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CHAPTER 7
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 capital market development and 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 become more inward looking (as did some crisis-affected countries), the Singapore government hastened financial liberalisation with the aim of creating a more resilient financial sector that 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 describes Singapore's development as a regional financial centre and the coming challenges. The next section describes in detail Singapore's financial sector development 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 recent financial liberalisation measures enacted

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by the government, particularly the opening-up of the banking sector to foreign financial institutions. The next section discusses the challenges Singapore faces 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 2003, Singapore's financial sector had 117 commercial banks (5 local and 112 foreign), 164 Asian Currency Units, 5 finance companies, 53 merchant banks, 143 insurance companies, 57 insurance brokers, 51 bank representative offices, 59 stockbroking companies, 90 fund management companies, 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,

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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 (Figure 7.1).

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 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, it maintains separate accounting records for its financial transactions to ensure that they do not disrupt domestic monetary

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

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management.

ACUs grew spectacularly, **both in numbers and in assets,** since their inception. ACU assets 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 perce**nt of bank assets accounted for by the first ACU (Bank of America) in its initial year of operation **(Figure 7.2)**. **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. ACU assets reached 11 times Singapore's GDP in 1987, and total ACU assets were 5 to 10 times GDP throughout the 1990s .

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 in 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 allow 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.

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> 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 7.1)**. 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 overseas assets represented about 22 percent of the total assets of Singapore's top four banks (DBS, OCBC, OUB, and UOB) in 1999 (**Table 7.2**).

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 7.3)**. 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

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Securities Trading Mainboard.

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 end-1987 to S$6.1 billion in 2003 (Figure 7.4).

The securities trading division of SGX, which includes both the Mainboard and SESDAQ, recorded initial public offering (IPO) listings of 55 companies that raised S$1.7 billion in 2003. Including the 55 IPOs, the Singapore stock exchange listed a total of 431 companies on the Mainboard and 138 companies on SESDAQ with a total market capitalisation of S$390 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. In May 2001, five AMEX-listed ETFs were listed on the SGX-Securities Trading (SGX-ST) trading 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 formation of the Singapore Exchange (SGX) **was intended to exploit the** synergies between the securities and derivative business 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 between SES and SIMEX as well as strategic alliances with foreign stock exchanges should attract global investors by opening access to international brokers and other market players. It will also mean

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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. The exchange 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 that 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 35.6 billion in 2003 (**Figure 7.5**). Over the past decade, **Singapore's derivatives exchange** has built a reputation as a successful regional risk management centre for investors.

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 their over-dependence on commercial bank

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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 MAS Notice no. 757 revision in December 2000 making 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 for investment purposes 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 to complement the 3-Month Singapore Dollar Interest Rate Futures **contract** and provide 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 attaining the liquidity required to achieve critical mass. From 1999 to 2003, the amount of corporate debt issuance increased by almost 245 percent from S$19.5 billion to S$67.2 billion (**Figure 7.6**). Outstanding debt in 2003 stood at S$49.5 billion, which represents 31.1 percent of GDP. Moreover, the inclusion of SGS in the JP Morgan Government Bond Index Global Broad index November 2000 will likely give the

2 According to MAS, QDS are basically debt securities that are substantially arranged by financial institutions in Singapore.

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Singapore bond market an additional boost.[3]

Fund Management Industry

Over the past ten years, the Government has been increasingly focussed on making Singapore a leading international fund management centre. The domestic fund management industry has seen assets under management ballooned to **S$465** billion in **2003**, more than a thirty-eight-fold increase compared to S$11.8 billion in 1989 (**Figure 7.7**). The number of fund management companies increased from 191 in 1999 to 230 in 2003. 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 (i.e. The Central Provident Fund) have attracted many global fund managers to set-up shop in Singapore.

There has 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 S$25 billion and S$10 billion respectively to external fund managers within three to five years. At end-2001 GIC had placed out S$21 billion of the S$25 billion to 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

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.

4 According to the Hong Kong Investment Fund Association, there were 1,872 authorised funds in Hong Kong, with total net asset value of US$534.4 billion (as at 31 March 2004).

5 The GIC manages Singapore's huge foreign reserves (estimated to be above US$100 billion) and has over 200 investment managers.

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couple of years. CPF members were allowed to invest all their Special Account and Ordinary Account balances in approved retirement-related financial instruments. This consequently freed up a substantial amount of CPF funds, raising the funds available for investment to S$41 billion. Since September 1998, revised investment guidelines have provided CPF members 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, the Government has also raised the investment limit of professional managed financial products to 100 per cent from the current 80 percent in September 1999. As at end-2001, 155 out of a total of 319 unit trusts in Singapore are under the CPFIS.

In the Economic Review Committee Report entitled, “Positioning Singapore as a Pre-eminent Financial Centre in Asia” (September 2002), the committee recommended the following policy recommendations to develop Singapore’s fund managements 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 from 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, stock and future 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

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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 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 the protection of depositors' and investors' interests. Moreover, MAS has endeavoured to minimise risks, banking 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 where most domestic banks maintain minimum CAR of 12 percent.

Since the listing of SGX in November 2000, the regulatory relationship between MAS and SGX has become more clearly defined. MAS will administer statutory laws regulating the capital markets and have oversight of SGX's regulatory functions. Meanwhile, SGX will retain the frontline responsibility of 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 the 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

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is both dynamic and unpredictable.

Corporate Governance

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

In March 2001 the first review committee, the corporate governance committee, 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, there has been significant improvement in bank disclosure and corporate governance practices. In the May 1998 report by the Committee on Banking Disclosure, banks are required to disclose details relating to principal sources of income, loan-loss provisions, and off-balance sheet items. They are also required to provide information regarding their non-performing loans as well as the market value of their 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 their 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 appointed some time ago continue to meet the criteria for re-appointment.

In February 2003, MAS came out with 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

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the proposed guidelines build on the existing Code of Corporate Governance. In essence, the consultative paper clearly defines what is meant by an 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

Recognising the concerns about over-regulation, MAS has shifted progressively from "one-size-fits-all" regulation to a risk-focused supervisory approach. As such, MAS is moving away from relying on extensive regulation as a means to protect investors and customers. Consequently, 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, the focus of supervision is on systemic risk rather than the risks of individual institutions or 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, a proposed deposit insurance scheme to protect Singaporean depositors during periods of financial crisis. In August 2002, MAS released a consultative paper on the proposed features of a deposit insurance scheme in Singapore. The deposit insurance scheme will 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.

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Another important financial safeguard that MAS is considering is the requirement that foreign banks with a large retail presence have to subsidiaries their operations in Singapore. Subsidiarisation would involve foreign banks having to incorporate in Singapore and meet MAS' minimum paid-up capital requirement of S$1.5 billion and capital adequacy ratio requirements (8 per cent Tier I capital and 12 per cent Tier 1 and Tier II capital). This would also allow for better supervision of the subsidiary and greater flexibility in containing any potential financial contagion arising from problems in the 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. 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 programme regarding foreign banks has two key elements: granting foreign banks new licences and more access to the domestic market and lifting foreign ownership restrictions on local banks. **In the first phase,** MAS plans **to introduce** a new category of full banking licence known as a Qualifying Full Bank (QFB) **and to issue QFB licenses** to up to six foreign banks by 2001. Each QFB will be allowed additional branches, off-premise automatic teller machines (ATMs), and ATM-sharing privileges. It had already issued QFB licenses had already been issued to four foreign banks, namely ABN Amro Bank, Banque Nationale de Paris, Citibank, and Standard Chartered Bank by the end of 2000 (see **Table 7.3**).

MAS has renamed the Restricted Bank licence to the Wholesale Banking licence to better reflect the wide range of financial activities that they are now undertaking. This would include increasing their lending limits and reducing restrictions on Singapore dollar swaps Unlike a QFB, a Restricted Bank can have only one branch and is not allowed to accept Singapore dollar

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savings accounts or fixed deposits of less than $250,000 from non-bank customers. Fifteen banks were awarded wholesale banking licences in December 2001 and an additional five licences were made available in 2002.

The 40-percent aggregate foreign shareholding limits imposed on local banks were lifted in July 1999 and local banks are allowed to merge their local and foreign share tranches. The elimination of the 40-percent limit was intended to increase the liquidity of local banks' shares, 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). **An individual shareholder still requires approval before increasing domestic bank holdings above the 5-percent and 20-percent level, as well as a new intermediate 12 percent shareholding threshold**.

On 29 June 2001, MAS announced the second phase of financial liberalisation.[6] Compared to the 1999 package of financial reforms, the second package of measures represents a more substantial opening up of the financial sector to foreign banks which will intensify competition in the hitherto protected domestic wholesale and retail markets. Furthermore, the latest version of MAS Notice No. 757 (issued in December 2000) has 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 sets the stage for deeper and broader capital markets—expediting the government's plans to transform Singapore into an international financial centre.

Foreign participation in the domestic wholesale market will broaden. MAS will move away from the multi-tiered licensing regime of Full, Restricted, and Offshore Banks towards a licensing agreement that differentiates between retail and wholesale banks. The existing Restricted Bank licence will be renamed the "Wholesale Banking" licence and Qualifying

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

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Offshore Bank (QOB) and Offshore Bank (OB) licences will be phased out. Meanwhile, existing QOBs and OBs will be upgraded to Wholesale Bank status. This upgrading will allow these foreign banks to accept Singapore dollar fixed deposits above S$250,000 and operate Singapore dollar current accounts. MAS plans to grant twenty Wholesale Banking licences over the next two years.

In December 2001, MAS awarded the remaining two QFBs to Malaysia's Maybank and HSBC. Moreover, MAS plans to the allow QFBs to:

establish up to 15 locations of which up to 10 (previously 5) can operate as 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 QFBs' delivery capabilities 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 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 high levels 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).

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- 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, 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 make Singapore's advantages, such as a developed infrastructure and a favourable time zone, less essential requirements for a major financial centre.

Trends in global finance raise other concerns about Singapore's future role as a financial centre. IMF (2000) found that financial restructuring in Europe in the 1980s, which spread to East Asia since the 1997 crisis, may result in the consolidation of financial activity into fewer centres. 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 new offices to be set-up in Northeast Asia may affect Singapore’s efforts in developing its domestic fund management industry.

Singapore is situated in a region of increasing economical and political uncertainty since

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the 1997 financial crisis. Certainly, the 11 September terrorist attacks on the United States and the Bali bombing incident in October 2002 have raised the risk premium in terms of 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 lead to greater demand for Hong Kong's financial services, giving the latter 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, Singapore's role as a regional financial centre faces challenges from global financial trends and new competitors such as China 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. With a total population of more than 500 million, ASEAN is a potentially lucrative market for trade and investment, which could generate substantial demand for capital and financial services. The recent ASEAN initiative to form an ASEAN Economic Community 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 have agreed to explore the possibility of forming an ASEAN Economic Community. Although, the concept of such as economic community was not elaborated on during the Summit, this would undoubtedly involve deeper

7 At the Ninth ASEAN Summit in Bali in October 2003, ASEAN leaders have agreed to establish an ASEAN Economic Community (AEC) by 2020. It is envisaged that the AEC will be a single market and production base with free flow of goods, services, investments, capital and skilled labour.

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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 could potentially become an important supplier of capital to Southeast Asia as well as 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 also need to leverage on China's expanding economy by positioning itself within its slipstream. Besides Hong Kong, the spillover effects of China's growing need for funds could be sourced from Singapore. Hence, the Singapore government should continue to forge a close economic relationship with China. The China-ASEAN free trade agreement (FTA) which is expected to be realised by 2010 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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8 ASEAN signed a framework agreement on comprehensive economic co-operation with China on 4 November 2002. This agreement would pave the way towards realising an FTA with China for the ASEAN-6 member countries (i.e. Brunei, Indonesia, Malaysia, the Philippines, Singapore and Thailand) by 2010 and for the newer member countries (i.e. Cambodia, Laos, Myanmar and Vietnam) by 2015.

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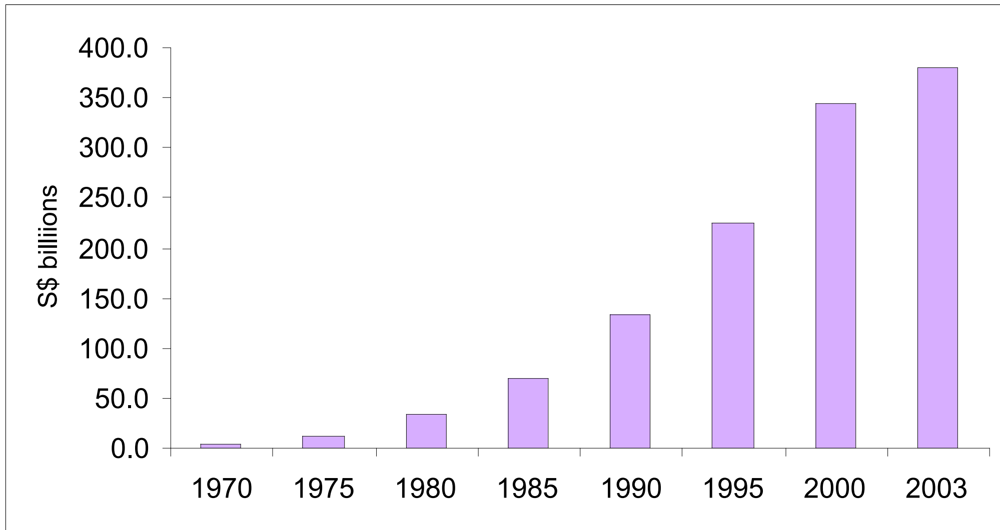
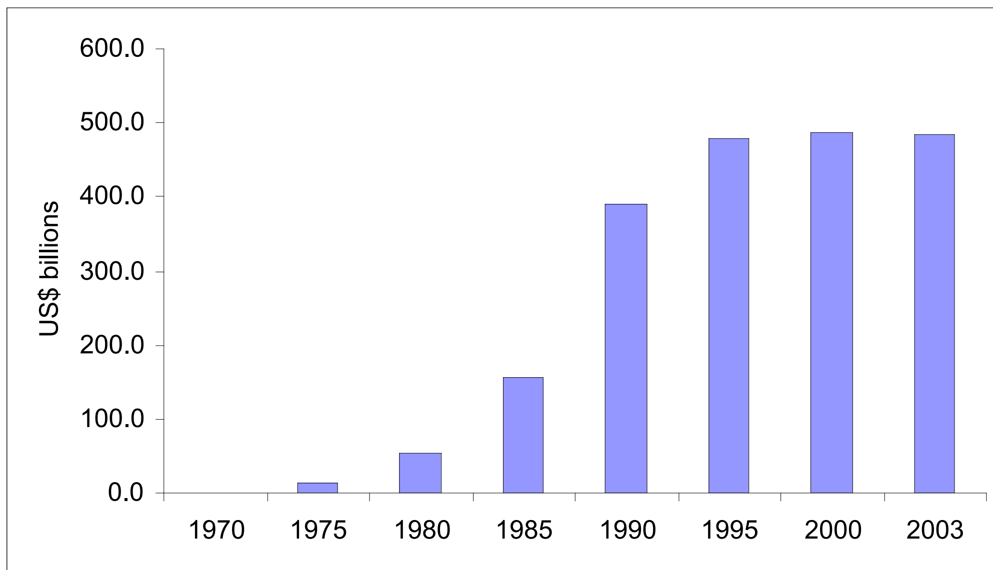
FIGURE 7.1
Total Assets of DCUs (Commercial Banks), 1970-2003



Source: Monetary Authority of Singapore.

FIGURE 7.2
Total Assets of DCUs, 1970-2003



Source: Monetary Authority of Singapore.

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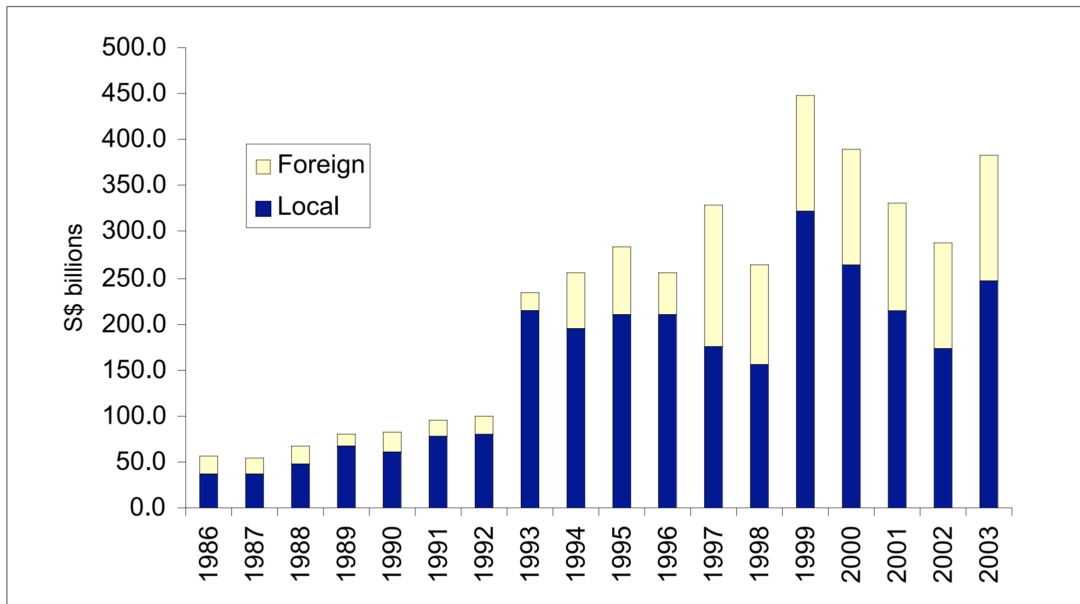
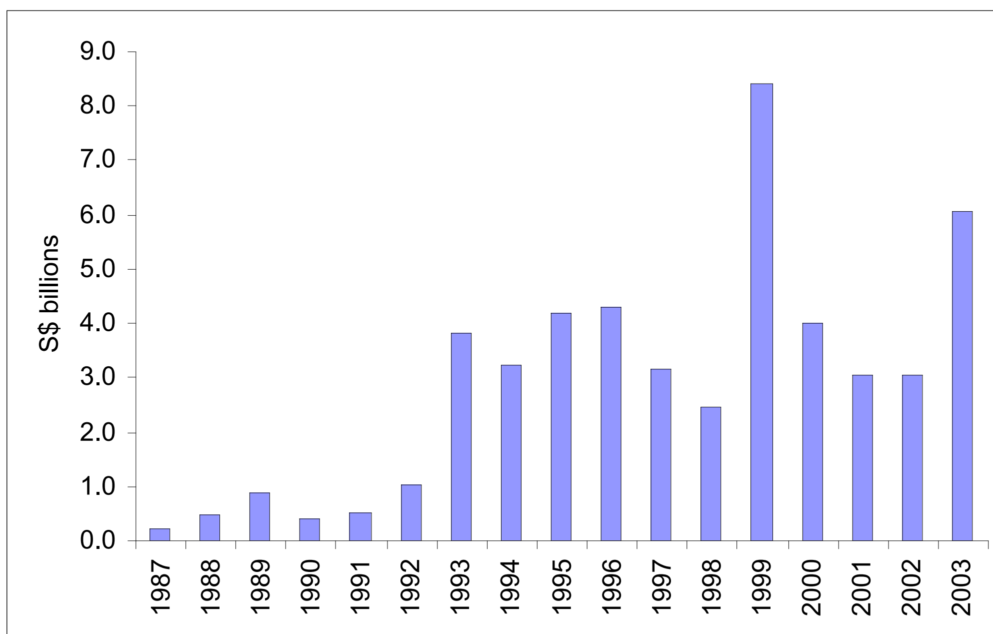
FIGURE 7.3
Market Capitalisation of Singapore Equity Market
1986-2003



Source: CEIC Data.

FIGURE 7.4
Market Capitalisation of SESDAQ
1987-2003



Source: CEIC Data.

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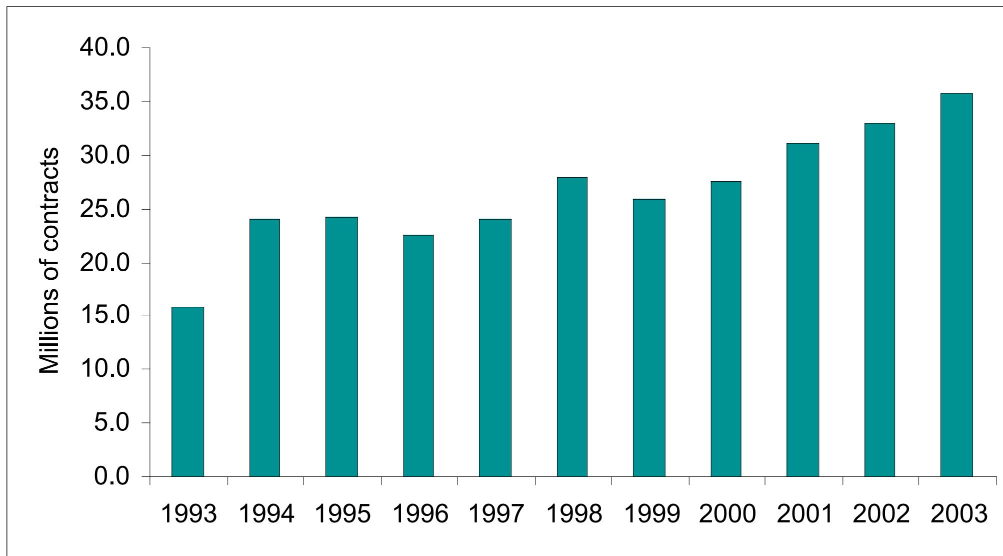
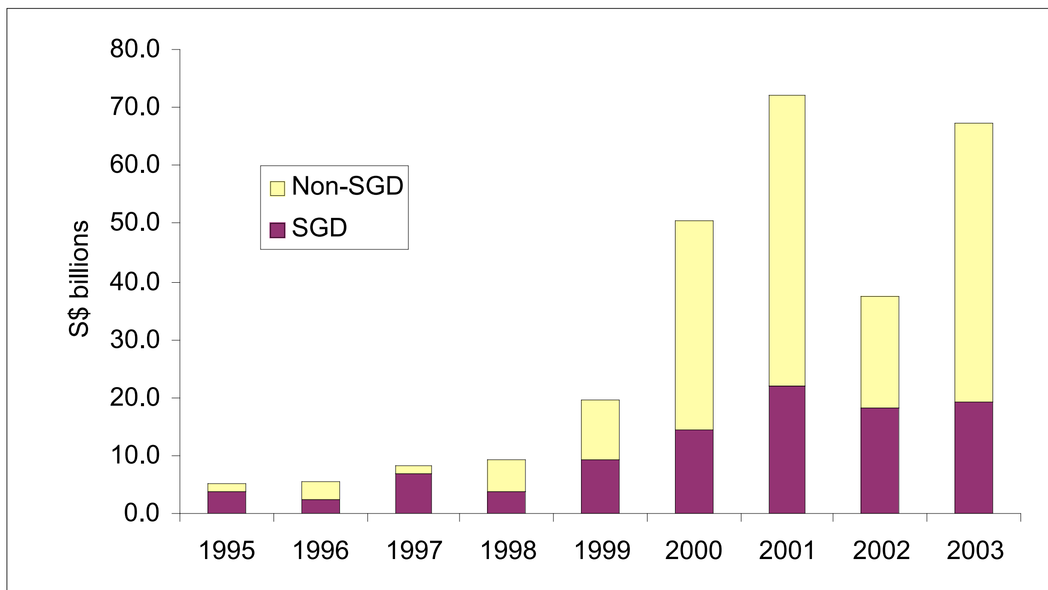
FIGURE 7.5
Annual Turnover of SIMEX/SGX-DT Futures and Options
1993-2003



Source: CEIC Data.

FIGURE 7.6
Issuance of Corporate Bond in Singapore Dollars and Other Denominations,
1995-2003



Source: CEIC Data.

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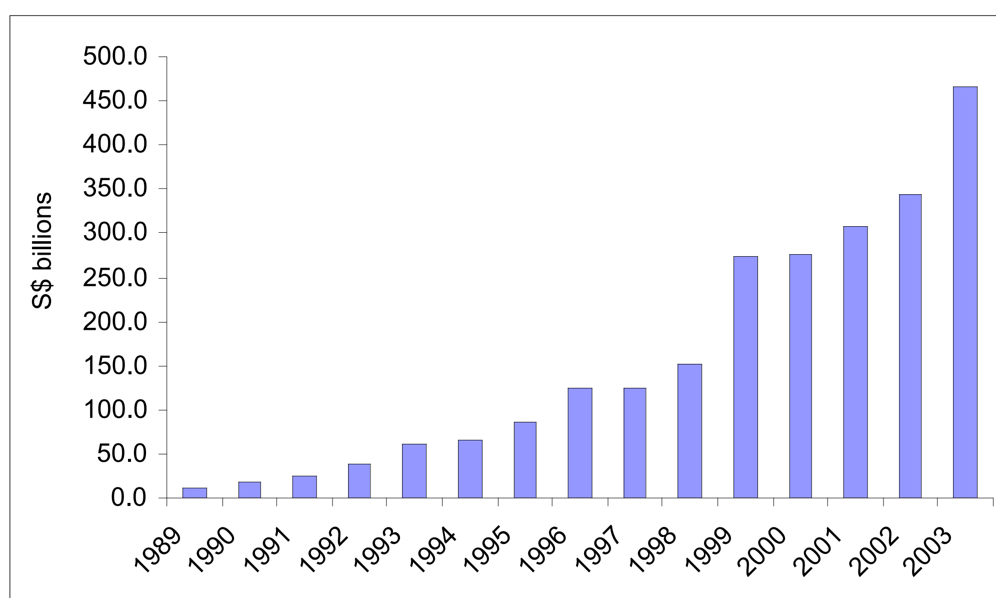
FIGURE 7.7
Total Assets under Management
1989-2003



Source: Monetary Authority of Singapore (MAS).

TABLE 7.1
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 7.2
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.

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TABLE 7.3
Foreign Banks in Singapore as of September 2002

Bank	Origin	Granted QFB	Operates an ACU
ABN Amro	Netherlands	Yes	Yes
Citibank	USA	Yes	Yes
HSBC	Hong Kong	Yes	Yes
Standard Chartered Bank	UK	Yes	Yes
Malayan Banking	Malaysia	Yes	Yes
BNP Paribas	France	Yes	Yes
Bank of America	US	No	Yes
Bank of China	China	No	Yes
Bank of Tokyo-Mitsubishi	Japan	No	Yes
Credit Agricole Indosuez	France	No	Yes
JP Morgan Chase	USA	No	Yes
RHB Bank	Malaysia	No	Yes
Bangkok Bank	Thailand	No	Yes
Bank of East Asia	Hong Kong	No	Yes
Bank of India	India	No	Yes
Bank Negara Indonesia	Indonesia	No	Yes
HL Bank	Malaysia	No	Yes
Sumitomo Mitsui Banking	Japan	No	Yes
Indian Bank	India	No	No
Indian Overseas Bank	India	No	No
Southern Bank	Malaysia	No	No
UCO Bank	India	No	No

Source: EIU Country Finance: Singapore, September 2002.

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