Annex 1

Recommendations of the Debt Capital Market Working Group

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Response by the Monetary Authority of Singapore (MAS)

	Group's Observations & Recommendations / MAS' Comments
	[A]Boosting the Singapore Government Securities (SGS) market.
	(i) Creating the Benchmark The issue of 10-year maturity SGS bonds as well as the commitment to issue more SGS to create a free float over and above the banks' captive requirement is commendable. To create a greater liquid benchmark, the Group feels that reopening issues to increase the size of the issue, rather than new issuance, would be more beneficial.
	<ins>Recommendation 1</ins> To reopen more issues, rather than launch new issues, to achieve an increase in size for a liquid benchmark. <ins>MAS' Comments</ins> MAS will consider reopening existing benchmark issues to increase the size for a liquid benchmark as appropriate, after taking into account primary dealers' feedback on market demand and preferences.
	(ii) Withholding tax At the Budget announced by Minister for Finance in February 1998, the Minister had extended the package of bond incentives to cover SGS. This has created a situation where SGS issued prior to 28 February 1998 do not qualify for the withholding tax exemption while those issued after this date are eligible. This resulted in two distinct classes of SGS especially in instances of reopened SGS issues. The same problem arose for issues under various tranches of Medium Term Note (MTN) Programmes issued before and after 28 February 1998. With the growing interest in the trading of SGS and bond issues, the Group feels that uniform tax treatment should apply as this would facilitate trading and therefore

liquidity in the market.

Recommendation 2

To allow SGS and tranches under the MTN programmes issued prior to 28 February 1998 to qualify for witholding tax.

MOF / MAS? Comments

No. Tax concessions / incentives granted do not have retrospective effect. For re-opened issues, MAS? circular of 26 Apr 1999 has clarified that where an SGS issue was originally made before 28 Feb 1998 but re-opened thereafter, the re-opened issue would not be regarded as qualifying debt securities (i.e. the treatment for bonds issued under the re-opening will be the same as the bonds originally issued)

(iii) Master Repurchase Agreement (Repo)

Presently, the Master Repurchase Agreement signed by most SGS market players does not follow the standard ISMA documentation. As a result, a number of foreign banks have been unable to obtain approval from their Head Offices to be a participant under the current Master Repo Agreement. While the Group recognises that it is normal for differences in repo documents between local and international markets, standardising the Master Repo Agreement to follow ISMA documentation would encourage greater participation by foreign banks in transacting repos in SGS.

Recommendation 3

To standardise the Master Repo Agreement used by the SGS market players to be in line with the internationally accepted ISMA repo documentation.

MAS' Comments

Agree. MAS is working with the primary dealers to adapt the PSA-ISMA Repo Agreement to the SGS market.

(iv) Registered Dealers

To further increase liquidity in the SGS market, a system of registered dealers in addition to the current pool of primary dealers would be beneficial. The distinction of registered dealers from primary dealers would be that they would only be able to bid for SGS directly for their own account, and would have a lower or no underwriting commitment and a smaller market making responsibility. Registered dealers would however have direct access to MAS' repo facilities.

The role of a registered dealer is especially appealing to foreign banks who have either a restricted or offshore bank licence status as the lack of retail deposits will not seriously impact their ability to trade SGS. The Group believes that there would be demand for positions as registered dealers.

Recommendation 4

MAS to reactivate the system of registered dealers.

MAS' Comments

No. The market making responsibility of primary dealers is an important element in generating liquidity in the SGS market. Any bank or non-bank investor who wishes to buy or sell SGS can do so in the market, as primary dealers are committed to quote two-way prices under all market conditions.

With the increased activity in the SGS market, there is more scope to increase the number of primary dealers to provide greater liquidity to the market. MAS welcomes more qualifying banks to become SGS primary dealers instead of having another category of dealers with "smaller market making responsibilities". Liquidity in the SGS market can also be enhanced with the establishment of commercial brokers.

[B] Encouraging issuance / arrangement / trading of debt securities

The Group feels that it is important to look into ways to encourage and promote debt issuance in Singapore as this would also attract more intermediaries to Singapore. The Group is encouraged that the government has been successful in bringing the statutory boards to the market. The Group is also encouraged by the policy to allow foreign entities to issue S$ bonds. This would create a good mix of both domestic and foreign issuers and will help to provide a variety of papers in the market. The guidelines on asset securitisation for financial institutions which MAS is presently finalising, will encourage securitisation deals and add to the variety in the market. The maintenance of minimum cash balance (MCB) and minimum liquid assets (MLA) requirements on S$ funds received by banks from non-bank customers via currency swaps related to S$ bond issuance impedes competitive pricing, and discourages S$ bond issuance. However, the Group notes that MAS had subsequently issued a circular on 16 October 1998 (MAS Notice 613) exempting banks from maintaining the MCB and MLA requirements on such S$ funds received. This is a welcomed move which is in line with international practice, and has facilitated the issuance of S$ bonds by foreign entities.

(v) Treatment of S$ Swaps by Offshore Banks

Presently, offshore banks are disadvantaged in arranging S$ debt issuance for foreign entities because they are not able to provide the corresponding swap out of S$ to foreign currencies due to the position taken by MAS that the S$ received from the swaps constitute the receipt of S$ deposits from residents. The Group feels that there may be room to allow offshore banks to enter into such S$ swaps, which are transacted in relation to S$ bond issues arranged by them. Some of the offshore banks have good relationships with reputable foreign corporates and supranationals, and would be able to add variety to the bond market by bringing different types of issuers to the market. As all S$ bond issues by foreign entities require MAS' approval, MAS would still be able to retain control over the amount of such S$ swaps transacted by offshore banks.

Recommendation 5

MAS to consider allowing offshore banks to transact S$ swaps which are done in relation to S$ bond issues by foreign entities which are arranged by them.

MAS' Comments

Yes. As part of the May 99 banking liberalisation package, MAS had announced that offshore banks will be given greater flexibility in S$ wholesale business. Specifically, all offshore banks are allowed to accept S$ funds from non-bank customers through currency swaps, where the S$ funds are the proceeds raised by the non-bank customer through a S$ bond issue managed or arranged by the respective offshore bank. However, Qualifying Offshore Banks will be allowed to accept S$ funds from non-bank customers through currency swaps regardless of the source of the S$ funds.

(vi) Repurchase Agreements S$20m limit with non-residents

An efficient repurchase agreement (repo) market would increase the liquidity in a bond market and would encourage trading as well. The development of a highly liquid repo market is a critical component for the successful development of the SGS and S$ debt market. An active repo market enables investors and primary dealers to finance their inventories and hedge their S$ debt positions. The recent initiative to allow banks to transact S$ repos of up to S$20m with non-bank non-residents is a move in the right direction. However, the limit of S$20m is too small and will not help to stimulate and develop the market, since international investors often transact in much larger amounts.

Recommendation 6

To remove the S$20m limit for non-bank non-residents. Alternatively, if this is too onerous a requirement at this point in time, the group recommends that MAS raise the limit to S$100m.

MAS' Comments

Will study further. The S$20 million limit is a consultation limit. Applications to transact repos above S$20 million may still be allowed upon consultation with MAS. MAS is currently reviewing MAS Notice 757 and will take this recommendation into consideration.

(vii) Tax treatment of zero coupon /discounted bonds

The Group would like to seek clarification on how zero coupon bonds or deep discount instruments are taxed. Presently, financial institutions can have the option of fixing a low coupon for a bond issue, so that the issue price would be at a deep discount to par. There is some uncertainty among financial institutions over whether the deep discount could be legitimately considered a capital gain for investors, and hence, be exempt from tax. In the extreme case, a zero coupon bond could be issued, where all the returns to investors would come from the deep discount from the bond. Banks which are more cautious have refrained from advising clients to issue zero / deep-discount bonds, while some banks have gone ahead and arranged such bond issues and assumed that the deep discount would be considered a capital gain and not be taxed.

Recommendation 7

To seek clarification on tax treatment.

MOF / MAS' Comments

Inland Revenue Authority of Singapore (IRAS) will be issuing a clarification on this matter in due course.

(viii) Market Making

To develop the secondary market, commitment to actively make market by financial institutions in bonds is important. Market making is an activity involving giving two-way quotes to potential buyers / sellers of bonds and helps to enhance the liquidity in secondary market trading. The Group identified section 31 of the Banking Act (Directive 10 for Merchant Banks) as a constraint to market making. Section 31, which limits share capital holdings or interest in an undertaking to 40% of the bank?s capital funds (20% of share capital for merchant banks), restricts a bank from holding bonds and puts a cap on the size of its bond holdings. This discourages market making and trading activity as banks could inadvertently breach the limit if they were sold bonds by their clients.

Recommendation 8

To exempt holdings in bonds from the provisions of Section 31 of the Banking Act.

MAS' Comments

Will study further. MAS is currently reviewing Section 31 of the Banking Act, and will take this recommendation into account in its review.

(ix) Swap Market

Having a liquid long term S$ swap market is important for the development of a vibrant S$ bond market, as it provides market players with an avenue for hedging their risks and arbitraging opportunities. Currently, there are less than a handful of committed swap houses in Singapore. There is a need to create a critical mass of players in the long term S$ swap market to improve its liquidity.

Recommendation 9

To create seed volume of activity, MAS could consider playing a more active role, not just in the short term S$ foreign currency swaps, but also in the long term S$ cross currency swap market.

MAS' Comments

MAS' role is to create conditions conducive to the development of the market, and not to increase market activity via our direct participation.

But in recognition of the need to further develop the long-term swap market, MAS will exempt S$ funds received by banks from non-bank customers via foreign currency swaps with original maturity of one year or

more from MCB and MLA requirements.

MAS has also implemented a variety of measures to develop the SGS market and create a benchmark that is responsive to demand and supply conditions. A credible SGS benchmark not only provides market players with an avenue to hedge their positions, but also allows them to capitalise on arbitrage opportunities, thereby encouraging greater participation in the swap market. The launch of S$ interest rate futures contracts, although short term in nature, will provide market players with an alternative instrument to hedge their positions. With these conditions in place, the next level of development would depend on market players stepping up their activities in the swap market.

(x) Rates Fixing

There is currently an Asian currency swap offer rates fixing page on Telerate Page 44178. Rates fixing is important as it provides banks with benchmarks to price floating rate swaps. Presently there are 12 banks on the rate fixing panel. However, the quality and frequency of the updates as well as the active participation by all the 12 banks, have been poor. Having timely and accurate rate fixing is critical to the development of the swap market, which would in turn help the development of the debt capital market by providing a means for banks to hedge their interest rate risks. The Group feels that a body of authority like the MAS, could help to play a role in monitoring and ensuring that banks posted the rates diligently. The Group agreed that it was also important to have the leading and large players involved, and to have enough banks (at least 20), to contribute to the rate fixing.

Recommendation 10

To establish an oversight committee comprising representatives from the Group, the SFEMC and MAS to improve and increase professionalism in the current practice on Asian interest rate fixing.

MAS' Comments

The Association of Banks in Singapore (ABS) has already formed a panel of rate fixing banks comprising 18 contributor banks, and will administer and monitor the rate fixing process of S$ SIBOR as well as SOR. ABS will help ensure timely updates and increase the professionalism in the current practice on interest rate fixing by banks.

(xi) Tax Treatment on Swaps

Financial institutions generally manage fixed income cash (e.g.

bonds) and derivatives as an integrated risk. The Group feels that a favourable tax treatment should be extended to swaps to further develop the swap market and encourage swap trading. At the last Budget, Minister for Finance gave a blanket withholding tax exemption on interest from debt securities, and a concessionary tax rate of 10% on income earned from trading securities.

Recommendation 11

To extend the withholding tax exemption to the interest payments on swaps, and to extend the concessionary rate of 10% to income earned from trading swaps.

MOF / MAS' Comments

Will study further. Tax recommendations are being considered. Decisions will be announced when finalised.

(xii) Bond Clearing / Settlement System

The development of an electronic book-entry system by the Central Depository (Pte) Ltd (CDP) for S$ private sector debt securities is a timely one. However, the establishment of a Cedel / Euroclear bridge with CDP is a critical consideration of issuers in deciding whether to use CDP. The Group would like to know whether the CDP system has successfully linked up with MAS? Electronic Payment System to enable full delivery vs payment, and whether a direct bridge to Cedel / Euroclear has been established. The Group feels that this is necessary to be in line with international clearing and settlement systems.

Recommendation 12

To establish linkage of CDP with Cedel and Euroclear and to upgrade the system to enable full delivery vs payment.

CDP / MAS' Comments

Although CDP does not have a direct link to Euroclear and Cedel, there are indirect linkages between CDP, Euroclear and Cedel that already allow for cross-border trades for both S$ and non-S$ bonds. CDP has an account with Cedel, while both Euroclear and Cedel have an account with depositary agents of CDP.

The CDP system has also successfully linked up with MAS? Electronic Payment System and has full delivery versus payment capability now for OTC S$ bond trades.

[C] Broadening the Investor Base

The retail market in Singapore, although small, can nevertheless contribute to creating demand for bonds as the savings rate in Singapore is amongst the highest in the world. The Group has identified the following which would help to develop the retail market?s appetite for bonds:

(xiii) Widening the retail market

Facilitating the repackaging of new or existing bonds for retail consumption would help develop the retail market and at the same time generate increased origination and trading activities for financial institutions in Singapore. Currently, in repackaging new or existing bonds for distribution to the public (e.g. a 5 year bond having a 4 year remaining life may be repackaged into a 1 year bond and offered to the retail investor as an alternative to deposits), a prospectus is required to be issued and signed by both the directors of the sponsoring financial institutions and the corporation that had originally issued the new or existing underlying bonds. This increases the time and cost of the transaction. Moreover, the issuer, in most cases, has no interest in the repackaging and would be reluctant to sign on a new prospectus. Internationally, the common practice is that financial institutions repackaging new or existing bonds are not obliged to go back to the original issuers of the bond.

Recommendation 13

In line with common practice internationally, to allow the prospectus of repackaged bonds to be signed only by the directors of the financial institution doing the repackaging.

RCB / MAS' Comments

Agree in principle. RCB will study further.

The Companies Act and the prospectus requirements are under the purview of the Registry of Companies and Business (RCB). MAS has forwarded the recommendation to RCB. RCB will also review the Companies Act to take this recommendation into account.

RCB has in-principle no objection to the recommendation subject to the following:

1. The financial institution is not acting as an agent of the original issuer, but as an independent third party repackaging and selling the bonds;
2. There are no representations by the original issuer in the repackaging prospectus;

3. Full & fair disclosure in the repackaging prospectus to enable investors to make informed decisions. This should include:

- nature & structure;
- differences in risk return of repackaged bonds vis-a-vis the original bonds;
- statement that investing in those bonds are not placing a deposit with the financial institution;
- statement whether repackaged bonds are to be listed. If not, state how bonds will be bought and sold and whether there is a ready market for repackaged bonds;
- statement as to whether financial institution or original issuer is obligated to service interest payment and redeem the repackaged bonds;
- statement whether investors of repackaged bonds rank as unsecured creditors of the financial institution and whether this is independent of the financial status of the original issuer;
- in event of default, whether investors have recourse to the financial institution selling the repackaged bonds;
- other risk warnings.

(xiv) Extend Bond Tax Incentives to Individuals

At the last Budget announcement, Minister for Finance granted a concessionary tax rate of 10% on interest income earned by financial institutions and corporations in Singapore from holding debt securities arranged by financial institutions in Singapore. Bonds are a safe form of investment and extending the incentive on the interest income from bonds to individuals, would create an awareness and generate an interest in bond investment.

<u>Recommendation 14</u>

To extend the concessionary tax rate of 10% on the interest income earned from holding qualifying debt securities to individuals.

MOF / MAS' Comments

No. The existing incentives extended to financial institutions and corporations are currently sufficient. These are larger buyers of bonds than individuals. MOF has reservations about introducing additional incentives that may further distort individual savings and investment decisions.

(xv) Attracting Bond Funds

Presently, most of the fund managers in Singapore are equity-based, and it is useful to attract more fixed income fund managers to Singapore to help create greater demand for bonds being issued out of Singapore. Taiwan experienced tremendous growth in its bond mutual fund industry in recent years through exempting interest income earned from investment in the bond funds from personal income tax. To stimulate investor interest in bond funds, and to attract bond funds to Singapore, an incentive similar to that in Taiwan could be explored.

Recommendation 15

To grant a 10% tax concession on interest income earned by financial institutions, corporates and individuals from investing in bond funds.

MOF / MAS' Comments

Income received by financial institutions and corporations in Singapore from unit trusts already qualify for the concessionary tax rate of 10%, if the income is declared out of interest income derived by the unit trust from investing in qualifying debt securities (see MAS? Circular FPD 01/1998). Having additional tax concessions for interest income earned by individuals may further distort individual savings and investment decisions.

[D] Manpower

(xvi) Increase Fixed Income Professionals

There is a lack of professionals for fixed income and derivatives activities in Singapore. Despite an increasingly more conducive living environment, it is still difficult to entice professionals to relocate to Singapore. One significant factor (compared to Hong Kong) is the high personal income tax rate in Singapore.

Recommendation 16

To give tax incentives to banks who relocate fixed income/ derivatives professionals to Singapore. Banks can then tax equalise its professionals that have relocated to Singapore.

MOF / MAS' Comments

There is already an existing scheme for tax deduction for expenses incurred in the relocation or recruitment of overseas talent. The scheme allows employers to claim further deduction for expenses incurred in the successful relocation or recruitment of overseas talent.

(xvii) Increase critical skills

There is also a critical need for skills upgrading in fixed income expertise of existing financial markets professionals. The recent 10-week derivatives course conducted by ACI Singapore last November met with overwhelming response. The two new master degrees in financing engineering conducted by the two local universities are a step in the right direction to fill the skills gap. A more urgent need would be for the universities to conduct short specific courses targeted at fixed income related topics.

Recommendation 17

To encourage the universities to devote resources to conducting fixed income related courses.

MAS' Comments

Agree. MAS will take this recommendation into consideration when setting the framework for the Financial Sector Development Fund.