RESPONSE TO FEEDBACK RECEIVED - CONSULTATION PAPER ON PROPOSALS FOR THE IMPLEMENTATION OF BASEL II IN SINGAPORE (PHASE 1)

1. General Comments

1.1 In August 2005, MAS issued a consultation paper inviting views on the draft rules and guidelines for implementing Basel II.

1.2 We thank all respondents for their comments. MAS has considered carefully the feedback received, and where it agreed with the comments, has incorporated them into the revised draft guidance (PDF, 327KB). Comments that are of wider interest, together with MAS' responses are set out below.

2. Scope of Application

Treatment of Joint Ventures

2.1 One respondent sought clarification on the capital treatment of a joint venture which is consolidated on a proportionate basis under FRS 31.

MAS' Response

2.2 If a Reporting Bank accounts for a joint venture by consolidating it on a proportionate basis under FRS 31, it should apply the relevant risk weights to its proportionate share of the underlying assets of the joint venture which has been consolidated into its consolidated financial statements for the purposes of calculating Group CAR. For calculating Solo CAR where the joint venture is approved or excluded under section 32 of the Banking Act, the Reporting Bank should risk weight the first 20% of the investment in the joint venture and deduct any investment in excess of 20% from capital.[1] However, if the Reporting Bank is able to exercise majority control of the joint venture, the investment should be treated as an investment in a subsidiary and be deducted fully from capital.[1]

3. Minimum Tier 1 and Total Capital Adequacy Ratios

3.1 Singapore-incorporated banks ("Reporting Banks") are required to maintain a Total Capital Adequacy Ratio ("CAR") of at least 10%, of which at least 7% must be in Tier 1 Capita l. Separately, Basel II requires certain deductions from capital to be taken 50% from Tier 1 Capital and 50% from Upper Tier 2 Capital. Some respondents therefore suggested that Tier 1 CAR should be calibrated at 50% of Total CAR.

MAS' Response

3.2 MAS has fine-tuned the risk-based capital rules for Reporting Banks (including the minimum CAR requirements) after completing an extensive review in May 2004. We believe the current capital requirements remain appropriate for our banking system and compatible with international and regional practices. We therefore do not intend to vary the minimum CAR requirements at this point in time. However, MAS will review the capital requirements from time to time, taking into consideration, among other things, the results from the 5th Quantitative Impact Study and banks' capital levels during the parallel run.

4. Definition of Capital

a) Revaluation Gains on Available-for-Sale ("AFS") Equity Securities

4.1 MAS allows 45% of the revaluation gains on AFS equity securities that are listed on any securities exchange in Singapore or any recognised group A exchange as set out in Table 6 of the Fourth Schedule to the Securities and Futures (Financial and Margin Requirements for Holders of Capital Markets Services Licenses) Regulations to be recognised as Upper Tier 2 Capital at both the Solo and Group levels.

4.2 One respondent proposed that Reporting Banks be given the flexibility of deciding whether or not to recognise such revaluation gains as Upper Tier 2 Capital.

MAS' Response

4.3 MAS will accord Reporting Banks the flexibility to decide whether to recognise the revaluation gains on AFS equity securities as Upper Tier 2 Capital.

4.4 A Reporting Bank that has chosen not to recognise such revaluation gains should inform MAS and apply this approach consistently to all its AFS equity securities on an on-going basis. Notwithstanding the non-recognition of such revaluation gains, any impairment charges taken against any equity security should be taken as a charge to the profit and loss account and should not be netted against gains from any other asset.

b) Deferred Tax Assets Associated with Total Eligible Provisions ("TEP")

4.6 One respondent sought clarification on whether the limit on the amount of TEP that can be recognised as Upper Tier 2 Capital excludes deferred tax assets associated with such TEP.

MAS' Response

4.7 MAS confirms that the limit on the amount of excess TEP over Expected Loss that can be recognised as Upper Tier 2 Capital excludes the deferred tax assets associated with such TEP.

5. Operational Risk

a) Partial Use of Basic Indicator Approach ("BIA") and Standardised Approach ("SA(OR)")

5.1 One respondent asked if a Reporting Bank can use the SA(OR) for some entities in the banking group and the BIA for other banking group entities.

MAS' Response

5.2 MAS recognises that there could be difficulty in rolling out SA(OR) to all entities within a banking group, e.g. new acquisitions. MAS has therefore provided flexibility in the Notice (see paragraph 9.1.4) to allow a Reporting Bank to use a combination of operational risk approaches in exceptional cases with good reasons. This is subject to the Reporting Bank having a reasonable timeline for rolling out the more sophisticated approach to those entities in the banking group using the less sophisticated approach.

b) Definition of Gross Income

5.3 Respondents sought clarification on the treatment of provisions, fee expenses, interest-in-suspense, unrealised gains/losses from the revaluation of banking book financial assets as well as dividend and rental income in the calculation of gross income. One respondent suggested a 10% materiality threshold for allowing exclusions from the Gross Income computation.

MAS' Response

5.4 With the exception of interest expense, the Gross Income figure should be gross of all provisions and all operating and non-operating expenses. The intent is to obtain a measure of a Reporting Bank's activity level, which serves as a proxy for its operational risk exposure. Applying a 10% materiality threshold for such adjustments would not be appropriate, as it could unintentionally exclude activities with significant operational risks, for example, in new business lines. To be excluded from the definition of Gross Income, the income or expense item should not be derived from the ordinary activities of the Reporting Bank and it should not be expected to recur regularly.

5.5 Based on the above principles, provisions and expenses should be grossed back when calculating Gross Income. Similarly, interest-in-suspense should be added back to interest income for pre-FRS39 accounting periods and included in the Gross Income calculation. Subsequent recoveries can be excluded when calculating Gross Income. Unrealised gains/losses arising from the revaluation of financial assets in the banking book that are reflected in the income statement can be excluded from Gross Income. Dividend and rental income may be excluded from the Gross Income calculation only if these items are not derived from the ordinary activities of the Reporting Bank, and are not expected to recur regularly.

c) Mapping of Business Lines under Standardised Approach to Operational Risk ("SA(OR)")

5.6 Under the SA(OR), a bank is required to map all its activities to eight business lines in accordance with specified mapping principles. Several respondents sought clarification on the mapping of non-standard hybrid products.

5.7 Under the mapping principles, any activity that cannot be mapped into a particular business line is to be mapped into a business line with an 18% beta factor. Some respondents requested that a lower beta factor be considered. One respondent sought clarification on the requirement to ensure consistency of business line definitions across credit risk, market risk and operational risk.

MAS' Response

5.8 The mapping principles provide for the following treatment of non-standard activities. A non-standard activity should be mapped into the business line that it supports. If it supports more than one business line, an objective criterion should be used to allocate the gross income from that activity among the different business lines. If an activity cannot be mapped to any particular business line based on the business line definitions or the business line(s) that the activity supports, it should be mapped to a business line with an 18% beta factor. The mapping principles and beta factors are consistent with Basel II, and are similarly adopted in other markets.

5.9 As far as possible, MAS expects the mapping of business lines for operational risk to be consistent with business line definitions under credit risk and market risk. However, a Reporting Bank may deviate from this principle if the deviation is properly supported by valid reasons and adequate documentation.

d) Frequency of Operational RWA Calculation

5.10 One commentator sought clarification on how frequently a Reporting Bank should recalculate its Operational RWA.

MAS' Response

5.11 Under the Basic Indicator Approach ("BIA") and SA(OR), the amount of capital that a Reporting Bank is required to maintain on an ongoing basis to cover its operational risks is a function of a three-year quarterly moving average of the Reporting Bank's gross income. Accordingly, Operational RWA needs to be recalculated only on a quarterly basis, unless the Reporting Bank has made adjustments to any of its quarterly financial statements for the past 12 quarters, in which case Operational RWA should similarly be adjusted.

e) Tracking operational risk data

5.12 MAS proposed that a Reporting Bank which intends to use the SA(OR) should systematically track relevant operational risk data including material losses by business line as part of its internal operational risk assessment system.

5.13 One respondent proposed that MAS set the *de minimis* gross loss threshold for internal loss data collection to ensure consistency across the industry.

MAS' Response

5.14 MAS does not intend to prescribe a *de minimis* threshold as the appropriate threshold could vary from one Reporting Bank to another depending on each Reporting Bank's circumstances. A Reporting Bank should be able to demonstrate that its own established threshold is reasonable and appropriate for operational risk measurement and management. This includes the ability to capture a significant proportion of the Reporting Bank's operational risk losses.

MONETARY AUTHORITY OF SINGAPORE
8 March 2006

[1] Such deductions from capital are to be taken 50% from Tier 1 Capital and 50% from Upper Tier 2 Capital.

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