

ANNEX 3: APPLICATION OF THE LIMITS ON PERPETUAL NON-CUMULATIVE PREFERENCE SHARES, INNOVATIVE TIER 1 CAPITAL INSTRUMENTS AND TIER 2 CAPITAL

This Annex explains by way of a examples, the application of –

- the 30% limit on perpetual non-cumulative preference shares and innovative Tier 1 capital instruments;
- the 15% limit on innovative Tier 1 capital instruments;
- the limit on Tier 2 Capital; and
- the limit on Lower Tier 2 Capital,

set out in paragraphs 13 to 15, 17 and 17A of the Notice.

Example of financial information of a Reporting Bank:

Paid-up ordinary share capital	\$55
Disclosed reserves	\$25
Perpetual non-cumulative perpetual preference share capital ("Preference shares")	\$14
Innovative Tier 1 Capital approved by the Authority ("IT1")	\$16
Upper Tier 2 capital instruments approved by the Authority ("UT2")	\$15
Minority Interest ("MI")	\$5
Goodwill	\$10
Intangible assets	\$5
General provisions	\$5
45% of revaluation surplus on land and building assets ("Revaluation surplus")	\$5
45% of revaluation gains on AFS equity securities ("Revaluation gains")	\$6

Application of the 30% Limit on IT1 and Preference shares

Example 1:

- Step 1: Calculate the portion of Tier 1 Capital that will form the threshold to compute the Allowable IT1 and Preference shares as defined in Step 2 below according to the following formula:

<p><i>Paid-up ordinary share capital (\$55)</i></p> <p style="text-align: center;">+</p> <p><i>Disclosed reserves(\$25)</i></p> <p style="text-align: center;">+</p> <p><i>MI (\$5)</i></p> <p style="text-align: center;">less</p> <p><i>Goodwill (\$10)</i></p> <p style="text-align: center;">less</p> <p><i>Intangible assets (\$5)</i></p>
<p><i>Portion of Tier 1 Capital that will form the threshold for Step 2 = \$70</i></p>

- Step 2: Calculate the maximum amount of IT1 and Preference shares that can be included as Eligible Tier 1 Capital (“Allowable IT1 and Preference shares”) as follows:

<p><u>Portion of Tier 1 Capital that will form the threshold (\$70) * 30%</u></p> <p style="text-align: center;">70%</p>
<p><i>Allowable IT1 and Preference shares = \$30</i></p>

Application of the 15% Limit on IT1

Example 2:

- Step 1: Determine the 30% limit for Allowable IT1 and Preference shares (See Example 1)
- Step 2: (A) Where the amount of Preference shares (e.g. \$16) is more than half of Allowable IT1 and Preference shares
- Calculate the amount of IT1 that can be included as Eligible Tier 1 Capital (“Allowable IT1”) as follows:

<p><i>Allowable IT1 and Preference shares (\$30)</i> Less <i>Preference shares (\$16)</i></p>
<p><i>Allowable IT1 = \$14</i> <i>and</i> <i>Excess of \$2 can be included in Upper Tier 2 Capital for calculating Total CAR</i></p>

(B) Where the amount of Preference shares is less than half of Allowable IT1 and Preference shares

Calculate the amount of non-IT1 that can be included as Eligible Tier 1 Capital as follows:

<p><i>Paid-up ordinary share capital (\$55)</i> + <i>Disclosed reserves (\$25)</i> + <i>Preference shares (\$14)</i> + <i>MI (\$5)</i> less <i>Goodwill (\$10)</i> less <i>Intangible assets (\$5)</i></p>
<p><i>Amount of non-IT1 = \$84</i></p>

Step 3: Calculate Allowable IT1 as follows:

<p><u><i>Amount of non-IT1(\$84) * 15%</i></u> 85%</p>
<p><i>Allowable IT1 = \$14.82</i> <i>and</i> <i>Excess of \$1.18 can be included in Upper Tier 2 Capital for calculating Total CAR</i></p>

Application of the Limit on Tier 2 Capital

Example 3:

Step 1: Calculate Eligible Tier 1 Capital (following from Example 2B) as follows:

<i>Paid-up ordinary share capital (\$5)</i> + <i>Disclosed reserves (\$25)</i> + <i>Preference shares (\$14)</i> + <i>IT1 (\$14.82)</i> + <i>MI (\$5)</i> less <i>Goodwill(\$10)</i> less <i>Intangible assets (\$5)</i>
<i>Eligible Tier 1 Capital = \$98.82</i>

Step 2: Calculate the amount that is allowable as Tier 2 Capital as follows:

<i>Eligible Tier 1 Capital (\$98.82) *100%</i>
<i>Allowable Tier 2 Capital = \$98.82</i>

Application of the Limit on Lower Tier 2 CapitalExample 4:

Step 1: Calculate Eligible Tier 1 Capital (Step 1 of Example 3).

Step 2: Calculate Upper Tier 2 Capital as follows:

<i>General provisions (\$5)</i> + <i>UT2 (\$15)</i> + <i>Excess IT1 inadmissible as Eligible Tier 1 (\$1.18)¹</i> + <i>Revaluation surplus (\$5)</i> + <i>Revaluation gains (\$6)</i>
<i>Upper Tier 2 Capital = \$32.18</i>

Step 3: Calculate the amount allowable as Lower Tier 2 Capital as follows:

$\frac{[\text{Eligible Tier 1 Capital } (\$98.82) + \text{Upper Tier 2 Capital } (\$32.18)] * 25\%}{75\%}$
<i>Allowable Lower Tier 2 Capital = \$43.67</i>

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¹ Following from Example 2B, there is \$1.18 of IT1 that is inadmissible as Eligible Tier 1 Capital which can be included as Upper Tier 2 Capital for the purposes of calculating Total CAR.