

Positioning Singapore as a Pre-eminent Financial Centre in Asia

Main Report

**ECONOMIC REVIEW COMMITTEE
SUB-COMMITTEE ON SERVICES INDUSTRIES
FINANCIAL SERVICES WORKING GROUP**

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1 INTRODUCTION

OVERVIEW

- 1.1 On the back of a vibrant domestic economy, increasing prosperity in the region, and the success of the Asian Dollar Market, Singapore experienced a rapid ascent to achieve international standing as a financial centre. However, the Singapore financial sector is facing a number of critical challenges. Globally, the trend towards consolidation of financial activities in leading financial centres has accelerated. This has intensified the competition for “location-independent” financial activities and top talent. Economic vibrancy of North Asia vis-à-vis Southeast Asia has also increased the relative attractiveness of Hong Kong and Shanghai.
- 1.2 Against this backdrop, the authorities and various industry committees have focused on developing a competitive domestic business environment. These efforts should continue in order to foster an environment that is flexible and highly responsive to emerging opportunities in financial services. However, going forward, there is a need to identify and develop regional or global niches that play to Singapore’s sustainable competitive advantages as a business and financial hub.

BRIEF HISTORICAL BACKGROUND

Economic Vibrancy: Leveraged Financial Sector Growth

- 1.3 In the early 1960s, Singapore implemented an economic blueprint that encouraged inward investments of multinational corporations to Singapore. The inflows of foreign direct investment from the UK, US and Japan provided an impetus to the development of the financial sector. By the 1980s, many of the world’s leading financial institutions had set up operations in Singapore.

First-Mover Advantage: Asian Dollar Market

- 1.4 Funds from merchants in neighbouring Southeast Asian countries were traditionally deposited in Singapore dollars with Singapore-based banks. In the late 1960s however, the higher euro-dollar interest rates led to a rise in industry interest to attract US dollar deposits. Bank of America obtained a license to establish a currency unit that competed with London-based banks in seeking euro-dollar deposits. This marked the genesis of the Asian Dollar Market that underpinned the early rise of Singapore as a financial centre.

Critical Mass: Treasury and Foreign Exchange

- 1.5 On the back of growing prosperity in the region and support from the authorities, Singapore developed into a regional, and subsequently, global foreign exchange trading centre. Today, only London, New York and Tokyo record higher foreign exchange trading volumes than Singapore. The Singapore International Monetary Exchange (SIMEX)¹, the first derivative exchange in Asia, also grew in stature to become a key Asian node in the global chain of leading futures markets.

RECENT INITIATIVES AND PERFORMANCE

Financial Sector Development and Liberalisation

- 1.6 In 1997, Singapore commissioned a Financial Sector Review Group to undertake a strategic review of the financial sector and formulate strategies for liberalisation and development. In a series of calibrated measures, the Monetary Authority of Singapore (MAS) liberalised key sectors of the financial sector, including retail banking, insurance and stockbroking. MAS sharpened its focus on proactive development of Singapore as a financial centre, establishing a new, dedicated department with offices in London and New York to fulfil this role. In addition, concerted efforts were made to broaden and deepen the local debt markets, and increase wealth management activities.

Financial Sector Growth²

- 1.7 The importance of the financial services industry in the overall economy has been growing over the past decade, with the financial sector's share of nominal GDP increasing from an average of 10% of nominal GDP in the 1980s to an average of 12.3% over the period 1998-2001 (Chart 1.1).
- 1.8 Debt market activities have intensified since 1998, when measures were first implemented to develop both the government and local corporate debt market in Singapore.
- 1.9 In 2001, total corporate debt issuance increased by 43% on a year-on-year basis to S\$72 billion (Chart 1.2). Of the total issuance volume, 31% was denominated in Singapore dollars. The number of issues increased from 909 in 2000 to 1450 in 2001.

¹ SIMEX and the Stock Exchange of Singapore (SES) have since merged to become the Singapore Exchange (SGX).

² Source: Economics Department, the Monetary Authority of Singapore (MAS).

Chart 1.1: Share of Financial Services in Overall Nominal GDP (1980-2001)

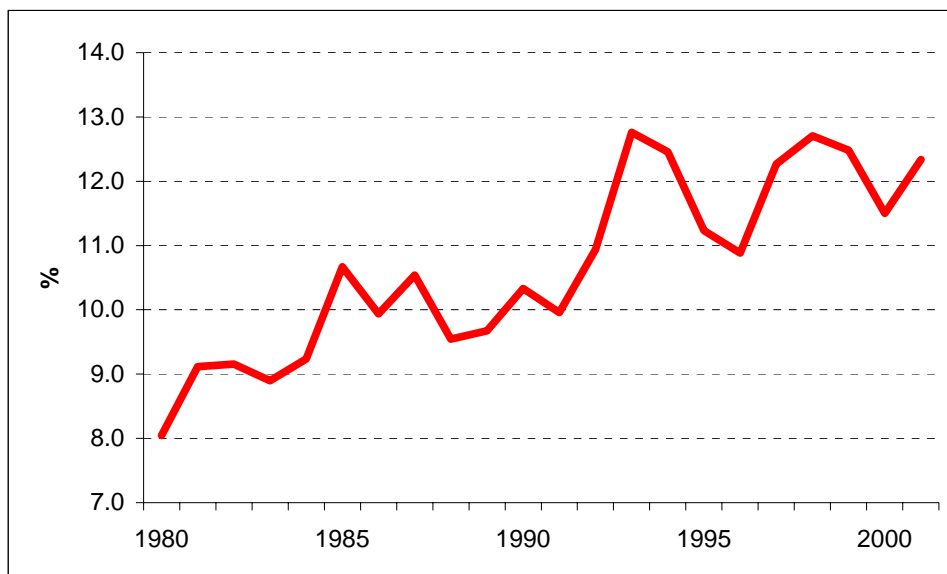
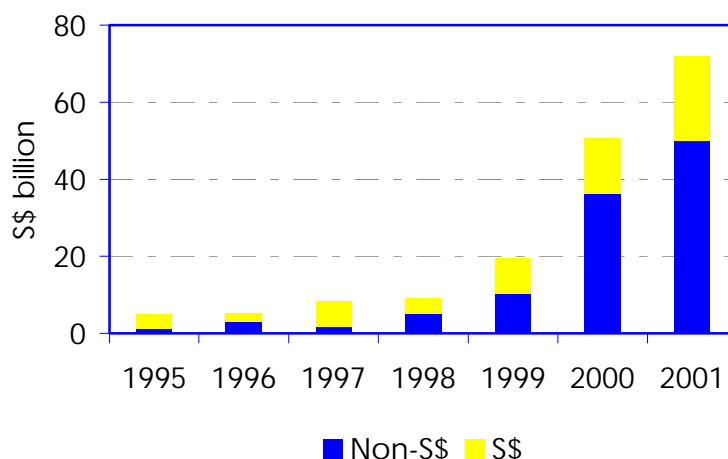
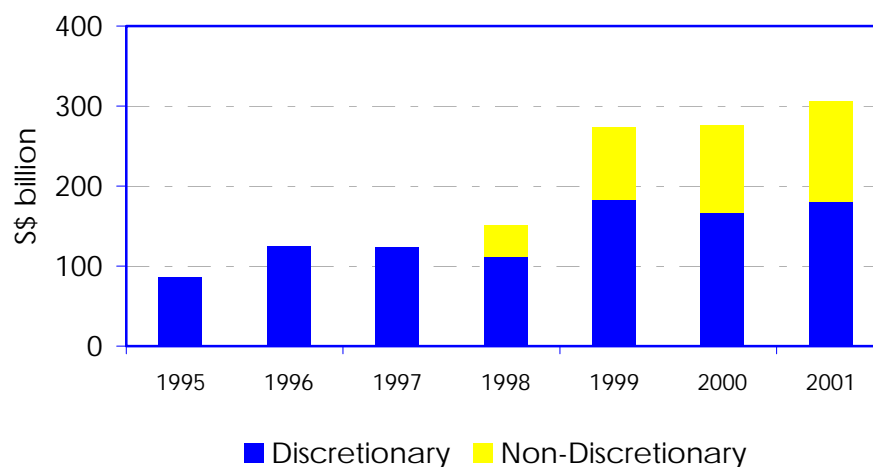


Chart 1.2: Corporate Debt Issuance in Singapore (1995-2001)



1.10 Wealth management activities have also seen healthy expansion. Assets under management by Singapore-based institutions totalled S\$307 billion as at end-2001, recording an 11% year-on-year growth (Chart 1.3).

1.11 Fund management companies in Singapore have expanded in terms of size, regional responsibility and capabilities, with 70% of funds under management sourced from the US, Europe and Asia.

Chart 1.3: Assets Under Management (1995-2001)

- 1.12 Non-bank lending in the Asian Dollar Market continued its negative downward trend. Lending to Asia has not recovered from the 1997 Asian crisis and is unlikely to do so, given weak global economic conditions. Singapore has fallen a notch from 9th to 10th position in terms of international lending.
- 1.13 Although Singapore has retained 4th position in foreign exchange trading behind London, New York and Tokyo, Singapore slipped to 13th position in OTC derivatives trading due to the consolidation of Euro trades to London and domestic centres.
- 1.14 Overall, the Singapore financial sector has enhanced its domestic competitiveness and broadened its activities. However, the traditional businesses that have underpinned Singapore's success as a financial centre, like foreign exchange trading, have matured. Going forward, there is a need to look externally and to develop new growth engines for the financial sector.

CHALLENGES FOR SINGAPORE'S FINANCIAL SECTOR

Financial Activity Agglomeration

- 1.15 Globally, the trend towards consolidation of financial activities in leading financial centres has accelerated. This has led to increased competition for "location-independent" financial activities and top talent.
- 1.16 With the exception of foreign exchange trading (ranked 4th globally) and international lending (10th), Singapore's financial sector lacks the necessary critical mass to further attract "location-independent" financial activities. To illustrate, Singapore's total market capitalisation accounts for just 0.3% of the MSCI All Country World Index Free Index.

- 1.17 Singapore must therefore review its strategies to develop and grow its financial sector in the light of this trend. A high-quality living environment, a competitive tax regime, a vibrant cultural landscape, and a conducive environment for research and information exchange, will be critical to ensuring that Singapore continues to be able to retain and attract top talent.
- 1.18 Going forward, Singapore will also need to specialise by identifying and developing regional and global niches in which it can attain critical mass.

Economic Vibrancy of North Asia vis-à-vis Southeast Asia

- 1.19 Singapore's attractiveness as a regional centre for financial institutions is being challenged by the contrasting economic fortunes of Southeast Asia and North Asia.
- 1.20 Singapore's immediate hinterland has been hit by two adverse shocks in the past five years. The Asian financial crisis has left high levels of distressed assets and non-performing loans, which hinder recovery and discourage foreign investor interest. The US war on terrorism has further delayed economic recovery.
- 1.21 In contrast, foreign investor interest is currently directed towards North Asia. South Korea is experiencing good economic recovery and has made steady progress in corporate restructuring, while China's entry to the WTO has created increased business and investment opportunities. Hong Kong and Shanghai are geographically well positioned to serve the investment banking (mergers and acquisitions, and capital raising activities) and other financial needs arising from the burgeoning economic activity in North Asia.
- 1.22 In response to these developments, Singapore will need to identify new product niches within the region and tap new markets in North Asia and beyond.

OPPORTUNITIES FOR SINGAPORE'S FINANCIAL SECTOR

- 1.23 Despite the uncertain outlook for Southeast Asia and the structural shifts toward North Asia, Singapore has a unique suite of competitive offerings as a business and financial hub. Singapore's English-speaking and well-educated workforce, pro-business policies, fiscal strength, first-rate business infrastructure and living environment are significant advantages that are not easily replicated. Singapore's regional hub status and cultural links to the growth markets of China and India also open new opportunities for the financial sector.

Recovery of Southeast Asia

- 1.24 As corporate and financial restructuring processes run their course and stability returns to Southeast Asia, investor interest in the region will gradually increase. Commercially viable but cash-strapped businesses in

the region will require financing and insurance to rebuild their operations. Singapore-based financial institutions well positioned to help finance or underwrite the risks of investing in these companies through financial guarantees, securitisation of the income streams, and credit enhancement. Singapore's capital markets are also well placed to support corporate restructuring and financing in the region.

Tapping Growth of China and India

- 1.25 The influx of foreign direct investment to China and the rise in domestic credit require heightened standards of financial intermediation in the mainland. Singapore is in a good position to tap the need for prudent management of Chinese wealth and offshore financing. Deeper business and government networks between the two countries will permit greater risk and financial intermediation between financial institutions in Singapore and commercial parties in the mainland.
- 1.26 India is another source of business growth and entrepreneurial talents, with individual states specialising in different economic activities. Singapore should forge stronger private sector linkages between the two countries to tap the growth opportunities and to complement the competitive advantages offered by Indian states.

Leveraging Technology and Information Communications

- 1.27 Technology and information communications developments are enabling the decomposition of the financial services value-chain. The financial services industry has been an early adopter and beneficiary of these developments to globalise its operations. Together with the trend of financial activity agglomeration, these technological advancements have led to the growth of "location dependent" financial activities.
- 1.28 Singapore, with its developed and reliable technology infrastructure and availability of skilled labour, is particularly suited as a hub for "location independent" financial activities to expand its market and product reach in financial services.

FINANCIAL SERVICES WORKING GROUP – TERMS OF REFERENCE AND APPROACH

Terms of Reference

- 1.29 Against this background, the Financial Services Working Group (FSWG) was established with the following terms of reference:
- To study impediments to the growth of the financial services industry in Singapore;

- To identify distinctive and self-sustaining competitive advantages that Singapore has or can develop as a financial centre and recommend appropriate strategies to develop and exploit these advantages;
- To identify new market and business opportunities in the global and regional financial services industry where Singapore can be competitive and develop strategies to position Singapore to play a leading role in these areas; and
- To recommend appropriate strategies to enhance the financial ecosystem in Singapore.

1.30 A large number and diverse range of professionals from the financial services and related business services sectors participated in FSWG deliberations, meetings and workshops. Participants include representatives from banks, insurance companies, brokerage, fund management, private equity and strategy consulting firms, universities as well as the government. Members of the public also submitted ideas and recommendations to develop Singapore's financial sector.

1.31 Various focus groups were established to concentrate on specific industry areas such as banking, insurance, trust and topical issues such as tax and education/training for the financial sector. Meetings and interviews were also conducted with a group of advisors, comprising key local and global financial sector players such as bank chairmen, diplomats, top local businessmen and senior government officials (see Annexes A1-A3 for information on FSWG members, participants and advisors).

Approach

1.32 Previous studies and reviews of Singapore's financial sector have led to significant improvements in Singapore's domestic competitiveness. These include the Financial Sector Review Group in 1997, Committee on Singapore's Competitiveness in 1998, and the Financial Centre Advisory Group in 1999-2000.

1.33 However, several industry-wide issues need to be addressed if Singapore is to compete successfully. These include ways to create an attractive business environment for financial services to flourish in Singapore, focusing on its international "branding" as a financial centre, ability to attract, develop and retain talent, tax competitiveness, and the quality of its business infrastructure.

1.34 We also sought to identify and develop regional or global niches for Singapore. Our recommendations were made following detailed analyses of global trends (e.g. specialisation, consolidation for scale benefits, customer differentiation, new technologies, etc.) in financial services, lessons from other financial centres (the global centres of London, New York and Tokyo as well as niche financial centres such as Bermuda for risk management, Zurich and Geneva for private banking, and Dublin for

processing and fund administration activities), and Singapore's competitive advantages as a business and financial hub.

VISION AND STRATEGIC THRUSTS FOR SINGAPORE'S FINANCIAL SECTOR

1.35 In the light of a more challenging external environment and increasing competition between financial centres, we have articulated the following vision for Singapore's next phase of financial centre development:

To position Singapore as a pre-eminent financial centre in Asia for select regional/global niches

1.36 Our vision captures the imperatives for Singapore to:

- Develop regional and global niches in financial services to increase its depth and international market share of select financial activities; and
- Anchor itself as a choice location for finance and ancillary professionals to study, research, live and work here.

1.37 Through an iterative process of deliberation and validation, we distilled and identified four strategic thrusts to support our vision:

- Develop Singapore as a Regional Leader in Wealth Management;
- Develop Singapore as a Regional/Global Processing Centre;
- Develop Singapore as the Asia Pacific Risk Management Centre; and
- Create an Attractive Business Environment.

1.38 We believe that the identified niches on wealth management, processing and risk management/transfer are aligned with Singapore's distinctive and self-sustaining competitive advantages of economic and political stability, a highly skilled and largely bilingual workforce, a well-regulated financial sector and an advanced IT platform. The corresponding recommendations and action steps are discussed in Chapters 2 to 4.

1.39 The fourth strategic thrust on creating an attractive business environment in Singapore focuses on four areas, namely, financial services promotion, education and training, taxation and business infrastructure. Chapter 5 presents the recommendations and corresponding action steps in these areas.

2 WEALTH MANAGEMENT

OVERVIEW

- 2.1 We have identified wealth management as a source of good growth potential and competitive advantage for Singapore's financial sector. A well-developed wealth management industry, encompassing both institutional and private wealth management, has numerous spin-off benefits. It reinforces capital market and treasury activities and provides business to the suppliers of trust and custody services.
- 2.2 As a private wealth management centre, we believe that Singapore already has many important advantages such as political stability, economic strength and a well-regulated, well-regarded international financial sector. This chapter recommends measures to increase the depth and breadth of Singapore's institutional asset management industry, which will also have spin-off benefits for the private wealth management business. We recommend that the government play a catalytic role in cultivating and fostering local players and attracting foreign firms to Singapore. We also recommend developing ancillary services to support the wealth management industry.

KEY CONSIDERATIONS

Recent Developments in Traditional Asset Management Business

- 2.3 Singapore's asset management industry has managed good growth since 1994. Assets under management (AUM) by Singapore-based financial institutions have grown steadily from S\$66 billion in 1994 prior to the implementation of developmental measures to S\$307 billion as at end-2001.¹ Singapore has evolved into a major regional asset management centre, hosting more than 200 asset management outfits, which employed 1114 professionals as at end-2001. Almost three-quarters of discretionary AUM is sourced from overseas.
- 2.4 Singapore's developmental objective was to become a centre for (a) managing the Asian investment portfolios of both Asian and Western clients and (b) managing global investments of clients in Asia. Today, 43% of assets managed in Singapore were sourced from Europe and North America, with 30% of assets invested in Singapore, 9% in Japan and 48% in the rest of the Asia Pacific. However, Singapore remains a predominantly Asian mandate centre, with funds mostly invested in Asia, although the amount of investment in the US and Europe carried out from Singapore has increased in recent years.

¹ Source: MAS Asset Management Survey 2001.

- 2.5 Given the trends of consolidation and restructuring in the global asset management industry, Singapore's bid to develop as a centre for international mandates is made more difficult. Fund management activity is being carried out from fewer centres in the world. In addition, Asia ex-Japan markets have shrunk to only 2.7% of world capitalisation.

Alternative Investments

- 2.6 Alternative investments, encompassing private equity (including venture capital and leveraged buyouts), hedge funds, mezzanine securities, distressed debt and real estate investment securities, constitute an increasingly important asset class in mature markets such as the US and Europe. As these markets are relatively young in Asia, Singapore should capitalise on the opportunity now to position itself as a significant hub within Asia for alternative assets.

Private Equity

- 2.7 The location of private equity managers will deepen the talent pool in Singapore, while the attraction of quality private equity funds from the US and Europe to Singapore will increase the pool of assets under management. Private equity also provides capital to fund entrepreneurs, growth and restructuring. Annex B1 discusses the economic impact of private equity in mature markets in Europe and the US.
- 2.8 Private equity in Asia has been characterised as being 10 years behind Europe and 20 years behind the US.² In Asia, cumulative funds under management now total approximately US\$80 billion, compared with an estimated US\$834 billion and US\$160 billion in the US and Europe, respectively. From 1992 to 2001, funds under management increased by 16% per annum in Asia.
- 2.9 From 2001 to 2006, net funds under management (excluding funds divested or written down) are projected to grow about 7% per annum, with the largest markets likely to be Japan, China and India. South Asia³ continues to have significant potential. In 2001, South Asia represented 42% of funds invested⁴, and 52% of cumulative investments under management.⁵
- 2.10 There is significant potential for Singapore to increase its share of regional private equity fund management. Singapore is primarily a hub for managing South Asia investments. Approximately 65% of private equity funds in Asia are regional in coverage, with Hong Kong managing US\$26 billion of Asian funds and Singapore managing US\$12 billion.⁶

² Source: Euromoney Institutional Investor PLC, Vol. 12, No. 6, pages 2-76.

³ South Asia defined as Australia, New Zealand, India and Southeast Asian markets.

⁴ Source: Asian Venture Capital Journal.

⁵ Source: Asian Venture Capital Journal and Thomson Financial.

⁶ Source: Asian Venture Capital Journal.

Hedge Funds

- 2.11 Hedge funds are pooled investment vehicles that seek to offer investors absolute returns that are uncorrelated to the underlying stock, bond or cash markets. These investment vehicles are gaining widespread acceptance among institutional investors and high net worth individuals and today constitute an important asset class that allows effective portfolio diversification.
- 2.12 Globally, hedge fund activity is concentrated in US and Europe. Asia represents about 3% of the global market, with the remainder split between US (70%) and Europe (30%).
- 2.13 A robust hedge funds industry in Singapore will help to extend the range of investment instruments available in Singapore and also contribute to Singapore's development as a premier asset management hub. This will also have beneficial spin-offs to ancillary service sectors such as legal, trustee and custody services, scrip lending and borrowing, prime broking and securities and derivatives distribution.

KEY RECOMMENDATIONS

Recommendation 1 Expand Government's Role in Developing Asset Management Industry

Action Step #1: Develop Start-ups and Small and Medium Sized Fund Managers

- 2.14 Singapore's developmental strategy has focused on encouraging large international traditional fund management companies to expand their activities in Singapore. To build critical mass in asset management activity, Singapore should also: (a) foster strong indigenous firms and develop start-ups; and (b) attract small and medium-sized foreign fund management companies.
- 2.15 Smaller operations tend to be anchored to their start-up domiciles and can form a stable cluster of indigenous firms over time. We recommend that the government play an incubator role, to provide seed capital and take equity stakes in start-ups and small and medium-size fund management companies, both local and foreign.
- 2.16 Incentives should also be given to foreign small and medium sized fund managers to relocate their headquarters to Singapore. Assuming that developmental performance requirements are met, these incentives should be back-loaded, increasing with the length of a firm's presence in Singapore.

2.17 A suitably staffed and supported government agency, such as International Enterprise Singapore, should also make it a priority to promote and support the international marketing of indigenous financial institutions.

2.18 We also recommend that the government focus on broader considerations, such as cost of living, business costs and quality of life. The location of start-up operations, which tend to have few professionals, often depends on livelihood considerations.

Action Step #2: Extend Fund Management Mandates Granted by GIC and MAS

2.19 To strengthen Singapore's position as a centre for managing global mandates, we recommend that GIC and MAS grant mandates other than Asia ex-Japan mandates to be managed by fund managers located in Singapore.

Action Step #3: Provide Funds to Attract Private Equity Players

2.20 The Technopreneurship Investment Fund ("TIF"), which was established to develop the venture capital business in Singapore, was successful in attracting foreign fund managers⁷ to establish operations in Singapore.⁸ This illustrates how the government, through funding, can attract players to Singapore. The US\$1 billion allocated to the TIF is largely invested and a supplementary amount of US\$300 million has been provided.

2.21 We recommend broadening the scope of TIF to include all types of private equity funds, from venture capital to buyouts. As buyout funds tend to be larger than venture capital funds, we recommend that TIF's supplementary fund of US\$300 million be increased.

**Recommendation 2
Boost Competitiveness as a Pre-eminent Asset Management Centre**

Action Step #1: Improve Tax Treatment

2.22 Under the current Singapore tax system, interest income derived by a Singapore resident individual from investing in Singapore interest-bearing instruments will be taxed at the individual's highest applicable marginal tax rate. As unremitted interest income from offshore investments is not subject to Singapore tax, individuals are motivated to move savings offshore and not repatriate these funds.

2.23 The repatriation of offshore Singapore wealth will provide a substantial boost to the local wealth management industry. This will help to anchor

⁷ Fund managers from the US, the UK, Canada, France, Israel, Taiwan and Hong Kong.

⁸ Since the inception of the TIF till 31 March 2002.

financial institutions in Singapore. We propose that tax exemptions be granted for: (a) domestic source investment income and foreign source income remitted to Singapore, and (b) management fee income earned by fund managers from managing funds sourced overseas. This will encourage firms to source for more foreign funds for management in Singapore.

Action Step #2: Review Central Provident Fund (CPF) Structure

2.24 We made specific recommendations to the ERC Sub-committee on Land, Wages, Taxes and CPF on restructuring the CPF. The main aim of our recommendations is to ensure an investment return that can meet the long-term retirement needs of CPF members. We agree with the Sub-committee's finding that the high expense ratios and retail distribution costs of CPFIS unit trust investments erode a significant portion of the terminal value of invested funds. We also agree that the current rates of return on CPF balances are not adequate for retirement funds with a long investment horizon. Because individual CPF members generally do not have access to professional portfolio management expertise or adequate investment information, they are unable to achieve balanced and diversified investment portfolios that can yield lower risks and higher returns over the long-term.

2.25 We therefore recommend that the changes to the CPF be implemented in accordance with the following principles:

- **Aggregation:** CPF members should be given the choice of investing CPF funds in a professionally managed aggregated pool. The aggregation of CPF funds can reduce the administration costs to CPF members. It allows CPF members to benefit from wholesale management fees, and to overcome the relatively high distribution and processing costs under the current CPFIS.
- **Appropriateness:** To achieve a more appropriate risk budgeting over time, the asset allocation of CPF funds should be appropriate to the member's investment time horizon. Under such an approach, often referred to as the "life-cycle" approach to investing, members under the age of 30 should be permitted to invest in an aggregated pool which has an aggressive asset mix largely in equities and alternative assets. There should then be a gradual transition to a higher proportion of bonds and cash as the member transits to successive pools corresponding to his age.
- **Balance:** Members' CPF funds should also be invested in a way as to provide adequate diversification across various asset classes. This will help improve investment returns and lead to greater accumulation and stability of expected retirement assets.

Action Step #3: Improve Investor Education

- 2.26 A long-term public financial education programme should be implemented to promote basic financial planning and money management skills. This can be a joint public and private sector initiative.

Action Step #4: Improve Professional Training

- 2.27 Priority must be placed on the professional training of fund managers, research analysts and private bankers. The local universities do not provide such industry-based training, while companies here tend to under-invest in training and development. The skills shortage is similar to that faced in the foreign exchange (FX) trading market in the 1970s. Then, MAS' initiative to train FX dealers proved critical to Singapore's development as a FX trading hub.
- 2.28 We recommend the establishment of a post-graduate training programme administered jointly between the Investment Management Association of Singapore and a tertiary education institution such as the Singapore Management University, INSEAD or University of Chicago Graduate School of Business. Courses could be jointly conducted by leading industry players and professors from the tertiary institutions. We also recommend that Singapore seek to attract international educational entities such as the Association of Investment Management and Research to base their regional training hubs in Singapore.

Recommendation 3 Increase Focus on Developing Alternative Assets Cluster

Action Step #1: Raise Developmental Focus and Regulatory Responsiveness

- 2.29 We recommend that the authorities have a dedicated focus on developing and promoting the alternative assets cluster. The regulatory environment should be nimble and responsive to ensure that Singapore is an attractive location for the alternative assets cluster. Policies and incentives adopted should accord the alternative assets sub-sector with as high a priority as other asset classes.

Action Step #2: Establish Limited Partnership Structure in Singapore

- 2.30 Alternative investment firms are typically structured as limited partnerships, which are normally regarded as transparent for tax purposes. As such, the partnership is not taxed, and gains distributed to the partners of the partnership would only be subject to tax where the partners are resident.

- 2.31 We endorse the recommendation of the Company Legislation and Regulatory Framework Committee to introduce in Singapore the limited partnership structure.

Action Step #3: Reform Trustees Act

- 2.32 We recommend that the Trustees Act's investment restrictions be lifted or that investments by the statutory boards and GLCs be governed by different legislation. The bulk of funds available for investment in Singapore are concentrated in institutional hands. Many Singapore entities, including statutory boards, are bound by the Trustees Act. The investment guidelines under the Trustees Act, which were intended for the protection of widows and orphans, work against the growth of the asset management industry, as non-retail hedge funds, foreign funds, non-Singapore equities and derivatives are not permitted investments. While the governing council or board can waive the restrictions of the Trustee Act, there is reluctance to do so because of the lack of familiarity with investment products.

Action Step #4: Streamline Tax Incentives for Private Equity into One Single Package

- 2.33 Currently, there are tax incentives for the private equity industry administered by the EDB and the MAS. The schemes are underpinned by different objectives. While the MAS seeks to develop the financial sector in Singapore, the EDB seeks to develop and increase economic activity in Singapore. For example, to qualify for the incentive offered by the EDB, the EDB takes into account the amount of investments made into Singapore or Singapore companies. The MAS incentive does not impose such a requirement. There is a risk of inconsistency in the qualifying conditions imposed by them.
- 2.34 We recommend that comprehensive tax incentives for the private equity industry be implemented. The incentives should apply across all types of private equity funds, and not be restricted to any particular type of fund. There should be incentives for private equity funds and fund management companies. MAS should administer these incentives with the objective of enhancing Singapore's financial sector, while the EDB administers separate incentives targeted at enhancing the competitiveness of investee companies in Singapore.

Action Step #5: Increase Tax Certainty for Private Equity

- 2.35 Tax considerations arise at various levels: (i) taxation of gains made by the fund; (ii) taxation of gains made by the fund management company; (iii) taxation of individual fund managers; and (iv) taxation of gains made by investors in the fund.
- 2.36 In Singapore, the tax treatment is currently not competitive in a number of respects. A fund's investment gains are normally taxed as income,

because the fund would be regarded as being in the business of making investments.

2.37 Even if a fund is established offshore, there is a risk the fund would be taxed in Singapore if it is managed from Singapore. This discourages private equity firms from locating too many of their professionals here, as their fund would risk being characterised as being managed from Singapore.

2.38 Management fees received by fund management companies from the funds would be taxed as income. Hence, offices in Singapore tend to be organised on a “cost-plus” basis.

2.39 The treatment of carried interest received by fund management companies and by private equity professionals is not clear in Singapore. There is a risk that these payments would be regarded as income, as opposed to capital gains, which would work against Singapore from a tax competitiveness viewpoint.

2.40 It is thus recommended that:

- All gains made by a fund and investors in the fund from the divestment of investments should be treated as capital gains, and therefore not subject to income tax in Singapore.
- Carried interest payments made to fund management companies and private equity professionals should be treated as capital gains, and therefore not subject to income tax in Singapore. In various jurisdictions, such as US and Hong Kong, the practice is to treat these payments as capital gains.
- Management fees derived by fund management companies should be tax exempt.

Action Step #6: Establish Favourable Tax Environment for Alternative Investments

2.41 Alternative investment managers are generally disadvantaged vis-à-vis mainstream fund managers in terms of tax. The qualifying criteria for the Approved Fund Manager (AFM) incentive, which requires fund managers to have at least S\$100 million under management and two investment professionals, is biased against start-ups and alternative investment managers. We recommend removing the requirement of a minimum fund size of S\$100 million and two investment professionals for fund managers to qualify for the AFM incentive.

Action Step #7: Upgrade Professional Skills in Private Equity

2.42 Developing talent will be integral to creating a critical mass of investment professionals in Singapore with the skill sets required by private equity

industry. Private equity houses should be encouraged to develop and train private equity professionals.

- 2.43 We recognise and commend the efforts of the Singapore Venture Capital and Private Equity Association to promote a deeper understanding and more widespread awareness of the private equity industry in Singapore. We believe that their efforts to develop an Asia Pacific Venture Capital and Private Equity Institute should be supported, through funding or otherwise.

Action Step #8: Use Private Equity as an Option to help GLCs spin-off non-core assets

- 2.44 Government-Linked Companies (GLCs) will have to continually enhance their core competencies and sharpen their competitive edge in venturing beyond Singapore. The recent release of Temasek Holdings' charter underscores this. Private equity investment is an option for GLCs seeking expansion capital or seeking to divest their non-core assets.

- 2.45 We recommend that the government assist with making GLC managers more aware of and open to private equity as an option, including the possibility of managers leading management buyouts of non-core assets. If these managers succeed, it will give the entrepreneurial drive a strong impetus. While each GLC should continue to act in its own best interests in how it chooses to divest non-core assets, many GLCs may not currently consider private equity as an option that is available to them.

**Recommendation 4
Develop Ancillary Services**

Action Step #1: Develop Trustee and Custody Services

- 2.46 It is recommended that Singapore develop trustee and custody services to support the growth of the wealth management industry. Singapore is well positioned to develop a niche industry in trust services.

- 2.47 We recommend the following initiatives:

- Modernise trust and company legislation;
- Introduce regulatory framework for trust companies, which should include provisions for privacy of information of trusts;
- Further enhance the Approved Trustee Company Tax Incentive Scheme;
- Raise education and professional standards in trust law and related disciplines; and

- Promote industry dialogue with the Society for Trust and Estate Practitioners and Singapore Trustees Association.

Action Step #2: Develop Specialized Legal, Custody and Other Ancillary Services

- 2.48 With the increasing sophistication of investment instruments, the availability of specialised custody, fund administration, legal and accounting services is important to enhance the depth of the wealth management industry.
- 2.49 We recommend that Singapore take concerted steps to attract specialised ancillary services providers, through proactive promotion and incentives.

3 PROCESSING

OVERVIEW

- 3.1 Processing activities remain largely fragmented with no clear regional/global centre for such activities. However, as financial institutions face intensifying pressures to cut costs and refocus on core activities, they will look increasingly towards centralising their processing activities into cost-effective locations, as well as outsourcing some of these activities.
- 3.2 We recommend that Singapore capitalise on the 2 to 3-year window of opportunity arising from these trends by establishing universal processing centres (regional/global outsourcing facilities). Given the relatively low upfront capital investment that is required, this is an inexpensive initiative that could generate substantial benefits, as well as mitigate the current threat of job losses. In the longer term, it will support Singapore's efforts to develop front-office and middle-office activities, and could lead to the anchoring of strong financial services technology companies in Singapore.

KEY CONSIDERATIONS

Global Trends Towards Centralisation and Outsourcing

- 3.3 Financial institutions worldwide are under intensifying pressure to cut costs. This has led to an increased centralisation of processing activities on a regional and even global basis into cost-effective locations. Consolidation enables financial institutions to exploit scale economies, reduce operational risk and improve quality control.
- 3.4 Outsourcing, commonly adopted for data centres and other aspects of information systems management, is beginning to gain traction for many banking and capital markets processing activities. Against spiralling back-office investment costs, outsourcing offers the potential to replace large fixed overheads with a transparent variable cost, based on a "per trade" charge basis. More importantly, outsourcing allows financial institutions to refocus on their core activities.
- 3.5 These trends present both threats and opportunities for the Singapore financial sector.

Threat: Processing Activities Migrating Overseas

- 3.6 Singapore has emerged as one of the preferred locations for international financial institutions to centralise their regional processing activities in the Asia Pacific time zone. For example, Citibank has established a regional cash management centre in Tampines.

3.7 However, with intensifying pressures to cut costs, financial institutions are considering migrating their processing activities to lower factor cost locations.

3.8 Sydney, which enjoys cost advantages in labour and office space as well as a high availability of technology skills, has become an increasingly attractive location for global financial institutions to base their regional processing centres. In addition, many financial institutions are beginning to turn to low-cost countries such as India and China. Such trends could result in the loss of a substantial number of back-office jobs in Singapore over the next 1-2 years.

Current Positioning

3.9 Although disadvantaged by relatively higher factor costs, Singapore has a number of compelling advantages as a processing hub. These include world-class telecommunications and physical infrastructure, a large number of global bank regional headquarters, a stable political environment, a sound and progressive regulatory framework, a strong culture of process efficiency, an educated English-speaking workforce, and a vibrant IT sector.

3.10 Given this competitive profiling, Singapore should actively retain and pursue **high value-added, technology-intensive** processing activities.

Opportunity: Regional/Global Processing Centre

3.11 We believe that Singapore has a compelling proposition to become a regional/global processing centre by offering itself as a **one-stop intermediary** for processing services. To give effect to this, we recommend that Singapore establish universal processing centres (UPCs) – outsourcing facilities that **aggregate transactional volumes** for activities that are highly commoditised, technology-intensive, and associated with large scale economies. UPCs will allow Singapore to overcome factor cost disadvantages through scale economies, and exploit the 2 to 3-year window of opportunity arising from the global trends of centralisation and outsourcing.

3.12 The long-term vision is for Singapore to develop a world-class **cluster** of UPCs, technology companies and related services. We propose a business model under which Singapore will focus on technology development, high value-added processing and middle-office activities, while outsourcing lower value-added processing activities to low-cost countries such as India and China.

Disaster Recovery Services

3.13 Financial institutions set up continuity of business sites for data centres and critical operations like trading and processing. These sites largely comprise rented space, terminals and connectivity. This is a growth market as the events of September 11 have led to increased industry

awareness of, and supervisory attention to, business continuity planning. Recent cross-border tensions have also increased the demand for disaster recovery services by financial institutions in the affected countries. Leading third party disaster recovery service providers tend to focus on data centres and not on processing centres.

- 3.14 We believe that disaster recovery services are a compelling ancillary proposition for UPCs, and Singapore should position to capitalise on this. Given that UPCs need to set up disaster recovery sites for their operations, they could charge financial institutions that have outsourced processing to them for this additional service. UPCs could also offer disaster recovery services to financial institutions that are not already their customers.

Benefits from UPCs

- 3.15 Given the relatively low upfront capital investment that is required, the establishment of UPCs is an inexpensive initiative that could generate substantial benefits, as well as mitigate the current threat of job losses.

Direct Benefits

- 3.16 The establishment of UPCs is defensive in the short-term. By offering financial institutions lower unit processing costs through volume aggregation, the impetus to move processing activities out of Singapore will be reduced. In the medium-term, UPCs are expected to generate hundreds of relatively high-paying jobs and a few hundred million dollars in sustainable annual revenues.

Spin-Off Benefits

- 3.17 UPCs will support Singapore's efforts to develop front-office and middle-office activities. As financial institutions outsource non-core functions to UPCs, they will see improvements in efficiency and competitiveness.
- 3.18 There will also be spin-off benefits for the information, communications and technology industry. In particular, UPCs could lead to the anchoring of strong financial services technology companies in Singapore, which will enhance the financial services ecosystem. The trade sector will also benefit from improvements in the efficiency of trade processing.

Key Success Factors

UPC Structure

- 3.19 UPCs need to offer cost savings in excess of 20% and hence would need to build up scale rapidly to ensure commercial viability. They also need to deliver best-in-class capabilities, particularly in terms of technology, and ensure high processing reliability.

- 3.20 Each UPC should thus be an independent (i.e. maintains an arm’s length relationship with its founding partners), commercially driven “for-profit” company with sufficient segregation and confidentiality measures in place. This would preserve the incentive to increase market share and innovate continually. Each should have at its core a leading technology company and “anchor tenants” to provide scale. Building scale is critical at the outset, and UPCs should adopt a focused product strategy as the technology companies and anchor tenants are distinct for each product.
- 3.21 Each UPC should also have an open structure that allows for the “incentivisation” of new customers. In addition, the ownership structure should minimise political sensitivities that would hinder the UPC’s expansion into the region.

Banking Privacy

- 3.22 In the context of banks in Singapore, the Banking (Amendment) Act 2001 already recognises outsourcing to third parties as an exception to the general banking privacy rule. In the case of financial institutions based in the region, we note that foreign regulators in the region have largely accepted outsourcing, including out-of-country outsourcing. Given that many countries in the region also aspire to be regional processing hubs, we believe that out-of-country outsourcing would be permitted on a reciprocal basis.

KEY RECOMMENDATION

Recommendation Establish Regional/Global Universal Processing Centres (UPCs)

Action Step: Government to Sponsor the Establishment of UPCs

- 3.23 We recommend that the government sponsor the establishment of UPCs by facilitating discussions between strategic partners and injecting investment capital.
- 3.24 UPCs should be eligible for tax incentives such as EDB’s Pioneer Status and Development and Expansion Incentive. Joint development of software by a UPC and its technology partner should qualify for Double Tax Deduction for Research and Development. UPCs should also be eligible for grants on qualifying expenses under MAS’ Innovation in Financial Technology & Infrastructure Grant Scheme.

4 RISK MANAGEMENT

OVERVIEW

- 4.1 Globally, there is insufficient capacity in traditional insurance markets to absorb sudden and specialised risks. At the same time, there are increasing links between banks and insurers through the rapidly growing markets for risk transfer. We believe that Singapore is well placed to capitalise on these developments to position itself as the premier risk management centre in the Asia Pacific region. Key to this strategic thrust would be the establishment of the Asia Risk Exchange (ARX) in Singapore. ARX will provide the physical facility and capital to accept, take, and facilitate the exchange of risks between financial institutions and capital markets.

KEY CONSIDERATIONS

Current Positioning

- 4.2 Singapore is not a significant player in global risk transfer markets. Relatively few insurance risk securitisation deals have been structured from Singapore. Although Singapore is the largest captive domicile in the Asia Pacific region, it is outside the top 10 global positions.

Insufficient Capacity to Absorb Sudden and Specialised Risks

- 4.3 Globally, there is insufficient capacity in traditional insurance markets to absorb sudden and specialised risks. A study on alternative risk transfer (ART) conducted by the European Commission¹ noted that there is insufficient capacity in traditional insurance markets to absorb the losses from large natural catastrophes and certain specialised lines such as medical malpractice. The September 11 attacks have severely constrained capacity further and traditional coverage is not available for some terrorism-related risks.
- 4.4 Financial institutions are responding by pooling capital together to underwrite sudden event and unusual risks to meet the needs of clients, and to co-share the risks of providing coverage. In response to the increased need for terrorism coverage, six leading European insurers and reinsurers – Allianz, Hannover Re, SCOR, Swiss Re, XL Capital and Zurich Financial Services – have recently set up a private insurer to provide solely terrorism cover. This new company, called Special Risk Insurance & Reinsurance Luxembourg (SRIR), is capitalised at US\$430m and will offer the largest capacity for terrorism insurance in Europe.

¹ European Commission ART Market Study Final Report, 2 Oct 2000.

Increasing Links between Banks and Insurers

- 4.5 There are increasing links between banks and insurers through the rapidly growing markets for risk transfer. While banks and insurers are traditionally repositories and managers of risk, increasingly sophisticated capital markets provide alternative risk management solutions such as loan trading, portfolio securitisation, derivatives and other ART methods.
- 4.6 A Bank of England study concluded that the main motivation for firms to engage in cross-sectoral risk transfers is economic.² Firms that structure financial services may not have a comparative advantage in bearing and managing the resulting risks. They would therefore benefit from risk transfer and diversification across other types of exposures.

Rapid Growth and Potential of Risk Transfer Markets

- 4.7 The global risk transfer markets have been growing rapidly in recent years. Over 1995-2001, the asset-backed securities market in the US grew by 333%, while the global collateralised debt obligations market experienced a 300 to 400-fold increase.³ There is also large growth potential for the credit derivatives and insurance securitisation markets (Annex C).

Opportunity: Asia Pacific Risk Management Centre

- 4.8 We believe that Singapore is well placed to capitalise on these developments to position itself as the premier risk management centre in the Asia Pacific region.

KEY RECOMMENDATION

Recommendation Establish Asia Pacific Risk Management Facility

- 4.9 We recommend that Singapore make a strong bid to be at the forefront of risk management and provide solutions for innovative risk transfers in the Asia Pacific region. Key to this strategic thrust is the establishment of a risk management facility – Asia Risk Exchange (ARX) – in Singapore.

ARX

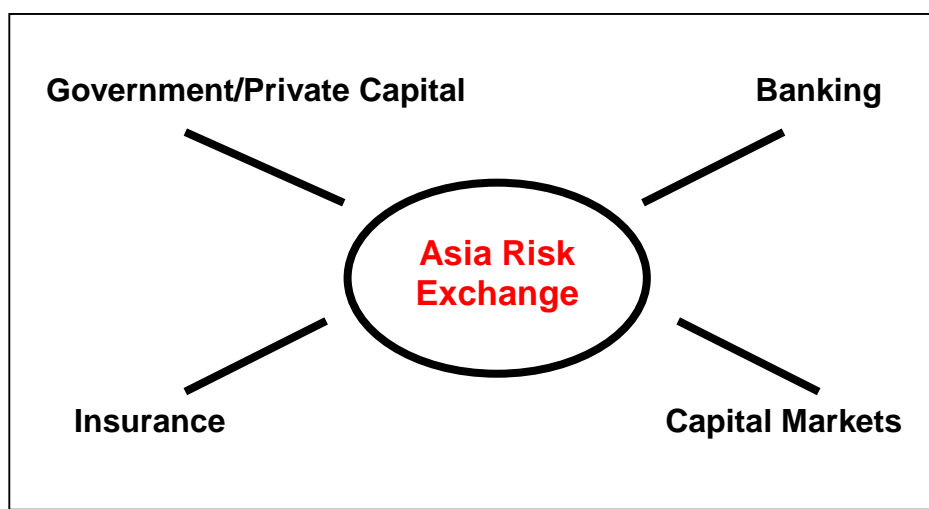
- 4.10 ARX will provide the physical facility and capital to accept, take, and facilitate the exchange of risks between financial institutions and capital markets, i.e. ARX will be the conduit for interaction between banking, insurance and capital markets (Diagram 4.1). It will aim to:

² Rule, D (2001) "Risk transfer between banks, insurance companies and capital markets: an overview", Bank of England Financial Stability Review, December.

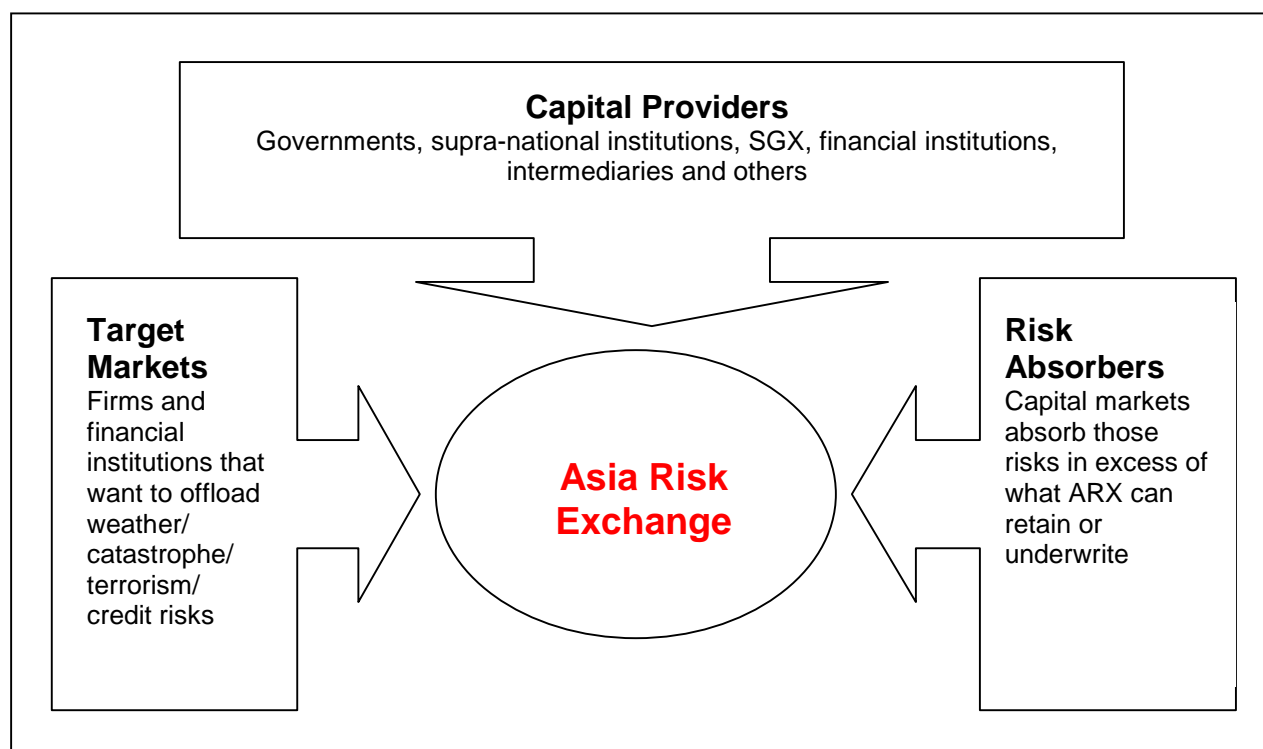
³ Ibid.

- Provide capital to facilitate risk exchange between financial institutions and capital markets;
- Enable banks to hedge residual portfolio risks and credit risks;
- Enable insurers to hedge/insure catastrophic and sudden event risks; and
- Enable capital markets to securitise ARX risks.

Diagram 4.1: ARX – Conduit for Interaction between Financial Institutions and Capital Markets



- 4.11 ARX will be a value-adding institution to the financial landscape (Diagram 4.2). As ARX will primarily undertake risks and exposures which players are unwilling or unable to individually assume, and securitise them for absorption by capital markets, it will not displace existing market players. Instead, we believe that ARX will enhance the financial system's risk management capability. The risks that ARX will undertake include weather/catastrophe/terrorism insurance and large credit exposures. In doing so, ARX will enhance Singapore's risk taking ability and position Singapore as the premier risk management centre in the Asia Pacific region.
- 4.12 It is worth noting that given the market's unmet demand for coverage against complex and sudden risks, the market is already evolving toward solutions that approximate ARX. As noted above, financial institutions are beginning to come together to jointly underwrite some of these risks.

Diagram 4.2: Operation of ARX in Financial Landscape**Action Step #1: Conduct Feasibility Study**

- 4.13 As a prelude to setting up ARX, we recommend conducting a feasibility study to further develop ARX's business plan and structure. The study should involve key industry players to validate the target markets, growth potential, market volumes, as well as identify the product rollout and risk coverage techniques.
- 4.14 The feasibility study should also assess whether a consortium set-up, with collective equity ownership of ARX, is suitable. We believe that potential equity investors in ARX would prefer to invest as part of a consortium as this would spread their individual risk and reduce their individual exposure. A consortium would also allow the partners to combine their expertise beneficially as ARX's intent would be to offer products that would be technically difficult to create. Potential ARX partners could include banks, insurers, SGX, intermediaries such as clearing/settlement and risk index providers, technology service providers, as well as other private and public investors. Seed capital from governments and supra-national institutions would also lend significant weight to ARX's reputation, credibility and success. For a start, we envisage ARX to be capitalised at S\$500m. This initial capitalisation should be adequate for ARX to take on and underwrite complex, specialised risks.

Action Step #2: Develop Regulatory Structure

- 4.15 The feasibility study should also identify the most appropriate structure for ARX with respect to its risk-taking and risk transfer activities. We believe that it is important to engage the authorities in discussions regarding ARX's regulatory and legislative implications. A proper prudential framework for ARX would lend comfort to and safeguard the interests of users and investors.

5 BUSINESS ENVIRONMENT

OVERVIEW

- 5.1 Singapore's development as a pre-eminent financial centre in Asia must be underpinned by the existence of an attractive business environment for financial institutions and a desirable quality of life for professionals. Effective promotion to communicate Singapore's value proposition and financial sector opportunities is important to attract financial institutions and talent to Singapore. A deep pool of financial sector expertise, pro-business government policies, both fiscal and administrative, and modern physical infrastructure are key components of an attractive business environment. This chapter makes specific recommendations to create an attractive environment, focusing on promotion of Singapore's financial centre, education and training, taxation policies and business infrastructure.

(A) FINANCIAL SERVICES PROMOTION

INTRODUCTION

- 5.2 Effective communication of Singapore's value proposition as a financial services hub will raise Singapore's international profile and attract quality financial institutions and financial sector professionals.

KEY CONSIDERATIONS

Public and Private Sector Roles

- 5.3 The MAS is the lead public agency with the mandate to develop and promote the financial services industry. The twin functions of financial sector regulation and promotion are performed within the MAS as financial services is a specialised area where domain knowledge and awareness of regulatory objectives and developments are critical to effective promotion.
- 5.4 The private sector plays an important role in financial services promotion, but has different incentives from the public sector. The private sector does not have a natural incentive to lead efforts in inward promotion, i.e. attracting foreign financial institutions to locate or expand in Singapore, as this would increase competition. It is primarily motivated towards outward promotion, i.e. promoting its services to overseas markets.
- 5.5 There is therefore scope for the private sector and industry associations in Singapore to be more proactive in industry development and promotion. The private sector plays an active role in services promotion in several

other countries. In London, the International Financial Services, London (IFSL), a private sector organization funded mainly by member subscriptions, promotes the international activities of UK-based financial institutions and related business services. London First, also private sector-driven, promotes London as a location for business investment and development across all industry sectors. Hong Kong and the US have private sector Coalitions of Service Industries, representing the services sector as a whole. These groups represent private sector interest, provide a focal liaison point with government, and engage in services negotiations in international forums such as the WTO.

KEY RECOMMENDATIONS

Recommendation 1 Enhance Public-Private Sector Cooperation in Promotion

Action Step #1: Establish the “Friends of Singapore” Network

- 5.6 We recommend that a “Friends of Singapore” network of professionals overseas be established by MAS. This will create a network whereby financial professionals with prior working experience in Singapore can be regularly informed of developments in Singapore and play the role of informal ambassadors of Singapore. The network can also be extended beyond financial services.

Action Step #2: Establish Regular Forums and Dialogue Sessions

- 5.7 We recommend that forums and dialogue sessions be held regularly between the MAS and the private sector, including the industry associations, to foster closer interaction and draw the private sector more actively into industry development and promotion issues. Regular forums and dialogue sessions would serve as feedback channels and platforms for industry networking.
- 5.8 MAS should consider providing funding assistance to industry associations for strategic promotion initiatives.

Action Step #3: Use Private Sector Endorsement

- 5.9 Private sector testimony of the attractiveness of Singapore as a financial services hub add credibility to Singapore’s proposition. MAS should continue to use private sector endorsement, where appropriate, to enhance the effectiveness of its promotion initiatives.

Recommendation 2 Increase the International Profile of Singapore's Financial Sector

Action Step #1: Attract High-Profile Conferences to Singapore

- 5.10 Hosting financial conferences in Singapore will help to increase the international profile of Singapore's financial sector. Singapore has managed to attract a number of international and regional financial conferences to be hosted here. We recommend that the government take concerted steps, by way of financial support, endorsement or assistance in fielding speakers, to attract key financial conferences to Singapore, particularly those on wealth management and risk management.

Action Step #2: Improve Singapore's Public Relations and Brand Internationally

- 5.11 We support the ongoing initiative of the government to review Singapore's branding and project a positive perception of Singapore internationally. The government should consider how the branding of Singapore's financial sector specifically can best be enhanced.

(B) EDUCATION AND TRAINING

INTRODUCTION

- 5.12 Singapore should develop itself as a centre of excellence for education and training in financial services. This should be promoted to raise the international profile of Singapore's financial sector, as well as to attract talent and financial sector players to Singapore.
- 5.13 We recommend a sharper focus and higher profile for efforts currently undertaken to address manpower capability gaps and develop education and training facilities in Singapore, especially for the target sub-sectors that Singapore wants to develop.

KEY CONSIDERATIONS

Need for Domestic Talent

- 5.14 Singapore has relied on foreign talent to meet the demand for expertise in specialist and management positions, achieving this through a relatively open immigration policy and by lowering personal tax rates. Over the longer term, Singapore needs to ensure greater availability of a deep pool of skilled financial sector manpower domestically. While this would not replace the need to tap talent from overseas, it will help develop local talent and address the shortage of expertise here.

- 5.15 The MAS and the Institute of Banking and Finance (IBF) play key roles in driving and executing initiatives on financial services education and training in Singapore. The MAS also administers a funding scheme, the Financial Sector Development Fund (FSDF), for education and training programmes. (See Annex D1 for a description of these roles.)

KEY RECOMMENDATIONS

Recommendation 1 Sharpen Focus and Raise Priority of Education and Training Initiatives

Action Step #1: Establish Clear National Mandate and Introduce Accountability for Progress

- 5.16 A clear national mandate and strategic vision should be established for effective oversight of education and training initiatives. Accountability for progress, in the form of tangible targets and results, should be introduced.

Action Step #2: Increase Working-Level Resources

- 5.17 We recommend that resources within MAS be increased to support the implementation of education and training initiatives.

Action Step #3: Review Minimum Standards

- 5.18 We propose a review be undertaken with the industry groups on the need to set minimum standards for financial sector professionals, where appropriate. Such standards would address the need for continuing education, requirements for tertiary education and the desirability of examinations for membership.

Action Step #4: Establish Accreditation Systems

- 5.19 We recommend that accreditation systems, where appropriate, be established for institutions providing financial services education and training programmes. Accreditation can be accorded for areas of specialisation, such as risk management and fund management. A successful accreditation system would ensure quality control amongst training providers and attract professionals to Singapore.

Action Step #5: Strengthen Financial Services Research

- 5.20 Strong ties between academia and the financial services industry exist in financial centres like New York, London and Chicago. This should be fostered in Singapore, as research is a source of innovative practical applications, as well as expertise for specialities and sub-specialities in finance. Stronger industry participation in universities should also be encouraged, in particular, through appointment of adjunct professorships.

Action Step #6: Industry Associations to Play Greater Role

- 5.21 Industry associations, which best understand the needs of members, should play a greater role in driving and supporting professional education of their members and consumer education, where appropriate.

Recommendation 2
Raise International Profile of Singapore's Education and Training Environment

Action Step #1: Promote Singapore as a Premier Education Hub

- 5.22 We recommend that Singapore be promoted as a premier education location to those interested in financial services careers. This would involve establishing a credentialed education culture in Singapore through the combination of recognised accreditation and quality education, training and research facilities.

RECOMMENDATIONS FOR SPECIFIC SUB-SECTORS

- 5.23 Specific recommendations on education and training in earlier chapters of this report are referenced in Table 5.1.

Table 5.1: Specific Recommendations on Education and Training

S/No	Recommendations	Objectives	Para No.
	Wealth Management		
1.	<ul style="list-style-type: none"> To establish a post-graduate training programme administered between the Investment Management Association of Singapore and a tertiary institution. To attract international educational entities, such as the Association of Investment Management and Research, to base their regional training hubs in Singapore. 	<ul style="list-style-type: none"> To improve professional training for the wealth management industry. 	2.27-28

S/No	Recommendations	Objectives	Para No.
2.	<ul style="list-style-type: none"> Government to support efforts by the Singapore Venture Capital and Private Equity Association to develop an Asia Pacific Venture Capital and Private Equity Institute, through funding or otherwise. 	<ul style="list-style-type: none"> To develop professional skills for the private equity industry. 	2.42-43

(C) TAXATION

INTRODUCTION

5.24 Tax-friendly conditions are essential to creating an attractive business environment. While tax is only one factor in deciding where to locate business operations, it is often a significant factor for consideration, especially with increasing labour and capital mobility.

5.25 We recommend that to maintain Singapore's domestic competitiveness as a financial centre, there should be a general shift in resources from the public sector to the private sector through reduced tax collections. The use of targeted tax incentives should also be maintained, as this would give Singapore an edge in attracting expertise and higher-value added financial activities.

5.26 We note the tax measures announced at Budget 2002 and welcome in particular the reduction in personal and corporate tax rates and incentives introduced for the financial sector.

KEY RECOMMENDATIONS

Recommendation 1 Further Enhance Singapore's Tax Environment

Action Step #1: Exempt Domestic Source Investment Income and Foreign Source Income Remitted to Singapore Resident Individuals

5.27 The current tax system encourages the movement of excess funds offshore, due to the taxation of foreign source income on a receipts basis and taxation of investment income at the Singapore resident individual's marginal tax rate. This is detrimental to the economy as capital is moved offshore to generate savings income, thereby stimulating foreign

economies rather than Singapore's. Once offshore, there is no incentive to bring the funds back to Singapore.

- 5.28 To stimulate the further growth of the wealth management sector in Singapore, tax exemption on domestic source investment income and foreign source income should be provided to individuals to encourage savings and investment in the domestic market.

Action Step #2: Enhance Group Relief Provisions

- 5.29 We recommend that the proposed group relief provisions be enhanced. Many financial institutions, due to regulatory and legal constraints, operate through different forms of legal entities, some of which sustain tax gains and others, losses. The grouping of such gains and losses can help to reduce overall business costs. The measures recommended below would closely align group relief provisions to those in the UK.

- 5.30 We recommend the removal of the requirement to have a Singapore holding company structure in order to enjoy group relief provisions. Many foreign financial institutions based in Singapore do not have such a structure for commercial reasons, as it creates additional costs and administrative burden and may result in adverse tax issues in the home country.

- 5.31 We also recommend that group relief measures be extended to branches of foreign companies.

Action Step #3: Improve Foreign Tax Credit Mechanism

- 5.32 The current basis of granting relief for foreign taxes is ineffective. Credits are granted on a source-by-source basis. Many forms of foreign source income not covered by treaties are granted no relief or minimal relief, although the unilateral tax system is expanded to all services income from non-treaty countries in the recent budget.

- 5.33 The current system still results in inefficiencies from investing into both higher tax and lower tax jurisdictions, particularly with credits only given for taxes paid at the first tier. This results in double taxation of income through domestic holding company structures used in such countries as Indonesia and New Zealand. It is not always effective or in fact possible to invest directly into an operating company. Hence, companies invest into a holding company structure, which then owns the operating company. With domestic dividends being exempt from tax in the domestic holding company, this results in a loss of the foreign tax credits in Singapore when the dividend from the operating company is paid by the holding company to the Singapore parent. Countries like the US and the UK adopt measures to allow foreign tax credits for more than the first tier of investment.

- 5.34 Furthermore, banks with profitable foreign branches and subsidiaries but with losses in the Singapore operations are required to absorb the

domestic losses when the income is remitted into Singapore (to enable payment of a dividend by the Singapore company, for example). Further, the foreign taxes applicable to the foreign source income are lost. In a profitable situation, no additional Singapore tax would have been payable because of the higher foreign taxes paid. In a loss situation, however, the losses are utilised against income that would not ordinarily have been subject to Singapore tax and the resulting excess foreign tax credits lost. It would therefore seem inequitable that foreign profits remitted to Singapore in the form of a dividend or branch profit remittance should reduce the amount of Singapore losses available for carry forward against future Singapore based profits.

5.35 We would like to propose the following measures for consideration:

- Removal of the one-tier system for foreign tax credit relief, i.e. allow Singapore holding companies to claim foreign tax credits in respect of underlying tax paid by foreign related companies and branches beyond the first tier.
- In cases where the Singapore operations are loss-making, for foreign source dividends (or foreign branch profits) with foreign tax paid in excess of the Singapore tax, that would have been payable had the Singapore operations been profitable, there should be no utilisation of Singapore losses against the foreign income, i.e. the foreign remittances are treated separately from the Singapore losses. Only in cases where the foreign tax paid is less than the Singapore tax are the losses used against the additional Singapore tax payable. This would create equitable treatment for foreign income in both profitable and loss making situations and would fit in with the move to a one-tier system on Singapore dividends.
- Grouping of foreign tax credits by income type to allow greater utilisation of foreign taxes and carry forward of excess credits.

Action Step #4: Enhance Not Ordinarily Resident Taxpayer Scheme

5.36 Under the Not Ordinarily Resident (NOR) Taxpayer Scheme announced in Budget 2002, the employer's contributions to overseas pension funds on behalf of a non-citizen NOR taxpayer, is now exempt from income tax in the hands of the employee, subject to CPF capping rules.

5.37 To attract global talent to Singapore, we propose to allow non-citizen NOR taxpayers to claim tax deduction on their contributions to overseas pension funds. Presently, the employee's contribution to overseas pension funds is non-tax deductible. This is less favourable than for Singaporeans, who can claim tax deduction on their CPF contributions.

Action Step #5: Clarify Withholding Tax Treatment

5.38 The Treasury Industry Incentive provides withholding tax exemptions on over-the-counter financial derivatives for Asian Currency Units and

Approved Securities Companies. There is some confusion in the industry regarding this and certain ad-hoc exemptions. The Inland Revenue Authority of Singapore (IRAS) views payments under derivative contracts as interest in nature or payments in connection with an indebtedness, and hence subject to withholding tax unless specifically exempted (Annex D2 lists the existing exemptions). However, the exemption under Section 13(4) covers only interest rate and currency swaps and the new incentive only covers qualifying transactions. Treatment of other derivative instruments, e.g. equity swaps, forwards, caps and collars, remains unclear. In addition, transactions between non-financial institutions in Singapore and non-residents are not covered under the current exemption.

- 5.39 The existing treatment inhibits financial innovation in Singapore. The OECD does not regard swap payments as interest where there is no underlying debt (as in the case of interest rate swaps). Further, countries such as Hong Kong, USA, UK, Japan and Australia also do not tax cross-border derivative payments at source (i.e. no withholding tax).
- 5.40 We recommend that broad-based exemption of withholding tax in respect of bona fide derivative payments be adopted and specific anti-avoidance provisions be introduced to deal with tax abuse, should it arise.

Action Step #6: Allow Mark-to-Market Accounting for Approved Finance and Treasury Centres

- 5.41 Approved Finance and Treasury Centres should be allowed to opt for the same concession as that granted to banks in accounting for their profits on a mark-to-market basis for tax purposes.

RECOMMENDATIONS FOR SPECIFIC SUB-SECTORS

- 5.42 Specific recommendations on taxation in earlier chapters of this report are referenced in Table 5.2.

Table 5.2: Recommendations on Taxation

S/No	Recommendations	Objectives	Para No.
Wealth Management			
1.	<u>Asset Management</u> <ul style="list-style-type: none"> • To grant tax exemption to asset management companies for fee income derived by fund management companies from managing offshore funds. 	<ul style="list-style-type: none"> • To encourage firms to source foreign funds for management in Singapore. 	2.22-23
2.	<u>Private Equity</u> <ul style="list-style-type: none"> • To streamline the tax incentives currently administered by EDB and MAS for the private equity industry into one single package. 	<ul style="list-style-type: none"> • To ensure that tax incentives are comprehensive and cover all types of private equity activity. 	2.33-34
	<ul style="list-style-type: none"> • To increase tax certainty by: <ol style="list-style-type: none"> a) Treating all gains made by a fund and investors in the fund from divestments of investments as capital gains, and hence not subject to income tax. b) Treating carried interest payments made to fund management companies and private equity professionals as capital gains, and hence not subject to income tax. c) Exempting management fees derived by fund management companies from tax. 	<ul style="list-style-type: none"> • To improve Singapore's tax competitiveness and encourage private equity activity in Singapore. 	2.35-40

(D) Business Infrastructure

INTRODUCTION

- 5.43 Business infrastructure and technology are important factors in developing the financial services industry. Financial institutions will prefer to locate where modern and high-quality building facilities are available, if other factors such as market opportunities, political stability, regulatory and tax policies and talent availability are comparable.
- 5.44 As Singapore competes with regional financial centres, it must plan ahead strategically to ensure its business infrastructure and amenities are internationally competitive and relevant to the changing needs of financial institutions.

KEY RECOMMENDATIONS

Recommendation 1 Provide State-of-the-Art Building Facilities for the Financial Sector

- 5.45 We recognise the merits of developing state-of-the-art building facilities and amenities that cater to the requirements of the financial sector. Similar projects to provide modern infrastructure undertaken in other financial centres include the development of Canary Wharf in London and World Financial Centre in New York. These developments have been flexible in catering to the development needs of banks as they expanded. Asian cities such as Hong Kong and Tokyo are also developing integrated projects tailored to the needs of financial institutions.
- 5.46 Singapore's financial sector is presently based at Raffles Place and Shenton Way where most buildings are inefficient and getting obsolete. They no longer sufficiently cater to the needs of large financial institutions, which include column-free, large floor plates, flexible and scalable designs, high ceiling height, raised floors and uninterrupted power supply. Looking forward to the next 5 to 10 years, it is important that Singapore plans for the availability of such facilities to support the requirements of the large global financial players.

A1 COMPOSITION OF THE FINANCIAL SERVICES WORKING GROUP (FSWG)

Mr Robert Stein (Chairman)	Chairman and Chief Executive Officer Adelphi Capital Partners Pte Ltd
	Senior Advisor, Private Clients and Asset Management, Deutsche Bank Group (until July 2002)
Mr Mark Daniell	Managing Director Bain & Company (Asia)
Mr Tileman Fischer	Chief Executive Officer Allianz AG Reinsurance Branch Asia Pacific
Mr David Gibson	Managing Director, Asia Pacific Schroders
Mr Venky Krishnakumar	Vice President and Regional Director, Operations and Technology, Asia Pacific Citibank
Mr Eugene Lai	Managing Director, Asia The Carlyle Group
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	Managing Director DBS Bank
Mr Stephen Stonefield	Vice Chairman Credit Suisse First Boston
Dr Teh Kok Peng	President GIC Special Investments Pte Ltd

Ms Teo Swee Lian

Assistant Managing Director (Development
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Mr Tracy Wolstencroft

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(until July 2002)

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Ms Ho Ching	Executive Director Temasek Holdings
Mr Lee Seng Wee	Chairman Oversea-Chinese Banking Corporation
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Mr Colm McCarthy	President, Asia Bank of America
Prof Robert C Merton	Professor Harvard Business School
Mr Kai Nargolwala	Group Executive Director Standard Chartered Bank
Mr Hubert Neiss	Chairman (Asia) Deutsche Bank AG, Asia Pacific Head Office
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Mr Wee Cho Yaw

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United Overseas Bank Ltd

Ms Jeanette Wong

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Officer,
JPMorgan Chase Bank

Dr Y Y Wong

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Monetary Authority of Singapore

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Mr Paul Chung

Ms Sandy Ho

Ms Alison Lim

Mr Gary Tan

Mr Edgar Teo

Economic Development Board

Ms Irene Yeo

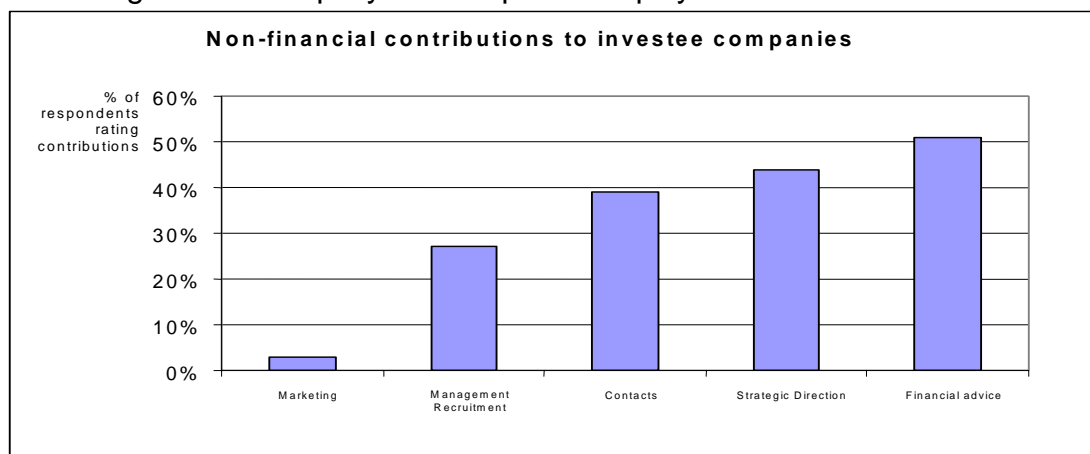
B CASE FOR PRIVATE EQUITY

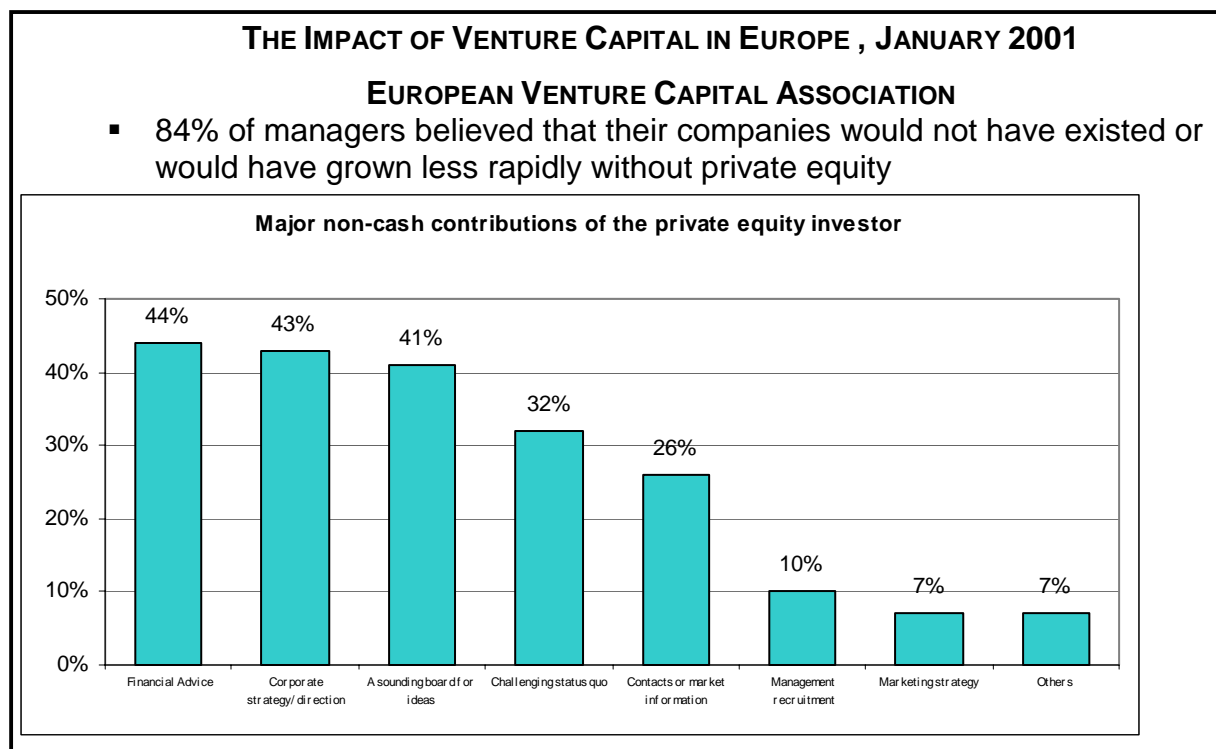
PRIVATE EQUITY TRANSFORMS COMPANIES

B.1 Private equity is a significant source of capital to fund entrepreneurs, growth and restructuring. Private equity professionals add value by providing financial advice, strategic direction, a sounding board for ideas, market information, and their network of international contacts. The two tables below show the various value-added activities attributed to private equity by managers of investee companies in the United Kingdom and Europe.

THE ECONOMIC IMPACT OF PRIVATE EQUITY IN THE UK 2001 BRITISH VENTURE CAPITAL ASSOCIATION

- 87% of managers believed that their companies would not have existed or would have grown less rapidly without private equity





PRIVATE EQUITY TRANSFORMS THE ECONOMY

- B.2** The growth of the buyout private equity business in the US has been an important element in the strength of its economy over the last decade. Buyout fund managers have bought out under performing businesses, introduced better corporate governance, aligned incentives, and recruited management. The impact of their activities has extended beyond the companies they invested in. Because buyout firms have bought over under performing public companies, they have spurred public companies to restructure themselves to be competitive with the returns delivered by buyout firms.
- B.3** Just as in Europe, where the US model helped kick start the buyout business, the buyout industry would also represent a vehicle for global best practices to disseminate throughout Asia. By encouraging US and European buyout funds to set up in Singapore, we could become the hub from which such best practices radiate across the region. It would represent an extension of Singapore’s role, both as a regional financial centre and regional MNC headquarters.
- B.4** Private equity boosts the economy through the success of investee companies, as indicated in the chart below on the U.K. and Europe.

THE ECONOMIC IMPACT OF PRIVATE EQUITY IN THE UK 2001
BRITISH VENTURE CAPITAL ASSOCIATION

Sales Revenue

- Investee companies' sales rose by 27% per annum, 2¼ times higher than those for FTSE 100 companies, and just under 2 times higher than those for FTSE mid-250 companies.

Job Creation

- The number of people employed by investee companies increased by an average of 29% per annum, against a national private sector employment growth rate of just over 2% per annum.

Export Sales

- Exports of investee companies grew by 27% per annum, compared with a national growth rate of 4.4%.

THE IMPACT OF VENTURE CAPITAL IN EUROPE , JANUARY 2001
EUROPEAN VENTURE CAPITAL ASSOCIATION

Sales Revenue

- Investee companies' sales increased sales by 35% per annum, 11% more than the top 500 European companies.

Job Creation

- Employment grew more than 7 times faster in investee companies compared to the top European companies.

Export Sales

- Exports sales of investee companies grew more than 30% a year.

Research and Development Expenditure

- Research and Development Expenditure represented a 8.6% of total sales compared with 1.3% for the top European companies.

C POTENTIAL OF CREDIT DERIVATIVES AND INSURANCE SECURITISATION

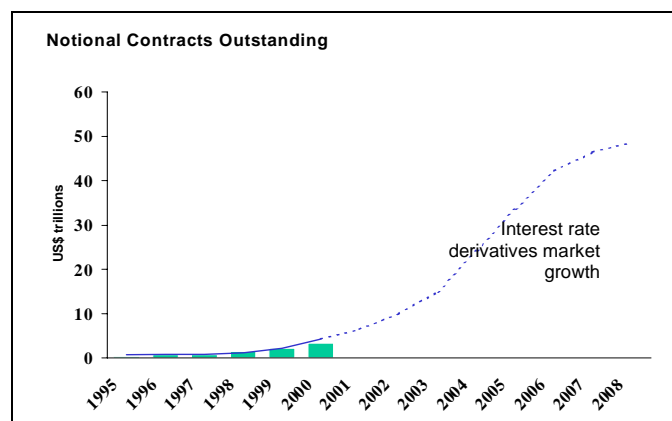
C.1 We believe that two risk transfer markets – credit derivatives and insurance securitisation – have large growth potential. In view of this, we recommend that these products be considered as the initial products for ARX.

CREDIT DERIVATIVES

C.2 Credit derivatives are swap, forward, and option contracts that transfer risk and return from one counterparty to another without actually transferring the ownership of the underlying assets. There are many types/models of credit derivatives, the most commonly used being credit default swaps and total return swaps.

C.3 Based on the growth of the interest rate derivatives market, the implied growth of the credit derivatives market will be spectacular (Chart C.1). JP Morgan estimates that over the past few years, several thousand contracts have been triggered and settled, resulting in the transfer of several billion dollars of credit losses.¹

Chart C.1: Implied Growth of the Credit Derivatives Market



Source: "Credit Derivatives Update 2002", Euromoney, Mar 2002

INSURANCE SECURITISATION

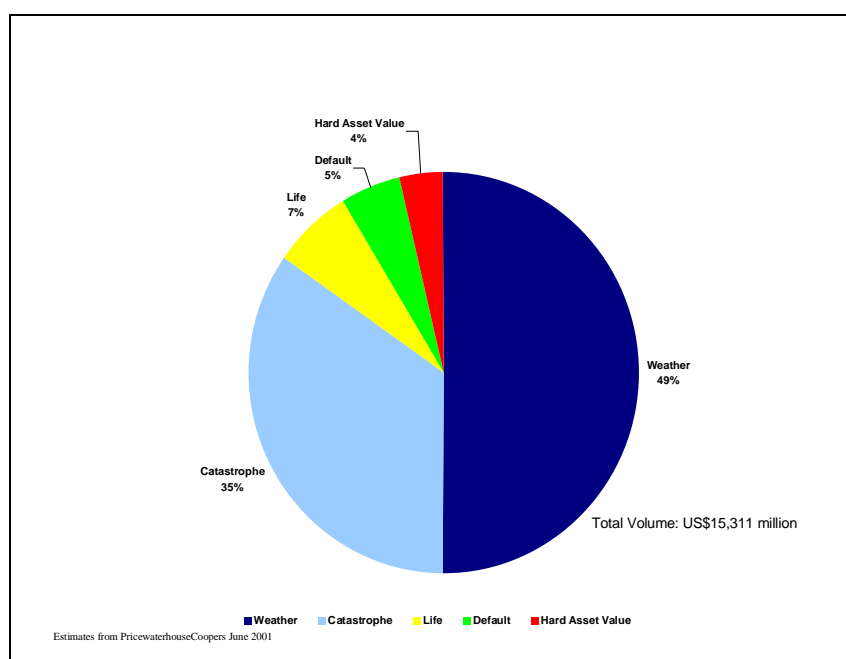
C.4 "Securitisation" occurs when a company uses a financial instrument instead of an insurance or reinsurance contract to transfer risk. The

¹ "Credit Derivatives Update 2002", Euromoney, Mar 2002.

securitised risk products most frequently used to transfer risk have been various types of bonds, but equity instruments are also possible.

C.5 Insurance companies have been actively offloading risks from their portfolios to the capital markets. The size of the insurance securitisation and derivatives markets is estimated to be about US\$15 billion (Chart C.2). It is believed that the trend towards insurance securitisation will continue to increase as the exposure value to catastrophe losses increases, and insurers and reinsurers alike seek to limit their potential exposures. At the same time, sophisticated investors looking to deploy their capital resources efficiently are turning to insurance securitisation products to maximise their returns.²

Chart C.2: Sectors of the Insurance Securitisation and Derivatives Markets



² Source: "Securitisation of Insurance Risk", Dr Alan Punter, AON, Apr 1999.

D1 ROLES OF MAS AND IBF ON EDUCATION AND TRAINING IN FINANCIAL SERVICES

Roles of MAS and IBF	
MAS	<ul style="list-style-type: none"> • Assesses manpower capability needs, through monitoring present and anticipated skills gaps in the financial sector. • Attracts tertiary institutions, training providers and corporate training centres to establish training programmes in Singapore. • Encourages financial services research activity in academic institutions and the establishment of think tanks or research institutes that focus on the financial sector.
FSDF	<ul style="list-style-type: none"> • The Financial Sector Development Fund (FSDF) is administered by the FSDF Secretariat, which is staffed by MAS. The FSDF provides grants to financial institutions for executive training of staff and to training providers for set-up or operational costs. The FSDF Advisory Committee, which has senior representation from the financial sector, MAS and Ministry of Manpower (MOM), provides direction and advice to the FSDF Secretariat on its schemes.
IBF	<ul style="list-style-type: none"> • Acts as facilitator between financial institutions and financial training providers on training needs. The IBF is advised by its Council, which comprises senior persons in the financial sector, MAS and MOM. • Examines, with regulators and industry groups, the need to establish minimum standards for its participants. • Facilitates the establishment of quality education and training programmes in Singapore.

D2 EXEMPTIONS FOR WITHHOLDING TAX

- Ministerial remission for inter-bank/inter-branch payments under Section 12(6);
- OTC derivatives under the new tax incentive to encourage growth of the derivatives market;
- Bona fide interest rate and currency swap payments under Section 13(4);
- Ministerial discretion under Section 13(4) on a case-by-case basis; and
- Exemption under the "Business Profits" Article under the relevant tax treaties.

