RESPONSE TO FEEDBACK RECEIVED – CONSULTATION ON PROPOSED REVISIONS TO THE REGULATORY CAPITAL FRAMEWORK FOR HOLDERS OF CAPITAL MARKETS SERVICES LICENCES

1 INTRODUCTION

1.1 MAS will strengthen the risk-based capital ("RBC") framework for capital markets services licensees ("CMSLs") so that capital requirements better reflect the risks that CMSLs undertake. The changes will enhance the risk-sensitivity of the RBC framework, strengthen the quality of capital and apply the RBC framework across CMSLs[1]. The revised RBC framework will strengthen the ability of CMSLs to withstand the risks to which their business is subject, and help safeguard financial stability. In revising the framework, MAS considered the comments received from the consultation paper on proposed revisions to the regulatory capital framework for CMSLs, issued in April 2012.

Revised RBC Framework

1.2 Under the RBC framework, a CMSL is required to maintain a minimum level of financial resources to meet risk requirements that reflect the nature of risks and amount of business undertaken by the CMSL.

1.3 Financial resources comprise base capital[2] and other forms of capital, less deductions. The limit on the recognition of irredeemable and cumulative preference shares and redeemable preference shares, which are other forms of capital, will be tightened to 100% of base capital. Qualifying subordinated loans will be recognised as financial resources only on a

[1] CMSLs licensed to carry out the regulated activity of dealing in securities, trading in futures contracts, leveraged foreign exchange trading, securities financing, fund management, real estate investment trust management, advising on corporate finance, or providing custodial services for securities. The RBC framework is currently applied to CMSLs which are members of approved exchanges or designated clearing houses.

[2] Base capital comprises paid-up ordinary share capital, paid-up irredeemable and non-cumulative preference share capital, reserve fund, and retained earnings.

temporary basis, for up to 90 calendar days in a year and up to 100% of base capital.

1.4 Risk requirements cover operational risk, counterparty risk, position risk, underwriting risk, and large exposure risk, and will be applied to CMSLs in a manner proportionate to the nature and amount of risks undertaken. CMSLs that do not ordinarily take on counterparty or market exposures[3] will be subject to risk requirements that address counterparty and position risks, if the exposures exceed a threshold level.

1.5 The computation of risk requirements will be enhanced to increase the risk-sensitivity of the RBC framework. These enhancements include the revision of counterparty risk weights to reflect the creditworthiness of counterparties, updating of conversion factors and netting conditions to address counterparty risks arising from over-the-counter derivatives and securities financing transactions, and enhancement of conditions for recognition of collateral. The position risk requirement will be enhanced to address the risks of market exposures through revisions to position risk factors, provisions for deriving notional positions of derivatives, and netting conditions. The computation of operational risk requirement will be enhanced to be based on gross income to reflect the scale of business undertaken by the CMSL.

1.6 The revised RBC framework takes effect from 3 April 2013 and is set out in the revised Securities and Futures (Financial and Margin Requirements for Holders of Capital Markets Services Licences) Regulations

[3] These are CMSLs licensed only to carry out the regulated activity of –

a) fund management;
b) real estate investment trust management;
c) advising on corporate finance;
d) providing custodial services for securities;
e) dealing in securities or trading in futures contracts, where the CMSL in carrying on such activity, does not carry any customer's position, margin or account in its own books, does not hold any customer's moneys or assets and does not accept moneys or assets from any customer as settlement of, or as margin for, or to guarantee or secure, any contract for the purchase or sale of securities or futures contract by that customer, and is not a member of an approved exchange or designated clearing house; or
f) a combination of the above activities.

(“SFR(FMR)”) and a new MAS Notice SFA 04-N13 on Risk Based Capital Adequacy Requirements for Holders of Capital Markets Services Licences, which are published on the MAS website. The rules provide a transitional period till 2 April 2015 to comply with the revised RBC framework and a transitional period till 2 October 2013 to comply with the revised definition of base capital. Comments that are of wider interest, together with our responses, are set out below. We would like to thank all respondents for their comments[4].

2 ALIGNMENT OF THE REGULATORY CAPITAL FRAMEWORK

2.1 The consultation proposed to expand the application of the RBC framework across CMSLs. CMSLs that do not ordinarily take on counterparty or market exposures as part of their licensed activities[5] would be required to compute capital requirements for their counterparty or market exposures if these exposures, calculated based on average adjusted assets, exceed a certain threshold.

Application of the RBC framework

2.2 Respondents generally agreed with the proposal. Some respondents requested that the adjusted assets threshold be made available to CMSLs which are licensed to carry out the regulated activity of dealing in securities or trading in futures contracts, provided the CMSL does not take on customers’ positions, margins or accounts when engaging in such activity. A number of respondents requested to be exempted from counterparty risk and position risk requirements, on the basis that they deal only with accredited and institutional investors.

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[4] A total of 97 respondents submitted comments. The respondents are listed in the Annex.

[5] The consultation paper referred to such CMSLs as CMSLs licensed only to carry out the regulated activity of fund management, real estate investment trust management, advising on corporate finance, or providing custodial services for securities (or a combination of such activities).

MAS’ Response

2.3 MAS will expand the application of the adjusted assets threshold to include CMSLs licensed to carry out the regulated activity of dealing in securities or trading in futures contracts, where the CMSL, in carrying on such activity, -

(a) does not carry customer’s position, margin, or account in its own books;
(b) does not hold any customer’s moneys or assets, and does not accept moneys or assets from any customer as settlement of, or as margin for, or to guarantee or secure, any contract for the purchase or sale of securities or futures contract by that customer; and
(c) is not a member of an approved exchange or designated clearing house.

This recognises that such CMSLs do not ordinarily take on counterparty or market exposures in carrying out these activities.

2.4 MAS will not exempt a CMSL from counterparty risk and position risk requirements solely on the basis that a CMSL deals only with accredited and institutional investors. This would not be prudent as such a CMSL may take on significant risks arising from counterparty or market exposures.

Calibration of Adjusted Assets Threshold

2.5 The consultation proposed to set the adjusted assets threshold at the lower of 10 times of the CMSL’s base capital requirement, or five times of the CMSL’s positive financial resources. Respondents commented that the limit based on 10 times of the CMSL’s base capital requirement was inconsistent with the lower base capital requirements applicable to CMSLs engaging in activities considered to be of lower risk or impact.

MAS' Response

2.6 MAS agrees with the respondents and will set the adjusted assets threshold at the lower of $10 million (instead of 10 times base capital requirements), or five times of the CMSL's positive financial resources. CMSLs with adjusted assets above $10 million will be subject to counterparty and position risk requirements, while the limit of five times of the CMSL's positive financial resources will constrain the leverage of CMSLs below the threshold.

Exclusions from Adjusted Assets Measure

2.7 The consultation proposed that adjusted assets be calculated as the sum of on-balance sheet and off-balance sheet assets, less assets deducted from financial resources, deposits with banks licensed in Singapore which are of credit quality grade 1 (AA-/Aa3 and above) and cash balances. Respondents suggested that Singapore dollar-denominated bonds with investment grade ratings and other bank deposits be excluded from the adjusted assets measure. Some respondents also requested that receivables from related corporations and fee receivables from funds managed by the CMSL be excluded from the adjusted assets measure.

MAS' Response

2.8 Singapore-dollar denominated bonds which are of investment grade and other bank deposits will not be excluded from the adjusted asset measure, as these instruments give rise to counterparty and position risks.

2.9 MAS will exclude receivables from related corporations, as well as fee receivables owed by a fund managed by the CMSL, that are due for settlement within 90 days and not past due, from the adjusted asset measure. This will incentivise CMSLs to restructure their receivables to be due within 90 days.

Frequency of Computation of Adjusted Assets

2.10 Some respondents were concerned about the computational effort required for the adjusted assets measure, based on an average of weekly adjusted assets in a quarter. The respondents suggested that the adjusted asset measure be computed, based on an average of adjusted assets at the end of each month in a quarter.

<u>MAS' Response</u>

2.11 To address the respondents' concerns, the adjusted assets measure will be based on an average of monthly adjusted assets in a quarter.

3 FINANCIAL RESOURCES

Qualifying Subordinated Loans

3.1 The consultation proposed that qualifying subordinated loans ("QSLs") be eligible as financial resources to meet risk requirements only on a temporary basis. Some respondents requested that QSLs continue to be included in financial resources on an ongoing basis, and that MAS could instead consider tightening the set of recognition criteria in place for QSLs under the existing framework.

3.2 Other respondents suggested that either the temporary period for recognition of QSLs in financial resources be extended from the consultation proposal of 30 calendar days, or that the aggregate limit for which QSLs can be used as part of financial resources on a temporary basis be increased from 100% to 200% of base capital so as to have sufficient time to execute capital plans to raise more permanent forms of capital.

<u>MAS' Response</u>

3.3 To strengthen the quality of capital maintained by CMSLs to meet regulatory capital requirements, MAS will recognise QSLs (which are a form of debt), in financial resources only on a temporary basis. Taking into account the feedback that the period for temporary use of QSLs should provide sufficient time for CMSLs to execute capital plans, MAS will increase the temporary period for the use of QSLs to 90 calendar days in a year, from the consultation proposal of 30 calendar days.

Irredeemable and cumulative preference share capital and redeemable preference share capital

3.4 A few respondents suggested that the limit for irredeemable and cumulative preference share capital and redeemable preference share capital recognised in financial resources be increased from the proposed aggregate limit of 100% of base capital.

MAS' Response

3.5 As irredeemable and cumulative preference share capital and redeemable preference share capital have lower loss absorption capability than base capital, MAS will maintain the consultation proposal to subject the inclusion of such preference share capital as financial resources to an aggregate limit of 100% of base capital.

Inclusion of interim profits as base capital

3.6 A few respondents requested the inclusion of interim profits in the computation of base capital, subject to a review by an auditor. The respondents were of the view that inclusion of interim profits would better mitigate the impact of the required deduction of any dividends declared after the financial year end from the CMSL's base capital.

MAS' Response

3.7 To maintain the quality of base capital, MAS will retain the existing treatment of not including in base capital interim profits that are unaudited, taking into consideration that these may be unrealised, for example, if they are in the form of trading gains.

Treatment of capital investments in associates or subsidiaries

3.8 Respondents have requested for capital investments in associates or subsidiaries to be subject to a risk factor of 50%, instead of a full deduction from financial resources.

<u>MAS' Response</u>

3.9 MAS will require a full deduction of capital investments in associates or subsidiaries from financial resources, as this is necessary to address risks of contagion and double gearing from intra-group exposures.

Application of illiquidity adjustments

3.10 Some respondents requested that in addition to CMSLs licensed only to carry out fund management or real estate investment trust management, MAS should allow CMSLs with low liquidity risks, to risk-weight non-current assets, assets not convertible to cash within 30 days, and receivables from related companies that are due to be repaid within 90 days, instead of requiring these items to be deducted from financial resources.

<u>MAS' Response</u>

3.11 MAS will apply the treatment of risk-weighting non-current assets, assets not convertible to cash within 30 days, and receivables from related companies that are due to be repaid within 90 days to CMSLs licensed only to carry out the regulated activity of fund management, real estate investment trust management, advising on corporate finance, providing custodial services for securities, or dealing in securities or trading in futures contracts where the CMSLs are engaging in limited activities[6] (or a

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[6] This is limited to CMSLs licensed to carry out the regulated activity of dealing in securities or trading in futures contracts, where the CMSL, in carrying on such activity, -

(a) does not carry customer's position, margin or account in its own books;
(b) does not hold any customer's moneys or assets, and does not accept moneys or assets from any customer as settlement of, or as margin for, or to guarantee or secure, any contract for the purchase or sale of securities or futures contract by that customer; and
(c) is not a member of an approved exchange or designated clearing house.

combination of such activities). This recognises that for these CMSLs, their licensed activities would not ordinarily give rise to liquidity risks and therefore, full deduction of non-current assets, assets not convertible to cash within 30 days, and receivables from related companies that are due to be repaid within 90 days from financial resources is not warranted.

4 COUNTERPARTY RISK REQUIREMENT

Cash-in-transit exposures

4.1 Respondents sought clarification on the 20% risk weight to be applied to cash-in-transit exposures[7] and commented that the risk weight did not reflect their loss experience.

MAS' Response

4.2 MAS will maintain the 20% risk weight for cash-in-transit exposures, to address the risks arising from such exposures. The risk requirement will not apply, where a CMSL has systems and controls in place to ensure that cash has been received before securities or other items are released to customers.

Deposits

4.3 Under the consultation, long-term exposures to banks are subject to higher counterparty risk weights than short-term exposures. Respondents sought clarification on the counterparty risk weights to be applied for current account deposits, savings account deposits and fixed deposits.

MAS' Response

4.4 In consideration that CMSLs have to maintain deposit accounts with banks as part of their business operations, MAS will subject current account deposits, savings account deposits, and fixed deposits with an original

[7] Cheques, drafts and other items drawn on banking institutions that are either payable immediately upon presentation or that are in the process of collection.

maturity of three months or less placed with banks and which can be unconditionally withdrawn within 30 days, to the same set of counterparty risk weights as short-term exposures.

Netting

4.5 The consultation proposed that the netting conditions for counterparty exposures arising from OTC derivative and securities financing transactions be updated.

4.6 Some respondents requested for the current netting conditions to be retained. Other respondents commented that it was unnecessary to update legal opinions on standardised netting agreements. One respondent proposed that legal opinions on standardised netting agreements be updated once every three years, instead of annually.

<u>MAS' Response</u>

4.7 MAS will maintain the revised set of netting conditions, which are necessary to ensure that counterparty risk requirements properly reflect the risks of netting arrangements. The legal opinions on the enforceability of netting agreements should be reviewed annually. The CMSL may rely on independent legal opinions commissioned and collated by the International Swaps and Derivatives Association, the Securities Industry and Financial Markets Association, the International Capital Market Association and the International Securities Lending Association, which are updated on an annual basis, in its assessment of whether the netting agreements satisfy the netting conditions.

Interest charged on amounts owed by counterparty

4.8 The consultation proposed to subject interest payments owed by the counterparty to risk weights based on the credit rating of the counterparty, in the computation of the counterparty risk requirement.

4.9 Respondents commented that it is administratively onerous to compute counterparty risk requirement on the interest charged on amounts owed by each counterparty based on the counterparty's credit rating, as the number of counterparties could be numerous and the quantum of interest receivable is typically not large.

MAS' Response

4.10 To address the respondents' concerns, MAS will provide a simpler option of subjecting such interest amounts to the risk weights applicable to unrated exposures of the corresponding counterparty types. CMSLs may still choose to compute the counterparty risk requirement on interest receivables for each counterparty exposure based on the counterparty's credit rating.

5 POSITION RISK REQUIREMENT

Equity position risk factors

5.1 Respondents proposed that the 32% risk factor applicable to "any other equity" under the Equity Standard Method for computing equity position risk requirement be lowered.

MAS' Response

5.2 The risk factor for all single equities under the Equity Standard Method will be lowered to 16%. This revised risk factor is consistent with the sum of the general and specific risk factors applied to single equities under the alternative Equity Building Block method for computing equity position risk requirement.

Position risk requirements arising from holding of real estate investment trust units and seed investments

5.3 Some respondents proposed that real estate investment trust units be exempted from position risk and large exposure risk requirements, where these holdings arise from management fees received in the form of real estate investment trust units. A number of fund managers also proposed that an exemption from position risk and large exposure risk requirements be made for investments in funds managed by their firms, as such investments help promote alignment of interest between the fund manager and investors in the fund.

MAS' Response

5.4 As real estate investment trust managers and fund managers do face market risks and potential concentration risks from their holdings in units in real estate investment trusts or funds that they manage, MAS will maintain its position to impose position risk requirements and large exposure risk requirements on such holdings. However, in recognition that alignment of interests can be enhanced where real estate investment trust managers or fund managers have investments in real estate investment trusts or funds that they manage, the large exposure risk requirement will be halved in relation to a position in a collective investment scheme or a closed-end fund that is managed by the CMSL.

6 OPERATIONAL RISK REQUIREMENT

6.1 The consultation proposed that the operational risk requirement be based on a percentage of gross income. Respondents requested to maintain the operational risk requirement as a percentage of the other risk components. Respondents were also concerned that the proposed operational risk requirement may be onerous, and not reflective of risks in their businesses or comparable to other jurisdictions. Some respondents also requested for performance fees arising from fund management activities to be excluded from gross income.

MAS' Response

6.2 Operational risk generally increases as a CMSL grows in size, giving rise to higher operational complexity. As such, gross income, as an indicator of size, is a better proxy for operational risk. An operational risk requirement which is based on a percentage of the other risk requirements may not reflect the extent of operational risks from CMSLs' fee-based activities.

6.3 To ensure that the operational risk requirement remains prudentially sound while addressing the respondents' concerns, MAS will set the operational risk requirement as follows –

(a) for CMSLs licensed to carry out the regulated activity of dealing in securities, trading in futures contracts[8], leveraged foreign exchange trading or securities financing, the higher of -

(i) 5% of the three-year average[9] annual gross income ("AAGI"); or

(ii) $100,000;

(b) for CMSLs licensed only to carry out the regulated activity of fund management, real estate investment trust management, advising on corporate finance, providing custodial services for securities, or securities dealing or futures trading, where the CMSL is engaging in limited activities[10] (or a combination of such activities), the higher of -

(i) the sum of -

- 5% of the AAGI, for the first $10 million of AAGI; and
- 2% of any AAGI in excess of $10 million; or

[8] This excludes CMSLs licensed to carry out the regulated activity of dealing in securities or trading in futures contracts, where the CMSL is engaging in limited activities, referred to in paragraph 6.3(b).

[9] For the three immediately preceding financial years.

[10] This is limited to CMSLs licensed to carry out the regulated activity of dealing in securities or trading in futures contracts, where the CMSL, in carrying on such activity, -

(a) does not carry customer's position, margin, or account in its own books;

(b) does not hold any customer's moneys or assets, and does not accept moneys or assets from any customer as settlement of, or as margin for, or to guarantee or secure, any contract for the purchase or sale of securities or futures contract by that customer; and

(c) is not a member of an approved exchange or designated clearing house.

(ii) $100,000.

6.4 Only income or expenses which are not derived from the ordinary activities of a CMSL and are not expected to recur frequently or regularly may be excluded. Performance fees arising from fund management activities are derived from the ordinary activities of CMSLs or expected to recur regularly and hence will not be excluded from the computation of the operational risk requirement.

7 TRANSITIONAL PERIOD

7.1 Respondents requested a transitional period longer than six months to comply with the revised RBC framework, to allow sufficient time for them to implement and operationalise systems to comply with the requirements.

MAS' Response

7.2 Taking the respondents' feedback into consideration, MAS will provide a transitional period of 24 months from 3 April 2013, the effective date of the revised SFR(FMR), for existing CMSLs, exempt fund managers and registered fund management companies[11] that are in operation as at 3 April 2013, to comply with the revised RBC framework. The transitional period for existing CMSLs to comply with the revisions to the definition of base capital will be maintained at six months, commencing from 3 April 2013.

MONETARY AUTHORITY OF SINGAPORE
2 April 2013

[11] The transitional period will apply to exempt fund managers and registered fund management companies that are granted capital markets services licenses to carry out the regulated activity of fund management within 24 months after 3 April 2013.

ANNEX

LIST OF RESPONDENTS TO THE CONSULTATION ON PROPOSED REVISIONS TO THE REGULATORY CAPITAL FRAMEWORK FOR CMSLs, ISSUED IN APRIL 2012

1. Aberdeen Asset Management Asia Limited
2. Acadian Asset Management (Singapore) Pte Ltd
3. Aisling Analytics Pte Ltd
4. AL Wealth Partners Pte Ltd
5. Allianz Global Investors Singapore Limited
6. AmFraser Securities Pte Ltd
7. APS Asset Management Pte Ltd
8. Ascott Residence Trust Management Limited
9. Association Of Banks In Singapore
10. Aviva Investors Asia Pte Limited
11. AXA Investment Managers Asia (Singapore) Ltd
12. Blackstone Singapore Pte Ltd
13. Canaccord Genuity Singapore Pte Ltd
14. Capitacommercial Trust Management Limited
15. Capital International, Inc.
16. Capitamall Trust Management Limited
17. Capitaretail China Trust Management Limited
18. CBRE Global Investors (Singapore) Pte Ltd
19. CDH Investment Advisory Private Limited
20. China International Capital Corporation (Singapore) Pte Limited
21. CIMB Securities (Singapore) Pte Ltd
22. CSAM Asset Management Pte Ltd
23. DBS Vickers Securities (Singapore) Pte Ltd
24. Deloitte & Touche Corporate Finance Pte Ltd
25. Duxton Asset Management Pte Ltd
26. Eastspring Investments (Singapore) Limited
27. Effissimo Capital Management Pte Ltd
28. Ernst & Young LLP

29. FIL Investment Management (Singapore) Limited
30. Fullerton Fund Management Company Ltd
31. G.K. Goh Financial Services (S) Pte Ltd
32. GFT Global Markets Asia Pte Ltd
33. ICAP Financial Products Pte Ltd
34. iFAST Financial Pte Ltd
35. IG Asia Pte Ltd
36. Investment Management Association Of Singapore
37. J.P. Morgan Securities Asia Private Limited
38. J.P. Morgan Securities Singapore Private Limited
39. Jafco Investment (Asia Pacific) Ltd
40. KE Capital Partners Pte Ltd
41. Keppel REIT Management Limited
42. Lasalle Investment Management Asia Pte Ltd
43. Legg Mason Asset Management Singapore Pte Limited
44. Lim & Tan Securities Pte Ltd
45. Lion Global Investors Limited
46. Mapletree Logistics Trust Management Ltd
47. Merrill Lynch (Singapore) Pte Ltd
48. MFS International Ltd (Singapore Branch)
49. Mitsubishi UFJ Trust International Limited
50. Mizuho Securities (Singapore) Pte Ltd
51. Navigator Investment Services Limited
52. Newedge Financial Singapore Pte Ltd
53. Nomura Asset Management Singapore Limited
54. Nomura Securities Singapore Pte Ltd
55. OCBC Securities Private Limited
56. Octagon Capital Management Pte Ltd
57. Pacific Alternative Asset Management Company Asia Pte Ltd
58. Phillip Financial Pte Ltd
59. Phillip Futures Pte Ltd
60. Phillip Securities Pte Ltd
61. Prudential Property Investment Management (Singapore) Pte Ltd
62. Saxo Capital Markets Pte Ltd

63. SBICAP (Singapore) Limited
64. Schroder Investment Management (Singapore) Ltd
65. Schroder Investment Management North America Limited Singapore Branch
66. Singapore Mercantile Exchange
67. ST Asset Management Ltd
68. Standard Chartered IL&FS Management (Singapore) Pte Limited
69. Tantallon Capital Advisors Pte Ltd
70. Templeton Asset Management Ltd
71. Trident Trust Company (Singapore) Pte Limited
72. Tudor Capital Singapore Pte Ltd
73. UBS Custody Services Singapore Pte Ltd
74. UBS Custody Singapore Pte Ltd
75. UBS Futures Singapore Ltd
76. UBS Global Asset Management (Singapore) Ltd
77. UBS Securities Pte Ltd
78. Unison Capital Management Pte Ltd
79. UOB Asset Management Ltd
80. UOB Bullion And Futures Limited
81. UOB Kay Hian Private Limited
82. Wellington International Management Company Pte Ltd
83. Western Asset Management Company Pte Ltd
84. Wong Partnership LLP
85. 13 Other respondents who requested for confidentiality