Jacqueline Loh: Integrating Asia's capital markets

Keynote address by Ms Jacqueline Loh, Deputy Managing Director of the Monetary Authority of Singapore, at the ASIFMA (Asia Securities Industry and Financial Markets) Annual Conference 2014 "Developing Asia's Capital Market", Singapore, 5 November 2014.

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Mark Austen – CEO, ASIFMA

Ashley Alder – CEO, Hong Kong Securities and Futures Commission and my fellow keynote speaker

Fellow regulators and central bankers

Distinguished guests

Ladies and gentlemen

1. It is my pleasure to join you this afternoon at the ASIFMA annual conference held in Singapore.

2. We have a very ambitious agenda ahead of us. The title of the conference, "Developing Asia's Capital Markets", certainly does not do full justice to the breadth of topics covered in the breakout sessions and roundtable discussions over these two days. These topics are very wide ranging indeed, from traditional equity and debt markets, to foreign exchange, investment banking, fund management, financing of Asia's infrastructure needs, market infrastructures; as well as specific geographic markets China and India. Each segment not only aims to address opportunities and challenges in each market or asset class, but also opportunities and challenges across markets and asset classes.

3. Accordingly, I will focus my remarks on integrating Asia's capital markets as a natural pairing to the conference theme on developing Asia's capital markets.

I. Economic dynamism and wealth creation in Asia

4. Asia remains the fastest growing and most dynamic region in the world today and is likely to remain so in the foreseeable future. According to projections by The Conference Board, China's growth in the next ten years will average close to 5% per annum, with India at about 4.2% and the rest of Asia at 4.5%.[1] These projected growth rates for Asia are well above the 3.8% for emerging economies as a whole, and the 1.7% expected for the advanced economies over the same period. Looking further into the future, the Asian Development Bank has projected that the sum of the GDP of China, India and ASEAN in purchasing power parity terms could quadruple by 2030 and even exceed that of the US and Europe combined.[2]

5. Asia's already large middle class, will continue to register strong growth. In ASEAN for instance, the middle class is projected to rise to two-thirds of the population by 2030, from less than a quarter in 2010.[3] The rapid expansion of the middle class will, from the demand side, spur the growth and development of a wide range of goods and services.

6. Alongside Asia's sustained economic development in the medium-term, financial services will be an important facilitator of growth as well as a growth engine in its own right.

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[1] "New measures for global growth projections for The Conference Board Global Economic Outlook 2014," The Conference Board, November 2013.

[2] "ASEAN, PRC and India: The Great Transformation," ADB Institute, Asian Development Bank, 2014.

[3] Ibid.

As income increases and wealth accumulates, the demand for modern services is likely to grow faster, as they have higher income elasticities. Thus, we expect that demand for financial services in Asia – such as wealth management – will rise more than proportionately to the increase in household income. For instance, assets under management attributed to mass affluent and high net worth investors in Asia is expected to expand by 60% to reach USD 176 trillion by 2020.[4]

7. These positive economic factors will continue to drive the growth of Asian financial institutions and Asian capital markets. Today, five of the top ten largest banks in the world by market capitalisation are Asian banks.[5] Primary market capital-raising in Asia via IPOs is the highest in the world. In the debt market, capital raised via Asian bond issuances have also doubled since 2009 after having achieved record sales in each of the past three years.

II. Asia's capital markets are ripe for closer integration

8. The strong growth of Asian economies and financial markets has created the conditions that are driving greater financial integration in the region. In China, home to the largest bank in the world by assets, banks and asset managers have acquired sufficient scale domestically to expand and look abroad to grow their businesses. Since 2012, the total amount of RQFII quota awarded by China has more than doubled for qualified foreign institutional investors to purchase mainland RMB-denominated securities. The RQDII scheme will allow qualified domestic institutional investors to purchase RMB-denominated securities abroad, which was recently approved. In Myanmar, one of the most under-banked countries with bank loans amounting to just one-fifth of GDP[6], the issuance of nine licences to foreign banks (including two Singapore banks) will help to bring much-needed capital for economic development, financial services and technology transfer. These are but two examples of the blossoming of financial services in Asia – whether through cross-border channels, overseas expansion or domestic liberalisation – which will integrate the region financially.

9. Financial integration brings clear benefits to both users and providers of financial services. It leads to more effective mobilisation of savings from surplus countries to countries that need capital, and improve the efficiency of investment allocation. A well-developed and competitive financial sector can thus be a catalyst to spur and sustain economic growth. The opening up of the financial sector to foreign participation adds to the sector's development as foreign financial institutions also promote competition and innovation, and create the urgency for local institutions to upgrade capabilities. This has been our experience in Singapore.

10. International regulatory reforms are adding impetus to market integration. Let me cite two examples. First, as new Basel 3 capital and liquidity rules come into force, banks are seeking ways to manage their capital and liquidity more efficiently. Nowhere is this more obvious than in the OTC derivatives market, where banks are trying to compress hundreds and thousands of lines (and over USD 700 trillion of notional value[7]) of OTC derivative transactions, so as to consolidate liquid collateral for margin efficiency. Second, as jurisdictions roll out clearing and trading mandates for OTC derivatives, more transactions will be traded and cleared on regional and global platforms to reap the benefits of scale and liquidity. This will be instrumental in transforming complex webs of gross exposures into smaller sets of net exposures, reducing systemic risk and strengthening the derivatives

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4 "Asset Management 2020: A Brave New World," PwC, 2014.

5 Market capitalisation as of 31 March 2014, Relbanks.

6 "Myanmar's Banking Sector Liberalisation: A Win-win for All," PwC, 2014. http://pwc.blogs.com/growth_markets/2014/10/myanmars-banking-sector-liberalisation-a-win-win-for-all.html

7 BIS derivatives statistics, September 2014. http://www.bis.org/statistics/dt1920a.pdf

market. These pressures will naturally drive more aggregation across geographies and asset classes, and place the issue of market integration squarely on the agenda. Global reforms, if they are implemented consistently, can also support financial integration by making it less burdensome for financial institutions to comply with regulations in different jurisdictions and for regulators to mutually recognise and defer to each other where appropriate.

III. Market integration is happening at two levels: among jurisdictions and among participants

11. Over the last three years, market integration has been taking place in Asian financial markets. It is steadily making progress in individual asset classes, among small groups of countries, sometimes bilaterally, where there is common interest and where markets and institutions are at similar stages of development.

12. We can see evidence of market integration among jurisdictions in several areas:

a. ***Banking.*** ASEAN is in discussions to complete a banking integration framework that will allow qualified ASEAN banks to progressively expand in each other's' jurisdictions. This initiative aims to create opportunities to strengthen regional banks in ASEAN and improve banking services offered to local markets. Even in other Asian countries where cross-border bank financing is restricted, we are seeing pockets opening up. For example, since China issued cross-border RMB rules for Suzhou Industrial Park (SIP) and Tianjin Eco City (TEC) in the middle of the year, about RMB 2 billion of loans have been approved from Singapore-based banks to companies in the two industrial parks.

b. ***Equity Markets.*** In 2012, stock exchanges and regulators in Malaysia, Thailand and Singapore launched the ASEAN trading link to offer easy access to each other's stock markets. Singapore and China have also established a Direct Listing Framework for Chinese companies last year. The framework will facilitate interested Chinese companies seeking direct listing opportunities in Singapore.

c. ***Debt Markets.*** ASEAN securities regulators have since April last year implemented common disclosure standards, which would allow issuers to issue debt securities across various ASEAN markets with a single prospectus. Under this scheme, the time required to issue in multiple markets will be the same as that for issuing in one market, reaping both cost and time savings for issuers. The cross border RMB channels with SIP and TEC, which I mentioned earlier, would also allow corporates in these locations to issue RMB bonds in Singapore. These initiatives in the debt and equity markets will allow companies to diversify their sources of funding abroad, more easily tap investors in overseas markets as well as broaden the array of debt investment choices in local markets.

d. ***Fund Management.*** There are two similar initiatives for mutual recognition of collective investment schemes in Asia. The first, among Singapore, Malaysia and Thailand, led by the ASEAN securities regulators. The second, involving Singapore, Korea, Australia and New Zealand, called the Asian Region Funds Passport under the auspices of APEC. These initiatives will widen the opportunities for investors and fund managers abroad.

13. In addition, we see evidence of partnerships among market participants, especially in the area of OTC derivatives which has been typically a fragmented market:

a. ***Collateral Management.*** The global reforms for OTC derivatives have drastically increased the demand for collateral. To date, Asian collateral is not widely traded or commonly accepted outside of their home market. This has created inefficiencies as financial institutions can neither obtain specific, nor deploy excess, Asian collateral outside of their home market. Two developments have helped. First, private partnerships such as that between Clearstream and SGX, allow customers to better allocate and optimise collateral resources in Asia by enabling collateral to be managed on a fully automated and real-time basis. Second, central banks have also stepped in with cross-border collateral arrangements to permit the deployment of head-office cash and government securities to support local currency liquidity requirements of their branches and subsidiaries overseas.

b. ***Futurisation.*** Even before most jurisdictions introduce trading mandates, some segments of the OTC derivatives markets are already coming together to create exchange traded products. One example lies in Asian currency futures contracts traded on exchanges like SGX. With the introduction of new listed contracts, market participants have chosen to futurise some of their rolling forward contracts. Compared with OTC markets, exchange-traded futures have more transparent pricing, and are faster to execute and more cost effective.

14. These developments demonstrate that commercial incentives can be brought into alignment with regulatory priorities, which aim to reduce aggregate risk in financial markets and promote greater financial soundness and stability.

15. We also see promise for integration in infrastructure finance and insurance to produce exciting outcomes.

16. The World Bank Group Singapore Hub, expanded from the initial set up in 2010, draws together the different infrastructure expertise along the transaction chain – firstly, project management of the World Bank; secondly, structuring expertise of the International Financial Corporation (IFC); and thirdly, credit enhancement of the Multilateral Investment Guarantee Agency (MIGA) – to deliver practical project advisory and financing solutions to governments globally. This includes its ongoing efforts to develop a bankable Public-Private-Partnership (PPP) project pipeline for ASEAN. The Asian Infrastructure Centre of Excellence (AICOE), set up in April this year, would also work with governments to catalyse infrastructure development in Asia, starting with Southeast Asia. Similar to the Singapore Hub, the AICOE will select infrastructure projects based on needs in the region, grow them to a bankable stage, and match these projects with private investors.

17. These efforts will help make infrastructure financing more accessible to a broader group of investors, and help banks to recycle their capital more quickly to other greenfield projects. Transactions can be structured such that institutional investors can, through capital market instruments such as infrastructure projects bonds or securitisation, take over the financing of projects from banks after the construction phase is completed. By facilitating financing to what industry estimates to be USD 300 billion of marginal bankable projects in Asia, these integration efforts will enhance long term growth prospects of Asian economies.

18. One less-talked about area where market integration holds great promise is in insurance. Although natural catastrophes – and damage caused by them – have risen in Asia in the last ten years, we remain significantly underinsured against perils like flooding. As disaster risk exposures grow in scale, size and complexity, it would exceed the individual capacity of local insurance markets, and governments, to insure the risks of its populations and communities. PPPs between public and private sectors, and across national borders, can be effective in maximising the benefits of insurance. Such examples of horizontal integration between markets are key in managing the region's rising exposures to natural catastrophe risks.

19. Collation of natural catastrophe risk data and analytics across ASEAN countries is a necessary first step toward more comprehensive catastrophe protection, paving the way for insurance integration in this region. Currently, the fragmented market structure in ASEAN constrains data sharing and the capacity of domestic insurers to pool and underwrite risks. In Singapore, key partners from academia and industry, alongside the MAS, have come together to form a work group to explore the establishment of a Natural Catastrophe Data Analytics Exchange. This Exchange serves as a regional platform to collect data and model

less understood regions at risk in Asia-Pacific, facilitate better pricing of such risks, and eventually pave the way for more comprehensive insurance against these risks.

20. In combination, these comprehensive efforts among jurisdictions and participants are very encouraging. And if they are completed successfully and demonstrate meaningful benefits for the countries involved, they can be replicated very quickly to other interested jurisdictions. Singapore is helping to drive many of these market integration initiatives through our participation in ASEAN/ASEAN+3, APEC and G20, but also bilaterally with our economic partners.

21. Vertical integration through the value chain can achieve cost efficiency and more effective surveillance, particularly in capital markets and in OTC derivatives. Let me elaborate:

a. ***Capital Markets.*** Although the ASEAN Trading Link created horizontal integration opportunities for investors to access ASEAN stocks of members in the trading link, settlement and custody still goes through non-exchange channels. This Link can be further enhanced and it is the reason why the ASEAN regulators and exchanges set up a task force to design the ASEAN Capital Markets Infrastructure Blueprint to implement post-trade linkages that are vertically integrated with exchange trading. The post-trade infrastructure linkages, which will allow investors in one country to purchase shares in the other markets through their local broker and hold them in their local account, will lower not only cost and transaction time, but also settlement risks.

b. ***OTC Derivatives.*** Many jurisdictions will eventually implement the full suite of trading, clearing and reporting mandates. Indeed, the way the OTC derivatives market has blossomed today – if we extend the metaphor – is to "allow a thousand flowers to bloom". In other words, a bank could trade a currency derivative on an electronic platform in Singapore, clear the transaction through a central counter party in London and report it to a repository in the US. And the bank could be using different platforms, clearing houses and trade repositories for different types of derivatives. But if all three activities in the trade cycle could be vertically integrated into the same platform, with the trading linked to post-trade services, it would not only be more efficient for the bank, but also be more convenient for regulators to access transactional data from the same market infrastructure for market surveillance and monitoring financial stability.

IV. Concluding remarks

22. I am genuinely excited by the opportunities that I see in Asia's capital markets. An integrated capital market is not only bigger, but offers more choices for investors, more sources of financing for companies, and generally deeper liquidity and better pricing through competitive spreads. Over time, greater scale and greater integration within and across asset classes can create opportunities in new financial products, such as through securitisation.

23. Singapore is well positioned to offer integrated capital market solutions, given that many of the different parts of the value chain – trading, clearing, settlement, reporting – are already being offered in Singapore across the spectrum of asset classes including equities, bonds, foreign exchange and derivatives. At the same time, financial institutions that are able to harness innovative technology to increase productivity or differentiate their business offerings would be better positioned to capture these opportunities. With technology transforming activity across financial markets, the profile of jobs in finance will change in the years to come. Through the Institute of Banking and Finance, MAS is working with the industry on an enhanced set of desired competency standards to grow the pipeline of skilled talent ready to service the growth in capital markets in Asia.

24. I hope I have touched on the key themes and issues that you will be discussing over these two days, and may I wish you a most fruitful conference ahead.

25. Thank you.