# Fostering a sound and progressive financial sector

The Monetary Authority of Singapore

## 1. Introduction

The Government and the Monetary Authority of Singapore set up a Financial Sector Review Group (FSRG) in 1997. MAS' regulatory approach, centred on high admission and prudential standards as well as rigorous enforcement, had produced a strong and well capitalised banking system. But rapid technological advances and consolidation sweeping the global financial industry presented new challenges and risks. This necessitated a fundamental rethink of its approach to supervising and developing the financial sector.

To help the FSRG in its work, a few private sector committees were commissioned to study specific issues like banking competitiveness, banking disclosure, corporate finance and the stock exchange, and consultants engaged to undertake financial sector and IT strategy studies. The review resulted in a new approach to supervising and developing the financial sector. There were three main thrusts.

### Liberalising the financial sector

First, MAS liberalised the financial sector to promote competition and enterprise. Greater participation by strong foreign financial institutions would speed up the transfer of new technology, management expertise and financial innovation to Singapore. The stockbroking industry was deregulated and protective barriers in banking and insurance were lowered.

These financial reforms were undertaken through a steady series of incremental changes rather than in a "big bang". MAS was mindful of the need to manage these reforms in an orderly manner so as to allow time for its regulators, financial institutions and investors to develop new expectations of one another, and understand the new way things worked.

### Reviewing the regulatory and supervisory framework

Second, MAS shifted its emphasis from "one-size-fits-all" regulation to risk-based supervision, so that it could focus more attention on issues of systemic risk, and calibrate supervisory intensity to the risk profiles of financial institutions. While maintaining the high standards of sound financial management that have become associated with Singapore, it recognised the need for a more conducive regulatory environment, including providing financial institutions the leeway to respond to the increasingly sophisticated needs of their clients.

MAS strengthened disclosure and market discipline, to enable investors to better judge and take risks for themselves. It pushed for higher standards of corporate governance in the financial sector, to cultivate a stronger self-regulating corporate culture, better risk management and internal controls, and greater transparency. It also moved to greater transparency and clarity in its regulations and built a closer partnership with the industry.

### Taking a more strategic and proactive approach to development

Third, MAS adopted a more strategic and proactive approach to developing the financial sector. Besides being the central bank and supervising the financial sector, MAS is also responsible for development of the sector. The breadth of its coverage gives it a good vantage point from which to gather industry views on promising growth areas and help bring value-adding activities and key global financial institutions to anchor in Singapore.

The Asian crisis that was engulfing the region confirmed the importance of MAS' long-standing fundamentals but also highlighted lessons and potential risks. Due to the strong foundation laid earlier, Singapore's financial system was relatively unscathed. This gave MAS the flexibility to press on with reforms and even liberalise at a time when the environment was more risky.

This paper highlights the key changes and initiatives in MAS's policies and organisation for supervising and developing the financial sector following the review in 1997. Section 2 provides details on the phased liberalisation of the banking industry. Section 3 describes MAS' risk-focused, stakeholder-reliant, disclosed-based and business-friendly supervisory approach. Section 4 sets out the deposit insurance scheme that it is putting in place to provide an appropriate level of systemic protection. The paper concludes with the organisation changes MAS has introduced to strengthen its capabilities in carrying out its core functions.

## 2. Banking liberalisation

Starting in 1999, MAS allowed foreign banks meeting its eligibility criteria greater access to the domestic retail market. MAS gave enhanced access privileges only to banks that met its prudential criteria and that were able to contribute to the financial sector by introducing new services and expertise to the market.

MAS phased in the liberalisation to give time to its local banks to respond to the increased competition. Four foreign banks were first given enhanced market access privileges in 1999, followed by another two in 2001. The access privileges (such as number of service locations, access to Electronic Funds Transfer at Point of Sales systems, and Automated Teller Machine networks) granted to these six banks were also progressively improved over five years.

MAS also eased entry to the wholesale banking market. This significantly broadened participation by foreign banks in the domestic wholesale market and encouraged international banks of good standing to use Singapore as their Asian base. It gave sophisticated customers in Singapore better access to world-class financial products and services.

Besides giving foreign banks leeway to grow organically in Singapore, MAS also allowed strategic cooperation between Singapore and foreign banks. The 40% aggregate foreign shareholding limit for local banks was lifted. In its place, MAS implemented nationality requirements for the board of directors and tightened the single shareholding approval thresholds at 5%, 12% and 20%. MAS also signalled willingness to consider proposals by foreign banks to acquire strategic stakes in the local banks if they could add value and strengthen the local banks as a result.

## 3. A principle-based supervisory approach

The phased liberalisation was complemented with a review of MAS's regulatory and supervisory framework. To clarify and guide this ongoing process, MAS issued a monograph in 2004 entitled "Objectives and Principles of Financial Supervision", which spells out MAS's objectives of supervision, the functions it performs and the principles that guide its supervisory approach.[1]

Moving away from "one-size-fits-all" regulation, the approach strives to be **risk focused, stakeholder-reliant, disclosure-based and business-friendly**.

[1] Available on the MAS website (www.mas.gov.sg) under "Publications".

## Risk-focused

### *Regulatory framework*

MAS has been systematically reviewing its regulations to address well-defined risks that can have systemic implications and to sieve out those which are no longer relevant or necessary. Institutions launching new products need not come to MAS for approval, as long as the institution as a whole keeps within MAS's prudential supervisory framework. Limits on car loans and aggregate investments in equity have also been lifted as it was assessed that banks could manage these risks. MAS also recently reviewed its requirements on securitisation transactions and replaced the need for prior approval with a notification requirement, to enable banks to bring securitisation transactions to the market more quickly.

To provide institutions with incentives to better manage their risks, MAS has put in place risk-based capital frameworks. It has also revised its minimum liquidity requirements for banks, making them forward-looking and taking into account supervisory reviews of banks' liquidity policies and practices.[2] Banks that passed MAS's bank-specific liquidity assessment may peg their requirement to the volatility of their cash flows.

### *Supervision*

Starting in 1998, MAS adopted a top-down, risk focused approach to bank examination, moving away from the traditional, bottom-up method. Emphasis is placed on the process by which a bank's management itself addresses its risks, instead of reviewing the books for control deficiencies.[3]

MAS also put in place structured frameworks to evaluate the risk profiles of its institutions and assess the potential impact they would have on Singapore's financial system, economy and reputation. To strengthen the integrated supervision of institutions, it harmonised industry-specific risk assessment frameworks into a single framework that applies to all classes of institutions that it supervises. This activity-based framework emphasises the evaluation of risks and the quality of governance, controls and risk management processes commensurate with the scale and complexity of an institution's operations.[4]

To better understand the risks of a more inter-connected system, MAS has put more resources into macro-prudential surveillance. Analysis of macroeconomic and financial developments and their implications for the stability of the financial system has been enhanced and there are regular meetings to bring together macro- and micro-prudential perspectives on risks and other stability issues. Since December 2004, MAS has also published a Financial Stability Review (FSR) on a semi-annual basis to communicate its views and findings on the risks and vulnerabilities facing Singapore's financial system.

## Stakeholder-reliant

MAS has introduced initiatives to encourage and reinforce self-governance in financial institutions.

### *Regulations and Guidelines on Corporate Governance*

As part of the banking liberalisation measures, MAS had required local banks to appoint Nominating Committees within their boards to ensure that only competent individuals who can contribute to the bank and discharge their responsibilities in the interests of all shareholders are appointed to the board and key management positions in the bank. This has been further strengthened by the issuance in September 2005 of a set of Corporate Governance Regulations ("Regulations") and Guidelines on Corporate Governance ("Guidelines") that are consistent with global best practices.

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2 Prior to the review, banks compute and maintain a minimum amount of liquid assets based on their historical liability base as defined by MAS.

3 MAS's FY1997/98 Annual Report has details on this on pages 67-68.

4 MAS's FY2004/05 Annual Report has details on this on pages 26-27.

The Regulations contain requirements that MAS considers essential for sound corporate governance, in particular the presence of an independent element on each bank's board. The Regulations specify the proportion of directors on the board and board committees who must be independent of the financial institution's management, business relationships and substantial shareholders. The Regulations also include rules that require banks to separate their management from those of the affiliates of their substantial shareholders, and for the separation of the Chairman and CEO roles within a bank or an insurance company. MAS also strongly encourages its banks and direct insurers to adopt the best practices in the Guidelines, given the diverse and complex risks undertaken by these institutions and their responsibilities to depositors and policyholders.

#### *Separation of financial and non-financial activities*

In June 2000, MAS required banks in Singapore to focus on their core financial business, so as to minimise the risk of non-arm's length transactions between banks and their non-bank affiliates, and to limit the risk of contagion. Under the policy, the local banking groups are required, over a period of six years, to separate their financial and non-financial activities, divest control of all non-financial activities, and unwind all cross-shareholdings within these groups. In addition, local banks are allowed to undertake equity portfolio and venture capital investments, and to hold properties solely for their own use or for investment purposes.

#### *Strengthening the quality of external audits*

The local banks have publicly disclosed all non-audit consulting fees paid to their external auditors since 1999. They are also subject to the listing requirement of the Singapore Exchange that audit partners be rotated every five years.

In 2002, MAS required banks incorporated in Singapore to change their audit firms every five years. In doing so, MAS had recognised that frequent rotation of auditors could be resource-consuming and could result in audit gaps. After consultation with banks, it was decided that a five-year rotation period would balance the need to enhance audit independence and bring fresh perspectives to the audit process with the desire to provide for continuity and contain costs.

### Disclosure-based

Steps have been taken to put in place a regulatory framework that provides timely, accurate and meaningful disclosure of material information that consumers could reasonably rely on to evaluate the product, judge its risks, and make financial decisions.

#### *Benchmarking disclosure norms to international standards*

Banks in Singapore raised their disclosure standards significantly following a 1998 review by a private sector committee. The local banks began disclosing the market value of their investments, the level of their non-performing loans, past and future provisions, off-balance sheet items, and significant exposures. They have continued to improve disclosure in line with industry developments and international best practice. Local banks now publish their annual accounts within five months of the financial year-end. As with other listed companies, local banks started quarterly reporting of interim financial announcements with effect from January 2003. They also disclose pertinent information relating to the areas of corporate governance practices, financial performance review, risk exposure, risk management practices and risk taking philosophy in their annual reports, in line with international standards.

In the supervision of capital markets activities, MAS is also placing increased emphasis on market discipline through a disclosure-based regime. For example, disclosure standards for prospectuses have been tightened and the continuous disclosure of material information is mandated for listed companies. MAS has also made issuers and their advisers more accountable for making relevant disclosure, and subject inadequate or misleading disclosures and material omissions to statutory penalties. Investors now have access to civil remedy against offenders, while criminal sanctions remain for serious market misconduct.

### *Empowering consumers to assess and assume financial risks*

As more financial products are introduced, consumers need to understand these products well to make informed decisions. To enhance the basic financial literacy of consumers, Singapore launched a national financial education programme called MoneySENSE in October 2003. The MoneySENSE programme adopts a three-tiered approach that focuses on basic money management at the lowest tier, then looks at financial planning at the next tier, before moving on to the last tier on investment know-how.

### *Establishing efficient and affordable dispute resolution mechanisms*

MAS also facilitated the establishment of a Financial Industry Disputes Resolution Centre (FIDReC) in August 2005 to enhance the efficiency of dispute resolution mechanisms for retail consumers. FIDReC brings together existing dispute resolution schemes under the banking and insurance sectors, with extended coverage to include the capital markets sector. Mediation services, the main way of resolving disputes, are provided free by FIDReC. If mediation fails, the dispute then enters into adjudication for a fee of just S$50.

### Business-friendly

### *Formalising consultation*

MAS introduced guidelines in 2002 to formalise public consultation as a standard procedure whenever significant changes in its regulatory framework are planned. Besides raising levels of transparency, consultation has helped MAS tap industry expertise and experience on new products and business models, better understand the impact of new regulations on competitiveness and compliance costs, and identify the operational and implementation issues that industry may face.

## 4. Safety net

MAS is introducing a deposit insurance (DI) Scheme in April 2006. The main objectives are to provide a basic level of protection for small depositors, and to reduce the moral hazard from any mistaken perception of an implicit government guarantee on deposits.[5]

As its local banks expand overseas and foreign banks increase their presence in Singapore, the banking system and depositors will be exposed to more risks from these banks' international operations. International experience has shown that the possibility of a bank failure and loss to depositors cannot be eliminated even in reputable and well supervised jurisdictions. Moreover, as most foreign banks in Singapore operate as branches, MAS's supervision is confined to their operations in Singapore, even though the risks to their viability may arise from any part of their global operations. Cross-border insolvency proceedings will also present significant uncertainty and delay claims in Singapore against a bank's overseas assets.

Greater certainty of and clarity in depositor compensation will enhance public confidence in banks, and the financial system's stability. In the event of a bank's failure, the DI Scheme will compensate individual depositors and charities up to S$ 20,000 per depositor[6] per institution through a fund built up from contributions by Scheme members. The Singapore Deposit Insurance Corporation Limited (SDIC) was established in January 2006 to administer the DI Scheme and manage the deposit insurance fund. To strengthen recovery by the SDIC from the failed institution of any compensation paid out, Scheme members that operate as foreign bank branches are required to maintain sufficient eligible assets located in Singapore to meet its insured deposit liabilities.

[5] Depositors' expectation of a government bail-out would reduce their incentive to seek out sound banks and weaken market discipline on banks, potentially undermining banking system stability.

[6] This amount is on a per depositor per institution basis which would apply in the case of failure of more than one bank.

## 5. Strengthening the organisation

MAS is fairly unique in that it is the central bank, integrated financial supervisor and financial sector developer. Since 1998, MAS has undertaken a series of internal organisational changes to bring together departments with existing and potential synergies and to facilitate a more integrated approach to meet its core mission and objectives.

MAS has grouped its banking and insurance supervision departments to focus on prudential, and its securities departments to focus on market conduct regulation and supervision, for a more holistic view in supervising financial institutions and markets. Next, the prudential and market conduct policy functions across the three industries have been clustered together in order to better harmonise regulations and policies across financial activities. A Complex Institutions Supervision Department was set up to take a more integrated approach to supervising financial groups, evaluating them on a whole-group basis. This allows MAS to develop and retain both the depth and breadth of skills and expertise necessary for assessment of individual industries and complex financial conglomerates.

MAS has given more focus to financial surveillance and financial stability. A Macroeconomic Surveillance Department (MSD) within the monetary policy arm of MAS was established to better identify and monitor emerging trends and potential vulnerabilities in the financial system and markets. As mentioned earlier, MAS has institutionalised a regular meeting to discuss financial stability issues, bring together macro-and microprudential perspectives, as well as market insights from the reserve management and financial development functions.

MAS has also strengthened working arrangements between the developmental and supervisory functions. However, these separate and dedicated departments within MAS for financial supervision and financial centre development report to different senior management staff. In addition, officers involved in supervision are not charged with initiating and implementing developmental initiatives. Any potential tensions or trade-offs between supervision and development are resolved at the senior management level, which has collective responsibility for MAS's dual mandate for supervision and development.

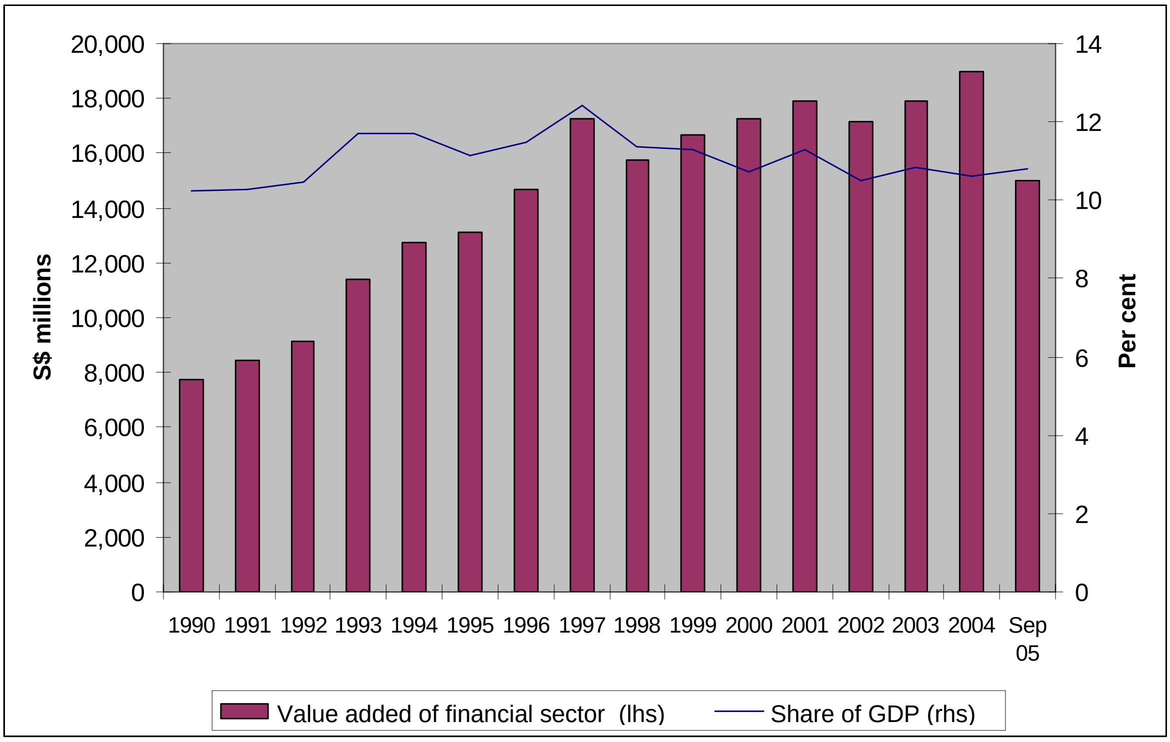
In light of organisational restructurings and changes in the structure of financial markets and its regulatory approach, MAS has fine-tuned and specified more clearly in legislation its objectives and responsibilities relating to monetary policy and financial supervisory policy. In addition, it has used mechanisms such as key performance indicators, periodic External Perception Surveys,[7] and peer assessment through the IMF and World Bank's Financial Sector Assessment Programme to measure the performance of each group carrying out the functions under its different roles.

This ongoing process of organisational review will strengthen MAS's ability to more effectively carry out its core functions in a challenging external environment.

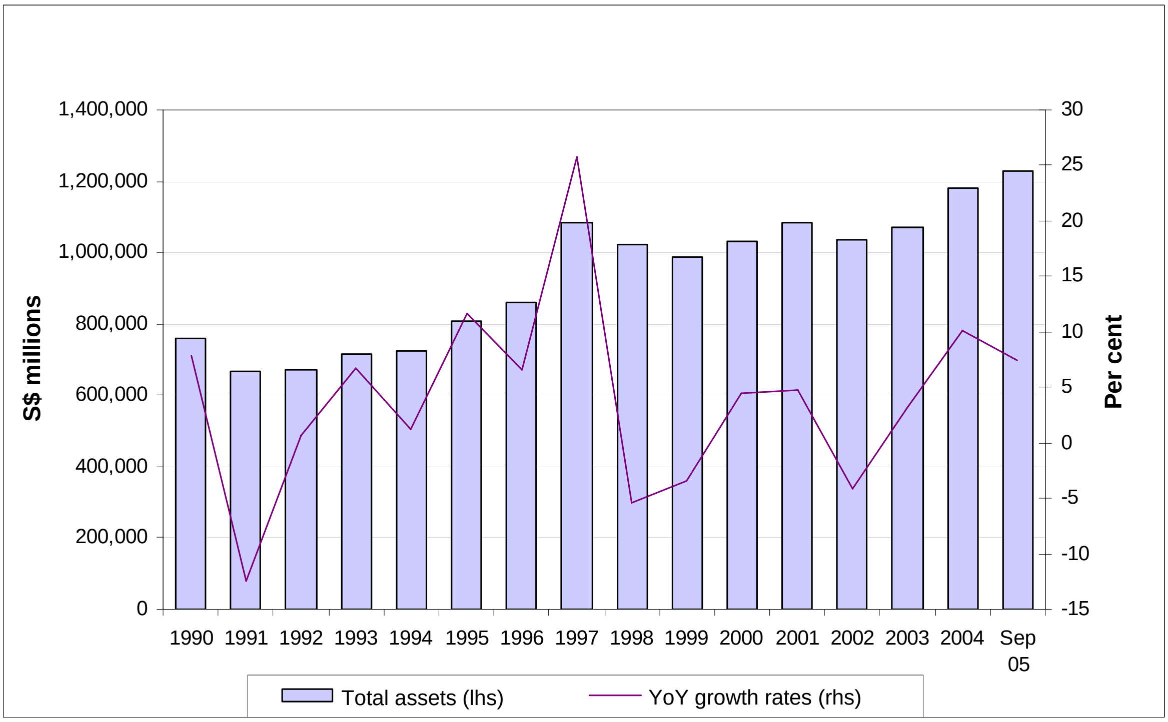
[7] The External Perception Survey (EPS) seeks to obtain feedback from external stakeholders on MAS's performance as a central bank, integrated financial supervisor and financial centre developer, as well as on its general attributes such as competence and responsiveness. MAS publishes a summary of the main EPS findings on its website.

# Annex

**Financial Sector's Contribution to GDP**




**Total Assets of Banking System**



| Some Banking Sector Financial Indicators | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | **Q3 2003** | **Q4 2003** | **Q1 2004** | **Q2 2004** | **Q3 2004** | **Q4 2004** | **Q1 2005** | **Q2 2005** | **Q3 2005** |
| **Banking Sector*** | | | | | | | | | |
| **Loan Concentrations (% of Total Commercial Bank Loans)** | | | | | | | | | |
| Bank Loans | 64.8 | 65.8 | 67.1 | 66.2 | 65.6 | 66.0 | 65.4 | 65.1 | 65.4 |
| Non-Bank Loans | 35.2 | 34.2 | 32.9 | 33.8 | 34.4 | 34.0 | 34.6 | 34.9 | 34.6 |
| **Loans through the Asian Dollar Market and Domestic Banking Units (% of Total Commercial Bank Loans)** | | | | | | | | | |
| Total ADM Loans | 72.3 | 72.8 | 71.9 | 72.3 | 72.7 | 72.6 | 71.5 | 71.7 | 73.1 |
| Total DBU Loans | 27.7 | 27.2 | 28.1 | 27.7 | 27.3 | 27.4 | 28.5 | 28.3 | 26.9 |
| **Sectoral Distribution of DBU Loans** | | | | | | | | | |
| Manufacturing | 4.7 | 4.6 | 4.1 | 4.1 | 4.2 | 3.9 | 3.9 | 3.9 | 3.9 |
| Building & Construction | 10.6 | 10.4 | 9.5 | 9.6 | 9.6 | 9.4 | 8.9 | 8.8 | 8.9 |
| Housing | 21.8 | 22.7 | 21.6 | 22.5 | 23.9 | 23.4 | 23.4 | 23.2 | 23.7 |
| Professionals & Private Individuals | 14.0 | 14.2 | 12.9 | 13.1 | 13.3 | 13.0 | 12.6 | 12.4 | 12.7 |
| Non-Bank Financial Institutions | 9.6 | 9.4 | 8.8 | 8.5 | 8.7 | 8.8 | 8.4 | 7.9 | 8.0 |
| Banks | 26.2 | 25.5 | 30.8 | 29.3 | 26.9 | 28.8 | 30.9 | 31.4 | 30.1 |
| **Domestic Liquidity Indicators** | | | | | | | | | |
| Liquid Assets to Total Assets | 14.1 | 14.3 | 14.0 | 13.1 | 13.6 | 13.0 | 12.8 | 13.1 | 13.0 |
| Loan/Deposit | 90.4 | 88.3 | 85.9 | 85.7 | 88.2 | 86.9 | 84.3 | 83.4 | 82.1 |
| **Local Banks' Indicators** | | | | | | | | | |
| **Capital Adequacy (Per Cent)** | | | | | | | | | |
| Regulatory Capital to Risk-Weighted Assets | 15.9 | 16.0 | 16.7 | 15.5 | 16.3 | 16.1 | 15.9 | 14.8 | 15.3 |
| Regulatory Tier I Capital to Risk-Weighted Assets | 11.7 | 12.0 | 11.9 | 12.3 | 11.8 | 11.4 | 11.5 | 10.4 | 10.9 |
| Shareholders' Funds to Total Assets | 10.6 | 10.7 | 10.3 | 10.1 | 10.0 | 9.7 | 10.1 | 9.8 | 10.0 |
| **Asset Quality (Per Cent)** | | | | | | | | | |
| NPLs to Non-Bank Loans | 7.0 | 6.7 | 6.2 | 5.5 | 5.4 | 5.0 | 4.6 | 4.2 | 4.0 |
| Total Provisions to NPLs | 64.4 | 64.9 | 67.8 | 71.5 | 72.8 | 76.6 | 77.7 | 78.9 | 80.0 |
| Specific Provisions to NPLs | 37.0 | 36.2 | 37.1 | 37.6 | 40.0 | 41.3 | 41.9 | 41.9 | 41.2 |

* Data relates to all commercial banks, Singapore operations only.

Sources: MAS, local banks.

| Number of Financial Institutions in Singapore | |
|---|---|
| **Type of Institution** | **Number of Institutions as at 24 Nov 2005** |
| **Commercial Banks** | **110** |
| Local | 5 |
| Foreign | 105 |
| Foreign Full Banks | 24 |
| Wholesale Banks | 34 |
| Offshore Banks | 47 |
| **Merchant Banks** | **49** |
| **Representative Offices of Banks** | **42** |
| **Finance Companies** | **3** |
| **Insurance Companies** | **150** |
| Direct Insurers | 59 |
| Professional Reinsurers | 27 |
| Captive Insurers | 59 |
| Authorised Reinsurers | 5 |
| **Insurance Brokers** | **62** |
| **Money Brokers** | **9** |
| **Holders of Financial Adviser's License** | **58** |
| **Holders of Capital Markets Services License**[1] | **173** |
| Dealing in Securities | 70 |
| Trading in Futures Contracts | 39 |
| Leveraged Foreign Exchange Trading | 13 |
| Advising on Corporate Finance | 34 |
| Fund Management | 91 |
| Securities Financing | 16 |
| Providing Custodial Services for Securities | 30 |

[1] The licensing regime under the Securities and Futures Act allows holders of a Capital Market Services license to engage in seven regulated activities.