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Subject: Speech by Mr Koh Yong Guan, 11 Dec 98

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SPEECH BY MR KOH YONG GUAN, MANAGING DIRECTOR, MONETARY AUTHORITY OF SINGAPORE, AT THE 30TH ANNIVERSARY DINNER OF THE FINANCE HOUSES ASSOCIATION OF SINGAPORE, AT THE RAFFLES HOTEL, RAFFLES BALLROOM ON FRIDAY, 11 DECEMBER 1998

Mr Peter Tan, Chairman of the Finance Houses Association of Singapore
Ladies and Gentlemen,

Thank you for inviting me and my colleague, Mr Tharman Shanmugaratnam, to the 30th Anniversary celebrations of the Finance Houses Association of Singapore.

FINANCE COMPANIES' CONTRIBUTION TO SINGAPORE

2 Over the last 30 years, finance companies have been an important source of funds for small and medium-sized enterprises in Singapore. They have provided financing to various sectors of the economy such as building and construction, commerce, manufacturing and shipping. They have also been key lenders in the housing and hire purchase markets. The strong growth in finance companies' assets, from $0.4 billion in 1968 to around $22 billion now, is evidence of the important role they have played in our financial market.

IMPACT OF ASIAN ECONOMIC CRISIS

3 However, this growth is likely to moderate in the face of the regional economic crisis. While finance companies do not have significant regional exposures, they would nonetheless be hurt by the domestic economic downturn. For example, loans by finance companies contracted by 3.7% in the first nine months of this year, compared with a 7.7% increase over the same period last year. With the soft property market and weak consumer sentiments, the loan situation is not likely to improve soon. Additional provisions for diminution in asset values and contingencies are also expected to hurt finance companies' earnings this year.

GLOBAL TRENDS IN THE FINANCIAL SERVICES SECTOR

4 More importantly, finance companies must prepare themselves for the larger forces at work in the financial services sector world-wide. Falling regulatory barriers, advances in information technology and mergers among financial institutions are rapidly transforming the global financial landscape. Financial institutions now face rivals from across time zones and industries. Singapore is not immune to these global trends. The local banking sector is expected to become more competitive following the Keppel-Tat Lee and DBS-POSBank mergers. Many foreign ones are also keen to get a foothold in the domestic market. Finance companies must adapt themselves to thrive in this environment of intensifying competition.

SHIFTING FROM REGULATION TO SUPERVISION

5 To help finance companies make the necessary adjustments, MAS will shift from "one-size-fits-all" regulation of finance companies to a supervisory approach that differentiates among institutions, just like we are doing for the other industries in the financial sector. We will review our rules to allow the better-managed finance companies more leeway in managing their risks without compromising prudential standards.

Provisioning Policy For Housing Loans And Investments

6 In July 1998, MAS lifted the administrative guidelines on provisions for non-performing housing loans to harmonise the provisioning requirement for non-performing housing loans Finance companies now make provisions for the difference between the outstanding loan and security value. Previously, finance companies had to discount the value of the residential property used as security for the loan based on the number of arrears in the loan and provide for the difference between the outstanding loan and the discounted value of the property. with that for other non-performing loans backed by properties. This rationalisation provides a level provisioning policy for different types of loans. Finance companies will also make provisions for their short-term investments and government securities on a portfolio rather than line-by-line basis. These changes help bring the provisioning policies for finance companies in line with those of the local banks to promote a level playing field among both types of institutions.

Minimum Cash Balances

7 Currently, finance companies must maintain minimum cash balances and minimum liquid assets equal to 6% and 10% respectively of their liabilities base. As the MCB does not earn any returns, it is a relatively costly way to ensure that finance companies have sufficient liquidity. Furthermore, maintaining a large cash buffer is less relevant today than it was in the past as most finance companies have

improved on their liquidity management systems over the years. In July, MAS halved the banks' MCB from 6% to 3%. To promote a level playing field among banks and finance companies, finance companies' minimum cash balances will also be reduced to 3% with effect from 17 Dec 98.

8 To ensure that finance companies maintain adequate liquidity following the reduction in MCB, the minimum liquid assets requirement will be raised from the present 10% to 13% of the liabilities base. Currently, at least 5% of the liabilities base must be held in Singapore Government Securities (SGS) with the remaining in either trade bills or overnight repurchase agreements (repos) in SGS. With the increase in minimum liquid assets requirement to 13%, finance companies must continue to hold at least 5% of their liabilities base in SGS. The amount of trade bills must not exceed 4% of the liabilities base and SGS held under overnight repos 5%. This change will bring the limits for trade bills and overnight repos in SGS in line with those for banks.

9 These rule changes would allow the finance companies to manage their liquidity more flexibly.

Unsecured Loans

10 MAS has also decided to make further changes in its regulations to encourage more independent risk assessments by the finance companies and to supervise them on a more level plane with the banks.

11 Currently, finance companies are not allowed to grant unsecured loans exceeding $5,000 to any person at any time. In addition, the limit on the aggregate amount of unsecured loans cannot exceed 10% of a finance company's capital funds.

12 MAS is revising the $5,000 unsecured loan limit so that finance companies need only ensure that the loan amount does not exceed the collateral value by more than $5,000 at the time of loan approval, rather than at all times thereafter. Finance companies may also exclude housing loans when computing the 10% limit on the aggregate amount of unsecured loans.

13 The changes are part of the shift in MAS' approach from regulation to supervision. They will place greater responsibility for loan decisions on the finance companies without lowering overall prudential standards. Finance companies will be able to make their own judgements, especially on whether to require a borrower to top up collateral after a loan has been granted, while retaining a cap on the overall level of unsecured loans. These are credit decisions which are for the finance company to make, based on the credit quality of the borrower and risk profile of the finance company's overall loan portfolio. Well-managed finance companies will have greater flexibility in making their own credit decisions and in managing their business risks.

14 MAS will however monitor the loan quality of finance companies, and will place restrictions where necessary on the weaker companies, as it already does as part of its supervisory function. Moreover, loans which are classified as non-

performing would continue to be subject to the normal provisioning requirements applicable to finance companies.

Risk-Focused Examination of Finance Companies

15 To differentiate the stronger finance companies from the weaker ones, MAS will conduct inspections more frequently and on a more regular basis. Our inspections will focus on ensuring that finance companies have proper risk management and internal control systems. MAS will also hold pre-consultation with a finance company's management before an inspection so that the inspection can focus on specific risk areas. Finance companies with inadequate control systems will be required to review and rectify the weaknesses in their systems.

DEVELOPING STRONG FINANCE COMPANIES

16 MAS will continue to review its regulations to help finance companies compete in the new financial landscape. At the same time, finance companies themselves must develop realistic strategies and work concertedly to meet the challenges ahead. Since the 1980s, a number of finance companies have merged with stronger institutions while some ceased to operate, reducing the number of finance companies from 35 in 1981 to 18 now. Finance companies have recognised that they need to consolidate further, streamline their operations and improve efficiency to thrive in the more competitive environment. If they do it right, they will continue to contribute to the development of Singapore's financial sector in the next millennium.