INFORMATION NOTE

The development of government bond market in Singapore

1. Background

1.1 Announced in the 2009-2010 budget speech by the Financial Secretary, the Government intends to implement a programme to issue government bonds denominated mainly in Hong Kong dollar to promote the development of the local bond market. The programme will comprise bond issues for both institutional and retail investors, and bonds of tenors within the range of two to 10 years will likely be issued at the initial stage of the programme. In the future, issuance of bonds with tenors of 15 years or longer may also be considered based on market demand. In addition, arrangements will be made to seek listing status for the bonds to be issued under the programme. The sums raised will be credited to a fund to be established under the *Public Finance Ordinance (Cap. 2) (PFO)* known as the Bond Fund. The Bond Fund will not be treated as part of the fiscal reserves and will be managed separately.

1.2 The Hong Kong Monetary Authority (HKMA) will be tasked to assist the Government in co-ordinating the offering of the bonds under the programme. In so doing, it will engage banks and/or financial institutions as primary dealers to offer bonds for institutional investors, co-arrangers for managing and offering of retail bonds and placing institutions for distributing bonds to retail investors to provide the necessary assistance in implementing the bond programme. Expenses arising from the procurement of the relevant services by HKMA will be met by the Bond Fund.

1.3 The Government will seek the Legislative Council's approval for two separate resolutions under section 29 of *PFO* and section 3 of the *Loans Ordinance (Cap. 61) (LO)* respectively for the implementation of the bond programme. The purpose of the resolution under section 29 of *PFO* is to establish the Bond Fund for the management of the sums raised under the programme. The purpose of the resolution under section 3 of *LO* is to authorize the Government to borrow for the purposes of the Bond Fund such sums not exceeding in total HK$100 billion or equivalent at any time.

1.4 Against this background, the Research and Library Services Division has prepared this information note covering the measures undertaken by the Singaporean government for promoting the government bond market. Singapore is selected in the study because it has operated substantial fiscal surpluses for many years and accumulated sizeable reserves, similar to the situation in Hong Kong[1]. The Singaporean government does not need to finance its expenditures through the issuance of government bonds, which are called the Singapore Government Securities[2] (SGS). The Singaporean government has explicitly stated that SGS issuance is aimed primarily at developing Singapore's capital markets. Hence, its experience will be useful to Hong Kong.

2. Development of the government bond market in Singapore

2.1 In 1997, in the course of the Asian financial crisis, the Monetary Authority of Singapore (MAS), Singapore's central bank, embarked on a fundamental review of its policies on regulating and developing Singapore's financial sector. One component was the development of a liquid bond market. MAS found that an overdependence on the banking system could exacerbate problems for borrowers during a financial crisis. It was considered that having a deep and liquid bond market would offer borrowers the flexibility to diversify their sources of funding and provide them with a good alternative source of raising long-term capital for matching any long-term expenditure needs.

2.2 MAS noted that many investors in financial assets in Singapore held short-term money market products, equities or properties. The development of the bond market would make available to investors a wider choice of assets, of varying credit risks and maturities, to bridge this gap in the risk spectrum. Insurance companies could also utilize such bonds as long-term assets to match their long-term liabilities and would not need to resort to a heavy allocation into equities.

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1 At the end of March 2009, Singapore's foreign reserves amounted to US$166.1 billion (HK$1,293.9 billion), compared to US$186.2 billion (HK$1,450.5 billion) in Hong Kong.

2 SGS, which are scripless and denominated in Singaporean dollar, are marketable debt instruments issued by the Singaporean government through MAS by means of public auction. These debt instruments are in the form of either treasury bills or bonds. The government is obliged to pay the holder of the treasury bill or bond a fixed sum of money on the maturity date of the security. Although SGS cannot be cashed in before their maturity dates, investors can sell them in the SGS market. SGS primary dealers are prepared to buy and sell SGS at any time. However, SGS are not listed on the Singapore Exchange.

2.3 At the time when they were first issued, the SGS market was relatively small and inactive. In the absence of a liquid benchmark yield curve[3], the private sector was reluctant to tap the debt market, with most corporations relying on bank borrowings and equity to meet their funding needs. Hence, since 1998, the Singaporean government has committed to creating a sizable and liquid government bond market as part of its strategy to develop the bond market.

2.4 The Singaporean government has stated the main objectives for issuing government bonds to be:

(a) providing low-risk liquid investment instruments to individual and institutional investors;

(b) establishing a liquid government bond market that serves as a benchmark for the corporate bond market; and

(c) encouraging the development of financial expertise in fixed income and other debt instruments.

3. Measures undertaken for promoting the Singaporean government bond market

3.1 The Singaporean government has implemented a number of measures for promoting the government bond market over the past ten years. Some of the major measures are discussed below.

[3] A benchmark yield curve refers to a line that plots the interest rates, at a set point in time, of bonds having equal credit quality, but differing maturity dates. In the financial world, the most frequently used benchmark yield curve is the United States (US) Treasury Department's bond yield curve, which is used as an indicator for other debt in the market, such as mortgage rates or bank lending rates.

Creating a sizable government bond market

3.2 MAS is empowered by the *Development Loan Act* and the *Government Securities Act* to undertake the issue and management of securities on behalf of the Singaporean government. The quantity of SGS issued is authorized by a resolution of Parliament with the President's concurrence. Each year, MAS seeks approval from the Minister for Finance for the total quantity of SGS issued for the next financial year. MAS decides, in consultation with SGS primary dealers[4], the timing and amount of individual bond issues.

3.3 MAS has embarked on a focused issuance programme[5] aimed at building a liquid bond market through issuing new SGS bonds and re-opening of existing issues. MAS issues treasury bills[6] and bonds[7] on a regular basis. Whilst three-month treasury bills are issued weekly, one-year treasury bills, two-, five-, seven-, 10-, 15- and 20-year bonds are issued according to an annual issuance calendar, which is usually pre-announced in September of the previous year. In 2009, MAS has a plan to issue SGS bonds in May (one-year), June (10-year), September (15-year), October (five-year) and November (one-year).

3.4 The size of each treasury bill and bond auction is typically announced five business days ahead of the scheduled auction date. The typical size for treasury bills and bonds issued is S$900 million – S$1 billion[8] (HK$5.0 billion – HK$5.5 billion) and S$2 billion – S$3 billion (HK$11.0 billion – HK$16.5 billion) respectively.

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4 There are currently 11 primary dealers, comprising ABN AMRO Bank, Bank of America, Barclays Bank, Citibank, Credit Suisse, Deutsche Bank, Development Bank of Singapore, Hongkong and Shanghai Banking Corporation, Oversea-Chinese Bank, Standard Chartered Bank and United Overseas Bank. Their major functions include: (a) providing liquidity to the SGS market by quoting two-way prices under all market conditions; (b) underwriting issuance at SGS auctions; and (c) providing market feedback to MAS.

5 All proceeds from the issuance of SGS are placed in the Government Securities Fund established under the *Government Securities Act*. The *Government Securities Act* and the *Financial Procedure Act* outline the instruments in which funds held in the Fund can be invested. Funds can be invested in any stocks, funds or securities authorized for the investment of trust funds, or in securities issued or guaranteed by any government or international financial institution except those issued by the Singaporean government. Funds also may be invested in gold and other bullion, or held on deposit in any bank.

6 Treasury bills are sold at a price lower than the face value. At maturity date, holders receive the full face value of the instrument.

7 Bonds holders receive a fixed rate of interest (coupon rate) every six months during the life of the instrument. The principal amount (or face value) is repaid on maturity date. The coupon rate reflects the market interest rate when the issue was offered, and thus coupon rates vary among bonds traded in the market.

8 The average exchange rate in 2008 was S$1=HK$5.51.

3.5 To make SGS more accessible to the investing public and broaden the investor base, the Singaporean government reduced the minimum denomination of both treasury bills and bonds from S$10,000 (HK$55,100) in 2002 to S$1,000 (HK$5,510). As of December 2008, the total SGS outstanding were S$104.6 billion (HK$576.3 billion), comprising S$35.9 billion (HK$197.8 billion) treasury bills and S$68.7 billion (HK$378.5 billion) bonds. In 2008, the monthly average daily turnover volume of SGS ranged between S$2.3 billion (HK$12.7 billion) and S$5.2 billion (HK$28.7 billion).

Promoting investor awareness

3.6 MAS has conducted various international road-shows in major international financial centres such as New York, London and Tokyo to raise awareness of SGS and attract foreign investor participation. Separately, to educate retail investors on the SGS market, MAS has launched a dedicated SGS website (http://www.sgs.gov.sg) to provide a one-stop portal for comprehensive information and data on the SGS market, including macro-economic overview, basic facts on SGS, list of primary dealers, issuance calendar and daily SGS prices. In addition, MAS has published a booklet entitled *A Guide to Singapore Government Securities* providing basic information on the SGS market.

Launching of electronic trading platform

3.7 MAS has launched the Singapore Government Securities Electronic Bond Trading Platform, jointly developed by MAS, Bloomberg and the SGS primary dealer community, to facilitate information transmission and SGS transactions between MAS and primary dealers. All users of the Bloomberg terminal, both in Singapore and internationally, are able to see the complete trading information in the SGS market.

3.8 According to MAS, the electronic trading platform has significantly improved market transparency, by making available information on transaction time, prices, and volumes of trades executed between primary dealers using the platform, which, in turn, has enhanced market stability and encouraged wider participation in the SGS market. At present, the platform is available only to primary dealers. There is a plan to include other market participants, such as non-primary dealer banks and insurance companies.

3.9 SGS transactions are cleared on a delivery-versus-payment[9] settlement on a real-time basis over MAS electronic payment system and book-entry clearing system. This settlement procedure has enabled both domestic and international investors to settle their deals faster, reducing time costs and settlement risk

Offering tax incentives

3.10 The Singaporean government has encouraged the development of the SGS market by offering tax incentives[10] to primary dealers and investors. Income earned by primary dealers from trading in SGS is exempted from tax. As regards interest income, there are different arrangements depending on the category of investor concerned:

(a) Financial institutions: interest and discount income earned on SGS issued on or after 28 February 1998 is taxed at a concessionary rate of 10%. Income received by financial institutions in Singapore from designated unit trusts also qualifies for the concessionary tax rate of 10% if the income is declared out of interest income derived by the unit trust from investing in SGS.

(b) Individuals: interest income derived by individuals from SGS is exempted from tax.

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9 Delivery-versus-payment refers to a settlement procedure in which a customer instructs that he or she will make immediate payment upon delivery of the purchased security. It is also called cash on delivery.

10 There is no capital gains tax in Singapore.

Developing the sale and repurchase agreement (repo) market

3.11 MAS has implemented a number of measures for developing the repo[11] market, which provides a financial instrument for SGS investors to hedge their interest rate risks. These measures include:

(a) allowing all SGS held under repos by a bank to be included in the bank's liquid asset base for purposes of compliance with the minimum liquid asset requirements; and

(b) permitting offshore banks and primary dealers to engage in SGS repo transactions.

3.12 According to MAS, the repo market has played a critical role in generating secondary trading activities that adds breadth and depth to SGS trading in Singapore. In 2008, the monthly average daily turnover volume of SGS in the repo market ranged between S$1.6 billion (HK$8.8 billion) and S$2.6 billion (HK$14.3 billion).

Enhancing market professionalism

3.13 MAS has worked with primary dealers to publish the *Rules and Market Practices of the Singapore Government Securities Market* which set out the rules of conduct for primary dealers, transaction practices, confirmation of deals, settlement, failed trades and interest calculations. If a breach of the rules of conduct is detected, primary dealers are subject to disciplinary actions by the Singaporean government, including censure.

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11 A repo transaction is one in which the seller agrees to sell a particular security at a certain price, with the commitment to repurchase that security from the buyer at a pre-determined price at a mutually-agreed future date.

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