SINGAPORE AS A REGIONAL FINANCIAL CENTRE

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INTRODUCTION

A regional financial centre can be defined as a central location where there is a high concentration of financial institutions and capital markets that allow financial transactions in the region to take place efficiently. Singapore has been a remarkable success as a regional financial centre. In just over three decades, the city-state has become one of the world's leading financial centres. The Singapore government has been actively undertaking financial liberalisation and reforms since the 1960s. As a result of its endeavours, Singapore has become a leading financial centre serving the domestic economy as well as neighbouring economies in Southeast Asia. As a financial centre, Singapore has facilitated greater financial intermediation in the region, contributing to the development of capital markets and to cross-border trade and business investment.

Singapore was the economy in Southeast Asia least affected by the Asian financial crisis. Nevertheless, the crisis exposed Singapore's vulnerability to external shocks and financial contagion. Rather than becoming more inward looking (as did some crisis-affected countries), Singapore hastened financial liberalisation in order to create a more resilient financial sector, which could compete in an increasingly globalised environment. The liberalisation has involved strengthening domestic banks through consolidation and increasing foreign participation in the financial sector.

This chapter discusses Singapore's development as a regional financial centre and the coming challenges. The next section describes in detail the development of Singapore's financial sector since the 1960s and the government's efforts to develop the capital markets.

The third section provides some background on central banking activities and regulatory framework in Singapore as well as recent developments in corporate governance and regulatory reform. The fourth section reviews the recent financial liberalisation measures enacted by the government, particularly the opening-up of the banking sector to foreign financial institutions. The next section discusses the upcoming challenges to Singapore as a regional financial centre, including global financial restructuring and the emergence of new competitors. The chapter concludes by evaluating Singapore's prospects as a regional financial centre.

FINANCIAL SECTOR DEVELOPMENT

In the 1960s, Singapore chose a different route from many of its Southeast Asian neighbours by adopting an outward-looking financial development strategy, with the aim of transforming into a regional financial centre. Over the next 30 years, the Singapore government implemented financial sector reforms, opened new financial markets, and enacted regulatory and fiscal incentives to attract foreign financial institutions to Singapore. This strategy has proven to be very successful. The number of foreign financial institutions as well as offshore and non-banking financial institutions increased significantly during this period. Ariff and Khalid (2000) found that the number of institutions in the financial sector increased from less than 100 in the mid-1970s to almost 450 in the 1990s. In the banking sector, the increase in the number of competitors has forced local banks to upgrade their financial products and services as well as management expertise. Successful financial centres such as Singapore also attract highly skilled foreign workers as well as other services such as accountancy, law, management consultancy, and information technology.

As of March 2001, Singapore's financial sector had 133 commercial banks (8 local and 125 foreign), 184 Asian Currency Units, 11 finance companies, 58 merchant banks, 151 insurance companies, 88 insurance brokers, 63 bank representative offices, 81 stock broking companies, 168 investment advisers, and 8 international money brokers.

ACUs, DBUs and the Asian Dollar Market

Singapore's banking system is unique as it consists of two types of financial institutions–commercial banks, or Domestic Banking Units (DBUs), and Asian Currency Units (ACUs). Only commercial banks can undertake transactions in Singapore dollars, while ACUs, which can deal in any currency except the Singapore dollar, are involved in international financial transactions. This two-tier banking sector was designed in the early 1970s to partition domestic and international banking activities. The main rationale was to promote Singapore as a base for international financial activities, while at the same time protecting domestic banks from larger and more sophisticated foreign financial institutions.

DBUs deal mainly with deposits and loans denominated in Singapore dollars and are subject to stricter liquidity and reserve requirements and higher tax rates than ACUs. DBUs must hold a minimum cash balance of 3 percent of their liabilities with the Monetary Authority of Singapore (MAS) and hold 18 percent of their liabilities in liquid assets (at least 10 percent of which must be in the form of Singapore government debt securities). Over the twenty years from 1971 to 1990, assets of DBUs grew at an average annual rate of 19 percent, in tandem with the economy's growth during this period.

Bank of America set up the first ACU in Singapore in 1968 to accept deposits in U.S. dollars and other major foreign currencies from non-residents. The withholding tax on interest paid on such deposits was waived. ACUs were licensed to deal in the Asian Dollar Market, which is essentially an international money and capital market dealing in foreign currencies.[1] Singapore was the first economy in the region to allow foreign banks to operate off-shore banking units such as ACUs, and the success of the Asian Dollar Market has undoubtedly contributed to Singapore's becoming a regional, if not international, financial centre.

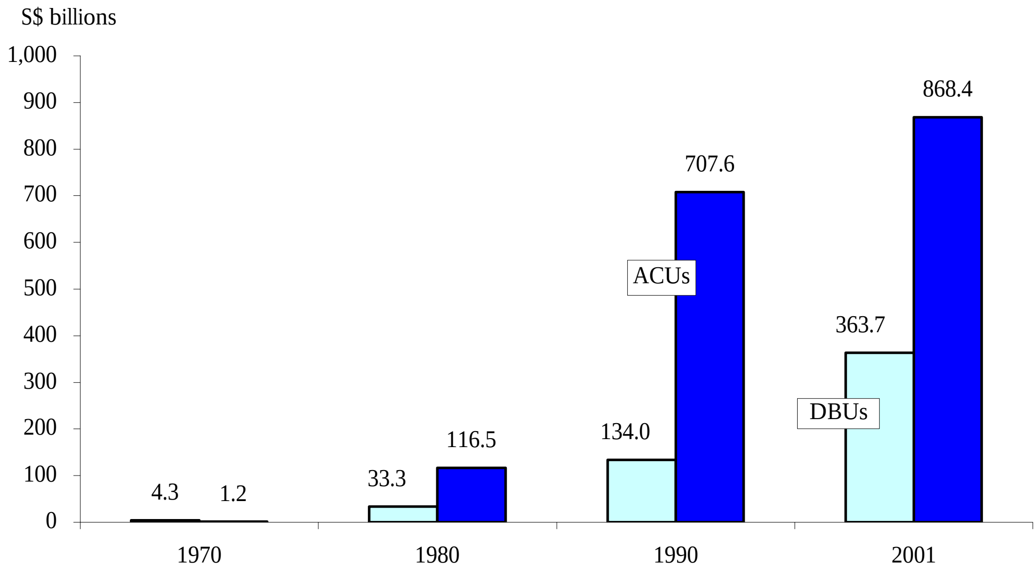
Although ACUs are subject to Singapore banking laws and regulation, they are exempted from several provisions of the Banking Act in order to attract foreign financial

1. It was called the Asian Dollar Market because most transactions were denominated in U.S. dollars.

institutions. For example, they are not subject to reserve requirements or minimum liquidity ratios, and the concessionary tax rate on transactions with non-residents and approved foreign institutions is just 10 percent. Although an ACU is an integral part of a bank, its accounting records are kept separate to ensure that the ACU's transactions do not disrupt domestic monetary management.

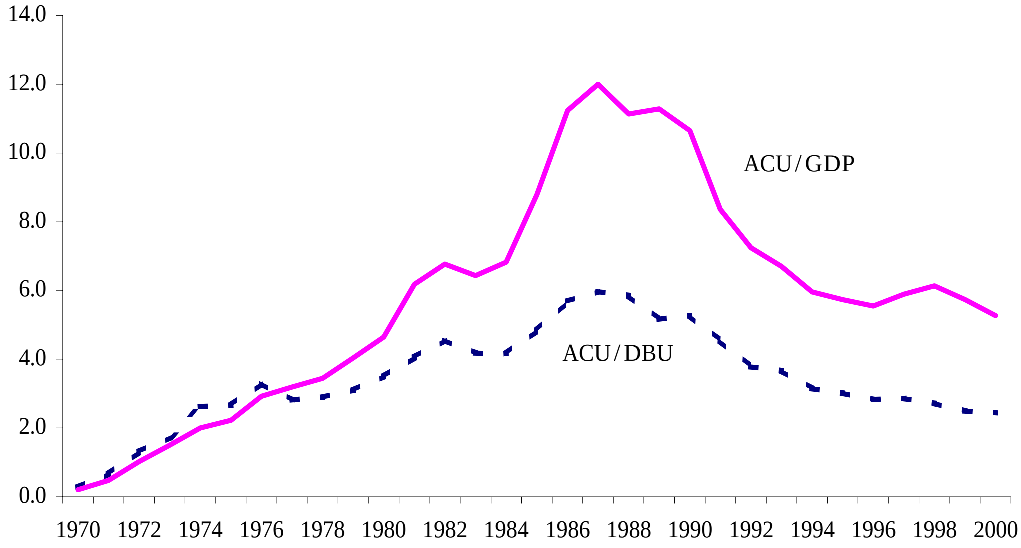
Both numbers and assets of ACUs have increased spectacularly since the inception of the two-tier system. Assets of ACUs grew at a rate of 22 percent per annum during the 1980s, but the rate of growth slowed to about 3.7 percent per annum in the 1990s. By 1993, ACUs accounted for 66.2 percent of all the assets of Singapore's banks, a vast increase over the 0.1 percent of bank assets accounted for by the first ACU (Bank of America) in its initial year of operation (Figure 1). The growth of international financial operations outpaced expansion of the domestic banking sector. ACU assets climbed from 28 percent of DBU assets in 1970 to a peak of 596 percent in 1987 before declining to 239 percent in 2001 (Figure 2). ACU assets reached 11 times Singapore’s GDP in 1987, and total ACU assets were 5 to 10 times GDP throughout the 1990s (Figure 2).

FIGURE 1
Total Assets of ACUs and DBUs, 1970-2001



Source: Monetary Authority of Singapore.

FIGURE 2
ACU Assets Relative to GDP and to DBU Assets, 1970 to 2000



Source: Monetary Authority of Singapore and CEIC Data.

The success of the Asian Dollar Market—which made Singapore the fourth largest foreign exchange market after London, New York, and Tokyo—globalised Singapore's financial sector and contributed to transforming the city-state into a leading financial centre. The Asian Dollar Market grew rapidly during the 1970s and 1980s as it provided a channel for investing savings from the United States, Europe, and Japan in the expanding economies of East Asia. In addition, Singapore's geographic location and time zone enable dealers to engage in foreign exchange transactions with financial centres around the globe 24-hours a day. The Asian Dollar Market also attracted multinational corporations to set-up regional treasury and financing operations in Singapore. These currently number about 5,000.

Bank Consolidation

Since 1998, when Development Bank of Singapore (DBS) acquired the Post Office Savings Bank (POSB) and Keppel Bank merged with Tat Lee Bank, the Singapore government has been encouraging domestic banks to consolidate to prepare them for stiffer competition from foreign banks. In fact, for Singaporean banks to compete successfully in the new era of globalisation, the government would like to see them eventually merge into two "super banks".

Merger and acquisition activity among Singaporean banks increased during 2001:

- In April 2001 DBS acquired Hong Kong's fourth largest bank, Dao Heng Bank, for US$5.7 billion as part of its regional expansion plans.
- On 12 June 2001, Singapore's third largest bank, Overseas-Chinese Banking Corporation (OCBC) announced a S$4.8 billion bid (voluntary general offer) for Keppel Capital Holdings (KCH), which owns Singapore's smallest Bank, Keppel TatLee Bank.
- Two weeks later, on 22 June 2001, DBS Holdings Group (which owns Singapore's largest bank, DBS) made an unsolicited bid of S$9.4 billion for Overseas Union Bank (OUB), the fourth largest bank.
- On 29 June 2001, second largest United Overseas Bank (UOB) made a competing bid for OUB, consisting of a cash and stock offer. UOB's bid succeeded in August 2001 and the merger will form Singapore's largest bank in terms of assets.

Despite this merger activity, Singaporean banks are still relatively small compared to foreign banks such as Citibank and Hong Kong Shanghai Banking Corporation (HSBC), which are global players in the banking business (Table 1). Moreover, with limited growth prospects in the small domestic market, Singaporean banks need to expand activity in the region. For example, DBS's acquisition of Hong Kong's Dao Heng Bank reflects its ambition to become a regional player. To date, Singapore's regional expansion in banking has had some limited success. Tschoegl (2002) found that in 1999 overseas assets represented about 22 percent of the total assets of Singapore's top four banks (DBS, OCBC, OUB, and UOB) (Table 2).

TABLE 1
Characteristics of Singapore's Largest Banks after M& As in 2001

	DBS	UOB + OUB	OCBC + KCH
Total Assets (S$ billion)	111.0	113.7	83.0
Total Loans (S$ billion)	54.2	61.5	50.4
Total Deposits (S$ billion)	92.8	96.6	71.1
Total S/H funds ($S billion)	8.4	13.1	8.3
Number of branches	107	93	74
Number of ATMs	900	426	381

Note: DBS is the Development Bank of Singapore; UOB is the United Overseas Bank; OUB is the Overseas Union Bank; OCBC is the Overseas-Chinese Banking Corporation; and KCH is the Keppel Capital Holdings (which owns Keppel Tat Lee Bank). Data for DBS exclude Dao Heng Bank.
Source: Singapore Exchange Web, Bank Annual Reports.

TABLE 2
Domestic and Overseas Assets of Singapore's Largest Banks, 1999

	Domestic Assets (S$000)	Overseas Assets (S$000)	Total Assets (S$000)	Overseas Assets as % of Total
DBS (Development Bank of Singapore)	86,241	20,224	106,465	19
OCBC (Overseas-Chinese Banking Corp.)	40,734	13,555	54,290	25
OUB (Overseas Union Bank)	30,582	8,790	39,372	22
UOB (United Overseas Bank)	43,154	13,346	56,499	24

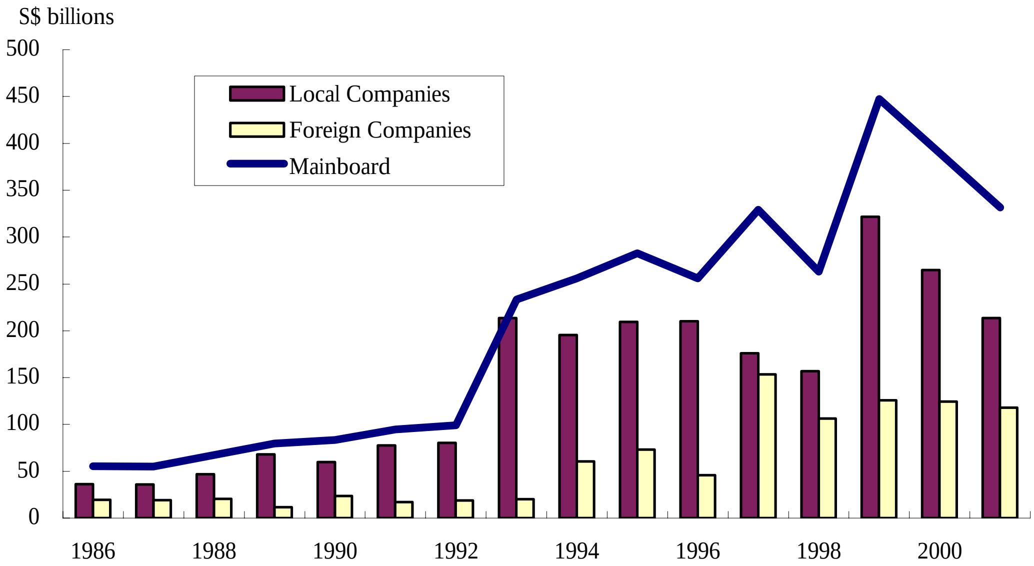
Source: Tschoegl 2002.

Singapore Exchange

The Stock Exchange of Singapore (SES) was incorporated in 1973, after the Stock Exchange of Malaysia and Singapore (SEMS) was split into two separate exchanges. Since then, the SES has become one of East Asia's largest and most developed stock exchanges. In December 1999 the SES merged with the Singapore International Monetary Exchange (SIMEX) to form the Singapore Exchange (SGX). Under the new arrangement, the SES and SIMEX were integrated into a single, privately held stock company, which was officially listed on 23 November 2000.

Market capitalisation of the Singapore equity market increased significantly when secondary foreign listing was allowed in the 1980s (Figure 3). Since 1987 the SES increased foreign participation by liberalising foreign ownership restrictions on member firms and relaxing listing requirements for foreign companies. The SES also introduced international memberships, which allow members to trade freely in SES-quoted securities with non-residents. In 2001 foreign companies contributed about one-third of total market capitalisation in the SGX Securities Trading (SGX-ST) main board.

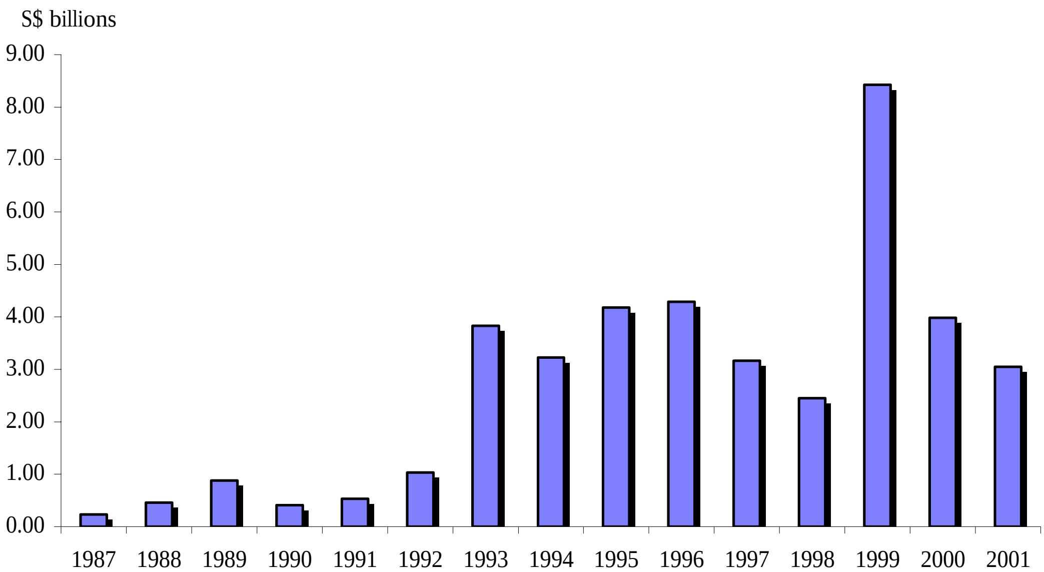
FIGURE 3
Market Capitalisation of Singapore Equity Market



Source: CEIC Data.

The authorities set up the Stock Exchange of Singapore Dealing and Automated Quotation (SESDAQ) in 1987 to enable smaller companies, particularly high-technology companies, with a shorter track record of profits to tap the stock market for capital. Market capitalisation of SESDAQ rose from S$235 million at the end of 1987 to S$3 billion in 2001 (Figure 4).

FIGURE 4
Market Capitalisation of SESDAQ, 1987-2001



Source: CEIC Data.

The securities trading division of SGX, which includes both the Mainboard and SESDAQ, recorded initial public offering (IPO) listings of 65 companies that raised S$1.7 billion for the period ending July 2001. Including the 65 IPOs, in December 2001, the Singapore stock exchange listed a total of 491 companies with market capitalisation of S$331.7 billion.

Brokerage commissions were fully liberalised in October 2000, giving the SGX a more diversified shareholding structure. Commission rates have fallen to an average of 0.4 to 0.5 percent for retail dealers and 0.2 percent for institutional dealers. Meanwhile, trading and settlement systems are being improved to match international best practices. For example, the SGX reduced the settlement period from trade-day-plus-five market days (T+5) to T+3 in March 2000. The SGX also plans to implement straight-through processing of stock trades by the end of 2002.

In June 2000, SGX entered a joint venture with the American Stock Exchange (AMEX) to trade and list AMEX-listed exchange traded funds (ETFs) and structured products. A year later, in May 2001, five AMEX-listed ETFs were listed on the SGX-ST main board. In December 2001, SGX and the Australian Stock Exchange (ASX) launched the world's first co-trading linkage for securities, which allowed for 50 SGX stocks and 51 ASX stocks to be traded across this linkage.

The merger of SES and SIMEX to form the Singapore Exchange (SGX) was intended to exploit the synergies between the securities and derivative businesses and to increase the financial capability to undertake heavy capital investments and financial innovation. De-mutualisation made the market more vibrant by including non-brokers and shareholders. The merger as well as SGX's strategic alliances with foreign stock exchanges should attract global investors by opening access to international brokers and other market players. It will also mean lower transaction costs through greater competition and provide more efficient and flexible funding from the capital markets. The Singapore government envisages that these measures will contribute to elevating Singapore to the status of international financial centre—the ultimate goal of its financial development strategy.

Singapore's Derivatives Exchange

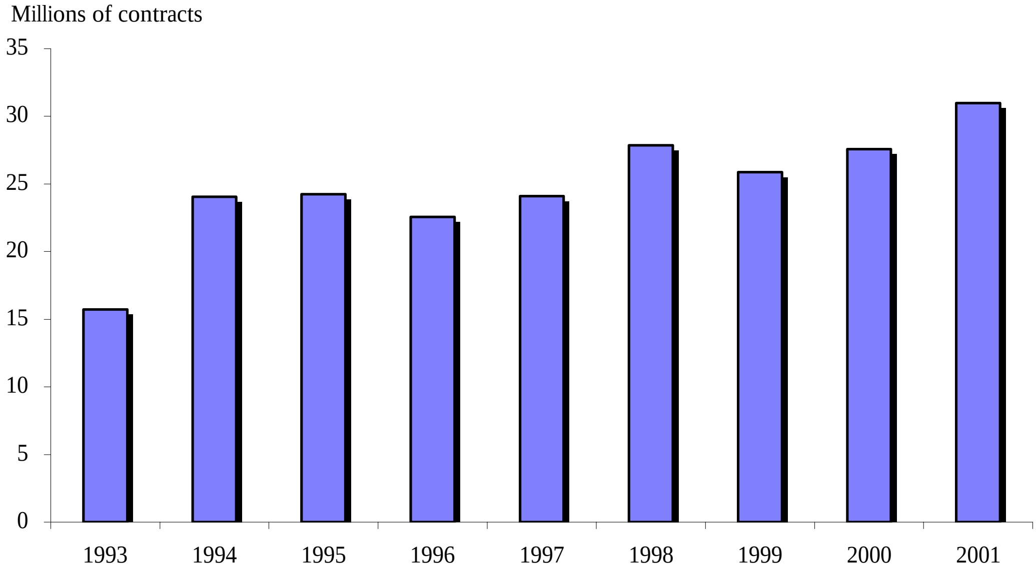
The government launched the Singapore International Monetary Exchange (SIMEX) in 1984. Now called SGX-DT (Singapore Exchange Derivatives Trading, Limited) since the 1999 merger with SES, the exchange has become one of Asia's largest derivatives exchanges trading the widest range of Asian derivatives in the world and the widest range of international derivatives in the Asia-Pacific region. It trades seventeen instruments in all, comprising interest rate futures (especially Eurodollar futures); currency futures; stock index futures; and commodity futures (such as Brent Crude Petroleum futures).

The derivatives exchange operates with an open outcry system, which ensures that prices of futures contracts respond sensitively to relevant new information, and an Electronic Trading System, which complements the open outcry system. Both systems provide extended trading hours that span different time zones, increasing investment opportunities and flexibility.

The Singapore derivatives exchange started off with its doors wide open to foreign participation. In fact, now most futures companies, corporate clearing members, and non-members are foreign-owned. Furthermore, customers from outside Singapore originate a significant proportion of the trades transacted on the derivatives exchange.

Financial derivatives trading volume in Singapore grew from about half a million contracts in 1985 to 31 billion in 2001 (Figure 5). Over the past decade, Singapore's derivatives exchange has built a reputation as a successful regional risk management centre for investors.

FIGURE 5
Annual Turnover of SIMEX / SGX-DT Futures and Options, 1993-2001



Source: CEIC Data.

Bond Market

The development of bond markets has become a key priority in many crisis-affected countries in the region since the Asian financial crisis. Debt securities are increasingly seen as an alternative source of capital that may help businesses reduce over-dependence on commercial bank intermediated financing and avoid resorting to short-term capital to finance long-term development projects.

In Singapore, domestic private companies and government/statutory organisations have been tapping the domestic bond market more and more to fund development projects. In recent years, the Singapore government has been actively promoting the city-state as a regional hub for arranging and trading debt securities. Key initiatives taken by the government to deepen and broaden the domestic bond market include:

- The September 2001 announcement of plans to issue a 15-year bond to extend the benchmark yield curve beyond the current 10-year maturity. The first 10-year government bond issue was successfully auctioned in July 1998.
- Announcement in May 2000 that the size of benchmark issues would be raised from S$1.5 billion to at least S$2 to 2.5 billion to create more liquid and substantial benchmark issues
- The revision to MAS Notice no. 757 in December 2000 that made it easier for foreigners to issue Singapore dollar bonds, subject to certain financial safeguards.

In particular, banks can now lend any amount to non-residents provided the proceeds are to be invested in Singapore assets (financial assets and real assets).

- Enactment of a number of attractive tax incentives since 1998 to boost the bond market. For example, until February 2003, primary dealers are exempted from paying tax on profits generated from trading in the Singapore bond market. Meanwhile, financial institutions in Singapore that are involved in the arrangement, underwriting, and distribution of Qualifying Debt Securities (QDS) are exempted from paying tax on their fee income.[2]
- SGX's launching a 5-Year Singapore Government Bond Futures contract on 29 June 2001 which complements the 3-Month Singapore Dollar Interest Rate Futures contract and provides investors with risk management tools to cover the short- and medium- end of the benchmark yield curve.
- The re-opening of an existing 5-year bond issue as a new 2-year benchmark in November 2000 to decrease the number of illiquid off-the-run issues and re-channel them into larger and more liquid benchmark bonds.

The Singapore bond market appears to be gaining the liquidity required for critical mass. From 1999 to 2000, the amount of corporate debt issuance increased by 159 percent from S$19.5 billion to S$50.5 billion (Figure 6). Outstanding debt in 2000 stood at S$49.5 billion, which represents 31.1 percent of GDP (Table 3). The inclusion of SGS in the JP Morgan Government Bond Index Global Broad index since November 2000 will likely give the Singapore bond market an additional boost.[3]

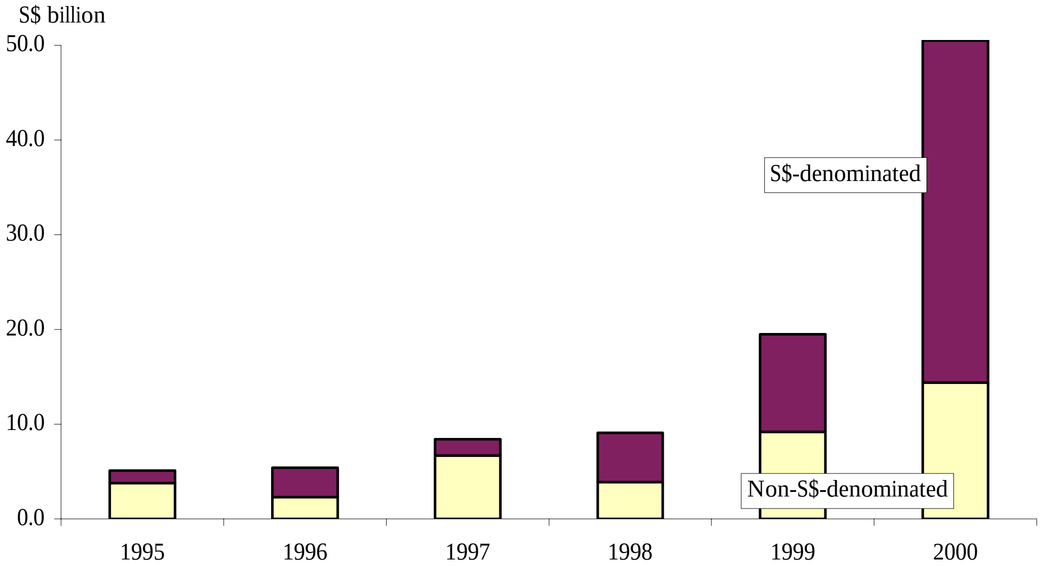
TABLE 3
Corporate Bond Market, 2000

	Denominated in S$	**Denominated in other currencies**
Total bond issuance	14.4	36.1
Issue Type		
Financial institutions (FI)	0.4	1.8
Non-FI corporates	11.4	33.2
Non-residents	2.6	1.1
Maturity		
Less than 1 year	2.3	30.6
1 to 9 years	9.6	4.3
10 years and longer	2.5	1.2
Outstanding bonds	34.0	15.5

Source: IMF 2001.

2. According to MAS, QDS are basically debt securities that are substantially arranged by financial institutions in Singapore.
3. The J.P. Morgan Government Bond Indices are tools for measuring performance and quantifying risk across international fixed income markets. The Government Bond Index Global Broad includes government bonds from G-7 countries, Spain, Netherlands, Belgium, Denmark, Sweden, Australia, Finland, Ireland, New Zealand, Portugal, South Africa, Switzerland, Austria, and Singapore.

FIGURE 6
Issuance of Corporate Bond in Singapore Dollars and Other Denominations, 1995-2000



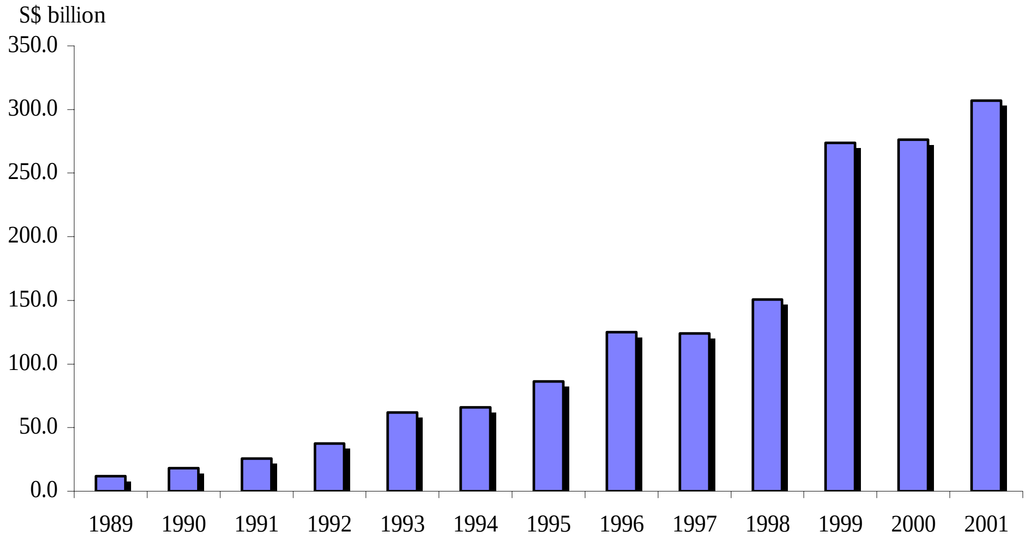
Source: CEIC Data.

Fund Management Industry

Over the past ten years, the government has increasingly focussed on making Singapore a leading international fund management centre. The domestic fund management industry has seen assets under management balloon to S$307 billion in 2001, more than a twenty-five-fold increase compared to S$11.8 billion in 1989 (Figure 7). However, Singapore still lags significantly behind Hong Kong, which is the largest fund management centre within Asia (excluding Japan).[4] Nevertheless, Singapore's high savings rate (over 40 per cent of GDP) and the opportunity to manage funds from the country's extensive national pension scheme, the Central Provident Fund, have attracted many global fund managers to set-up shop in Singapore.

4. According to the Hong Kong Investment Fund Association, there were 1,890 authorised funds in Hong Kong, with total net asset value of US$285.2 billion.

FIGURE 7
Total Assets under Management, 1989 to 2001



Source: Monetary Authority of Singapore (MAS).

There have also been growing calls to use Singapore's huge foreign reserves to help boost the domestic fund management industry. With that in mind, the Government of Singapore Investment Corporation (GIC) and MAS announced in February 1998 that they would place out to external fund managers within three to five years S$25 billion and S$10 billion, respectively. At end-2001 GIC had placed S$21 billion of the S$25 billion with external fund managers.[5] GIC has given 54 fund managers (including five boutique fund management firms) a total of 144 mandates. In 2000, MAS reached the final stage of its funds outplacement exercise and has selected most of the external fund managers for the fund.

The government also liberalised the CPF Investment Scheme (CPFIS) over the past couple of years. CPF members were allowed to invest 100 percent of Special Account and Ordinary Account balances in approved retirement-related financial instruments. This freed up a substantial amount of CPF funds, raising the funds available for investment to S$41 billion. Since investment guidelines were revised in September 1998, CPF members have access to a wider pool of fund managers and unit trusts, as well as better information on investment risk and fund performance. To enhance the returns from CPF savings, in

5. The GIC manages Singapore's huge foreign reserves (estimated to be above US$100 billion) and has

September 1999 the government also raised the limit on investment in professionally managed financial products from 80 percent to 100 percent. As at end-2001, 155 out of a total of 319 unit trusts in Singapore were under the CPFIS.

In a report entitled “Positioning Singapore as a Pre-eminent Financial Centre in Asia” (September 2002), the Economic Review Committee made the following policy recommendations to develop Singapore’s funds management industry:

- Develop start-ups and small and medium sized fund managers
- Extend fund management mandates (i.e., other than Asia ex-Japan) granted by GIC and MAS
- Provide funds to attract private equity players such as venture capitalists
- Grant tax exemptions to domestic source investment income and foreign source remitted to Singapore; and management fee income earned by fund mangers for managing funds sourced overseas.

REGULATION AND GOVERNANCE OF FINANCIAL INSTITUTIONS

Central Banking and Regulatory Framework

The Monetary Authority of Singapore (MAS) was established as a statutory board in 1971 by virtue of the Monetary Authority of Singapore Act. MAS functions as the de facto central bank for Singapore. It is responsible for the formulation and implementation of monetary policies and supervises and regulates the activities of commercial banks, finance companies, insurance companies, and stock and futures exchanges. It acts as banker and financial agent to the Singapore Government, and hence, serves as the lender-of-last-resort to the banking system.

The issue and redemption of currency notes and coins, which is not entrusted to MAS, is the responsibility of the Board of Commissioners of Currency of Singapore (BCCS). Under the currency board system, the BCCS stands ready to exchange domestic currency for the foreign reserve currency at a specified fixed rate. The currency must be backed at least 100 percent. The Singapore government has announced that BCCS will be merged with MAS by March 2003 in order to improve organisational efficiency by streamlining overlapping functions. But the currency board system under the Currency Act will remain intact and there

over 200 investment managers.

will be no change in the issuance of currency.

The ultra conservative approach adopted by MAS sets Singapore clearly apart from other financial regulators in the region. MAS has given top priority to maintaining the soundness and resilience of Singapore's financial system as well as to the protection of depositors' and investors' interests. Moreover, MAS has endeavoured to minimise risks, bank failures, and financial scandals so as not to undermine Singapore's credibility as a regional financial centre.

The regulatory framework consists of a set of laws including the Banking Act, the Finance Companies Act, the Insurance Act, the Securities Industry Act, the Futures Trading Act, the Development Loan Act, and the Local Treasury Bill Act. MAS has some regulatory role under each of these laws. For example, the Banking Act (enacted in 1970 and revised in 1993) called for all Singapore-incorporated banks to maintain the minimum capital adequacy ratio (CAR) recommended by the Bank of International Settlements (BIS), which is 8 percent. This has led to a financially sound banking sector, with most domestic banks maintaining a CAR of 12 percent.

Since was SGX was listed in November 2000, the regulatory relationship between MAS and SGX has become more clearly defined. MAS administers statutory laws regulating the capital markets and has oversight of SGX's regulatory functions. Meanwhile, SGX retains the frontline responsibility for regulating market participants and ensuring compliance.

MAS's stringent system of prudential regulation and supervision certainly prevented a banking crisis from breaking out in Singapore as it did in neighbouring Southeast Asian countries during the Asian financial crisis of 1997. MAS's strict regulatory approach can become a double-edge sword, however. Because it makes Singapore's financial sector appear inflexible and over-regulated compared to its more laissez faire rival, Hong Kong, it could possibly impede Singapore's development as a regional financial centre in the current global environment, which is both dynamic and unpredictable.

Corporate Governance

In December 1999 the Ministry of Finance, MAS, and the Attorney General's Chambers established the Corporate Regulation and Governance Policy Committee. Three private sector-led committees under its wing were mandated to review Singapore's corporate regulatory framework, disclosure standards, and corporate governance.

In March 2001 the review committee on corporate governance issued a Code of Corporate Governance that sets out recommended principles and practices for listed companies in Singapore. The second review committee, the Disclosure and Accounting Standards Committee, completed a draft report reviewing the processes by which accounting standards are set, maintained, and regulated in Singapore. This draft report is currently posted on the Internet to solicit public comments. The third review committee, the Company Legislation and Regulatory Framework Committee, which was given the mandate to recommend revisions to the Companies Act, have organised a public consultation.

Over the past few years, bank disclosure and corporate governance practices have improved significantly. The May 1998 report by Committee on Banking Disclosure required banks to disclose details relating to principal sources of income, loan-loss provisions, and off-balance sheet items. It also required them to provide information regarding non-performing loans as well as the market value of investments and properties. In order to strengthen corporate governance in the banking sector, all local banks are required to appoint a five-member Nominating Committee within the board and key management positions. Under the Banking Act, MAS will retain its powers to approve appointments. It will also extend the vetting process to re-appointments in order to ensure that candidates who were seated some time ago continue to meet the criteria for appointment.

In February 2003, MAS issued a consultative paper on proposed guidelines and regulations to enhance the corporate governance framework for locally incorporated banks and direct insurers. The consultative paper provides a set of principles of corporate governance and its proposed guidelines build on the existing Code of Corporate Governance. In essence, the consultative paper clearly defines the meaning of 'independent director' and sets out the requirements for the composition of the board of directors and board committees. The proposed regulations also require the clear separation of the roles of Chairman and Chief

Operating Officer and outline the application of this rule. MAS is currently seeking public feedback and comments on the consultative paper.

Regulatory Reforms

MAS has shifted progressively from “one-size-fits-all” regulation to a risk-focused supervisory approach in recognition of concerns about over-regulation. As such, MAS is moving away from relying on extensive regulation as a means to protect investors and customers. This new role will promote adequate disclosure and greater transparency in the market. Better disclosure and market scrutiny will sharpen the competitive edge of financial institutions by putting pressure on them to operate efficiently. The new approach will entail monitoring and examining institutions for compliance with guidelines and assessing the adequacy of internal controls and risk management systems.

Furthermore, supervision focuses on systemic risk rather than risks in individual institutions or in individual transactions. MAS is developing internal rating systems for financial institutions, which will allow Singapore to move towards performance-based regulation by giving greater leeway to stronger and better managed financial institutions.

MAS is also considering instituting financial safeguards in an increasingly liberalised financial environment. In particular, in August 2002, MAS released a consultative paper on the proposed features of a deposit insurance scheme in Singapore. The deposit insurance scheme would cover all Singapore dollar deposits held by individuals up to a limit of S$20,000 and will be backed by a fund targeted to reach 0.3 per cent of insured deposits (or an estimated S$120 million). This fund will be built up over a span of ten years, based on premium contributions from banks and finance companies that offer retail deposit facilities.

Another important financial safeguard that MAS is considering is to require foreign banks with a large retail presence to conduct their operations in Singapore through local subsidiaries. Foreign banks would have to incorporate in Singapore and meet MAS’s requirements for minimum S$1.5 billion paid-up capital, 8 percent CAR for Tier I capital, and 12 percent for Tier 1 and Tier II capital. This system would improve MAS's ability to supervise the subsidiaries and give it more flexibility to contain any potential financial contagion that arose from problems in a foreign bank's home market or global operations.

RECENT FINANCIAL LIBERALISATION MEASURES

On 17 May 1999, MAS introduced a five-year programme to liberalise Singapore's banking sector and expedite the development of local banks. A second phase of measures was announced in 2001. The main objective of this programme is to create a stronger and more competitive banking environment in the face of globalisation trends and rapid developments in electronic delivery channels. It also means that the previously coddled local banking sector will face intense competition from foreign banks, which will have greater access to the domestic market.

The liberalisation of the banking sector has two key elements: granting foreign banks new licences and more access to the domestic market and lifting restrictions on foreign ownership of local banks. In the first phase, MAS introduced a new category of full banking licence, "Qualifying Full Bank" (QFB), which allowed selected foreign banks additional branches, off-premise automatic teller machines (ATMs), and ATM-sharing privileges. MAS had issued QFB licenses to ABN Amro Bank, Banque Nationale de Paris, Citibank, and Standard Chartered Bank by the end of 2000 and it awarded the last two of the planned six initial QFB licenses to Malaysia's Maybank and HSBC in December 2001. At the same time, MAS increased lending limits for Restricted Banks and reduced restrictions on Singapore dollar swaps. Restricted Banks could have only one branch and were not allowed to accept Singapore dollar savings or fixed deposits of less than $250,000 from non-bank customers.

The government lifted the 40-percent limit on aggregate foreign shareholding of local banks in July 1999 and allowed local banks to merge their local and foreign share tranches. The elimination of the limit on foreign shareholding was intended make local bank shares more liquid, which would make it easier for them to forge strategic partnerships with foreign banks. In turn, this would mean foreign banks could potentially own significant stakes in local banks (although the authorities are unlikely to allow a foreign take-over of a local bank, for the time being). Individual shareholders still must obtain approval before increasing domestic bank holdings above 5 percent, 20 percent, and a new intermediate 12-percent shareholding threshold.

MAS announced the second phase of the financial liberalisation on 29 June 2001.[6] This package of measures represents a more substantial opening up of the financial sector to foreign banks and it will intensify competition in the hitherto protected domestic wholesale and retail markets. Furthermore, MAS Notice No. 757 (latest version issued in 20 March 2002) removed most obstacles against non-residents accessing Singapore dollar credit facilities for economic and financial activities in Singapore, including to undertake trading activities in Singapore dollars. This set the stage for deeper and broader capital markets–expediting the government's plans to transform Singapore into an international financial centre.

Under phase two of the liberalisation, foreign participation in the domestic wholesale market will broaden. MAS began a move away from the multi-tiered regime of Full, Restricted, and Offshore licenses for foreign banks towards a licensing system that differentiates between retail and wholesale banks. The Restricted Bank licence was renamed the Wholesale Bank licence to better reflect the wide range of financial activities that such institutions now undertake. In addition, Qualifying Offshore Bank (QOB) and Offshore Bank (OB) licences were phased out. Existing QOBs and OBs were upgraded to Wholesale Bank status which allows them to accept Singapore dollar fixed deposits above S$250,000 and operate Singapore dollar current accounts. Fifteen more foreign banks were awarded Wholesale Bank licences in December 2001 and five additional licences were made available in 2002.

Moreover, with the second phase MAS announced further liberalisation measures that allowed QFBs to:

- Establish up to 15 locations of which up to 10 (previously 5) can operate as

6. "Consolidation and Liberalisation: Building World-Class Banks", speech by Deputy Prime Minister Lee Hsien Loong, Chairman of MAS, at the Association of Banks Annual Dinner, 29 June 2001.

branches, with the rest off-site ATMs.

- Provide debit services on an electronic point-of-sale payment service network (such as the Network for Electronic Transfers (S) Pte. Ltd. (NETS), Visa, or Mastercard), from 1 July 2002. Issuing debit cards that can access such a network will enhance the delivery capabilities of QFBs in the retail market.
- Offer Supplementary Scheme accounts, accept CPF fixed deposits, and offer agent bank accounts under CPF Investment and Minimum Sum Schemes, also from 1 July 2002.

The liberalisation of the ATM network presents a particular challenge to local banks as it broadens the scope for foreign bank expansion in the retail market. If all six QFBs join in a network, they will have ATMs in 90 locations around Singapore. Even more challenging for local banks is the possibility that MAS will grant more QFBs licenses and that these foreign banks might eventually gain access to the extensive ATM networks of local banks (just over 1,700 ATMs).

FUTURE CHALLENGES FACING SINGAPORE'S FINANCIAL CENTRE

According to Tan and Chen (1999), a successful financial centre should have a politically stable environment with an effective government, strong economic fundamentals, state-of-the-art physical and financial infrastructure, good geographic and time zone location, internationally recognised accounting standards and regulatory laws, and a skilled labour force with a high level of English proficiency. Singapore clearly meets most if not all of these requirements for success. Besides being a politically stable country with little corruption, Singapore's key strengths as a regional financial centre include its:

- Highly successful and sophisticated offshore market. It is also an important centre for loan syndication (i.e., syndicated offshore loans arranged in Singapore).
- Active and liquid foreign exchange market, which is the fourth largest in the world.
- Well-regarded and pro-active financial regulator.
- Financially sound and resilient banking sector.
- Well-developed infrastructure including state-of-the-art information and communication technology (ICT) infrastructure, an established legal and accounting framework, high corporate governance and compliance standards, and professional management.
- The first integrated stock and derivatives exchange in Asia, SGX, which offers such advantages over local exchanges as greater access for global investors, lower transaction costs, and more efficient and flexible funding from capital markets.

- Highly developed and vibrant derivatives market which has made it a major risk management centre.
- Multi-lingual population, proficient in English, Mandarin, Bahasa Melayu, and Tamil, making it an ideal financial services hub for East Asia and the Indian sub-continent.

Singapore’s financial centre will face numerous challenges in the coming decade, however. While Singapore is strong in international banking and foreign exchange, its bond and fund management industries remain relatively underdeveloped. Singapore will also face rising competition from neighbouring countries as they liberalise and develop their own financial sectors. For example, Malaysia is actively carving out a niche as an international centre for Islamic banking and finance. Advances in technology may diminish the advantage that such features as a developed infrastructure and a favourable time zone confer on Singapore as a major financial centre.

Trends in global finance raise other concerns about Singapore's future role as a financial centre. According to the IMF (2000) financial restructuring in East Asia since the 1997 crisis may result in the consolidation of financial activity into fewer centres, as it did in Europe with the restructuring there during the 1980s. This may make it harder for Singapore to find and sustain a niche as a financial centre. For example, SGX is already facing stiff competition for global funds from consolidated stock exchanges such as the Euronext, which is a merger between the Paris, Amsterdam, and Brussels bourses. Also, global consolidation of fund management companies and the rising trend for them to locate their new offices in Northeast Asia may affect Singapore’s efforts to develop the domestic fund management industry.

Singapore is situated in a region of increasing economic and political uncertainty since the 1997 financial crisis. Certainly, the 11 September 2001 terrorist attacks on the United States and the Bali bombing incident in October 2002 have raised the risk premium on foreign investments into the region.

Singapore's rival, Hong Kong, is next door to economically powerful China. Rapid economic growth and rising foreign direct investment in China in recent years will benefit Hong Kong’s financial centre possibly at the expense of Singapore. China’s growing appetite for capital to finance its development will certainly increase demand for Hong Kong’s financial services and give it a vital boost as a regional financial centre. Furthermore, the Chinese government has been aggressively investing and promoting Shanghai as a future financial centre. The Hong-Kong-Shanghai combination could potentially be a formidable competitor to Singapore.

CONCLUSION

In the new millennium, global financial trends and new competitors such as China pose a challenge to Singapore's role as a regional financial centre, and Singapore will need to re-position itself within this new environment. With world-class infrastructure, institutions, and capital markets, Singapore is well placed to be the financial centre for an integrated ASEAN market. ASEAN's total population of more than 500 million makes it a potentially lucrative market for trade and investment, which could generate substantial demand for capital and financial services. The ASEAN Free Trade Agreement (AFTA) and the ASEAN Investment Area (AIA) could pave the way for such an integrated market within the region.[7] At the ASEAN Summit meeting in Cambodia in November 2002, ASEAN leaders agreed to explore the possibility of forming an ASEAN Economic Community. Although summit participants did not elaborate on the concept of such an economic community, it would undoubtedly involve deeper economic integration within the ASEAN region.

Singapore is strengthening its position as a regional capital centre for Southeast Asia through recent financial liberalisation measures that allow equity listing and bond issues in Singapore dollars for non-residents. Singapore could mobilise funds from its equity and bond markets for Southeast Asian countries as they revitalise their economies. In particular, Singapore’s bond market has the potential to become an important supplier of capital to

7. Indonesia, Malaysia, the Philippines, Thailand, Brunei, and Singapore (the ASEAN-6) implemented AFTA in 2002, and are committed to common effective preferential tariffs rates of between 0 to 5 percent. AFTA will be implemented in Vietnam by 2006, Laos and Myanmar by 2008, and Cambodia by 2010. In September 1999, ASEAN economic ministers agreed to a target of zero tariffs for the ASEAN-6 by 2015, and for the remaining member countries by 2018.

The framework agreement for the AIA was signed in Manila, Philippines on 7 October 1998 with the

Southeast Asia as well as to the expanding economies of China and India. Singapore is also building a niche as a private banking centre, attracting capital from high net worth individuals across Asia.

Singapore will need to leverage on China's expanding economy by positioning within its slipstream. The spillover effects of China's growing need for funds could be sourced from Singapore as well as from Hong Kong. Hence, the Singapore government should continue to forge a close economic relationship with China. The China-ASEAN free trade agreement proposed in 2001 is a positive step that will undoubtedly benefit Singapore.[8] Moreover, there are still untapped opportunities outside Asia. For example, the adoption of the euro currency by the European Union will create new business opportunities that could consolidate Singapore's position as a premier foreign exchange centre.

At the same time, Singapore should continue financial liberalisation, which has so far been a gradual and cautious "big bang". Financial restructuring, strategic alliances, heavy investments in ICT, and skilled human resources will be crucial to keep Singapore competitive in this globalised financial environment. In short, Singapore needs to continue to plan, invest, and anticipate changes to stay ahead as a regional financial centre.

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target of realising the AIA by 2010. Under the AIA, all industries (except those on the Temporary Exclusion List and Sensitive List) will be open to all ASEAN investors and granted national treatment.

8. At the seventh ASEAN summit meeting in November 2001, ASEAN leaders agreed to pursue the idea of a free trade area (FTA) between ASEAN and China within the next 10 years.

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