

## **RESPONSE TO FEEDBACK RECEIVED - CONSULTATION PAPER ON CAPITAL TREATMENT FOR PRIVATE EQUITY AND VENTURE CAPITAL ("PEVC") INVESTMENTS**

### **1 General Comments**

1.1 In July 2004, MAS issued a consultation paper inviting views on proposed changes in capital treatment for PEVC investments. MAS has considered carefully the feedback received and where it has agreed with the comments, incorporated them into the relevant notices. We thank all respondents for their feedback. Comments of wider interest and MAS' responses are set out below.

### **2 Proposed Capital Treatment for PEVC Investments**

2.1 MAS proposed, in the consultation paper to calculate capital charges based on the size of the individual PEVC investments instead of the aggregate amount of PEVC investments. Under the proposal, any capital investment by a bank which represents not more than 10% of the capital of a PEVC entity will be risk-weighted. Where the bank invests in more than 10% of the PEVC entity, the first 10% of the investment will be risk-weighted while the portion that is in excess of 10% of the PEVC entity will be deducted from Total Capital.<sup>1</sup> The proposed capital treatment is consistent with the approach adopted for all capital investments in MAS Notice 637.

2.2 Most respondents agreed with the proposal to align the method for calculating risk charges for PEVC investments with that in MAS Notice 637, but suggested that the threshold for deduction from Total Capital be raised to 20%. They explained that substantial stakes of 20% or more would enable the banks to negotiate for and incorporate deal features that will lower their investment risk

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<sup>1</sup> Where the PEVC investment is a subsidiary of the bank, the entire investment (net of goodwill) will be deducted from Total Capital and goodwill will be deducted from Tier 1 Capital.

through improved structural protection and control. Larger stakes also command more attractive valuations.

### MAS' Response

2.3 After considering the feedback received, MAS has revised the capital treatment for PEVC investments as follows:

<b>Type of PEVC Investment</b>	<b>Capital Treatment</b>
Capital Investment $\leq$ 20% of PEVC Entity	Risk-weight at 200%.
Capital Investment $>$ 20% but $\leq$ 50% of PEVC Entity (i.e., not a subsidiary)	On solo and group basis, risk-weight the first 20% of the PEVC investment at 200%. The portion of the PEVC investment in excess of <u>20%</u> of the PEVC entity is deducted from Total Capital.
Capital Investment in PEVC Entity which is a subsidiary	On solo basis, deduct the PEVC investment net of goodwill from Total Capital. Goodwill is deducted from Tier 1 Capital.  On group basis, consolidate PEVC investment and apply applicable risk weights to net tangible assets. Goodwill is deducted from Tier 1 Capital.

## **3 Credit Conversion Factor (“CCF”) for Undrawn Commitments**

3.1 MAS proposed to apply a 100% CCF to undrawn commitments extended to PEVC entities regardless of their original maturity. Commitments that can be cancelled unconditionally at any time without prior notice may be accorded a 0% CCF, as provided for under MAS Notice 637.

3.2 Two respondents suggested lowering the CCF as they were of the view that a 100% CCF is excessive.

MAS' Response

3.3 As the drawdown of PEVC commitments is relatively certain, MAS is of the view that a 100% CCF is appropriate.

**4 Risk Weight for Capital Investments in Listed PEVC Entities**

4.1 MAS also sought the banks' views on whether a reasonable distinction could be made between a capital investment in an actively-traded listed PEVC entity vis-à-vis an illiquid or unlisted PEVC investment, and if so, the appropriate criteria that could be set to justify a lower risk weight for listed PEVC investments.

4.2 One respondent suggested using market capitalization ( $\geq$  US\$200 million) or annual profits ( $\geq$  US\$20 million) as possible thresholds for determining a lower risk weight of 100%.

MAS' Response

4.3 MAS has not adopted the suggestion as neither market capitalization nor profit is a robust indicator of an active secondary market for the trading of the shares of the PEVC entity.

MONETARY AUTHORITY OF SINGAPORE

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