



**SPEECH BY DR TONY TAN KENG YAM, DEPUTY CHAIRMAN AND EXECUTIVE DIRECTOR, GIC, AT THE 2008 ANNUAL MEETING OF THE INSTITUTE OF INTERNATIONAL FINANCE ON “THE FUTURE SHAPE OF GLOBAL FINANCE” ON SUNDAY, 12 OCTOBER 2008 AT 11AM IN WASHINGTON DC, USA**

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**I would like to thank your Chairman Dr Josef Ackermann and Managing Director Mr Charles Dallara for inviting me to share my thoughts on “The Future Shape of Global Finance.” This is indeed a timely and important issue with current market turmoil and dislocations leading to unprecedented flux and radical changes to the structure of the global financial landscape. Making predictions about the future environment is much more hazardous than usual.**

**Regardless of how the financial sector turmoil is resolved, there is little doubt that the turmoil will have an indelible impact on the shape of global finance in the coming years. In particular, regulation and supervision will be tightened, with real risks of over-regulation.**

**Protectionism in the US could rise, while the steady liberalisation of cross-border capital flows could be reversed.**

**In the last few decades, liberalisation, innovation, and technological improvements have underpinned a tectonic change in global finance. New institutions, markets, and instruments entered the marketplace. These changes have brought many benefits to borrowers, savers, and shareholders. Borrowers have been better able to access funds, and on more flexible terms. Savers have a greater array of instruments to invest in, improving prospects for diversification and risk management. Shareholders have also benefited: for example, returns over the last decade for financial stocks have outperformed the broader S&P500 index until very recently.**

**In tandem with the changes to financial landscape, there has been a rapid rise in cross-border investments as financial markets integrate across the world. Liberalisation of capital accounts together with increasing investor sophistication and a desire for geographical diversification facilitated this process. McKinsey, for example, estimates that there were US\$74.5 trillion in cross-border investments in 2006, the highest ever in modern history. Portfolios are becoming more diversified geographically**

but also more interconnected and more vulnerable to events in one market leading to immediate impact in another.

Unfortunately, as with previous crises, a combination of easy financing, over-optimism, inappropriate incentives, and failures in risk management led to over-leveraging and the bubble in housing markets in the US and other countries.

Given the size of the problem, state intervention in some form will prove necessary to stabilise the financial system. As a result, governments will be forced to re-think how they are regulating and supervising the financial sector to both safeguard public funds and prevent a recurrence of the current financial turmoil. The cost will likely be high in terms of prosecution, shareholder dilution and regulation.

In the developed world, this is likely to lead to more comprehensive regulation of financial institutions and markets. It also seems likely that both regulators and markets are going to require commercial banks, investment banks, and insurers to hold more capital and liquidity. Institutions with larger capital and depositor base cushions are weathering this crisis far better than their competitors who are dependent on inter-bank and wholesale market financing. Those institutions with greater

amounts of liquid assets have also been less subject to “runs”. Policy-makers in emerging economies are likely to re-think the pace of liberalization and how much trust to put in financial markets’ ability to regulate itself.

There is a danger that politicians and policy-makers will learn the wrong lessons from the current crisis. In the developed world, this could lead to over-regulation and could stifle the healthy development of the financial sector. Securitization, for example, is an important innovation to preserve even if it had contributed to the sub-prime crisis. In emerging economies, regulators could delay needed liberalization and hinder innovation. It may take years before securitization is allowed in these markets to play an optimal role in the new financial landscape. Finding the right balance between needed strengthening of regulation and over-regulation will be a challenge.

Financial institutions will also need more capital. An important source of such capital today would be emerging market economies which have, since 2002, become net providers of capital to the rest of the world. In 2006, for instance, emerging markets invested about US\$330 billion more abroad than they received in foreign capital inflows. This is a stark

contrast to the 1990s when many Asian and Latin American countries were dependent on foreign capital to finance their investments.

**Ironically, increasing investments by emerging markets in developed financial markets which has been made possible by the globalization of finance is now leading to some concern over such flows in the EU and US.**

**One reason for this is simply increasing protectionism in the developed world. Rising inequality and stagnating real wages over the past decade have increased disenchantment with globalization in many developed countries. The current environment of continued asset deflation, weaker growth, and rising unemployment is likely to accentuate the trend towards protectionism. To many people, it would appear that emerging markets are doing better economically and financially even though the developing countries remain, by most absolute measures, still far behind the developed countries. However, this perception could create tensions especially if combined with a view that emerging economies are doing better because they are not being “fair”, such as through restrictive trade policies, weaker environmental regulations or currency management.**

**Related to protectionism is the concern on the motives and purposes of investments made by Sovereign Wealth funds (SWFs). In particular, the**

**US and EU have expressed concerns that SWFs may invest in assets with non-financial interests in mind. There are also fears that SWFs may destabilize markets and financial systems.**

**This is understandable. In the past, when there were only a few SWFs like Abu Dhabi, Kuwait and Singapore, the size of SWF funds was too small to affect the markets. But now there are many more players including significant SWFs from China and Russia. By one count, 28 new SWFs have been created since the year 2000.**

**However, there is little evidence that SWFs have acted in a way to warrant such fears. Indeed, in their April 2008 Global Financial Stability Report (GFSR), the IMF tentatively concluded that SWFs played a shock-absorbing role in this crisis through their investments in banks. The US Government Accountability Office, in its September 2008 report on Sovereign Wealth Funds, stated that SWFs, in conjunction with other investors, supplied almost US\$43 billion of capital to major financial firms in the US between 2007 and early 2008.**

**During the World Economic Forum in Davos in January this year, I said that GIC will release a document to provide more information on its purpose, processes, governance, goals and its values. We believe such**

clarity and disclosure will benefit the international community. On 23 Sept 2008, GIC released its first annual report on the Management of the Singapore Government's portfolio for the year 2007/08. This report included information on GIC's governance framework, investment process, asset mix and historical rates of returns. I am confident that the GIC Report will enable the global community to appreciate the context and circumstances in which GIC operates and be assured that GIC has and will always invest for only one purpose – to achieve sustainable financial returns for the government's portfolio. Going forward, GIC will continue to make appropriate information available as and when it is helpful to do so.

We also welcome the release of a set of Generally Accepted Principles and Practices (GAPP) for SWFs by the International Working Group of SWFs (IWG). The GAPP supports the institutional framework, governance and investment operations of SWFs. Publication of the GAPP helps to improve understanding of SWFs as financially oriented entities in both the home and recipient countries, allay protectionist fears and keep the investment climate open and stable.

GIC actively participated in the development of the GAPP as we support the effort to enhance trust between SWFs and recipient countries.

**GIC will implement the GAPP appropriately and where necessary consult the Singapore Government in areas where they have the prerogative. In fact much of the principles and practices are in place in the daily operations of GIC. The GIC Report, I referred to earlier, reflects our commitment to adhere to the GAPP.**

**It is mutually beneficial, if not essential, for developed and emerging countries to maintain an international regime that allows for the free flow of capital. In my view, restrictions on investments would hurt both investors as well as recipients who would have to pay a higher cost for capital. More worryingly, it could also be part of a more pernicious trend that threatens the fundamentals of global prosperity offered by globalisation itself.**

**To conclude – We are experiencing unprecedented financial turmoil. We will need to examine how we got here and enact steps to prevent a recurrence. At the same time, what the 1930s has taught us is that we should guard against over- regulation and protectionism and a retreat from globalisation. All stakeholders should work towards maintaining a stable global financial system and free flow of trade, capital and investment.**

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