RESPONSE TO FEEDBACK RECEIVED –
CONSULTATION ON AMENDMENTS TO SECTION 29 OF THE
BANKING ACT

1 Introduction

1.1 MAS released on 14 Jan 2005 an industry consultation paper on proposed amendments to section 29 of the Banking Act. An industry briefing was also held on 4 Mar 2005.

1.2 We thank all respondents for their comments. Our responses are set out below. Comments relating to the criteria for disaggregating exposures for section 29 purposes have already been incorporated into the revised MAS Notice 629 issued on 6 Jan 2006. Additionally, banks raised a number of issues concerning the treatment of credit risk mitigation techniques under the new section 29. This subject is under study.

2 Single Risk – Common Control & Financial Interdependence

2.1 The proposed framework will require a bank to aggregate its exposures to entities posing a single risk to the bank. Entities under common control and entities which are financially interdependent will be regarded as posing a single risk. Besides qualitative considerations, the consultation paper defined the minimum threshold for control as a 20% equity stake or share of voting power. For multiple-level shareholdings, the consultation paper specified that the test for control will be applied at every level, with aggregation of exposures to all entities where control exists.

2.2 A number of banks noted that there are situations where an entity with shareholding or voting rights of 20% or more does not exercise control, especially if there are other substantial shareholders. Another bank noted that applying the 20% control test to multiple-level shareholdings could extend the aggregation requirement too far down the line, resulting in entities being categorised under a borrower’s control when another shareholder may actually be the controlling entity.
2.3 Banks also noted that there may be practical issues in identifying the controlling interests of customers in multi-level shareholdings, as well as ensuring completeness in customer disclosures. Customers may be reluctant or unable to provide information relating to financially interdependent entities. Further, if financially interdependent entities have no banking relationship with the bank, it may be difficult for a bank or the customer to obtain the information. Banks also asked about the extent to which they should attempt to obtain such information (and be apprised of any subsequent changes), since such due diligence work will necessarily entail costs.

MAS’ Response

2.4 MAS recognises that requiring aggregation of all direct and indirect 20% equity stake-owned companies indefinitely could pose practical implementation difficulties on banks. MAS will instead require aggregation where there is a parent-subsidiary relationship.\(^1\) This uses a control threshold of 50% which is widely accepted internationally as the threshold for control and should pose little compliance difficulty. Notwithstanding this, banks will still be required to aggregate entities which are under the de facto control\(^2\) of the controlling entity, or if there are reasons to regard these exposures as connected in such a way as to pose a single risk to the bank.

2.5 MAS will retain the principles-based guidance on financial interdependence and banks should exercise prudent judgment to assess financial interdependence on a best efforts basis. In this regard, MAS expects banks to monitor more closely, developments affecting their larger customers, particularly those with exposures that are close to the 25% large exposures limit.

---

\(^1\) A parent-subsidiary relationship will be determined based on section 5 of Companies Act (Cap. 50). Briefly, a corporation shall be deemed to be a subsidiary of another corporation if the latter (a) controls the composition of the board of directors of the first-mentioned corporation; (b) controls more than half of the voting power of the first-mentioned corporation; or (c) holds more than half of the issued share capital of the first-mentioned corporation. A corporation is also deemed to be a subsidiary of another corporation if the first-mentioned corporation is a subsidiary of any corporation which is that other corporation’s subsidiary.

In relation to a controlling entity that is an individual, aggregation will be required if he or his associates, whether directly or indirectly, (a) controls the composition of a corporation’s board of directors; (b) controls more than half of its voting power; or (c) holds more than half of its issued share capital.

\(^2\) Following the formulation in the Banking (Corporate Governance) Regulations, de facto control refers to the ability to control or materially influence the policies of a company.
3 Definition of Substantial Shareholder Group

3.1 The consultation paper defined a bank’s substantial shareholder group (SSG) as comprising entities in which a substantial shareholder or his associates hold a major stake. *Major stake* was in turn defined to have a similar meaning as in section 32(7) of the Banking Act. Some respondents felt that the two different bases for aggregation for unrelated party exposures and SSG exposures could cause operational difficulties.

MAS’ Response

3.2 MAS does not view the two different bases for aggregation as a major issue, as a stricter definition of control for SSG exposures recognises the greater potential for conflict of interests. Nonetheless, to be consistent with the definition of “affiliate of substantial shareholder” under the Banking (Corporate Governance) Regulations, and to alleviate the extent of operational difficulty, MAS will amend the definition of SSG to **include only entities in which a substantial shareholder or his associates** hold a minimum 20% equity stake or share of voting power, either directly or through subsidiaries. This is depicted in the following diagram, where entities considered to be under common control are grouped within the dotted circles.

![Diagram showing relationships between entities A, B, C, and D as per the revised definition of SSG.](diagram.png)

3 This refers to the substantial shareholder’s family members as set out in Section 15B(4)(c)(i) of the Banking Act.
4 Unsecured SSG Exposures

4.1 A few banks commented that the 5% capital funds limit on unsecured exposures to a bank’s SSG may be onerous as it is not uncommon to extend credit facilities to financially sound borrowers on an unsecured basis.

MAS’ Response

4.2 Recognising that a 5% capital funds limit on unsecured exposures to a bank’s SSG may restrict unsecured credit to financially strong borrowers in the SSG on an arm’s length basis, MAS will not impose it as a mandatory limit. Nonetheless, given the potential for conflict of interests and the risk of non-arm’s length transactions, banks will be required to monitor unsecured exposures to their SSG that exceed 5% of their capital funds, and to submit reports on such exposures to their board of directors. MAS expects the board to exercise appropriate oversight over these exposures to safeguard the interests of the bank and its depositors. Aggregate exposures to a bank’s SSGs will continue to be subject to an overall cap of 25% of a bank’s capital funds.

5 Exposures to Directors and Director-Related Entities

5.1 In line with the shift to an exposures-based framework, the consultation paper proposed that the $5,000 unsecured limit should be applied on all exposures instead of only to credit facilities granted to a director and his related entities. Banks felt that this change would exacerbate compliance difficulty, especially if the restriction applies to directors of foreign banks incorporated outside Singapore.

MAS’ Response

5.2 The risk of conflict of interests is relevant to both Singapore incorporated banks and foreign banks and the limit should apply to both. However, in view of the potential compliance difficulty, MAS will retain the existing approach of subjecting only unsecured credit facilities to the $5,000 limit. As proposed in the paper, credit card facilities granted to directors will be exempted from this limit.

5.3 The consultation paper proposed to regard directors who are employed with the bank on a full-time basis, as employees of the bank and
therefore allowed unsecured credit facilities of up to one year’s emoluments. To limit the scope for conflict of interests, MAS has decided to retain the current practice of subjecting unsecured credit facilities to any director, including an executive director, to the $5,000 unsecured limit. To reiterate, this limit will not apply to credit card facilities.

5.4 The existing section 29 framework exempts director-owned or controlled entities that are listed on approved stock exchanges from compliance with the $5,000 unsecured limit in section 29(1)(d)(iii). The consultation paper proposed to remove this exemption, on the basis that the risk of non-arm’s 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. A bank commented that doing away with this exemption will make it difficult for banks to attract successful businessmen who are controller-shareholders of publicly-listed companies to serve as directors.

MAS’ Response

5.5 Only a person who owns more than 50% of the issued capital of a public listed company or controls the composition of its board of directors, would be affected by this requirement. MAS’ view is that the resulting impact on a bank’s ability to attract board directors is limited and this limited impact does not outweigh the risk of non-arm’s length transactions. MAS will retain the proposal to remove the exemption.

6 Group Compliance

6.1 MAS Notice 625 presently requires banks to aggregate on a pro-rated basis credit facilities granted by their subsidiaries. Exposures of associated companies are not subject to aggregation. However, banks may be obliged to support their subsidiaries for reputational reasons. Banks may also have to bear losses arising from an associate’s exposures in proportion to their shareholding in the associate. The consultation paper therefore proposed that exposures of subsidiaries and associated companies be aggregated on a full and pro-rated basis, respectively.

6.2 Banks responded that it would be difficult for them to comply with the pro-rated aggregation requirement for associated companies. There may be practical problems in obtaining information from associated companies due to the absence of management control over these entities, as well as potential customer confidentiality restrictions.
MAS’ Response

6.3 After considering the feedback received, MAS will retain the existing practice of not requiring banks to aggregate exposures of their associated companies. However, exposures of subsidiaries, or any other entities under the de facto control of the bank, will have to be aggregated in full. For consistency, MAS will be adopting a similar approach for group compliance with the 2% single security limit and 20% aggregate property investment limit under sections 31 and 33 of the Banking Act.

Uncommitted and Undrawn Facilities

7.1 The consultation paper proposed that the higher of the approved limit or amount outstanding under a credit facility be counted towards compliance with section 29 limits. Banks commented that they will have difficulty complying if uncommitted and unutilised facilities are included. Banks noted that it is a common industry practice to grant uncommitted facilities to well-rated customers. While banks may advise customers of the availability of such uncommitted facilities, these facilities are subject to the bank’s absolute discretion to review and cancel at any time.

MAS’ Response

7.2 A committed facility is subject to drawdown by the borrower at any time, and hence the undrawn amounts of committed facilities should count towards the exposures limit. MAS will not require uncommitted facilities to count towards the exposures limit. This is consistent with the practice under the Basel II framework, which adopts a 0% credit conversion factor for uncommitted facilities. Banks with such uncommitted facilities should obtain a legal opinion that their facility documentation confers upon the bank an unconditional right to refuse drawdown. MAS expects banks to have proper procedures in place to enable them to exercise their rights to decline drawdown requests for uncommitted facilities.

Interbank Exposures

8.1 The current section 29 exempts all transactions with “banks”. The consultation paper proposed to exempt from section 29 exposures to “banks in Singapore”, i.e. foreign bank branches in Singapore and Singapore

---

4 Unadvised facilities and internal limits will not be considered exposures subject to section 29.
incorporated banks (including their overseas branches). An additional cap on original maturity of less than a year was proposed. Overseas branches and head offices of foreign banks and banks not licensed in Singapore will therefore be excluded from the scope of the interbank exemption under the new section 29.

8.2 A number of banks have highlighted that this will be too restrictive. A bank suggested that all short-term or overnight exposures to banks be exempted, as the daily monitoring of such exposures for section 29 purposes would be onerous. Another bank highlighted that from a credit risk perspective, most banks do not differentiate between banks operating in or outside Singapore. Additionally, a number of banks suggested alternative bases for the exemption of interbank transactions, such as banks located in OECD jurisdictions, and financial soundness as proxied by a minimum financial strength rating or equivalent. Separately, a number of banks expressed the concern that the one-year maturity cap would adversely affect banks with funding centre roles for their global operations.

MAS’ Response

8.3 After considering the feedback received, MAS will exempt interbank exposures (regardless of whether the bank is licensed in Singapore) and a bank’s exposures to its related merchant bank(s) in Singapore, with no restriction on maturity, except for a Singapore-incorporated bank’s exposures to its banking and merchant bank subsidiaries. For the latter group, only exposures with a residual maturity of 1 year or less will be exempted. However, this does not preclude MAS from imposing additional supervisory requirements on specific banks should there be prudential concerns. Additionally, banks will be required to report to MAS their exposures to any bank/merchant bank (or group of banks/merchant banks posing a single risk) that would have exceeded the 25% large exposures limit if such exposures had not been exempted. MAS intends to incorporate such reporting into the MAS Notice 610/1003 returns.

9 Exposures to Foreign Governments and Central Banks

9.1 MAS Notice 623 currently requires the aggregation of credit facilities to foreign governments, quasi-government entities, and government-owned companies if they do not meet the conditions that (a) the borrower must have its own resources and income to service the loan; and (b) the loan
proceeds should be used for borrower’s own business. Banks sought clarification on the treatment of foreign government-owned and quasi-government entities under the new section 29.

MAS’ Response

9.2 Banks will be **allowed to disaggregate entities or sub-group of entities within a foreign government-linked group** if they satisfy the following conditions:

(a) Each entity in the sub-group has sufficient financial resources (either on its own or together with the financial resources provided by other entities in the sub-group) to fully service its liabilities, and does not need to depend on any other entity in the foreign government-linked group that does not fall within the sub-group (“external group entity”) for financial assistance in meeting its liabilities;

(b) Proceeds received by each entity in the sub-group from the credit facilities granted by the bank are only used by the entity or other entities in the sub-group for the operations of the entity or other entities in the sub-group, and are not transferred to any external group entity;

(c) None of the entities in the sub-group is dependent on any external group entity, either singly or in the aggregate with other external group entities, for more than 50% of its operating revenues.

Similarly, the external group entities must be financially independent of the entities to be disaggregated.

10 Settlement Exposures

10.1 A number of banks asked if exposures arising from time differences in the settlement of cross-border transactions should be counted in the large exposures and substantial exposures limits. For example, a bank in Singapore may sell SGD against USD with an overseas counterparty. While the bank in Singapore may pay out Singapore dollars to settle the transaction in the morning, the crediting of US dollars to its account may be confirmed only in the afternoon. The bank in Singapore is therefore exposed to the risk

---

5 Exposures to foreign government-owned banks will come under the scope of the general exemption for interbank exposures.
of its counterparty defaulting during the few hours where settlement is not completed.\(^6\)

**MAS’ Response**

10.2 Given the very short-term nature of settlement exposures and the lower risk they pose, MAS will **exempt such exposures for two working days.**\(^7\)

11 **Substantial Exposures Limit**

11.1 A number of banks raised the scenario where a bank has an exposure to a customer who is concurrently part of two borrower groups. It was noted that where the respective exposures to both borrower groups exceed the 10% capital funds definition of substantial exposures, banks could end up *double-counting* these exposures when monitoring their compliance with the substantial exposures limit.

**MAS’ Response**

11.2 To avoid double-counting such exposures, MAS will **clarify that an exposure to a borrower should not be counted twice when aggregating substantial exposures.**

12 **Valuation**

12.1 The consultation paper specified that exposures should be marked-to-market on a daily basis. Banks noted that this approach would make it difficult for banks to estimate their exposures in volatile markets. Additionally, FRS 39 does not require banks to mark-to-market debt securities which are held till maturity.

**MAS’ Response**

12.2 In computing the exposures for section 29 purposes, MAS will **allow banks to use the same measurement basis that has been applied to the exposures in preparing their financial statements, provided that the same measurement basis is used consistently and in a manner that complies with the requirements of the Singapore Financial Reporting**

---

\(^6\) This describes a non-delivery-versus-payment transaction.

\(^7\) The two working days exclude any market holidays in the other jurisdiction.
Standards. For any exposure, the same measurement basis should be applied to both the numerator (exposures) and denominator (capital) in computing the large exposures limit and substantial exposures definition.

12.3 Currently, Singapore-incorporated banks use their annual audited capital funds for purposes of compliance with section 29. Going forward, the base will be changed to regulatory (Tier 1 and Tier 2) capital. In line with this, Singapore-incorporated banks will be allowed to use, for each quarter, their regulatory capital as at the end of the quarter falling two quarters ago as the denominator for the large exposures limit and substantial exposures definition. For example, Singapore-incorporated banks’ regulatory capital as at 31 December will be the basis for section 29 compliance in the period from 1 April to 30 June. Foreign bank branches will continue the current practice of updating their capital funds daily for section 29 compliance.

13 Accrued Interest and Fees Outstanding

13.1 A number of banks sought to clarify if accrued interest should be counted as an exposure. Banks noted that internal system limitations make it tedious for them to aggregate exposures with accrued interest, and it would be costly for banks to reprogram their systems only for this purpose.

MAS’ Response

13.2 Given the understanding that such amounts are generally immaterial relative to the total exposure, MAS will allow banks to exclude accrued interest. On the same basis, MAS will allow banks to exclude fees outstanding when calculating exposures for section 29 purposes. This does not preclude a bank from including accrued interest and fees outstanding in monitoring its exposures for section 29 purposes should the bank wish to do so or if such sums are material.

14 Use of Internal Models

14.1 The consultation paper stated that pre-settlement exposures should include add-ons for potential future exposures, as set out by the BIS under the new capital adequacy framework. Banks asked if internal models can be used to derive the add-ons.

---

8 This will enable the section 29 denominator to be updated more frequently on a quarterly basis, compared with the existing practice of using annual audited capital funds.
MAS’ Response

14.2 MAS will **allow banks to use their internal models to derive appropriate add-ons if the bank has received the relevant supervisory permission to use these internal models for capital adequacy purposes.**

15 **Size Exemption**

15.1 Section 29(3) of the Banking Act exempts banks with total Singapore dollar credit facilities to non-bank customers that are less than S$100 million from the substantial loans limit in section 29(1)(b). A number of banks sought clarification on whether this exemption will be retained in the new section 29.

MAS’ Response

15.2 The exemption will be retained.

16 MAS thanks all respondents for their feedback in response to the industry consultation. The changes set out above will be incorporated into the amendments to section 29 of the Banking Act. The draft legislation and Notice will be issued for consultation in due course.

MONETARY AUTHORITY OF SINGAPORE
15 May 2006