

# CONSULTATION PAPER

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# Regulatory Framework for Financial Holding Companies

MAS

Monetary Authority of Singapore

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## **PREFACE**

Financial groups in Singapore are mostly headed by an operating entity such as a bank or an insurance company. Some financial groups are also held under a non-operating financial holding company (“FHC”). To provide greater clarity on the prudential framework for FHC groups, MAS proposes a Financial Holding Companies Act to regulate designated FHCs.

This consultation paper sets out the proposed regulatory framework for FHCs. MAS invites interested parties to forward their comments on the proposals and responses to the consultation questions set out in this paper. Electronic submission is encouraged. Please submit your written comments by 19 March 2012 to:

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Please note that any submission received may be made public unless confidentiality is specifically requested for the whole or part of the submission.

## GLOSSARY

<b>Financial holding company (“FHC”)</b>	A non-operating company that holds as its subsidiary, a bank or an insurance company.
<b>Parent financial holding company</b>	The financial holding company at the head of a financial group.
<b>Intermediate financial holding company</b>	The financial holding company at the head of a sub-group within a larger financial group.
<b>Controlling intermediate financial holding company</b>	An intermediate financial holding company deemed to exercise effective control over at least one Singapore-incorporated bank or an insurance company.
<b>Financial group</b>	A group of companies headed by an FHC or a bank or an insurance company and comprises every company in which the FHC, bank or insurance company acquires or holds, directly or indirectly, a major stake approved by the MAS.
<b>Major stake</b>	A reference to “major stake” in relation to an FHC shall mean: (a) any beneficial interest exceeding 10% of the total number of issued shares in a company; (b) control over more than 10% of the voting power in a company; or (c) any interest in a company, where the directors of the company are accustomed or under an obligation, whether formal or informal, to act in accordance with the FHC’s directions, instructions or wishes, or where the FHC is in a position to determine the policy of the company.
<b>Insurance Groups Consultation Paper (“IGCP”)</b>	<i>Consultation Paper on Insurance Group-Wide Supervision</i> published on 17 February 2012
<b>Full Bank</b>	A bank licensed by the MAS and may provide the whole range of banking business approved under the Banking Act.
<b>Wholesale Bank</b>	A bank licensed by the MAS and subject to the <i>Guidelines for the Operation of Wholesale Banks</i> .

## 1 INTRODUCTION

1.1 Banking and insurance groups in Singapore are mostly held by a parent bank or insurance company. Internationally, it is not uncommon for financial groups to be organised under a non-operating financial holding company (“FHC”).

1.2 A formal FHC regulatory framework consisting of a Financial Holding Companies Act (“FHC Act”) and subsidiary regulations will provide greater clarity to the industry and other stakeholders on the prudential standards and expectations applicable to FHCs. Australia, Canada and the US are among the countries that have set out formal regulations for holding companies of banks and/or insurance companies. In Europe, the EU Directives on banking, insurance and financial conglomerates provide guidance to regulators on the supervision of financial groups, including those headed by an FHC. The Joint Forum, an international group of banking, insurance and securities regulators, has recently published a consultation paper<sup>1</sup> on supervisory principles for financial conglomerates. The paper recognises the need to take the FHC into account for group supervision.

1.3 In line with international regulatory developments, MAS has also developed a group-wide supervision framework for insurance groups<sup>2</sup>, which may be headed by an insurance company or an FHC. MAS is consulting separately on the proposed insurance groups prudential framework in the insurance groups consultation paper (“IGCP”). Regulatory proposals specific to FHCs of insurance companies are, however, discussed in this consultation paper.

1.4 Proposals in this consultation paper are intended for FHCs *with at least one Singapore-incorporated bank or a Singapore-incorporated insurance company* (and which may also include securities companies). The proposals in this paper do not apply to holding companies with only securities companies or holding companies of exchanges and clearing houses.

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<sup>1</sup> The Joint Forum, *Principles for the Supervision of Financial Conglomerates*, 19 December 2011.

<sup>2</sup> These groups do not have banking entities.

## **2 RATIONALE FOR FINANCIAL HOLDING COMPANIES ACT**

2.1 An FHC is a non-operating entity that holds as its subsidiary, a bank or an insurance company. Proposals in this consultation shall apply to a Singapore-incorporated FHC with one or more bank and/or insurance subsidiaries incorporated in Singapore. By non-operating, the FHC will not be engaged in any financial or commercial activity, except for certain ancillary services in support of its financial group.

2.2 MAS supervises banks on both solo and group-wide levels. Group-wide supervision allows MAS to assess the impact a financial institution's affiliation with related group entities may have on its safety and soundness. As the parent of the financial group, the FHC helps to define the boundaries of a financial group, and hence the locus of group-wide regulation. The FHC, as a parent company of the financial group, is in a position to influence and control the direction of the group. In many financial groups, the FHC also shares certain board members with its material financial subsidiaries. Growing international recognition of the role of the FHC has prompted regulators in many jurisdictions to extend direct or indirect regulation to the FHC as an integral part of financial group supervision.

2.3 MAS has considered the options of direct regulation of FHC and indirect regulation through the regulated bank or insurance company. While indirect regulation may be effective in some cases, FHC group structures can be complex and involve many entities. The Singapore-incorporated bank or insurance subsidiary may not have access to information on unregulated or overseas entities held by the FHC. The FHC as the parent company, on the other hand, can be expected to have access to information on its subsidiaries that is relevant to MAS supervision of the group. To support effective prudential oversight of FHC groups, MAS proposes an FHC Act.

### 3 DESIGNATION OF A REGULATED FINANCIAL HOLDING COMPANY

#### Threshold Conditions for Designation

3.1 A primary objective of FHC regulation is to strengthen prudential oversight of the financial group in Singapore. To this end, the head of the financial group has to be identified and the boundaries of the financial group established for regulation. In the case of a financial group based in Singapore, the head of the financial group will be the parent bank or insurance company or highest level FHC incorporated in Singapore. In some cases, it may be useful to also directly regulate an intermediate FHC within the group, particularly if the intermediate FHC holds Singapore subsidiaries that MAS assesses to be significant to Singapore's financial system or to the sub-group.

3.2 Foreign-owned intermediate FHCs in Singapore will, by definition, be part of an international financial group. In many cases such an international financial group, particularly a banking group, will already be subject to group-wide prudential oversight by the group's home regulator. In developing the FHC regulatory framework, an added layer of regulation is justified where it is assessed to strengthen the overall effectiveness of group prudential oversight and supports the safety and soundness of the financial system. To this end, not all FHCs in Singapore will be regulated by MAS. The regulatory proposals in this consultation paper will apply only to FHC groups that are designated by MAS, unless otherwise indicated.

#### **Proposal 1**

Only FHCs designated by MAS will be subject to the proposed FHC regulatory framework. A list of all designated FHCs will be published by MAS.

#### **Proposal 2**

In deciding whether to designate a Singapore-incorporated FHC for regulation, MAS will consider the following conditions:

- (a) the FHC is the parent of a financial group, that has a bank or insurance subsidiary in Singapore;
- (b) the FHC is an intermediate FHC under a parent FHC or regulated financial institution in Singapore and whose subsidiaries in Singapore are significant to the Singapore financial system, or to the intermediate FHC group; or
- (c) in the case of a foreign intermediate FHC,
  - (i) the parent group of which the intermediate FHC is a member is not subject to group-wide supervision by its home supervisor; and
  - (ii) the FHC's subsidiaries in Singapore are significant to the Singapore financial system, or to the intermediate FHC group.

**Proposal 3**

Non-designated FHCs incorporated in Singapore with at least one bank or insurance subsidiary in Singapore may be required to submit information on the financial group to MAS.

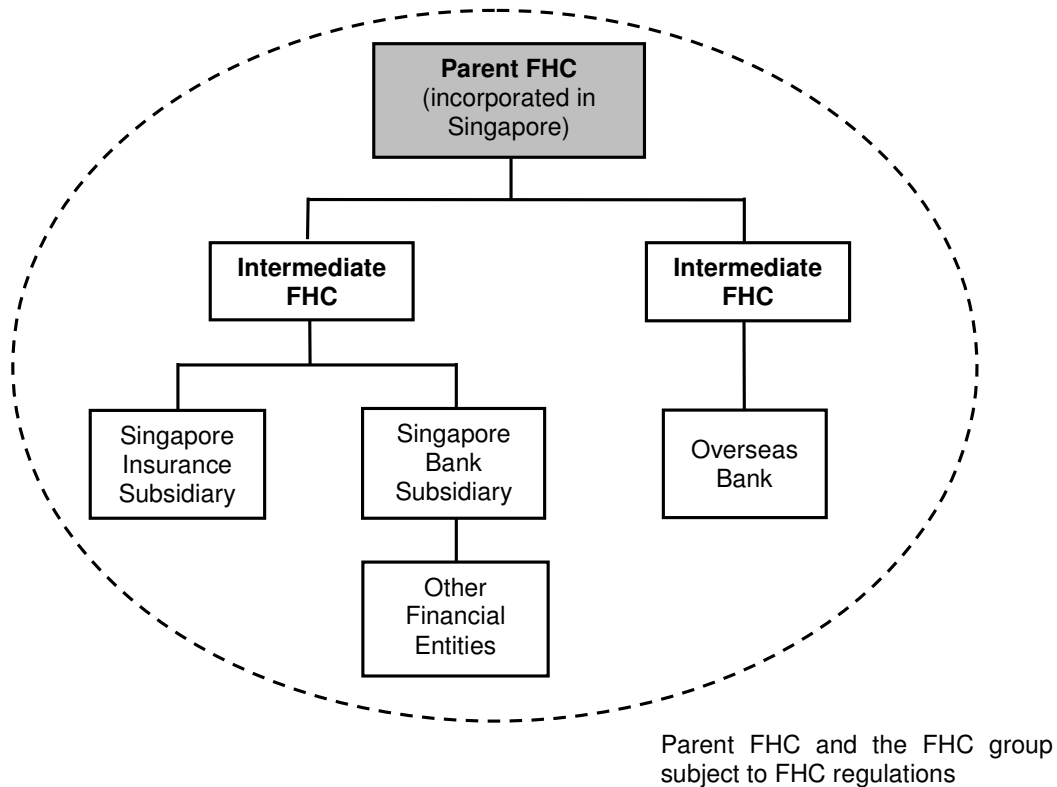
**Consultation Question 1**

Are the proposed conditions for designating an FHC for regulation appropriate? What additional conditions should be taken into account?

Scope of Application

3.3 In the case of a Singapore-based financial group, the Authority shall look through intermediate FHCs of the Singapore bank and/or insurance company to include the parent FHC in its supervision of the group (Figure 1). The FHC group will, *at a minimum*, comprise the parent and all intermediate FHCs and downstream subsidiaries.

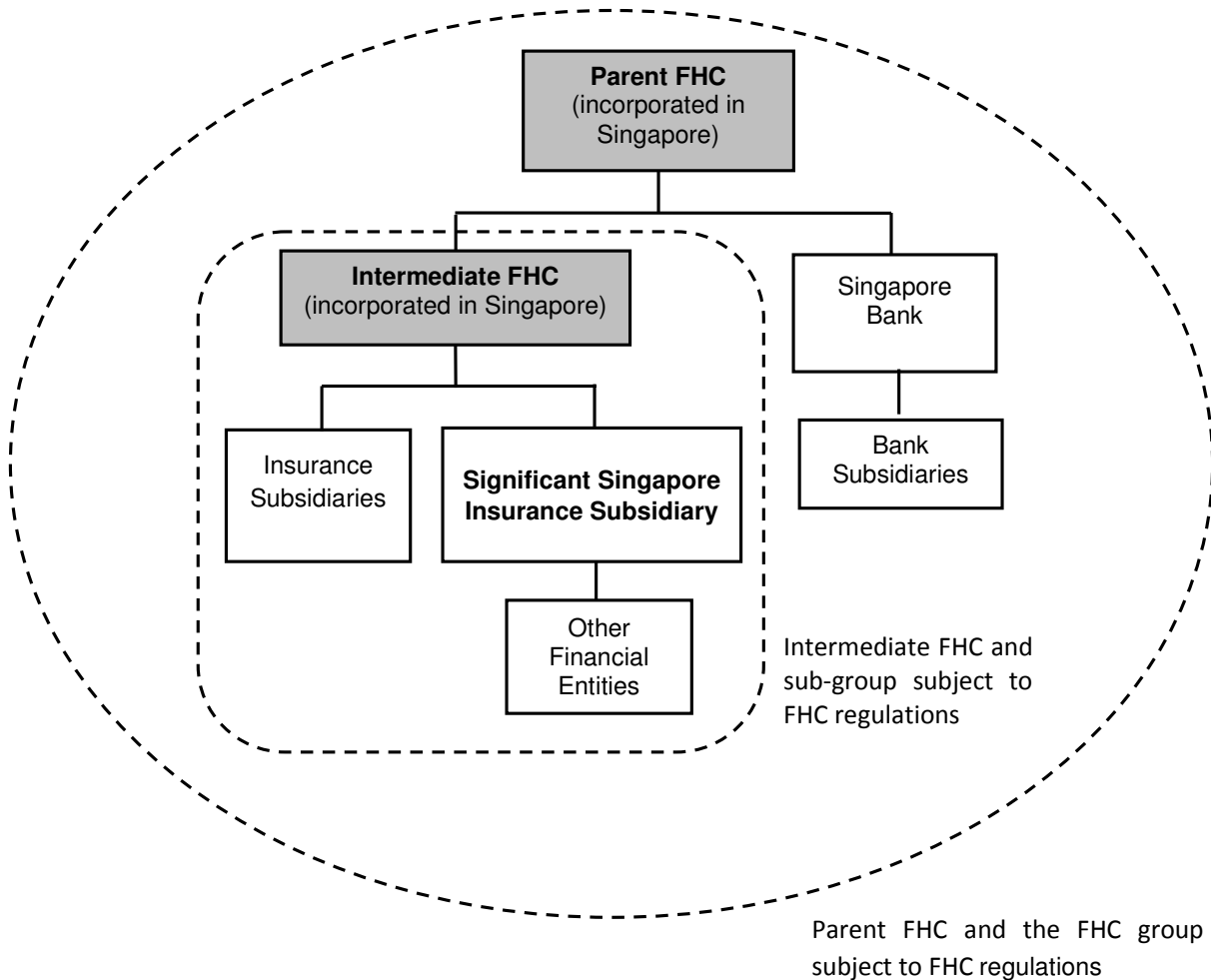
**Figure 1: Scope of Regulation for Parent FHC Group**





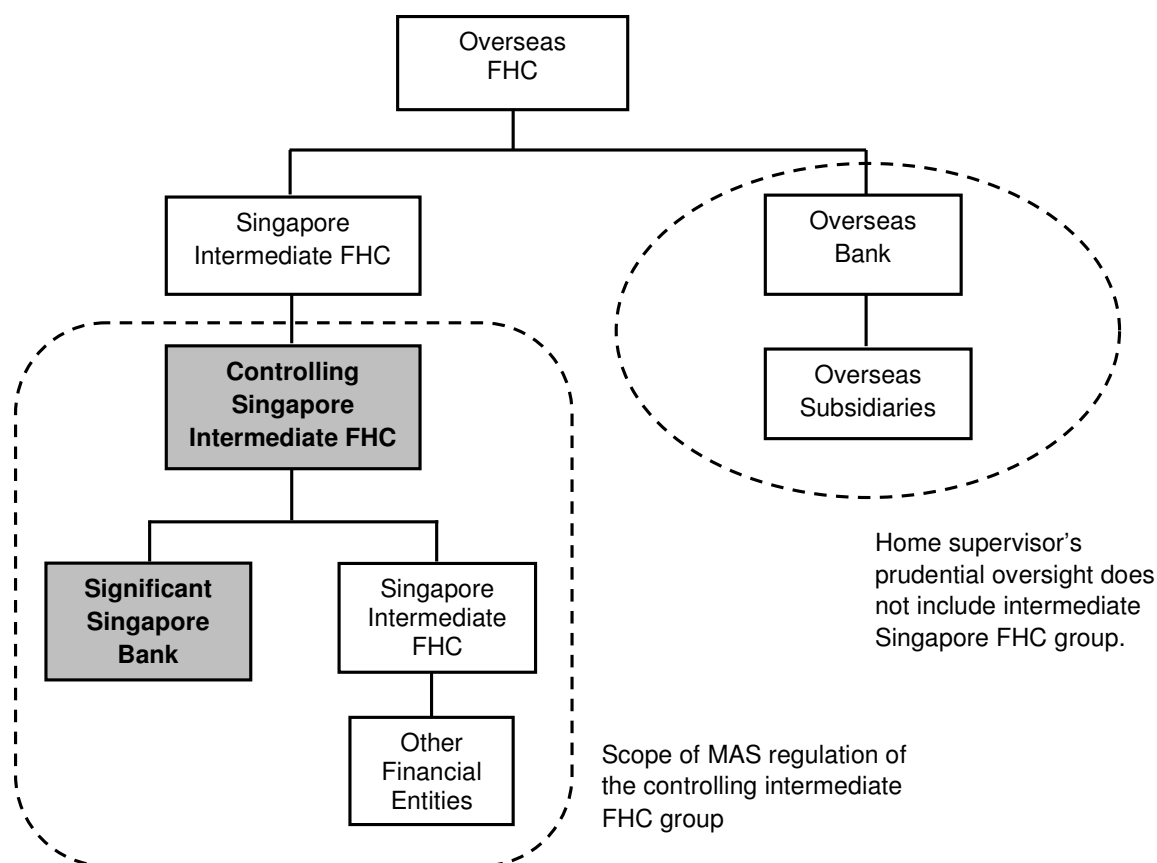
3.4 The scope of regulation of an FHC group illustrated in Figure 1 will take into account downstream entities of the parent FHC, including the intermediate FHCs. In large FHC groups, an intermediate FHC may itself be at the head of a financial sub-group with entities that are significant to the Singapore financial system. In these instances, the effectiveness of prudential oversight may be strengthened by directly regulating the intermediate FHC (Figure 2).

**Figure 2: Scope of Regulation for Financial Group (Intermediate FHC)**



3.5 In the case of a foreign FHC group, the scope of MAS regulation will encompass the *controlling intermediate FHC* in Singapore and all downstream subsidiaries in Singapore and overseas (Figure 3). A controlling intermediate FHC is one that is deemed to exercise control over a Singapore-incorporated bank or insurance company that is assessed to have a material impact on the Singapore financial system or its sub-group.

**Figure 3: Scope of MAS Regulation of a Singapore Intermediate FHC**



#### Proposal 4

The scope of FHC regulations for a designated FHC will include, *at a minimum*:

- (a) in the case of a Singapore parent FHC, the parent FHC and all downstream subsidiaries;
- (b) in the case of an intermediate FHC in Singapore that is part of a larger Singapore-based financial group, the intermediate FHC and all downstream subsidiaries in Singapore and overseas; and
- (c) in the case of a foreign-owned intermediate FHC, the *controlling* intermediate FHC in Singapore and all downstream subsidiaries in Singapore and overseas.

## 4 OWNERSHIP AND CONTROL

### Ownership and Control of Designated FHCs

4.1 Currently, the Banking Act (“BA”) and the Insurance Act (“IA”) stipulate shareholding and control thresholds in a Singapore-incorporated bank and insurance company that require approval by the Minister in charge of MAS (for Singapore-incorporated banks and FHCs of banks) and MAS (for insurance companies). In evaluating the application, the Minister and MAS will assess whether the prospective shareholder is fit and proper and take into account the prudential implications of the shareholding, as well as national interest considerations (for banks and FHCs of banks). The approval, if given, is contingent on the continuing satisfaction of these criteria and other conditions that may be imposed at the point of approval and thereafter.

4.2 Shareholding in an FHC can provide indirect control over regulated financial institutions held by the FHC. Hence the ownership and control of the designated FHC should be subject to approval and any conditions attendant to the approval as if the FHC were a bank or insurance company, as the case may be.

#### **Proposal 5**

Prior approval must be obtained for shareholding and control of designated FHCs. The shareholding and control thresholds for approval will be consistent with the requirements stipulated in the BA or IA, as appropriate. Specifically,

- (a) where an FHC holds a bank in Singapore, approval from the Minister in charge of MAS will be required for acquiring ownership and control at thresholds of 5%, 12% and 20%; and
- (b) where an FHC does not hold a bank in Singapore (e.g. an insurance-only group), approval from MAS is required for acquiring ownership and control at thresholds of 5% and 20%.

### Cyclical Shareholdings Prohibited

4.3 Since 2004, banks in Singapore have been subject to regulations restricting affiliated entities from owning or holding shares in the parent bank (cyclical shareholding). Banking Regulation 12 defines an “affiliated entity” of a bank as:

- (a) any subsidiary of the bank;
- (b) any company in which the bank and its subsidiaries hold in the aggregate a beneficial interest in not less than 20% of the share capital;
- (c) any company in which the bank and its subsidiaries control in the aggregate not less than 20% of the voting power;

- (d) any other company where the directors of the company are accustomed or under an obligation, whether formal or informal, to act in accordance with the bank's directions, instructions or wishes, or where the bank is in a position to determine the policy of the company; or
- (e) any subsidiary of a company referred to in sub-paragraph (b), (c) or (d).

4.4 The restriction of cyclical shareholdings aims to improve transparency in a financial group's shareholding structure and lines of control, as well as prevent multiple gearing of capital within the group. These considerations are also relevant to FHC groups and cyclical shareholdings in the FHC by its affiliates should be prohibited. Non-proprietary fund investments in the FHC made by any relevant affiliated entities for third parties will not count towards cyclical shareholding.

**Proposal 6**

Affiliates of the FHC shall be prohibited from acquiring or having cyclical shareholdings in the FHC. The definition of affiliates in Banking Regulation 12 shall apply to the FHC group, *mutatis mutandis*.

## 5 CORPORATE GOVERNANCE

5.1 Corporate governance (“CG”) requirements for holding companies of banks are set out in *Part III of the Banking (Corporate Governance) Regulations 2005* and related Amendment regulations. The relevant regulations will continue to apply to FHCs with bank subsidiaries.

5.2 In principle, requirements and considerations for CG should apply to FHCs of insurance companies as they do to FHCs of banks. The FHC as the controlling parent entity is in a position to make key decisions and profoundly influence the business direction and risk culture of the group. It is therefore necessary to ensure that its board of directors is suitably qualified, competent and able to discharge its oversight role objectively and free of undue influences.

### Requirements to Differ Depending on Significance of the Insurance Group

5.3 The proposed requirements for FHCs of insurance companies will take into consideration the nature and scale of the insurance group. The FHC board of an insurance group deemed to be significant will be subject to a higher intensity of regulation and vice versa. The IGCP proposes to define a “significant insurance group” as one that meets the following thresholds:

- for a group conducting life and composite business, total insurance assets equal to or greater than S\$20 billion;
- for a group conducting non-life business, total gross premiums equal to or greater than S\$2 billion; or
- the group comprises a “Tier 1” insurer in Singapore.

5.4 MAS is concurrently consulting on the requirements on the boards of insurance companies at the solo level (refer to IGCP). Under the proposals, an insurance company is categorised as either a “Tier 1” or “Tier 2” insurer and each category is subject to a different intensity of requirements on its board (see Annex 1 on the different requirements). “Tier 1” insurers rank amongst the top few significant insurers in Singapore in terms of the market shares of their respective sectors (life and non-life). FHCs of significant and non-significant insurance groups will be subject to CG requirements for “Tier 1” and “Tier 2” insurers, respectively.

#### **Proposal 7**

FHCs with banking subsidiaries in Singapore will be subject to relevant provisions in *Banking (Corporate Governance) Regulations 2005*.

### **Proposal 8**

For insurance groups<sup>3</sup>, the FHC of a significant group (as defined in paragraph 5.4) will be subject to CG regulations similar to those of “Tier 1” insurers; the FHC of a non-significant group will be subject to CG regulations similar to those of “Tier 2” insurers, as set out in Annex 1.

#### Approval and Disqualification of Persons

5.5 The BA empowers MAS to require a bank to seek the Authority’s approval for the appointment of key personnel. Under Section 65 of the BA, persons who might present fit and proper concerns are disqualified from holding or continuing to hold positions within the bank, unless prior written consent of MAS is obtained. The rules for approval and disqualification of officers aim to ensure that the bank is appropriately staffed at all levels by fit and proper persons. While an FHC does not operate a regulated financial business, fit and proper considerations are equally relevant for the FHC as head of a financial group.

5.6 Key FHC personnel appointments for the chief executive officer (“CEO”) and his deputy, chief financial officer (“CFO”) and chief risk officer (“CRO”) will require MAS’ approval. Approval for the appointment of CFO and CRO will not be required for FHCs of non-significant insurance groups. Arising from considerations such as reporting lines within the FHC and the business of the financial group, MAS may also require approval for other key appointment holders.

5.7 A disqualification rule will be revised and applied to FHCs.<sup>4</sup> First, the FHC, rather than the affected individual (as is presently the case under the BA), will be required to obtain MAS’ written consent for a waiver of disqualification. The FHC has to assess the risks and merits in each case of employment to determine if it will employ or retain the person and satisfy MAS in its application that it has put in place adequate safeguards to manage any potential risks. This is consistent with MAS’ supervisory philosophy that financial institutions are ultimately responsible for proper risk management. Second, a distinction will be made between persons who hold key positions in the FHC and those who do not. Directors and executive officers<sup>5</sup> of FHCs are in positions to influence or control the direction of the corporation. Such

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<sup>3</sup> Such groups do not have banking subsidiaries.

<sup>4</sup> The revised rule will also apply to banks and insurance companies. For insurance companies, please refer to the IGCP for details on the proposal to extend approval and disqualification rules to the insurance sector.

<sup>5</sup> “Executive Officer” is defined in the BA and the IA as any person, by whatever name described, who (a) is in the direct employment of, or acting for or by arrangement with, the bank/insurer and (b) is concerned with or takes part in the management of the bank/insurer on a day-to-day basis. Such persons will include persons at the function head level.

persons should be held to the highest standards and grounds for disqualification should also be more stringent.

**Proposal 9**

Regulations on the approval of officers currently applicable to banks will be extended to FHCs. In the case of an FHC of a non-significant insurance group, MAS will ordinarily require approval only for the appointment of the CEO and his deputy. MAS may also require approval for other key appointments in an FHC where warranted.

**Proposal 10**

Regulations on the disqualification of officers currently applicable to banks will be extended to FHCs but with the following modifications.

- (a) The FHC, rather than the affected individual, will be required to obtain MAS' written consent for any such disqualification to be waived.
- (b) The grounds for disqualifying directors and executive officers as a category of persons are, where the person:
  - (i) has been convicted, whether in Singapore or elsewhere, of an offence involving fraud or dishonesty or an offence of a criminal nature;
  - (ii) is or becomes financially compromised<sup>6</sup>; or
  - (iii) has been a director of, or directly concerned in the management of, an MAS licensed entity which is being or has been wound up by a court or the licence of which has been revoked.
- (c) For all other officers and employees of the FHC, (b)(i) and (b)(ii) but not (b)(iii) will apply.

<sup>6</sup> Under the BA, this includes any person who is an undischarged bankrupt, has had execution against him in respect of a judgement debt returned unsatisfied in whole or in part or has, whether in Singapore or elsewhere, entered into a compromise or scheme of arrangement with his creditors, being a scheme of arrangement that is still in operation.

## 6 PERMITTED ACTIVITIES

### Name-Sharing

6.1 The BA and IA restrict the use of the words “*bank*” and “*insurance*”, and their derivatives to prevent misrepresentations that may mislead the public into entrusting monies with unlicensed entities. Name-sharing and other representations of association with a bank or an insurance company in Singapore are also restricted. The anti-commingling policy for banks, which requires the separation of financial and non-financial businesses, also imposes name-sharing restrictions to segregate banking and other financial businesses from non-financial businesses. Notwithstanding the general restriction on name-sharing, certain related corporations and officers of the bank as set out in Sections 5 and 30 of the BA may use the name of the bank. Examples of such a related corporation include one that is carrying on a business regulated by MAS, incidental to banking or other MAS-regulated business or a business prescribed or approved by MAS under Section 30 of the BA.

#### **Proposal 11**

The FHC may share the same name and logo/trademark with the regulated bank or insurance company.

#### **Proposal 12**

Where an FHC includes the word “*bank*” or “*insurance*” or their derivatives in its name, it must clearly indicate in its name that it is a “holding” company.

#### **Proposal 13**

Related corporations of the FHCs which are carrying on activities regulated or approved by MAS, and the officers and agents of such related corporations, may share name and other representations that indicate an association with the FHC.



### Major Stakes

6.2 Section 32 of the BA requires banks to obtain prior approval from the Authority to acquire or hold, directly or indirectly, a major stake in any company. The FHC's financial and other commitments to entities that it acquires and holds can have a bearing on the financial soundness of the FHC. In addition, the business operations of newly acquired entities can have a material impact on the risk profile of the financial group and present prudential concerns.

#### **Proposal 14**

The FHC shall obtain the prior approval of the Authority for the direct or indirect acquisition, and holding of a major stake in any company. The FHC shall also notify MAS in advance of divestments made.

### Ancillary Support Services

6.3 MAS' anti-commingling policy will also apply to FHCs. The activity of an FHC should consist in the main of holding financial entities. The Authority recognises that there can be potential efficiency gains and other benefits from the FHC carrying out certain support services incidental and complementary to the holding of financial entities. Permitted ancillary support services performed by the FHC will include fund raising, central liquidity management and group accounting and IT services.

#### **Proposal 15**

FHCs shall not undertake any non-financial or commercial business, except the provision of ancillary support services for its financial group.

### Investment in Immovable Property

6.4 As a non-operating entity, the FHC should not be actively engaged in property development and investment. The FHC's investment in immovable property will generally be restricted to properties for carrying on the business of its financial subsidiaries.

#### **Proposal 16**

FHCs shall not acquire or hold immovable property, except property used to conduct its financial group's business.

## 7 PRUDENTIAL REGULATION OF FHC GROUPS

### Minimum Paid-Up Capital and Capital Funds

7.1 Currently the minimum paid-up capital (“PUC”) requirements for Singapore-incorporated banks and insurance companies are determined by the type of licence held. Banks are also required to maintain capital funds not less than the specified minimum PUC. As the parent company of a financial group, the FHC should demonstrate a minimum level of financial commitment to support the operations of the group. The FHC should therefore have PUC and capital funds that are comparable with the PUC requirement of its regulated financial subsidiaries.

#### **Proposal 17**

The FHC shall have minimum PUC and capital funds equivalent to the highest minimum PUC and capital funds requirements among its subsidiaries regulated by MAS. For example, where an FHC holds a Full Bank and a Wholesale Bank, its minimum PUC shall be S\$1.5 billion. The required minimum PUC and capital funds may be held in Singapore dollar and other currencies approved by MAS.

MAS may require an FHC to have a higher minimum PUC and capital funds where warranted, having regard to the risks arising from the activities of the group.

### Predominance Test

7.2 Where a financial group is engaged only in banking or insurance, the relevant sectoral rules may be applied at the FHC group level. In a cross-sectoral financial group it may be possible to identify a predominant sector representing the primary financial business of the group. The predominant sector may be determined by appropriate quantitative measures such as relative balance sheet size, revenue, risk-weighted assets and intra-group financial exposures.

7.3 In some cases, quantitative criteria alone may not be sufficient to establish the relationships among entities within a financial group and determine the predominance of entities. The quantitative assessment should therefore be supplemented by qualitative evaluation of such factors as the organisational structure and hierarchy of the FHC group and the extent of common directors between the FHC parent and its main operating subsidiaries.

7.4 The identification of a predominant sector will help determine whether an appropriate sectoral rule can be applied at the FHC group level, with the aim of regulatory consistency and ensuring a level playing field for financial groups engaging in broadly similar businesses, regardless of the status of the parent (e.g. whether bank/insurance company or FHC).

### **Proposal 18**

A predominance test will be applied to identify the predominant sector, if any, in a cross-sectoral FHC group. The predominance test will comprise quantitative criteria of relative balance sheet size, revenue and risk-weighted assets and supplemented by qualitative assessment such as the FHC group organisational hierarchy and the extent of common directors between the FHC and its primary financial subsidiaries.

### **Consultation Question 2**

What are the relevant quantitative measures and qualitative assessments that should be considered in determining sector predominance in a cross-sectoral FHC group?

### **Consultation Question 3**

What should the absolute or relative size of a sub-sector be for it to be deemed the predominant sector within a cross-sectoral FHC group?

### Group-wide Concentration Limits

7.5 Risks of contagion and common exposures exist in a financial group whether the parent company is an operating entity (e.g. bank and insurance company) or an FHC. The board of the FHC is responsible for ensuring that the FHC group has in place a robust risk management framework addressing, *inter alia*, risk concentrations and intra-group exposures.

7.6 A group-wide concentration limit for FHCs can mitigate group concentration risks that may not be adequately addressed when applying these limits at the solo operating entity or sectoral sub-group levels only. A second objective for a group-wide limit is to avoid regulatory arbitrage arising from a bank/insurer-held group restructuring under an FHC. Application of the same prudential rules regardless of the status of the group parent also helps to ensure a level playing field for financial groups engaging in similar lines of businesses under different group structures.

7.7 In Singapore, concentration limits include the large exposure limit (Section 29 of the BA and MAS Notice 639), the equity investment limit (Section 31) and property investment limit (Section 33), each of which imposes a “hard” limit on the respective exposures. Large exposures and investments at insurance companies are currently not subject to “hard” limits as banks are. It may therefore not be appropriate to extend banking limits to FHC groups comprising only insurance companies.<sup>7</sup>

<sup>7</sup> MAS is reviewing the merits of “hard” concentration limits for insurance groups. The IGCP sets out some of the preliminary considerations for discussion.

**Proposal 19**

Banking groups structured under an FHC will be subject to the same group-wide concentration limits (large exposure limit, equity investment limit and property investment limit) currently applicable to bank-held groups.

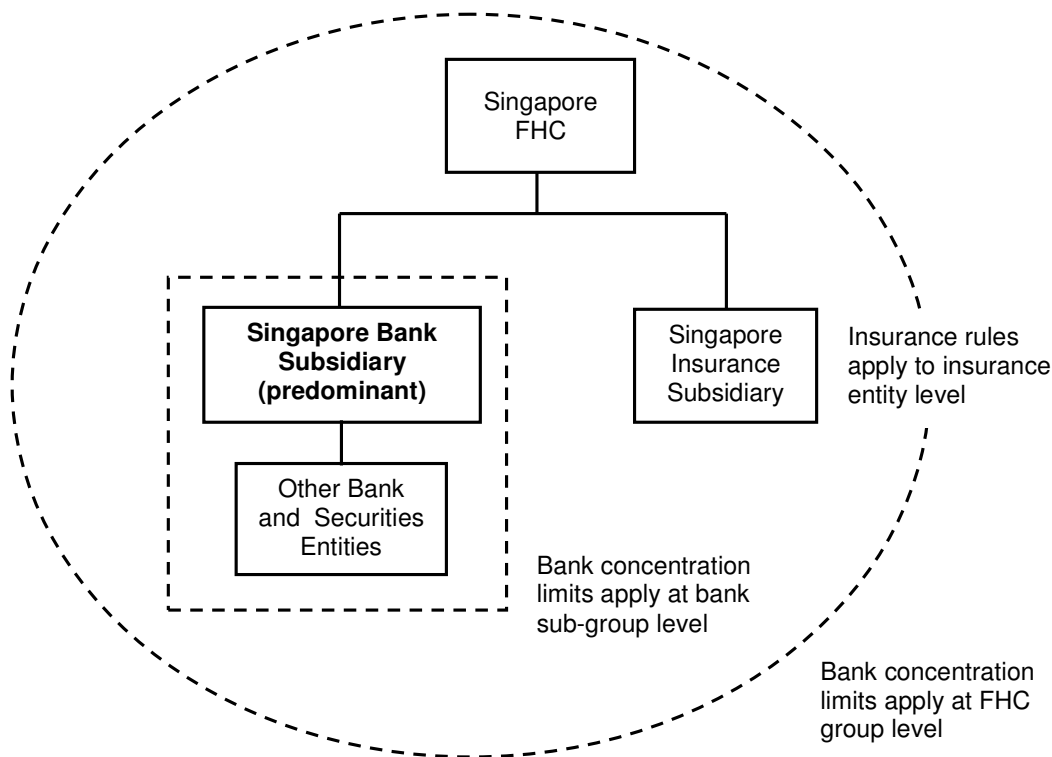
**Consultation Question 4**

Are the current concentration limits for banks appropriate for banking groups structured under an FHC? What modifications might be needed?

*FHC Groups where Banking is Predominant*

7.8 In Singapore, concentration limits on large exposures, and equity and property investments for banking groups, including the holding company, are well-established and are set out in the BA and subsidiary legislation. These are applied at both bank and bank group levels. To ensure regulatory consistency and a level playing field for financial groups engaged in similar businesses, banking rules should apply to FHCs at the group level where banking is assessed to be the predominant activity (“predominantly banking”) using the predominance test as set out in paragraphs 7.2-7.4 (Figure 4).

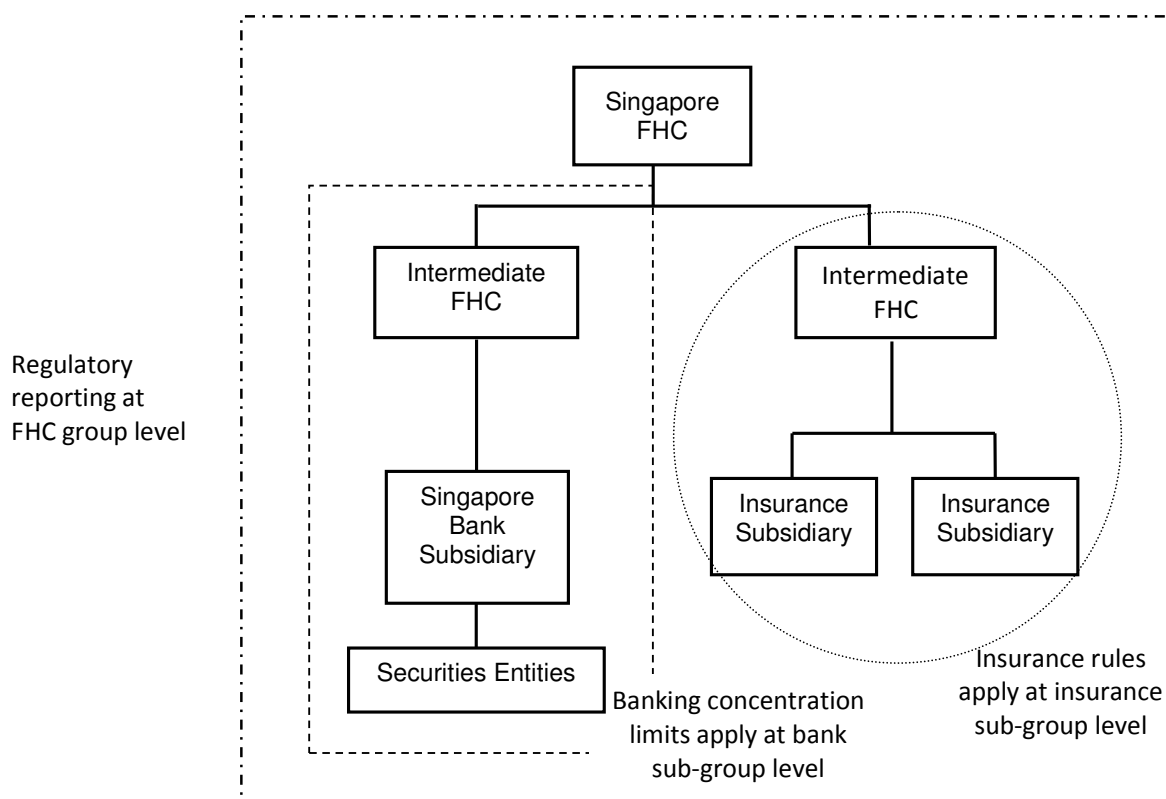
**Figure 4: Prudential Regulation of Predominantly Banking FHC Group**



*FHC Groups where Banking is Not Predominant*

7.9 Where banking is not the predominant sector, it may not be appropriate to impose banking rules at the FHC group level. Each sectoral sub-group within the FHC group, however, should continue to be subject to the relevant sectoral regulations. While it may not be feasible to subject such an FHC group to “hard” concentration limits, the FHC group will be required to monitor its aggregate exposures at the group level and report material exposures (Figure 5).

**Figure 5: Prudential Regulation of FHC Group where Banking is Not Predominant**



**Proposal 20**

Where banking is assessed to be the predominant sector within an FHC group, banking regulations will apply to the FHC at the group level. Sectoral rules will apply to the relevant sectoral sub-groups.

Where banking is not the predominant sector within an FHC group, the FHC will be required to report on group exposures while each sectoral sub-group will be subject to its respective sectoral group regulation. MAS may impose concentration limits to the FHC group where warranted.

### **Proposal 21**

The FHC is required to have in place a robust group concentration risk management policy. In addition, the FHC will be required to report its loans to all group affiliates, whether financial or non-financial, regulated or non-regulated. MAS may impose limits on FHC lending to group affiliates where warranted.

### **Consultation Question 5**

How might group-wide concentration limits for an FHC group where banking is not the predominant sector be designed? What might be appropriate thresholds for identifying FHC group exposures to be reported to MAS?

### Capital Adequacy

7.10 The application of a risk-based capital adequacy framework to an FHC group seeks to ensure that the group as a whole maintains capital that is commensurate with the risks it takes. It is important that a risk-based capital adequacy framework is applied to an FHC group, notwithstanding that sector-specific capital rules continue to apply to individual regulated entities and sub-groups within the FHC group. This is aimed at addressing the following prudential concerns.

- (a) Double or multiple gearing: Double or multiple gearing occurs when capital is simultaneously used as a buffer against risk in two or more entities. This could arise through down-streaming of capital raised by the holding company two or more times, or through intra-group holdings of capital, e.g. when one entity in the group holds regulatory capital issued by another entity within the same group and the issuer is permitted to include the capital to meet its own regulatory capital requirements. When double or multiple gearing is present, relying on measures of solo capital adequacy of regulated entities within the group alone may overstate the capital adequacy of the FHC group as a whole.
- (b) Excessive leverage including capital upgrading: Excessive leverage can occur when one entity issues debt, or capital instruments which are not acceptable as regulatory capital, and channels the proceeds to another entity in the FHC group in the form of equity or other capital instruments qualifying as regulatory capital in that entity. In such cases, relying on measures of solo capital adequacy of regulated entities within the group alone may overstate the ability of the FHC group to service all its external debt.

- (c) *Transferability of capital*: Regulatory, market and legal restrictions could limit the amount of capital that may be freely transferable across different entities within the FHC group. They could also limit the extent to which any capital transferred would be eligible to meet regulatory requirements in different sectors or jurisdictions.
- (d) *Group-wide risks*: Risks to an FHC group may arise from activities of unregulated entities as well as the FHC and intermediate holding entities within the group, and need to be considered in a capital assessment of an FHC group.

#### *FHC Groups where Banking is Predominant*

7.11 The Basel capital framework is applicable to FHC groups where banking is assessed to be predominant sector (“predominantly banking”). A **uniform approach** can be used to apply bank capital requirements<sup>8</sup> at the FHC group level based on the consolidated accounts of the FHC group. The use of consolidated accounts to compute capital requirements under this approach will eliminate the effects of intra-group capital investments and loans, hence addressing the risks of double-gearing and excessive leveraging. As the capital rules will be applied to exposures in all group entities, including those that are not subject to regulatory capital requirements on a solo basis, it will ensure that capital is held for risks arising from such entities at the group level.

7.12 Pillar 2 of the Basel capital framework will also apply to predominantly banking FHC groups, to ensure that the assessment of group capital adequacy takes into account group-wide risks that may not be addressed through the minimum capital requirements. This will entail an FHC group having an internal capital adequacy assessment process (“ICAAP”) that is subject to supervisory review by MAS. Under Pillar 2, the FHC group’s ICAAP is also required to take into account restrictions on capital transferability, which could arise from regulatory, market or legal restrictions<sup>9</sup> on the assessment of group capital adequacy. This is important as the application of a uniform capital framework on consolidated financial accounts as proposed in paragraph 7.11 assumes that capital is freely transferable between entities within the FHC group.

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<sup>8</sup> This will be based on the capital computation rules under the risk based capital adequacy requirements for banks incorporated in Singapore under MAS Notice 637, which is aligned to the Basel capital framework.

<sup>9</sup> Examples of such restrictions include asset maintenance requirements, exchange and currency controls, rights of other shareholders, and regulatory expectations for entities subject to regulatory capital requirements at solo level to maintain capital buffers above the prescribed regulatory minimums.

7.13 The capital adequacy ratio (“CAR”) requirements for common equity Tier 1 CAR, Tier 1 CAR and Total CAR to be applied to predominantly banking FHC groups at the group level will be set at levels that are no lower than the standards recommended by the Basel Committee on Banking Supervision (“BCBS”). MAS may set higher CAR requirements where warranted, having regard to the significance of the FHC group in Singapore and other relevant factors.

**Proposal 22**

Bank capital requirements shall apply to predominantly banking FHC groups at group level uniformly on the consolidated accounts of the FHC group.

Pillar 2 of the Basel capital framework shall also apply to predominantly banking FHC groups.

The common equity Tier 1, Tier 1 and Total CAR requirements to be applied to predominantly banking FHC groups at the group level will be set at levels that are no lower than the standards recommended by the BCBS. MAS may set higher CAR requirements where warranted.

*FHC Groups where Banking is Not Predominant*

7.14 For cross-sectoral groups that are not predominantly banking, it may not be appropriate to apply a uniform set of capital rules across the group, as capital frameworks differ significantly across the banking, insurance and securities sectors. There can also be substantial variations across jurisdictions within a sector for entities in the insurance or securities sectors.

7.15 We propose a **modular approach** to assess the capital adequacy of such FHC groups. The modular approach aims to ascertain whether the FHC group has a surplus of available capital over required capital to meet the risks arising from all group entities. Capital surpluses or deficits within the FHC group are determined using relevant sector-specific or entity-specific capital rules, after elimination of intra-group investments and transactions and after assessing the transferability of any surpluses to support other entities within the group.

7.16 The proposed modular approach comprises the elements set out in paragraphs 7.17 to 7.18. It is designed to address the prudential concerns set out in paragraphs 7.10, while providing sufficient flexibility to accommodate the issues in paragraph 7.14 faced by cross-sectoral FHC groups. Each regulated FHC group will be expected to submit to MAS its detailed methodology and analysis in applying the proposed modular approach.



*Identifying capital surplus or deficit of each entity or sub-group within the FHC group*

7.17 The first step entails determining the capital surplus or deficit of each entity or sub-group within the FHC group, as follows.

(a) *Use of unconsolidated or sub-consolidated financial statements*

The modular approach uses the unconsolidated financial statements of each entity or sub-group<sup>10</sup> within the FHC group, adjusted to eliminate intra-group investments and transactions (“adjusted financial statements”). The elimination of intra-group investments and transactions addresses the effects of multiple gearing and leveraging within the FHC group. The items to be eliminated should include intra-group account balances (e.g. loans and receivables), risk transfers (e.g. guarantees), capital investments and internal profits and losses. Capital generated through structures or methods that artificially inflate capital levels (e.g. circular funding, where an entity in the group provides funds to third parties which then invest those same funds as capital in another entity within the group) should also be eliminated.

(b) *Determining the required capital or capital demand of each regulated entity or sub-group within the FHC group*

In the case of regulated entities or sub-groups within the FHC group, the relevant regulatory capital rules applicable to each entity or sub-group will be applied to exposures in the adjusted financial statements of the entity or sub-group, to determine the required capital for that entity or sub-group.

(c) *Determining the available capital or capital supply of each regulated entity or sub-group within the FHC group*

In the case of regulated entities or sub-groups within the FHC group, the relevant regulatory capital rules applicable to each entity or sub-group will determine the available capital in that entity or sub-group. The adjusted financial statements of the entity or sub-group will be used for this purpose. Goodwill and intangible assets must be deducted in full from the available capital for each entity or sub-group, if

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<sup>10</sup> Sub-consolidated financial statements of a sub-group of entities within the FHC group may be used where appropriate, e.g. in the case of a banking sub-group which is already subject to the Basel capital standards on a consolidated basis.

not already the case under the regulatory capital rules applicable to that entity or sub-group.

- (d) *Determining the required capital and available capital of each entity within the FHC group that is not subject to regulatory capital requirements at solo level*

There may be entities within the FHC group that are not subject to regulatory capital requirements at solo level. As such entities may have exposures which pose risks to the FHC group, the assessment of capital adequacy of the FHC group must account for such risks.

Where such entities are engaged in financial activities, we propose that a proxy be applied to determine the required capital and available capital attributable to that entity. The proxy to be applied will be the most relevant capital framework based on the activities of the entity. In other cases, we propose to deduct the investments in such entities from group capital.

- (e) *Determining the required capital and available capital of the holding company*

The assessment of group capital adequacy must also account for risk exposures of the holding company itself.<sup>11</sup> We propose applying banking capital rules to determine the required capital arising from risk exposures of the holding company, and the available capital of the holding company. In view that the holding company is expected to be primarily a financing vehicle, banking capital rules will be an appropriate proxy.

- (f) *Identifying the capital surplus or deficit of each entity or sub-group*

The capital surplus or deficit attributable to each entity or sub-group within the FHC group is calculated as the difference between the required capital and available capital, based on sub-paragraphs (a) to (e) above.

In respect of entities which are less than 100% owned by the FHC group, we propose that identified surpluses be pro-rated, so as not to overstate the extent to which such surpluses are available to absorb losses in other parts of the FHC group. On the other hand, we propose

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<sup>11</sup> For the avoidance of doubt, the proposed treatment in sub-paragraphs 7.17 (d) and (e) is to attribute an appropriate amount of capital surplus or deficit to unregulated entities and the holding company for the purpose of assessing group capital adequacy, and not to separately impose solo regulatory capital requirements on those entities *per se*.

that any deficits in subsidiaries that are less than 100% owned be accounted for in full, so as not to understate a parent entity's *de facto* responsibility to make up for a subsidiary's capital shortfall should the need arises. Nevertheless, where the FHC group is able to demonstrate that the responsibility of a parent entity is limited strictly to its share in the subsidiary, MAS would consider allowing the deficit to be pro-rated accordingly.

*Assessing the extent of freely transferable surplus capital within the FHC group*

7.18 Any surplus capital identified by the FHC group as being available to support other entities within the group with a deficit, must be assessed in detail to determine if the surplus is freely transferable. The FHC group will be responsible for making the assessment, which will be subject to supervisory review by MAS.

(a) *Regulatory, market and legal restrictions on transferability*

Capital surpluses subject to regulatory, market and legal restrictions on transferability should be accounted for, and rendered unavailable to the rest of the group as appropriate.

(b) *Accounting for differences in eligibility of capital between regulated entities*

Entities in different sectors or jurisdictions may be subject to significantly different definitions of regulatory capital, which can distort the FHC's group capital assessment. Where any surplus is identified by the FHC group to meet deficits in another part of the group, MAS may, on a case-by-case basis:

- (i) require the surplus or deficit identified in an entity to be recalculated based on the relevant Singapore capital rules or, in the case of insurers, the relevant Singapore capital and valuation rules; or
- (ii) require adjustments to be made to the computed surplus (e.g. by adjusting specific components of available capital or required capital, or both).

(c) Safeguarding against regulatory arbitrage

FHC groups will, in principle, be given the flexibility to determine how their capital is to be held and distributed across the group. However, MAS may determine that surplus capital in a regulated entity should not be recognised as freely transferable within the group, such as where risks are being transferred between entities solely for the purpose of avoiding a particular capital regime.

(d) Treatment of insurance-specific capital surpluses

While certain insurance-specific capital components are typically recognised as capital of an insurance entity on a solo basis, capital surpluses of insurance entities comprising such components of insurance entities need to be separately assessed for transferability within the FHC group. The proposed treatment for such surpluses is as follows:

- (i) the balance in the surplus account of each participating fund, in the case of insurance entities regulated in Singapore, will be fully recognised as being freely transferable. This is because such balances are monies belonging to the shareholder of the insurer and there are no restrictions on the insurer subsequently transferring such amounts to other funds such as the shareholders' fund;
- (ii) the aggregate of surpluses of assets over liabilities in insurance funds (except for participating funds) will be recognised as being freely transferable to other insurance entities only, subject to a 55% haircut for any surpluses of assets over liabilities arising from unrealised gains in property holdings. These will not be considered transferable to banking or securities entities in the FHC group, given that such surpluses depend significantly on the valuation of insurance liabilities; and
- (iii) the aggregate of allowances for provision of non-guaranteed benefits in respect of participating funds<sup>12</sup> will *not* be recognised as being freely transferable. Although recognised as a capital

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<sup>12</sup> In Singapore and some other jurisdictions, life insurers writing participating life insurance business must ensure that policy liabilities are sufficient to meet all future non-guaranteed bonuses. However, they have the discretion to cut bonuses when the existing bonus rates are not supportable. In recognition of this discretion, the aggregate of allowances for provision of non-guaranteed benefits is currently included in the available capital (also known as financial resources) of an insurer up to a certain percentage of future non-guaranteed bonuses. Under Singapore's risk-based capital framework for insurers, this percentage is 50%.

buffer for solvency purposes, such allowances are not transferable outside of the participating funds.<sup>13</sup>

**Proposal 23**

A modular approach will be applied to assess the capital adequacy of non-predominantly banking FHC groups. The elements of the proposed modular approach are set out in paragraphs 7.15 to 7.18.

**Consultation Question 6**

Is the modular approach appropriate for assessing the capital adequacy of non-predominantly banking FHC groups? How might the modular approach be improved? What implementation issues may arise for your financial group?

Capital Management Policies and Plans

7.19 FHC groups will be required to develop capital management policies and maintain an appropriate capital planning process that considers risk assessment on a group-wide basis. It will be the responsibility of the FHC's board of directors to approve and review the capital management policies and capital planning processes, as well as the capital plans and group-wide risk assessment. These will be subject to supervisory review by MAS.<sup>14</sup> Predominantly banking FHC groups will be subject to Pillar 2 of the Basel capital framework, which requires an ICAAP to be in place, as set out in paragraph 7.12.

7.20 The capital management policies and capital planning processes should address the following:

- (a) additional demand for capital arising from risks, that are not addressed or not adequately addressed by regulatory capital requirements;
- (b) the need to maintain additional buffers for group-level risks;
- (c) the process to determine, monitor and maintain the FHC group's capital surplus and the FHC group's capital targets;
- (d) the process for determining the extent of transferability of capital; and
- (e) stress testing and contingency planning to manage the risks of the FHC group.

<sup>13</sup> There are strict rules on how monies can be taken out of the participating fund. Under the IA, monies can only be taken out of the participating fund if bonuses are declared to policyholders, in which case shareholders get up to 1/9<sup>th</sup> of those bonuses, or if the monies are a recovery of past capital injections into the participating fund for meeting shortfalls in solvency.

<sup>14</sup> This is consistent with "*Principles for the Supervision of Financial Conglomerates*", issued by the Joint Forum on 19 December 2011.

### **Proposal 24**

All FHC groups will be required to develop and maintain appropriate capital management policies and capital planning processes that consider risk assessment on a group-wide basis.

The FHC's board of directors will be responsible for approving and reviewing the capital management policies and capital planning processes, as well as the capital plans and group-wide risk assessment, and cover the scope set out in paragraph 7.20. These will be subject to supervisory review by MAS.

Predominantly banking FHC groups will be subject to Pillar 2 of the Basel capital framework.

### Leverage Ratio

7.21 The leverage ratio refers to the ratio of capital to assets and is calculated based primarily on accounting measures. It provides a measure of the level of leverage taken by an FHC group.

7.22 All FHCs will be required to report to MAS, their leverage ratios<sup>15</sup> at solo and group levels. MAS will have the power to impose a leverage ratio limit on an FHC at solo or group level, where MAS considers it appropriate, having regard to the risks arising from the activities of the FHC group and other relevant factors.

7.23 The Basel III capital reforms by the BCBS have introduced a leverage ratio requirement for banks.<sup>16</sup> The Basel capital framework is applicable to predominantly banking FHC groups,<sup>17</sup> which will be subject to the leverage ratio requirements under the Basel III capital framework, in accordance with the Basel III timelines.

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<sup>15</sup> The calculation of the leverage ratio for non-predominantly banking FHC groups will be consulted on at a later stage.

<sup>16</sup> Please refer to paragraphs 151 to 167 of "*Basel III: A Global Regulatory Framework for More Resilient Banks and Banking Systems*" issued by the BCBS in December 2010 (revised June 2011) for details of the leverage ratio requirement. Under the BCBS timeline, banks will report their leverage ratios to their regulators during the parallel run period from 1 January 2013 to 1 January 2017. Disclosure by banks of the leverage ratio and its components will commence on 1 January 2015. The BCBS may make final adjustments to the definition and calibration of the leverage ratio in the first half of 2017, with a view to migrating to a minimum regulatory requirement on 1 January 2018.

<sup>17</sup> As set out in "*International Convergence of Capital Measurement and Capital Standards*" (Basel II), issued by the BCBS (revised June 2006), the Basel capital framework applies to predominantly banking groups, including any holding company that is a parent entity within a banking group.

**Proposal 25**

All FHCs will be required to report to MAS their leverage ratios, at solo and group levels. In addition, MAS will have powers to impose a leverage ratio limit on an FHC at solo or group level where warranted. Predominantly banking FHC groups will be subject to the leverage ratio requirements under the Basel III capital framework, in accordance with the Basel III timelines.

Liquidity Requirements

7.24 Banks are exposed to significant liquidity risks and severe liquidity stress could lead to financial distress or even insolvency with serious ramifications for the financial system. In Singapore, banks are already subject to minimum liquid assets requirements to mitigate liquidity risks. Internationally, the BCBS will be introducing liquidity requirements for banks and predominantly banking groups. MAS will be reviewing our liquidity framework for banks in line with developments in international standards to apply liquidity requirements to banks and predominantly banking groups. MAS will study whether and how liquidity requirements should be applied to an FHC at the solo level and at the FHC-group level for cross-sectoral groups where banking is not predominant. The FHC Act will provide MAS with the power to impose liquidity requirements.

## **8 SUPERVISORY POWERS**

8.1 Effective prudential oversight requires regulation to proceed alongside with supervision of FHC groups. The BA and IA provide MAS with various powers over banks and insurance companies to carry out its supervisory responsibilities. Many of these supervisory powers are also relevant to FHC groups and will be provided for in the FHC Act. They include, but are not limited to, powers to:

- (a) conduct on-site visits to the FHC and its financial subsidiaries, whether located in Singapore or overseas;
- (b) request and obtain information for supervision and surveillance purposes;
- (c) require the FHC to submit solo and group audited accounts;
- (d) in relation to (c), to approve the auditor and to request for additional information and enlarge the audit scope;
- (e) require the FHC to inform MAS when it is likely to become insolvent or unable to meet its obligations, and to exercise broad powers to direct the FHC to take or desist from any action under such extraordinary circumstances; and
- (f) impose penalties on the FHC for contravention of any FHC regulations and on its directors, executives and officers for certain acts of commission or omission, such as the willful provision of misleading information.

### Annual Fees

8.2 MAS levies licence fees on banks and annual fees on insurance companies. The supervision of FHCs will impose additional demands on MAS' supervisory resources for which an annual fee on the FHC may be appropriate. The FHC Act will provide MAS with powers to impose annual fees on FHCs.



## **9 IMPLEMENTATION TIMELINE**

9.1 MAS will carefully consider the feedback from this consultation in finalising the regulatory approach for FHCs. The draft FHC Bill and related regulations will be published for consultation. When the FHC Act comes into effect, current Directives issued to individual FHCs will be cancelled and the relevant FHCs will be subject to provisions in the FHC Act.

**ANNEX 1**

**Summary of Proposed Requirements for Tier 1 and Tier 2 Insurance Companies**

	<b>Proposals for Tier 1 Insurers (As per current CG Regulations for 'Significant Insurers')</b>	<b>Proposals for Tier 2 Insurers</b>
Board Size	Implicit requirement of a board size of 3 directors.	Require a minimum board size of 3 directors.
Board Composition	Require a majority of independent directors <sup>18</sup> . If the insurance company is a subsidiary, then requirement is at least one-third independent directors.  In respect of FHCs, for parent FHCs, to require a majority of independent directors. For intermediate FHCs, to require at least one-third independent directors.	Require at least one-third independent directors.
Board Committees	Requirement to establish the following board committees: <ul style="list-style-type: none"> <li>• Nominating Committee</li> <li>• Remuneration Committee</li> <li>• Audit Committee</li> <li>• Risk Management Committee</li> </ul> Where the insurance company is a subsidiary, exemption may be given for the setting up of a Nominating Committee, Remuneration Committee and Risk Management Committee if the company can demonstrate that these functions can be performed by the main board.	No requirement for the establishment of board committees.
Chairman cannot be an executive director or immediate family of the CEO	Apply	Apply
Required appointments that are also subject to MAS' approval	Board chairman, members of the board, members of the Nominating Committee, CEO, CFO and CRO.	Board chairman, members of the board and the CEO.

<sup>18</sup> Under the CG Regulations, an 'independent director' is one who:  
(a) is independent from management and business relationships with the insurer;  
(b) is independent from any substantial shareholder; and  
(c) has not served on the board of the insurer for a continuous period of nine years or longer.



Monetary Authority of Singapore