Jacqueline Loh: Strengthening Asia's bond markets

Keynote address by Ms Jacqueline Loh, Deputy Managing Director of the Monetary Authority of Singapore, at the Asia Securities Industry & Financial Markets Association's Annual Conference, Singapore, 17 November 2016.

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Andrew Ng – Chairman, ASIFMA

Mark Austen – CEO, ASIFMA

Greg Medcraft – Chairman, Australian Securities and Investments 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 10th ASIFMA Annual Conference.

2 When I last spoke here two years ago, the global economy was confronted by what the IMF described as “legacies, clouds and uncertainties”, and was forecast to grow at just 3.3%[1]. Two years on, in 2016, the IMF has lowered its forecast for the current year further to 3.1%, reflecting a more subdued outlook for advanced economies, before recovering to 3.4% in 2017[2]. This is below the immediate pre-GFC average of 4.2% over 1998–2007, though more aligned with its long-term average of 3.1% over 1980–1998.

3 The medium-term growth story for Asia is bright. The IMF’s outlook for the next five years is for emerging and developing Asia to grow by a robust 6.3%, well above the forecast for the US (1.9%), Europe (1.5%) and Japan (0.5%), and will underpin the higher investment returns in this part of the world.

4 Asia’s bond markets have softened in recent years but has much potential alongside its relatively strong economic growth outlook. Total debt issuance last year was USD 1.25 trillion, about 30% lower compared to 2013[3]. Morgan Stanley and Oliver Wyman estimate that industry balance sheets committed to bonds, foreign exchange and commodities contracted 25% over the past five years owing to tighter post-crisis regulations, and could decline another 10% in the next three to four years, with banks looking to trim capacity to improve returns on risk-weighted assets as regulatory costs and challenging markets continue to drag on returns[4].

5 However, the story going forward is more upbeat. Infrastructure and sustainable financing offer opportunities for investors. Asia will need USD 8 trillion of infrastructure by 2020[5], and within that, ASEAN will need USD 110 billion a year in infrastructure investment through 2025[6]. The World Bank Group has pledged to support climate-friendly development with USD 16 billion per annum in direct funding and mobilised USD 13 billion in external private sector capital annually by 2020. Technology and innovation will underpin and drive such growth opportunities. The inaugural Singapore FinTech Festival running this week demonstrates the tremendous potential that technology holds for capital markets to seize these opportunities and helps us cope with the market challenges.

6 The ASIFMA conference programme reflects these trends, opportunities and challenges. Tomorrow’s concurrent panels will cover macro and market developments in China, India and ASEAN, as well as opportunities in infrastructure financing, sustainable financing, big data and

cyber security. I hope to touch on some of the topics, and leave you with some thoughts as you go about today's and tomorrow's sessions.

The last decade

7 As we celebrate ASIFMA's 10th anniversary this year, let us reflect on how far Asia's capital markets have grown over the past decade:

a. Ten years ago, only two Asian stock exchanges ranked in the world's top ten by market capitalisation. Today, four out of the ten largest exchanges are in Asia[7]. Asia contributes nearly half of the total number of IPOs globally, compared to 28% a decade ago[8]. The value of share trading in Asia grew 80% over the past ten years, almost double the pace worldwide (41%)[9].

b. Asia's bond markets grew to USD 4.7 trillion in 2015 from about USD 700 billion ten years ago, representing an annualised growth rate of 24%. As a result, Asia's share of the global bond market has increased significantly, from just 2% in 2006 to 9% in 2015[10].

8 The developments are being supported by two trends:

a. On the demand side, Asia's middle class is growing, per-capita incomes are rising, and saving rates remain high. The Asian Development Bank estimates that 64% of ASEAN, 79% of China and 69% of India populations will move into the middle-income bracket between 2010 and 2030[11]. This reflects a more than three-fold increase to 3.6 billion persons in 2030, and will continue to drive the need for long-term investment for retirement.

b. On the supply side, the major markets China, India and ASEAN have made good progress in market reforms and cross-border connectivity. Allow me to elaborate on some recent measures.

9 China has facilitated greater cross-border investment flows and allowed for more cross-border market activities. In the past year alone, China liberalised access to the interbank bond market to foreign financial institutions and institutional investors. Offshore corporates can now tap the onshore market for Panda bond issuances, while Chinese corporates in certain parts of China – such as Chongqing, Suzhou and Tianjin – can issue bonds in offshore markets and repatriate the proceeds to support onshore economic activities.

10 India has likewise liberalised cross-border capital market activities. Indian banks and corporates are now allowed to issue Rupee-denominated bonds overseas as part of their external commercial borrowings which enables Indian issuers to diversify their funding base and achieve more efficient cost of funding.

11 In ASEAN, capital market development and integration efforts are underway. The ASEAN Trading Link provides investors with a single screen to access stock exchanges in Malaysia, Thailand and Singapore. These three jurisdictions have also adopted fully harmonised prospectus disclosure requirements known as the ASEAN Disclosure Standards, which facilitate the multi-jurisdictional offering of equity as well as debt. The ASEAN Collective Investment Framework (CIS) was launched in 2014 to facilitate cross-border offering of CIS to retail investors in Malaysia, Singapore and Thailand, under a streamlined authorisation process. A total of 12 funds are now available under the Framework. Together, these initiatives benefit both issuers and investors by streamlining and lowering the cost of access to capital and investment,

and help to recycle capital within the region.

12 Singapore's capital markets have likewise developed well on the back of Asia's growth and capital market liberalisation:

a. ***Bonds.*** The size of the corporate bond market grew 2% year-on-year to reach SGD 315 billion in 2015 comprising SGD 140 billion in Singapore Dollar bonds and SGD 175 billion in non-Singapore Dollar bonds. This represents an annualised growth rate of 12% over the past five years. The market serves a diverse range of issuers, raising funds in various currencies and instruments, including:

(i) One, ***Covered Bonds***: DBS issued the first covered bond of USD 1 billion in July 2015. UOB is the first global issuer to publish its Harmonised Transparency Template (HTT)[12] which was developed by the European Covered Bond Council, and aims to promote an enhanced level of transparency and comparability for covered bond investors.

(ii) Two, ***Masala Bonds***: Following India's liberalisation, as I mentioned earlier, three Masala bonds were issued in Singapore and listed on SGX this year: Adani Transmission, NTPC Limited and Indiabulls Housing Finance. They also represent the world's first green corporate Masala bond and first privately-owned enterprise Masala bonds.

(iii) Lastly, ***Green Bonds***: To meet the demands of an expanding pool of socially responsible investors, a Singapore property company is set to roll out the first green bond in Singapore.

b. ***Foreign Exchange.*** A well-functioning bond market serving a broad spectrum of international issuers and investors needs to be supported by a deep foreign exchange market, and Singapore is the largest foreign exchange market in Asia and the third largest globally. Based on the triennial survey by the Bank for International Settlements, average daily turnover reached USD 517 billion in April 2016, a 35% increase from three years ago. Our share of global market has increased from 6% to 8%. Singapore exchanges offer a suite of 21 Asian FX currency futures and option contracts. The Singapore Exchange's Indian Rupee and Renminbi futures contracts are amongst the most liquid globally.

The next decade

13 As we chart our next lap in developing Asia's capital markets, we need to take into account trends and driving forces that will shape capital markets in the years ahead. Let me highlight three of them:

14 First, technology is transforming capital markets in significant ways.

a. This is most obvious in foreign exchange, which is the most advanced in contract standardisation and market practices. New electronic trading platforms are blooming alongside mature systems, and are beginning to enter emerging markets. Technology is also enabling OTC platforms to clear on exchanges, and for exchange-traded futures to be distributed on OTC platforms.

b. Even in bond markets, technology is being used to improve pre-market price transparency by pulling price feeds from traders directly. To ameliorate the impact of bank balance sheets shrinking, companies are using technology to experiment with bringing buy-side liquidity into secondary markets. The challenge, as many have observed, is how these solutions can help to maintain liquidity in times of market volatility.

15 Second, companies are staying private for longer. According to McKinsey, in the US which drove the dot-com boom and is driving the "unicorn" and "decacorn" phenomenon, the average age of technology companies going public in 2014 was 11 years, up from 4 years in 1999[13]. This has been enabled by the prolonged period of low yields, which has driven institutional investors to seek higher returns from liquidity and credit risk in private markets. McKinsey also found that 150 software companies were able to reach USD 10 billion in value through private financing in 2015, compared to just 10 in 2011. In Singapore, private equity assets under management grew 24% per annum on average for the last five years to over USD 100 billion in 2015. This creates a role for industry bodies like ASIFMA, which are set up around public markets like credit and equity, to support companies on their longer journey in private markets, and introduce the benefits of market transparency and market discipline while the companies remain private.

16 Third, underlying macro trends are supportive of investment continuing to flow from Developed Markets to Emerging Markets. On the one hand, accommodative monetary policies in developed economies will drive an ongoing search for relative yield in emerging markets, including in Asia. On the other hand, emerging and developing Asia are expected to grow more than three times as quickly as advanced economies[14].

17 In order for Asia to fully reap the fruits of these favourable macro trends, it will need to raise the needed long-term capital for sustainable growth, including by further strengthening its bond markets. Today, I will touch on three areas: first, a new Asian Bond Grant to support a broader base of Asian issuers; second, efforts to encourage rated issuances; and lastly, supporting secondary market liquidity. Let me start first with the Asian Bond Grant initiative.

Measures to strengthen Asia's bond markets

Introducing the Asian Bond Grant

18 In many ways, Singapore has always been a bridge between Asia and the rest of the world, whether as an entry point for global investors looking into Asia or as a launchpad for Asian companies seeking to regionalise and globalise. We have had some success in developing the Asian G3 bond market, but Asian local currency issuances have room to grow. When I spoke here two years ago on integrating Asia's capital markets, it was against the context that the markets were fragmented on several dimensions: laws, currencies, market practices as well as market infrastructure. Investors need to understand each market and each set of laws before investing. Likewise, Asian companies seeking to raise international capital, on top of domestic capital, may need to obtain international ratings and international documentation, and these require international lawyers and accountants, and international roadshows.

19 Singapore already offers an excellent ecosystem of financial institutions, professional services like legal and accounting, credit rating agencies, and market infrastructure for Asian companies to issue, market, list and trade their bonds. To make it more attractive for Asian issuers to raise international capital in Singapore and benefit from the ecosystem here, we will introduce an Asian Bond Grant scheme next year. The scheme aims to broaden the base of issuers in our bond market, which will add to the breadth and diversity of debt instruments for the

investing community. Qualifying Asian issuances will be able to offset up to 50% of one-time issuance costs such as international legal fees, arranger fees and credit rating fees. We have consulted with local market participants on various aspects of the scheme to ensure a smooth implementation. I am glad to say that the industry has been supportive of this initiative, and together we are confident that this will enhance Singapore's value proposition.

Encouraging rated issuances

20 Even as we draw Asian issuers to Singapore, we want to encourage these issuers to be rated. Credit ratings improve general market transparency by providing independent and comparable assessments of the credit worthiness of issuers. Together with business and financial information provided in the offering documents or company announcements, credit ratings can assist investors to better understand the issuer's business and financial health. Issuers that are rated, in comparison, also gain access to a broader investor base, as many institutional mandates invest only in rated bonds. To encourage rated issuances, rated issuers will be eligible for a larger grant quantum under the Asian Bond Grant.

21 Ratings can also benefit bond issuers. In the Singapore Dollar bond market, we have been encouraging frequent bond issuers to obtain credit ratings. The Housing and Development Board (HDB) is an example of a frequent domestic issuer that recently obtained a rating and benefited from tighter issuance spreads. About 40% of outstanding Singapore Dollar bonds are rated[15], and we would like to see this share go up. To give this another boost, we are considering ways to nurture a healthy and sustainable credit rating culture in our bond market. For instance, under the Asian Bond Grant scheme, for Singapore Dollar bonds, only rated issuances would be eligible. Another possibility we are considering is to help existing issuers offset the costs in obtaining a credit rating.

22 Even as we encourage more rated issuances, I must caution against basing investment decisions solely on ratings. Regardless of whether a bond is rated or not, investors need to make their own credit assessments. Perhaps more importantly, and as the saying "do not put all our eggs in one basket" goes, the key to long-term investing is diversification and avoiding concentrated exposures to any one security. This approach is inherent in the way institutional investors manage portfolios – broad diversification across asset classes, sectors and securities.

23 Individual investors building their own investment portfolios should take special care to diversify and avoid concentrated exposure to any one investment or issuer. One way for individual investors to gain exposure to a diversified portfolio of bonds in a cost-efficient manner is to invest through bond funds. MAS has for many years promoted the development of index bond funds in the regional markets, through the Asian Bond Fund (ABF) initiative led by the EMEAP Group. Today, there are many such offerings, some of which can be bought and sold through the exchange as exchange-traded funds (ETFs). We encourage fund managers to increase the number and variety of bond funds and ETFs available to individual investors.

Supporting secondary market liquidity

24 Let me now turn from our efforts in the primary market to secondary market liquidity. Market participants generally agree that bond market liquidity has become more challenging. This is the case globally but also in Singapore. Banks continue to provide prices for a majority of bonds issued here, although the amounts they are willing to transact in, may be smaller for weaker credits and smaller issuances.

25 A functioning secondary market is critical for the sustainable growth of the bond market. To deepen the secondary market, MAS has been working with the industry on several initiatives over the years. For example, to improve price transparency, we collaborated with banks and service providers, such as Bloomberg and Markit, to make available end-of-day corporate bond prices on

their platforms. Last year, MAS launched the Securities Repo Facility, under which eligible banks can borrow certain Singapore Dollar corporate bonds via repo transactions to facilitate their market making activities. These efforts will take time to bear fruit. We are also engaging investors, issuers and intermediaries to assess if more can be done to facilitate an active repo market and whether this will help deepen liquidity in bond markets.

26 Before I conclude, I should address the issue of defaults and restructuring exercises in the domestic bond market recently. These have so far mostly been from the oil and gas sector, and reflects the protracted weakness in the sector arising from a slump in energy prices. Rising defaults over the late part of the credit cycle and difficulties in particular sectors are to be expected, but MAS' stress test suggests that most corporates in Singapore remain fairly resilient, and banks' exposures to weaker issuers are likely to be manageable. The key here again is to ensure that one has a diversified portfolio. Following the recent restructurings and defaults, we have also received feedback calling for a review of the regulations and market practices around the Singapore bond market. Some ideas include enhancing sales practices, recourse for investors when a bond defaults, and the need for credit ratings. We are considering these feedback and will respond soon.

Conclusion

27 To sum up, Asia's capital markets have enjoyed a very good run, owing to a confluence of macroeconomic fundamentals and policy liberalisation. ASIFMA has supported that journey over the past ten years by improving transparency through market surveys, advocating innovative solutions through white papers and roadmaps, and building consensus on best practices through events like these and collaboration with other industry bodies.

28 The economic opportunities in Asia are immense, and despite the cyclical slowdown, the region's financing needs will continue to grow. Asia needs to continue strengthening its capital markets, especially its bond markets. Singapore will support Asia's bond market by introducing a new Asian Bond Grant scheme, encouraging rated issuances, and supporting secondary market liquidity.

29 Please enjoy the rest of the conference. Thank you.

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1 IMF World Economic Outlook, October 2014

2 IMF World Economic Outlook, October 2016

3 Dealogic data

4 "Learning to Live with Less Liquidity", Morgan Stanley and Oliver Wyman, 13 March 2016

5 "Infrastructure for a seamless Asia", Asian Development Bank, 2009

6 "The ASEAN Investment Report 2015 Infrastructure Investment and Connectivity", the ASEAN Secretariat and UNCTAD, November 2015

7 World Federation of Exchanges 2015 and 2006 data

8 "EY Global IPO Trends", Ernst & Young, 2006–2015 and "IPO Watch, Asia", PricewaterhouseCoopers, 2007–2014

9 World Federation of Exchanges 2015 and 2006 data

10 Dealogic data

11 "ASEAN, PRC and India", Asian Development Bank, 2014

12 "United Overseas Bank (UOB) publishes the first global Covered Bond Label Harmonised Transparency

Template", Covered Bond Label, 19 January 2013

[13] "Grow fast or die slow: why unicorns are staying private", Mckinsey & Company, May 2016

[14] IMF World Economic Outlook, October 2016

[15] MAS estimates as at 30 September 2016