



## **DIRECTIVE 9**

13 April 2010

### **DIRECTIVES TO MERCHANT BANKS**

(Directive 9 dated 12 June 2009 is hereby cancelled)

#### **INVOLVEMENT IN TRADE**

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9(1) A merchant bank shall not engage, whether on its own account or on a commission basis, and whether alone or with others, in the wholesale or retail trade, including import or export trade, except in the course of satisfaction of debts due to it for the purpose of carrying on its merchant banking business.

(2) Notwithstanding Directive 9(1) and subject to Directive 9(9), a merchant bank may carry on the business of purchasing and selling assets if such business is carried on under the following arrangement:

- (a) the merchant bank, at the request of and for the purpose of financing the purchase of each of those assets by a customer, purchases the asset from the seller in circumstances where the asset is existing at the time of the purchase;
- (b) the merchant bank sells the asset to the customer;
- (c) the customer is under a legal obligation to the merchant bank to take delivery of the asset;
- (d) the amount payable by the customer for the asset (the marked-up price) is greater than the amount paid by the merchant bank for the asset (the original price), and the difference between the marked-up price and original price is the profit or return to the merchant bank for providing such financing to the customer;

- (e) the merchant bank does not derive any gain or suffer any loss from any movement in the market value of the asset other than as part of the profit or return referred to in sub-paragraph (d); and
  - (f) the marked-up price or any part thereof is not required to be paid until after the date of the sale.
- (3) Notwithstanding Directive 9(1) and subject to Directive 9(9), a merchant bank may carry on the business of purchasing and selling assets if such business is carried on under the following arrangement:
- (a) for the purpose of making funds of a customer available to a merchant bank, the customer appoints the merchant bank or any other person as agent, to purchase on his behalf, an asset for an amount of money (the original price), in circumstances where the asset is existing at the time of the purchase;
  - (b) the merchant bank purchases the asset from the customer at a price (the marked-up price) that is greater than the original price, and sells the asset or appoints the customer, or any other person as an agent of the merchant bank, to sell the asset on its behalf;
  - (c) the merchant bank and customer, respectively, do not derive any gain or suffer any loss from any movement in the market value of the asset other than the difference between the marked-up price and the original price (which represents the profit or return to the customer for making funds available to the merchant bank); and
  - (d) the marked-up price or any part thereof is not required to be paid by the merchant bank to the customer until after the date of sale of the asset by the bank.
- (4) Notwithstanding Directive 9(1) and subject to Directive 9(9), a merchant bank may carry on the business of purchasing and selling assets if such business is carried on under the following arrangement:
- (a) for the purpose of making funds of the merchant bank (“A”) available to another bank or merchant bank (“B”), A purchases, or appoints B or any other person as an agent of A to purchase on its behalf, an asset for an amount of money (the original price), in circumstances where the asset is existing at the time of the purchase;
  - (b) B purchases the asset from A at a price (the marked-up price) that is greater than the original price, and sells the asset, or appoints A, or any other person as an agent of B, to sell the asset on its behalf;

- (c) A and B, respectively, do not derive any gain or suffer any loss from any movement in the market value of the asset other than the difference between the marked-up price and the original price (which represents the profit or return to A for making funds available to B); and
  - (d) the marked-up price or any part thereof is not required to be paid by B to A until after the date of sale of the asset by B.
- (5) Notwithstanding Directive 9(1) and subject to Directive 9(9), a merchant bank may carry on the business of purchasing and selling assets if such business is carried on under the arrangement described in Directive 9(4), in circumstances where the roles of A and B are reversed.
- (6) Notwithstanding Directive 9(1), a merchant bank may, subject to Directive 9(9), carry on the business of purchasing and selling assets if such business is carried on under the following arrangement:
- (a) the merchant bank, or its agent, jointly purchases an asset with the customer at the request of the customer and contributes an amount of money towards the purchase price (the contribution) for the purposes of financing the use or purchase, or both, of the asset by the customer;
  - (b) the merchant bank, or its agent –
    - (i) sells a portion of its share of the asset in a periodic basis to the customer for an amount of money determined at the start of the arrangement (the redemption); and
    - (ii) leases the unsold portion of its share of the asset to the customer for an amount of money determined at the start of the arrangement (the rental);
  - (c) in a case where the asset is not in existence at the time of the joint purchase and the merchant bank, or its agent, leases the unsold portion of its share of the asset to the customer, an amount of money (the advance payment) may be paid by the customer to the merchant bank, or its agent, for the subsequent use of that portion of the asset;
  - (d) the merchant bank, or its agent, appoints the customer, or a third party, to take on the obligations in connection with the use of the asset, including its maintenance and insurance;
  - (e) in the event of an early termination of the arrangement, the customer shall purchase from the merchant bank, or its agent, the remainder of the unsold portion of the merchant bank's, or its agent's, share of the asset at a price determined at the start of the arrangement (the early termination price);

- (f) upon expiry of the arrangement, the customer shall have purchased from the merchant bank, or its agent, the whole of the merchant bank's, or its agent's, share of the asset and obtained full ownership of the asset;
- (g) the total amount payable by the customer for the asset comprising –
  - (i) the advance payment;
  - (ii) the redemption;
  - (iii) the rental; and
  - (iv) the early termination price,is greater than the contribution, and the difference between the total amount payable and the contribution is the profit or return to the merchant bank for providing such financing to the customer;
- (h) the merchant bank, or its agent, does not derive any gain or suffer any loss from any movement in the market value of the asset, including total loss of the asset, other than as part of the profit or return referred to in sub-paragraph (g), except in circumstances provided in sub-paragraph (i); and
- (i) in a case where the customer is unable to pay the merchant bank, or its agent, the early termination price, the merchant bank, or its agent, may sell the asset to a third party at a price lower than the outstanding amount payable by the customer.

(7) Notwithstanding Directive 9(1) and subject to Directive 9(9), a merchant bank may carry on the business of purchasing and selling assets if such business is carried on under the following arrangement:

- (a) for the purposes of effecting payment resulting from the carrying on of any business by the merchant bank which, if it were a bank, would fall under section 30(1)(a), (b) or (c) of the Banking Act –
  - (i) the merchant bank undertakes to purchase an asset from a customer (merchant bank purchase undertaking);
  - (ii) the customer undertakes to purchase an asset from the merchant bank (customer purchase undertaking);
  - (iii) the merchant bank undertakes to sell an asset to a customer (merchant bank sale undertaking); or

- (iv) the customer undertakes to sell an asset to the merchant bank (customer sale undertaking),

for an amount of money determined at the time the undertaking is given by the merchant bank or the customer, as the case may be (the agreed price).

- (b) where the merchant bank purchase undertaking is exercised by the customer, or the customer sale undertaking is exercised by the merchant bank, the merchant bank will purchase the asset from the customer at the agreed price in circumstances where the asset is existing at the time of the purchase, and immediately sells the asset to a third party as spot price;
- (c) where the customer purchase undertaking is exercised by the merchant bank, or the merchant bank sale undertaking is exercised by the customer, the merchant bank will purchase the asset from a third party as spot price in circumstances where the asset is existing at the time of the purchase, and immediately sells the asset to the customer at the agreed price;
- (d) the merchant bank does not take physical delivery of the asset; and
- (e) the merchant bank does not derive any gain or suffer any loss from any movement in the market value of the asset other than the difference between the spot price and the agreed price.

(8) Notwithstanding Directive 9(1) and subject to Directive 9(9), a merchant bank may carry on the business of procuring and selling assets (whether in the form of movable and immovable property) if such business is carried on under the following arrangement:

- (a) the merchant bank, or its agent, at the request of the customer and for the purposes of financing the procurement and the use or purchase, or both, of an asset by the customer, commissions the customer to construct the asset in accordance with the customer's specifications for an amount of money (the purchase price);
- (b) contemporaneously with the commissioning referred to in sub-paragraph (a) —
  - (i) the merchant bank, or its agent, and the customer enter into an arrangement prescribed under regulation 23B of the Banking Regulations where the asset is not in existence at the time the asset is leased to the customer (the lease arrangement); or
  - (ii) the customer gives an undertaking to the merchant bank, or its agent, to purchase the asset from the merchant bank, or its agent, immediately after the transfer of the ownership of the asset to the

merchant bank, or its agent, by the customer under sub-paragraph (e)(i) (the purchase undertaking);

- (c) the customer procures the construction of the asset by a third party;
  - (d) the merchant bank, or its agent, makes payment of the purchase price to the customer on a periodic basis (the progress payment);
  - (e) one of the following takes place:
    - (i) the customer transfers the ownership of the asset to the merchant bank, or its agent, on a mutually agreed date on or after the completion of the construction of the asset by the third party;
    - (ii) the customer refunds all progress payments to the merchant bank, or its agent, and the lease arrangement or the purchase undertaking, as the case may be, is cancelled; or
    - (iii) the merchant bank, or its agent, agrees to the substitution of the asset that is the subject of the lease arrangement or the purchase undertaking with a comparable asset, and the customer transfers the ownership of the comparable asset to the merchant bank, or its agent, on a mutually agreed date;
  - (f) the merchant bank, or its agent, does not take physical delivery of the asset or the comparable asset;
  - (g) at the end of the arrangement, the merchant bank, or its agent, transfers ownership of the asset, or of the comparable asset, to the customer pursuant to the lease arrangement or the purchase undertaking, except in the circumstances referred to in sub-paragraph (e)(ii);
  - (h) the amount payable by the customer for the asset, or the comparable asset, is greater than the purchase price, and the difference between the total amount payable and the purchase price is the profit or return to the merchant bank for providing such financing to the customer;
  - (i) the merchant bank, or its agent, does not derive any gain or suffer any loss from any movement in the market value of the asset, including from the total loss of the asset, other than the profit or return referred to in sub-paragraph (h)
- (9) The merchant bank referred to in Directive 9(2), 9(3), 9(4), 9(5), 9(6), 9(7) or 9(8) shall notify the Authority of its –

- (a) intention to commence the business referred to in Directive 9(2), 9(3), 9(4), 9(5), 9(6), 9(7) or 9(8) as the case may be; or
  - (b) commencement of such business within 14 days after the commencement of such business.
- (10) In this Directive, “asset” includes any commodity as defined in section 2 of the Commodity Trading Act (Cap. 48A).