Singapore's Financial Centre: Resilience, Dynamism, Trust

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Good afternoon. I accepted your invitation to speak not without some trepidation.

- The Foreign Correspondents Association in any country makes for a formidable audience.
- But I figured that if you were going to write about Singapore's financial sector or economy, it might as well be with at least some residue at the back of your minds of what MAS has to say.
- In any case, having partaken of your generous luncheon meal, it is too late to escape now.

Before I go any further, some disclosures:

- If you came for this luncheon expecting to hear about 1MDB, I am sorry I will not be mentioning that word or anything associated with it for the rest of my remarks.
- I am also sorry I have no juicy announcements to make. For central bankers and regulators, no news is generally good news.
- So, if you want to slip away quietly, now would be a good time to do so. I will pretend I did not notice.

This afternoon, I want to share my thoughts with you on how the MAS sees the financial sector. Many of you, especially from abroad, are sometimes intrigued by MAS' role as both regulator and developer of the financial sector.

- As one of you put it recently, the adjectives used by bankers to describe the MAS are *"no-nonsense", "business-friendly", "pragmatic"*.
- You will be forgiven to think that we are sometimes schizophrenic.
- In my meetings with foreign bank CEOs, I have sometimes, in the same breath, said we would like to see an improvement in the bank's risk management and internal controls and then asked what we could do to encourage the bank to expand its operations in Singapore – safely of course!

Let me explain why we are both "no-nonsense" and "business-friendly".

The financial services sector is one of the key pillars of the Singapore economy.

- It accounts for about 13% of GDP and has strong positive demand spillovers on the rest of the economy.
- The sector employs about 200,000 people, 84% of them are Singapore citizens and PRs.
  - ➢ It creates good jobs.
  - ➢ The median wage for Singaporeans in financial services is $6,400, compared to the national median of $4,000.

Financial services will become even more important in the future economy.

- The sector grew by an average of 8.6% p.a. during the last five years (2011-2015), two times faster than the overall economy at 4.0%.
- If the sector continues to grow twice as fast as the economy over the *next* five years – not easy but we aim to – financial services will make up 14% of the economy in 2020, compared to 11% in 2010.

Now, the bad news.

The financial sector is inherently vulnerable to risk and volatility.

- As crisis after crisis has shown, problems in the financial sector quickly become problems for the entire economy.
- The Global Financial Crisis imposed a tremendous cost with the global economy estimated to have lost 5 percentage points of growth between 2007 and 2009, not to mention the human dimension in jobs lost and companies closed.
- As an international financial centre - connected to the global network of financial flows and playing host to hundreds of foreign financial institutions - Singapore is particularly vulnerable to contagion and shocks from abroad.

The global financial industry is facing unprecedented headwinds.

- We are looking at a prolonged period of low growth and low interest rates – a combination that spells reduced earnings and increased risks for most financial institutions.
- The regulatory and compliance burden has increased significantly, following wide-ranging regulatory reforms in the wake of the global financial crisis.
- The reforms were necessary to help make global finance safer; but their cumulative effects do pose a challenge for the profitability of financial institutions, especially banks.
- Unprofitable banks are not necessarily safe banks.

Finally, the financial industry in many parts of the world is facing a crisis of trust.

- Financial institutions have come under increasing public scrutiny over their business conduct.
- Globally, we have seen repeated cases of mis-selling financial products, manipulating benchmark rates, and using the financial system for illicit transactions.

Singapore's financial sector has to overcome these headwinds and manage these risks as it develops further. And it must do this while seizing on opportunities presented by a growing Asia and technological change.

Let me touch on three attributes that our financial sector needs to maintain and strengthen in the years ahead: *resilience*, *dynamism*, and *trust*.

A RESILIENT FINANCIAL CENTRE

I will start with resilience.

- We cannot insulate our financial sector from the stresses and turbulence in international financial markets.
- We must remain open but be able to absorb shocks from abroad and bounce back.

High prudential standards have therefore been a hallmark of Singapore's financial sector since the very beginning.

- In recent years, we have further strengthened the resilience of the system through higher capital requirements and enhanced liquidity rules.

Singapore banks operate well above the regulatory capital minimums.

- The Basel Committee prescribes a minimum Tier 1 capital adequacy ratio of 6%;
- MAS has set a regulatory minimum of 8%;
- The three local banking groups have Tier 1 ratios in excess of 13%.

Singapore banks are well-placed to meet the Basel III leverage ratio requirements, currently proposed as 3%.

- In fact, the three local banks have leverage ratios above 7%.

MAS has had a liquidity requirement long before an international standard was developed and has recently increased the risk sensitivity of our liquidity rules.

- The three local banks' Liquidity Coverage Ratio or LCR is already well above 100%, the target set by the Basel Committee for 2019.

These strong buffers – built up in good times – are now serving us well as we enter a soft patch in economic conditions.

- The banking system's ratio of non-performing loans went up to 1.9 % in Q2, from 1.3% a year ago.
- But the banking system has set aside provisions to cover more than 100% of its NPLs.

There have been concerns raised about the impact of the oil and gas (O&G) sector.

- The O&G industry has been under pressure from low global oil prices for some time.
- We expect to see some of that pressure showing up in our banks' NPLs.

The banks have been actively managing the risks from the O&G sector.

- The banking system's exposures to the O&G sector as a proportion of total exposures (i.e. including non-bank loans, debt securities and contingent liabilities) is less than 10%.
- Among the local banks, O&G exposures are even lower, at about 6%.

It is also important to appreciate that there is no systemic problem across the O&G industry.

- The problems in the O&G industry are concentrated in the upstream marine and offshore engineering segment which makes up less than one-fifth of the industry.
- About 60% of the surveyed banks' O&G exposures are to the more resilient downstream, oil trading, and integrated firms, which are less impacted by the decline in oil prices.
- Firms focusing on oil refining have also fared better on account of regional demand for refined petroleum products and lower feedstock prices.

The most recent stress tests conducted by the MAS indicates that the banking system would not do too badly even under some pretty severe scenarios.

The stress scenario assumed:

- the US, EU, Japan and several emerging Asian economies slipping into recession and China's economic growth falling below 3%;
- sharp depreciation in regional currencies and oil and commodity prices falling by another 50% over 3 years;
- a protracted recession in Singapore with resident unemployment spiking to more than 6%;
- property prices falling by another 50% over 3 years, with similar declines in China and Hong Kong; and
- the banks' top O&G counterparties failing.

Under these rather dire conditions, the banks' NPL ratios could rise to 8-10% by the end of 2018. That should not be surprising. What's important is that the banking system will be able to absorb these losses.

- Banks will continue to meet the Basel minimum capital requirements comfortably.
- And they will have sufficient liquidity to meet their cash flows.

This resilience did not come about by accident. It reflects prudence and sound financial management in the financial industry:

- building up capital and liquidity buffers;
- identifying and managing risks proactively;
- provisioning against losses conservatively.

A DYNAMIC FINANCIAL CENTRE

I have talked about imagining the worst and preparing for it – that is resilience. Let me now talk about seizing opportunities – that requires dynamism.

Our financial sector has been able to grow handsomely because it is plugged into the region – which is growing two to three times faster than our own economy.

- But the continued growth of the financial sector is not a given.
- MAS and the financial industry have been working hard together to realise this potential.

A key priority is to strengthen infrastructure. Let me give an example.

Emerging Asia has enormous infrastructure needs. At the same time, global investors are seeking investment projects with good, long-term yields. There ought to be a good match.

Yet, for all the promise and rhetoric, infrastructure finance has not really taken off.

- The basic problem is this: infrastructure projects are not structured in a way that would draw investors.

MAS has been working closely with stakeholders to improve the bankability of projects.

- There is now a recommended template to help regional governments structure meaningful public-private-partnership agreements for infrastructure projects.

The latest innovation is an infrastructure debt takeout facility.

- By providing a guaranteed takeout arrangement, the facility will enhance banks' ability to originate, arrange and provide infrastructure project finance loans.
- At the same time, it will make it easier for institutional investors to invest in long-term infrastructure debt instruments as an asset class.

Second, we need to deepen our markets.

Take the asset management industry, where Singapore plays the role of a regional hub with S$2.6 trillion of assets under management. To deepen our market, we are embarking on several initiatives:

- To add diversity and resilience to the industry, we are seeking to anchor sovereign wealth funds and pension funds.
- To fund managers who use Singapore as their hub for Asian growth, build their investment capabilities and strengthen their local talent pool, MAS is giving out more investment mandates.
- To facilitate the domiciliation of funds in Singapore, MAS together with the Ministry of Finance is putting in place a more efficient corporate fund administration structure for asset managers.

- To meet the growing demand for family offices, we are providing greater clarity on the regulatory treatment of single family offices.

The third way in which we build dynamism in the financial sector is by enhancing connectivity.

One of Singapore's key roles as a financial centre is to connect investors and markets across Asia and beyond. Our expanding financial ties with China is a good example.

Singapore is one of the top three offshore RMB centres globally.

- Singapore's financial centre has played a constructive role in supporting the internationalisation of the RMB.
- This has in turn helped to forge stronger trade and investment links between China and South-east Asia.

Singapore also offers a gateway for the expansion of Chinese corporates into the region.

- More than 6,500 Chinese enterprises are established in Singapore.
- Many of them have based their regional headquarters in Singapore to cover their Southeast Asia portfolio – well-known firms like Xiaomi, Alibaba, Haier, Baosteel and Qingjian, to name a few.

As an international financial centre, Singapore offers Chinese corporates the necessary breadth and depth of banking and capital market services – from advice on regional markets to funding solutions.

A TRUSTED FINANCIAL CENTRE

The third key attribute for the success of Singapore's financial centre is trust.

- Financial institutions from all over the world come to Singapore because this is a jurisdiction they can trust.

- There is rule of law, clarity and consistency in regulation, rigour and fairness in supervision, and no tolerance for misconduct.

Upholding high standards of integrity in the financial industry is an absolute priority. This means having an effective regime against:

- market misconduct and misdemeanours; and
- illicit finance, namely money laundering and terrorism financing.

MAS is stepping up enforcement action against misconduct such as insider trading, false trading and front running by individuals and traders in the securities market.

- We have sought criminal actions or higher civil penalties to send the right deterrent message.

- In April last year, MAS imposed a civil penalty of close to $12 million for insider trading – the highest quantum in a single case so far.

When it comes to anti-money laundering and countering the financing of terrorism (AML/CFT), the rules are strict and in line with international standards. Financial institutions must:

- know their customers;
- assess the risks and perform additional due diligence where the risks are higher;
- monitor transactions on an ongoing basis and report any suspicious activities.

Supervision of financial institutions is rigorous.

- In recent years, MAS has stepped up its onsite supervision of AML/CFT controls – increasing the number of inspections by s*ix-fold*.
- This is resource-intensive business: each AML/CFT inspection of a bank takes about 4-8 weeks and involves 4-6 supervisors.

We have now set up a dedicated AML Department. We will:

- make more robust risk assessments of financial institutions' business activities, client profiles, geographical connections, transaction volumes, and quality of controls;
- intensify supervision of financial institutions that pose higher risks;
- conduct thematic inspections of activities that pose higher risk across financial institutions; and
- step up engagement with financial institutions to promote deeper understanding of emerging risks and typologies as well as best practices to mitigate these risks.

But MAS cannot inspect every bank every year. Nor can we go through all transactions. And we certainly do not set out to detect fraud – which would take months of intense scrutiny.

Responsibility for AML/CFT rests with the board and senior management of financial institutions. They must:

- put in place robust monitoring mechanisms to detect suspicious activities;
- promote strong risk awareness and constant vigilance among all staff; and
- empower their compliance and risk management people.

My advice to senior managers in our financial institutions is this: keep your risk and compliance people close to you.

- They are often seen as hindering opportunity and profits.
- But when things go wrong, you wish you had heeded them.
- When they say 'I think something's not right here', listen to them.

Ultimately, trust and conduct boil down to culture more than any externally imposed rules. By culture, I mean the shared values, attitudes and norms that guide behaviour. Financial institutions must *get the culture right*.

This requires setting the right moral tone from the top.

- Boards and senior management in particular must send a clear signal that profits do not come before values and ethics.
- Compensation structures must motivate not just high performance but also right conduct.

Conclusion

Good fortune has played a role in the growth of Singapore's financial sector.

- Our financial centre has benefited from connecting one of the fastest growing regions in the world with global markets.

But fortune can be fickle and economic cycles will turn. To stay relevant and thrive as a financial centre requires us:

- to remain resilient through good times and bad;
- to be dynamic in serving the changing needs of the region; and at all times
- to be trusted as a clean and credible place to do business in.

MAS is committed to working with the industry and all our stakeholders – including an inquisitive and fair media - to ensure that. Thank you.