industry and associations like IMAS, that we can make this happen – Singapore as a premier financial centre in the emerging landscape of tomorrow.

I wish you all a fruitful conference. Thank you.