Mr Lee examines issues relating to the changing financial landscape

Keynote address by Mr Lee Hsien Loong, Chairman of the Board of Directors of The Monetary Authority of Singapore and Deputy Prime Minister, at the 16th General Meeting of the Asian Bankers Association, held in Singapore on 26 November 1999.

Introduction

The international financial landscape is changing rapidly. In Asia, economies and financial systems have undergone a traumatic two years. Weakening economies uncovered flaws in financial institutions and supervision. Entire financial systems went down, undermined by slack lending practices and inadequate legal frameworks. The financial troubles in turn affected the real sector, sending economies into steep decline.

Now the crisis is passing. In many countries, macro indicators have stabilised, and growth has resumed. But it will take years of hard work to clean up the bad loans, recapitalise the banks, strengthen the legal and supervisory framework, change long established cosy relationships, and put long-term growth on a firmer foundation.

While Asia has been preoccupied with reconstruction and recovery, globalisation and technology have progressed apace, especially in the US and Europe. Technology is both a critical cause and a catalyst. Financial arenas are becoming more open, new products and services are being invented and marketed, and regulators everywhere are scrambling to assess the changes and master the flux. An international wave of mergers and acquisitions has swept the industry, as boundaries between financial sectors and products have blurred dramatically. The recent repeal of the Glass-Steagall Act in the US will allow the creation of “financial super-markets” or one-stop shops that offer banking, securities and insurance services, and further push this trend towards consolidation.

Developments in banking

In this brave new world, one fact remains unchanged: the need for countries to have sound, resilient banking systems, and strong banks. But countries cannot achieve this by closing their markets and excluding foreign competition, except at a very high price. Instead, they must use competition to strengthen and upgrade their institutions, so that they can hold their own in an increasingly open environment.

This is why Singapore has embarked on a five-year bank liberalisation programme, granting foreign banks new licences and more access to the domestic market, lifting foreign ownership restrictions on local banks, and upgrading standards of disclosure and corporate governance of local banks.

Corporate governance

Strengthening corporate governance is key to upgrading standards of integrity, professionalism and service in banks in Asia. Relationships between shareholders, the board of directors, management, and other stakeholders must all be configured in a way that encourages sound and rigorous banking practices and strengthens corporate performance. To be an effective instrument of corporate governance, the board of directors must act independently, and participate actively in shaping the strategies of the bank. The board should deliberate and decide on issues in the best interests of the bank, its depositors and all its shareholders. Board members must also be able to participate actively in strategic discussions, to facilitate the flow and cross-fertilisation of ideas, and exercise effective oversight over the management. Thus in the US, the Federal Reserve Board inspects banks’ board minutes to determine if all board members are active and contribute to discussions on important matters.

Singapore banks are prudently managed and financially sound. According to the latest Moody's ratings, they were collectively rated the ninth best in the world and best in Asia. But benchmarked against international best practices of corporate governance and disclosure, they still have some way to go. One major step we have taken is to require all local banks to appoint nominating committees within their boards, following common practice in the developed economies. The task of the nominating committees is to ensure that only the most competent and qualified individuals, who can contribute actively to the bank and discharge their responsibilities in the interests of all shareholders, are appointed to the board and to key management positions.

Such appointments are not a one-off exercise, but a continuing requirement. In Singapore politics we have made self-renewal of leaders a norm. As a result the political leadership belongs to the same generation as the population, and stays vigorous, up to date, and in tune with the electorate. But self-renewal is necessary in every field, including banking. The boards of Singapore banks have done commendable jobs discharging their responsibilities. But on the whole they have not given enough attention to self-renewal, to inducting and testing out new talent and getting people who have served long and well to make way gracefully for a younger team. In contrast, many international banks have, as a matter of board policy, set age limits and limited the length of tenure of all board members.

MAS has discussed this important issue with the local banks. We understand how difficult it is for a director to give way to a younger replacement, particularly if he has performed well over many years and still feels able to fulfil his responsibilities. But unless we overcome this psychological hurdle, we will be unable to sustain the vitality and drive of the organisation, and the quality of our banks will decline.

The local banks have agreed that self-renewal of their boards should be a priority, and have told MAS that they will start to make some changes soon. MAS looks forward to receiving nominations from the local banks for new board appointments, and to working with their boards to strengthen corporate governance in the local banks.

Technological innovation: cheque truncation

A second area of focus for banks is technology. Technological innovations have dramatically altered the financial landscape. Payment systems, for example, can be improved by technology. Ideally, payment systems should be paperless, and in the long run this will happen. But today's reality is a long way from that. Even a technology pioneer like the US depends on large volumes of paper cheques. Therefore to apply technology to the payment system, a realistic interim target is to aim for *cheque truncation*.

Cheque truncation means that the physical cheque is scanned at the point of deposit, and thereafter the electronic image of the cheque, rather than the paper cheque itself, is transmitted to the clearing house for sorting, and then onwards to the paying banks. In other words, the flow of the physical cheque is fully truncated at the point of deposit.

The Singapore Clearing House Association, together with the Association of Banks in Singapore, is currently developing a cheque truncation system. This should be much faster and cheaper than handling paper cheques.

We are also considering a national image archive to centralise the storage of cheques. The consolidation of such shared back-end services will yield economies of scale at an institutional level. To the customer, cheque truncation will mean faster processing of cheques deposited, thereby increasing the customer's liquidity and reducing settlement risk. The system will be implemented nationwide by 2001, making Singapore the first country to implement cheque truncation on such a scale.

Development of capital markets

Besides the need for strong banks, a second lesson from the Asian crisis is the importance of deep and liquid capital markets. There is now widespread recognition that Asian countries depended too heavily on bank loans for financing. Domestic banks lent excessively. Foreign banks also went on a lending binge in Asia in the years leading up to the crisis in 1997, and just as surely accounted for the bulk of the sudden withdrawal of capital in the two years that followed. Had Asia relied more on bond and equity financing, it would have had alternative sources of financial intermediation, and the subsequent credit crunch in the banking system would have had a smaller impact on the real economy.

Bonds and equities offer significant advantages over bank borrowing. They are a means of long-term financing and investment to corporates, unlike short-term credit lines which mean funds being pulled out of a company at the first sign of trouble. They facilitate asset-liability management. They mobilise savings and widen the range of investment alternatives for both institutional and retail investors. They create transparent market-determined assessments of creditworthiness.

Singapore believes there is good potential for developing domestic bond markets, and an Asian bond market. We have actively promoted the growth of the bond market in Singapore, as one of the centres for the Asian bond market. Previously, MAS did not allow foreign entities to borrow in Singapore dollars, whether from banks or through bond issues, except to finance economic activities related to Singapore. This was to deter the internationalisation of the S$. But last year we reviewed this policy, and issued new guidelines, a Notice (MAS 757) that made it easier for foreign entities to list S$ shares and issue S$ bonds, subject to safeguards. For example, the S$ proceeds must be swapped into foreign currency if they are to be used outside Singapore.

Our approach was a cautious one, for although we wanted to promote the bond market, we maintained our basic stance of discouraging the internationalisation of S$. But we stated that so long as the stability of the exchange rate was not compromised, the actual implementation of the non-internationalisation policy would continue to evolve as we gained experience with the new rules, and as our financial sector and capital markets grew and developed. We also committed to review the restrictions after a year.

We have now completed the review. The response to our new policy has been encouraging. Since the new Notice was introduced, there have been 19 S$ bond issues by 16 foreign entities, raising a total of almost S$3 billion. The issuers were a good mix of supranationals, financial institutions and corporates of good credit standing from around the world.

The financial institutions have given MAS feedback, proposing changes to the Notice to give the players more flexibility and generate more liquidity and depth in the market. We have adopted many, but not all, of their suggestions. We will liberalise guidelines in four key areas.

Repo consultation limit

The development of a liquid repo market is critical to the Singapore government securities (SGS) and S$ debt market. An active repo market enables investors and primary dealers to finance their bond inventories and hedge their S$ debt positions. This would facilitate more active trading of SGS and S$ bonds and deepen bond market liquidity.

Repo transactions with non-residents are presently subject to a S$20 million consultation limit. Banks have told us that this requirement to consult is a psychological hurdle, even though MAS has assured them that the decisions will be liberal and quick.

A non-resident borrowing S$ through a repo must first obtain the equivalent amount in SGS, which is a S$ asset. Given that MAS Notice 757 already limits a non-resident to no more than S$5 million of Singapore dollar credit for such investments, allowing banks to transact S$ repos freely with non-residents will not lead to a significant net increase in S$ credit facilities to non-residents.

MAS has therefore decided to lift the S$20 million consultation limit. Banks in Singapore may now, without prior consultation with MAS, enter into repo transactions in Singapore government securities and S$ denominated bonds listed on SES with any party, and for any amount, on condition that there is full delivery of collateral.

OTC interest rate derivatives

OTC interest rate products would open more avenues for non-resident investors to manage their S$ interest rate risks arising from investing in the S$ debt market. But hitherto MAS has restricted OTC interest rate derivatives, because they could facilitate speculative volatility in the S$.

In September this year, SIMEX introduced the S$ three-month interest rate futures contract. MAS will follow up by allowing S$ OTC interest rate derivatives, such as interest rate swaps, forward rate agreements, interest rate options and swaptions, to be transacted freely without consultation. Banks will, however, be required to submit monthly reports on details of interest rate derivative transactions exceeding S$5 million with counterparties outside Singapore.

Credit rating of foreign entities issuing S$ bonds

So far, we have required foreign entities which wish to issue S$ bonds to be of good credit standing. Up till now the lowest credit rating of foreign entities that have tapped the S$ bond market has been single A. Debt intermediaries have told us that investors in the S$ market would like to see a wider credit spectrum of S$ bonds. MAS recognises that allowing more diversely rated bond issues would increase investment opportunities for investors with different risk-return appetites, allow portfolio diversification, and create more investor interest in our debt market.

To widen the credit spectrum of foreign entities tapping the Singapore dollar bond market, MAS will allow the following to issue Singapore dollar denominated bonds: a) all rated foreign corporates; b) all sovereigns, rated or unrated; and c) unrated foreign corporates, provided the investor base is restricted to sophisticated investors.[1]

However, the requirement for the non-resident issuers to convert or swap the S$ proceeds into foreign currency for use outside Singapore remains. MAS still does not allow S$ funding of non-residents where the proceeds are to be used outside Singapore, or for purposes which do not generate economic value to Singapore.

S$ equity listing

Related to the bond market is the development of the Asian equities market. Companies will increasingly turn to the equity market to raise capital or reduce their debt-equity ratios. They will either seek to list in their home exchange or list abroad, and their shares will often be traded on more than one exchange. The Singapore stock exchange aims to be one of the centres in the Asian equities market.

Foreign companies seeking to list on SES often want to do so in S$. This enables them to tap the local investor base, which contributes significantly to liquidity, and hence to higher stock valuations. However, we have required foreign companies wanting to list in S$ to have at least 20% of their revenues, profits, or expenses attributable to Singapore.

MAS has now decided to remove this requirement. We will allow all foreign-owned companies to list S$ denominated shares freely on SES, without consultation, subject of course to meeting SES' listing

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[1] Defined in the Companies Act (Cap 50) as an individual whose total net personal assets exceed S$1 million or its equivalent in foreign currencies or whose income in the preceding 12 months is not less than S$200,000 or its equivalent in foreign currencies; or a corporation whose total net assets exceed S$5 million in value or its equivalent in foreign currencies as determined by the last audited balance sheet of the corporation.

requirements. However, the S$ proceeds from the share issue must be maintained with a bank in Singapore and converted into foreign currency before they can be used outside Singapore.

Foreign-owned companies whose shares are currently traded in foreign currencies on SES can convert the quotation of their stocks into S$. SES will announce details for such conversion shortly. Subsequent share issues by such companies will be subject to the same requirement, i.e. proceeds must be converted into foreign currency before being used outside Singapore.

This change is in line with the caveat emptor principle. Singaporean investors considering buying shares in a foreign company not operating in Singapore should learn for themselves what the company is doing, how successful it is likely to be, and what the risks are, before deciding whether or not to invest in the company. There is no need to deter them from investing in the company, by making the company list in a foreign currency.

MAS will be issuing a revised MAS 757 shortly, incorporating these revisions. We hope the changes will increase international participation in our S$ capital markets and add to their depth and critical mass. MAS will, of course, continue to review the Notice on an ongoing basis, in line with market needs and financial innovation.

Year 2000

Lastly, it being so close to the end of the year, let me make some remarks on Y2K.

Singapore's financial sector is fully ready for the new millennium. All banks and financial institutions have taken all necessary steps to achieve Y2K readiness. They have tested all important internal systems and participated in extensive industry-wide tests, both within the financial sector and with critical infrastructure providers. MAS has also established a Y2K liquidity scheme for a two-month period, from 29 November 1999 till 28 January 2000, to help meet temporary Y2K-related liquidity needs of banks and finance companies, in the unlikely event that they are unable to obtain funding in the market during the crossover.

Independent assessments by global industry bodies rate Singapore among the countries best prepared for the date change. In the nature of the Y2K problem and despite all best efforts, some glitches may still occur. We therefore have a range of contingency plans ready. MAS and many financial institutions in Singapore will set up command centres during the crossover to monitor closely all aspects of operations, and respond promptly to any problems that arise.

Singaporeans should rest assured that electronic services such as ATMs, electronic funds transfer and credit card facilities have been fully tested. All their financial records are backed up daily and are safe. They need not take any special measures in preparation for the New Year, like withdrawing additional amounts of cash. Their money in the banks will be as safe as it has always been. The Y2K technological issue will not be a major thing in Singapore. We are determined to ensure that Year 2000 will be remembered for its celebration of the new millennium, not for disruption due to a simple programming convention inherited from the 1950s.

Conclusion

Beyond the immediate Y2K issue, it is clear that Asian bankers face many serious challenges. They need to keep abreast of changing developments, and anticipate new trends. They must significantly improve their corporate governance. Technological innovations will continue. Policymakers have a full agenda to liberalise prudently, while tightening standards of supervision and enforcement. As financial liberalisation proceeds, new market opportunities will emerge and there will be a demand for more differentiated products and services. Capital markets should grow in Asia, providing an alternative means of intermediation for regional economies. If Asian financial systems can do these things and respond to new opportunities, they will be a source of strength, and not weakness, to their countries as the new millennium dawns.