CONSULTATION PAPER ON THE REMOVAL OF THE DBU-ACU DIVIDE

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On 31 August 2015 the Monetary Authority of Singapore (the "**MAS**") issued a consultation paper setting out the proposed consequential amendments to regulatory requirements (the "**Consultation Paper**") following the announcement by the Deputy Prime Minister and Chairman of the MAS, Mr Tharman Shanmugaratnam, in June 2015 to remove the Domestic Banking Unit ("**DBU**") and the Asian Currency Unit ("**ACU**") divide.

Currently, all banks in Singapore must maintain two separate accounting units – the DBU and the ACU. Transactions in Singapore dollars may be booked only in the DBU, whereas transactions in foreign currencies are typically booked in the ACU. In his keynote address at the Association of Banks in Singapore Annual Dinner on 30 June 2015, Mr Tharman Shanmugaratnam stated that the DBU-ACU divide will be removed as, although the DBU-ACU divide had served Singapore well for decades, it has in recent times been losing its relevance due to a number of reasons.

- First, since 2004, Singapore's developmental incentives have no longer been based on the domestic vs offshore distinction as the offshore banking sector is now well established in Singapore.
- Second, the divide between domestic and offshore banking has in practice become increasingly porous.
- Third, there have been major global regulatory developments in the last five years in the wake of the global financial crisis that has resulted in banks' offshore activities being subject to rules that are broadly similar to those governing the domestic banking business in Singapore.
    - New global rules have increased the amount and quality of capital as well as the liquidity buffers that banks need to hold
    - Global regulators have also agreed on a common framework to control large exposures to a single counterparty

These global regulatory reforms have put all banks on a sounder footing and reduced the relevance of MAS rules that distinguish between offshore and domestic banking activities of foreign banks, as now home regulators require their banks to meet enhanced standards on a group-wide basis.

- A fourth reason why the DBU-ACU divide is of less relevance today relates to the significant changes in MAS' banking regulations aimed at reducing systemic risks.
    - The MAS will require all banks to meet enhanced liquidity requirements that apply to the entirety of their operations by January 2016.
    - Banks which are designated as domestic systemically important banks (D-SIBs) in Singapore will be subject to additional supervisory measures over both their domestic and offshore businesses.
    - In addition, where a foreign bank branch has a significant retail presence in Singapore, it will

also be required to locally incorporate its retail operations. The subsidiary will be subject to the same suite of regulation as the local banks, and the same supervisory regime aimed at minimising risks to local depositors.

Together, the enhanced global and domestic regulatory standards have rendered the DBU-ACU no longer useful and Mr Tharman Shanmugaratnam noted that if Singapore were to continue with the divide, this would merely impose an undue administrative burden on banks without materially enhancing prudential soundness or systemic stability.

Consultation Paper Proposals

The proposals in the Consultation Paper relate to key regulatory provisions which reference the DBU-ACU divide. A summary of the key proposals in the Consultation Paper is as follows:

The priority of Specified Liabilities in Insolvency

Section 62(1) of the Banking Act ("**BA**") specifies the priority ranking of the liabilities of a bank in Singapore, in the event of a winding-up of a bank. Under Section 62(1), the liabilities of a bank are currently ranked in the following order:

1. Premium contributions due and payable by the bank under the Deposit Insurance and Policy Owners' Protection Schemes Act ("**DI premiums**");
2. Liabilities incurred by the bank in respect of insured deposits, up to the amount of compensation paid or payable out of the Deposit Insurance Fund by the Agency under the Deposit Insurance and Policy Owners' Protection Schemes Act ("**insured deposits**") in respect of the insured deposits;
3. Deposit liabilities incurred by the bank with non-bank customers other than those in (b) and (d) (i.e. uninsured non-bank deposits in the DBU); and
4. Deposit liabilities incurred by the bank with non-bank customers when operating an ACU.

With the removal of the DBU-ACU divide, MAS proposes amending section 62(1) of the BA to rank uninsured non-bank deposits in insolvency (i.e. (c) and (d) above) by the currency denomination of the deposits instead. This approach would be a natural replacement of the current priority ranking since the DBU and ACU are broadly differentiated by currency. The proposed priority ranking is as follows:

1. DI premiums;
2. Insured deposits;
3. Uninsured Singapore dollar non-bank deposits; and
4. Uninsured foreign currency non-bank deposits

Asset Maintenance (“AM”) Requirements

The AM requirements for banks as currently set out in MAS Notice 640 (the “**Minimum AM Requirements**”) are applied based on the amount of DBU non-bank deposits held by a bank.
With the removal of the DBU-ACU divide, MAS proposes to apply the AM requirements by currency denomination instead. This means that the current asset maintenance ratios applied on DBU non-bank deposits will henceforth be applied on Singapore dollar non-bank deposits instead. This proposal is aligned with the suggested approach to the priority ranking of specified liabilities in insolvency set out above.

There will be no change to the list of eligible assets, which are selected on the basis of their quality and recoverability and are therefore independent of the DBU-ACU divide.

Anti-Commingling Limits

Regulations 23F and 23G of the Banking Regulations specify the anti-commingling limits applicable to banks (see Table 1 below). These limits are currently expressed as a proportion of a bank’s capital funds.

The anti-commingling policy remains relevant – it aims to limit the reputational risks arising from banks engaging in non-financial businesses and ensure that bank management focuses its attention on the core banking business. Therefore, MAS will continue to apply the anti-commingling limits to all banks. However, with the removal of the DBU-ACU divide, the computation of the limit will need to be revised, as the concept of capital funds will no longer apply for banks incorporated outside Singapore.

MAS proposes to revise the methodology for computing the limits for all banks to be based on total assets instead of capital funds. An asset-based limit is a reasonable measure of a bank’s investments in non-financial businesses and will help ensure that the bank’s interests in non-financial businesses do not become a substantial part of its total assets.
The proposed revised limits, as described in Table 1, are calibrated at lower absolute levels than the current limits, as banks’ total assets are significantly larger than their capital funds.

Table 1: Proposed anti-commingling limits under regulations 23F and 23G of the Banking Regulations

Current	Proposed
Regulation 23F (Prescribed private equity or venture capital ("PEVC") business): Bank incorporated in Singapore: Total net book value of PEVC business cannot exceed 10% of the bank's capital funds. Bank incorporated outside Singapore: Total net book value of PEVC business (in the DBU) cannot exceed 10% of the bank's capital funds.	Total net book value of a bank's PEVC business cannot exceed 2% of its total assets i.e.
Regulation 23G (Prescribed related or complementary business): Aggregate Size of related or complementary business cannot exceed 15% of a bank's capital funds. If a bank carries on businesses under both regulations 23F and 23G, the bank is required to limit the Aggregate Size of all such businesses to 20% of its capital funds.	Aggregate Size of related or complementary business cannot exceed 2% of a bank's total assets i.e. If a bank carries on businesses under both regulations 23F and 23G, the bank is required to limit the Aggregate Size of all such businesses to 4% of its total assets.

Equity Investments Limit

Banks are currently subject to limits on equity investments and immovable property under sections 31 and 33 of the BA, respectively. These limits under sections 31 and 33 apply only to the DBU of a bank incorporated outside Singapore.

As the concept of capital funds will no longer apply for banks incorporated outside Singapore, MAS proposes not to apply general limits on equity investments and immovable property to banks incorporated outside Singapore. Nonetheless, where appropriate, MAS may impose limits on investments in equity and/or immovable property for an individual bank or a class of banks incorporated outside Singapore for supervisory or prudential reasons.

Concentration Limits

MAS Notice 639 ("**Exposures to Single Counterparty Groups**") applies various concentration limits on banks.

As the concept of capital funds will no longer apply for banks incorporated outside Singapore, MAS proposes not to apply certain concentration limits in MAS Notice 639 to banks incorporated out-side Singapore.

MAS also proposes to remove the limits on unsecured credit facilities to director groups for all banks. The risks of conflicts of interest would be better managed through sound processes and risk management controls. Table 2 provides a summary of the proposals for the application of existing limits under MAS Notice 639.

Table 2: Summary of Proposals for the Application of Limits under MAS Notice 639

<table>
<tr><th>Limit

(relevant paragraph under Mas Notice 639)</th><th>Proposal</th></tr>
<tr><td><u>Large Exposures Limit (paragraphs 6(a) and 7(a)):</u>

A bank's aggregate exposure to a single counterparty group cannot exceed 25% of its eligible capital (for a bank incorporated in Singapore) or capital funds (for a bank incorporated outside Singapore).</td><td rowspan="3">Applicable to banks incorporated in Singapore</td></tr>
<tr><td><u>Substantial Exposures Limit (paragraphs 6(b) and 7(b)):</u>

The aggregate of the exposures of a bank exceeding 10% of its eligible total capital or capital funds (as the case may be) cannot exceed 50% of the bank's total exposures.</td></tr>
<tr><td><u>Limits for Investments in Index or Investment Fund (paragraph 16):</u>

The aggregate of a bank's exposures arising from investments in any index or investment fund cannot exceed 2% of the bank's eligible total capital or capital funds (as the case may be).</td></tr>
<tr><td><u>Limits on Unsecured Credit Facilities to Director Groups (paragraphs 14(a) and (b)):</u>

· Aggregate unsecured credit facilities granted to any director group (other than persons in limb (d)(i) of the definition of "director group") cannot exceed $5,000.

· Aggregate unsecured credit facilities to all persons defined in limb (d)(i) of the definition of "director group" cannot exceed $5,000, unless the giving of the additional unsecured credit facilities over the limit has been approved by the board of directors of the bank. In such a case, aggregate unsecured credit facilities to the director group cannot exceed 2% of the bank's eligible total capital or capital funds (as the case may be).</td><td>Not applicable to banks incorporated in Singapore</td></tr>
</table>

Implementation Timeline

MAS proposes to give banks two years from the time MAS issues the revised regulatory requirements to implement these changes. During this period, banks will be required to comply with the prevailing rules and guidelines in force.

Conclusion

Commentators have opined that the removal of the DBU-ACU divide would simplify Singaporean banking regulations by taking away one layer of regulation which is now, in essence, supererogatory, as the original considerations for the implementation of ACU-DBU divide have lost their relevance and foreign banks in Singapore are now already subject to higher standards by their home regulators. Removal of the DBU-ACU divide would also make banking laws more consistent and would be in line with the Singapore Government's general approach to legislation, which is to avoid overregulation.

Others have expressed the view that the removal of the divide and the implementation of certain prudential limits should result in a more vibrant domestic banking market as banks incorporated outside Singapore, i.e., foreign banks would no longer be constrained by their capital funds in Singapore intended for the expansion of their domestic banking business.

From an international perspective, the removal of the DBU-ACU is in alignment with the movement towards uniform cross-border banking regulations as increasingly global regulators now work towards avoiding multiple regulations which may lead to gaps and potentially, regulatory arbitrage.