

RESPONSE TO FEEDBACK RECEIVED – CONSULTATION ON PROPOSALS FOR THE IMPLEMENTATION OF BASEL II IN SINGAPORE – PHASE 5

1 Introduction

1.1 In May 2007, MAS invited Singapore-incorporated banks and interested parties to comment on revised draft rules and guidelines for computing minimum capital adequacy requirements for credit risk under Basel II.

1.2 We thank all respondents for their comments. MAS has considered carefully the feedback received, and will incorporate them into the rules and guidance where it has agreed with the feedback. Comments that are of wider interest, together with MAS' responses are set out below.

2 Exposure Measurement of Available-for-sale (“AFS”) Debt Securities and AFS Loans

2.1 The revaluation gains on AFS debt securities and AFS loans are currently not recognised as capital. One respondent sought clarification on the exposure measurement of such assets.

MAS' Response

2.2 For regulatory capital purposes, AFS debt securities and AFS loans shall be measured at the fair value of the asset, adjusted by deducting unrealized fair value gains and adding back unrealized fair value losses on revaluation. This is to ensure that the exposure measurement is consistent with the non-recognition

of unrealized fair value gains on AFS debt securities and AFS loans in Upper Tier 2 Capital. This has been clarified in the draft rules.

3 Exposure Measurement of Pre-settlement Counterparty Exposure Arising from Sold Credit Default Swaps in the Banking Book

3.1 One respondent sought clarification on how the exposure arising from sold credit default swaps in the banking book should be measured.

MAS' Response

3.2 The E or EAD arising from sold credit default swaps in the banking book, where the credit default swaps are treated as credit protection sold by the Reporting Bank, should be equal to the full notional amount of the underlying reference credit that the Reporting Bank is providing protection for.

4 Exposures Secured by Residential Property under SA(CR)

4.1 One respondent proposed that exposures secured by residential property with loan-to-value ("LTV") ratios between 80% and 90%, be risk-weighted at 50% and that such exposures be excluded from the \$2 million threshold used to determine if exposures to a obligor or group of obligors can be included within the regulatory retail asset class under the SA(CR).

MAS' Response

4.2 MAS will not be introducing a new risk weight category of 50% for exposures secured by residential property with LTV ratios between 80% and 90%. This approach is consistent with the Basel Committee's approach to risk weight categories for this class of exposures. After considering the feedback received, however, MAS has decided to exclude from the \$2m threshold all exposures secured by residential property regardless of LTV ratio. Consequently, the SA(CR) asset class for exposures secured by residential property will be segmented into three asset sub-classes, all of which will be subject to the

conditions in paragraph 7.3.1(h), with the exception of the condition relating to LTV ratio in paragraph 7.3.1(h)(v). Specifically,

- (a) for exposures with LTV ratio of :
 - (i) less than or equal to 80%; or
 - (ii) more than 80% but less than or equal to 90%, which is insured with qualifying mortgage insurance that meets the conditions in Annex 7T covering at least the portion of each exposure in excess of 80%;a 35% risk weight will apply;
- (b) for exposures with LTV ratio of more than 80% but less than or equal to 90% and without qualifying mortgage insurance, a 75% risk weight will apply; and
- (c) for exposures with LTV ratio of more than 90% and without qualifying mortgage insurance, a 100% risk weight will apply.

4.3 The draft rules will be amended to reflect the above.

5 Aggregation of Retail Exposures to Single Counterparty under IRBA

5.1 One respondent proposed that exposures within the residential mortgage asset sub-class be excluded from the \$2 million retail exposure threshold used to determine whether exposures to small businesses are to be included within the other retail exposures asset sub-class under the IRBA.

MAS' Response

5.2 In view of this feedback and to maintain consistency between the SA(CR) and IRBA approaches on this issue, exposures within the IRBA residential mortgage asset sub-class will be excluded from the \$2 million threshold used to determine whether exposures to small businesses are to be included within the

IRBA's other retail exposures asset sub-class. The draft rules will be amended to reflect this.

6 Eligible External Credit Assessment Institutions (“ECAIs”) – Application for Recognition

6.1 Some respondents proposed that MAS should recognise ECAIs that have been recognised by other regulators (i.e. indirect recognition) without conducting its own assessment of those ECAIs.

MAS' Response

6.2 MAS will assess each ECAI application based on whether it meets the criteria set out in Division 3 of Part VII of our draft rules. This will help foster consistency in our approach to recognising ECAIs for the purpose of regulatory capital computation in Singapore. Nonetheless, in deciding whether to recognise an ECAI, MAS may, among other things, consider whether that ECAI has been recognised in other reputable jurisdictions.

7 Eligible ECAIs – Letter of Support from Reporting Banks

7.1 Some respondents proposed the removal of the requirement in paragraph 7.3.54 for each ECAI recognition application to be accompanied by a letter of support from a Reporting Bank.

MAS' Response

7.2 After carefully considering the feedback, MAS has decided to retain the requirement. This will help ensure that recognition applications are only received for ECAIs which Reporting Banks will use for their regulatory capital computation. MAS expects banks to satisfy themselves of the reliability of an ECAI's ratings before issuing a letter of support for that ECAI or using the ECAI's ratings for regulatory capital computation.

8 Eligible ECAIs – Recognition Criteria

(a) Objectivity

8.1 MAS proposed that as a demonstration of an ECAI's objectivity, it should have an independent internal audit function to assess the compliance of the ECAI with its internal policies. One respondent proposed that some flexibility be accorded in the structure of such a function.

MAS' Response

8.2 MAS will accord some flexibility to allow for the possibility of alternative functions within ECAIs that are similarly independent, and which are able to achieve the same objective in assessing the compliance of the ECAI with its internal policies. The draft rules will be amended to reflect this.

(b) Independence

8.3 MAS proposed that as a demonstration of an ECAI's independence, there should be legal separation of the businesses that are unrelated to its credit assessment business. Some respondents highlighted that legal separation may not be the only means to demonstrate an ECAI's independence.

8.4 MAS also proposed that as a demonstration of an ECAI's independence, credit assessments recommended by analysts should be endorsed by a credit assessment committee, which members should possess at least three years of relevant credit assessment experience. One respondent proposed that greater flexibility should be accorded to the governance structure of the rating process.

MAS' Response

8.5 While legal separation is often seen as an indicator of independence, we agree that it is not of the only means of demonstrating independence. In view of this, the requirement for legal separation will be removed. Notwithstanding, ECAIs should be able to demonstrate effective operational separation of unrelated businesses from the credit assessment business. This may take the form of robust firewall policies and procedures.

8.6 After considering the feedback received, we will exercise more flexibility with regard to the governance structure of the rating process. The requirement will be amended so that credit assessments endorsed by a credit assessment committee composed of adequately qualified and experienced individuals, in accordance to an ECAI's established criteria and methodology, will be sufficient to meet this criterion.

9 Best Estimate of Expected Losses for Defaulted Exposures under IRBA

9.1 Some respondents asked for more guidance relating to the construction of the best estimate of expected losses (EL_{est}) for defaulted exposures under the IRBA.

MAS' Response

9.2 For defaulted exposures within the wholesale asset class where a Reporting Bank is using the F-IRBA, the LGD prescribed under paragraph 7.4.29 may be used as its best estimate of expected losses. For defaulted exposures within the retail asset class or the wholesale asset class where a Reporting Bank is using the A-IRBA, the Reporting Bank should construct its EL_{est} for each defaulted exposure based on current economic circumstances and exposure status. Where it is deemed appropriate, specific provisions and partial write-offs may be used by a Reporting Bank as a consideration in the construction of EL_{est} for defaulted exposures provided that any foreseeable losses of the exposure, where applicable, are taken into account. As a guide, EL_{est} of a defaulted exposure should not be less than the sum of specific provisions and partial write-offs.

10 Definition of Default under IRBA

10.1 One respondent highlighted that it is common for Reporting Banks to reverse out or waive the annual fees for credit cards. The reversal process may sometimes take more than 90 days, which will render the exposure to be in default, only to be “cured” when the annual fee is reversed out. The respondent proposed that Reporting Banks be accorded some flexibility to exclude such exposures from being classified as in default.

MAS' Response

10.2 Reporting Banks will be accorded the necessary flexibility. The definition of default is not intended to include an obligor that is deemed to be in default only by virtue of an annual fee payable for credit cards to a Reporting Bank where the bank has already commenced steps to reverse or waive the annual fee.

11 Clean Sale Requirements for Securitisation Exposures Held in the Trading Book

11.1 One respondent highlighted the possible difficulties in applying the clean sale requirements to securitisation exposures held in the trading book and proposed that these requirements be removed.

MAS' Response

11.2 MAS agrees with the feedback and will remove the need to apply the clean sale requirements to securitisation exposures held in the trading book.

Monetary Authority of Singapore
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