



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 (“Reporting Banks”) and interested parties to comment on proposed amendments to MAS Notice 637. The proposed amendments incorporated enhancements by the Basel Committee on Banking Supervision (“BCBS”) issued in July 2009 on capital requirements and disclosures for market risk and securitisations and guidance on bank-wide risk management and capital planning processes under Pillar 2¹, as well as other policy enhancements arising from MAS’ ongoing review of the capital rules. On 18 June 2010 and 11 February 2011, BCBS published further adjustments to the Basel II market risk framework. The BCBS also revised the implementation date for enhancements to capital requirements and disclosures for market risk and securitisations to no later than 31 Dec 2011.

1.2 Following the consultation in January 2010, MAS amended MAS Notice 637 in July 2010 to strengthen the guidance under Pillar 2 on bank-wide risk management and capital planning processes, as well as some amendments arising from MAS’ policy review. MAS’ response to feedback relating to those amendments was issued on 5 July 2010.

1.3 The revisions to MAS Notice 637 relating to capital requirements and disclosures for market risk and securitisations, as well as other amendments

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).

arising from MAS' policy review, will be implemented on 31 December 2011. Comments received from the consultation relating to these areas that are of wider interest and MAS' responses are set out below. The revisions to MAS Notice 637 also incorporate the adjustments to the Basel II market risk framework issued by the BCBS on 18 June 2010 and 11 February 2011.

1.4 We thank all respondents for their comments.

2 Stress period used for stressed VaR

2.1 The new paragraph 8.3.70(f) requires that the stressed VaR measure be based on model inputs calibrated to historical data from a continuous 12-month period of significant financial stress relevant to the Reporting Bank's portfolio, and that the period used shall be approved by MAS. The 2007/2008 period was cited as an example of such a period. One respondent sought clarification on the stress period chosen and the grounds on which deviation from the 2007/2008 period would be admissible.

MAS' Response

2.2 Reporting Banks are expected to run stress tests on their portfolio to discover portfolio vulnerabilities on an ongoing basis. The stressed VaR should be calibrated to a period relevant to the Reporting Banks' portfolio. The period of 2007/08 was cited as an example of a 12-month period during which many portfolios would have experienced significant stress. It was not intended to be prescriptive or exhaustive. A Reporting Bank must consider if there are other periods that are relevant to its portfolio.

3 Stressed VaR

3.1 A respondent requested clarification on whether stressed VaR applies to only general market risk or both general and specific market risk.

MAS' Response

3.2 The intention is for stressed VaR to cover both general and specific market risk. We have revised Schedule 3-2A of Part XII (Reporting Schedules) of MAS Notice 637 to reflect this.

4 Use of anti-thetic data in computing stressed VaR

4.1 The new paragraph 8.3.70(g) cites the use of anti-thetic data as an example that the Reporting Bank should consider in computing an appropriate stressed VaR. One respondent sought clarification on how this should be interpreted and applied.

MAS' Response

4.2 Anti-thetic in this context means that price movements are considered relevant irrespective of their direction. For example, if a time series included a significant upward spike in equity prices, the model could apply significant movements in equity prices both upwards and downwards. This might be particularly relevant if a Reporting Bank's portfolio is the "right way" to a period of financial stress (i.e. long equities in a period of stock market surge) and should reflect that open risk positions (in either direction) are vulnerable to stressed variables.

5 Market risk capital requirement shall be met daily

5.1 With reference to the new paragraph 8.3.70(h), one respondent sought clarification on whether the phrase "shall be met daily" was intended to mean that there should be monitoring against specific internal or external thresholds, or that the market risk capital requirement was to be computed every day.

MAS' Response

5.2 Reporting Banks are expected to calculate their market risk capital requirement, and ensure that there is enough capital to meet its market risk capital requirement, on a daily basis.

6 Average of stressed VaR over the preceding 60 business days

6.1 In computing the market risk capital requirement, the new paragraph 8.3.70(h)(ii) requires that the Reporting Bank determines the higher of its latest available stressed VaR measure and an average of the stressed VaR measures over the preceding 60 business days. One respondent requested clarification on whether the latter refers to the average of weekly stressed VaR available and falling within 60 days before the reporting date.

MAS' Response

6.2 The average of the stressed VaR measures over the preceding 60 business days would refer to the average of the weekly stressed VaR measures for the preceding 60 days for Reporting Banks which calculate stressed VaR weekly.

7 Backtesting general and specific market risk

7.1 With respect to the new paragraph 8.3.78F, one respondent sought clarification on the scope of backtesting general and specific market risk, in particular –

- whether backtesting of general risk refers to performing backtesting based on an aggregate VaR measure against total profit and loss at the entire trading book level; and
- whether backtesting of specific risk refers to backtesting at sub-portfolio level and not the total trading book level, and whether the respective

portfolio VaR should be used against the corresponding portfolio level profit and loss.

MAS' Response

7.2 At a minimum, backtesting of general risk is to be performed on an aggregate level for all general risks that the Reporting Bank has approval from MAS to use a VaR model and backtesting of specific risk is to be performed at sub-portfolio levels pertaining to specific risk, i.e. based on the respective portfolio VaR against the corresponding portfolio level profit and loss. However, the Reporting Bank should also incorporate other backtesting methods to assess the performance of its VaR model.

8 Changes to sub-portfolio structure

8.1 The new paragraph 8.3.81A states that the Reporting Bank shall not make changes to any sub-portfolio structure without MAS' prior approval. One respondent sought clarification on the approval process involved. As portfolio groupings may change based on how the trading business or trading desks are organised over time, this requirement could potentially pose operational constraints.

MAS' Response

8.2 The Reporting Bank should decide on a meaningful sub-portfolio structure and this is not expected to vary significantly over time. Where it is absolutely necessary to make changes to the sub-portfolio level, the Reporting Bank would have to maintain backtest results on both the current and proposed sub-portfolio levels for a period of time in order to assess the model performance.

9 Requirement for incremental risk capital charge

9.1 One respondent asked if incremental risk capital charge was intended to replace specific risk capital charge.

MAS' Response

9.2 Incremental risk capital charge is in addition to specific risk capital charge, not a replacement. Incremental risk capital charge represents the charges on incremental default and migration risks, which are not fully captured by the specific risk model.

10 Clarifications on Reporting Schedule 3-2A

10.1 One respondent requested the following clarifications on Reporting Schedule 3-2A:

- whether the schedule is applicable only at the Group level or at both Group and Solo levels;
- if it is applicable at both Group and Solo levels, whether the scaling factor for Group and Solo market risk-weighted assets ("RWA") could differ based on the respective backtesting results at the Group and Solo levels;
- whether the intention is to require details of backtesting exceptions to be based on both hypothetical profit and loss ("P&L") and actual P&L; and
- if the Reporting Bank has only adopted IMA for general risk, whether backtesting based on aggregate VaR would suffice.

MAS' Response

10.2 The schedule should be prepared on both Group and Solo levels. The scaling factor for Group and Solo market RWA may differ based on the respective backtesting results.

10.3 For reporting purposes, the Reporting Bank is only required to submit the reasons for backtesting exceptions based on hypothetical P&L. However, there could be situations where MAS may require the Reporting Bank to furnish reasons for exceptions based on actual P&L.

10.4 For reporting purposes, the Reporting Bank is only required to provide backtesting results on an aggregate VaR basis for general market risk. However, the Reporting Bank should also perform backtesting at sub-portfolio levels within its overall market risk portfolio as required under paragraph 8.3.101, as part of model validation.

11 Adjustments to the Basel II market risk framework published by BCBS in June 2010 and February 2011

11.1 The BCBS published an update of its document “Revisions to the Basel II market risk framework” in February 2011. The updated document incorporated the stress testing guidance for the correlation trading portfolio and the following adjustments to the Basel II market risk framework issued by the BCBS on 18 June 2010:

- a transitional provision that allows the higher of the capital charges for net long securitisation positions and net short securitisation positions to be taken, until 31 December 2013.
- the capital charge for an individual position in a credit derivative or securitisation instrument to be capped at the maximum possible loss.
- a floor capital charge for the correlation trading portfolio under the comprehensive risk model to be set at 8% of the capital charge for specific risk under the SA(MR).

11.2 MAS has incorporated these updates in the revised MAS Notice 637.

12 Deduction of capital investments in associates and major stake companies

12.1 The proposals in the MAS January 2010 consultation paper required Reporting Banks to deduct capital investments in every associate which is approved by MAS under section 32 of the Banking Act. This was to allow Reporting Banks to transit gradually to the proposed treatment under the BCBS 17 December 2009 consultation proposals, where such investments were proposed to be deducted in full from common equity under Basel III. In view that the treatment of such investments would be given limited recognition under the threshold deductions under the final Basel III rules text published in December 2010, this issue will be reviewed as part of the implementation of the Basel III rules on the definition of capital. In the interim, the current capital treatment set out in paragraphs 6.1.10(h) and 6.2.12(e) continues to apply.

Monetary Authority of Singapore
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