Ong Chong Tee: Regulatory landscape for 2016 – positioning for a dynamic, trusted and vibrant market

Keynote address by Mr Ong Chong Tee, Deputy Managing Director (Financial Supervision) of the Monetary Authority of Singapore, at the SGX Equities Dialogue 2016, Singapore, 28 January 2016.

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Mr Loh Boon Chye, CEO of SGX

Ladies and Gentlemen

Good afternoon. I am delighted to join you at the inaugural SGX Equities Dialogue.

A challenging start

1. 2016 has started on a challenging note for global stock markets. The first trading week of this year alone saw global markets losing close to S$3 trillion,[1] led by sharp declines in the Chinese stock market. The STI Index has fallen by more than 20% during the last 12 months to the lowest level since October 2011. Oil prices are testing lows last seen in 2004 and many other commodity prices are also under downward pressure.

2. The prevailing negative market sentiments reinforce the importance of various measures undertaken by both MAS and SGX together with different market stakeholders, to build a more robust and resilient financial market. These include areas relating to capital, liquidity and margin rules, infrastructure resilience and so on; all of which complement various measures on promoting high standards of professional conduct, improved corporate disclosures as well as retail investor education. We have also worked with the industry at large on regular stress tests and crisis management exercises. The current uncertain macroeconomic and market environments underscore the importance of staying vigilant to new or growing risk areas and vulnerabilities.

3. But it is also important not to lose sight of the long-term positives. Our capital markets continue to attract a diverse range of players and activities. Besides SGX, international exchange groups such as the InterContinental Exchange (ICE) and EUREX, have or will establish exchanges and clearing houses in Singapore. These will add to the vibrancy of our exchange landscape in parallel with the continued growth in our asset management industry. The last asset management survey done for 2014 showed robust growth in total assets under management, with assets under management increasing by 30% to S$2.4 trillion. There is clearly a role for our capital markets to help match savers and users of capital and in the management of financial risks.

4. The SGX Equities Dialogue this afternoon is a good occasion for sharing, discussion and reflection on developments affecting our securities market. Allow me to use this address to share some thoughts on our market regulatory structure, and MAS' roles in market surveillance and enforcement; and I will conclude by sharing some shorter remarks on new trends and on skills development.

A sound regulatory system

5. As an international centre, Singapore's financial market is influenced by many external factors. The growth of our financial sector in part has been driven by our ability to attract

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[1] *Source:* http://www.bloomberg.com/news/articles/2016-01-07/global-markets-at-the-beginning-of-a-crisis-george-soros-says

international investors, traders and financial intermediaries to participate in our financial markets, and for foreign corporates to tap our markets for their funding and hedging needs. Clearly, Singapore does not and cannot operate in isolation from rest of the world; indeed, we have become an important node in the global financial system.

6. Singapore's attraction and standing as an international financial centre must be underpinned by investor confidence in a stable business environment, with clear rule of law and a sound regulatory framework. Only when there is confidence and stability in the system would corporates, financial institutions and individuals tap our financial centre to invest, to raise capital and to manage risks.

7. As our markets develop, we must continue to safeguard this reputation of integrity, trust and resilience. Because many global financial institutions operate here, we have to also measure ourselves to international standards and expectations by incorporating international rules and best practices where appropriate. In the securities markets, the MAS has an active role in international standard setting bodies such as International Organisation of Securities Commissions (IOSCO); as an example, we co-chair a CPMI-IOSCO Working Group on strengthening the cyber resilience of financial market infrastructures, including dealing with cyber-threats.

8. As exchanges in Singapore are key financial market infrastructure with a global participation, they are regulated to meet international standards. Many of these standards are implemented through the exchanges' own business rules to ensure fair and orderly trading.

9. This brings me to the subject of SGX as a self-regulatory organisation or SRO. Singapore's capital markets operate under a dual-level regulatory framework. The MAS is the statutory regulator, and we have the broad mandate of overseeing the proper functioning of financial markets, including exchanges like the Singapore Exchange (SGX) and newer entrants such as ICE Futures Singapore (ICE Futures) and EUREX. The MAS, as you all know, is an integrated financial supervisor and our Capital Markets Group performs the equivalent regulatory functions as other standalone securities regulators including the SEC in the US, the SFC in Hong Kong or ASIC in Australia; our regulatory powers encompass policy making, supervision and enforcement.

10. The exchanges, with their frontline interface with industry players, traders and investors, perform complementary and important roles in ensuring fair, orderly and transparent markets. The exchanges are accountable to MAS on how they exercise these regulatory responsibilities.

11. Questions have been raised, and quite understandably so, on whether a listed for-profit exchange can discharge its role as a regulator.

12. In Singapore, this issue has been reviewed periodically since the demutualisation and merger of the Stock Exchange of Singapore (SES) and Singapore International Monetary Exchange (SIMEX) in 1999, to form SGX. It is important to be mindful of what the SRO function entails.

13. Let me elaborate. The SRO function goes beyond listings, which has been the main area of focus. This is partly because the listings function is the more visible part of the SRO to investors and listed companies. But in fact, the SRO function is much broader. Besides functioning as a listing authority, the SGX's SRO role also encompasses a market surveillance function to uphold the integrity of the market, and a member supervision function to ensure participants' adherence to trading and clearing rules.

14. So removing the SRO function from the SGX – as some have suggested – could mean that the exchange will not need to undertake market surveillance; nor to regulate members for compliance with rules of the exchange. Others have suggested removing only the listing authority function from SGX. But the flip side is that this risks losing the synergy of its regulatory function with its other roles pertaining to the development of a viable and credible marketplace; and creates ambiguity as to who oversees proper conduct of listed companies – the separate listing authority or the exchange.

15. It is worth noting that SGX's SRO function is neither a new invention nor "uniquely Singapore". Exchange self-regulation has a long history in financial markets and in many established markets. Most, if not all exchanges globally, perform a varying range of SRO functions. Global exchanges – like the New York Stock Exchange (NYSE), NASDAQ, ICE and Chicago Mercantile Exchange (CME) in the US, and London Stock Exchange (LSE) in the UK, and Hong Kong Exchange (HKEx), Australian Securities Exchange (ASX) Group and the Japan Exchange (JPX) Group in Asia – are also SROs. This brings me to my next point.

16. There is no single "correct" model for the SRO. Neither is a particular model cast in stone and unchangeable. The division of regulatory responsibilities between the statutory regulator and the exchange's SRO function – or some other regulatory model – has to reflect and adapt to each jurisdiction's circumstances, market environment and other idiosyncrasies. To illustrate this diversity:

- In the US, the SEC has primary responsibility for reviewing IPO filings made by companies. Member supervision is undertaken by the Financial Industry Regulatory Authority (FINRA), a separate industry SRO which supervises all securities broker dealers. US exchanges are responsible for market surveillance, although some have outsourced the duties to FINRA.
- In UK, the LSE performs market surveillance and member supervision, while listings are approved by its statutory regulator i.e. the Financial Conduct Authority.
- In Asia, HKEx, JPX Group and ASX Group perform all SRO functions in the areas of listings, member supervision and market surveillance, much like in Singapore. There may also be additional structures and processes in place to supplement the SRO functions. For example HKEx has an independent Listing Committee that makes all formal decisions on listing applications.

17. The varied practices across the globe suggest the viability of different SRO models with their attendant benefits and limitations that may be appropriate to one jurisdiction while not necessarily to others. But what is common is that the notion of exchanges as frontline regulators has not been radically changed nor dismantled.

18. In Singapore's context, when we review the role of the MAS vis-à-vis an SRO, a key consideration is who is better placed to make that assessment of risk-return tradeoffs in the strategy to support a sustained thriving marketplace. A stringent set of entry or policing criteria can limit growth and development; a loose set of criteria can undermine long-term confidence of market participants including investors and companies. On either end, the exchange's own shareholders and other stakeholders including the investing public will be worse off. In addition, we have to consider who is in a more nimble position to manage the different types of risks posed by market participants on the exchange itself including early detection and preliminary investigations.

19. I should emphasise that these do not mean that concerns over potential conflict of interest especially with respect to the listing function are unfounded. Hence the MAS regularly reviews the extent to which the SRO functions – listings, member supervision and surveillance – should reside with the exchange. The answer is not necessarily a binary "yes" or "no" outcome each time but involves a review of whether there are sufficient safeguards and conflict-mitigants incorporated into the exchange's governance, organisation structure and including its reward and recognition system in relation to the SRO function.

20. I will highlight our recent review in the three areas of listing, member supervision and market surveillance. Much work has been done to enhance the exchange's role around listings. We believe that SGX – as the only securities exchange in Singapore – remains an appropriate listing authority. SGX has raised its admission criteria, and enhanced the governance process by setting up three new independent listings committees to complement SGX's listing and disciplinary processes. The committees comprise a diverse mix of reputable, independent and experienced individuals to represent both investor and public interest. We believe these are

positive developments and we should allow these committees to carry out their respective oversight functions.

21. However, we have also determined that there is scope to recalibrate the responsibilities of the exchange vis-à-vis the MAS in the areas of member supervision and market surveillance. The impetus for such a recalibration is not because we think that there is material or potential conflict-of-interest risk. Rather, as Singapore's financial landscape features more than one exchange, it is not efficient to have each exchange carry out similar supervisory roles of common members.

Member supervision

22. Therefore, with respect to member supervision, MAS will redefine the scope of regulatory responsibilities between MAS and exchanges so that overlaps faced by intermediaries who are members of different exchanges, and at the same time regulated by MAS, are minimised. To elaborate, exchanges typically supervise intermediaries to ensure that they comply with the exchange rules, uphold high standards of market integrity and are financially sound. MAS, on the other hand, supervise intermediaries for compliance with MAS' statutory licensing requirements pertaining to systemic and conduct risks.

23. In practice, exchange rules can and do overlap with the statutory requirements under the Securities and Future Act. The regular dialogue and co-ordination between MAS and SGX have allowed us to manage inspection visits in a way that reduces the burden on intermediaries who are both licensed by MAS and are members of SGX.

24. However, this will become more challenging when more than one exchange operates in Singapore. For example, an intermediary that is licensed by MAS, can also be a member of both SGX and ICE Futures; it should not have to undergo three separate inspections a year, especially if a number of areas are duplicative.

25. In the US which has many more exchanges, they have either set up a separate industry SRO to undertake member supervision in the case of the securities market or relied on an exchange to play a "lead SRO" role in the futures market.

26. As a statutory regulator, MAS will remain primarily responsible for the supervision of intermediaries who are our licensees in areas of capital and reserves, business conduct, anti-money laundering & counter terrorist financing (AML/CFT) and operational resilience. These are areas which have been stipulated in our regulations and notices, and are statutory obligations to be complied with. Starting from this year, MAS will no longer require exchanges to inspect their members in these areas as long as the entities are licensed by MAS. In other words, MAS will effectively be the "lead regulator" in these areas.

27. The need to form a separate SRO at this juncture for the purpose of member supervision is in our view, not compelling. It is unlikely to be an efficient model given the size of our market. In fact, it may require greater coordination since there will be more parties involved, namely MAS, the exchanges and yet another SRO.

28. The exchanges will remain responsible for areas affecting their respective market operations such as those relating to the priority of orders on a trading floor or risk management rules on margin requirements. In other words, these are business rules which members have to comply with, and may differ from exchange to exchange. Exchanges will need to supervise their members for compliance, in accordance with the risks these members pose to the markets or clearing houses, and undertake disciplinary proceedings for members who breach their rules.

29. Clearly, we cannot avoid all overlaps and even some differences between MAS' regulations and exchanges' rules in certain areas such as those relating to financial resources and business conduct requirements. This is in a way inevitable as MAS' regulations have to cover all capital markets intermediaries regardless whether they are members of exchanges or not.

Exchanges, depending on the type of products that they offer, may need to impose differentiated requirements on different members depending on the assessment of product risks and credit worthiness of their members, which may or may not be regulated by MAS. Protocols on information sharing between MAS and exchanges' SRO units will hence be mapped out.

30. At a broader level, we believe this change will lead to greater supervisory efficiency and better system-wide risk management. While exchanges will retain their regulatory responsibilities in terms of member supervision, their resources can be concentrated on the supervision of members with significant risk exposures on their respective exchange. This can include members which are not under MAS' oversight such as those based overseas.

Market surveillance

31. The MAS on our part will be enhancing our surveillance capabilities both within and across markets. The presence of multiple exchanges, each focused on its own markets, can give rise to blind spots as each exchange may not have the complete picture of common members' exposure and activities. There are also certain markets such as in the OTC derivatives space that are not under the direct surveillance of exchanges.

32. Hence MAS, as the statutory regulator, will be in a better position to aggregate and review different pools of information in the activities across exchanges and market sectors to anticipate possible risk and to investigate potential misconduct and market abuses.

33. Advancement in technology, particularly in the field of data analytics, has brought about enhanced surveillance techniques. In terms of capacity building, the MAS will enhance our analytics and thematic studies of big datasets to detect hitherto complex patterns, for potential market misconduct and abuses.

34. What all these mean, is that in each market, both the exchange and MAS will be looking out for potential risks, albeit based on different parameters. This will increase the robustness of the overall oversight of market activities.

Robust enforcement and market discipline

35. These enhancements to our surveillance efforts will complement, in a significant way, our enforcement actions against market misconduct. The objective is on early detection as well as to support more expedient investigations and tough enforcement actions. This will also augment our toolkit to combat misdemeanors such as market manipulation and insider trading.

36. MAS has and will spare no effort to investigate any serious market misconduct and to take appropriate enforcement action. This is not always an easy task because investigations into market misconduct often involve complex and large scale relationships, which will necessitate considerable investigation resources. Market misconduct is often perpetrated by multiple parties, some of whom may be outside our jurisdiction. Such cross-border investigations present additional challenges, as crucial evidence may be situated beyond the jurisdictional reach of enforcement agencies and require coordination by multiple agencies globally.

37. I am pleased to note that the joint investigations arrangement between MAS and the Commercial Affairs Department (CAD) which commenced last year for all potential market misconduct offences has facilitated greater efficiency in the enforcement process and enabled both agencies to pursue more effective enforcement outcomes. There have been queries on the status of the investigations by MAS and CAD in the penny stocks debacle; it is still premature for me to comment but I just want to note that this is a complex exercise that is ongoing and involves reviewing vast amounts of trade data from more than 500 trading accounts (both local and overseas), requiring our investigators to obtain and comb through more than 20,000 communication messages, many witnesses and other pieces of potential

evidence. Investigations are at an advanced stage and charges are likely to be filed against the responsible parties in the course of this year.

38. Notwithstanding the complexity of current or future investigations, our enforcement agencies will be relentless in our pursuit of persons who break our securities laws. We will also seek criminal actions or higher civil penalties in appropriate cases to send the right deterrent message. I encourage you to read our Capital Markets Enforcement monograph which outlines our philosophy and approach to enforcement.

39. However, it is neither realistic nor desirable for regulators to police every single trade in our financial markets, which will require inordinate resources. Instead, the surveillance and enforcement functions of the MAS should be complemented by a culture of market discipline through greater transparency. This will allow market participants including investors and analysts to query, and to exercise their interests as stakeholders. As former Federal Reserve Chairman Alan Greenspan once said, “Transparency challenges market participants not only to provide information, but also to place that information in a context that makes it more meaningful”.

A dynamic and evolving market

40. I will now move on to some broader development areas. Financial markets will evolve, in part driven by technology and as a response to regulatory requirements. Just as technology has improved operational efficiency of stock exchanges in the 1990s from an open-outcry pit system to real-time electronic trading screens, technology will continue to transform and improve how exchanges and other financial market infrastructures work.

41. The trend of financial markets “electronification” is inevitable as more financial products are standardised and traded electronically. We are likely to see more algorithmic trading which do not require human intervention in trading decisions. As the cost of setting up trading platforms declines, trading venues including exchanges, electronic crossing networks, multilateral trading facilities will proliferate and compete for liquidity.

42. We have seen significant investments in technology to reduce latency and design in ever-smarter algorithms to trade more efficiently. Whether such innovations have led to more efficient markets for end-users to invest and to manage their risks are still subject to some debate. Regulators worldwide also have been keeping abreast with innovative developments to understand newer forms of risks and market linkages, as well as to embrace the opportunities that these may bring. I will highlight a few examples that will be relevant to the world of exchanges.

43. I think we can expect innovations in distributed ledger technology that will be applied to the “plumbing” of financial markets, areas which we hitherto tend to take for granted. A distributed system should in theory improve resilience as it theoretically removes the risk of a single point of failure. If the clearing and settlement of equity trades can be reduced from the existing standard of 2–3 days to as little as 10 minutes, this will further reduce settlement risk. Some have said that the near instant settlement of transactions can transform the financial system and free up billions of dollars’ worth of collateral that is locked up during the trade settlement period.

44. Technology can also lead to “commoditisation” of certain financial intermediation functions. Just 15 years ago, the cost of brokerage for retail investors was as much as 1%. But now our retail investors are able to access global markets at significantly lower brokerage costs. There will be no let up on cost pressure. We used to hear about brokerages such as E-Trade offering stock trading at a $9.99 flat commission; now we have the likes of Robinhood in the U.S. offering retail trading for free.

45. The advent of “robo advisers” also suggests that investors can access automated investment advice on their Smartphones, without the need for human interface. Some

commentators believe that computer algorithms can essentially provide customized advice to investors at a fraction of costs compared to human financial advisers.

46. The interplay of new technology, different platforms and new players inevitably suggests faster and cheaper options ahead. These can impinge on the existing job roles in our financial marketplace. Technology-driven applications may very well become alternatives to the traditional stockbroking service offering. If a consumer is already getting regular and instant updates on the markets using his Smartphone, it is only natural for him to expect higher service levels from his stockbroker beyond ad-hoc market updates and pure execution. If consumers are already comfortable with making and receiving payments instantly via internet banking, there will be calls to shorten if not eliminate the 2 to 3 days taken to settle and deliver his stock. So the business model of CDP as a central securities depository may need to be reviewed in future.

Upskilling the stockbroking industry

47. This leads me to the subject of skills upgrading. The Government has launched the SkillsFuture initiative last year, to allow all Singaporeans to acquire a mastery of skills and to be better prepared for future jobs. This can be helpful to financial market professionals such as our trading representatives as example.

48. The Institute of Banking and Finance (IBF) has worked with SGX to conduct a survey polling some 1,200 trading representatives last year for their feedback on their training needs and professional development. IBF has also organised extensive consultations with multiple stakeholders such as Securities Association of Singapore (SAS) and the Society of Remisiers of Singapore (SRS), as well as arranged focus group discussions with individual remisiers and dealers.

49. As a follow up to these consultations, IBF will be introducing a new set of competency standards to help trading representatives acquire competencies to service their clients better. IBF will also be working closely with the SGX Academy, SRS as well as the larger broking-firms to have in place a wide offering of training programmes to be made available to trading representatives

50. MAS will continue to support the various training initiatives. All learning and development programmes formally recognised by IBF will receive at least 50% funding subsidy[2] [2] from the Financial Sector Development Fund (FSDF). In addition, trading representatives who are prepared to undergo the IBF Standards certification programme will receive 70% funding subsidy. You might be aware that the SkillsFuture Credit has already been rolled out early this month. Trading representatives can use the $500 Credit for eligible training programmes. I encourage all trading representatives to make use of these schemes to upskill themselves.

51. MAS has also looked into some feedback from the industry that certain business conduct rules pose operational challenges to trading representatives who provide advice to customers on their trades. Currently, trading representatives are subject to the same requirements as those imposed on financial advisory representatives, and are required to take into consideration the customer's investment objectives, financial situation and particular needs to ensure suitability of the products recommended which can take time to do so. Yet we recognise the time-sensitive nature of execution services for listed non-complex products such as SGX-listed shares. MAS will therefore look to exempt trading representatives from requirements that apply to financial advisory representatives by the middle of this year. This change will make it easier for trading representatives to provide investment advice on simple products.

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[2] *Funding subsidies are subject to eligibility criteria, grant caps and available to Singaporeans and Singaporean Permanent Residents only.*

Conclusion

52. Finally, let me conclude here and thank you all for your patience and attention. May I wish everyone a very energetic and prosperous year of the Monkey.