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Industry Consultation on Amendments to Section 29 of The Banking Act

MAS Monetary Authority of Singapore

INDUSTRY CONSULTATION ON AMENDMENTS TO SECTION 29 OF THE BANKING ACT

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1 INTRODUCTION

1.1 Section 29 of the Banking Act sets prudential limits on credit facilities extended by banks to a single borrower or group of related borrowers and is designed to limit concentration risk. It also sets limits on unsecured credit facilities to counterparties related to the bank to limit contagion risk and to minimise the scope for conflicts of interest. The various limits are summarised below:

Subsection	Policy Objective
S.29(1)(a): Single borrower limit (SBL) of 25% of capital funds.	Minimise concentration risk.
S.29(1)(b): Substantial loans limit (SLL). A clustering limit that limits the aggregate of all substantial loans[1] granted to 50% of total credit facilities.	
S.29 (1)(d): Limit of $5,000 on unsecured credit facilities to directors, director-related entities and related corporations of the bank.	To reduce scope for conflict of interest arising from related party lending and to limit risk of contagion from other entities in the group.
S.29(1)(e): Limit on unsecured loans to employees of the bank (other than directors) to one year's emoluments.	

1.2 MAS proposes a number of changes to section 29 of the Banking Act to ensure that the prudential limits remain relevant and are in line with international best practices. The proposals include a shift away from limits based on credit facilities granted to a more all-encompassing approach based on exposures. We also propose changes to rules for determining when parties to whom a bank has exposures constitute a "single risk", and changes to limits on exposures to parties connected to the bank.

[1] Any credit facility granted by a bank to a single person or to any group of persons under the control or influence of a single person which in the aggregate exceeds 15% of the bank's capital funds.

2 SHIFT TO AN EXPOSURES-BASED APPROACH

Computation of Exposures in the Numerator

2.1 Section 29(1)(a) of the Banking Act limits credit facilities[2] granted by a bank to any one person, or group of persons under the control or influence of any one person, to 25% of its capital funds, while section 29(1)(b) limits substantial loans to 50% of total credit facilities. These sections seek to limit large risk concentrations, and hence the maximum possible loss arising from the failure of a single counterparty or group of related counterparties. However, the existing approach sets limits only on the amount of credit facilities granted by a bank. It does not capture all of a bank's exposures to a counterparty that could lead to losses to the bank, e.g. from the diminution in value of equity investments, or from the cost of replacing off-balance sheet transactions, in the event that the counterparty fails.

2.2 A more all-encompassing exposures-based approach that seeks to capture all on- and off-balance sheet exposures will transform the section 29(1)(a) single borrower limit and the section 29(1)(b) substantial loans limit into large exposures and substantial exposures limits, respectively. This approach to setting prudential limits based on exposures is consistent with the practice in most major jurisdictions.

2.3 Instead of setting out a prescriptive approach for the computation of exposures, a general definition of exposures is proposed to provide the key guiding principle for determining the nature and size of an exposure:

> *An exposure is the maximum loss that a bank may incur as a result of the failure (assuming no recovery value) of a counterparty to meet its obligations to the bank, including losses that may be incurred on credit facilities, equity investments, contingent liabilities, or other transactions with the counterparty.*

2.4 Specific provisions made against an exposure may be netted off against the exposure amount. Annex A proposes changes to the valuation

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[2] Section 2(1) of the Banking Act defines credit facilities to mean:

a) the granting by a bank of advances, loans, and other facilities whereby a customer of the bank has access to funds or financial guarantees; or

b) the incurring by a bank of other liabilities on behalf of a customer.

methodology, as well as illustrative examples of how the exposures generated by various transactions may be computed.

2.5 A bank does not need to count towards the limits an exposure to the issuer of an asset if the title to the asset and the associated risks and rewards are completely transferred to another party with no recourse to the bank. Examples include outright asset sales and fully funded synthetic asset securitisation transactions which satisfy the clean sale criteria detailed in MAS Notice 628. The requirement for a synthetic sale to be fully funded, i.e. accompanied by cash payment or deposit, minimises the bank's exposure should the transferee default and is consistent with the recognition of cash as qualifying collateral in the following paragraph.

Exemptions And Qualifying Collateral

2.6 Section 29(2) of the Banking Act exempts certain transactions from the limits in section 29(1). We have reviewed the relevance of these exemptions, and propose to remove the exemptions for the following transactions as there is little prudential justification for continuing to exempt such transactions.

a) The purchase of telegraphic transfers or loans or advances made against telegraphic transfers.

b) Any facility granted against letters of credit or bills or guarantees or documents in respect of imports into or exports from Singapore.

Corporate credit card facilities granted by a bank will continue to be an exempted transaction if such facilities are fully secured by cash collateral.

2.7 We also propose in Annex B a number of revisions and additions to the list of exemptions, taking into account practices in other advanced jurisdictions, as well as the prescriptions in the Standardised Approach to capital requirements for credit risk under the new Basle Capital Framework. The revised list of exemptions includes, *inter alia*, exposures to certain categories of sovereigns and selected multilateral development banks, as well as exposures to banks in Singapore with residual maturity not exceeding one year.

2.8 For an exposure that is secured by cash or government securities, the value of the collateral can be used to offset against the amount of the exposure provided the collateral satisfy the conditions set out in Annex B.

Changes to the Denominator

2.9 The existing section 29(1)(a) single borrower limit is set as a percentage of a bank's capital funds. We propose that for compliance with the relevant provisions of the Banking Act, including section 29, by banks incorporated in Singapore, "capital funds" be replaced by "eligible total capital" as defined in MAS Notice 637. Eligible total capital include innovative Tier I and Tier II instruments as capital, with deductions made for goodwill and investments in unconsolidated banking and financial subsidiary companies.

2.10 The definition of capital funds for foreign bank branches will remain unchanged[3].

Threshold for Substantial Exposures

2.11 In section 29(1)(b) of the Banking Act, a "substantial loan" is defined as credit facilities granted to a single person or to any group of persons under the control or influence of a single person, which in the aggregate exceeds 15% of a bank's capital funds. The Core Principles for Effective Banking Supervision issued by the Basle Committee on Banking Supervision suggest a threshold of 10% of capital for classifying substantial exposures. This is also the threshold adopted by most foreign regulators. To be in line with international practice, we propose that the threshold for an exposure to be classified as a substantial exposure be set at 10% of eligible total capital or capital funds, as the case may be. The aggregate amount of all such substantial exposures will continue to be limited to 50% of total exposures.

Supervisory Flexibility to Raise Limits

2.12 To facilitate greater supervisory flexibility, we propose to amend the Banking Act to permit MAS to raise the single counterparty exposures limit in section 29(1)(a) and the substantial exposures limit in section 29(1)(b) for individual banks on a case-by-case basis, subject to conditions that MAS may impose. However, MAS will not ordinarily approve any application for higher exposure limits unless it is supported by strong justification.

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[3] The ACUs of foreign bank branches will, in line with the provisions of section 77(4)(a) of the Banking Act, continue to be exempted from section 29(1)(a), (b) and (d)(iv) of the Banking Act.

3 SINGLE RISK

3.1 The proposed framework will require a bank to aggregate its exposures to entities posing a *single risk* to the bank. The following entities will be regarded as posing a single risk:

a) entities under common control; and

b) entities which are financially interdependent.

Where two entities are financially interdependent, the bank should also aggregate exposures to all other entities controlling, controlled by, or under common control with, the two interdependent entities.

Entities under Common Control

3.2 Section 29(1)(a) and (b) require credit facilities to entities under *common control* to be aggregated for the purpose of compliance with the single borrower limit and the substantial loans limit. The rationale is to aggregate the exposures to counterparties that could pose a *single risk* to the bank because of the potential for liquidity or solvency difficulties to be transmitted from one entity to another within the group.

3.3 We propose to adopt the following definitions of "control": A person (either a natural person or legal person) is deemed to exercise control over a entity if:

a) the person owns at least 20% of the shares of the entity;

b) the person controls at least 20% of the voting power in the entity; or

c) the directors of the entity are accustomed or under an obligation, whether formal or informal, to act in accordance with the directions, instructions or wishes of that person, or the person is in a position to determine the policy of the entity.

3.4 Where there are multiple-level shareholdings, the above tests for control should be applied at every level, and the bank should aggregate exposures to all entities to which the chain of control extends.

3.5 The reference to "a natural person" in paragraph 3.3 includes the "associates" of a person as defined in section 15B(4)(c)(i) of the Banking Act, i.e. the spouse, parent, remoter lineal ancestor, step-parent, son, daughter, remoter issue, step-son, step-daughter, brother and sister of the person.

Financial Interdependence

3.6 The concept of *common control* alone does not capture all situations under which a group of entities pose a single risk to a bank. We therefore propose to require aggregation of exposures in all situations where there is either common control or *financial interdependence*.

3.7 Financial interdependence is defined to include instances where two or more natural or legal persons have some legal or economic relationship with each other such that if one were to experience difficulties in meeting its financial obligations, the other(s) would likely encounter similar difficulties. Examples include situations where one entity derives a significant amount (50% or more) of its gross revenues from its transactions with another; or where an entity would be materially and adversely affected by the default of other entities to which it is financially linked.

3.8 An individual and his associates referred to in paragraph 3.5 above will be presumed to be financially interdependent unless the bank has a sound basis for determining that the individual family members have resources of their own to meet their obligations without depending on each other and the exposures that arise from credit facilities granted are not for the use of other family members. The basis for not aggregating such exposures should be documented.

3.9 Members of a partnership, joint venture or other common enterprise will similarly be presumed to be financially interdependent unless the bank has a similar basis for determining financial independence, i.e., individual members have resources of their own to meet their obligations without depending on each other and the exposures that arise from credit facilities granted are not for the use of other members. The basis for not aggregating such exposures should be documented.

3.10 These examples are non-exhaustive and a bank should aggregate its exposures if there is any other reason to believe that the entities concerned are financially interdependent.

Aggregation Even If Controlling Entity Does Not Borrow

3.11 MAS Notice 623 provides general guidance to banks on the aggregation of credit facilities to various borrowers. Aggregation of credit facilities to entities under common control is generally not required if the

controlling entity does not borrow.[4] Under the new framework, we propose that all exposures to entities under common control should be aggregated, regardless of whether the controlling entity borrows. Doing so will more appropriately reflect the reality of entities under common control posing a single risk to the bank, since a controlling entity is in a position to determine the way financial resources are allocated or transferred between entities under its control.

Criteria for Disaggregation of Exposures

3.12 As stated above, banks should aggregate exposures to entities as long as common control or financial interdependence exists. However, MAS recognises that there may be situations where despite the existence of common control by virtue of shareholding or voting power, entities within the group do not necessarily pose a single risk to the bank. Such situations could exist where there is *financial independence* between the entities within the group.

3.13 We therefore propose that disaggregation of exposures be allowed where banks have a sound basis to determine that, despite being under common control, an entity is financially independent of the parent as well as other entities within the group such that the failure of this entity will not cause the failure of the parent or the group and vice-versa. The evidence and basis for such a determination should be documented and should, at the minimum, satisfy all of the following conditions:

a) The entity to be disaggregated has resources of its own to fully service its liabilities, and does not need to depend on any other entity within the group for assistance in meeting its financial obligations.

b) Proceeds from the banking facility are used by the entity to be disaggregated solely for its own operations, and are not transferred to any other entity within the group.

c) The entity to be disaggregated is not dependent on any other entity within the group, either singly or in aggregate, for more than 50% of its operating revenues.

d) The entity to be disaggregated does not use any name, logo or trade mark in a manner which indicates or represents that the entity is related to or associated with other entities in the group.

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[4] The only exceptions to this are where the parent guarantees the loan of a subsidiary; where the loan is for the use of the parent; or where loans are made to financially interdependent subsidiaries.

e) The entity to be disaggregated is listed on a recognised exchange under the Securities and Futures Act, or rated by either Standard & Poors, Moody's, or Fitch IBCA.

f) A majority of the directors of the entity to be disaggregated are independent of the controlling entity and does not share executive officers with any other entity within the group. It must also be shown that the controlling entity does not in fact exercise control over the management or the board of directors of the entity.

3.14 For an entity to be disaggregated, conditions (a) to (d) must also be met by the entity(ies) from which it is to be disaggregated. For example, if entity A is to be disaggregated from the rest of the group comprising entities B and C, A must not depend on B and/or C to meet its financial obligations, and likewise B and/or C should not depend on A to meet their financial obligations.

3.15 The conditions above will also allow the disaggregation of a sub-group of entities, if they are met by each entity in the sub-group vis-à-vis the rest of the group. For condition (e), it will be sufficient for one of the entities within the sub-group to be listed and rated.

3.16 Notwithstanding the above, a bank should continue to aggregate exposures to entities within a particular borrower group if there are reasons to regard these exposures as connected in such a way as to pose a single risk to the bank. MAS will also reserve the right to require such exposures to be aggregated for compliance with section 29(1)(a) and (b) if there is sufficient justification to demonstrate that the entities within a group pose a single risk to the bank.

4 EXPOSURES TO THE SUBSTANTIAL SHAREHOLDER GROUP AND FINANCIAL ARM

Exposures to the Substantial Shareholder Group

4.1 The limits on large exposures and substantial exposures, and the rules for aggregation of exposures as described in section 3 above, also apply to a bank's exposure to its substantial shareholder group (SSG). In addition to the concentration risk that these two limits seek to contain, a bank's exposures to its substantial shareholders and their affiliates could also give rise to contagion risk and the potential for non-arm's length transactions.

4.2 To address these other risks, we propose to impose an aggregate *unsecured exposures* sub-limit of 5% of eligible total capital to the bank's exposures to each of its SSG. Where an exposure is backed by security but the security does not meet certain specified criteria, the exposure should be deemed unsecured, and the full value of the exposure should be included for compliance with the 5% sub-limit. Annex C sets out the criteria for determining whether a particular collateral is considered acceptable security for this purpose.

4.3 The SSG will be defined as the substantial shareholder and his "associates" as defined in section 15B(4)(c)(i) of the Banking Act (includes the spouse, parent, remoter lineal ancestor, step-parent, son, daughter, remoter issue, step-son, step-daughter, brother and sister of the substantial shareholder), or entities in which the substantial shareholder or his associates hold a major stake. *"Major stake"*[5] will have a similar meaning as in section 32(7) of the Banking Act.

4.4 The limit on exposures to the SSG will be applied to banks incorporated in Singapore. Substantial shareholders of Singapore-incorporated banks are required to be approved by MAS, and will be required to provide information to the bank to enable the bank to comply with these provisions. The limit will not be applied to branches of foreign

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[5] Section 32(7) of the Banking Act defines major stake to mean:

a) any beneficial interest exceeding 10% in the share capital of a company;

b) control over more than 10% of the voting power in a company; or

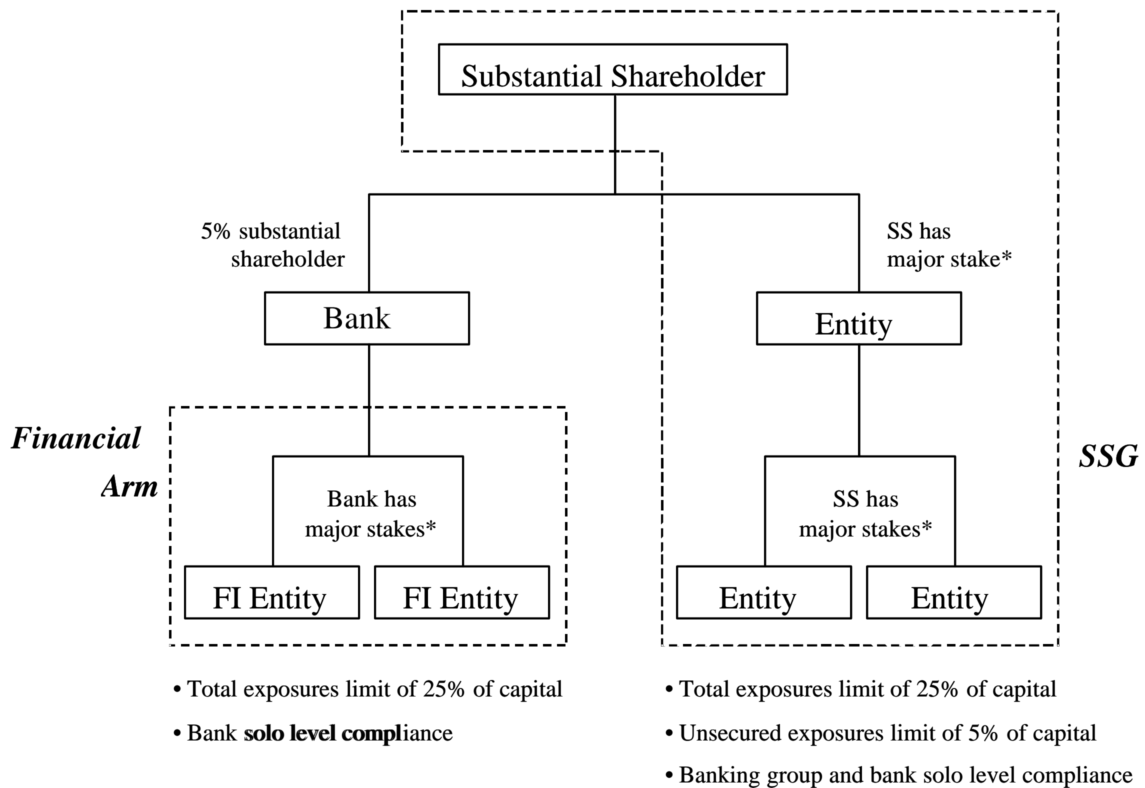
c) any interest in a company, where the directors of the company are accustomed or under an obligation, whether formal or informal, to act in accordance with the bank's directions, instructions or wishes, or where the bank is in a position to determine the policy of the company.

banks, as substantial shareholders of foreign banks are not within MAS' regulatory ambit.

Exposures to the Bank's Financial Arm

4.5 Section 29(1)(d)(iv) prohibits a bank from granting unsecured credit facilities exceeding $5,000 to related corporations of the bank. We propose removing this limit. With banks in Singapore having divested their non-financial businesses as required under section 32 of the Banking Act by July 2006, related corporations of a bank will comprise only entities engaging in financial activities approved by MAS. Removing the $5,000 limit will facilitate a bank's funding of the operations of its related entities. However, as the risks to the bank from such exposures is not immaterial, the large exposure limit of 25% of eligible total capital or capital funds, as the case may be, will be applicable to the bank's exposures to its financial arm comprising companies in which the bank holds a "major stake" as defined in section 32(7) of the Banking Act and which are required to be approved under that section. For banks not incorporated in Singapore, this limit will be applicable only to the financial businesses held by and reflected in the books of the Singapore branch.

4.6 The above limits and aggregation rules for the bank's exposure to its substantial shareholder group and financial arm are depicted in the following diagram:



5 EXPOSURES TO DIRECTORS AND DIRECTOR-RELATED ENTITIES

Shift to Exposures-Based Limits

5.1 Section 29(1)(d)(i), (ii), and (iii) presently sets a $5,000 limit on aggregate unsecured credit facilities granted by a bank to a director of the bank, to a firm in which a director has an interest, or to a company that is owned or controlled by a director. The intent of this limit is to reduce the scope for conflicts of interest arising from non-arms length transactions with directors and director-related entities.

5.2 In line with the shift to an exposures-based framework under section 29(1)(a) and (b), we propose that the $5,000 unsecured limit should similarly be applied on all exposures instead of only to credit facilities granted to a director and his related entities. This limit would apply on a per-director-group basis, i.e. the limit applies to the aggregate exposures to all entities that are related to the director. Where an exposure is not backed by security meeting the criteria set out in Annex C, the exposure should be deemed unsecured, and be subject to the limit on unsecured exposures.

Exposures to Companies Owned or Controlled by a Director

5.3 Section 29(1)(d)(iii) exempts director-owned or controlled companies listed on approved stock exchanges from the $5,000 unsecured credit facilities (exposures) limit. We propose removing this exemption. The risk of non-arms length transactions between a bank and any company owned or controlled by a director of the bank exists regardless of whether the company is listed on a stock exchange. However, if a director of a bank exercises control over a company by virtue of the bank's holding of a major stake in the company rather than in his personal capacity, the $5,000 unsecured exposures limit to director-related entities will not apply to the bank's exposures to the company, but the exposures will be included in the 25% large exposure limit on the bank's exposures to its financial arm.

Exemptions from the $5,000 Unsecured Exposures Limit

5.4 Whilst section 29(1)(d) is intended to minimise potential conflicts of interest in transactions between the bank and its directors, it also restricts the directors of a bank from being granted basic credit facilities that are available to the bank's customers or its employees. We therefore propose that the following exposures be exempted from the $5,000 limit on unsecured exposures to directors of a bank:

a) *Credit card facilities granted to directors.* This recognises the fact that such cards generally serve as transactional payment instruments. However, the existing requirements for the issuance of credit cards in the Banking (Credit Card and Charge Card) Regulations will continue to apply.

b) *Exposures to directors who are full-time employees of the bank.* We propose to regard these as exposures to employees of the bank under section 29(1)(e).

Joint and Several Liability of Directors

5.5 In line with the shift to an exposures-based limits framework for section 29(1)(a) and (b), section 29(4) on the joint and several liability of directors for losses arising from any unsecured credit facility, or any credit facility which subsequently becomes unsecured, granted to directors and director-related entities, will also be extended to cover all unsecured exposures to directors and director-related entities.

6 GROUP COMPLIANCE AND IMPLEMENTATION

Group Compliance

6.1 In addition to solo bank-level compliance with section 29(1)(a) and (b), MAS Notice 625 also requires a bank to aggregate its credit facilities with those of its subsidiaries for the purpose of securing group compliance with section 29(1)(a) and (b). In line with the shift to exposures-based limits and to ensure comparability and consistency of the numerator and denominator, we propose to change the numerator to group exposures and the denominator to eligible total capital, or capital funds, as the case may be, at the group level for group compliance with section 29(1)(a) and (b).

6.2 MAS Notice 625 currently prescribes a pro-rated aggregation of credit facilities granted by the bank's subsidiaries based on the bank's percentage shareholding in the respective subsidiaries. We propose that exposures granted by the bank's subsidiaries be aggregated in full with the exposures granted by the bank, rather than on a pro-rated basis. This is because a subsidiary is an integral part of the banking group. If a subsidiary faces a financial default as a result of a default by its counterparty, the bank is likely to be faced with the moral obligation to rescue its subsidiary because of reputational considerations. As such, the bank may have to make good the losses incurred by the subsidiary.

6.3 In addition, we propose that exposures granted by the bank's associated companies be aggregated on a pro-rated basis with the exposures granted by the bank, on the basis that the bank may have to bear losses arising from its associates' exposure to the defaulting counterparty in proportion to its shareholding in the associates. However, MAS may require exposures of an associated company to be aggregated in full if it is of the opinion that, having regard to the entire relationship between the bank and the associated company, the exposures of the bank through the associated company is in fact greater than the amount pro-rated by the shareholding of the bank in the associated company.

6.4 Group compliance will also be extended to the $5,000 unsecured exposures limit to directors of the bank and their related entities, and the limit on unsecured exposures to employees of one year's emoluments.

6.5 Subsidiaries and associated companies of the bank may include insurers and asset management companies that hold assets in their insurance or investors' funds. Exposures to counterparties arising from such assets

held for the benefit of third parties (other than the bank or other group entities) will be excluded from the exposures limits in the section 29 framework.

6.6 In relation to a bank in Singapore that is incorporated outside Singapore, a reference to an "associated company" or "subsidiary" of the bank is a reference to a company that is an associated company or subsidiary of the bank which is attributable to investments held by the bank and reflected as such in the books of the bank in Singapore.

Implementation

6.7 We propose to implement the above changes in two years from the approval of the Banking Act amendments in Parliament, in order to provide banks sufficient time to make the appropriate adjustments.

Annex A

COMPUTATION OF EXPOSURES

1 INTRODUCTION

1.1 This Annex provides the principles that banks should use in their computation of exposures for the purpose of compliance with the proposed large exposures and substantial exposures limits. **Given the variety of financial transactions undertaken by banks with their customers, it is not the intention of MAS to prescribe an exhaustive list of exposures and computation methodologies for exposures.** Banks should take cognizance of the principles laid out in the examples below to determine the amount of exposures to each counterparty.

2 DEFINITION AND COMPUTATION

2.1 *Exposure:* An exposure is the maximum loss that a bank may incur as a result of the failure (assuming no recovery value) of a counterparty to meet its obligations to the bank, including losses that may be incurred on credit facilities, equity investments, contingent liabilities or other transactions with the counterparty.

2.2 The applicable value of a facility will be taken to mean the full approved limit or to the amount outstanding, whichever is greater.

2.3 Exposures may be grouped into two broad categories – on balance sheet and off balance sheet exposures. Some examples of these exposures and the methodology to compute the amount of exposure are provided below.

a) *On Balance Sheet Exposures*

	Instrument	Exposure Computation
1	Loans, overdrafts, revolving credit facilities.	The full value of such facilities, including the undrawn portion and accrued interest, should be counted as an exposure to the borrower.

	Instrument	Exposure Computation
2	Equity or debt security	The mark-to-market value of the investment should be counted as an exposure to the issuer of the security. Capital investments that are required to be deducted from eligible total capital under for the purposes of regulatory capital computation may be excluded from the computation of exposure. .
3	Linked spot and forward purchases of securities, e.g. repurchase transactions/reverse repurchase transactions or other 'securities lending' transactions that function economically like a secured loan.	Where the bank sells a security with an agreement to buy it back at a specified date and price, the bank is required to count towards section 29 exposures to the counterparty, as well as to the issuer of the security. In the case of a repurchase transaction, the following should be counted towards section 29: i) The replacement cost of the security, less the cash received by the bank should be counted as an exposure to the counterparty. ii) The mark-to-market value of the securities lent by the bank should continue to be counted as an exposure to the issuer of the security. In the case of a reverse repurchase transaction (bank buying the security with an agreement to sell back the security at a specified future date and price, i.e. bank giving a secured loan), the amount due from the counterparty (i.e. sum of principal and interest) when the bank returns the security to the counterparty should be counted as an exposure to the counterparty. Where the security received is a qualifying collateral as set out in paragraph 2.1 of Annex B, the exposure may be reduced by the mark-to-market value of the security. There is no exposure to the issuer of the security for the purpose of compliance with section 29, as the counterparty is obliged to buy back the security at the pre-agreed price even if the issuer were to default.
4	Discounted bills held by the bank.	With the exception of re-discounted bills, the face value of the bill should be counted as an exposure to the acceptor of the bill. In the case of re-discounted bills, the bank should count towards section 29 an exposure to the re-discounting bank.

	Instrument	Exposure Computation
5	Outstanding claims against a counterparty arising from its failure to settle foreign exchange or other transactions with the bank	The amount of outstanding claims should be counted as an exposure to the counterparty.
6	Accounts receivable	The full amount of accounts receivable should be counted as an exposure to the debtor.

b) *Off Balance Sheet Exposures*

	Instrument	Exposure Computation
1	Direct credit substitutes such as guarantees issued by the bank, bills accepted but not held by the bank, etc.	The facility limit should be counted as an exposure to the customer.
2	Transaction related contingent items: Standby letters of credit relating to particular transactions performance bonds, bid bonds and warranties.	The facility limit should be counted as an exposure to the customer.
3	Short-term self-liquidating trade related credits: Documentary credits collateralized by underlying shipments.	The facility limit should be counted as an exposure to the customer.
4	Asset sales or other transactions where there is recourse to the bank.	The mark-to-market value of the asset should be counted as an exposure to the issuer of the underlying asset, since the counterparty is entitled to return the asset to the bank if its value deteriorates within a specified time frame.
5	Forward purchase /sale agreements	The replacement cost of the forward contract should be counted as an exposure to the counterparty, for both forward purchase and sale agreements. In the case of a forward purchase agreement, the amount of the underlying asset valued at the forward purchase price should be counted as an exposure to the issuer of the asset.

	Instrument	Exposure Computation
6	Note issuance facilities and revolving underwriting facilities	An amount equivalent to the facility limit multiplied by 50% should be counted as an exposure to the issuer of the security.
7	Securities underwriting commitments	An amount equivalent to the commitment limit multiplied by 20% should be counted as an exposure to the issuer of the securities underwritten. On the earlier of the issue date or eight weeks from the date of launch of the issue, the amount of securities that has not been sold must be counted as an exposure to the issuer of the securities.
8	Re-discounted bills	A bank which has re-discounted a bill should continue to count towards section 29 an exposure to the customer.
9	Credit derivative transactions, including credit default swaps and total return swaps.	Bank as: a) Protection Seller The following should be counted as an exposure to the issuer of the reference asset, as the bank has to pay the protection buyer if the issuer defaults: • For credit default products, the exposure to be counted is the credit event payment to the protection buyer in the event the issuer defaults;. • For total return products, the exposure to be counted is the mark-to-market value of the reference asset. Where the reference assets consist of multiple names, the bank should count towards section 29 an exposure to each asset in the underlying basket equivalent to the amount of the credit event payment that would be triggered should that asset default. Accordingly, for a first-to-default product, the bank should count towards section 29 an exposure to each asset in the underlying basket of assets equivalent to the amount of the credit event payment. b) Protection Buyer The replacement cost of the protection should be counted as an exposure to the protection seller, given that the bank loses the protection that it has purchased if the protection seller defaults.

	Instrument	Exposure Computation
10	Options on securities/warrants	Puts Written. The amount of the underlying security valued at the strike price should be counted as an exposure to the issuer of the security, since the counterparty will exercise the option to sell the security to the bank at the strike price should the market price drop below the strike price. Puts Purchased. The replacement cost of the put option should be counted as an exposure to the seller of the put. Calls Written. There is no necessity to count towards section 29 an exposure to the issuer of the underlying security since the writer of the call will not incur any loss as a result of the default of the issuer. The option will simply expire worthless to the buyer. Calls Purchased. The replacement cost of the option should be counted as an exposure to the seller of the call.
11	Financial instruments that generate a combination of both on and off-balance sheet exposures, e.g. equity linked notes ("ELNs") and credit linked notes ("CLNs").	Both the on and off-balance sheet exposures should be counted towards section 29. For example, in the case of a CLN where the bank is the protection seller, the principal and interest payable on the note if no credit event occurs should be counted as an exposure to the issuer of the note (the protection buyer). The maximum amount by which such payment would be reduced as a result of a credit event should be counted as an exposure to the issuer of the reference asset. Where the protection buyer is a special purpose vehicle (SPV) that has been specially set up to issue the notes, the protection seller should also count towards section 29 an exposure to the issuer of the collateral securities that are acquired by the SPV with the proceeds from the issuance of the note. Paragraph 5 sets out additional rules relating to SPVs. In the case of a CLN where the bank is the protection buyer, it may reduce the dollar amount of its exposure to the issuer of the reference asset by the amount of funding received. This is in line with the proposal in Annex B to recognise cash collateral as qualifying collateral.

3 OFF BALANCE SHEET PRE-SETTLEMENT EXPOSURES

3.1 Pre-settlement exposures can be calculated using the methodology for computing exposures set out in Section 2 above, plus an add-on for potential future exposure calculated on the basis of the total notional principal amount of its book. MAS proposes to adopt the add-ons proposed

by BIS under the new capital adequacy framework, as detailed in the following table.

Residual Maturity	Interest Rate	FX & Gold	Equity	Precious Metals (Except Gold)	Other Commodities
One year or less	0.0%	1.0%	6.0%	7.0%	10.0%
Over one year to five years	0.5%	5.0%	8.0%	7.0%	12.0%
Over five years	1.5%	7.5%	10.0%	8.0%	15.0%

3.2 However, a number of banks have been developing internal market risk models as part of their preparations for the new capital adequacy framework. MAS is prepared to allow banks to use add-ons generated by their internal market risk models for calculating exposures, provided that these models have been validated by their home regulators or by MAS for capital adequacy purposes.

4 EXPOSURES TO AN INDEX OR INVESTMENT FUND

4.1 A bank may take on exposures to underlying assets through investing in an index or an investment fund. A strict application of the exposures-based approach would require banks to look-through to the issuer of each underlying asset. However, we recognise that this may not be practicable or necessary in all situations due to the difficulty in monitoring exposures to a large number of issuers which, on an individual basis, may be immaterial relative to the size of the bank's capital funds. We therefore propose that a bank be required to look through to the issuer of an underlying component of an index or an underlying asset in an investment fund only where the proportionate exposure to the issuer through the index or investment fund would exceed 0.25% of the bank's eligible total capital or capital funds, as the case may be.

5 EXPOSURES TO SPECIAL PURPOSE VEHICLES

5.1 Banks may from time to time enter into transactions with special purpose vehicles (SPVs). As SPVs typically do not have financial resources of their own apart from the underlying assets, banks should look through the SPV and count towards section 29 an exposure to the issuer of the underlying assets instead of to the SPV. For reasons similar to those outlined in section 4, banks will be required to look through to the issuer of

the underlying asset where the effective exposure[6] to the issuer through the SPV would exceed 0.25% of the bank's eligible total capital or capital funds, as the case may be.

5.2 MAS recognizes that there may be instances where banks face practical difficulties looking through the SPV to its underlying assets. An example would be where an SPV is unable to disclose the nature of the assets it holds. Under such circumstances, banks may count towards section 29 an exposure to the SPV in place of the underlying assets. However banks should document the reasons for their inability to look through the SPV, and have these available to MAS for review.

[6] Where there is more than one underlying asset, the effective exposure to each issuer is the lower of (a) the exposure to the SPV and (b) the book value of the underlying asset.

Annex B

EXEMPTIONS AND QUALIFYING COLLATERAL

1 EXEMPTIONS

1.1 MAS proposes to exempt the following exposures from inclusion in the large exposure/substantial exposure limits:

a) Exposures to the Singapore Government, including holdings of SGS, and MAS. Banks should note that exposures to statutory boards are not considered exposures to the Government.

b) The following exposures to central banks or central governments of sovereign countries:

   i. The exposure is to a central bank or a central government which is rated Aaa (or its equivalent) by at least two of the following rating agencies: Standard & Poor's, Moody's and Fitch IBCA.[7]

   ii. The exposure is granted by the bank's overseas branch or subsidiary to the central bank or central government of the jurisdiction where the branch or subsidiary is located, subject to the following conditions:

      - It is to meet the statutory liquidity and reserves requirement or other statutory requirements imposed by the central bank in the jurisdiction concerned, or
      - It is denominated in the local currency of the jurisdiction concerned and its original maturity is not greater than three months. The amount to be exempted from the exposure limits is capped at the amount of the local currency denominated liabilities of the branch or subsidiary concerned.

[7] The rating assessments should generally be in respect of the sovereign's long-term domestic rating for domestic currency obligations and foreign rating for foreign currency obligations.

c) Exposures to the following multilateral development banks:[8]

- The World Bank Group, comprising of the International Bank for Reconstruction and Development (IBRD) and the International Finance Corporation (IFC).
- The Asian Development Bank (ADB).
- The European Bank for Reconstruction and Development (EBRD), the Council of Europe Development Bank (CEDB), the European Investment Bank (EIB), and the Nordic Investment Bank (NIB).
- The Inter-American Development Bank (IADB) and the Caribbean Development Bank (CDB).
- The African Development Bank (AfDB).

d) Exposures guaranteed by the entities listed under paragraphs 1.1(a), 1.1(b)(i), and 1.1(c). These guarantees should be unconditional, irrevocable and payable on demand.

e) Interbank exposures with original maturity of less than a year to banks in Singapore or to overseas branches[9] of Singapore-incorporated banks.

2 QUALIFYING COLLATERAL

2.1 The portion of an exposure secured against the following qualifying collateral can be offset from the original amount of exposures:

a) Cash.

b) Securities issued by central banks and central governments of sovereign countries that are exempt under paragraphs 1.1(a) and 1.1(b)(i).

2.2 Such collateral must be marked-to-market on a daily basis. All collateral arrangements must also be properly documented, and the bank must take all steps necessary to fulfil statutory and contractual requirements in respect of the enforceability of security interest – for example, by registering a security interest with a registrar. The bank must have proper internal legal procedures relating to the liquidation of collateral upon the

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[8] These are accorded a 0% risk weight under the Basle II standardised approach.

default of customers, with a view towards timely liquidation. If the securities are held by a custodian, the bank must satisfy itself that there is adequate segregation between the collateral instruments and the custodian's own assets.

2.3 The bank should compute the difference between the daily mark-to-market value of the collateral and the mark-to-market value of the original exposure as its net exposure. Where the original exposure is not marked-to-market (for instance for exposures in the banking book) the bank should compute the difference between the daily mark-to-market value of the collateral and the book value of the original exposure as its exposure.

2.4 Where the original exposure and collateral are denominated in different currencies, a haircut (based on the haircuts for FX pre-settlement exposure calculations detailed in paragraph 3.1 of Annex A) will be applied to the collateral's mark-to-market value.

Annex C

ACCEPTABLE SECURITY FOR RELATED PARTY EXPOSURES

MAS proposes the following criteria to be applied to collateral arrangements to determine if a related party exposure is unsecured in relation to the limit of 5% of capital funds for unsecured exposures to a bank's SSG, and $5,000 for unsecured exposures to a bank's directors and director-related entities.

a) All collateral arrangements must be properly documented, and the bank must take all steps necessary to fulfil statutory and contractual requirements in respect of the enforceability of security interest – for example, by registering a security interest with a registrar.

b) The bank must have proper internal legal procedures relating to the liquidation of collateral upon the default of customers, with a view towards timely liquidation.

c) If the securities are held by a custodian, the bank must satisfy itself that there is adequate segregation between the collateral instruments and the custodian's own assets.

d) The exposure should be secured at all times.

e) The market value of the collateral should be readily determinable.

f) The value of the collateral should not have a material positive correlation with the credit quality of the counterparty.

2 Examples of assets that are generally regarded as acceptable security include cash deposits, marketable equity and debt securities, and property. On the other hand, securities issued by the counterparty, a related group entity, or an entity in the substantial shareholder group would provide little protection, and hence would not be acceptable. In addition, guarantees and letters of credit will not be regarded as acceptable security.

Monetary Authority of Singapore