

# CONSULTATION PAPER

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## MAS Notice 639 - Exposures to Single Counterparty Groups

MAS

Monetary Authority of Singapore

## **PREFACE**

Section 29 of the Banking Act sets prudential limits on credit facilities granted by a bank to a single borrower or group of related borrowers, to limit the concentration risk of a bank. It also sets limits on unsecured credit facilities to persons related to the bank to limit contagion risk and to minimise the scope for conflict of interests. MAS proposes a number of changes to ensure that the prudential limits remain relevant and are in line with international best practice. MAS had earlier consulted the industry on the policies before developing the detailed requirements in the proposed MAS Notice 639. In finalising the Notice, MAS will also consider comments received during the recent consultation on the draft Banking (Amendment) Bill 2006, which included proposed changes to section 29, pursuant to which MAS Notice 639 will be issued, as well as industry feedback on the proposed recognition of credit risk mitigation techniques for the purpose of section 29.

2 MAS invites interested parties to forward their views and comments on the draft MAS Notice 639. Electronic submission is encouraged. Please submit your written comments by 13 October 2006 to:

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

Fax: 62203973  
Email: [policy@mas.gov.sg](mailto: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.

## MAS 639

(date)

### NOTICE TO BANKS BANKING ACT, CAP 19

#### Exposures to Single Counterparty Groups

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#### Introduction

1. This Notice is issued pursuant to section 29(1) of the Banking Act (Cap.19) [“the Act”] and applies to all banks in Singapore.
2. It sets out the limits on a bank’s exposures to a single counterparty group, the types of exposures to be included in or excluded from those limits, the basis for computation of exposures, the approach for aggregating exposures to counterparties that pose a single risk to the bank, the recognition of credit risk mitigation and aggregating of exposures at the bank group level.

#### Definitions

3. For the purposes of this Notice—

“**Accounting Standards**” has the same meaning as in section 4(1) of the Companies Act (Cap 50);

“**affiliate**” has the same meaning as in regulation 2(1) of the Banking (Corporate Governance) Regulations 2005;

“**bank group**” means a bank in Singapore, its subsidiaries and any other company treated as part of the bank’s group of companies according to Accounting Standards and in the case of a bank incorporated outside Singapore, only where such subsidiary or company is reflected as an investment in the financial statements of the bank in relation to its operations in Singapore;

“**counterparty**” means an entity—

- (a) which has an obligation to the bank as a result of the bank’s contractual arrangements or other arrangements; or
- (b) to whom a bank is exposed to, as a result of the bank’s contractual arrangements or other arrangements or investments;<sup>1</sup>

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<sup>1</sup> “Counterparty” includes an issuer of any security.

**“capital funds”** in relation to a bank incorporated outside Singapore or its bank group, means the net head office funds of the bank and such other liabilities as defined in MAS Notice 601;

**“director group”**, in relation to a bank in Singapore or bank group, means:

- (a) a director of the bank<sup>2</sup>;
- (b) a firm or limited liability partnership in which the director has an interest as a partner, manager or agent, or any individual, firm or limited liability partnership of whom or of which the director is a guarantor or surety<sup>3</sup>;
- (c) a company in which the director is an executive officer or of which the director is a guarantor or surety; and
- (d) a company in which the director, whether legally or beneficially, owns more than half of the issued share capital, control more than half of voting power or in which the director controls the composition of the board of directors<sup>4</sup>;

**“eligible total capital”** in relation to a bank incorporated in Singapore, has the same meaning as ‘Eligible Total Capital’ in MAS Notice 637, on a standalone (“Solo”) or consolidated (“Group”) level, as the case may be;

**“entity”** means any individual, corporation, association or body or persons, whether corporate or unincorporated, sole-proprietorship, partnership or limited liability partnership as defined under Limited Liability Partnership Act 2004;

**“executive officer”** has the same meaning as in section 2(1) of the Banking (Corporate Governance) Regulations 2005;

**“exposure”** means the maximum loss that a bank may incur as a result of the failure of a counterparty to meet its obligations<sup>5</sup> and includes any loss that may be incurred on any equity investment or contingent liability;

**“exempt exposure”** means any exposure set out in Appendix 1;

**“family member”**, in relation to an individual, means the individual’s spouse, parent, remoter lineal ancestor, step-parent, son, daughter, remoter lineal issue, step-son, step-daughter, brother and sister;

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<sup>2</sup> “Director” includes the family members of the director.

<sup>3</sup> Notwithstanding this sub-paragraph and sub-paragraph (c), a bank need not treat a director as a person caught under the director group of another director only by virtue of the application of section 29(5) of the Act.

<sup>4</sup> The composition of a company’s board of directors shall be deemed to be controlled by a director of the bank if he, by the exercise of some power exercisable by him without the consent or concurrence of any other person, can appoint or remove all or a majority of the directors of that company.

<sup>5</sup> When determining the maximum loss that a bank may incur, a bank shall not take into account any collateral available to the bank and the likelihood of recovery from an administrator or liquidator of the counterparty.

**“financial assistance”** includes the making of a loan, the giving of a guarantee, the provision of security, the release of an obligation and the release of a debt;

**“financial group”**, in relation to a bank in Singapore, means any entity in which a bank in Singapore holds a major stake as defined in section 32(7) of the Banking Act, other than an entity excluded under section 32(5), and in the case of a bank incorporated outside Singapore, only where such an entity is reflected as an investment in the financial statements of the bank in relation to its operations in Singapore;

**“financially interdependent”** refers to a situation where two or more persons have a legal or economic relationship with each other such that if one were to experience difficulties in meeting its financial obligations, the other is likely to encounter similar difficulties<sup>6</sup>;

**“Rating Agency”** means Standard and Poor’s, Moody’s or Fitch Ratings;

**“single counterparty group”** means any counterparty, a director group, a financial group, a substantial shareholder group or any third party single counterparty group;

**“subsidiary”**, in relation to a bank incorporated outside Singapore, has the same meaning as section 5 of the Companies Act, except that the control of, or holding of shares in, any corporation by the bank in Singapore, is by way of investments reflected in the financial statements of the bank in respect of its operations in Singapore;

**“substantial shareholder group”** means

- (a) in the case of a bank incorporated in Singapore—
  - (i) where the substantial shareholder is an individual—
    - (A) the substantial shareholder of the bank and his family members; and
    - (B) an affiliate of the substantial shareholder of the bank and his family members;
  - (ii) where the substantial shareholder is a corporation, the substantial shareholder and its affiliates; and

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<sup>6</sup> Examples of entities which are financially interdependent include the following

- (a) where one entity derives 50% or more of its operating revenues from another entity;
- (b) where two or more entities have given cross-guarantees for each other’s liabilities;
- (c) an individual and his family members except where the individual and the family members have resources of their own to meet their obligations without depending on each other and credit facilities granted are not for the use of other family members. In this regard, the bank shall have a sound basis for making such determination, which shall be documented;
- (d) partners or participants of a partnership, joint venture or other common enterprise, except where the partners or participants have resources of their own to meet their obligations without depending on each other and credit facilities granted are not for the use of other partners or participants.

- (b) in the case of a bank incorporated in Singapore that is a subsidiary of a financial holding company or another bank (“parent bank”)—
  - (i) where the substantial shareholder is an individual—
    - (A) the substantial shareholder of the bank, financial holding company or parent bank, as the case may be, and his family members; and
    - (B) an affiliate of the substantial shareholder and his family members;
  - (ii) where the substantial shareholder is a corporation, the substantial shareholder of the bank, financial holding company or parent bank, as the case may be, and its affiliates; and

**“third party single counterparty group”** means—

- (a) a controlling entity and in a case where the controlling entity is an individual includes his family members; and
- (b) all entities under the control of the controlling entity (referred to collectively with the controlling entity as “common control group”).

4. An entity is considered to be under the **control** of another entity (referred to in this Notice as “**controlling entity**”) if it is —

- (a) an entity in which the controlling entity holds more than half of the issued share capital;
- (b) an entity in which the controlling entity controls more than half of the voting power;
- (c) an entity in which the controlling entity controls the composition of the board of directors;
- (d) an entity which is a subsidiary of an entity falling within sub-paragraphs (a), (b) and (c); or
- (e) an entity (not being an entity which is caught under sub-paragraphs (a), (b), (c) or (d)) the policies of which the controlling entity is able to control.

5. 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 Act.

## **Large Exposures and Substantial Exposure s Limits to Single Counterparty Group**

### Solo Level

- 6. Subject to paragraphs 9 and 10, a bank in Singapore shall not permit:
  - (a) the aggregate of its exposures to a single counterparty group to exceed —

- (i) in the case of a bank incorporated in Singapore, 25% or such other percentage of its eligible total capital as may be approved by the Authority<sup>7</sup>; or
  - (ii) in the case of a bank incorporated outside Singapore, 25% or such other percentage of its capital funds as may be approved by the Authority,
- (hereinafter referred to as “large exposures limit”); and
- (b) the aggregate of exposures exceeding 10% of its eligible total capital or capital funds, as the case may be, to any single counterparty group<sup>8</sup>, to exceed 50% or such other percentage of its total exposures as may be approved by the Authority (hereinafter referred to as “substantial exposures limit”).

### Group Level

7. Subject to paragraphs 9 and 10, a bank in Singapore shall aggregate its exposures to a single counterparty group, with the exposures of its subsidiaries<sup>9</sup> to the same counterparty group and shall not permit—

- (a) the aggregate of the exposures of the bank group to a single counterparty group to exceed—
  - (i) in the case of a bank incorporated in Singapore, 25% or such other percentage of the eligible total capital of the bank group as may be approved by the Authority; or
  - (ii) in the case of a bank incorporated outside Singapore, 25% or such other percentage of the capital funds of the bank group as may be approved by the Authority,(hereinafter referred to as “large exposures limit”); and
- (b) the aggregate of the exposures of a bank group exceeding 10% of the eligible total capital or capital funds, as the case may be, to any single counterparty group, to exceed 50% or such other percentage of its bank group’s total exposures as may be approved by the Authority (hereinafter referred to as “substantial exposures limit”).

8. A bank in Singapore shall aggregate exposures to entities which are financially interdependent and treat such entities as a single counterparty group, notwithstanding that such entities are not in a common control group.

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<sup>7</sup> While the Authority may raise the limits for a bank or bank group, as the case may be, on a case-by-case basis, it will not ordinarily approve any application for higher exposure limits unless the application is supported by strong justification.

<sup>8</sup> Where an entity is included in more than one single counterparty group, a bank or bank group’s exposure to that entity need only be accounted for under one single counterparty group.

<sup>9</sup> A subsidiary of the bank may include an insurer or asset management company which holds assets in its insurance or investors’ funds. Exposures to counterparties arising from such assets held for the benefit of any third party (other than the bank or other bank group entities) shall be excluded from the large exposures and substantial exposures limits.

9. Notwithstanding that an entity may not be included in a director group, a financial group, a substantial shareholder group or any third party single counterparty group, a bank in Singapore shall aggregate the exposures of one or more entities with that of a director group, a financial group, a substantial shareholder group or any third party single counterparty group, as the case may be, if there are reasons for the bank to regard these exposures as connected in such a way so as to pose a single risk to the bank. The Authority may also require the bank to aggregate any of its exposures, where the Authority is of the view that these exposures pose a single risk to the bank.

10. The substantial exposures limit, at both the Solo and Group level, shall not apply to a bank in Singapore whose total Singapore dollar credit facilities to its non-bank customers do not exceed \$100 million.

### **Exclusion from Large Exposures and Substantial Exposures Limits**

11. For the purpose of complying with the large exposures and substantial exposures limits at the Solo or Group level in paragraphs 6 and 7, a bank in Singapore when aggregating its exposures or the exposures of the bank group, as the case may be, —

- (a) may exclude one or more of the exempt exposures, and
- (b) need not aggregate exposures to an entity or a sub-group of entities in a common control group with the other entities of the group if the entity or sub-group of entities, as the case may be, fulfill the criteria for disaggregating exposures of financially independent entities set out in Appendix 2.

12. Any entity or sub-group of entities disaggregated from a common control group shall be treated by a bank as a single counterparty group for the purposes of complying with paragraphs 6 and 7.

13. A bank incorporated in Singapore, may exclude an exposure from its aggregate exposures or the aggregate exposures of the bank group, as the case may be, to a single counterparty group if the exposure has been deducted from its eligible total capital at the Solo or Group level<sup>10</sup>

### **Limits on Unsecured Credit Facilities at Solo or Group Level**

14. Subject to paragraphs 15 and 22, a bank in Singapore shall not—

- (a) permit its aggregate unsecured credit facilities (other than credit card and charge card facilities)<sup>11</sup> and the aggregate unsecured credit facilities of its

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<sup>10</sup> For example, a bank incorporated in Singapore may exclude from the computation of its aggregate exposures, its capital investments in a company or its securitisation exposures if these are deducted from eligible total capital for purposes of computation of regulatory capital.

<sup>11</sup> Credit card and charge card facilities are subject to the requirements in the Banking (Credit Card and Charge Card) regulations.



bank group (other than credit card and charge card facilities) to any director group to exceed \$5,000; and

- (b) grant, whether on its own or collectively with any entity in the bank group, to any of its officers (other than a director) or employees, or any other person who receives remuneration from the bank (other than for professional services rendered to the bank), any unsecured credit facility which in the aggregate and outstanding at any one time exceeds one year's emoluments<sup>12</sup> of that officer, employee or person.

15. For the purposes of complying with paragraph 14(a), a bank need not include any unsecured credit facility granted to any entity within the director group which is—

- (a) an entity carrying on banking business (whether in Singapore or elsewhere) or merchant bank approved under section 28 of the Monetary Authority of Singapore Act (Cap 186); and
- (b) a related corporation of the first-mentioned bank,

provided that in the case of a bank incorporated in Singapore, the bank may only exclude such an unsecured credit facility if the residual maturity of the credit facility does not exceed one year.

### **Limits for Internal Monitoring and Reporting**

16. A bank incorporated in Singapore shall monitor its unsecured exposures to each substantial shareholder group exceeding 5% of its eligible total capital, on a Solo and Group level, and submit a report of such exposures to its board of directors on a quarterly basis.

### **Measurement of Exposures**

17. A bank in Singapore shall apply the basis for computation of exposures set out in Appendix 3.

18. In view of potential changes to the shareholding structure of a counterparty and its financial relationship with other entities, a bank in Singapore should review the profile of its counterparties at least once every 12 months, but in any case, a review shall be conducted by the bank no later than 15 months from the last review<sup>13</sup>.

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<sup>12</sup> "Emoluments", in relation to an individual, means the salary and bonuses of the individual in the previous year but does not include any allowances.

<sup>13</sup> The Authority expects a bank to monitor more closely, developments affecting its customers with larger exposures particularly those with exposures that are close to the limits set out in this Notice.

## **Application of Certain Credit Risk Mitigation Techniques<sup>14</sup>**

### Bilateral Netting of Exposures

19. Subject to paragraph 20, a bank in Singapore may compute its exposure from off-balance sheet derivatives transactions with the same counterparty on a net basis if it satisfies the requirements set out in paragraphs 2 to 6 of MAS Notice 638<sup>15</sup> and notifies the Authority in writing.

20. If the Authority is of the view that a bank is unable to comply with the minimum requirements in MAS Notice 638 or such other conditions imposed by the Authority for the purpose of recognising the netting of its off-balance sheet derivatives transactions under section 29 of the Act, the Authority may require the bank to cease computing exposures on a net basis.

### Exposures Secured Against Collateral

21. For the purposes of complying with the large exposures and substantial exposures limits, a bank in Singapore may offset from the gross exposure, the portion of the exposure which is secured against qualifying collateral, to compute its resulting exposure to a counterparty. The list of qualifying collateral and conditions to be fulfilled before the collateral may be used for offsetting purposes, are set out at Appendix 4.

22. A bank in Singapore may also offset any collateral<sup>16</sup> satisfying the conditions set out in paragraph 2 of Appendix 4, for the purpose of:

- (a) complying with the unsecured credit facilities limit of \$5,000 to any director group;
- (b) complying with the unsecured credit facilities limit of one year's emoluments to any officer (other than a director), employee, or person receiving remuneration from the bank (other than for professional services rendered to the bank); or
- (c) monitoring any unsecured exposure to a substantial shareholder group exceeding 5% of the bank's eligible total capital.

23. Where the gross exposure and collateral are denominated in different currencies, the value of the collateral shall be subject to a haircut based on the figures for "FX" set out in Table 1 of Appendix 3.

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<sup>14</sup> The requirements in this section and the applicable appendices are based on proposals set out in MAS' consultation paper on credit risk mitigation. The consultation period closed on 21 Aug 06 and the Authority is currently considering the feedback.

<sup>15</sup> MAS Notice 638 sets out the requirements that a bank incorporated in Singapore will need to comply with in order to recognise bilateral netting in respect of transactions entered into with a counterparty covered under a netting agreement for the purposes of calculating its capital adequacy ratio under MAS Notice 637.

<sup>16</sup> Acceptable collateral includes any cash deposit, property and any marketable debt or equity security (other than any security issued by the counterparty, a related corporation of the counterparty, or any entity in the substantial shareholder group or financial group of the bank) but does not include any guarantee or letter of credit.

### Substitution of Exposures

24. Subject to paragraph 25 and 26, for the purpose of complying with the large exposures and substantial exposures limits, a bank in Singapore that has obtained credit protection may substitute its exposures to a counterparty, with its exposure to the provider of credit protection.

25. A bank in Singapore may only substitute its exposures to a counterparty with that of the provider of credit protection if there is no mismatch in the currency or maturity of the credit protection with the underlying exposure and the provider of credit protection satisfies the following criteria:

- (a) the provider of credit protection shall have a minimum credit rating of “A-” (or its equivalent) by at least two Rating Agencies;
- (b) the provider of credit protection shall be better rated than the counterparty;
- (c) the provider of credit protection shall not be the head office of the bank or parent bank, the bank’s sister branches, subsidiaries and associated companies, the immediate or ultimate holding company of the bank, the subsidiaries and associated companies of any holding company of the bank or any entity in the substantial shareholder group or financial group of the bank;
- (d) the provider of credit protection shall be financially independent of the counterparty and vice versa.

26. Only the following types of credit protection may be used as substitutes for an exposure to a counterparty:

- (a) any guarantee which satisfies the conditions at Appendix 5A; and
- (b) any single name credit default swap, total return swap or first-to-default credit derivative providing credit protection equivalent to a guarantee, which satisfies the conditions at Appendix 5B.

27. The resulting exposure of a bank in Singapore to the provider of credit protection shall be aggregated with the bank’s other exposures to this same provider, for the purpose of compliance with the limits set out in this Notice.

28. Where the provider of credit protection is an entity to whom exposures of a bank in Singapore are exempt exposures under this Notice, the bank shall not treat any exposure acquired indirectly by the bank as a result of substitution of exposures through credit risk mitigation as an exempt exposure.

### **Effective Date and Transitional Provisions**

29. Subject to paragraph 30, this Notice shall take immediate effect. MAS Notice 623 dated 11 November 2002 and MAS Notice 629 dated 4 January 2006 shall be cancelled with immediate effect.

30. A bank in Singapore carrying on banking business immediately before the date of commencement of this Notice shall continue to comply with the requirements set out in MAS Notices 623, 625 and 629 relating to the repealed section 29 of the Act unless the

bank has elected to comply with the new section 29 of the Act pursuant to section 56 of the Banking (Amendment) Act 2006. Where the bank in Singapore has so elected, the bank shall comply with this Notice from the date of election specified in the notice of election.

**Exempt Exposures**

For the purposes of this Notice, the following exposures are exempt exposures :

- (a) an exposure to the Singapore Government<sup>17</sup> and to the Authority;
- (b) an exposure to a central bank<sup>18</sup> or a central government of a sovereign country that is rated “AAA” (or its equivalent) by at least two Rating Agencies;
- (c) an exposure of an overseas branch or subsidiary of a bank incorporated in Singapore, to the central bank or central government of the jurisdiction where the branch or subsidiary is located, where :
  - (i) the exposure is to meet the statutory liquidity and reserves requirement or other statutory requirements imposed by the central bank in that jurisdiction; or
  - (ii) the exposure is denominated in the local currency of the jurisdiction and its original maturity is not greater than three months. The amount to be exempted is limited to the amount of local currency denominated liabilities of the branch or subsidiary concerned;
- (d) an exposure to any of the following entities :
  - (i) a regional government or local authority that is able to exercise one or more functions of the central government at the regional or local level;
  - (ii) an administrative body or non-commercial undertaking responsible to, or owned by, a central government, regional government or local authority, which performs regulatory or non-commercial functions;
  - (iii) a statutory board in Singapore (other than the Authority); or
  - (iv) a town council in Singapore established pursuant to the Town Councils Act (Cap 392A); and

where the entity is rated “AAA” (or its equivalent) by at least two Rating agencies;
- (e) an exposure to the following multilateral development banks:
  - (i) the World Bank Group, comprising the International Bank for Reconstruction and Development and the International Finance Corporation;
  - (ii) the Asian Development Bank;
  - (iii) the European Bank for Reconstruction and Development, the Council of Europe Development Bank, the European Investment Bank, the European Investment Fund and the Nordic Investment Bank;
  - (iv) the Inter-American Development Bank, the Islamic Development Bank and the Caribbean Development Bank;
  - (v) the African Development Bank;

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<sup>17</sup> For the avoidance of doubt, an exposure to a statutory board in Singapore is not considered an exposure to the Singapore Government.

<sup>18</sup> This includes any entity which performs the role of a central bank of any jurisdiction.

- (f) an exposure guaranteed by or hedged by a credit derivative with any entity listed in sub-paragraph (a), (b), (d) and (e) above, which fulfills the conditions in Appendix 5A or 5B, as the case may be;
- (g) an exposure arising from a foreign exchange or money market transaction, to a bank, whether or not licensed in Singapore, except that in the case of an exposure of a bank incorporated in Singapore to its bank subsidiary, the residual maturity of the exposure shall not exceed one year;
- (h) an exposure arising from a foreign exchange or money market transaction, to a merchant bank which is a related corporation of the bank licensed in Singapore, except that in the case of an exposure of a bank incorporated in Singapore to its merchant bank subsidiary, the residual maturity of the exposure shall not exceed one year;
- (i) an exposure to a counterparty arising from settlement of transactions, where the bank has fulfilled its obligation under the transaction but the counterparty has not, up to two business days from the date of settlement.

**Criteria for Disaggregating Exposures to Financially Independent Entities Under Common Control**

1. Where the controlling entity is not a foreign government or foreign central bank, the exposures of an entity or a sub-group of entities in a common control group can be disaggregated from the exposures of the common control group where:
  - (a) the entity or each entity in the sub-group, as the case may be, has sufficient financial resources (either on its own or together with the financial resources provided by the other entities in the sub-group) to fully service its liabilities, and does not need to depend on any other entity in the common control group that does not fall within the sub-group (“external group entity”) for financial assistance in meeting its liabilities;
  - (b) the entity or each entity in the sub-group, as the case may be, is not dependent on by any external group entity for financial assistance in meeting the external group entity’s liabilities;
  - (c) proceeds received by the entity or each entity in the sub-group, as the case may be, 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, as the case may be, and are not transferred to any external group entity;
  - (d) the entity or the entities in the sub-group, as the case may be, does not receive the proceeds of the credit facilities, whether in whole or in part, obtained by any external group entity from the bank;
  - (e) the entity or the entities in the sub-group, as the case may be, is dependent on any external group entity, whether singly or in the aggregate with other external group entities, for more than 50% of its operating revenues;
  - (f) the entity or the entities in the sub-group, as the case may be, is not dependent on by any external group entity, either singly or in the aggregate with other entities in the sub-group, for more than 50% of the external group entity’s operating revenues;
  - (g) the entity or the entities in the sub-group, as the case may be, 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 any external group entity;
  - (h) none of the names, logos or trademarks of the entity or any of the entities in the sub-group is used by any external group entity in a manner which indicates or represents that the external group entity is related to or associated with the entity or any of the entities in the sub-group;
  - (i) a majority of the directors of the entity or each of the entities in the sub-group, as the case may be, do not fall within any of the following categories:
    - (i) the controlling entity;

- (ii) family members of the controlling entity;
  - (iii) employees of the controlling entity;
  - (iv) concurrently directors of the controlling entity;
  - (v) employees of any other external group entity.
- (j) no external group entity that is a controlling entity or family member of such a controlling entity is an executive officer or chairman of the board of directors of the entity or any of the entities in the sub-group;
  - (k) no chief executive officer of any external group entity that is a controlling entity is an executive officer or chairman of the board of directors of the entity or any of the entities in the sub-group
  - (l) apart from being in the common control group, the entity or each of the entities in the sub-group, as the case may be, and any external group entity are not financially interdependent.

2. Where the controlling entity is a foreign government or foreign central bank, the exposures of an entity or a sub-group of entities in a common control group can be disaggregated from the exposures of the common control group where the criteria in 1(a) to (f), and (l) are met.



### **Basis of Computation of Exposures**

1. For the purpose of compliance with the exposure limits set out in this Notice, a bank shall record an exposure arising from:

- (a) **actual outstanding position or claim against a single counterparty group**, including:
- (i) any loan or advance granted;
  - (ii) any bills purchased or any discounted bills held;
  - (iii) any linked spot and forward purchases of securities that function economically like a secured loan<sup>19</sup>;
  - (iv) any debt securities purchased or sold;
  - (v) any financial derivative purchased or sold over-the-counter<sup>20</sup>;
  - (vi) any margin held with any exchange, clearing house or other counterparty.

A bank should measure these exposures based on their carrying value, i.e. the same measurement basis that has been applied to the exposures in the preparation of the bank's financial statements. The same measurement basis is to be used consistently and in a manner which complies with the requirements of the Singapore Financial Reporting Standards. The same measurement basis should be applied to both the numerator and denominator in computing large exposures and substantial exposures.

- (b) **any contingent liability or commitment arising from the normal course of business as a result of utilisation of limits available or drawing down of undrawn advised facilities which the bank has committed to provide**, including:
- (i) any undrawn credit facilities;
  - (ii) any direct credit substitutes such as guarantees issued by the bank, bills accepted but not held by the bank;
  - (iii) any transaction related contingent items such as standby letters of credit, performance bonds, bid bonds or warranties;
  - (iv) any short-term self-liquidating trade related credits such as documentary credit collateralised by underlying shipments.

A bank should measure these contingent liabilities and commitments based on the facility limit that has been granted to the counterparty, excluding any amount that has been utilised or drawn down.

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<sup>19</sup> For a reverse repurchase transaction, where the security received is a qualifying collateral, the exposure may be reduced by the value of the security.

<sup>20</sup> Include forwards, options, swaps and similar derivative contracts on interest rates, foreign currencies, equities, securities and commodities.

- (c) **any assets whose value depends on an issuer performing its obligations, or whose value otherwise depends on that issuer's financial soundness,** including securities, warrants and options.

A bank should record an exposure to the issuer of the security based on their carrying value i.e. the same measurement basis that has been applied to the exposures in the preparation of the bank's financial statements, provided that the same measurement basis is used consistently and in a manner which complies with the requirements of the Singapore Financial Reporting Standards.

- (d) **any investment in an index or an investment fund.**

- (i) A bank that invest in an index or an investment fund should record an exposure to the issuer of each of the underlying asset based on the relative size of the issuers' contribution to the index or investment fund;
- (ii) Where the proportionate exposure to the issuer through the index or investment fund does not exceed, in the case of a bank incorporated in Singapore, 0.25% of its eligible total capital or in the case of a bank incorporated outside Singapore, 0.25% of its capital funds, the bank may record the exposure as an exposure to the index or the investment fund.

- (e) **any outstanding claims on a special purpose vehicle ("SPV") as part of a securitisation transaction,** including on-balance sheet exposure to securities issued e.g. asset-backed securities, mortgage-backed securities and collateralised debt obligations, and off-balance sheet exposures e.g. through credit enhancements, liquidity facilities, interest rate or currency swaps or credit derivatives, regardless of whether it was retained by the bank at, or repurchased by the bank after, the origination of the securitisation.

- (i) A bank should record an exposure to the issuer of each of the underlying assets based on the relative size of the issuers' contribution to the pool of securitised assets;
- (ii) Where the proportionate exposure to the issuer through the pool of securitised assets held by the SPV does not exceed, in the case of a bank incorporated in Singapore, 0.25% of the bank's eligible total capital or in the case of a bank incorporated outside Singapore, 0.25% of its capital funds, the bank may record the exposure as an exposure to the SPV;
- (iii) A bank may count an exposure to the SPV in place of the underlying assets under extenuating circumstances where the bank is unable to look through the SPV to its underlying assets. Where this occurs, the bank should document the reason(s) for its inability

to look through the SPV. Such documentation shall be made available for review by the Authority at all times.

- (f) **any commitments due to underwriting.**
  - (i) In the case of securities underwriting, a bank should record an amount equivalent to the commitment limit multiplied by 20% 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 should be counted as an exposure to the issuer;
  - (ii) In the case of notes issuance facilities and revolving underwriting facilities, a bank should record an amount equivalent to the facility limit multiplied by 50% as an exposure to the issuer.
- (g) **any potential future credit exposure over the remaining life for over-the-counter off-balance-sheet items.** The potential future credit exposure for these items shall be computed by applying an add-on factor to the effective notional principal amount as set out in the table below.

Table 1: Add-on for Potential Future Exposure

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%

The Authority may allow banks to use their internal models to derive appropriate add-ons if these models have been validated by their home regulators or the Authority for capital adequacy purposes.

**Exclusions**

- 2. A bank may exclude the following from the computation of exposures:
  - (a) unadvised or uncommitted facilities and internal limits. For uncommitted facilities, a bank in Singapore should obtain a legal opinion that its facility documentation confers upon the bank an unconditional right to refuse drawdown. The Authority expects all banks in Singapore to have proper procedures in place to enable them to exercise their rights to decline drawdown requests for uncommitted facilities.
  - (b) accrued interest and fees outstanding. Nevertheless, a bank in Singapore may include these items if they wish to do so, or if such sums are material.

**Recognition of Collateral**

1. “Qualifying collateral” means any cash deposit pledged, charged or secured as collateral and any security issued by entities listed in paragraphs (a), (b) and (d) of Appendix 1.
2. A bank shall ensure the following conditions are fulfilled before offsetting collateral in its computation of exposures:
  - (a) all collateral arrangements shall be properly documented, and the bank shall take all steps necessary to fulfill statutory and contractual requirements to ensure that it is able to enforce its security interest;
  - (b) the bank shall 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 shall satisfy itself that there is adequate segregation between the collateral instruments and the custodian’s own assets;
  - (d) the market value of the collateral shall be readily determinable or marked to market on a regular basis; and
  - (e) the value of the collateral shall not have a positive correlation with the credit quality of the counterparty.

**Requirements for Recognition of Guarantees**

A bank shall meet the following conditions before it can recognise guarantees:

- a) The guarantee shall be an explicitly documented obligation assumed by the guarantor;
- b) All documentation used for guarantees should be binding on all parties and legally enforceable in all relevant jurisdictions. Such documentation shall be subject to sufficient legal review. Further reviews should be required as necessary to ensure continuing enforceability of legal documentation in all relevant jurisdictions;
- c) The guarantee shall represent a direct claim on the guarantor and must be explicitly referenced to specific exposures or a pool of exposures, so that the extent of the cover is clearly defined and incontrovertible;
- d) The guarantee shall be irrevocable, i.e. there is no clause in the contract that allows the guarantor to unilaterally cancel the guarantee or that increases the effective cost of cover as a result of deteriorating credit quality in the hedged exposure;
- e) The guarantee shall be unconditional, i.e. there is no clause in the contract outside the direct control of the bank that could prevent the guarantor from being obliged to pay out in a timely manner in the event that the original counterparty fails to make the payment(s) due;
- f) On the qualifying default or non-payment of the counterparty, the bank should be able in a timely manner pursue the guarantor for any monies outstanding under the documentation governing the transaction. This means that the bank should have the right to receive any payments<sup>21</sup> from the guarantor without first having to take legal actions in order to pursue the counterparty for payment;
- g) The guarantee shall cover all types of payments the underlying obligor is expected to make under the documentation governing the transaction. Where a guarantee covers payment of principal only, interests and other uncovered payments would be treated as unsecured and recorded as exposure to the original counterparty; and
- h) Where the amount guaranteed is less than the amount of the original exposure, and the secured and unsecured portions are of equal seniority i.e. the bank and the guarantor share losses on a pro-rata basis, a bank may recognise exposure to guarantor for the portion of the original exposure that is covered by the guarantee.

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<sup>21</sup> The guarantee payments may be in the form of the guarantor making a lump sum payment of all monies to the bank or the guarantor assuming the future payment obligations of the counterparty covered by the guarantee, as specified in the relevant documentation governing the guarantee.

**Requirements for Recognition of Credit Derivatives**

A bank shall meet the following conditions before it can recognise any credit protection arrangements:

- a) the terms and conditions of any credit protection arrangements shall be set out in writing by both the bank and the protection seller;
- b) all documentation used for credit derivatives shall be binding on all parties and legally enforceable in all relevant jurisdictions. Such documentation shall be subject to sufficient legal review. Further reviews should be required as necessary to ensure continuing enforceability of legal documentation in all relevant jurisdictions;
- c) The credit derivative should represent a direct claim on the protection seller and should be explicitly referenced to specific exposures or a pool of exposures, so that the extent of the protection is clearly defined and incontrovertible;
- d) Other than non-payment by a bank protection buyer of money due in respect of the credit protection contract, there should exist an irrevocable obligation on the part of the protection seller to make up the credit loss borne by the bank as a result of the occurrence of a credit event specified in the contract<sup>22</sup>;
- e) The credit protection shall be unconditional. This means there should be no clause in the protection contract outside the direct control of the bank that could prevent the protection seller from being obliged to pay out in a timely manner in the event that the original counterparty fails to make the payment(s) due;
- f) The credit events specified by the contracting parties shall at a minimum cover:
  - (i) failure to pay the amounts due under terms of the underlying obligation that are in effect at the time of such failure (with a grace period that is closely in line with the grace period in the underlying obligation);
  - (ii) bankruptcy, insolvency or inability of the obligor to pay its debts, or its failure or admission in writing of its inability generally to pay its debts as they become due, and analogous events;
  - (iii) restructuring of the underlying obligation involving forgiveness or postponement of principal, interest or fees that results in a credit loss event (i.e. charge-off, specific provision or other similar debit to the profit and loss account); and
- g) In the event when only the restructuring of the underlying obligation is not specified as a credit event in the contract, partial recognition of the credit derivative under a substitution approach will be allowed. If the protection cover provided by the credit derivative is less than or equal to the amount of the

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<sup>22</sup> There is no clause in the contract that would allow the protection seller to unilaterally cancel the credit cover or that would increase the effective cost of cover as a result of deteriorating credit quality in the hedged exposure.

underlying obligation, only 60% of the amount of the hedge can be attributed to the protection seller while the residual exposure is attributed to the original obligor for the purposes of Section 29. If the amount of the credit derivative is larger than that of the underlying obligation, the amount of eligible hedge is capped at 60% of the amount of the underlying obligation;

- h) The credit derivative shall not terminate prior to the maturity of the underlying exposure or expiration of any grace period required for a default on the underlying obligation to occur as a result of a failure to pay;
- i) The maturity of the underlying exposure and the maturity of the credit derivative should both be defined conservatively<sup>23</sup>;
- j) A robust valuation process should be put in place in order to estimate loss reliably for credit derivatives that allow for cash settlement. There should be a clearly specified period for obtaining post-credit event valuations of the underlying obligation;
- k) If the protection buying bank's right/ability to transfer the underlying obligation to the protection seller is required for settlement, the terms of the underlying obligation should provide that any required consent to such transfer may not be unreasonably withheld;
- l) The identity of the parties responsible for determining whether a credit event has occurred should be clearly defined. This determination should not be the sole responsibility of the protection seller. The protection buying bank should have the right or ability to inform the protection seller of the occurrence of a credit event;
- m) A mismatch<sup>24</sup> between the underlying obligation and the reference obligation under the credit derivative is permissible if:
  - (i) The reference obligation ranks *pari passu* with or is junior to the underlying obligation;
  - (ii) the underlying obligation and reference obligation share the same obligor (i.e. the same legal entity) and legally enforceable cross-default or cross-acceleration clauses are in place; and
- n) Where the amount of the credit protection afforded by the credit derivative is less than the amount of the exposure, and the secured and unsecured portions are of equal seniority i.e. the protection buying bank and the protection seller

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<sup>23</sup> The effective maturity of the underlying should be gauged as the longest possible remaining time before the counterparty is scheduled to fulfill its obligation, taking into account any applicable grace period. For the credit derivative, embedded options which may reduce the term of the credit derivative should be taken into account so that the shortest possible effective maturity is used. Where a call is at the discretion of the protection seller, the maturity will always be at the first call date. If the call is at the discretion of the protection buying bank but the terms of the arrangement at origination of the credit derivative contain a positive incentive (e.g. there is a step-up in cost in conjunction with a call feature) for the bank to call the transaction before contractual maturity, the remaining time to the first call date will be deemed to be the effective maturity.

<sup>24</sup> This sub-paragraph refers to (i) a mismatch between the underlying obligation and the obligation used for purposes of determining whether a credit event has occurred and (ii) a mismatch when the reference obligation (i.e. the obligation used for purposes of determining cash settlement value or the deliverable obligation) under the credit derivative covers obligations that do not include the underlying obligation.

share losses on a pro-rata basis, a bank may recognise exposure to the protection seller for the portion of the original exposure that is hedged; and

- o) There is no material positive correlation between the creditworthiness of the protection seller and the obligor of the underlying exposure.





Monetary Authority of Singapore