

CONSULTATION PAPER

P009 - 2009
December 2009

Proposed Requirements For Banks' Private Equity and Venture Capital Investments

MAS

Monetary Authority of Singapore

PREFACE

This consultation paper sets out proposed changes to the Banking Regulations and MAS Notice 630 (Private Equity and Venture Capital Investments) with regard to banks' private equity and venture capital investments.

2 MAS invites interested parties to forward their views and comments on the proposals made in this paper, and the draft amendments to the Banking Regulations and MAS Notice 630, which are appended at Annex 1 and 2 respectively. Electronic submission is encouraged. Please submit your written comments by 22 January 2010 to:

Prudential Policy Department
Monetary Authority of Singapore
10 Shenton Way
MAS Building
Singapore 079117

Fax: 62203973
Email: policy@mas.gov.sg

3 Please note that all submissions received may be made public unless confidentiality is specifically requested for whole or part of the submission.

1. INTRODUCTION

1.1 Section 32 of the Banking Act prohibits banks from acquiring or holding major stakes in any company without MAS' approval. This prohibition forms part of MAS' policy, announced in June 2000, of separating the financial and non-financial activities of banking groups.

1.2 Regulation 7 of the Banking Regulations excludes from the operation of section 32 private equity and venture capital (PE/VC) investments, as defined in Regulation 7 and MAS Notice 630. MAS Notice 630 further prescribes rules on the aggregate investment limit, duration, valuation, management, and other matters relating to PE/VC investments. The exclusion in Regulation 7 and rules in MAS Notice 630 were designed to facilitate banks' participation in PE/VC business as part of the continuum of their financial activities, while mitigating two key risks - the risk that the exclusion could be used to circumvent MAS' policy of separating financial and non-financial activities, and the financial risks associated with PE/VC investments.

1.3 This consultation paper proposes the following changes to provide banks with greater scope and flexibility in their PE/VC investments -

- a) scope of PE/VC investments;
- b) duration of investments; and
- c) bank's involvement in management.

2 SCOPE OF PE/VC INVESTMENTS

2.1 Currently, the scope of the PE/VC exclusion is limited to investments involving "high growth from the exploitation of high technology, emerging technology or new business models" or "at the time of the investment, undergoing a reorganisation ... or restructuring"¹. The characterisation of PE/VC investments in Regulation 7 and MAS Notice 630 was deliberately narrow in scope in consideration of the inherent difficulties in differentiating *bona fide* PE/VC investments from prohibited non-financial investments, and the need to prevent the exclusion from being used to circumvent MAS' policy of separating financial and non-financial activities.

¹ Please refer to paragraph 2.2 of MAS Notice 630 for the text of the scope of PE/VC investments.

2.2 In view of feedback from the industry and experience from the implementation of Regulation 7 and MAS Notice 630, MAS proposes to revise the current scope of permitted PE/VC investments to encompass a wider range of PE/VC investments, in a manner that is industry-neutral. The revised scope would regard investments where significant stakes are taken in companies with potential for high growth or value creation as PE/VC in nature. The detailed scope of permitted PE/VC investments is set out in the amendments to the Banking Regulations and paragraph 2.1 and 2.2 of MAS Notice 630, as appended in Annex 1 and 2 respectively. Banks should make an assessment on whether an investment is a *bona fide* PE/VC investment, as part of their internal investment approval process, and submit such assessments to MAS when requested.

3 DURATION OF INVESTMENTS

3.1 MAS Notice 630 allows direct investments or investments in funds managed by the bank to be held for up to 10 years, and investments in independent funds to be held for up to 15 years. Banks are required to apply to MAS for approval for extensions of the holding periods.

3.2 MAS proposes to reduce the duration of investments to a 7 year limit for direct PE/VC investments or investments in funds managed by the bank, and a 12 year limit for PE/VC investments in independent funds. Banks may hold a PE/VC investment in a fund that is managed by a party related to the bank for 12 years, if the bank's investment in the fund is less than 50% of the total fund size within five years from the date of inception of the fund, or if the duration of investment for each underlying PE/VC investment in the fund is less than 7 years. As industry practice suggests that the typical lifespan of a private equity fund is 10 years, while the expected holding period for an individual private equity investment is often around 3 to 5 years, banks would still have a substantial buffer period to plan and account for delays in the divestment of their PE/VC investments.

3.3 MAS also proposes to require banks to deduct from capital PE/VC investments which have exceeded the permitted holding periods and to submit regular reports on the divestment progress instead of applying for case-by-case approval for extensions. Extensions to the permitted holding periods to exempt such PE/VC investments from being fully deducted from capital will only be granted under exceptional circumstances.

4 BANK'S INVOLVEMENT IN MANAGEMENT

4.1 Banks are currently prohibited from involvement in the day-to-day management of their PE/VC investee companies, except under extenuating circumstances, where a limit of three months would apply. Banks have provided feedback that permitting increased involvement would allow banks to build up their capabilities in private equity as a new business line and enable them to better safeguard their PE/VC investments.

4.2 The benefits from permitting increased involvement need to be weighed against the risk that such involvement increases the possibility of non-arms-length transactions between the bank and its PE/VC investee companies. Such involvement may also divert the bank's management attention from the core business of banking.

4.3 On balance, MAS proposes to allow involvement by bank executives under the bank's private equity business line in strategic areas of the bank's PE/VC investee companies that are Board-level in nature. MAS also proposes to extend the current three month limit for day-to-day management involvement by banks in their PE/VC investees under extenuating circumstances to six months. Banks' involvement in the day-to-day management of their PE/VC investee companies shall otherwise continue to be prohibited.

ANNEX 1

**DRAFT BANKING
(AMENDMENT NO. 4)
REGULATIONS 2009**

Disclaimer: This version of the Regulations is in draft form and is subject to change.

No. S 000 -

BANKING ACT
(CHAPTER 19)
BANKING
(AMENDMENT NO. 4)
REGULATIONS 2009

In exercise of the powers conferred by sections 30(1)(d), 32(5) and 78(1) of the Banking Act, the Monetary Authority of Singapore hereby makes the following Regulations:

Citation and commencement

1. These Regulations may be cited as the Banking (Amendment No. 4) Regulations 2009 and shall come into operation on 2009.

Amendment of regulation 7

2. Regulation 7 of the Banking Regulations (Rg 5) is amended by deleting paragraph (1) and substituting the following paragraph:

“(1) The Authority hereby excludes, from the operation of section 32 of the Act —

- (a) any company which carries on a business prescribed in regulation 23E(1) (whether as its principal business or otherwise); or
- (b) any other company whose principal business is that of investing in any company referred to in sub-paragraph (a).”.

New regulation 23E

3. The Banking Regulations are amended by inserting, immediately after regulation 23D, the following regulation:

“Prescribed private equity or venture capital business

23E.—(1) For the purposes of section 30(1)(d) of the Act and subject to paragraphs (3) and (4), a business which —

- (a) is carried on by a company or the trustee of a trust;
and
- (b) satisfies the requirement in paragraph (2),

is prescribed as a business that any bank in Singapore may carry on, or with whom a bank in Singapore may enter into any partnership, joint venture or any other arrangement to carry on.

(2) The business referred to in paragraph (1) is one which the bank in Singapore has determined to have potential for high growth or value creation.

(3) The reference to a company or trustee of a trust in paragraph (1) excludes a company or trustee which —

- (a) is not carrying on any substantial business or not in operation;
- (b) is carrying on the business of engaging in property-related activities; or
- (c) is carrying on the business of factoring, leasing equipment or otherwise purchasing debt obligations from others.

(4) Subject to paragraph (5), the bank in Singapore shall, when carrying on a business prescribed in paragraph (1), limit its total balance-sheet asset value of all such businesses to —

- (a) 10% of its capital funds or such other percentage as the Authority may approve in any particular case; and
- (b) where the bank is a bank incorporated in Singapore, 10% of the capital funds of its banking group or such other percentage as the Authority may approve in any particular case.

(5) The limits prescribed in paragraph (4)(a) shall not apply to any business prescribed in paragraph (1) and carried on in the operation of an Asian Currency Unit by a bank incorporated outside Singapore.

(6) In this regulation, unless the context otherwise requires —

“Asian Currency Unit” has the same meaning as in section 77(5) of the Act;

“banking group”, in relation to a bank incorporated in Singapore, means the bank incorporated in Singapore, its subsidiaries, and all other entities treated as part of the bank’s group of companies for accounting purposes according to Accounting Standards;

“capital funds” —

- (a) in relation to a bank incorporated in Singapore, means the capital of the bank that is used for the purposes of calculating the bank’s capital adequacy ratio under section 10 of the Act;

(b) in relation to the banking group of a bank incorporated in Singapore, means the aggregate of —

- (i) the capital of the bank;
- (ii) the capital of the subsidiaries of the bank;
and
- (iii) the capital of all other entities treated as part of the bank's group of companies for accounting purposes according to Accounting Standards,

that is used for the purposes of calculating the bank's capital adequacy ratio under section 10 of the Act; or

(c) in relation to a bank incorporated outside Singapore, means such net head office funds and such other liabilities as the Authority may, by notice in writing, specify.”.

*[G.N. Nos. S 622/2005; S 170/2006; S 325/2006;
S 238/2007; S 401/2008; S 18/2009; S 203/2009;
S 360/2009]*

Made this day of 2009.

HENG SWEE KEAT
*Managing Director,
Monetary Authority of Singapore.*

ANNEX 2

**DRAFT REVISED
MAS NOTICE 630**

Disclaimer: This version of the Notice is in draft form and is subject to change.

MAS 630

NOTICE TO BANKS
BANKING ACT, CAP 19

Private Equity and Venture Capital Investments

1 Overview

1.1 This Notice is issued pursuant to section 55 of the Banking Act (cap. 19) and shall apply to all banks in Singapore which acquire or hold a major stake in any company excluded from the operation of section 32 by virtue of regulation 7 of the Banking (Amendment No. 4) Regulations 2009.

1.2 In the case of a bank incorporated outside Singapore, the treatment of PE/VC investments for capital adequacy purposes would be a matter for its parent supervisory authority. However, a branch in Singapore of a bank incorporated outside Singapore shall comply with all requirements on PE/VC investments as set out in this Notice.

2 Scope of Notice

Definitions

2.1 In this Notice—

“direct PE/VC investment” in relation to a bank, means any PE/VC investment which is acquired directly by the bank or not held by the bank through a fund or a trust structure;

“indirect PE/VC investment” in relation to a bank, means any PE/VC investment other than a direct PE/VC investment;

“investee” means any company or trust in which a bank has made a PE/VC investment;

“PE/VC investments” means an investment in a company or trust—

- (a) that has potential for high growth or value creation;
- (b) which is acquired in the manner set out in paragraph 2.2 below; and
- (c) through one or more of the following types of investment instruments -

- (i) shares or partnership capital or other similar interest in an investee;
- (ii) convertible debentures issued by an investee, where if such debentures are converted to shares, the aggregate value of shares held exceeds 10% of the investee's share capital;
- (iii) warrants or options on shares issued or granted by an investee, where if such warrants or options are exercised, the aggregate value of shares held exceeds 10% of the investee's share capital; or
- (iv) debentures or credit facilities, where these are held concurrently with investment instruments that are within the preceding subparagraphs (i), (ii) or (iii)¹,

but does not include an investment in a company or a trust which is –

- (A) not carrying on any substantial business or is not in operation;
- (B) carrying on the business of engaging in property related activities (as defined in the Banking Regulations 2001); or
- (C) carrying on the business of factoring, leasing equipment or otherwise purchasing debt obligations from others.

“related party”, in relation to a bank, includes its head office, any of its branches, or any of its related companies.

Types of investees

2.2 A bank may acquire an investee using one or more of the following methods:

- (a) the financing of the investee's growth or expansion, funding research and development activities, operational improvements, or engaging new management;
- (b) delisting the investee from a securities exchange; or
- (c) corporate restructuring such as a reorganisation, merger, consolidation, recapitalisation, buy-out, buy-in, joint venture, spin-off, or equity carve-out.

¹ The requirements in this Notice do not apply where the investment is initially by way of debentures and credit facilities alone. However, if subsequent investment instruments within paragraphs (c)(i), (ii) or (iii) are acquired, then the requirements of this Notice will apply to both the subsequent investment instruments as well as the debentures and credit facilities.

Related Companies

2.3 Where a company—

- (a) is the holding company of another company;
- (b) is a subsidiary of another company; or
- (c) is a subsidiary of the holding company of another company,

that first-mentioned company and that other company shall be deemed to be related to each other.

2.4 In the case of a company which has a board of directors and a share capital, the definition of “subsidiary” and “holding company” shall be as set out at section 5 of the Companies Act (Cap 50) where all references to “corporation” shall be replaced with “company”.

2.5 In the case of any other company, a company shall be a “subsidiary” of another company if the latter company is in a position to determine or govern the financial and operating policies of the first-mentioned company; and a company shall be a “holding company” of another company if the first-mentioned company is in a position to determine or govern the financial and operating policies of the latter company.

2.6 The expressions used in this Notice, shall, except where defined in this Notice or where the context otherwise requires, have the same meanings as in the Banking Act (the “Act”) and in the Banking Regulations.

3 Capital Treatment

The capital requirements for the PE/VC investments of a bank incorporated in Singapore is as set out in MAS Notice 637.

4 Duration of Investments

4.1 A bank should not hold any direct PE/VC investment for a period exceeding 7 years from the date of its first investment in the investee.

4.2 A bank should not hold any indirect PE/VC investment—

- (a) where such investee is managed by a related party, for a period exceeding 7 years from the date of its first investment in the investee;

- (b) where such investee is not managed by a related party, for a period exceeding 12 years from the date of its first investment in the investee;
- (c) where such investee is managed by a related party, and
 - (i) the bank's investment in the investee is less than 50% of the total size of the investee after five years from the date of its first investment in the investee; or
 - (ii) each underlying PE/VC investment invested through the investee is held for a period not exceeding 7 years,

for a period exceeding 12 years from the date of its first investment in the investee.

4.3 A bank shall deduct the book value of any PE/VC investment which is held beyond the relevant holding period as set out in paragraphs 4.1 and 4.2 from the bank's capital funds².

5 Valuation of Investments

Unless otherwise directed by the Authority, every bank in Singapore shall undertake regular reviews of all its directly held PE/VC investments to ascertain their net book values after provisioning for permanent diminution in the values of the PE/VC investments. Such reviews shall be conducted by a person who is independent of the officers involved in the process of making the PE/VC investment, and the PE/VC investments shall be valued prudently.

6 Involvement in Management

6.1 Subject to paragraphs 6.2 and 6.3, a bank may not advise and take part in the management of an investee.

6.2 Only a bank employee who is employed primarily to carry out the activities of the PE/VC business unit may be involved in the day to day management of the investees and shall restrict such involvement to strategic issues which are Board-level in nature. A director or an employee of the bank may only serve as a non-executive director of an investee.

² A bank incorporated in Singapore shall deduct the book value of any PE/VC investment which is held beyond the relevant holding period from the bank's capital funds in accordance with MAS Notice 637.

6.3 A bank may only take part in the management of an investee under circumstances which are in the opinion of the Authority, extenuating circumstances, such as the need for prompt action in the event of a stress situation for example, the loss of the investee's senior management or the impending bankruptcy of the investee, but such participation in management shall not exceed 6 months, except with the prior written approval of the Authority. A bank shall notify the Authority of any involvement in management of the investee within 3 months thereof of such involvement and provide relevant details as to the extent of and the reasons for the involvement in management.

7 Risk Management Framework

A bank in Singapore shall have in place documentation setting out its risk management policy for its PE/VC investments. This policy shall include the bank's policies on types of investments, risk identification and mitigation, pre-specified investment limits (including single investment limits, industry investment limits, geographical limits and limits based on the stage of investment), due diligence, investment approval, post-investment monitoring, accounting and valuation, exit strategies and other relevant procedures and processes.

8 Qualification of Persons Engaged in PE/VC Investment Activities

8.1 As investing in a PE/VC investment requires skill, experience and judgment on the part of an individual, a bank shall employ professionals with relevant work experience and knowledge to manage its PE/VC investments.

8.2 A bank shall have in place a written policy for assessing the qualifications of employees entrusted to handle PE/VC investments and managers in investees not managed by a related party into which they have invested.

9 Investment Approval

9.1 A bank shall have in place a stringent internal assessment and approval process for each PE/VC investment. A bank shall keep detailed records of all PE/VC investments assessed and approved. These shall include, in the case of each investment the following:

- (a) an investment assessment stating the objective of the investment;
- (b) the performance benchmarks set, including the target internal rates of return and the expected holding period; and
- (c) the exit strategy for the investment.

10 Subsidiarisation

10.1 The Authority encourages banks to carry out their PE/VC investment business through a separately incorporated subsidiary to separate the bank's PE/VC investment business from its other financial businesses. It is recommended that PE/VC investment functions be retained within the bank only if such investment is made solely in an investee that is not managed by a related party.

10.2 In any case, every bank shall ensure that each PE/VC investment is identifiable and that separate records for each PE/VC investment are kept for internal monitoring purposes.

11 Reporting Requirements

11.1 Every bank in Singapore shall submit to the Authority a copy of its risk management policy and a copy of its policy for assessing the qualifications of PE/VC managers (as set out in paragraphs 7 and 8) within 90 days of the effective date of the Notice, in respect of existing PE/VC investments (where such policies have not been previously submitted to the Authority).

11.2 A bank in Singapore which intends to acquire or hold a PE/VC investment after the Notice comes into effect shall establish the relevant policies and submit copies of such policies to the Authority prior to the acquisition of PE/VC investments. In all cases, the bank shall notify the Authority in writing of any material changes in these policies as and when they occur.

11.3 Every bank in Singapore shall submit to the Authority, on a semi-annual basis, information on its PE/VC investments in accordance with the format specified in Annex A. The first submission will be for the bank's PE/VC investments as at 30 June 2001 and shall be submitted within 30 days of the date of this notice. For PE/VC investments held beyond the relevant holding periods, banks shall submit to MAS information on their PE/VC investments in accordance with the format specified in Annex B on an annual basis.

12 Effective Date

This Notice shall take effect on [date].

Instructions

Please complete the above table to facilitate MAS' monitoring of bank's private equity and venture capital investments that are held past permitted holding periods. Please indicate if the figures given are audited.

Item (1) - This refers to the name of the bank or its subsidiary.

Item (2) - This refers the name of the investee company or firm.

Item (3) - This refers to the industry, in which the investee company is conducting its business e.g. Consumer products/services, Communications, Electronics, Energy, Manufacturing, Medical/biotechnology, Information Technology.

Item (4) - This refers to the date of the initial PE/VC investment.

Item (5) - This refers to the value of the PE/VC investment as a percentage of the capital of the investee company or firm.

Item (6) - This refers to the value of the debt instruments and the credit facilities extended to the investee company or firm.

Item (7) - This refers to the net book value of the PE/VC investment.

Item (8) (a) - This refers to the net book value of the PE/VC investment expressed as a percentage of the capital funds at the solo level.

Item (8) (b) - This refers to the net book value of the PE/VC investment expressed as a percentage of the capital funds at the group level.

Instructions

Please complete the above table to facilitate MAS' monitoring of bank's private equity and venture capital investments that are held past permitted holding periods. Please indicate if the figures given are audited.

Item (1) - This refers to the name of the bank or its subsidiary.

Item (2) - This refers the name of the investee company or firm.

Item (3) - This refers to the industry, in which the investee company is conducting its business e.g. Consumer products/services, Communications, Electronics, Energy, Manufacturing, Medical/biotechnology, Information Technology.

Item (4) - This refers to the date of the initial PE/VC investment.

Item (5) - This refers to the date of the end of the permitted holding period for the PE/VC investment.

Item (6) - This refers to the date when the PE/VC investment is expected to be fully divested.

Item (7) - This refers to the value of the PE/VC investment as a percentage of the capital of the investee company or firm.

Item (8) - This refers to the value of the debt instruments and the credit facilities extended to the investee company or firm.

Item (9) - This refers to the net book value of the PE/VC investment.



Monetary Authority of Singapore