From supervision by rules to supervision by risk

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The diagnosis of 1997

The supervisory approach that MAS abandoned in 1998 had served Singapore well in one respect. It had produced a strong and well-capitalised banking system that withstood the Asian crisis, as the previous chapter shows. Its weakness lay in its uniformity, because the same detailed rules applied to well-managed and poorly managed institutions alike. The regulator also assessed products and transactions that the market could have judged for itself. In his speech of November 1997 Lee Hsien Loong called for a shift of emphasis from regulation to supervision. In his terms, regulation covered capital requirements and prudential rules, while supervision meant monitoring institutions for compliance and for the quality of their internal controls. He also argued that Singapore should "rely more on market discipline and full information disclosure to protect investors".[1]

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The experience of SIMEX and Barings, which Chapter II of this part describes, reinforced the diagnosis. No set of rules could replace the internal controls of a financial institution. A regulator could insist on adequate controls, verify that they existed and ensure that the market had enough information to impose its own discipline.

Building the risk-focused framework

The annual report of 1998/99 described the new approach in detail. MAS had shifted progressively from "one-size-fits-all" regulation to a risk-focused supervisory approach. Supervision would focus on systemic risk, with examinations that assessed the adequacy of internal controls and risk management systems. MAS was also developing internal rating systems for financial institutions, so that it could move towards performance-based regulation that gave stronger and better managed players greater leeway. The same report warned that the regional crisis had shown the dangers of liberalising financial markets without strengthening supervisory systems.[2]

Organisational changes followed the change of philosophy. In May 1998 MAS set up an inspection unit within its Securities and Futures Department to conduct on-site inspections of securities intermediaries, which began its work in August 1998. MAS also began to develop a common risk framework for banking, securities and insurance, because the distinctions between these industries were becoming obscured. The Banking (Amendment) Act 2001 gave MAS the power to set capital adequacy requirements for individual banks that differ from the stipulated minimum of 12 per cent. Capital could thus be calibrated to the risk of each institution.[3]

In April 2004 MAS published its *Objectives and Principles of Financial Sector Oversight in Singapore*. In June of the same year Lee summarised the change as a move away from "one-size-fits-all prescriptive regulation towards a more risk-focussed supervisory approach".[4]

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Impact and risk: the framework of 2007

The new approach received its definitive form in April 2007, when MAS published *MAS' Framework for Impact and Risk Assessment of Financial Institutions.* The monograph set out how MAS assessed the risks of institutions through its Common Risk Assessment Framework and Techniques, known as CRAFT. Its central statement was a rejection of perfectionism, in which MAS declared that it "does not aim to prevent all failures", because a zero-failure regime would place an excessive burden on institutions and impair the efficiency of the financial system.[5]

The framework combines two assessments of each institution. The impact assessment measures the relative importance of an institution within its sector and the damage its distress would cause to the financial system, the economy and the reputation of Singapore. The risk assessment, made with CRAFT, evaluates the inherent risks of the institution's significant activities, the quality of its controls, its oversight and governance and its capital and support. The two ratings place each institution in one of four supervisory buckets, with impact weighing more heavily than risk. Institutions in the highest bucket face frequent dialogue and on-site work, while smaller institutions of low impact and risk are subject mainly to off-site monitoring, surveys and thematic reviews.[6]

The framework assigns primary responsibility for risk to the boards and senior management of institutions. As long as risks are adequately managed, MAS seeks "to minimise the need to interfere with institutions' business operations". The revised version of March 2024 adds frameworks for identifying and supervising domestic systemically important banks and insurers. They show how the model has absorbed the lessons of the global financial crisis of 2008.[7]

Market discipline and deposit insurance

Risk-based supervision presupposes that institutions may fail. A credible framework therefore needs a mechanism that protects small depositors when they do. Singapore introduced explicit deposit insurance on 1 April 2006. The scheme initially covered

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the first S$20,000 of Singapore dollar deposits of individuals and charities in each bank or finance company. The limit was later raised and has stood at S$100,000 per depositor per member institution since 1 April 2024, when it rose from S$75,000.[8]

The explicit scheme replaced the implicit assumption that the state would stand behind every bank. Its limits leave larger depositors with an incentive to watch the soundness of their banks. Together with higher disclosure standards and the governance reforms of 1999 and 2001, deposit insurance completed the triangle on which the new approach rested: supervision focused on risk, institutions responsible for their own controls and markets equipped with information.

Notes

1. Lee Hsien Loong, speech of 4 November 1997, para. 41: "We need to shift emphasis from regulation to supervision"; regulation covers capital requirements and prudential rules, supervision the monitoring of institutions for compliance and internal controls – Lee Hsien Loong, speech of 4 November 1997, para. 53: "We should rely more on market discipline and full information disclosure to protect investors". ↩
2. MAS, *Annual Report 1998/99*, p. 52: MAS "has shifted progressively from 'one-size-fits-all' regulation to a risk-focused supervisory approach"; supervision is to focus on systemic risk, with less weight on the risks of individual institutions or transactions; internal rating systems to allow "performance-based regulation, where greater leeway is given to stronger and better managed players" – MAS, *Annual Report 1998/99*, p. 52: "The regional financial crisis has highlighted the dangers of liberalising financial markets without strengthening supervisory systems". ↩
3. MAS, *Annual Report 1998/99*, p. 55: "In May 1998, MAS set up a new inspection unit within the Securities and Futures Department to conduct on-site inspection of securities market intermediaries … The unit commenced inspection in August 1998." – MAS, *Annual Report 1998/99*, p. 55, "Developing a Common Risk Framework": international practice converging "towards a consistent risk-focused approach at a consolidated enterprise-wide level"; a

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common risk framework being developed – Lee Hsien Loong, second reading speech of 16 May 2001, para. 29: section 10 amended so that MAS may set "specific capital adequacy ratio requirements that vary from the stipulated minimum of 12%". ↩

4. MAS, *MAS' Framework for Impact and Risk Assessment of Financial Institutions*, April 2007 (revised March 2024), para. 1.1: the objectives and principles are "spelled out in 'Objectives and Principles of Financial Sector Oversight in Singapore', issued in April 2004" – Lee Hsien Loong, speech of 17 June 2004: MAS moved away from "one-size-fits-all prescriptive regulation towards a more risk-focussed supervisory approach". ↩

5. MAS, media release, "MAS Issues Monograph", 23 April 2007, mas.gov.sg: publication of "MAS' Framework for Impact and Risk Assessment of Financial Institutions", building on "Objectives and Principles of Financial Supervision in Singapore" and articulating the "Common Risk Assessment Framework and Techniques" (CRAFT). The revised monograph of March 2024 expands the acronym as "Comprehensive Risk Assessment Framework and Techniques" – MAS, *Framework for Impact and Risk Assessment*, para. 2.3: "MAS does not aim to prevent all failures. A 'zero failure' regime would place an excessive regulatory burden on financial institutions and could impair the efficiency of the financial system.". ↩

6. MAS, *Framework for Impact and Risk Assessment*, paras. 3.3–3.4 and 4.1–4.4: impact and risk ratings combined to assign each institution to one of four "supervisory buckets"; "the impact rating is accorded more importance relative to the risk rating"; impact criteria include share of activity in markets, retail reach and criticality to the financial system – MAS, *Framework for Impact and Risk Assessment*, paras. 3.8–3.12: lower bucket institutions supervised mainly off-site with periodic inspections; bucket 1 institutions subject to frequent dialogue and on-site work; smaller institutions such as financial advisers and insurance brokers subject to base-level monitoring, surveys and thematic reviews. ↩

7. MAS, *Framework for Impact and Risk Assessment*, paras. 2.7–2.9: the board and senior management "play the central role in maintaining adequate risk

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oversight"; "As long as risks are adequately managed, we seek to minimise the need to interfere with institutions' business operations." – MAS, *Framework for Impact and Risk Assessment*, April 2007 (revised March 2024), contents: Appendix 1, "Framework for identifying and supervising domestic systemically important banks"; Appendix 2, the corresponding framework for insurers. ↩

8. MAS and Singapore Deposit Insurance Corporation, joint media release, "Launch of Deposit Insurance Scheme in Singapore", 28 March 2006, mas.gov.sg: the scheme begins on 1 April 2006 and covers "the first $20,000" of Singapore dollar deposits of "individuals and charities"; it is "another layer of protection to complement the role of prudent bank management and MAS supervision" – Allen & Gledhill, "MAS to increase maximum deposit insurance coverage from S$75,000 to S$100,000 from 1 April 2024", 30 October 2023: MAS will "increase the maximum DI coverage from S$75,000 to S$100,000" with effect from 1 April 2024; announced on 22 September 2023. ↩

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