



MONETARY AUTHORITY OF SINGAPORE

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**GUIDELINES ON BANKING  
REGULATIONS 23G AND 7A**

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# **GUIDELINES ON BANKING REGULATIONS 23G AND 7A**

## **1 INTRODUCTION**

1.1 Regulation 23G of the Banking Regulations (“regulation 23G”) 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 23G 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 carrying on businesses under regulation 23G 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 carry on their operations under regulation 23G and regulation 7A.

1.2 Section 2 of these guidelines sets out guidance on how regulation 23G 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 23G 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 23G. 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 23G. Section 3 of these guidelines sets out MAS’ additional supervisory expectations of the bank when it uses regulations 23G 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 23G 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 23G AND 7A

2.1 Regulation 23G 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 23G 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 23G 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.

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 23G 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 prohibits under the laws of the bank's home jurisdiction. The bank should maintain the relevant supporting documentation that its parent supervisory authority permits the bank to carry on the business and that such business is permitted to be carried on by the bank under the laws of the home jurisdiction of the bank.

2.5 Finally, regulation 23G 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 23G 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). Businesses which have been approved under section 30(1)(e) of the Banking Act will continue to be subject to the conditions of approval granted earlier. 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 23G 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 23G.

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 23G, and to submit this approval framework to MAS **before** the bank commences any business under regulation 23G. This framework should detail the governance, internal approval processes and the parameters for businesses carried on under regulation 23G. 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 23G. 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 23G 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 23G 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 23G 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 direct 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 23G 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 23G, provided that the bank demonstrates that this business would otherwise be done directly by the bank under regulation 23G, 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 carrying on the business through a subsidiary would segregate the risks better than carrying on the business on its own balance-sheet. Where the Authority assesses prudential merits to do so, it may also require a bank to carry on the businesses carried on under regulation 23G in a regulation 7A subsidiary rather than within the bank. Regulation 7A excludes from the operation of section 32 any wholly owned subsidiary of the bank held mainly for the purpose of segregating risks arising from carrying on a business prescribed in regulation 23G(1), 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 carried on in accordance with all the other conditions of regulation 23G 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 written agreement entered into between the bank and the subsidiary, to request for any information from the subsidiary and to inspect the books of the subsidiary. Subsidiaries can only be established or operate in overseas jurisdictions where MAS or its appointee can be guaranteed full access to such information. Where the wholly-owned subsidiary is an overseas regulated financial institution, the bank should be satisfied from its own due diligence or having taken professional advice that the Authority and any person appointed by the Authority shall not be prohibited from requesting any information from, or inspecting the books of, the wholly-owned 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 23G limits the highest of the following three measures – total balance sheet asset value, total revenue, or total exposures<sup>1</sup> – of businesses under regulation 23G to 15% of the bank's capital funds at bank and bank group level. These three measures include all businesses carried on under regulation 23G, 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 23G 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

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<sup>1</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.

and bank group level for businesses being carried on under regulation 23G and PE/VC investments<sup>2</sup>. For a subsidiary under regulation 7A, the bank is required to include the highest of the following three measures – total balance sheet asset value, total revenue, or total exposures<sup>3</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, conditions or restrictions on a case-by-case basis, should these be appropriate. These limits, conditions or restrictions can apply to specific banks, in relation to the businesses of the bank carried on under regulation 23G.

2.13 The bank is required to provide quarterly reports to MAS on the scale and the scope of businesses carried on under regulation 23G, 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 23G and the bank's risk management practices. The quarterly report shall be submitted to MAS no later than the last day of the month immediately following the end of each quarter. The first quarterly report is to be submitted no later than 30 April 2011.

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

For the quarterly reporting (to be submitted no later than the last day of the month immediately following the end of each quarter of a year):

- (i) Balance sheet value, revenue numbers, and exposures of businesses prescribed in regulation 23G(1) carried on by the bank;
- (ii) Utilisation of the regulatory limits prescribed in regulation 23G(3) and (4);
- (iii) Key internal risk metrics, in addition to the regulatory limits prescribed in regulation 23G(3) and (4); and
- (iv) Business activities of every wholly-owned subsidiary of the bank excluded from the operation of section 32 of the Act under regulation 7A.

For the annual reporting (to be submitted no later than the last day of the month immediately following the end of the bank's financial year, and at such other times as the bank considers necessary):

- (i) External audit reports on the businesses prescribed in regulation 23G(1) carried on by the bank and the risk management of such businesses; and

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<sup>2</sup> Under regulation 23E, PE/VC investments are subject to a cap of 10% of the bank's capital funds at bank and bank group level.

<sup>3</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.

- (ii) Stress test results of such businesses.

and the following for quarterly reporting (to be submitted no later than the last day of the month immediately following the end of each quarter of a year), where applicable:

- (i) For every new businesses prescribed in regulation 23G(1) carried on by the bank, an assessment of the impact of the new business on the risk profile of the bank, and key risk mitigation and contingency plans;
- (ii) Changes in corporate governance structure and business activities of any wholly-owned subsidiary of the bank excluded from the operation of section 32 of the Act under regulation 7A;
- (iii) Provision by the bank of any guarantee or letter of comfort to any of the wholly-owned subsidiaries of the bank excluded from the operation of section 32 of the Act under regulation 7A;
- (iv) Changes in the bank's investment in, and exposure to, any of the wholly-owned subsidiaries of the bank excluded from the operation of section 32 of the Act under regulation 7A; and
- (v) Any supervisory, legal, reputational or other significant matters relating to any of the wholly-owned subsidiaries of the bank excluded from the operation of section 32 of the Act under regulation 7A.

Internal audit reports on new businesses carried on under regulation 23G and the risk management of such businesses should be submitted no later than the last day of the month immediately following the end of the first year that the business is carried on.

### Powers to Exclude Application of Regulation 23G

2.15 MAS has the power to issue a declaration to a bank to exclude the application of regulation 23G 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 regulation 23G by issuing a written declaration that regulation 23G 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 23G 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 23G. The approval framework should also outline the risk management processes and procedures for the use of regulation 23G 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 23G 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 23G. The approval framework should establish whether the Board and senior management would need to approve every business under regulation 23G, 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 23G (please see also paragraph 3.6). Businesses carried on under Regulation 23G may have risk factors that are not covered in a standard new product approval process (“NPAP”). Hence the bank may only submit its NPAP as the required internal approval framework where it has ascertained that the NPAP satisfies the requirements for such a framework as set out in Sections 2 and 3.

### **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 23G. 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 23G 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 23G a regulatory limit of 15% of the bank's capital funds (at both the solo and bank group levels) for businesses carried on under regulation 23G, and a combined regulatory limit for businesses carried on under regulation 23G and PE/VC investments of 20% of the bank's capital funds (at both the solo and bank group levels). 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 23G. 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 23G. 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 23G, 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 23G 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 23G. These should be performed at least annually. 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 23G, 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. If the bank is able to demonstrate that it or its subsidiaries and downstream affiliates will not be liable for any losses arising from the business, an application to the Authority may be made for consideration under section 30(1)(e) of the Banking Act.

### **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, and regularly thereafter. The bank should also engage an external auditor to audit, on an annual basis, the businesses carried on under regulation 23G, 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 23G.

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

3.11 On an ongoing basis, the bank is required under regulation 23G 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 to MAS. Given the diversity of businesses that may be carried on under regulation 23G, MAS expects the bank to supplement this minimum list of information with all pertinent information in its reporting. For avoidance of doubt, the reports are to be submitted only if the bank is carrying on the business under regulation 23G.

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 23G 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 23G AND 7A**

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

4.1 With the introduction of regulation 23G, 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 23G. If the business meets the conditions and pre-requisites of regulation 23G, the bank can carry on the business up to the regulatory limit under regulation 23G 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 23G first, as MAS is unlikely to approve businesses that do not qualify for regulation 23G under section 30(1)(e). For such businesses which the bank has assessed to qualify for regulation 23G, the bank may proceed to carry on the business under regulation 23G 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 23G regulatory limit as a condition of approval. If MAS does not grant approval and the bank is already carrying on the business under regulation 23G, MAS may direct the bank to stop the business altogether if MAS assesses that the business does not qualify for regulation 23G. Where MAS has directed the bank to stop a business or a class of business under regulation 23G 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 carry on a business that the bank has already assessed to qualify for regulation 23G, which the bank would otherwise engage in directly, for the purpose of segregating the risks arising from carrying on the new business<sup>4</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.

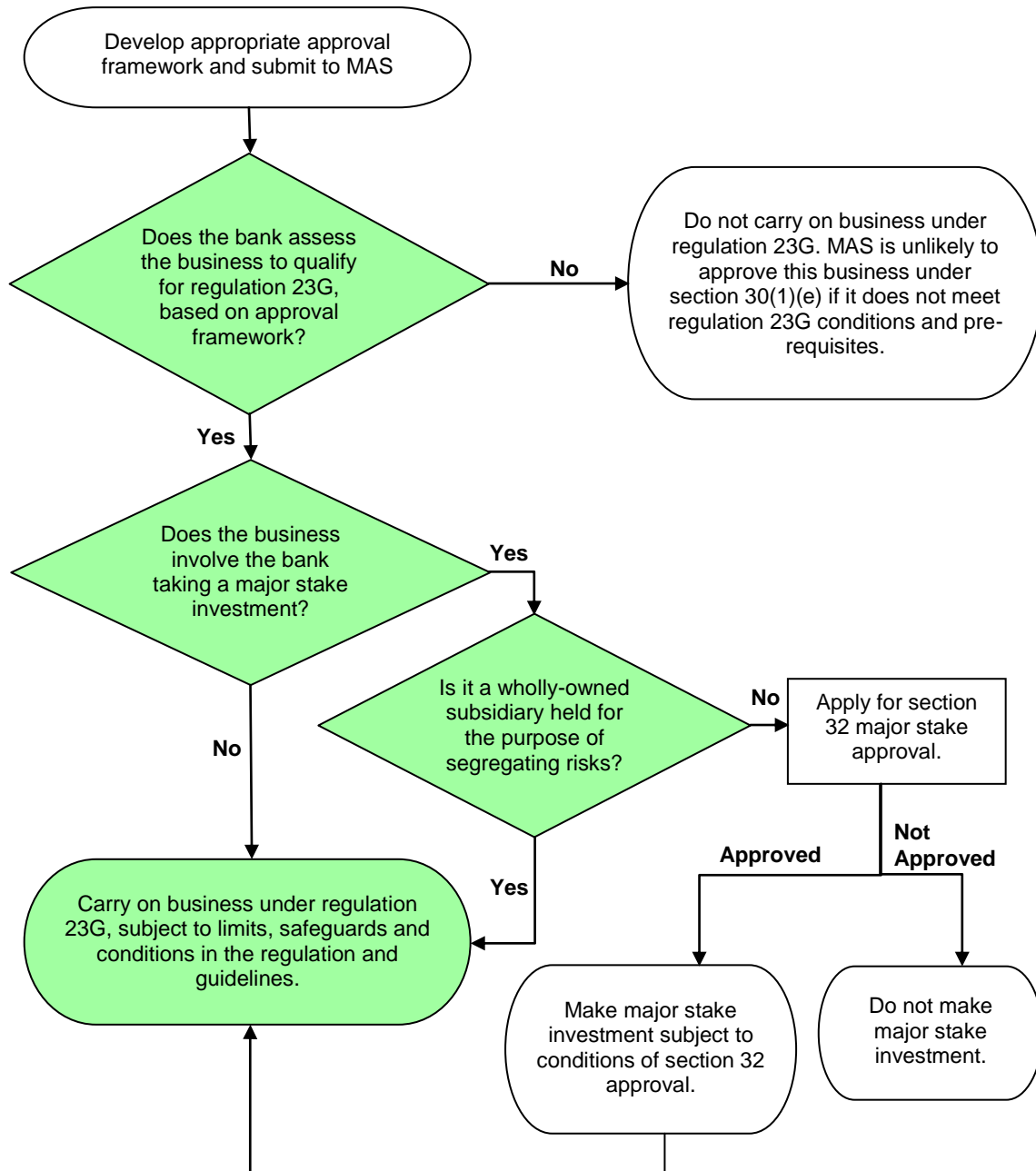
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<sup>4</sup> The exception has also been set out earlier in paragraph 2.10.

### 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 23G.

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



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