



## **RESPONSE TO FEEDBACK RECEIVED – CONSULTATION ON PROPOSED AMENDMENTS TO MAS NOTICE 637 TO IMPLEMENT BASEL III CAPITAL STANDARDS IN SINGAPORE**

### **1 Introduction**

1.1 On 28 December 2011, MAS issued a consultation paper inviting Singapore-incorporated banks (“Reporting Banks”) and interested parties to comment on proposed amendments to MAS Notice 637, which incorporated the Basel III capital reforms by the Basel Committee on Banking Supervision (“BCBS”) issued in December 2010 and revised in June 2011<sup>1</sup>, as well as other policy enhancements arising from MAS’ ongoing review of the capital rules and guidance.

1.2 The revisions to MAS Notice 637 to raise the quality of the regulatory capital base, enhance risk coverage of the capital framework, and introduce the new leverage ratio and capital buffer requirements, as well as other amendments arising from MAS’ policy review, will be implemented on 1 January 2013. Comments received from the consultation relating to these areas that are of wider interest and MAS’ responses are set out below.

1.3 We thank all respondents for their comments.

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<sup>1</sup> Please refer to “Basel III: A global regulatory framework for more resilient banks and banking systems” published by the Basel Committee in December 2010 and revised in June 2011 ([www.bis.org](http://www.bis.org)).

## **2 Definition of affiliate**

2.1 A respondent asked if the definition of “affiliate” could be aligned with “affiliated entity” under Regulation 12 of the Banking Regulations.

### MAS’ Response

2.2 The definition of “affiliate” is in line with the intended scope set out in footnote 30 of the Basel III framework. As the definition of “affiliated entity” in the Banking Regulations is wider than this intended scope, it will not be appropriate for use within MAS Notice 637.

## **3 Definition of a financial institution**

3.1 Financial institutions are defined in MAS Notice 637 for the purpose of regulatory adjustments to capital and for application of the asset value correlation multiplier for exposures to financial institutions under the internal-ratings based approach. A respondent sought clarification on the rationale for the scope of entities specified in the definition of financial institutions. Respondents also asked whether the following entities are classified as financial institutions –

- (a) pawnshops and gold bullion traders;
- (b) group holding companies involved in varied principal activities through their subsidiaries; and
- (c) companies that exist solely to issue securities not used as regulatory capital and whose activities are to provide financial services within the group.

3.2 In relation to the definition of regulated financial institutions, some banks asked for an elaboration on what is meant by “subject to minimum prudential standard and supervision by a regulatory agency”. Respondents also asked whether money changers, remittance agents and exempt fund managers would be considered as regulated financial institutions.

## MAS' Response

3.3 The definition of financial institutions in MAS Notice 637 is based on the Basel III text, as well as further interpretative guidance issued by the BCBS. The Basel III text and further interpretive guidance include, as financial institutions, insurance companies, broker/dealers, banks, funds and entities whose main business activities include management of financial assets, lending, factoring, leasing, provision of credit enhancements, securitisation, investments, financial custody, central counterparty services and proprietary trading. As the principal activity of a pawnshop is to carry on the business of lending and the principal activity of a gold bullion trader is to carry on the business of dealing or trading in gold-related exchange-traded derivatives or over-the-counter derivatives, these will be considered financial institutions for the purposes of MAS Notice 637.

3.4 A financial holding company, which holds as a subsidiary, a banking institution or an insurance entity, will be considered a financial institution for the purposes of MAS Notice 637. We will revise the definition of a financial institution to include a financial holding company.

3.5 Entities that exist solely to issue securities which are not used as regulatory capital and whose activities are to provide financial services within the group will be considered financial institutions for the purposes of MAS Notice 637. For the avoidance of doubt, financial institutions will exclude a special purpose entity through which a Reporting Bank issues its regulatory capital as referred to in paragraphs 6.2.5 and 6.3.5 of Part VI.

3.6 As for the definition of a regulated financial institution, examples of minimum prudential standards and supervision that regulated financial institutions are subject to include minimum capital requirements or restrictions or limits on exposures, and inspections or off-site supervision by the regulatory agency to assess compliance with prudential standards.

3.7 For the purpose of the application of the asset value correlation multiplier for exposures to financial institutions under the internal-ratings based approach, companies that conduct money-changing and remittance business activities in Singapore are regulated by MAS and are required to comply with prudential

requirements under the Money-changing and Remittance Businesses Act. They will be considered regulated financial institutions. Entities that carry on the principal activity of fund management in Singapore will also be considered regulated financial institutions.

#### **4 Exposure measure for the leverage ratio**

4.1 A respondent asked if the exposure measure for on-balance sheet, non-derivative exposures should be net of general allowances, for the purpose of computing the leverage ratio.

##### MAS' Response

4.2 The exposure measure for the leverage ratio should generally follow the accounting measure of exposure. Where general allowances are netted from total assets in accordance with the relevant accounting standards, the exposure measure may be net of general allowances.

#### **5 Minimum requirements for capital instruments – Recognition of proceeds**

5.1 A respondent sought clarification on the interpretation of “issued and fully paid-up in cash” relating to the recognition of capital instruments.

##### MAS' Response

5.2 The amount recognised as regulatory capital shall be net of issuance costs. This has been clarified in the rules text.

## **6 Minimum requirements for AT1 capital instruments and Tier 2 capital instruments – Seniority of claims**

6.1 A respondent highlighted that the requirements which prohibit the paid-up amounts of any AT1 capital instrument or Tier 2 capital instrument from being secured or covered by a guarantee of the Reporting Bank or any of its related corporations or other affiliates, were stricter than the requirements under the Basel III capital standards.

### MAS' Response

6.2 We have aligned the requirements to those under the Basel III capital standards. These are set out in paragraphs 6.2.2(c) and 6.3.2(c) of MAS Notice 637.

## **7 Minimum requirements for AT1 capital instruments and Tier 2 capital instruments - Inclusion of call options within the first five years from the issuance date**

7.1 A respondent asked for greater clarity on the situations that call options can be permitted within the first five years from the issuance date.

### MAS' Response

7.2 Call options are permitted within the first five years from the issuance date under the following situations, provided that the requirements set out in paragraphs 6.2.2(g) and 6.3.2(g) of MAS Notice 637 are met for AT1 capital instruments and Tier 2 capital instruments, respectively:

- (a) where there is a change in the tax status of the capital instrument due to changes in the applicable tax laws of the country or territory in which the capital instrument was issued; or

- (b) where there is a change relating to the recognition of the capital instrument as regulatory capital for calculating Tier 1 CAR and Total CAR.

MAS shall, in determining whether to grant approval, consider whether the Reporting Bank is in a position to anticipate the event at issuance. This has been clarified in footnote 58 and footnote 73 in Part VI of MAS Notice 637.

## **8 Minimum requirements for AT1 capital instruments and Tier 2 capital instruments - Purchase or funding of the purchase of capital instruments**

8.1 Some respondents highlighted that a Reporting Bank may not have sufficient influence over major stake companies to prohibit the purchase by such entities of the AT1 capital instruments and Tier 2 capital instruments issued by the Reporting Bank. Some respondents also stated that the inclusion of “major stake companies” within the scope of this requirement seems more stringent than the requirements under the Basel III capital framework.

### MAS’ Response

8.2 We agree and have amended the relevant paragraphs in MAS Notice 637 to limit the scope of this requirement to “banking group entities” and “associates”.

## **9 Recognition of minority interest**

9.1 A respondent asked if there could be flexibility in allowing Reporting Banks to apply minimum regulatory capital requirements that are higher than those specified in paragraph 4.1.4 of MAS Notice 637, in computing surplus CET1 Capital (e.g. to take into account the Countercyclical Capital Buffer should this be imposed).

## MAS' Response

9.2 In computing surplus CET1 Capital for the purposes of calculating the amount of minority interest and other capital issued out of consolidated subsidiaries that are held by third parties, only the minimum regulatory capital requirements and the Capital Conservation Buffer shall be applied. The Countercyclical Capital Buffer shall not be included. This is aligned with the requirements under the Basel III capital framework.

## **10 Regulatory adjustments - Deduction of Goodwill from CET1 Capital**

10.1 Some respondents sought clarification on whether the regulatory adjustment applied in the calculation of CET1 Capital set out in paragraph 6.1.3(a) of MAS Notice 637 should also include goodwill included in the valuation of associates that are accounted for using the equity method. The respondents noted that accounting standards presently do not require such goodwill to be separately recognised.

## MAS' Response

10.2 The policy intent is to require goodwill included within the carrying amounts of associates accounted for using the equity method, to be deducted from CET1 Capital at the Group level<sup>2</sup>. A Reporting Bank shall calculate the goodwill amount by separating any excess of the acquisition cost over its share of the net fair value of the identifiable assets and liabilities of the entity.

## **11 Regulatory adjustments - Investments in own capital instruments and capital instruments of other financial institutions**

11.1 Some respondents highlighted the operational difficulties with the look through approach to indirect holdings of the Reporting Bank's own capital instruments or capital instruments of other financial institutions. A respondent

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<sup>2</sup> Refer to BCBS Basel III definition of capital – Frequently asked questions, December 2011, Paragraphs 67-68 (Goodwill and other intangibles), Question 1.

suggested that the 2% eligible total capital limit on any index fund set out in MAS Notice 639 sufficed in addressing the risks of double counting of capital. Another respondent asked if the remaining exposures within index securities that are not deducted should continue to be subject to the applicable risk weighting requirements.

#### MAS' Response

11.2 A Reporting Bank could acquire exposures to several index funds, each of which is within the 2% eligible total capital limit, thereby accumulating very large exposures to such capital investments. As such, this existing limit within MAS Notice 639 will not be effective in minimising double counting of regulatory capital. The look through requirement continues to be necessary.

11.3 The deduction of indirect holdings held through index securities can be based on the weightage of the securities within the index. The amounts deducted need not be risk weighted; the remaining exposures that are not deducted shall continue to be risk weighted in accordance with the relevant provisions under Parts VII or VIII in MAS Notice 637.

## **12 Regulatory adjustments - Capital deficits in subsidiaries and associates that are regulated financial institutions**

12.1 A respondent sought clarification on whether the capital deficits in regulated subsidiaries and associates should be computed based on the regulatory capital requirements set by the host regulator.

#### MAS' Response

12.2 The regulatory capital requirements imposed by the host regulator are to be applied to the measurement of capital deficits of subsidiaries and associates.



### **13 Regulatory adjustments - Investments in unconsolidated financial institutions**

13.1 In identifying capital investments in unconsolidated financial institutions in which the Reporting Bank does not hold a major stake, a respondent asked if (a) a capital instrument recognised by a bank regulatory agency that has implemented the Basel III capital standards can be deemed to have met the criteria for recognition as regulatory capital of the Reporting Bank; and (b) how capital investments in a financial institution that is not a bank should be mapped into the relevant tiers of bank regulatory capital for the purpose of this regulatory adjustment.

#### MAS' Response

13.2 For the purpose of this regulatory adjustment:

- (a) where a capital instrument satisfies the applicable regulatory capital criteria imposed by a bank regulatory agency that has implemented the Basel III capital standards, such capital instruments would be deemed to have met the criteria for CET1 Capital, AT1 Capital and Tier 2 Capital, as the case may be. This has been clarified in footnote 47(a) of Part VI in MAS Notice 637; and
- (b) where the capital investment of the Reporting Bank (i) is in a financial institution that is not a bank; (ii) where the entity is subject to minimum prudential standards and supervision by a regulatory agency; and (iii) the investment is not in the form of ordinary shares but is nonetheless recognised as Tier 1 Capital (or its equivalent) or Tier 2 Capital (or its equivalent), the capital instrument can be deemed to have met the criteria for CET1 Capital, AT1 Capital and Tier 2 Capital, as the case may be.

## **14 Regulatory adjustments - Investments in the ordinary shares of unconsolidated major stake companies**

14.1 A respondent sought clarification on whether the risk-weighted assets (“RWA”) arising from investments that are within the thresholds set out in paragraph 6.1.3(p)(i) of MAS Notice 637 and risk-weighted at 250% pursuant to paragraph 6.1.3(p)(iii), should be included within SA(EQ) RWA or IRBA(EQ) RWA.

### MAS’ Response

14.2 As the risk weight of 250% for such exposures is not a risk weight currently prescribed under the SA(EQ) or the IRBA(EQ), such RWA shall not be classified as SA(EQ) RWA or IRBA(EQ) RWA. Notwithstanding this, such exposures shall be regarded as equity exposures and be taken into account in computing the threshold set out in paragraph 4.8 of Annex 7AC of Part VII in MAS Notice 637.

## **15 Regulatory adjustments - Investments in own capital instruments**

15.1 Some respondents sought clarification on how the minimum requirements for AT1 capital instruments and Tier 2 capital instruments set out in paragraphs 6.2.2(n) and 6.3.2(j) respectively, interact with the regulatory adjustments relating to the deduction of own AT1 capital instruments and Tier 2 capital instruments set out in paragraphs 6.2.3(a) and 6.3.3(a) respectively.

### MAS’ Response

15.2 The requirements set out in paragraphs 6.2.2(n) and 6.3.2(j) are minimum requirements that capital instruments need to meet before they can be recognised as AT1 Capital and Tier 2 Capital respectively. Any portion of capital instrument that has been directly or indirectly funded by the Reporting Bank, its banking group entities or associates shall not count towards regulatory capital. On the other hand, the regulatory adjustments set out in paragraphs 6.2.3(a) and

6.3.3(a) shall be applied where such capital instruments are subsequently held by the Reporting Bank or any of its banking group entities.

**16 Requirements to ensure loss absorbency at the point of non-viability  
- Compensation to holders as a result of a write-off**

16.1 A respondent highlighted that it might be operationally challenging for ordinary shares to be issued immediately, following the trigger event.

MAS' Response

16.2 When a trigger event occurs, any compensation made to the instrument holders in the form of ordinary shares shall be paid without delay, and as soon as possible. To this end, a Reporting Bank shall ensure that at all times, all prior authorisation necessary to ensure that the relevant number of shares can be issued immediately, has been obtained. The requirements, as drafted, reflect these expectations.

**17 Requirements to ensure loss absorbency at the point of non-viability  
- Conversion formula of capital instrument**

17.1 Some respondents asked if the requirement to fix the conversion formula at the point of issuance of the capital instrument allows subsequent adjustments to be made to the conversion formula, to take into account the occurrence of capitalisation issues.

MAS' Response

17.2 The requirement to fix the conversion formula at the point of issuance of the capital instrument does not preclude the possibility of subsequent adjustments to be made to the formula, to take into account the occurrence of capitalisation issues such as bonus issues or share splits.

## **18 Requirements to ensure loss absorbency at the point of non-viability – Scope of legal opinion**

18.1 A respondent sought clarification on the scope of the required external legal opinion set out in paragraph 1.8(a) of Annex 6B in MAS Notice 637.

### MAS' Response

18.2 To ensure that the requirements set out in Annex 6B of MAS Notice 637 are complied with, an external legal opinion is required to confirm that the write-off or conversion feature at the point of non-viability is enforceable, and that there are no impediments to the write-off or conversion of the instrument into ordinary shares of the Reporting Bank. In this regard, this shall include, amongst others, an assessment that all prior approvals have been obtained, and that the terms and conditions of the capital instruments do not impede conversion.

## **19 Asset value correlation multiplier**

19.1 A respondent asked if the computation of total assets for the determination of meeting the USD 100 billion threshold would include the ultimate parent company or stop at the parent that is a financial institution.

### MAS' Response

19.2 For the purposes of computing total assets, the Reporting Bank shall use the reported total assets of the consolidated group of companies which include the regulated financial institution. The consolidation is not limited to a parent company that is a financial institution.