CAPITAL MANAGEMENT AND PLANNING

OBJECTIVE

The capital management and planning process is overseen by the Capital Committee which is chaired by the Chief Financial Officer. Quarterly updates on the Group's capital position are provided to the Board of Directors.

The Group's capital management objective is to maintain a strong capital position consistent with regulatory requirements under the MAS' Notice to Banks No. 637 "Notice on Risk Based Capital Adequacy Requirements for Banks incorporated in Singapore" (Notice 637) and the expectations of various stakeholders, i.e., customers, investors and rating agencies. This objective is pursued while delivering returns to shareholders and ensuring adequate capital resources are available for business growth, investment opportunities as well as adverse situations.

The Group's capital management objective is articulated concretely as capital targets that are consistent with the need to support organic and inorganic business growth in line with its strategic plans and risk appetite. A key tool for capital planning is the annual Internal Capital Adequacy Assessment Process (ICAAP). Through the ICAAP, the Group assesses its forecast capital supply and demand relative to its regulatory and internal capital targets, under various scenarios, including stress scenarios of differing scope and severity, over a 3-year horizon.

The Group seeks to pay sustainable dividends over time, in line with its capital management objective and long-term growth prospects. For the year ended 31 December 2012, the Board has recommended a final dividend of $0.28 per ordinary share, to which the Scrip Dividend Scheme is being applied, bringing the total ordinary dividend for the year to $0.56.

CAPITAL STRUCTURE

The Group manages the structure of its capital resources in order to optimise the cost of these resources relative to the flexibility offered by the different types of resources and regulatory norms. In order to achieve this, the Group assesses the need and the opportunity to raise capital from the financial markets.

During the year, approximately 20 million ordinary shares were issued pursuant to the Scrip Dividend Scheme. This added $268 million to share capital. Refer to Note 35 to the Financial Statements for details on the movement of the Group's share capital and treasury shares during the year ended 31 December 2012.

The Group redeemed two Tier 2 instruments and issued three Tier 2 instruments with a year-on-year net increase in Tier 2 capital of $201 million. Refer to Notes 34 and 35 to the Financial Statements for the terms of the capital instruments other than ordinary shares that are included in Eligible Total Capital.

RISK-WEIGHTED ASSETS

During the year, risk-weighted assets increased in line with asset growth, moderated by savings from the partial divestment of the Group's stake in Bank of the Philippine Islands, ongoing efforts at data and process improvements in the computation of risk-weighted assets and improved credit quality. Refer to 'Pillar 3 Disclosures' section for further details on risk-weighted assets.

CAPITAL ADEQUACY RATIOS

The Group's Tier 1 Capital Adequacy Ratio (CAR) and Total CAR as at 31 December 2012 were well above the MAS' minimum requirements of 6.0% and 10.0% respectively.

The table below sets out the capital resources and capital adequacy ratios for the Group as at 31 December 2012. Refer to 'Ten-Year Summary' for the historical trend of Tier 1 and Total CAR.

In $ millions	**2012**	**2011**
Tier 1		
Share capital	9,645	9,350
Disclosed reserves and others	25,724	23,308
Less: Tier 1 Deductions	(5,173)	(5,123)
Eligible Tier 1 Capital	30,196	27,535
Tier 2		
Loan allowances admitted as Tier 2 Capital	1,283	1,151
Subordinated term debts	5,505	5,305
Eligible revaluation surplus from available-for-sale equity securities	95	29
Less: Tier 2 Deductions	(248)	(192)
Eligible Total Capital	36,831	33,828
Risk-weighted assets	215,591	213,722
CAR (%)		
Tier 1	14.0	12.9
Total (Tier 1 & Tier 2)	17.1	15.8
Pro forma Basel III CET1#		
– under transitional arrangements as at 1 Jan 2013	13.5	
– under final rules effective 1 Jan 2018	11.8	

Under Basel III rules, the proportion of adjustments previously applied to Tier 1 and/or Tier 2 under Basel II to be applied to CET1 will be 20% from 1 Jan 2014, 40% from 1 Jan 2015, 60% from 1 Jan 2016, 80% from 1 Jan 2017 and 100% from 1 Jan 2018

CAPITAL ALLOCATION

The Group allocates capital capacity on two dimensions: by business line and by entity. Capital allocations by business line are set as part of the budget process and monitored during the year. Return on regulatory capital is one of several metrics used to measure business performance. Capital allocations by entity seek to optimise the distribution of capital resources across the Group's various entities, taking into account that overseas subsidiaries and non-banking subsidiaries of the Group may be required to comply with country-specific and industry-specific capital requirements. Capital is allocated to ensure that each subsidiary is able to comply with regulatory requirements as it executes its business strategies in line with the Group strategy. During the course of the year, these subsidiaries did not experience any impediments to the distribution of dividends.

REGULATORY CHANGE

In December 2010, the Basel Committee for Banking Supervision published the Basel III framework (revised in June 2011) to strengthen global capital standards, with the aim of promoting a more resilient banking sector. On 14 September 2012, the MAS revised Notice 637 to implement Basel III capital standards for Singapore-incorporated banks. The Group is required to comply with the revised Notice 637 from 1 January 2013.

The revised Notice 637 sets out a minimum Common Equity Tier 1 (CET1) CAR of 4.5% and a minimum Tier 1 CAR of 6% with effect from 1 January 2013. These will increase progressively to 6.5% and 8% respectively by 1 January 2015. MAS' existing requirement for Total CAR will remain unchanged at 10%. The minimum capital requirements under Notice 637 are 2 percentage points higher than the Basel III minima specified by the Basel Committee. The Basel III CET1, Tier 1 and Total CAR minima are 4.5%, 6% and 8% respectively.

In line with Basel III, the revised Notice 637 also introduces a capital conservation buffer (CCB) and a countercyclical buffer. The capital conservation buffer of 2.5% will be phased in from 1 January 2016 to 1 January 2019 and will be an additional requirement above the CET1, Tier 1 and Total CAR minima. The countercyclical buffer will be phased in from 1 January 2016 to 1 January 2019. It is not an ongoing requirement but only applied as and when specified by the relevant banking supervisors. These two buffers are to be maintained in the form of CET1 capital.

The table below summarises the capital requirements under Notice 637.

From 1 Jan	2013	2014	2015	2016	2017	2018	2019
Minimum CAR %							
CET1 *(a)*	4.5	5.5	6.5	6.5	6.5	6.5	6.5
CCB *(b)*	–	–	–	0.625	1.25	1.875	2.5
CET1 including CCB *(a) + (b)*	4.5	5.5	6.5	7.125	7.75	8.375	9.0
Tier 1	6.0	7.0	8.0	8.625	9.25	9.875	10.5
Total	10.0	10.0	10.0	10.625	11.25	11.875	12.5
Countercyclical Buffer	–	–	–	0.625	1.25	1.875	2.5

In addition to changes in minimum capital requirements, Basel III also mandates various adjustments in the calculation of capital resources. These adjustments will be phased in from 1 January 2013 and are for items such as goodwill, and investments exceeding certain thresholds.

Lastly, Basel III has revised the criteria for the eligibility of capital instruments. The Group's existing preference shares and subordinated term debts are ineligible in the first instance as capital instruments under Basel III rules as they lack provisions for conversion to ordinary shares or write-down at the point of non-viability as determined by the MAS, but are accorded partial recognition under the Basel III transitional arrangements.

On a pro forma basis, the Group's Basel III CET1 CAR as at 31 December 2012 was 13.5% based on transitional rules effective on 1 January 2013 and 11.8% on a "look-through" basis, i.e., after all adjustments that will eventually be taken against CET1 by 1 January 2018. These levels exceed the minimum CET1 CAR requirements under Notice 637 of 4.5% effective on 1 January 2013 and 9.0% effective on 1 January 2019 and take into account higher risk-weights for exposures to financial institutions and new capital charges for over-the-counter derivatives under Basel III.

The Group is well-positioned to comply with other forthcoming Basel III requirements, viz., leverage ratio, liquidity coverage ratio and net stable funding ratio.