

## **RESPONSE TO FEEDBACK RECEIVED – CONSULTATION ON COVERED BONDS ISSUANCE BY BANKS INCORPORATED IN SINGAPORE**

### **1 Introduction**

1.1 On 9 March 2012, MAS issued a consultation paper inviting interested parties to provide their feedback to a draft MAS Notice relating to the issuance of covered bonds. The draft Notice proposed to allow a bank incorporated in Singapore to issue covered bonds subject to the aggregate value of assets in the cover pool being capped at 2% of the value of the total assets of the bank, as well as other requirements.

1.2 We have carefully considered the feedback received, and where appropriate, have incorporated them into the Notice, which has been issued as MAS Notice 648 on Issuance of Covered Bonds by Banks Incorporated in Singapore (“MAS Notice 648”). MAS Notice 648 takes immediate effect. This paper sets out general feedback received which could be of wider interest, together with our response.

1.3 We would like to thank all respondents for their feedback.

### **2 Encumbrance limit**

2.1 The draft Notice proposed that the aggregate value of assets in cover pools for all covered bonds issued by the bank, shall not exceed 2% of the value of the total assets of the bank, at all times.

## 2.2 Level of limit

### Feedback

2.2.1 Some respondents felt that the 2% limit was conservative and noted that it was low compared to other jurisdictions. They noted that covered bond investors preferred large transactions that were benchmark in size and widely placed. This would help ensure liquidity in the product and a bigger pool of potential buyers should the investors wish to sell. Investors also preferred issuers that were likely to access the market on a regular basis and were committed to using covered bonds as a funding tool.

### MAS' Response

2.2.2 We note that an encumbrance limit of 2% may not provide a sufficiently large demand and liquidity pool for the use of covered bonds as an additional source of funding for banks. MAS will allow a bank incorporated in Singapore to issue covered bonds subject to the aggregate value of assets in the cover pool being capped at 4% of the value of the total assets of the bank at all times.

## 2.3 Definition and value of “total assets of the bank”

### Feedback

2.3.1 A few respondents sought clarification on what constituted “total assets of the bank”. Another respondent also sought clarification on whether the “total assets of the bank” should be based on the bank’s latest audited financials or latest available unaudited financials.

### MAS' Response

2.3.2 “Total assets of the bank” includes the assets of the overseas branches of the bank incorporated in Singapore but not its subsidiaries, whether in Singapore or overseas, and may be valued using the bank’s latest audited financials.

### **3 Cover pool assets**

3.1 The draft Notice proposed that only residential mortgage loans and derivatives held for the purpose of hedging risks arising from issuing covered bonds qualify for inclusion in the cover pool.

#### **3.2 Inclusion of other types of assets**

*(i) Cash and cash equivalents*

##### Feedback

3.2.1 Some respondents suggested the inclusion of liquid assets such as cash and cash equivalents in the cover pool as substitute assets. Issuers include liquid assets in the cover pool to reduce the administrative burden of having to use principal repayments from mortgages to immediately purchase further mortgages to ensure there are sufficient assets within the cover pool. Allowing liquid assets also improves the liquidity of the cover pool, as they could potentially be liquidated more quickly than mortgages. Assets in the cover pool are typically sold to generate cash so that obligations on covered bonds can be met as they fall due.

##### MAS' Response

3.2.2 We will allow cash and cash equivalents namely, Singapore Government Bonds, Treasury Bills and MAS Bills to be included as eligible cover pool assets. However, as such assets are not meant to be primary assets of the covered bond programme, they should be capped at 15% of the cover pool.

*(ii) Commercial mortgage loans, public sector debt and shipping and aircraft loans*

##### Feedback

3.2.3 Some respondents also requested that commercial mortgage loans, public sector debt, and shipping and aircraft loans be included as eligible cover pool assets, in addition to residential mortgage loans.

## MAS' Response

3.2.4 Singapore's covered bond market is at a nascent stage of development. We also note that covered bonds in other jurisdictions remain predominantly collateralised by residential mortgage loans. We will hence allow residential mortgage loans as eligible cover pool assets and review the inclusion of other types of loans at a later stage.

### **3.3 Geographical scope of mortgages**

#### Feedback

3.3.1 A few respondents sought clarification on the geographical scope of residential mortgage loans eligible for the cover pool.

#### MAS' Response

3.3.2 There is no restriction on the geographical scope of the mortgages. However, if non-Singapore mortgages are included, the issuing bank should seek legal advice to ensure that the attendant laws of the foreign jurisdiction will not adversely affect the rights of covered bond holders, the cover pool monitor, liquidator, receiver or trustee (if any) appointed to hold the cover pool.

### **3.4 Valuation of mortgages**

#### Feedback

3.4.1 A few respondents sought clarification regarding the frequency at which properties should be re-valued and how they should be valued.

#### MAS' Response

3.4.2 We will require banks to revalue properties used to collateralise covered bonds on an annual basis at the very least. Nevertheless, where the property market is subject to significant changes in conditions, banks shall carry out revaluation of properties on a more frequent basis and adopt the appropriate valuation methodology in line with their risk management processes for covered bond programmes.

### 3.5 Ranking of derivatives

3.5.1 One respondent wanted clarification on the ranking of counterparties to derivatives held for the purpose of hedging risks arising from issuing covered bonds vis-a-vis the covered bond holders.

#### MAS' Response

3.5.2 Such counterparties will rank *pari passu* with covered bond holders.

## 4 Liabilities against which “cover pool” assets are secured

4.1 The draft Notice defined “cover pool” as assets securing liabilities to holders of the covered bond holders only.

### 4.2 Liabilities arising from the enforcement of the rights of covered bond holders

#### Feedback

4.2.1 One respondent proposed that liabilities arising from the enforcement of the rights of the holders of the covered bonds should be secured by the cover pool assets. Such liabilities may be costs of third party service providers who have been appointed to manage the enforcement process. They would typically be recoverable from the bank or the SPV.

#### MAS' Response

4.2.2 We agree and have made the amendments in paragraph 4 of MAS Notice 648, under the Definition of “Cover Pool”.

### 4.3 Other assets secured by same property as residential mortgage loans or which form part of security package provided by borrowers for the repayment of loans

#### Feedback

4.3.1 Another respondent proposed that other assets (i) secured by the same property as the residential mortgage loans or (ii) which form part of the

security package provided by borrowers for the repayment of loans (e.g. guarantees and indemnities) could be transferred to the SPV.

#### MAS' Response

4.3.2 Banks may transfer such other assets to the SPV but would be required to count them towards the encumbrance limit.

## **5 Risk management**

### Feedback

5.1 The draft Notice proposed that an issuing bank put in place adequate risk management processes and internal controls to manage the risks arising from the issuance of covered bonds. A few respondents asked if MAS could provide further details on the risk management processes required of issuing banks.

#### MAS' Response

5.2 MAS Notice 648 states that an issuing bank will be required to put in place adequate risk management processes and internal controls. This includes having in place appropriate governance arrangements (such as identifying the approval authority within the bank with respect to the covered bond programme) and conducting regular stress tests on risks arising from issuing covered bonds such as default, pre-payment, currency, interest rate, counterparty and liquidity risks. The bank should conduct its due diligence in assessing the risks associated with issuing covered bonds and ensure that risk management processes that are put in place for covered bonds are adhered to.

5.3 In addition to the examples cited in MAS Notice 648, banks should perform asset coverage tests (“ACTs”) on a regular basis and in any case, at intervals of not more than 12 months, to ensure collateral quality and the proper level of over-collateralisation. As the risk profiles across various covered bond programmes differ, banks should assess and develop the appropriate risk management processes and controls to address specific risks arising from the issuance of its covered bond programmes.

## **6 Cover pool monitors**

### Feedback

6.1 The draft Notice proposed that an issuing bank appoint an external third party, qualified to be an auditor under the Companies Act (Cap. 50), as the cover pool monitor. One respondent suggested that independent specialists, rather than auditors, be engaged. Another respondent wanted confirmation that a bank's external auditor may also act as the cover pool monitor concurrently, provided such an appointment did not conflict with appropriate corporate governance practices.

### MAS' Response

6.2 The cover pool monitor should be an auditor qualified under the Companies Act, to ensure compliance with MAS' requirements and regulations. Other jurisdictions similarly require or have proposed to require auditors to be appointed as cover pool monitors. The external auditor of a bank can concurrently act as the bank's cover pool monitor, if the bank assesses that there is no conflict of interest. In addition, cover pool monitors should independently review the ACTs performed by banks, to verify their accuracy.

## **7 Regulatory oversight and reporting**

### Feedback

7.1 A few respondents sought clarification on whether there will be an approval or licensing process for covered bond issuers.

### MAS' Response

7.2 All banks incorporated in Singapore and licensed by MAS to conduct banking business will be permitted to issue covered bonds subject to conditions under MAS Notice 648. Prior to the issuance of covered bonds, banks will be required to submit information on their covered bond programme one month in advance. In addition, MAS may assess the adequacy of the banks' policies and procedures relating to their covered bond programmes when we conduct on-site inspections of the banks. Cover pool

monitors are also required to report to MAS immediately, if they become aware that an issuing bank has breached any of the conditions in MAS Notice 648.

## **8 Disclosure requirements**

### Feedback

8.1 Some respondents sought clarification regarding disclosure to investors.

### MAS' Response

8.2 Banks will be required to disclose the results of their ACTs as well as cover pool characteristics to investors on a regular basis and in any case, at quarterly intervals at the minimum.

## **9 Notification to MAS prior to covered bond issuance**

### Feedback

9.1 The draft Notice proposed that a bank notifies MAS in writing one month prior to the issuance of new covered bonds. Some respondents noted that the 1-month notification period would impede an issuing bank from taking advantage of market opportunities in the covered bond market as and when they arise. The respondents requested that the notification period be shortened or the requirement be removed altogether.

### MAS' Response

9.2 We note the feedback from the respondents. MAS Notice 648 requires that a bank notifies MAS in writing three business days prior to the issuance of covered bonds, provided that the bank has already submitted information to notify MAS on its covered bond programme a month in advance.<sup>1</sup>

---

<sup>1</sup> This is not to be viewed as any form of endorsement by the MAS of the issuance of covered bonds by banks. Banks should seek their own legal advice as to the legality of their issuance of covered bonds, with all relevant laws, including MAS Notice 648.



## **10 Covered bond legislation**

### Feedback

10.1 A few respondents proposed that there be dedicated covered bond legislation to facilitate covered bond issuances and provide greater legal certainty to investors.

### MAS' Response

10.2 As the covered bond market in Singapore has not yet developed, the need for dedicated legislation will be assessed as the market takes shape. We would highlight that requirements set out in a Notice to Banks issued under the Banking Act are mandatory.

## **11 Issuance of covered bonds by foreign bank branches in Singapore and foreign subsidiaries of locally incorporated banks**

### Feedback

11.1 The draft Notice proposed to allow only banks incorporated in Singapore to issue covered bonds. Two respondents asked if foreign bank branches in Singapore could issue covered bonds. One of them also asked if a foreign subsidiary of a bank incorporated in Singapore would be allowed to issue covered bonds.

### MAS' Response

11.2 Only a bank incorporated in Singapore will be allowed to issue covered bonds, as a foreign bank operating as a branch in Singapore does not have a separate legal identity from its Head Office ("HO"). The insolvency laws of the jurisdiction where the foreign bank is established or incorporated may be different from the laws of Singapore. This may give rise to conflict when administering the covered bonds/cover pool in the event of insolvency of the bank.

11.3 Whether a foreign subsidiary of a bank incorporated in Singapore is permitted to issue covered bonds will depend on the rules of the jurisdiction where the subsidiary operates. However, a foreign subsidiary of a bank incorporated in Singapore, if permitted to issue covered bonds by the foreign jurisdiction, will only be allowed to use its own assets, and not those of other entities in the group to form the cover pool.

## **12 Structure of covered bond programme**

### Feedback

12.1 Some respondents sought clarification on the structure of covered bond programme that would be permitted in Singapore.

### MAS' Response

12.2 Banks will be allowed the flexibility to adopt the structure in which they have assessed to best suit their needs. Nevertheless, a bank should obtain legal confirmation that the cover pool assets are appropriately segregated even in an insolvency situation.

## **13 Administration of covered bonds in the event of an issuer's insolvency**

### Feedback

13.1 A few respondents suggested that MAS Notice 648 also address the appointment of an administrator after issuer default and the powers and duties of the administrator.

### MAS' Response

13.2 We note that the duties of an administrator would be to represent the interest of investors and enforce the investors' rights in the collateral in the event of the issuer's insolvency, among others. A bank undertaking to issue covered bonds is expected to provide for the appointment of such an administrator and set out its duties contractually.

## **14 Set-off and section 62A of the Banking Act in the event of issuer's insolvency**

### Feedback

14.1 One respondent sought clarification on whether section 62A of the Banking Act would apply in the event of bankruptcy of a bank that has issued covered bonds, even though equitable assignment to the SPV of residential mortgage loans used to collateralise the covered bonds, was perfected well before the bank's insolvency.

### MAS' Response

14.2 A bank that issues covered bonds would have to obtain legal advice on the application of section 62A of the Banking Act even if equitable assignment was perfected well before the insolvency of the bank. The bank would have to highlight the potential risk to investors of its covered bond programme and determine how it can structure its covered bond programme to provide the necessary assurance to investors. The bank should also make the appropriate disclosure in the notice of assignment to its borrowers the consequences of legal perfection, including whether the bank's borrowers will have the right to set-off their residential mortgage loans against any deposits that the borrowers may have placed with the banks.

## **15 Disclosure of information under Third Schedule of Banking Act**

### Feedback

15.1 One respondent sought clarification on whether existing provisions under the Third Schedule of the Banking Act would permit the following:

- (i) disclosure to professional advisers or service providers of parties involved in the covered bond programme, other than professional advisers or service providers appointed by the issuing bank; and
- (ii) further disclosure to the SPV's related parties or potential purchasers should the SPV choose to liquidate the cover pool where an issuing bank defaults, the guarantee is called upon and the SPV takes actions to raise monies to repay the covered bond holders.

## MAS' Response

15.2 Banks should seek legal advice and where it is assessed that disclosure is not permitted, customer consent should be obtained.

## **16 MAS Notice 637 on Risk Based Capital Adequacy Requirements for Banks Incorporated in Singapore and MAS Notice 639 on Exposures to Single Counterparty Groups**

### Feedback

16.1 In the case of a SPV guarantor structure, one respondent noted that it would be necessary for the bank to extend a loan to the SPV so that the SPV can give consideration to the bank for the legal true sale of cover pool assets. From an accounting perspective, it is likely that the cover pool assets will not be derecognised and, in addition, the loan to the SPV would be recognised as an asset in the bank's entity-level balance sheet. To avoid double counting both the cover pool assets and the loan to the SPV, the respondent proposed that the loan should be excluded from the scope of MAS Notices 637 and 639 at the bank solo level. The respondent also sought clarification on the capital treatment of assets in the cover pool.

### MAS' Response

16.2 MAS will set out in MAS Notice 637 and MAS Notice 648 a requirement that the issuing bank and the SPV be treated as a single entity for capital computation purposes. Under this approach, the bank would be required to treat the assets of the SPV as though they were held directly by the bank, without reference to the SPV, and compute capital on those assets accordingly. Capital requirements will apply at both the bank-solo and the bank-group levels, regardless of whether the assets remain recognised on the bank's balance sheet according to accounting standards.<sup>2</sup> At the bank-solo level, the portion of the loan by the bank to the SPV used for the purchase of the cover pool assets by the SPV can be excluded from the capital requirements under MAS Notice 637.

---

<sup>2</sup> This would mean, among others, that – (a) the bank would be expected to assess any interest rate risk arising from the covered bond issuance, including the cover pool assets held in the SPV; and (b) the bank would be required to include the assets held in the SPV in its capital reporting schedules under MAS Notice 637, at both the bank-solo and bank-group levels.

16.3 Similarly, such a loan can be excluded, at the bank-solo level, from the large exposure limit under MAS Notice 639 to avoid penalising the bank twice. MAS will review the need to amend MAS Notice 639, to cater for such situations, following the completion of the review of the large exposures regime by the Basel Committee on Banking Supervision (“BCBS”).

## **17 Covered bonds as eligible assets for the purposes of section 38 of the Banking Act and for repo transactions with MAS under the MAS Standing Facility**

### Feedback

17.1 Two respondents asked if covered bonds could be allowed as eligible assets for the purposes of meeting the minimum liquid assets (“MLA”) requirement under section 38 of the Banking Act, and for repo transactions with MAS under the MAS Standing Facility.

### MAS’ Response

17.2 In January 2013, the BCBS issued “Basel III: The Liquidity Coverage Ratio and liquidity risk monitoring tools”. MAS has proposed to replace the MLA framework with the adoption of the LCR rules in the Consultation Paper on Local Implementation of Basel III Liquidity Rules – Liquidity Coverage Ratio issued in August 2013. Under the LCR rules, covered bonds that meet the criteria of Level 2 assets, as set out in para 52(b) of the January 2013 BCBS paper, qualify to be included in the stock of high quality liquid assets. With respect to the MAS Standing Facility, MAS will review the eligibility of covered bonds for this purpose in line with the depth and liquidity of the covered bond market in Singapore.

MONETARY AUTHORITY OF SINGAPORE  
31 December 2013