

# CONSULTATION PAPER

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## Proposed Regulations to Allow Businesses Related or Complementary to Core Financial Business

MAS

Monetary Authority of Singapore

## PREFACE

As part of the anti-commingling policy, section 30 of the Banking Act (Cap. 19) prohibits banks from carrying on businesses other than banking business, financial businesses and businesses prescribed as a class or specifically approved by MAS. Section 30 gives banks some flexibility to carry on businesses that are not clearly financial if these businesses are assessed not to be in contravention of the anti-commingling policy objectives. MAS has been clarifying which businesses are not prohibited under section 30 by prescribing such businesses as a class of business which the bank may carry on, and approving such businesses on a case-by-case basis.

2 As a next step, MAS is proposing to allow banks to carry on new businesses that are related or complementary to the bank's core financial business but which may not be clearly financial, without the need for prior prescription by class or specific case-by-case approval by MAS, subject to certain conditions, limits and requirements. The proposed changes will allow banks to carry on such related or complementary businesses under section 30, and also allow banks to hold wholly-owned subsidiaries for the purpose of segregating risks arising from carrying on such businesses under section 32 without the need to get the Authority's prior approval provided that certain requirements are met by the bank. All other rules under the anti-commingling policy (i.e. sections 5A, 31, 33, and 36 of the Banking Act) remain unchanged.

3 MAS invites interested parties to give their views and comments on the proposals made in this paper. Electronic submission is encouraged. Please send your written comments by 19 April 2010 to:

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4 Please note that all comments received may be made public unless confidentiality is specifically requested for the whole or part of the submission.

## 1 INTRODUCTION

1.1 In June 2000, MAS announced a policy to separate the financial and non-financial businesses of banks, and to unwind cross-shareholdings within the locally incorporated banking groups (the anti-commingling policy). The policy is aimed at limiting the risks of contagion from non-banking businesses to banks, enhancing market discipline, increasing transparency of transactions, and ensuring that bank management focuses its attention on core banking business amid increasingly competitive conditions.

1.2 Amendments to the Banking Act giving legislative effect to the anti-commingling policy came into force on 18 July 2001. The amendments introduced new provisions that:

- prohibit banks from undertaking businesses other than banking business, financial businesses and businesses approved by MAS (section 30);
- prohibit banks from acquiring a major stake in a company, unless approved by MAS (section 32);
- prohibit any person from using any name, logo or trademark in a manner that would associate the person or his trade or business with a bank incorporated in Singapore or its subsidiaries carrying on financial business unless this person falls within any of the excepted categories in section 5A (section 5A);
- limit portfolio equity investments in a single company to 2% of the capital funds of the bank (section 31);
- limit holdings of immovable property to a reduced amount of 20% of bank's capital funds (section 33); and
- enable MAS to secure compliance with some of the above restrictions on a group basis (section 36).

1.3 Section 30 of the Banking Act (Cap. 19) prohibits banks from carrying on, or entering into any partnership, joint venture or other arrangement with any person to carry on businesses other than banking business, financial businesses and businesses approved by MAS. Section 30 gives banks some flexibility to carry on businesses that are not clearly financial if these businesses are assessed not to be in contravention of the anti-commingling policy objectives. MAS has been clarifying which businesses are not prohibited under section 30 by prescribing such businesses as a class of business which the bank may carry on, and approving such businesses on a case-by-case basis.

1.4 MAS is proposing to allow banks to carry on new businesses that are related or complementary to the bank's core financial business but which may not be clearly financial, without the need for prior prescription by class or specific approval on a case-by-case basis by MAS, subject to certain conditions, limits and requirements. The proposed changes will allow banks to carry on such related or complementary businesses under section 30, and also allow banks to hold wholly-owned subsidiaries for the purpose of

segregating risks arising from carrying on such businesses under section 32 without the need to get the Authority's prior approval provided that certain requirements are met by the bank. Businesses which are clearly non-financial in nature will continue to be prohibited. All other rules under the anti-commingling policy (in paragraph 1.2) remain unchanged.

## **2 PROPOSED CHANGES UNDER REGULATION 23F AND REGULATION 7A**

2.1 MAS is proposing to allow banks to carry on new businesses which are related or complementary to the bank's core financial business but do not clearly satisfy the legal criteria of being business that is financial or incidental to financial business under section 30 of the Banking Act. Banks will be allowed to carry on such businesses without the need for prior prescription by class or specific case-by-case approval from MAS, subject to certain conditions, limits and requirements. Such businesses, and the conditions, limits and requirements, will be prescribed in regulation 23F of the Banking Regulations ("regulation 23F"). MAS is also proposing that banks be allowed to hold wholly-owned subsidiaries for the purpose of segregating risks arising from carrying on the businesses prescribed in regulation 23F without the need for prior approval from the Authority under section 32 of the Banking Act. This will be given effect in the proposed regulation 7A of the Banking Regulations ("regulation 7A"), which will exclude such subsidiaries from the operation of section 32. The draft regulation 23F and regulation 7A are in Annex A of the consultation paper.

2.2 This is a next step to the current framework under section 30 where banks now have the flexibility to carry on certain businesses that are not clearly financial if MAS prescribes those businesses as a class of business which the bank may carry on, or approves those businesses on a case-by-case basis. The proposed changes will give banks greater flexibility to carry on in Singapore businesses related or complementary to financial business that are being done by financial institutions elsewhere in the world, where they are not subject to anti-commingling policies.

2.3 In order to ensure that banks take on new businesses prudently under regulation 23F and manage their risks appropriately, MAS is proposing to place conditions on the types of businesses allowed under regulation 23F, safeguards to ensure that banks are prepared to take on the new businesses, and limits and reporting requirements on the businesses being conducted. MAS will have the power to issue a declaration to a bank to exclude the application of regulation 23F on a case-by-case basis, having regard to the specific circumstances of the bank or in the event that any of the conditions are not satisfied by the bank at any point in time.

2.4 To prevent banks from taking on excessive risks, MAS is proposing to exclude from regulation 23F certain businesses that we have significant concerns with. These excluded businesses will be set out in regulation 23F. MAS will review the types of excluded businesses periodically and amend the regulation accordingly.

2.5 All other rules under the anti-commingling policy (in paragraph 1.2) will not be changed. All other prudential requirements and limits will apply to these businesses carried on under regulation 23F and major stakes held

under regulation 7A, including the capital requirements for banks incorporated in Singapore set out in MAS Notice 637.

2.6 In addition to regulation 23F and regulation 7A, MAS is also proposing to issue a set of guidelines in relation to the use of the two regulations. These guidelines will provide guidance on how banks should apply regulation 23F and regulation 7A, and also highlight MAS' expectations regarding the use of the two regulations. The expectations are complementary to the MAS Guidelines on Risk Management Practices<sup>1</sup>. The proposed guidelines are in Annex B of the consultation paper.

**Proposal 1: To allow banks to carry on businesses that are related or complementary to the bank's core financial business subject to the conditions, safeguards, limits and reporting requirements set out in the draft regulation 23F in Annex A.**

**Proposal 2: To allow banks to hold wholly-owned subsidiaries for the purpose of segregating risks arising from carrying on such new businesses, as set out in the draft regulation 7A in Annex A.**

**Proposal 3: To exclude from regulation 23F certain businesses that MAS has significant concerns with.**

**Proposal 4: To issue a set of guidelines (in Annex B) in relation to the use of regulation 23F and regulation 7A, to provide guidance on how banks should apply those regulations and highlight MAS' expectations.**

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<sup>1</sup> Please see [http://www.mas.gov.sg/legislation\\_guidelines/risk\\_mgt/Guidelines\\_on\\_Risk\\_Management\\_Practices.html](http://www.mas.gov.sg/legislation_guidelines/risk_mgt/Guidelines_on_Risk_Management_Practices.html)

**Annex A**

**PROPOSED REGULATIONS 23F AND 7A**

DISCLAIMER: This version of the amendment regulations is in draft form and subject to change. It is also subject to review by the Attorney-General's Chambers.

BANKING ACT  
(CHAPTER 19)

BANKING (AMENDMENT) (NO. [ ])  
REGULATIONS 2010

In exercise of the powers conferred by sections 30(1) (*d*), 32(5) and 78(1) of the Banking Act, the Monetary Authority of Singapore hereby makes the following Regulations:

**Citation and commencement**

1. These Regulations may be cited as the Banking (Amendment) (No. [ ]) Regulations 2010 and shall come into operation on [*insert date*].

**New regulation 7A**

2. The Banking Regulations are amended by inserting, immediately after regulation 7, the following regulation:

Part IIIA

EXCLUSION OF WHOLLY-OWNED SUBSIDIARIES OF BANK HELD  
MAINLY FOR THE PURPOSE OF SEGREGATING RISKS ARISING  
FROM CARRYING ON A BUSINESS PRESCRIBED IN REGULATION  
23F(1)

**7A.** —(1) The Authority hereby excludes from the operation of section 32 of the Act any company which is wholly-owned (referred to in this regulation and regulation 23F as “wholly-owned subsidiary”) by the bank held mainly for the purpose of segregating risks arising from carrying on a business prescribed in regulation 23F(1) from affecting the bank if, and only if,

- (a) the bank has entered into a legal arrangement with the wholly-owned subsidiary to allow the Authority and any person appointed by the Authority, at any time, to request for any information from the wholly-owned subsidiary and to inspect the books of the wholly-owned subsidiary; and

- (b) the bank procures that every wholly-owned subsidiary of the bank complies with any prudential requirement that the Authority may impose, from time to time, by notice in writing in relation to its carrying on of such business.

### **New regulation 23F**

3. The Banking Regulations are amended by inserting, immediately after regulation 23E, the following regulations:

#### **“Prescribed related or complementary business**

**23F.**—(1) For the purposes of section 30(1)(d) of the Act and subject to paragraphs (2), (3) and (4), a business which fulfils the following requirements is prescribed as a business that any bank in Singapore may carry on, or enter into any partnership, joint venture or any other arrangement with any person to carry on:

- (a) the business is related or complementary to any of the core financial business which is conducted by the bank;
- (b) the business is being carried on by a regulated financial institution in any jurisdiction and permitted —
  - (i) under the laws of that jurisdiction; and
  - (ii) by the supervisory authority of the financial institution;
- (c) the business is permitted to be carried on by the bank —
  - (i) under the laws of the home jurisdiction of the bank; and
  - (ii) by the parent supervisory authority of the bank; and
- (d) is not any other business prescribed for the purposes of section 30(1)(d) and approved under section 30(1)(e) of the Act.

(2) A bank in Singapore may carry on any business prescribed in paragraph (1) if, and only if:

- (a) the bank is satisfied that it has the appropriate policies and procedures, including well-defined risk management policies on financial and non-financial exposures and risk concentrations, and staff with the expertise to manage the business; and
- (b) where the bank is a bank incorporated outside Singapore or a foreign-owned bank incorporated in Singapore with no experience in carrying on the business in its head office or parent bank, it has obtained the prior written approval of its head office or parent bank (as the case may be), and its parent supervisory authority, to carry on the business; and
- (c) any equity investment in a company arising from the business —

- (i) is not intended to be held by the bank for more than 7 years;  
or
- (ii) is not intended to be held by the bank for the purpose of allowing the bank to participate in or make any management decisions for the company;

unless the company is a wholly-owned subsidiary of the bank held mainly for the purpose of segregating certain risks arising from the business prescribed in regulation 23F(1) from affecting the bank, in particular the financial soundness and stability of the bank.

(3) A bank in Singapore shall —

- (a) when carrying on any business prescribed in paragraph (1), limit the Aggregate Size of all such businesses to —
  - (i) 15% of its capital funds or such other percentage as the Authority may approve; and
  - (ii) 15% of the capital funds of its banking group or such other percentage as the Authority may approve;
- (b) when carrying on any business prescribed in paragraph (1) and any business prescribed in regulation 23E(1), limit the Aggregate Size of all such businesses to —
  - (i) 20% of its capital funds or such other percentage as the Authority may approve; and
  - (ii) 20% of the capital funds of its banking group or such other percentage as the Authority may approve;
- (c) provide quarterly reports to the Authority within 10 business days after the end of each quarter on the scale and scope of any business prescribed in paragraph (1) conducted, the risks involved in such business, the capabilities of the bank to manage such risks and such other information as the Authority may require in relation to the business including the requirements specified in the Fourth Schedule; and
- (d) comply with such other conditions or restrictions that the Authority may impose, from time to time, by notice in writing in relation to its carrying on of such businesses.

(4) The reference to a business in paragraph (1) excludes the following types of business:

- (a) property development, not including the “property-related businesses” set out in regulation 21;
- (b) manufacturing and selling of consumer goods;

- (c) provision of hotel and resort facilities;
  - (d) property management of properties not held by the bank or any of its major stake companies;
  - (e) owning, operating or investing in facilities for the extraction, transportation, storage or distribution of commodities; and
  - (f) owning, operating or investing in facilities for processing, refining or otherwise altering commodities.
- (5) If the Authority, having regard to the specific circumstances of a bank in Singapore (including whether the internal controls of the bank are sufficiently robust to effectively monitor and manage the risks of the bank), or in the event that any of the conditions in paragraphs (1), (2) and (3) are not satisfied by the bank at any point in time, issues to the bank a written declaration that paragraph (1) shall no longer apply to the bank in relation to any business specified in the declaration from a specified date, then paragraph (1) shall not apply to the bank from the specified date with respect to that specified business.
- (6) In this regulation, unless the context otherwise requires —
- “Aggregate Size” means the total balance sheet asset value, total revenue or total exposures (whichever is the highest of the three) or such other measure of the size of the businesses as the Authority may specify;
- “capital funds” means —
- (a) in relation to a bank incorporated in Singapore, its capital used for the purposes of calculating its capital adequacy ratio under section 10 of the Act,
  - (b) in relation to the banking group of a bank incorporated in Singapore, the aggregate of —
    - (i) the capital of the bank;
    - (ii) the capital of its subsidiaries; and
    - (iii) the capital of all other entities treated as part of the bank’s group of companies for accounting purposes according to Accounting Standards,that is used for the purposes of calculating its capital adequacy ratio under section 10 of the Act; or
  - (c) in relation to a bank incorporated outside Singapore, means such net head office funds and such other liabilities as the Authority may, by notice in writing, specify.
- “core financial business”, in relation to a bank, means the core business activities that the bank carries out based on its particular business model which are either —

- (a) businesses referred to in section 30(1)(a) to (c) of the Act; or
  - (b) businesses which are similar to the businesses referred to in section 30(1)(a) to (c) of the Act in terms of economic substance and risks;
- “equity investment” has the same meaning as in section 31(5) of the Act;
- “holding company” has the same meaning as in section 5 of the Companies Act (Cap. 50);
- “home jurisdiction”, in relation to a bank, means the jurisdiction under the laws of which the parent supervisory authority of the bank is responsible for supervising the bank, or has consolidated supervision authority over the bank, as the case may be;
- “regulated financial institution”, in relation to any jurisdiction, means a financial institution that is licensed, registered, approved or otherwise regulated in that jurisdiction;
- “supervisory authority” —
- (a) in relation to a financial institution, the ultimate holding financial institution of which is a financial institution incorporated, formed or established in Singapore, means the Authority; or
  - (b) in relation to a financial institution, the ultimate holding financial institution of which is a financial institution incorporated, formed or established in a jurisdiction outside Singapore, means the supervisory authority which is responsible, under the laws of that jurisdiction, for supervising the ultimate holding financial institution;
- “ultimate holding financial institution”, in relation to a financial institution, means —
- (a) if the ultimate holding company of the financial institution is a financial institution, the ultimate holding company; or
  - (b) in any other case, a holding company of the financial institution that is a financial institution and that is not itself a subsidiary of any other financial institution.”

### **New Fourth Schedule**

**4.** The Banking Regulations are amended by inserting, immediately after the Third Schedule, the following Schedule:

## “FOURTH SCHEDULE

Regulation 23F

### REQUIREMENTS FOR QUARTERLY REPORT TO BE SUBMITTED TO AUTHORITY

A bank shall submit the following information for the quarterly reporting:

- (i) balance sheet value, revenue numbers, and exposures of businesses carried on under regulation 23F;
- (ii) utilisation of the regulatory limit under regulation 23F and utilisation of the combined limit under regulation 23F and 23E;
- (iii) key internal risk metrics, in addition to the regulatory limit;
- (iv) for new businesses carried on under regulation 23F in the past quarter, an assessment of the impact of the new business on the risk profile of the bank, and key risk mitigation and contingency plans;
- (v) internal and external audit reports on the businesses and risk management of the businesses carried on under regulation 23F;
- (vi) stress test results of businesses carried on under regulation 23F;
- (vii) business activities, changes in corporate governance structure and business activities of the wholly-owned subsidiary of the bank referred to in regulation 7A;
- (viii) total balance sheet value, total revenue numbers, and total exposures of a wholly-owned subsidiary of the bank referred to in regulation 7A;
- (ix) provision by the bank of any additional guarantee or letter of comfort to the wholly-owned subsidiary of the bank referred to in regulation 7A;
- (x) changes in the bank’s investment in and exposure to the wholly-owned subsidiary of the bank referred to in regulation 7A; and
- (xi) any supervisory, legal, reputational or other significant matters relating to the wholly-owned subsidiary of the bank referred to in regulation 7A;”

**Annex B**

**PROPOSED GUIDELINES ON BANKING  
REGULATIONS 23F AND 7A**

**1 INTRODUCTION**

1.1 Regulation 23F of the Banking Regulations (“regulation 23F”) extends the flexibility given to banks in Singapore to carry on businesses which are related or complementary to the bank’s core financial business but do not clearly satisfy the legal criteria of being financial or incidental to financial business under section 30 of the Banking Act (“s.30”). Regulation 23F allows a bank to carry on such businesses without the need for prior prescription by class or specific approval on a case by case basis from the Monetary Authority of Singapore (“MAS”), subject to certain conditions, limits and requirements. Regulation 7A of the Banking Regulations (“regulation 7A”) excludes a wholly-owned subsidiary of the bank conducting businesses under regulation 23F from the operation of section 32 of the Banking Act provided the subsidiary is for the purpose of segregating risks arising from carrying on those businesses. These guidelines seek to clarify MAS’ policy on how banks should conduct its operations under regulation 23F and regulation 7A.

1.2 Section 2 of these guidelines sets out guidance on how regulation 23F and regulation 7A should be applied. In particular, it clarifies MAS’ position on how the conditions, limits and requirements should be met.

1.3 One of the requirements in regulation 23F is that the bank must be satisfied that it has the appropriate policies and procedures to carry on these businesses, including well-defined risk management policies on both financial and non-financial exposures and risk concentrations, and staff with the expertise to manage the businesses under regulation 23F. At the minimum, MAS expects a bank to have regard to the MAS Guidelines on Risk Management when formulating its policies and procedures for businesses carried on under regulation 23F. Section 3 of these guidelines sets out MAS’ additional supervisory expectations of the bank when it uses regulations 23F and 7A.

1.4 Section 4 of these guidelines clarifies the approvals that are required from MAS and the process banks should go through with the introduction of regulations 23F and 7A.

1.5 The Banking Regulations and Guidelines only apply to banks licensed under the Banking Act (Cap 19). Nothing in these guidelines modify or detract from the requirements set out in the Banking Act, Banking Regulations, and written directions issued pursuant to the Banking Act. Financial institutions should seek their own legal advice when applying the Banking Act and Banking Regulations.

## 2 GUIDANCE ON REGULATIONS 23F AND 7A

2.1 Regulation 23F allows banks to carry on businesses that do not fall within s.30(1)(a) to (c) of the Banking Act, subject to certain conditions, limits and requirements. Regulation 7A excludes wholly-owned subsidiaries carrying on businesses under regulation 23F from the operation of section 32, provided these subsidiaries are for the purpose of segregating risks arising from carrying on those businesses. This section clarifies MAS' policy on the application of these conditions, limits and requirements.

### Types of Businesses

2.2 Regulation 23F widens the permissible businesses beyond those that are strictly financial and incidental to financial, and allow businesses which are more broadly related or complementary to the core financial business of the bank. These businesses should support the bank's financial businesses and should not be unrelated to the core financial business of the bank. It is insufficient that the business is profitable for the bank – the bank has to show a connection between the businesses and the core financial business of the bank. For instance, such businesses could include Islamic finance businesses that have not been specifically provided for in regulations. Certain Shariah-compliant financing structures may be akin to trading or other non-financial businesses through the use of tangible assets and risk-sharing structures, but as they are fundamentally financing instruments, they are related to the core financial business of the Islamic bank. Other businesses that could be considered broadly related or complementary to the core financial business of the bank include businesses involving non-financial assets for the purposes of hedging or diversification of market positions.

2.3 Whether a business is considered related or complementary to the core financial business of a bank depends in part on the business model of the bank. A business related or complementary to the core financial business of one bank may not necessarily be considered related or complementary to the core financial business of another bank. For instance, businesses considered related or complementary to an investment bank's core financial business may not be considered related or complementary to a commercial retail bank's core financial business.

2.4 The businesses must already be carried on by a regulated financial institution in any jurisdiction, and permitted under the laws of that jurisdiction and by the supervisory authority of the financial institution. This is to ensure that the businesses carried on under regulation 23F are related or complementary to financial business and are carried out by financial institutions internationally. The businesses also have to be allowed by the parent supervisory authority of the bank, under the laws of the home jurisdiction of the bank. MAS will not allow a bank to carry on a business that the bank's parent supervisory authority does not permit or are not permitted under the laws of the bank's home jurisdiction.

2.5 Finally, regulation 23F does not apply to businesses which are already specifically prescribed under section 30(1)(d) or approved under section 30(1)(e) of the Banking Act. Thus, regulation 23F does not apply to private equity and venture capital (“PE/VC”) investments and those Islamic banking transactions which are prescribed in regulations issued pursuant to section 30(1)(d). Other specific limits in the Banking Act, such as the section 33 limit on investments in immovable property, will continue to apply.

### Safeguards

2.6 Regulation 23F also imposes safeguards in the form of pre-requisites a bank must fulfill. The bank must meet all these prerequisites before commencing new businesses under regulation 23F.

2.7 In order to ensure that the bank has assessed that all the conditions and prerequisites are met, MAS requires the bank to develop an approval framework for businesses to be carried on under regulation 23F, and to submit this approval framework before the bank commences any business under regulation 23F. This framework should detail the governance, internal approval processes and the parameters for businesses carried on under regulation 23F. It should also clearly set out criteria and parameters for the Board and senior management to assess whether a business meets the conditions and pre-requisites under regulation 23F. This approval framework is subject to additional expectations set out in Section 3 of these guidelines.

2.8 Where a bank is a bank incorporated outside Singapore or a foreign-owned bank incorporated in Singapore (“foreign bank”) seeks to carry on a new business in Singapore with no previous experience in carrying on the business in its head office or parent bank, it has to obtain the prior written approval of its head office or parent bank (as the case may be), as well as its parent supervisory authority’s prior written approval to carry on the business. This is to ensure that there is oversight by the head office or parent bank and parent supervisory authority over the foreign bank branch’s or subsidiary’s carrying on of this new business in Singapore.

2.9 Regulation 23F should not be used for any long term equity investment which is intended to be held by the bank for the purpose of allowing the bank to participate in or make any management decisions for the company, unless the company is a wholly-owned subsidiary of the bank held mainly for the purpose of segregating the risks arising from carrying on the businesses under regulation 23F from affecting the bank, in particular the financial soundness and stability of the bank. This is to prevent the bank from taking on excessive conglomerate risks by using regulation 23F to take long-term strategic stakes in non-financial companies. We would generally consider an investment that is intended to be held for a period longer than seven years to be an investment held in the “long term”.

## Subsidiaries under Regulation 7A

2.10 The exception to the restriction in paragraph 2.9 is the holding of a wholly-owned subsidiary by the bank for the purpose of segregating risks arising from businesses which may be carried on under regulation 23F from affecting the bank, in particular the financial soundness and stability of the bank. The bank may hold and control a wholly-owned subsidiary under regulation 23F, provided that the bank demonstrates that this business would otherwise be done directly by the bank under regulation 23F, and is being carried out using a subsidiary because the bank wishes to segregate the risks arising from carrying on the business. The bank must assess that conducting the business through a subsidiary would segregate the risks better than conducting the business on its own balance-sheet. Regulation 7A excludes the bank from the operation of section 32, so that the bank does not need to seek prior approval from MAS to hold a major stake in such a subsidiary. The subsidiary's business should be conducted in accordance with all the other conditions of regulation 23F and be subject to all the limits and requirements. Such a subsidiary should not be used to make equity investments in other entities. The bank is subject to all other prudential rules applicable in respect of such a subsidiary, including the limit of 2% of the bank's capital funds on an equity investment in a single company, under section 31 of the Banking Act. MAS and any person appointed by MAS must be allowed, at any time, under a legal arrangement entered into between the bank and the subsidiary, to request for any information from the subsidiary and to inspect the books of the subsidiary. Further, the bank is subject to additional limits and reporting requirements, set out in paragraphs 2.11 to 2.14, and additional expectations, set out in Section 3 of these guidelines, in respect of such a subsidiary.

## Limits and Reporting Requirements

2.11 Regulation 23F limits the highest of the following three measures – total balance sheet asset value, total revenue, or total exposures<sup>2</sup> – of businesses under regulation 23F to 15% of the bank's capital funds at bank and bank group level. These three measures include all businesses carried on under regulation 23F, regardless of whether the business is booked in the bank's DBU or ACU. This condition mitigates the direct financial risk of the investment in such businesses. As stated in paragraph 2.5, a bank is not allowed to include under regulation 23F other businesses which are specifically prescribed under section 30(1)(d), such as PE/VC investments. In addition, there is a combined cap of 20% of the bank's capital funds at bank and bank group level for businesses being carried on under regulation 23F and PE/VC investments<sup>3</sup>. For a subsidiary under regulation 7A, the bank is

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<sup>2</sup> This is as defined in the Fifth Schedule of the Banking Act. We would expect the bank to include any guarantee, indemnity, letter of comfort or any such letter imposing similar obligations on the bank in support of the subsidiary as an exposure.

<sup>3</sup> Under the proposed Regulation 23E, PE/VC investments are subject to a cap of 10% of the bank's capital funds at bank and bank group level.

required to include the highest of the following three measures – total balance sheet asset value, total revenue, or total exposures<sup>4</sup> – of the subsidiary for the calculation of whether the 15% and 20% limits have been met.

2.12 MAS may also impose other limits on a case-by-case basis, should these be appropriate. These limits can apply to specific banks, or to specific businesses or investments of the bank.

2.13 The bank is required to provide quarterly reports to MAS on the scale and the scope of businesses carried on under regulation 23F, the risks involved, and the capabilities of the bank to manage these risks and such other information as the Authority may require in relation to the business including the requirements specified in the Fourth Schedule. The quarterly reporting will enable MAS to maintain oversight over the businesses being carried on under regulation 23F and the bank's risk management practices. The quarterly report shall be submitted to MAS within 10 business days after the end of every quarter.

2.14 The minimum information banks are required to submit for the quarterly reporting has been set out in the Fourth Schedule of the Banking Regulations, and includes the following items:

- (i) Balance sheet value, revenue numbers, and exposures of businesses carried on under regulation 23F;
- (ii) Utilisation of the regulatory limit under regulation 23F and utilisation of the combined limit under regulation 23F and 23E;
- (iii) Key internal risk metrics, in addition to the regulatory limit;
- (iv) For new businesses carried on under regulation 23F in the past quarter, an assessment of the impact of the new business on the risk profile of the bank, and key risk mitigation and contingency plans;
- (v) Internal and external audit reports on the businesses and risk management of the businesses carried on under regulation 23F;
- (vi) Stress test results of businesses carried on under regulation 23F;
- (vii) Business activities, and changes in corporate governance structure and business activities of the wholly-owned subsidiary of the bank referred to in regulation 7A;
- (viii) Total balance sheet value, total revenue numbers, and total exposures of a wholly-owned subsidiary of the bank referred to in regulation 7A;
- (ix) Provision by the bank of any additional guarantee or letter of comfort to the wholly-owned subsidiary of the bank referred to in regulation 7A;
- (x) Changes in the bank's investment in and exposure to the wholly-owned subsidiary of the bank referred to in regulation 7A; and

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<sup>4</sup> This is as defined in the Fifth Schedule of the Banking Act. We would expect the bank to include any guarantee, indemnity, letter of comfort or any such letter imposing similar obligations on the bank in support of the subsidiary as an exposure.

- (xi) Any supervisory, legal, reputational or other significant matters relating to the wholly-owned subsidiary of the bank referred to in regulation 7A.

### Powers to Exclude Application of Regulation 23F

2.15 MAS has the power to issue a declaration to a bank to exclude the application of regulation 23F on a case-by-case basis. Based on its assessment of the specific circumstances of a bank, MAS may direct the bank to stop a business or a class of businesses under the regulation 23F by issuing a written declaration that regulation 23F shall no longer apply to the bank in relation to any business specified in the declaration. Such circumstances could include, but are not limited to, situations where the risk management and internal controls of the bank are not sufficiently robust to effectively monitor and manage the risks, or where any of the conditions or limits is no longer satisfied. This power to exclude the application of regulation 23F may be applied to specific banks, to specific businesses within a bank, or to specific types of businesses. MAS will have regard to the specific circumstances to determine a period in which the bank has to comply with the declaration to stop that business.

### **3 SUPERVISORY EXPECTATIONS**

#### **I INTERNAL APPROVAL FRAMEWORK**

3.1 As stated in paragraph 2.7, MAS requires the bank's Board of Directors and senior management to establish a clear internal approval framework to be submitted to MAS for information prior to any use of regulation 23F. The approval framework should also outline the risk management processes and procedures for the use of regulation 23F approved by the bank's Board and senior management. MAS expects the bank's internal auditors to test, on a regular basis whether the bank's decisions to carry on certain businesses under regulation 23F comply with the requirements set out in the regulation.

3.2 Given the risks of these new businesses, MAS expects the Board and senior management to approve proposals for these businesses under regulation 23F. The approval framework should establish whether the Board and senior management would need to approve every business under regulation 23F, or businesses above certain pre-determined thresholds. For example, if the bank's Board is located outside Singapore, the framework may provide that the bank's Chief Executive Officer and senior management in Singapore may approve businesses under a certain threshold.

3.3 If approval thresholds are established, the Board and senior management should approve these thresholds and review the validity of these thresholds regularly. In setting these approval thresholds, the bank should take into account not only the balance-sheet size of the business, but also other measures such as the bank's revenue or potential exposure – including exposure to reputational risk – of the business proposed to be carried on under regulation 23F (please see also paragraph 3.6).

#### **II RISK MANAGEMENT PROCESSES**

3.4 In addition to the internal approval framework, MAS expects the bank to demonstrate managerial expertise, and establish comprehensive and appropriate risk management processes and procedures for businesses carried on under regulation 23F. These include policies for monitoring, measuring, and controlling the credit, market, settlement, reputational, legal, and operational risks involved. The policies should also describe critical internal control elements, such as reporting lines, escalation procedures, and the frequency and scope of internal and external audits of the businesses. MAS expects internal audit to provide to the bank's Board and senior management periodic key performance indicator tracking reports and any additional measures tracked as part of the bank's change in business review process.

3.5 MAS emphasizes that the new businesses under regulation 23F may expose the bank to significantly different types of risks from those that the

bank traditionally takes on. As such, it is critical that banks carrying on such businesses have appropriate arrangements in place to manage the different types of exposures and the resulting range of risks.

### Risk Limits and Monitoring

3.6 MAS has prescribed in regulation 23F a regulatory limit of 15% of the bank's capital funds for businesses carried on under regulation 23F, and a combined regulatory limit for businesses carried on under regulation 23F and PE/VC investments of 20% of the bank's capital funds. In addition to these regulatory limits, MAS expects the bank to set additional risk metrics and trigger limits that are appropriate to each business carried on under regulation 23F. These internal metrics and limits should convey accurately and comprehensively all material risk types – not only financial but also non-financial risk such as operational, legal, reputational and other risks – to the bank of businesses carried on under regulation 23F. Risks from the business both on- and off-balance-sheet should be accounted for and monitored.

3.7 The bank should ensure that its risk management methodology with regard to these new businesses is robust. For instance, if non-financial assets are held by the bank under regulation 23F, the bank should ensure that it has a robust methodology for valuing the assets and assessing the non-financial risks from the businesses, such as any third party liability risks and uninsurable risks, in order to accurately capture both the financial and non-financial risks. MAS expects the business carried on under regulation 23F to have undergone a rigorous new product approval process. The bank should also consider an external audit on its risk management methodology for the new business.

3.8 MAS also expects the bank to conduct regular stress tests on businesses carried on under regulation 23F. The bank should identify potential stress scenarios or events that could adversely impact the bank arising from these new businesses. The stress tests should be sufficiently granular to examine the effects of shocks across all relevant risk factors from these new businesses and any potential inter-relations with other businesses of the bank that could be affected. The bank should not only consider financial risk to measures like asset value, exposure and revenue but also non-financial risk. The bank is also expected to put in place mitigating techniques and contingency plans against material risks identified from these stress tests.

3.9 There may be cases where the bank is carrying on a business under regulation 23F, but has booked the business in its Head Office or a related entity outside Singapore with profits and losses attributed back to the bank. Although the transactions do not appear on the bank's balance-sheet, the bank should account for the actual risk it is effectively taking on, through appropriate risk metrics. Where the bank has engaged in the business on a risk-sharing basis with its Head Office or related entity, the risk-sharing agreement should be clearly documented.

### **III INDEPENDENT REVIEW**

3.10 The bank's internal auditors are expected to conduct an end-to-end audit of the risk management process and internal controls within 1 year of the commencement of the new business. The bank should engage an external auditor to audit, on an annual basis, the businesses carried on under regulation 23F, including the robustness of the bank's internal approval framework, valuation methodology for non-financial assets, and risk management processes. Where circumstances warrant, MAS may specifically request external audits of the bank's control processes over the businesses carried on under regulation 23F.

### **IV REPORTING TO MAS ON BUSINESSES CARRIED ON UNDER REGULATION 23F**

3.11 On an ongoing basis, the bank is required under regulation 23F to submit quarterly reports to MAS on the scale and scope of its businesses carried on under the regulation, the risks involved in such business and the capabilities of the bank to manage such risks. MAS has set out in the Fourth Schedule to the Banking Regulations the minimum information banks are required to submit for the quarterly reporting. Given the diversity of businesses that may be carried on under regulation 23F, MAS expects the bank to supplement this minimum list of information with all pertinent information in its quarterly reporting. For avoidance of doubt, the quarterly report is to be submitted only if the bank is carrying on the business under regulation 23F.

3.12 Notwithstanding this regular reporting, the bank is expected to inform MAS promptly of pertinent issues and concerns encountered in businesses carried on under regulation 23F that have a material impact on the bank, as and when these occur. This includes issues and concerns relating to subsidiaries under regulation 7A, such as any changes that have a material impact on the subsidiaries' risk profile.

## **4 APPROVALS FROM MAS WITH THE INTRODUCTION OF REGULATIONS 23F AND 7A**

### **I APPROVALS UNDER S.30(1)(E) OF BANKING ACT**

4.1 With the introduction of regulation 23F, if the bank seeks to carry on a business that may not be clearly financial, the bank should first assess for itself whether the business meets the conditions and pre-requisites of regulation 23F. If the business meets the conditions and pre-requisites of regulation 23F, the bank can carry on the business up to the regulatory limit under regulation 23F without MAS' prior approval.

4.2 While the bank may still approach MAS for case-by-case approval of businesses under section 30(1)(e), MAS expects the bank to assess that the proposed business meets the conditions and pre-requisites under regulation 23F first, as MAS is not prepared to approve businesses that do not qualify for regulation 23F under section 30(1)(e). For such businesses which the bank has assessed to qualify for regulation 23F, the bank may proceed to carry on the business under regulation 23F while seeking approval under section 30(1)(e) from MAS.

4.3 Where the bank applies for case-by-case approval for a business under section 30(1)(e) from MAS, when granting approval MAS may require the bank to count the business towards the regulation 23F regulatory limit as a condition of approval. If MAS does not grant approval and the bank is already conducting the business under regulation 23F, MAS may direct the bank to stop the business altogether if MAS assesses that the business does not qualify for regulation 23F. Where MAS has directed the bank to stop a business or a class of business under regulation 23F by issuing a declaration, MAS will have regard to the specific circumstances to determine a period in which the bank has to comply with as stated in the declaration to stop that business.

### **II APPROVALS UNDER SECTION 32 OF BANKING ACT**

4.4 Banks continue to be required to seek section 32 approval for major stakes in companies, except where the bank wishes to hold a wholly-owned subsidiary to conduct a business that the bank has already assessed to qualify for regulation 23F, which the bank would otherwise engage in directly, for the purpose of segregating the risks arising from carrying on the new business<sup>5</sup>. Such subsidiaries are excluded from the operation of section 32 under regulation 7A, so banks do not need to seek prior approval to hold a major stake in such subsidiaries.

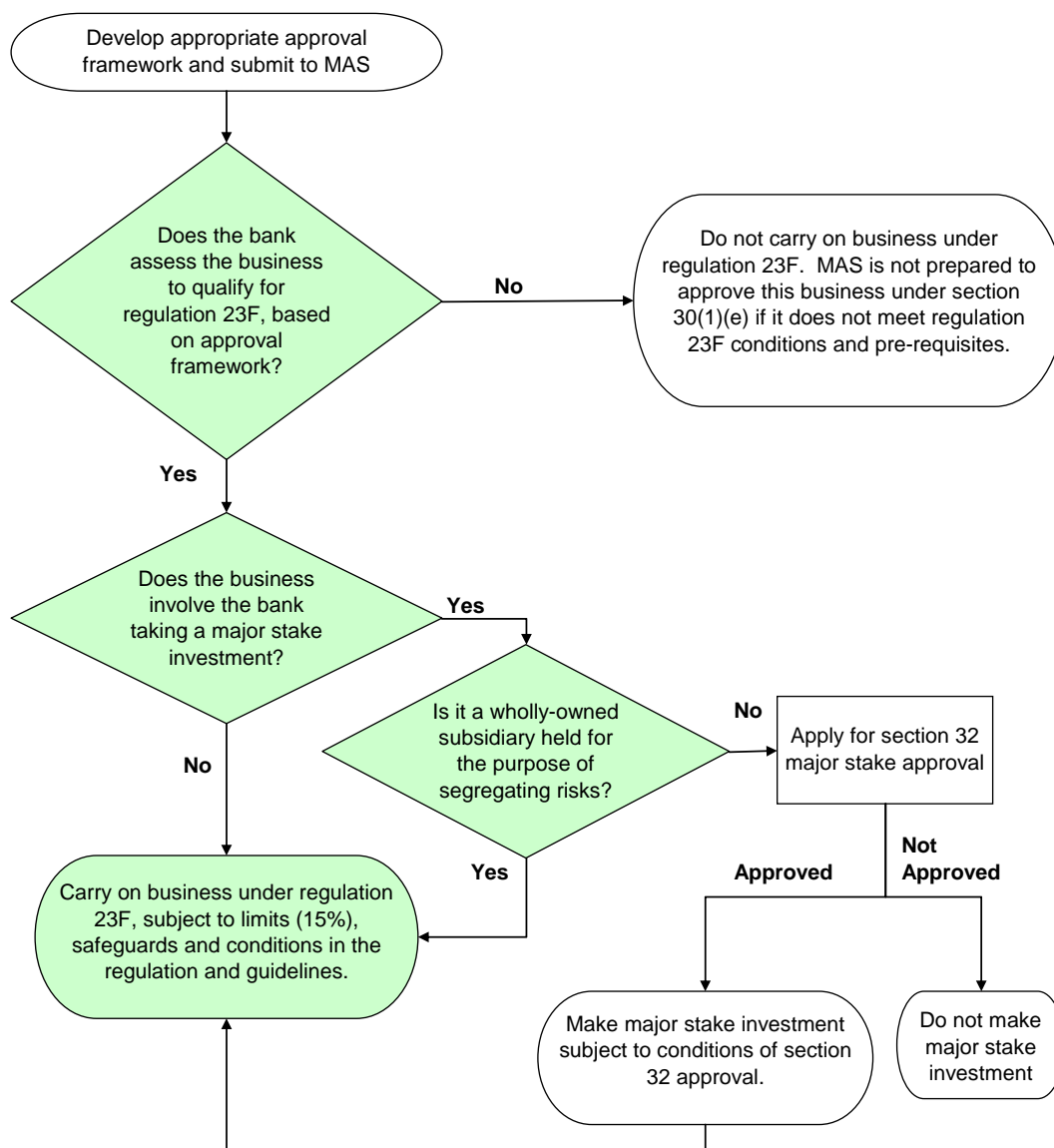
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<sup>5</sup> The exception has also been set out earlier in paragraph 2.10.

### III PROCESS

4.5 Diagram A outlines the process a bank should go through when it seeks to carry on a new business that may qualify for regulation 23F.

**Diagram A: Flowchart of Regulation 23F Process**



\* The parts of the process where the bank can make its own assessment and need not approach MAS are shaded in light green.



Monetary Authority of Singapore