



RESPONSE TO FEEDBACK RECEIVED – CONSULTATION ON PROPOSED AMENDMENTS TO MAS NOTICE 637 ON RISK BASED CAPITAL ADEQUACY REQUIREMENTS FOR BANKS INCORPORATED IN SINGAPORE

1 Introduction

1.1 On 15 January 2010, MAS issued a consultation paper inviting Singapore-incorporated banks and interested parties to comment on proposed amendments to MAS Notice 637 (“the Notice”), which incorporated recommendations by the Basel Committee on Banking Supervision (“BCBS”) to enhance the Basel II framework and to strengthen the rules governing trading book capital¹ (“BCBS July 2009 proposals”), as well as other proposed amendments arising from MAS’ ongoing policy review of the capital rules and guidance. We thank all respondents for their comments.

1.2 The responses provided herein relate to some proposed amendments arising from MAS’ ongoing policy review, as well as the proposals relating to Pillar 2 within the BCBS July 2009 proposals. In relation to the feedback received on these amendments, MAS has considered carefully the feedback received, and has incorporated them into the rules and guidance² where it has agreed with the feedback. Comments that are of wider interest, together with our responses, are set out below.

1.3 On 18 June 2010, BCBS announced certain adjustments relating to the market risk amendments. As part of the announcement, BCBS also agreed

¹ Please refer to “Enhancements to the Basel II framework”, “Guidelines for computing capital for incremental risk in the trading book” and “Revisions to the Basel II market risk framework” published by the Basel Committee in July 2009 (www.bis.org).

² The revisions have been incorporated in MAS Notice 637, revised on 1 July 2010.

to a revised implementation date by end-2011 for the market risk and Pillar 1 enhancements. MAS intends to follow the revised timeline and is currently assessing how these changes should be incorporated within MAS Notice 637. As such, the amendments to MAS Notice 637, other than those effected today, will now be implemented at a later date. We will issue responses to feedback received on those areas at a later date as well.

2 Regulated exchange

2.1 Some respondents requested for clarity on the definition of a “regulated exchange”.

MAS’ Response

2.2 MAS will clarify in Annex 2A of the Notice that a regulated exchange refers to any exchange regulated by MAS or regulated by a financial services regulatory authority of a country or territory other than Singapore.

3 Building capital buffers

3.1 With respect to the proposed amendments to paragraph 10.2.2, one respondent sought further guidance as to how the requirement that the ICAAP should “consider the prudence of building excess capital over benign periods of the credit cycle and also to withstand a severe and prolonged market downturn” is to be interpreted and applied. One interpretation is that a Reporting Bank identifies potential management actions and contingency plans as part of its multi-year capital stress test covering severe scenarios, and assesses that it is able to meet minimum capital adequacy requirements after considering the effect of those management actions.

MAS’ Response

3.2 Outside periods of stress, a Reporting Bank should hold adequate capital buffers which should be available to absorb losses and are large

enough for the bank to maintain its capital levels above minimum requirements as a “going concern” throughout a significant downturn, after allowing for realistic management actions. A Reporting Bank would need to assess its capital buffer by analysing the changes in capital resources and requirements in its multi-year capital plan under severe stress scenario(s) and critically evaluating the feasibility and impact of identified management actions and contingency plans.

4 Exposure measurement of available-for-sale (“AFS”) equity securities

4.1 One respondent requested clarification on the exposure measurement of AFS equity securities.

MAS’ Response

4.2 With effect from 5 July 2010, MAS intends to recognise revaluation gains arising from all marketable AFS equity securities as Tier 2 Capital (i.e. those that are listed or traded on a regulated exchange and not only those listed in Singapore or a recognised group A exchange). Notwithstanding this, the existing conditions pertaining to revaluations continue to apply (as set out in paragraph 6.2.1(d) of MAS Notice 637).

4.3 For exposure measurement purposes, the valuation of such AFS equity securities should be the sum of the cost of the equity investment and 45% of revaluation gains with respect to the equity investment (as set out in footnote 105(d)).

5 Option to recognise revaluation gains on AFS equity securities as Tier 2 Capital

5.1 Some respondents asked if the choice of whether to recognise revaluation gains from AFS equity securities within Tier 2 Capital will be

retained, and if banks would be able to re-elect whether or not to recognise such revaluation gains.

MAS' Response

5.2 Currently, where a bank elects not to recognise revaluation gains from AFS equity securities within Tier 2 Capital, such AFS equity securities will be measured at cost for capital adequacy calculation. This is not prudent for two reasons. Firstly, the use of cost for valuing marketable AFS equity securities may understate current market values and the corresponding risks arising from such holdings. Secondly, unrealised losses are similarly excluded from Eligible Total Capital (“ETC”) where a bank elects not to recognise revaluation gains on its equity investments. As noted in the global financial crisis and highlighted by the BCBS in its Dec 2009 proposals, the filtering of such unrealised losses overstates the level of capital and has undermined the confidence in Tier 1 Capital.

5.3 Accordingly, the current option that allows a bank not to recognise revaluation gains arising from AFS equity securities within Tier 2 Capital (the “option”) will be removed. For banks that currently opted not to recognise such gains, a transition period will be extended to such banks to achieve compliance from 1 Jan 2011 onwards. The issue of re-election would no longer be relevant given the removal of the current option.

MONETARY AUTHORITY OF SINGAPORE

5 July 2010