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**MAS' FRAMEWORK FOR  
IMPACT AND RISK ASSESSMENT OF  
FINANCIAL INSTITUTIONS**

**A GUIDE FOR SENIOR EXECUTIVES**

Impact Assessment

CRAFT Risk Assessment

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**Monetary Authority of Singapore**

**April 2007**

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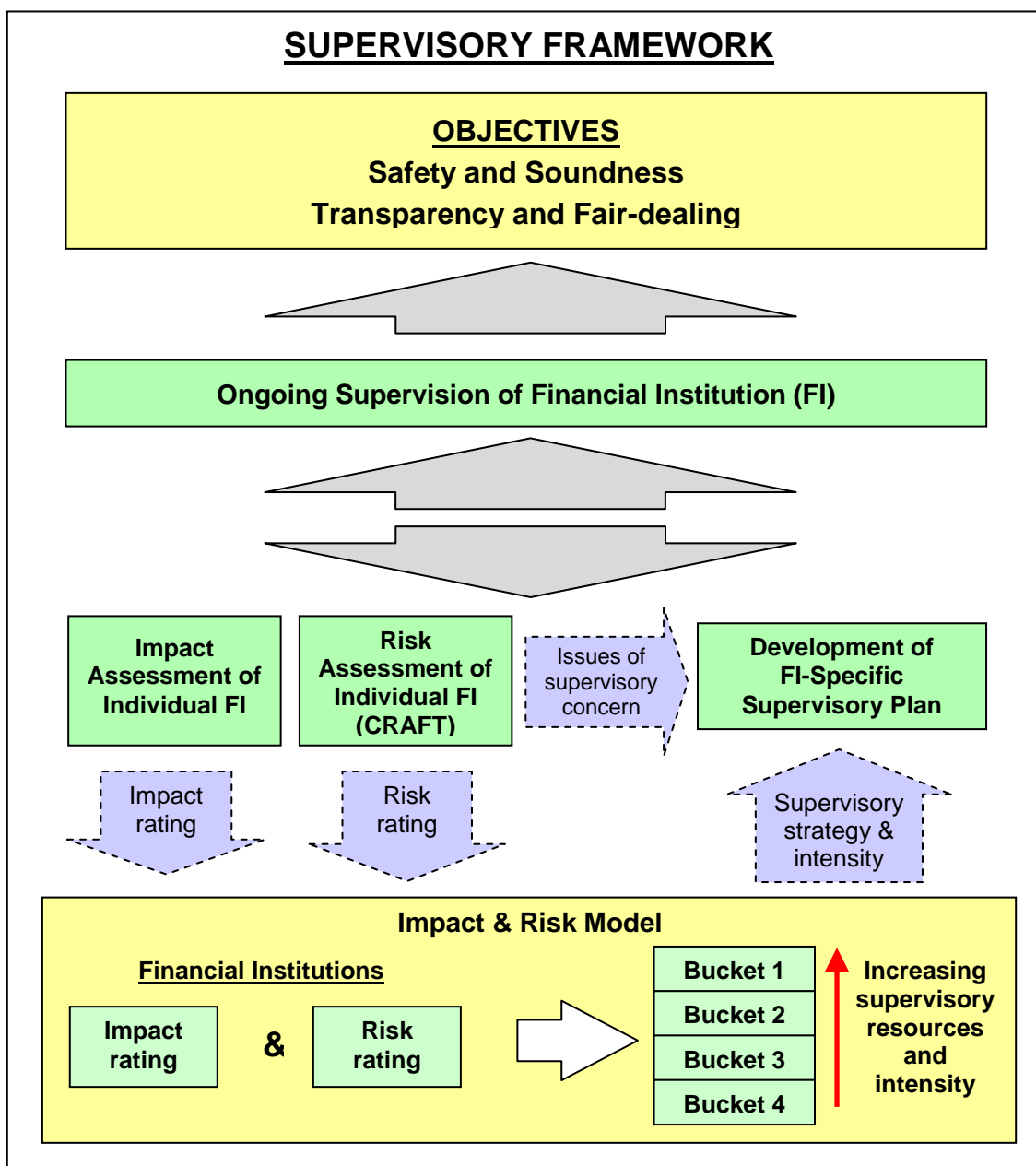


# Introduction

- 1 The Monetary Authority of Singapore (MAS) is the integrated supervisor of the financial services sector. The objectives of MAS' supervision, the functions we perform, and the principles that guide our approach are spelled out in "Objectives and Principles of Financial Supervision in Singapore", issued in April 2004.
- 2 This document gives more detailed information on one of MAS' key functions – the risk-based supervision of financial institutions. It covers how MAS' supervisory objectives and principles shape our supervisory framework, and the supervisory processes that underpin the framework including how MAS assesses the impact of financial institutions and the use of the **Comprehensive Risk Assessment Framework and Techniques (CRAFT)** to assess their risks. MAS' supervisory work to address themes that affect the industry as a whole and issues that cut across different financial service sectors is not, however, covered in this document.
- 3 We seek through this document to provide greater clarity on the desired outcomes of MAS' supervision of financial institutions and to promote the industry's understanding of how MAS' supervisory activities help achieve these outcomes. The supervisory framework and the processes described herein apply to licensed banks and merchant banks, finance companies, insurance companies and brokers, capital market intermediaries, and financial advisers.
- 4 The document should be of particular interest to the key stakeholders that MAS works with, principally the boards and senior management of financial institutions. This is because:
  - the supervisory assessment of an institution's impact and risk will determine MAS' supervisory strategy towards that institution and the supervisory activities in which MAS engages;
  - MAS expects an institution's board and senior management, with whom the primary responsibility for risk oversight lies, to address any issues of supervisory concern that are identified in the course of our supervision; and
  - how well institutions manage their risks determines the intensity of MAS' supervisory attention and whether supervisory requirements need to be imposed.
- 5 Details on the structure of the Supervisory Framework, the features of the Impact and Risk Model, the key components of the processes used in the Supervisory Framework, and how supervision is conducted in practice can be found in the detailed version of the monograph.

# The framework

- 6 The aim of MAS' risk-based supervision is to foster the safety and soundness of financial institutions and to promote transparency and fair-dealing by financial institutions in relation to their customers and counterparties. These two supervisory objectives contribute towards MAS' overarching objective of a stable financial system. We are concerned about any risks that prejudice the achievement of these objectives.



- 7 The ongoing supervision of a financial institution seeks, therefore, to identify and address potential risks that may affect the safety and soundness of the institution, or the transparency and fair-dealing of its market conduct practices. This means that MAS is concerned with institution behaviour that affects both its overall financial condition and its interaction with individual customers and counterparties.

- 8 In seeking to meet the two broad supervisory objectives mentioned in paragraph 6 above, MAS does not aim to prevent all failures. A ‘zero failure’ regime would place an excessive regulatory burden on financial institutions and could impair the efficiency of the financial system. Instead, we aim to reduce the risk and impact of failure of institutions or of inappropriate behaviour through increased supervision where it is both appropriate and likely to be effective.
- 9 This approach is articulated through the impact and risk model, which is at the heart of the framework. Within each financial services sector, we first evaluate and rate the impact of an institution relative to other institutions. We use a risk assessment system, CRAFT, to evaluate the risk of an institution. We then combine the assessments of both impact and risk ratings and distinguish those institutions that may pose a higher threat to the achievement of our supervisory objectives. Finally, we determine the appropriate supervisory strategies and, in turn, the level of supervisory intensity required.
- 10 Using the model, the impact rating within the relevant financial services sector and the risk rating of each institution are combined to assign the institution to one of four categories of supervisory significance. For institutions of the same risk, those having higher impact would generally be in a higher bucket. Similarly, where institutions have the same impact, those of a higher risk would generally be in a higher bucket. We call these separate categories “supervisory buckets” numbered 1 to 4, where bucket 1 contains institutions that have the greatest potential to affect the achievement of MAS’ supervisory objectives.
- 11 In assigning the supervisory buckets, the impact rating is accorded more importance relative to the risk rating. So, between a high-impact, low-risk institution and low-impact, high-risk institution, the model generally assigns the former to a higher supervisory bucket, given the likely greater overall consequences should things go wrong at the high-impact institution.
- 12 High-level supervisory strategies that influence the ongoing supervision of institutions have been developed for each supervisory bucket. These strategies consider the intensity of supervision and the share of MAS’ supervisory resources that are to be allocated to each bucket, given the impact and risk of the institutions therein, and provide guidance on how these limited resources could be used most effectively. The intensity of supervision varies for different buckets of institutions. The variation is mainly in terms of the frequency of on-site inspections and the nature of the supervisory oversight of each financial institution.

- 13 A supervisory plan designed to address issues of supervisory concern identified through the risk assessment of the institution is then prepared. The plan guides the supervisory activities undertaken during the ongoing supervision of the institution and takes into account the given level of supervisory intensity. It is updated at regular intervals with new information obtained from on-going supervisory activities.
- 14 The different components of the risk-based supervisory framework are not in practice discrete or rigid sequential steps, but operate in a dynamic and interrelated manner.

## **Working with financial institutions**

- 15 As well as being risk-focused, MAS' approach to supervision also relies on the board and senior management of each institution. The board and senior management play the central role in maintaining adequate risk oversight of the institution's business activities. They are responsible for implementing processes and controls to measure and manage the institution's risks, for ensuring its compliance with regulatory requirements, and for its dealing with customers and counterparties in a transparent and fair manner.
- 16 Risk decisions need to be taken and overseen at appropriate levels by people with adequate and relevant expertise and incentives. An environment of sensitivity to risk and sound risk management is to be cultivated through the value system of the institution and in the way that people are recognised and remunerated. Of equal importance, an institution needs to embrace a culture of dealing fairly with customers and counterparties in the conduct of its business.
- 17 MAS' seeks to reinforce the responsibilities of the board and senior management for the oversight and governance of the institution's activities and to support the efforts of the institution to improve its risk management and internal processes in order to protect the interests of its customers and counterparties, as well as its shareholders. As long as risks are adequately managed, we seek to minimise the need to interfere with institutions' business operations.
- 18 MAS performs its supervisory responsibilities by checking on the quality of corporate governance, internal controls and risk management of the institution and the institution's dealings with its customers and counterparties, with the aim of encouraging a system of sound management practices commensurate with the institution's type, scale and complexity of business activities, and their related risks.

- 19 As supervisory work is undertaken, weaknesses may be identified. Where the institution's problems are less serious, and if the institution's management is assessed to be willing and able to take prompt and effective action to deal with the problems, remedial tools may include moral suasion through oral advice, written recommendations, or supervisory warnings. However, where the risks of the institution escalate into serious problems, for instance, when there is a serious breach of rules and regulations, or where MAS believes the institution will not take appropriate remedial action on its own, MAS will not hesitate to take stronger action, such as issuing directives with the force of law or taking enforcement action.
  
- 20 To maintain a high degree of confidence in the quality of its supervision, MAS puts considerable resources into training its supervisory and surveillance staff and in developing the breadth and depth of the expertise and experience of its risk and product specialists. MAS also has in place measures to assure that our supervisory activities are proportionate to the institution's potential to affect the achievement of MAS' supervisory objectives and carried out in a consistent manner.