MAS proposes implementation of the Final Basel III reforms in Singapore

3 July 2019

In a nutshell

On 7 may 2019, The Monetary Authority of Singapore ("MAS") released a consultation paper on the implementation of the Final Basel III reforms in Singapore. Comments are due by 8 July 2019, with revisions to be implemented from 1 January 2022.

The guidelines propose ***revisions to the risk-based capital requirements and leverage ratio requirements*** for Singapore-incorporated banks and contain a number of revised standards across risk categories as well as back-stop metrics:

- Credit risk
- Credit valuation adjustment
- Market risk
- Operational risk
- Output floor
- Leverage ratio

The guidelines are meant to align with the Basel III reforms and the revisions are to be implemented by 1 January 2022.

This document provides our point of view on the potential key impacts of the changes, anticipated challenges of the implementation process and key considerations in preparation

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What will change?

Proposed changes cover a multitude of topics and, together, may have a fundamental impact on individual organisations and the industry as a whole. The impact can and will be different depending on the bank's business model, products, asset portfolio, commercial strategy, funding profile and other bank-specific considerations.

Proposed areas of changes at a glance

	Area	Proposed changes
1	Credit risk	• Scope of exposures to banks • External ratings in risk weightings for banks • New asset class thresholds for corporate exposures • Firm-size adjustment for corporate SMEs under the IRBA • Real Estate exposures under SA(CR): risk-weighting and valuation • Exposures secured by Residential and Commercial Real Estate under SA(CR) • LGD floor for exposures in the residential mortgage asset sub-class under IRBA • Phase-in arrangements for risk equity weights • Definition of committments under the SA(CR) and the IRBA • Eligible protection providers
2	Market risk	• Default Risk Charge under Revised SA(MR) • Use of the Simplified SA
3	Operational risk	• Used of historicall loss data for capital calculations • Loss data standards
4	Output floor	• Phase-in arrangements
5	Leverage ratio	• Measurement of derivative exposures • Treatment of Cash Pooling arrangements

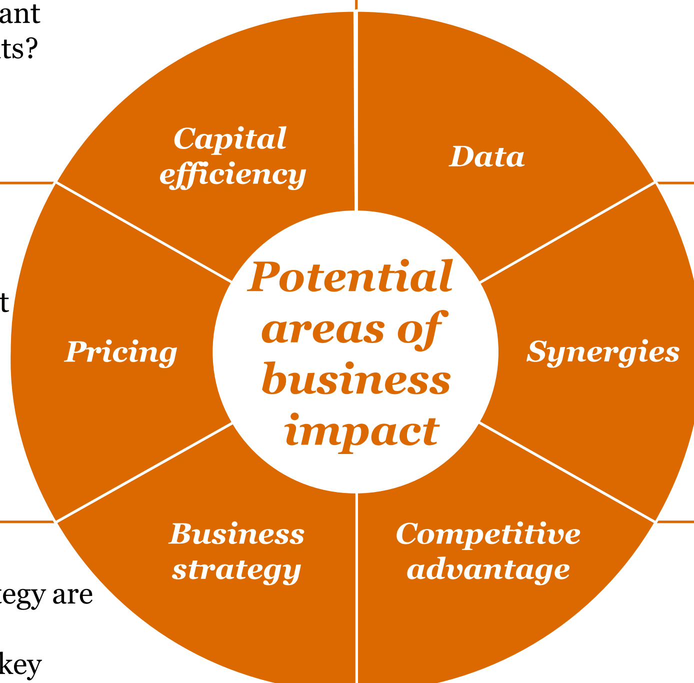
Have you considered..?

While achieving compliance, consider the bigger picture - optimizing capital management strategy amid digital disruption presents a different set of business challenges – and a harder look at reality

What does it mean for me?

We believe that the impact of the proposed changes goes beyond technical implementation and ***introduces significant business impact.*** Moreover that impact needs to be evaluated in the context of ***cumulative change – and how to use it to strengthen the business.***

The Basel "Butterfly Effect" - leveraging cumulative change for impact



Efficient use of capital

- Is your capital in an efficient manner while being compliant with regulatory requirements?

Leveraging the data

- Can existing infrastructure and data available be used effectively to assist with the proposed changes?
- Are your (loss) data standards in line with the requirements?

Pricing

- Are pricing changes required to ensure sufficient return on capital?

Priorities and holistic implementation

- What priorities should be set to drive business and cost synergies?
- Have you considered the key drivers of the effective implementation programme?

Business strategy

- What elements of your strategy are affected by the changes?
- Do you need to revisit your key markets, customer segments, value proposition?

Competitive advantage

- How will the proposed rules impact your product portfolio and profit drivers?
- Given the digital competitive landscape, which includes fintech companies with lower capital requirements, how do you stay relevant?

Reading the fine print

While banks have been implementing regulatory changes in capital requirements for a considerable time, these proposed guidelines introduce an additional level of ***implementation complexity***.

Anticipated challenges

Credit risk, output floor and leverage ratio

- Proposed changes to classification and/or thresholds for ***exposures to banks and corporates*** call for a comprehensive review of the existing portfolio. Depending on the portfolio size and complexity, a significant organized effort beyond BAU might be necessary, including design of new policies subject to MAS approval.
- Proposed changes on risk-weighting, valuation and classification ***exposures to real estate*** will require a strategic review of the real estate exposure portfolio.
- ***Proposed new definition of commitments and eligible protection providers*** will require an analysis and legal assessment of applicability of the new definition and identification of impacted portfolios and contracts.
- Refinements to the calculation of the ***leverage ratio*** (calculation methodology for derivatives exposures and criteria for cash pooling arrangements) ***need to be carefully calibrated.***

Market risk

- Proposed guidelines outline a number of ***qualitative criteria*** to designate banks which hold ***simple market risk portfolios***. Some of these criteria require ***detailed description and justification*** (e.g. the complexity of market risk exposures undertaken by the bank).

Operational risk

- Adoption of the ***revised operational risk framework*** will present a separate work program for banks as the new revised standardized approach will be adopted.
- In addition, the proposed requirement on ***disclosure of annual loss data*** sets the bar high for the ***quality and integrity of data***.

Have you considered..?

For some proposed amendments, the approach will ***depend on the designed policies and assessments of banks.*** What are some of the considerations to keep in mind?

- New definitions and approaches to be ***defined by the bank and approved by the MAS*** (for example, use of total assets to calculate the corporate SME threshold under IRBA):
  - Do you have a structured plan to design and deliver these definitions?
  - Have the right stakeholders been identified?
  - Have you defined a process and timeline for obtaining MAS approvals?
- Topics where the ***bank's assessment and/or development of internal policies*** is required to define the risk of the exposure (for example, the degree of diversification of cash flows generated by commercial real estate):
  - How will the process to of policy development be organized?
  - How will you demonstrate to the MAS that the approach is credible and sustainable?

What should I do next?

The effects of implementing the proposed changes are very ***bank-specific*** due to different business models, products, customers and balance sheets. Therefore, there is no "uniform" response to the new regulations. Moreover, depending on the ***results of the impact assessment***, proposed requirements can bring significant changes to internal processes and systems. This concerns data, models and systems of both front- and back-office as well as control functions.

Firms can take first steps to assess their readiness for implementation – by starting with the right questions

Questions to ask

1	***Impact assessment of changes in capital regime***	***Gap analysis***	What additional changes are required over and above the existing requirements?
		Business impact analysis	What do new changes mean for asset portfolios, product offerings, funding strategy, risk appetite, de-risking strategies etc?
		Process impact analysis	What are the changes required in the reporting process? What revisions are required in parameter estimation, model validation, model governance etc?
		Data availability	Is new data required? How will it be obtained? What are the ways to ensure its quality is up to the required standard? For qualitative metrics, how to translate it into regular data sets/reports and make it sustainable?
2	***Determine implementation process***	***Leadership***	Where in the organisation will the leadership of overall implemenation belong to? What decisions should be made to assign that responsibility?
		Implementation planning & priorities	What is the implementation effort and what are the specific steps to achieve timely implementation? Are priorities defined with respect to other regulatory initiatives?
		Project management	Are there dedicated project management resources?
3	***Optimise your capital strategy***	***Bigger picture***	With the changes required, how do we know the capital is used efficiently? Have you considered the broader implications e.g. disruption to the FS sector?
		Operational cost	Is the implementation program design effective in limiting cost, one-off as well ongoing?

How PwC can help you

As you begin to consider the proposed changes, we are happy to have a conversation on how we can support you ***across the lifecycle of designing an efficient capital management programme*** and effective implementation of the requirements.

Impact assessment

Business impact analysis

Identifying impact on your products, customer segments, pricing, etc.

Process impact analysis

End-to-end understanding of changes in BAU capital reporting and management process post implementation

Gap analysis

Assessment versus existing regulatory requirements and holistic view of balance sheet impact

Capital requirements

Assistance with the design of different criteria and approaches to metric calculations

Review of contracts and positions to identify areas for re-design

Data & simulations

Data management and analytics solutions for proposed new requirements

Simulation of capital efficiency for different implementation choices

Project management

Program management of the implementation project, incl. development of roadmaps and detailed action plans

Support of the design and development of **policies to demonstrate compliance**

If you would like further information on issues outlined above, please call your usual PwC contact or any of the individuals listed:

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