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### Response to Feedback Received - Review of the Deposit Insurance Scheme in Singapore

Monetary Authority of Singapore

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## **RESPONSE TO FEEDBACK RECEIVED – REVIEW OF DEPOSIT INSURANCE SCHEME**

### **1 Introduction**

1.1 On 25 February 2010, the Monetary Authority of Singapore (“MAS”) as part of its review with the Singapore Deposit Insurance Corporation (“SDIC”), conducted a public consultation on proposals to amend and enhance various features of the Deposit Insurance (“DI”) Scheme in Singapore. We would like to thank all respondents for their comments.

1.2 We have carefully considered the feedback received, and where appropriate, will incorporate them into the revised DI framework. Comments that are of wider interest, together with our responses, are set out below.

### **2 Proposal: To Expand Scope of DI Scheme to Insure Deposits of Other Non-bank Depositors.**

#### **2.1 Insuring Other Non-Bank Depositors**

2.1.1 Some respondents supported the proposal to insure other non-bank depositors besides individual depositors. One respondent felt that all business deposits should continue to be excluded as it was inconsistent with the objective of the Scheme to protect small depositors and could create moral hazard, as well as increase the costs of DI. A few respondents suggested excluding corporate depositors from DI coverage as corporate bodies should generally be in a better position to manage their cash flow, and the proposed S\$50,000 coverage limit would not yield significant benefit for corporate clients while increasing business costs to Scheme members from higher DI premiums. One respondent suggested excluding some categories of corporate bodies such as larger corporations, public listed companies or Government-linked companies.

Another respondent suggested giving banks the option of whether to insure corporate deposits.

### MAS' Response

2.1.2 The primary objective of DI remained that of protecting small depositors. Insuring businesses is not inconsistent with this objective as small businesses may similarly not be in a position to make an informed decision as to which banks to place their deposits with. According them with some deposit protection can help to mitigate potential cash flow problems in the event of bank failure. It would not be tenable to give Scheme members the option of determining its own depositor coverage as this could give rise to adverse selection where higher risk Scheme members may seek to attract more deposits.

2.1.3 To limit protection to small businesses, we considered several options such as insuring only certain types of businesses (e.g. sole proprietorships and partnerships) while excluding companies. However, differentiating by legal form is not ideal. While companies may tend to be larger entities, small businesses may also be incorporated as companies. On the other hand, large businesses may operate in the form of sole proprietorships and partnerships. We note that other jurisdictions that insure non-bank depositors generally do not single out companies.

2.1.4 We also explored the alternative of insuring businesses based on certain criteria that serve as a proxy for size (e.g. total assets, revenue, staff numbers etc). However, it would be difficult to establish an appropriate set of common criteria applicable to the diverse range of businesses. Furthermore, it would introduce operational challenges to verify the insured status of a depositor which could change when it no longer met the criteria, thus delaying the payout process to depositors.

2.1.5 Instead, we considered that it may be preferable to insure all non-bank depositors in general, which would be a more even-handed approach while mitigating concerns over moral hazard and costs, by keeping the DI coverage limit at a reasonable level.

### 2.2 Clarification on “Non-Bank” and Excluded Persons

2.2.1 A few respondents sought clarification on the scope of non-bank depositors, in particular, whether there are any qualifying criteria such as Singapore incorporation; and if non-bank financial institutions such as insurance companies, investment companies, fund management companies, as well as unincorporated entities such as Government bodies

and statutory boards, would be insured. This was in view that we had proposed excluding certain entities from DI coverage namely, merchant banks and finance companies in and outside Singapore, foreign central banks/monetary authorities and foreign governments. Scheme members highlighted additional operational effort required to identify and exclude specific entities. As an alternative, it was suggested that the exclusions be based on similar classifications as those used under existing regulatory returns, which do not require the same level of granularity.

### MAS' Response

2.2.2 The list of exclusions proposed earlier was on the basis that it would not be necessary to extend DI coverage to such entities. However, we have re-considered that it might be operationally simpler to insure all non-bank depositors in general and not to provide for specific exclusions. The additional cost of coverage is not expected to be significant.

### 2.3 Own and Client Accounts

2.3.1 Scheme members highlighted that they may not separately identify the office accounts of professional firms such as legal and accounting partnership firms, from the latter's client accounts.

### MAS' Response

2.3.2 Deposits held in client accounts are separate from the firm's own deposits and would be insured separately. In opening client accounts, the nature of the account should be specified. For instance, an account opened by a law firm with a Scheme member could carry <Name of Firm – Client Account> or similar wording in its name to indicate that these are held for clients.

### 2.4 Trust/Custodian/Client and Special Purpose Accounts

2.4.1 Respondents sought to clarify whether deposits in trust, custodian and client accounts, as well as balances in some special purpose accounts e.g. escrow and project accounts would be insured. One respondent proposed that such accounts be insured separately per account instead of aggregation by beneficiary.

### MAS' Response

2.4.2 Currently, for individual depositors, deposits held in trust or client accounts would be insured where the beneficiary is disclosed in the books of the Scheme member. To simplify DI coverage, we will insure

trust and client accounts maintained by individuals as well as other non-bank depositors, and each trust or client account will be insured up to the DI coverage limit. This means that there is no need to aggregate the beneficiary's share of monies in the trust or client account, with his personal deposits with the same Scheme member in determining his DI compensation. Escrow and project accounts that operate as trust or client accounts will be treated the same.

## 2.5 Joint Accounts

2.5.1 One respondent asked whether the aggregation rules for joint accounts opened by two companies would follow that for personal joint accounts.

### MAS' Response

2.5.2 The same aggregation rules apply, i.e. each joint account holder's share of the deposit (50% each) would be aggregated with deposits held under its own name.

## **3 Proposal: To amend the DI Act to allow MAS to prescribe products as insured deposits, and to prescribe *Murabaha* as an insured deposit under DI.**

### 3.1 Prescribing *Murabaha* as Insured Deposit

3.1.1 None of the respondents objected to the proposal. A respondent expressed support to insure *Murabaha* deposit as it would enable Islamic products to compete on equal footing with conventional products with similar features, encourage more product innovation, and widen consumer choice.

### MAS' Response

3.1.2 We will proceed with prescribing *Murabaha* as proposed.

## **4 Proposal: To enhance depositor protection by raising DI coverage limit from S\$20,000 to S\$50,000 per depositor per institution.**

### 4.1 Raising Coverage Limit

4.1.1 Respondents were generally supportive of the proposal to raise the coverage limit although there were some concerns over higher business costs associated with higher premiums. Some respondents proposed a higher level of coverage such as S\$100,000, while a few felt that all deposits should be fully insured as these were hard earned savings. They were of the view that it would not be fair for depositors to accept low interest rates while being subject to the high risks that banks may be engaging in. One respondent thought that full DI coverage would obviate the need for the Government to intervene in a distressed situation and could mitigate any potential outflow of deposits from Singapore to other jurisdictions.

### MAS' Response

4.1.2 MAS recognises the need to provide a basic safety net for small depositors who may be less able to make informed decisions and yet, may be most affected by the loss of their deposits in the event of bank failure. It is with this objective in mind that the DI scheme was put in place to provide an explicit level of protection for depositors. Such explicit coverage is consistent with DI schemes internationally, which do not seek to ensure full protection for all depositors against any bank failure. To do so would undermine market discipline and make the pre-funded scheme unviable as the costs to Scheme members would be prohibitive and these could then be passed on to depositors.

4.1.3 Therefore, in proposing DI coverage of S\$50,000 which applies on the basis of per depositor per scheme member, we considered the need to provide adequate protection to small depositors while limiting the cost to Scheme members and depositors.<sup>1</sup> S\$50,000 would fully insure 91% of depositors covered under the scheme. This is a reasonably high coverage. Beyond S\$50,000, the incremental benefit is small and may not justify the costs. For instance, doubling the proposed coverage from S\$50,000 to S\$100,000 would only fully insure another 4% of depositors at potentially twice the costs. Furthermore, if DI coverage was too generous, depositors may seek high interest rates without due regard to risks undertaken by the bank.

4.1.4 MAS, together with the SDIC, will continue to perform regular review of the DI scheme to ensure it remained relevant and appropriate.

## 4.2 Clarification on Applicable Coverage at Group Level

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<sup>1</sup> To further mitigate the cost impact on Scheme members, we have proposed in the consultation paper, to lower the annual premium rates and to extend the build-up period for the DI Fund.

4.2.1 A respondent sought clarification on whether coverage applies at the entity or group level in the case of a group of related entities. Another respondent asked whether separate coverage is applicable for a group of companies which had a cash pooling arrangement where cash balances in the subsidiaries' current account would be "swept" into the parent's current account at day-end.

#### MAS' Response

4.2.2 Coverage is not aggregated for a group of related entities. Each entity will be separately insured up to S\$50,000. For cash pooling arrangements, compensation of up to S\$50,000 will be made to each entity depending on its deposit balances existing in the Scheme member at quantification date.

**5 Proposal: In computing coverage for a sole proprietor, to aggregate deposits in his own name and under his sole proprietorship business; and for partnerships, to treat the partnership as a single entity.**

#### 5.1 Aggregation for Sole Proprietor and Sole Proprietorship

5.1.1 One respondent welcomed the proposal to aggregate the deposits of a sole proprietor and his sole proprietorship but highlighted the business costs arising from system enhancement. Some Scheme members noted the operational challenge and costs in aggregation as they may not capture the details of all sole proprietorships in their system or may not electronically link the personal and business accounts.

5.1.2 Several respondents noted the difference in treatment for sole proprietorships and partnerships. One respondent highlighted potential moral hazard where individuals could set up partnerships with nominee partners for the purpose of obtaining maximum protection for their deposits. Another respondent noted that it would be more advantageous for a depositor who has individual and partnership accounts, compared to an individual and sole proprietorship accounts.

#### MAS' Response

5.1.3 Sole proprietorships and partnerships are not treated as legal entities distinct from their owners under the law. Ideally therefore, deposits of the sole proprietor should be aggregated with those of his business, i.e. the proprietorship, as he may commingle these deposits. In practice, Scheme members should have a single customer view. We will

retain the proposal to aggregate the deposits of a sole proprietor with his sole proprietorship(s).

5.1.4 We note potential concerns over depositors setting up several partnerships with nominee partners for the purpose of maximizing DI protection. However, we are of the view that there is little incentive for an individual depositor to set up a business account(s) solely for the purpose of enjoying added protection with the same scheme member, with no other commercial reasons. Based on a coverage limit of S\$50,000, 91% of depositors would already be fully insured.

## 5.2 Sole Proprietorship Accounts Owned by Companies

5.2.1 One respondent asked whether deposits held by a sole proprietorship which is owned by a company would have to be aggregated with the company's own deposits.

### MAS' Response

5.2.2 The deposits of the sole proprietorship and the company will be aggregated.

## **6 Proposal: To streamline the DI coverage for CPF-related accounts, by aggregating an individual's CPFMS deposits with his monies in the CPFIS under a common S\$50,000 limit.**

### 6.1 Separate Coverage for CPFMS and CPFIS

6.1.1 One individual proposed a separate coverage for monies held under CPF Minimum Sum Scheme ("CPFMS") and CPF Investment Scheme ("CPFIS") instead of aggregating them under a common S\$50,000 limit, and to increase DI coverage limit for CPFMS. The individual was of the understanding that as the required minimum sum amount was currently S\$117,000 (to be raised to S\$120,000 in 2013), a limit of S\$50,000 would mean that only half of the minimum sum will be safe should CPF be affected by any liquidity problems. In addition, he noted that a CPF member does not have a choice of reducing his minimum sum amount to S\$50,000 to enjoy full coverage unlike voluntary savings accounts. The individual also expressed concern over higher default risks with banks expanding overseas.

### MAS' Response



6.1.2 The DI scheme only insures monies placed with DI Scheme members and not a CPF member's full minimum sum maintained with CPF. Our study of the deposit profile of DI Scheme members showed that the proposed DI coverage of S\$50,000 (even with CPFMS and CPFIS combined) would fully insure close to 100% of insured depositors who place CPF monies with DI scheme members.

## **7 Proposal: To amend the DI Act to clarify that SRS monies not invested and remaining in SRS accounts are insured under DI.**

### **7.1 Separate Coverage for SRS**

7.1.1 A respondent suggested that monies under the Supplementary Retirement Scheme ("SRS") be subject to a separate S\$50,000 limit given that they are like CPF monies, which are meant for retirement purposes.

### **MAS' Response**

7.1.2 While both CPF and SRS are meant for retirement purposes, SRS is a voluntary savings scheme that complements the CPF Schemes. As SRS monies do not form the core savings of depositors and the amounts held are not significant, a separate DI coverage may not be necessary currently.

## **8 Proposal: To adopt a gross payout approach for the purpose of DI payout, such that an insured depositor is paid the gross amount of his deposits up to the DI coverage limit, without first netting off his liabilities to the Scheme member.**

### **8.1 Whether to Proceed with Gross Payout**

8.1.1 Most respondents were not in favour of a gross payout approach. Several respondents felt that it would be fair to allow liabilities of depositor to the bank to be set off first, and to be consistent with the mandatory insolvency set-off rules. It was noted that a gross payout may not distinguish between prudent savers and net borrowers and could compromise the interests of other depositors and creditors. Operationally, it may be more practical to adopt netting to avoid situations of SDIC administering gross payout on one hand to a large customer base, and the liquidator having to subsequently recover amounts owed by the same customers. The latter could be a challenge. As existing payout was already based on netting, one respondent noted that

additional legal costs and costs arising from IT enhancements for the compensation payout system would have to be incurred.

### MAS' Response

8.1.2 Gross DI payout contributes to greater confidence and stability in a distressed situation as it is easier for depositors to understand and is operationally faster. It also provides depositors with quick access to the full amount of their deposits, up to the DI coverage limit. If payout is on a net basis, a depositor who has a loan with the same Scheme member may receive partial payout, or no payout if his loan is larger than his deposit, thereby limiting the effectiveness of the Scheme in protecting small depositors.

8.1.3 We note the concerns that have been highlighted over gross DI payout. We would like to clarify that gross DI payout per se is not unfair as it does not extinguish the depositor's liabilities to the Scheme member. A debtor or borrower will still have to repay his liabilities. The failure of his bank does not negate his obligation to do so. Debt recovery is an issue that a liquidator may face even where a debtor or borrower has no deposit with the failed institution or if there was no DI. In practice, we expect borrowers to continue to service their loans. A bad credit history could affect their ability to obtain credit from other institutions in the future. It should also be clarified that we are not proposing to return the depositor his full deposit, only up to the amount insured under DI, so that the Scheme can be effective. From a cost perspective, the impact to Scheme members arising from gross payout is not expected to be significant. Premiums are currently assessed on gross insured deposit base. Furthermore, gross payout is operationally simpler and Scheme members need not make significant changes to their system.

8.1.4 A gross payout approach will be consistent with international practice and developments. We understand that jurisdictions with relatively established DI Schemes including the US and Canada, have practised gross payout. More recently, the UK and the EU, have indicated that they will adopt a gross payout approach.

## **9 Proposal: To insure the amount of a pledged deposit that is not set aside by the Scheme member in respect of debt owing by the depositor, and that may be withdrawn by the depositor.**

### 9.1 Whether to Insure Pledged Deposits

9.1.1 One Scheme member expressed support for the proposal as this would bring significant benefits to its depositors.

9.1.2 However, most respondents did not favour the proposal compared to the status quo where pledged deposits were totally excluded from coverage. One Scheme member expressed the view that pledged deposits were fully encumbered and as such, no part of the deposit could be “freely” withdrawn so long as the facility (which the deposit was pledged against) remained in place.<sup>2</sup> Others were generally concerned that it would be operationally challenging<sup>3</sup> to determine the portion of deposits that are in excess of liabilities owed to the Scheme member in a timely manner to meet proposed ongoing disclosure requirements.<sup>4</sup> A few respondents informed that the amount of pledged deposits in excess of debts owing, should not be significant. One respondent felt that depositors should exercise prudence such that they do not place more monies as pledged deposits than necessary.

9.1.3 A respondent suggested insuring the full amount of pledged deposits (instead of only the “free” amount) as this would be administratively simpler and also make disclosure to customers easier.

#### MAS’ Response

9.1.4 We have re-considered the issue, and propose to insure pledged deposits as with normal deposits, and pay out on the same gross basis. This means that deposits (whether pledged or not) will be aggregated and capped at the DI coverage limit, in determining a depositor’s DI compensation. This will be simpler and easier to understand, which promotes public confidence.

9.1.5 Insuring pledged deposits does not interfere with the commercial arrangement between the Scheme member and his depositor (borrower). During normal times, depositors may still be precluded by their banks from withdrawing at least the portion of their pledged deposits that is set aside against liabilities. If the borrower defaults, the

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<sup>2</sup> For instance, in the case of an overdraft facility, cheques may already have been drawn against the facility, and hence the bank could not have allowed the customer to withdraw the pledged deposit at any point in time.

<sup>3</sup> Scheme members provided feedback that valuation for off-balance sheet derivatives may be complex. In addition, there are various types of pledge arrangements between Scheme members and their customers, which could make it difficult to determine the insured portion of any single deposit that was pledged.

<sup>4</sup> These include disclosing upfront and clearly to customers, the implications from pledging their deposits, as well as periodic disclosure on the insured status of their pledged deposits.

Scheme member can still exercise its rights over the pledged deposit. In the event that a Scheme member fails, insolvency set-off will apply irrespective of whether there is contractually a pledge arrangement. It may not be reasonable to deny the depositor quick access to his deposit (at least up to the DI coverage limit) when his bank was the defaulting party. The depositor will still have to subsequently repay any liabilities he may have to the Scheme member. As with gross payout approach, insuring pledged deposits seeks to compensate a depositor upfront for his deposit to mitigate potential issues with cash flow, and does not extinguish the depositor's liabilities to the Scheme member.

## 9.2 Premium Assessment

9.2.1 Some Scheme members asked whether premiums on pledged deposits which are proposed to be insured, would be assessed on a gross or net basis. One respondent suggested that the pledged deposit amount should be excluded from the insured deposit base for premium computation as the deposit would be backed by corresponding assets (that the deposit is pledged against).

### MAS' Response

9.2.2 Premiums will be assessed on the gross insured deposit base. The additional impact on Scheme members from insuring pledged deposits is not expected to be significant as they constitute only a small portion of deposits and these pledged deposits will be aggregated with other normal deposits of the same depositor, in determining the insured deposit base. For the purpose of computing a bank's asset maintenance ratio under the scheme, where the asset (to the bank) that the deposit is pledged against is an eligible asset, it can be included in the numerator of the asset maintenance ratio while the pledged deposit is included in the denominator.

## 9.3 Disclosure

9.3.1 In the consultation paper, we had expressed our expectation that Scheme members disclose upfront and clearly to customers, the implications on coverage under DI from pledging their deposits, as well as the insured status of their deposits (including the status of facilities they are pledged against) from time to time. Such disclosure could be done, for example, in periodic account statements sent to their customers. One respondent sought clarification on a reasonable time period to advise customers of the insured status of their deposits (including the status of the facilities they are pledged against) from time to time.

## MAS' Response

9.3.2 With the change to insure pledged deposits as with normal deposits, there is no specific DI disclosure required for pledged deposits. Nevertheless, Scheme members should still disclose to customers any implication arising from the pledge.

## **10 Proposal: To clarify that accrued interests that have been posted to the accounts of depositors are insured under DI.**

### 10.1 Clarification on Accrued Interests

10.1.1 Respondents sought clarification on whether accrued interest that has not been posted to the account of depositors, would be insured. Scheme members highlighted different practices on interest accrual.

## MAS' Response

10.1.2 We note that the policy on the accrual of interest and frequency at which interest was posted into depositors' accounts can vary across Scheme members, and even within the same Scheme member, interest accrual may vary for different types of deposit products. We would like to clarify that accrued interest that has not been posted to the account of depositors would not be insured. Accordingly, for the purpose of DI premium assessment and payout, Scheme members need only include the amount of accrued interest that has been posted to the account of depositors.

## **11 Proposal: To amend the DI Act such that deposits that are insured before a merger/acquisition of a Scheme member remain separately insured for one year after the transaction.**

### 11.1 Implementation

11.1.1 Respondents sought clarification on the implementation of the transition coverage such as how the coverage limit would apply, and whether the transition period would commence from the announcement or completion of the merger.

## MAS' Response

11.1.2 The transition coverage would take effect from the effective date of merger between the Scheme members say "A" and "B". A

depositor with deposits in both “A” and “B” would be insured up to the amount of his deposit in “A” capped at S\$50,000 and separately, up to the amount of his deposit in “B”, also capped at S\$50,000. For instance, say on 1 January 2012, “A” and “B” were legally merged into “C” and a depositor, prior to the merger, has insured deposits of S\$60,000 with “A” and S\$30,000 with “B”. The depositor would be insured up to S\$80,000 with “C” until 31 December 2012 (comprising S\$50,000 from “A” and S\$30,000 from “B”).

## 11.2 Longer Tenor Fixed Deposits

11.2.1 A respondent asked whether the proposal would discourage depositors from placing longer tenor fixed deposits.

### MAS’ Response

11.2.2 The proposal would enhance protection to depositors, whether or not they place fixed deposits with longer tenor. Under the proposal, a depositor with at least S\$50,000 in each Scheme member, can enjoy up to twice the amount of DI coverage for one year when previously, he would be insured for up to S\$50,000 with the combined entity.

**12 Proposal: To lower the rates for annual premium contributions to between 2bps (0.02%) and 7bps (0.07%) of insured deposit base and extend the fund build-up period by 4 years.**

## 12.1 Cost Concerns

12.1.1 With the expanded scope of DI coverage, respondents in general, noted that total premiums will have to be increased to build a larger DI Fund. They welcomed the proposal to reduce premium rates and to extend the build-up period, which would mitigate the impact on annual premiums. Some respondents hoped that the increase in premiums would not be passed on to customers. One respondent expressed concern that foreign institutions and high net worth individuals may transfer huge funds out of Singapore if their rates of return were trimmed due to higher DI costs.

12.1.2 Currently, the premium rate that a Scheme member pays is determined by the level of assets that it maintains in Singapore to back up its insured deposit base. One respondent noted that with the increase in its insured deposit base arising from the expanded scope of DI coverage, for the same level of eligible assets held in Singapore, its asset

maintenance ratio would now be lower, thus subjecting the Scheme member to a higher premium rate. This would increase the cost to the Scheme member.

### MAS' Response

12.1.3 The existing approach of taking into account the asset maintenance ratio of a Scheme member to determine its premium rate is appropriate. If proceeds from liquidation of a failed Scheme member's assets are insufficient to recover the amount of DI compensation that was drawn from the DI Fund to pay insured depositors, the DI Fund may suffer a loss. Therefore, all else being equal, it is reasonable for a Scheme member that maintains a higher level of eligible assets in Singapore relative to its insured deposit base to pay a lower premium rate, as it poses a lower risk of loss to the DI Fund. If there is no asset maintenance requirement, we would need to establish a larger DI Fund which would in turn increase the premiums payable by Scheme members.

## **13 Other Feedback**

### 13.1 Scheme Membership

13.1.1 A respondent noted that deposits placed by a large company with a full bank would be protected, while deposits placed by an individual with other deposit-taking institutions, i.e. wholesale banks, offshore banks and merchant banks, will not be. The respondent suggested broadening the Scheme membership to include these other deposit-taking institutions. Another respondent proposed including brokerage firms and insurance companies, which have money market fund accounts, to join the scheme, thus increasing the pool of DI Fund for payout.

### MAS' Response

13.1.2 The primary objective of DI is to protect retail depositors. As wholesale banks, offshore banks and merchant banks are not focused on domestic retail business, we will continue to require only retail deposit-taking institutions (full banks and finance companies) to become members of the DI Scheme. Monies set aside for investment do not form the core savings of small retail depositors and they will continue to be excluded from DI coverage. Hence, brokerage firms and insurers are not required to be members of the DI scheme.

## 13.2 Implementation Timeline

13.2.1 Respondents asked about the implementation timeline for the proposed DI changes, and other operational changes that would be required e.g. revised template for submission of DI returns. To implement the proposals, a few respondents suggested a transition period of six to twelve months.

### MAS' Response

13.2.2 Based on the final proposals, MAS will commence legal drafting on the proposed changes to the DI Act and regulations. With the revised proposals which seek to reduce operational complexities, implementation difficulties would be reduced. Nevertheless, we would still provide Scheme members a reasonable lead time to prepare for the changes.

MONETARY AUTHORITY OF SINGAPORE

3 September 2010