MAS Monetary Authority of Singapore

RESPONSE TO FEEDBACK RECEIVED – CONSULTATION ON DRAFT BANKING (AMENDMENT) BILL 2006

1 Introduction

1.1 On 31 July 2006, MAS released a consultation paper on proposed amendments to the Banking Act ("BA"), and the draft Banking (Amendment) Bill ("Bill"). We thank all respondents for their comments.

1.2 MAS has carefully considered the feedback received, and has incorporated the changes where appropriate into the revised Bill for introduction in Parliament. Comments that are of general interest to the industry, together with MAS' responses, are set out below.

2 Definition of Deposit (Section 4B)

2.1 It was proposed that MAS be accorded greater flexibility to prescribe what constitutes a deposit, to better deal with innovation in the financial sector. Respondents sought to confirm that financial products prescribed as deposits should be disclosed as "deposits of non-bank customers" in the financial statements pursuant to MAS Notice 608.

MAS' Response

2.2 Financial products prescribed as deposits should be disclosed as such, and in cases where the customer is a non-bank, to be disclosed as "deposits of non-bank customers".

2.3 Another respondent observed that the industry apply inconsistent treatment for structured deposits, citing dual-currency investment ("DCI") as an example. Some regard DCIs as deposits for the purpose of compliance with the BA, while others treat them as investment products for compliance with the Financial Advisers Act ("FAA"). The respondent sought MAS' comments on the practice.

MAS' Response

2.4 A product that meets the definition of deposit under section 4B of the BA would be regarded as a deposit for the purpose of complying with the requirements of the BA. A structured deposit refers to (a) a type of deposit under which any interest or premium is payable, or is at risk, in accordance with a formula which is based on (i) the performance of any financial instrument; or (ii) the occurrence of any credit event; or (b) a DCI. All structured deposits are regarded as investment products for the purpose of compliance with the FAA. The applications of the BA and the FAA to a deposit or structured deposit are not mutually exclusive. Specifically on DCIs, MAS restricts the marketing of such products as deposits or structured deposits as it could be misleading to consumers who may construe them as principal guaranteed in terms of the base currency. The product disclosure requirements in FAA Notice on DCI (FAA-N11) would apply, in addition to the FAA Guidelines on Structured Deposit.[1]

3 Use of the Word "Bank" (Section 5)

3.1 MAS had earlier proposed to qualify the restriction on the use of the word "bank", to accommodate certain legitimate uses. We received feedback expressing concern with the proposal to introduce automatic blanket exclusion (subject to disclosure requirements) on the use of the word "bank" for foreign-licensed banks and their representative offices that are not licensed to conduct banking business in Singapore. The respondent further commented that greater legislative protection should be accorded to the public and that the current practice of requiring case-by-case approval by the MAS on the use of the word "bank" for such entities has served the public interest well.

MAS' Response

3.2 After considering the feedback received, MAS would retain the requirement for case-by-case approval for banks licensed in foreign jurisdictions but not in Singapore to use the word "bank" in their names. An exception would be made for authorised representative offices of foreign-licensed banks which would be allowed to use the word "bank" in their names without the need for case-by-case approval, provided they disclose their licensing status in their home jurisdictions.

[1] For further details, please refer to FA (Structured Deposits - Prescribed Investment Product & Exemption) Regulations 2005, FAA Notice on DCI (FAA-N11) and FAA Guidelines on Structured Deposits.

4 Maintenance of Reserve Fund (Section 22)

4.1 MAS has proposed to repeal the requirement for banks to maintain a reserve fund. Respondents queried if foreign bank branches are allowed to repatriate their net profits (both prior years and subsequent) to their head offices without MAS' prior approval.

MAS' Response

4.2 Banks incorporated outside Singapore would be allowed to release existing balances in their reserve funds to their head offices over 5 years on a straight-line basis. From the effective date of the amendments to the BA, banks do not need to seek prior approval from the MAS to repatriate net profits to their head offices. Notwithstanding this, MAS may have imposed or may impose in the future specific prudential requirements on an individual bank that poses greater supervisory concern. Banks should continue to comply with these supervisory requirements.

5 Information to be furnished by banks (Section 26)

5.1 Respondents enquired on the term "public domain".

MAS' Response

5.2 It refers to publicly available information.

6 Large Exposures and Related Party Exposures (Sections 27 and 29)

6.1 Section 29 of the BA empowers MAS to establish limits on a bank's exposures to its substantial shareholder group(s), financial group, director group(s) or any other person or group of persons, while section 27 sets out the reporting requirements in respect of a bank's exposures to these persons.

6.2 Currently, the term "director" as used in section 27 and 29 of the BA, includes the spouse, parent and child of a director. MAS has proposed to expand the definition of director to include his spouse, parent, remoter lineal ancestor, step parent, son, daughter, remoter issue, step-son, step-daughter, brother and sister, which is in line with that of an associate of a controller (of a bank incorporated in Singapore), as defined in section 15B of the BA. Respondents sought clarity on the terms "remoter lineal ancestor" and "remoter issue", and proposed excluding the remoter lineal ancestor, remoter issue,

brother or sister of a director from the definition of a director as it would pose implementation challenges for directors to obtain information from these persons. It could also make it more difficult for banks to find persons of good standing to agree to be directors of banks incorporated in Singapore.

MAS' Response

6.3 "Remoter lineal ancestor" in relation to an individual, refers to his grandparent and persons above grandparent level while "remoter issue" refers to his grandchild and persons below grandchild level. In view of potential implementation difficulty, MAS will retain the existing definition of director (i.e. director includes the spouse, parent, and child) for the purpose of sections 27 and 29 of the BA.

6.4 Clarification was sought on whether reference to "director" applies only to banks incorporated in Singapore.

MAS' Response

6.5 "Director" refers to a director of a bank in Singapore, and in the case of a bank incorporated outside Singapore, includes a director of its head office.

6.6 Some respondents felt that there could be practical difficulties if the existing reporting requirements under section 27 of the BA were expanded to include a bank's credit facilities or other exposures to any company in which the bank has a major stake (whether held directly or through affiliated entities), where the bank has no management control over the affiliated entities or if the affiliated entities are prohibited from disclosing the information to the bank.

MAS' Response

6.7 The bank should have records of its exposures to any major stake entity that has been approved by the Authority under section 32 of the BA. Nevertheless, as part of MAS' review of its supervisory processes, the frequency of reporting under section 27 of the BA will be revised from monthly to quarterly. Banks will be required to submit the statement prepared under section 27 to its board of directors in the case of a bank incorporated in Singapore, or its head office in the case of a bank incorporated outside Singapore, and thereafter submit the statement to MAS.

6.8 Some banks were concerned that with the shift to an exposure-based approach to limiting concentration risk, they may not be able to accurately identify and compute the relevant exposures, particularly for more complex

instruments that generate a combination of on and off balance sheet exposures. It might be onerous and require much discretion on the part of the bank. Other banks expressed the concern that the basis of computation of exposures which MAS would be specifying in the Notice issued under section 29, may not be consistent with that adopted by their head offices, especially on the market risk component (or potential future exposure) of off-balance sheet items. Banks felt that it would not be operationally effective to develop two internal risk models – one for MAS reporting and the other for internal risk management. Furthermore, as banks may utilise different methodologies for computing the potential future exposure of off-balance sheet items, it was suggested that potential future exposure be excluded altogether from the computation of a bank's off-balance sheet exposures.

MAS' Response

6.9 MAS expects banks to be able to identify and measure their exposures as part of their risk management practices before dealing in any financial instrument or engaging in any transaction with a counterparty. The basis for computation of exposures would be set out in the proposed MAS Notice 639.[2] In general, a bank should measure its exposures based on their carrying value, i.e. the same measurement basis that has been applied to the exposures in the preparation of the bank's financial statements, and which complies with the requirements of the Singapore Financial Reporting Standards. The valuation requirements under section 29 are therefore, not over and above the usual accounting requirements for a bank in Singapore. As for the recognition of potential future exposure in off-balance sheet transactions, MAS had consulted the industry earlier and will be allowing banks the option of adopting the add-ons under BIS' capital adequacy framework or to use their internal models to derive appropriate add-ons if the bank has received the relevant supervisory permission to use these internal models for capital adequacy purposes.[3]

6.10 Respondents sought clarity on whether a bank is required to aggregate exposures to financially independent entities if they are subsidiaries of the same controlling entity, which the bank has no exposure to.

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[2] The proposed Notice 639 was issued for public consultation on 13 Sep 2006. Among others, it contained proposals on the basis of computation of exposures. The consultation period closed on 13 Oct 2006. MAS will consider feedback received on the proposed Notice.

[3] Please refer to MAS' response to industry feedback on amendments to section 29 of the BA, dated 15 May 2006.

MAS' Response

6.11 Banks will be required to aggregate exposures to entities in a common control group, regardless of whether they have an exposure to the controlling entity. However, MAS will allow a bank to disaggregate its exposures to any entity in a common control group if that entity is financially independent of the other entities in the group, based on the criteria for disaggregation under the proposed MAS Notice 639.

6.12 Clarification was sought on whether foreign exchange and other derivative transactions initiated by the Singapore branch of a bank incorporated outside Singapore but centrally booked in another overseas branch would be included as an exposure for the purpose of section 29.

MAS' Response

6.13 In general, a bank in Singapore would have to recognise an exposure if it may incur a loss as a result of the failure of a counterparty to meet its obligations. In the case of a central booking arrangement where the transaction is not booked in the Singapore branch, the Singapore branch need not recognise an exposure provided it is not exposed to any potential losses arising from the transaction.

6.14 Section 29 currently prohibits a bank from granting any credit facility against the security of its own shares. This provision will be retained in the revised section 29. Clarity was sought on whether the prohibition extends to shares of the parent company of a bank in Singapore.

MAS' Response

6.15 "Security of its own shares" refers only to the shares of the bank incorporated in Singapore, or in the case of a bank incorporated outside Singapore, the shares of its head office.

6.16 A respondent requested for confirmation that the credit card balances due from directors would be excluded from computation of exposures to directors, as was indicated in the earlier industry consultation for section 29.

MAS' Response

6.17 Credit card balances due from a director and entities related to a director ("director group") would be excluded from the $5,000 unsecured credit

facilities limit. This would be set out in the proposed MAS Notice 639.[4] Credit card and charge card facilities granted to a director group would continue to be subject to the requirements in the Banking (Credit Card and Charge Card) Regulations. The credit card balances would have to be aggregated with a bank's other exposures to the director group, for the purpose of complying with the large exposures and substantial exposures limits to a director group.

6.18 We received feedback, in relation to the category "any of its officers, employees or other persons being persons receiving remuneration from the bank in excess of one year's remuneration of the officer, employee or person", that the language used could technically be interpreted to include third party professional service providers who are not employees of the bank, and asked if that was the intent.

MAS' Response

6.19 MAS will make clear that this excludes persons receiving remuneration such as fees from the bank in respect of their professional services.

6.20 Respondents noted that MAS may impose limits or reporting requirements on "any other person or group of persons", and suggested that this category of persons be prescribed via regulations, if the intent is to provide flexibility for MAS to include other persons from time to time. Respondents also sought clarification on the term "class of banks".

MAS' Response

6.21 MAS will make it clear that "any other person or group of persons" refers to persons that the Authority may prescribe via regulations. The term "class of banks" refers to any group of banks possessing certain common characteristics, for example banks holding full bank licences.

7 Limit on Equity Investments (Section 31)

7.1 Some respondents queried the rationale for removing the exemption provision under section 31(3)(a), and asked about the status of previous exemptions.

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[4] Please also refer to the proposed MAS Notice 639 for the definition of "director group".

MAS' Response

7.2 A broad exemption power has been provided for under section 76A, rendering the specific provision under section 31(3)(a) unnecessary. Previous exemptions granted pursuant to section 31 (3)(a) would continue to hold as provided for in the draft Bill under the transitional and savings provisions.

8 Approval of Major Stakes (Section 32)

8.1 A respondent asked if the reference to "total number of issued shares in a company" would include, in addition to ordinary shares, other types of shares such as preference shares. Another requested that MAS consider excluding interests in investment funds structured as corporate entities, by way of regulations.

MAS' Response

8.2 The term "total number of issued shares in a company" refers to all types of shares, including ordinary and preference shares. Interests in investment funds structured as corporate entities will be subject to MAS' approval under section 32. Approval would ordinarily be granted as such entities are engaging in financial activities. The aggregation rules for section 32, as set out in Part VII of the Banking Regulations, would similarly apply.

9 Exemption Provision for Sections 29, 31 and 33 (Section 37)

9.1 A few respondents enquired about the rationale for repealing the exemption provision.

MAS' Response

9.2 As stated in the consultation paper, the repeal of section 37 is due to the introduction of general exemption power under section 76A. Previous exemptions granted pursuant to section 37 would continue to hold.

10 Minimum Liquid Assets (Section 38)

10.1 Several respondents felt that the grace period of 3 days for complying with MAS' revision to the minimum liquid asset ("MLA") requirements is too short, especially for banks without MEPS to react to MAS' requirements.

MAS' Response

10.2 The minimum notice period of 3 business days will be used only under exceptional circumstances. For policy changes or other material changes to the liquidity framework, MAS will continue to consult the industry before implementation. For specific changes to the MLA level, banks will be given a reasonable time period to comply with the new requirements.

11 Asset Maintenance Requirement (Section 40)

11.1 Some respondents expressed the concern that an asset maintenance ("AM") regime would increase the cost for foreign bank branches in Singapore as eligible assets are by nature, relatively less risky and hence would yield lower returns. A respondent further queried whether it was necessary for both AM and MLA requirements to be met separately. There was a suggestion to lower the haircuts for eligible assets, and expand the pool of eligible assets to include inter-bank assets and foreign currency assets such as loans. There was also a concern that the introduction of AM may cause foreign bank branches to subsidiarise in Singapore as an alternative to AM.

MAS' Response

11.2 An AM requirement is necessary as the resolution of cross-border insolvencies is often complex and drawn-out, and there is usually uncertainty concerning the amount and speed of any recovery. MAS recognises that while AM aims to protect the interests of depositors in an insolvency, it can inhibit a bank's ability to freely allocate assets on a global basis. The minimum AM requirements, as well as the pool of eligible assets and applicable haircuts, have been calibrated at a level to balance these considerations.

11.3 As explained during the earlier consultation[5] with the industry on the specific proposals, haircuts take into account the risk that assets could be transferred out of Singapore before they can be placed under the charge of liquidators, and the risk that banks will be unable to realise the full value of the asset during insolvency. Thus, even high quality assets may still be subject to haircuts due to potential flight risk. Most of the eligible assets are required to

[5] Please refer to MAS' response to feedback received on AM, dated 18 Jan 2006 and 14 Feb 2006. MAS has also issued the proposed Notice 640 which sets out the detailed compliance requirements, for public consultation on 13 Sep 2006. The consultation period closed on 13 Oct 2006. MAS will consider feedback received on the proposed Notice.

be denominated in Singapore dollars as the repayment of foreign currency assets takes place outside Singapore and funds may be frozen by foreign authorities. Inter-bank assets are not eligible as they can be easily set off, and may therefore not be available to meet deposit liabilities in Singapore. MLA assets are maintained for liquidity purposes and may no longer be available to meet the claims of depositors in the event of bank failure. Hence, assets maintained for liquidity and depositor protection purposes should be met separately.

11.4 The introduction of AM is not intended by MAS to induce banks to subsidiarise in Singapore. The level of minimum AM that has been proposed has been carefully calibrated to balance prudential objectives with banks' commercial considerations and determined after close consultation with industry.

12 Disqualification and Removal of Directors (Section 54B)

12.1 We received comments that the Act should provide (a) for the director to be given a right of hearing; (b) that it shall be a defence if the director has reasonable grounds for believing that another person was charged with the duty of securing compliance with the provisions of the Act and that person was competent and in a position to discharge that duty; and (c) for an avenue of appeal if the director concerned does not agree with the views of MAS. Respondents also sought clarification on whether the director is to secure compliance by the bank with the Act, or his own compliance.

MAS' Response

12.2 After considering the feedback received, provisions giving the bank and director a right of hearing and an avenue of appeal will be included in the draft Bill. The right for defence is already provided for under section 66 of the current Banking Act. As the requirements under the BA are imposed on the bank, the director is to secure compliance with the Act by the bank.

13 Compulsory Transfer of Business (Section 55E) and Shares (Section 55I)

13.1 Respondents appreciated the need to maintain a stable financial system and recognised international precedents for regulatory intervention to direct the transfer of a bank's business, but felt that the circumstances under which MAS could invoke this provision should be more clearly defined or restricted in its

scope of application. On transfer of shares, clarity was sought on whether the shareholder must have caused the situation, which prompted MAS to make such a determination. As the exercise of such powers deprives a shareholder of his shares, it was suggested that any order to transfer the shares of a bank be made based on proof of fault and that an avenue of appeal be made available, if the transferor disagrees with the transfer. In cases where MAS appoints a person to perform an assessment of a transfer of business or shares of a bank (including the compensation, if any, that should be paid by the transferee), some respondents suggested that there should be an avenue for appeal if the transferor does not agree with the valuation.

<u>MAS' Response</u>

13.2 MAS currently has limited powers in dealing with a distressed or insolvent bank. The bill will accord MAS a wider role in the resolution process and a broader range of resolution options. Before MAS makes a determination on a compulsory transfer of the business or shares of a bank or a restructuring of its share capital, there must be sufficient grounds for the Authority to do so.[6] In setting out these grounds, MAS has taken into account the powers and practices of other regulators in major jurisdictions. It is not feasible to provide for more precise trigger points as supervisory judgment would be involved. In addition, any determination by MAS may only be made if the Authority is satisfied that it is in the interests of the depositors, as well as the stability of the financial system in Singapore. MAS may also appoint one or more persons to perform an independent assessment of the proposed transfer, where appropriate, to ensure that the final valuation reflects fair market opinion. Furthermore, MAS' determination is subject to the approval of the Minister charged with the responsibility for banking matters. The Minister will give the affected parties an opportunity to make written representations, except where it is not practicable or desirable to do so, for instance, where an expeditious transfer is crucial to maintaining financial system stability.

[6] The grounds for exercising these powers are, where (a) the bank informs MAS that it is, or is likely to become, insolvent or unable to meet its obligations or that it has suspended or is about to suspend payments; (b) the bank has become unable to meet its obligations, or is insolvent, or suspends payments; (c) MAS is of the opinion that the bank (i) is carrying on business in a manner likely to be detrimental to the interests of its depositors or creditors; (ii) is, or is likely to become, insolvent or unable to meet its obligations, or that it is about to suspend payments; (iii) has contravened any of the provisions of the Act; (iv) has failed to comply with any condition attached to its licence; or (d) MAS considers it to be in the public interest.

14 Restrictions on Issuing and Promoting Credit Cards (Sections 57 and 57G)

14.1 A respondent sought to confirm that the approval requirement would not apply to a party with whom the bank has entered into an arrangement to issue co-brand credit cards. The respondent further enquired that the provision would not apply to 3rd parties engaged by the bank to perform certain sales and distribution functions of its credit card business, e.g. telesales companies, road shows and direct sales agents.

MAS' Response

14.2 Persons accepting applications or advertising, on behalf of a licensee who is permitted to issue credit cards in Singapore, need not be separately licensed.

14.3 Another respondent asked if, in the case of a single party merchant credit where the merchant enters into an agreement to sell the receivables and the risk thereon to the bank, would the scheme be excluded from the credit card regulatory regime. There was also a suggestion that MAS prescribe, where applicable, that the issuer for merchant credit must only hedge the credit risks it bears with banks in Singapore, to pre-empt non-banks from indirectly granting credit facilities to individuals through back-to-back arrangements with the merchants.

MAS' Response

14.4 A card qualifies as a single party card if and only if the card is used for purchasing goods and services on credit with the issuer, and the issuer bears the whole credit risk of the cardholder. Merchants that choose to pass on the risks to third parties (bank or non-bank) would not be bearing the whole credit risk of the cardholder, and therefore would not qualify as a single party card under the exemption in section 57G.

14.5 A respondent sought to confirm that cards with low credit limits (<S$500), which would be exempted from the regulatory regime, could be used for purchase of goods and services from merchants other than the card issuer. The respondent further proposed that, for a level playing field, banks should similarly be permitted to grant credit facilities up to an aggregate limit of S$500 on the same terms as those issuers of low credit limit schemes that are exempted from the regulatory requirement.

MAS' Response

14.6 Aggregate amounts of credit below S$500 granted to individuals through credit card facilities will be exempted from the regulatory regime. There are no restrictions on which merchants can accept such a credit card facility for payment for goods and services. This exemption similarly applies to banks that choose to issue such credit cards.

15 Duty not to Furnish False Information to Authority (Section 66A)

15.1 A few respondents expressed concerns that the punitive measures of a fine and/or imprisonment are too onerous and that it is possible for mistakes to occur due to oversight given that reporting to MAS occurs on a fairly regular basis. Other respondents felt that criminal sanctions should be imposed only when there is a wilful or fraudulent act.

MAS' Response

15.2 In response to industry comments, MAS would provide for a defence where a person has reasonable grounds to believe that another person was charged with the duty of ensuring that the information submitted was accurate and that person was competent and in a position to discharge that duty. In addition, the draft Bill would provide for a person not to be sentenced to imprisonment for an offence unless, in the opinion of the court, he committed the offence wilfully. We would also consolidate the proposed section 66A with the current section 66.

16 Operation of an Asian Currency Unit (Section 77)

16.1 Respondents sought to confirm that the Asian Currency Unit (ACU) of a foreign bank would continue to be exempted from the provisions of the Act.

MAS' Response

16.2 ACUs of foreign banks would continue to be exempted from certain provisions of the Act, as stipulated in section 77.

17 Others

17.1 For consistency with the proposal for large exposure limits (section 29) and to bring our prudential limits in line with international practice, the denominator for computation of the single security (section 31) and aggregate property investment (section 33) limits by locally incorporated banks would be changed from capital funds to eligible total capital (as defined in MAS Notice 637). The change would be incorporated into the draft Bill. Banks incorporated in a foreign jurisdiction would continue to use capital funds (as defined in MAS Notice 601) as the denominator for the purposes of compliance with sections 29, 31 and 33.

MONETARY AUTHORITY OF SINGAPORE
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