

RESPONSE TO FEEDBACK RECEIVED

January 2016

Response to Feedback Received – Related Party Transaction Requirements for Banks

MAS

Monetary Authority of Singapore

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1 Preface

1.1 MAS' requirements on banks' transactions with related parties ("RPTs") are currently set out in MAS Notice 643 ("the Notice") and the Banking Act ("BA"). In December 2013, MAS issued a consultation paper on proposed changes to the RPT requirements, to address industry feedback received on the requirements, and to ensure sufficient oversight and controls over RPTs.

1.2 Specifically, under the Notice, banks are required to ensure that

- (a) all RPTs are conducted at arm's length, i.e. based on terms and conditions that are not more favourable than similar transactions with non-related parties under similar circumstances;
- (b) RPTs with non-standard terms or which attract a material exposure are to be surfaced for prior board approval; and
- (c) all RPTs are monitored and subject to independent review.

1.3 MAS has carefully considered the feedback received, and would like to thank all respondents for their contributions. The feedback received, where appropriate, have been incorporated into the draft revised Notice, which has been published for consultation on 25 January 2016. The full list of respondents is in Annex A. Comments that are of wider interest, together with MAS' responses are set out in this response document.

2 Background

2.1 MAS' RPT requirements in MAS Notice 643 and the BA¹ are designed to ensure that banks exercise appropriate oversight and control over their RPTs. These are to mitigate the risk of abuses arising from conflicts of interest, and for alignment with international best practices, including the updated Core Principles for Effective Banking Supervision issued by the Basel Committee on Banking Supervision ("BCPs").

2.2 The key RPT requirements are –

- (a) Arm's length dealing: RPTs are to be on terms and conditions that are no more favourable than similar transactions with non-related parties;
- (b) Prior board approval for material RPTs: Materiality thresholds are to be set by a bank's board and RPTs that are material are to be subject to prior board approval. In the case of a bank incorporated outside Singapore, approval would be by any person authorised to carry on the role of approving and reviewing RPT policies ("authorised person"); and
- (c) Reporting, independent monitoring and review: Banks are required to report their credit facilities and other exposures to related persons to their board of directors or head office of the bank.² In addition, RPTs are to be independently monitored and reviewed.

2.3 In December 2013, MAS proposed changes to the RPT requirements, to address feedback received on implementation issues, and to rationalise the RPT requirements in the BA with the Notice. In general, the majority of the respondents agreed with the proposals, with some respondents providing additional feedback.

3 Arm's length dealing requirement

3.1 The Notice requires banks to ensure that their RPTs are conducted at arm's length. Respondents said that it would be difficult to conduct a specific assessment prior to each RPT, to ensure that it is not offered at preferential terms and conditions.

MAS' Response

3.2 MAS notes the feedback received, and clarifies that the arm's length dealing requirement can be satisfied by establishing and implementing the appropriate RPT

¹ Sections 27 and 28 of the BA.

² The format of and detailed instructions for the reporting requirements are in MAS Notice 639A.

policies and procedures, to ensure that the risks of conflicts of interest are addressed.³ This means that an ex ante assessment need not be conducted for each RPT, as long as the transaction is already conducted in accordance with the bank's RPT policies and procedures.

3.3 In addition, the following safeguards will apply –

- (a) Approval of key policies – Key RPT policies are to be approved and reviewed annually by the board⁴;
- (b) Oversight over deviations – Any transactions deviating from the RPT policies are to be escalated for independent review. Such deviations are to be reported to the board⁵ on a quarterly basis; and
- (c) Audit checks – Sample audit checks are to be regularly conducted on RPTs to ensure compliance with the bank's own RPT policies and procedures. The frequency of such checks is to be specified by the Audit Committee⁶.

3.4 These safeguards are to ensure the effectiveness of bank's policies and procedures in controlling the risks associated with transactions that may be susceptible to abuse. They also help the board retain oversight over the bank's RPT controls, as the board bears the ultimate responsibility for managing the bank's risks.

4 Scope of RPTs – Exclusion of nominal transactions

4.1 MAS had consulted on excluding transactions below a nominal threshold ("nominal transactions") from the scope of RPTs, as such transactions should pose lower risks. Specifically, MAS had proposed excluding RPTs below \$100,000 from the requirements in the Notice.

4.2 Respondents agree with the proposed exclusion, noting that it would balance the regulatory cost of implementing the requirements in the Notice. However, differing views were given on the \$100,000 threshold; some banks suggested higher levels, whereas others suggested that it be set as a percentage of the bank's capital or assets.

³ Banks can rely on existing policies and procedures (e.g. transfer pricing guidelines), where appropriate, where the policies and procedures meet the requirements in the Notice.

⁴ In the case of a bank incorporated outside Singapore, the authorised person.

⁵ In the case of a bank incorporated outside Singapore, the authorised person.

⁶ In the case of a bank incorporated outside Singapore, the authorised person.

MAS' Response

4.3 In view of the comments received, MAS proposes to allow banks the discretion to set their own thresholds used to determine the nominal transactions that are to be excluded from the scope of the RPTs requirements.⁷ This will be subject to the approval and annual review by the board of the banks⁸, taking into account the bank's business model and risk tolerance level.

4.4 This is in recognition of the fact that banks' RPTs vary in size, frequency and risk profile, such that it would not be meaningful to prescribe a single threshold across all banks.

5 Scope of RPTs – Definition of “related parties”

5.1 Under the Notice, transactions between a bank and its related parties are considered RPTs. Related parties of the bank include persons in any of its related party groups. A "related party group" can be a director group, senior management group⁹, financial group, substantial shareholder group¹⁰, or related corporation group¹¹, of the bank.

5.2 MAS had proposed several changes to the list of related parties for the purpose of the Notice. The proposals were to ensure comprehensive capture of relationships that may be susceptible to abuse, to rationalise the RPT requirements in the BA and the Notice, and to address banks' concerns about implementation challenges.

⁷ Banks may, if they wish, set different thresholds for different types of transactions. Where appropriate, banks may also set the threshold at \$100,000. As banks will set their own thresholds, MAS will similarly not prescribe the valuation methodology for non-exposure transactions. The measurement of exposures will be aligned with the BA and MAS Notice 639, since there are existing rules on this.

⁸ In the case of a bank incorporated outside Singapore, the authorised person.

⁹ For avoidance of doubt, the definition of “senior management group” excludes entities of which senior management members have been appointed by the bank as its nominee director on the board. This is because the interests of these entities are aligned with those of the bank, and the senior management member has no personal interest in the transactions.

¹⁰ “Substantial shareholder group” is only relevant for a bank incorporated in Singapore.

¹¹ These groups are defined in the Notice and the Fifth Schedule to the BA.

Exclusion of subsidiaries and other intra-group entities

5.3 MAS had proposed excluding majority-owned subsidiaries of a bank from its list of related parties, such that transactions with such subsidiaries need not be subject to the Notice requirements. As the operational and financial interactions between bank and its majority-owned subsidiary are generally intertwined, the risks of conflict are low. MAS had also sought views on the appropriate level of majority shareholding in a subsidiary, in order for the subsidiary to qualify for exclusion.

5.4 Respondents agreed with the proposal to exclude majority-owned subsidiaries. Some suggested that the qualifying criteria be aligned with the criteria for control in regulation 24(4) of the Banking Regulations¹². Some respondents also suggested that the other intra-group entities (e.g. head office, parent bank, sister subsidiaries) should similarly be excluded from the list of “related parties”.

MAS’ response

5.5 MAS will retain the exclusion of majority-owned subsidiaries.^{13,14} MAS is also agreeable to aligning the qualifying criteria with the criteria for control in regulation 24(4). This is because entities that satisfy the criteria would be controlled by the bank, such that the risks of abuse are lower. This approach would also allow for consistency across MAS’ rules.

¹² Regulation 24 empowers MAS to impose limits on a bank’s exposure to a group of persons, inter alia, where one person controls every person in that group. Under regulation 24(4), a person is controlled by the controlling person if the person is – (a) a person in which the controlling person holds more than half of the total number of issued shares, whether legally or beneficially; (b) a person in which the controlling person controls more than half of the voting power; (c) a person in which the controlling person controls the composition of the board of directors; (d) a subsidiary of a person described in sub-paragraph (a), (b) or (c); or (e) a person the policies of which the controlling person is in a position to determine.

¹³ For avoidance of doubt, the requirements in the Notice will continue to apply to transactions with an entity, if the entity is a subsidiary (i.e. meets the criteria under Regulation 24(4)), but is considered a related party of the bank by virtue of *another* relationship with the bank (e.g. a subsidiary that is an affiliate of a substantial shareholder of the bank).

¹⁴ In similar vein, MAS will not include in the list of “related parties”, any firm and limited liability partnership (“LLP”) of which a bank is a partner, a manager, and agent, a guarantor or surety, and any company of which a bank is a director, an executive officer, an agent, a guarantor or a surety. This is because such entities are directly related to the bank, as opposed to through a third party who wields influence over the policies and actions of the bank. It is not likely that the interests of such entities would diverge from those of the bank.

5.6 As for the proposal to similarly exclude other intra-group entities (e.g. head office, parent bank, sister subsidiaries) from the list of "related parties", MAS remains of the view that the risks arising from transactions with other intra-group entities are not the same as the risks arising from transactions with majority-owned subsidiaries. Transactions with other intra-group entities should therefore continue to be subject to the safeguards in the Notice.

Expansion of "director group", "senior management group", and "substantial shareholder group"

5.7 For the purpose of the requirements in the Notice, MAS had proposed expanding the definitions of "director group" and "senior management group", to include companies of which bank directors and senior management staff are directors or agents.

5.8 MAS had also sought views on expanding the definition of "substantial shareholder group". Specifically, to – (a) include the substantial shareholders of all the holding companies (both ultimate and intermediate holding companies) of a bank (and their respective affiliates¹⁵), and (b) delete the existing carve-out for major stake entities of the financial holding company and parent bank of the bank¹⁶, from the definition of an "affiliate" of a substantial shareholder.

5.9 In addition, MAS had invited comments on whether the shareholding thresholds of 5% and 20% in determining a "substantial shareholder" of a bank and an "affiliate" of a substantial shareholder, respectively, should be retained, for the purpose of the Notice.

5.10 These proposals were engineered to more comprehensively capture transactions with persons who may exert an influence over the bank. The proposals were also partly for alignment with the reporting requirements under the BA.¹⁷

¹⁵ The definitions of "substantial shareholder" and "affiliate" are in section 2 and the Fifth Schedule of the BA, respectively. The former is aligned with the Companies Act.

¹⁶ The definitions of "financial holding company" and "parent bank" are in section 2 and the Fifth Schedule of the BA, respectively.

¹⁷ Under section 27(1)(b) of the BA, a company of which any of the directors of the bank is a director or an agent, is considered to be the bank's related party.

5.11 Respondents felt that having differing definitions between the Notice and MAS Notice 639 would be confusing.¹⁸ Banks also gave feedback that the extension of the Notice requirements to such entities would require significant operational and system changes.

MAS' response

5.12 MAS notes the increased compliance burden associated with the inclusion of such entities in the list of “related parties” and has considered that the risks of conflicts of interest with these entities are lower. MAS will therefore not expand the definitions of “director group”, “senior management group” and “substantial shareholder group”. To minimise confusion across the different regulatory requirements, MAS will also retain the existing shareholding thresholds used in identifying a “substantial shareholder” of a bank and an “affiliate” of a substantial shareholder.

6 Prior board approval requirement

6.1 Material RPTs are to be subject to prior approval by a special majority of three-fourths of the board¹⁹. Material RPTs include those that exceed a specified materiality threshold and the write-off of exposures²⁰ to any related party of the bank. The prior approval requirement is to ensure sufficient board oversight over a bank’s RPTs.

Exemptions – Intra-group transactions and certain non-exposures

6.2 MAS had previously proposed exempting intra-group transactions from the prior board approval requirement. As respondents were generally in agreement, this

¹⁸ The definitions of “director group” and “substantial shareholder group” are currently used in the large exposure regime under MAS Notice 639. MAS had, however, intended to not extend the proposed changes to these definitions to MAS Notice 639. This was because the objectives of the RPT and large exposure regimes differ. The definitions under the former are designed to capture relationships that are susceptible to abuse arising from conflicts of interest; the latter, to identify counterparties of the bank that are financially interdependent.

MAS may reconsider rationalising the RPT and large exposure rules more holistically, when reviewing the latter to implement the Basel Committee’s large exposure standard. MAS will therefore not, as previously indicated, transfer the existing RPT requirements under MAS Notice 639 (e.g. unsecured lending limit on director groups, reporting of a bank’s exposures to its substantial shareholder group) to MAS Notice 643, for the time being.

¹⁹ In the case of a bank incorporated outside Singapore, the authorised person.

²⁰ “Exposure” is defined in the Fifth Schedule of the BA.

exemption will be retained, and MAS will exempt certain non-exposure RPTs from the prior board approval requirement.

6.3 MAS wishes to highlight that while these RPTs can be exempted from the prior board approval requirement, they remain subject to the other aspects of the Notice, such as the requirement on arm's length dealing and sample audit checks.

Setting of materiality thresholds

6.4 In determining whether a transaction should be surfaced for prior board approval, the bank would set the materiality thresholds, which would be subject to the approval and annual review by the board. Under the Notice currently, separate materiality thresholds are to be set for different exposure types (e.g. mortgages, unsecured credit).

Single threshold for exposures to any related party group

6.5 Instead of separate thresholds for different exposure types, MAS had proposed a single threshold for exposures to any related party group. This means that ex ante approval should be sought for a transaction that causes aggregated exposures to any related party group to exceed the applicable materiality threshold. For non-exposure RPTs, the materiality threshold can be set on a per-transaction basis instead. Respondents were agreeable to this approach.²¹

Calibration of thresholds

6.6 As banks had sought clarification from MAS on the thresholds that would be deemed appropriate, MAS had suggested specifying materiality thresholds for exposure and non-exposure RPTs.²² The feedback received on the suggested thresholds were similar to that on the threshold for identifying nominal transaction (please see section 4); some felt the thresholds were too low for wholesale and private banking business, while others disagreed with the reference to capital.

²¹ For avoidance of doubt, banks have the flexibility to set a different threshold for each related party group. For instance, banks are not expected to set the same threshold for each director group.

²² MAS had sought views on materiality thresholds set at the following levels:

- (a) Exposures (aggregate basis): 2% of a bank's Common Equity Tier 1 ("CET1") Capital or capital funds (in the case of a bank incorporated outside Singapore); and
- (b) Non-exposures (per-transaction basis): The lower of 0.05% of the bank's CET1 capital or capital funds (in the case of a bank incorporated outside Singapore) and \$2m.

MAS' Response

6.7 MAS notes a single threshold may not be suitably applied to all banks. It would not be appropriate for MAS to set a one-size-fits-all threshold given that banks have varying risk profiles and tolerance levels, depending on their sizes and business types. MAS will therefore allow banks, subject to approval by their boards, the discretion to set their own materiality thresholds, both for exposures and non-exposure²³ RPTs. MAS expects banks to take into account the nature and scale of their operations and RPTs in setting their materiality thresholds, and to seek the approval and review of their board (or authorised persons, in the case of a bank incorporated outside Singapore). This approach would be similar to the exclusion of nominal transactions from the Notice requirements, as described above.

Delegation to board committees

6.8 A respondent requested that the board be allowed to delegate the approval to board committees, for greater flexibility.

MAS' response

6.9 MAS is agreeable to this approach, as it would facilitate banks' compliance with the requirements, without compromising the objective of ensuring board oversight over RPTs. Nevertheless, the following conditions will apply, to ensure that the requirement acts as an independent check in ascertaining that the transactions are in the interest of the bank –

- (a) the three-fourths threshold will continue to apply; and
- (b) Delegation can only be to committees of which the majority comprises independent directors.

7 Director disclosure requirement

7.1 Section 28(1) of the BA requires a bank director to declare his interest in any credit facility from or exposure of the bank to the bank as soon as practicable. Section 28(4) of the BA also requires a bank director, who holds any office or possesses any property whereby duties or interest might be created in conflict with his duties or

²³ As the materiality threshold for non-exposure transactions will be determined by the banks, MAS will not prescribe the valuation methodology for such transactions.

interest as director, to declare the fact, nature, character and extent of the conflict, at the next board meeting.

7.2 As the current declaration requirement only applies to credit facilities and other exposures, MAS had sought views on extending the requirement to all types of transactions, including non-exposure transactions.²⁴ This was for alignment with the scope of the updated Basel Core Principles and the requirements in this Notice, and the existing declaration requirement on directors under section 156 of the Companies Act.²⁵ It was also to facilitate banks' compliance with the requirements in this Notice, as banks may otherwise only come to know of a new position that a bank director has taken up when the bank next requests for his update via his annual declaration on related parties. The comments received mainly sought to clarify whether it would apply to potentially sensitive transactions (e.g. placement of deposits) or nominal transactions.

MAS' response

7.3 Upon review, MAS has taken into consideration the fact that directors are already required under the Companies Act to declare such interests and as such, decided not to expand the BA disclosure requirement.²⁶

8 Others

Staff benefits and remuneration

8.1 MAS had suggested that all staff transactions, in addition to staff loans, be exempted from the Notice. One respondent requested for more clarity on the term "staff remuneration package" (which was employed in the previous version of the draft

²⁴ MAS had also consulted on extending MAS' power under section 27(3) of the BA to direct the unwinding of, and prohibit/restrict further, credit facilities and exposures, to all types of transactions, including non-exposure transactions. The consequential draft amendments to the BA were separately consulted on in January 2015 ("Proposed Amendments to the Banking Act").

²⁵ Under the Companies Act, directors are to declare their interest in all types of transactions.

²⁶ There are some differences between the expansion to the BA requirement that MAS had proposed and the existing requirement in the Companies Act. For instance, under the former, directors would have had to declare their interests as soon as practicable, and the secretary, circulate the declaration immediately; in contrast, under the latter, directors are required to declare their interests as soon as practicable, *at the next board meeting*. MAS is of the view that these differences are not critical to warrant the expansion of the BA director disclosure requirement.

Notice), as some benefits may be awarded to staff but may not be assigned a monetary value.

MAS' response

8.2 In view of feedback received, MAS will use the term “staff benefits” instead. Specifically, all staff benefits granted pursuant to a human resource policy approved by the bank’s board will qualify for the exemption. Remuneration, including salaries and directors’ fees, will also be exempted, on the basis that these are governed under other requirements that serve similar objectives to the RPT regime.

Scope of Notice – Operations in Singapore

8.3 Some respondents had enquired if the RPT requirements would apply to transactions booked in the overseas branches or subsidiaries of the bank in Singapore.

MAS' response

8.4 In view of the narrower scope of the revised RPT requirements and to facilitate group-wide oversight,²⁷ MAS will be extending the RPT requirements to the transactions booked in the overseas branches or subsidiaries of banks incorporated in Singapore. Specifically, in the case of banks incorporated in Singapore, the requirements in the Notice shall apply to the transactions booked in the overseas branches and subsidiaries of the bank, where the transactions are entered into with the related parties of the bank in Singapore. For banks incorporated outside Singapore, MAS intends for the Notice to govern transactions involving the bank’s operations in Singapore only. This means that for banks incorporated outside Singapore, only transactions booked in the books of Singapore operations will be subject to the requirements; the Notice will not apply to transactions booked in head office.

MONETARY AUTHORITY OF SINGAPORE

25 January 2016

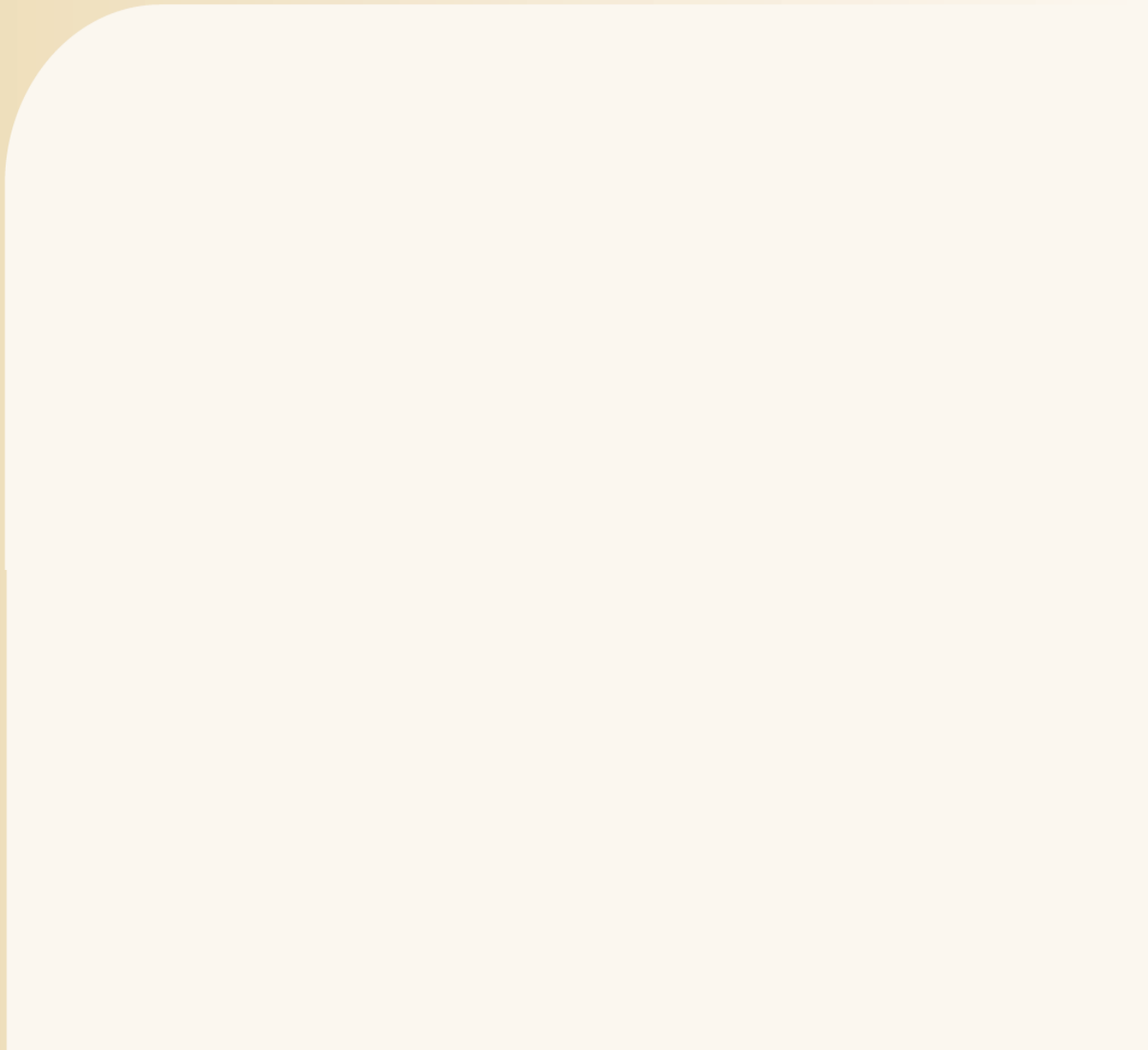
²⁷ Transactions that are below the nominal threshold established by the banks would now be exempt from the RPT requirements. Also, certain non-exposure transactions would also be exempted from the prior board approval requirements.

Annex A

**LIST OF RESPONDENTS TO THE CONSULTATION PAPER ON
PROPOSED RELATED PARTY TRANSACTION REQUIREMENTS FOR BANKS**

1. Standard Chartered Bank / Standard Chartered Bank (Singapore) Limited
2. Malayan Banking Berhad
3. State Bank of India
4. RHTLaw Taylor Wessing LLP
5. The Hongkong and Shanghai Banking Corporation Limited
6. Societe Generale
7. Sumitomo Mitsui Banking Corporation
8. BNP Paribas
9. The Association of Banks in Singapore

Note: This list only includes the names of respondents who did not request that their submissions be kept confidential



Monetary Authority of Singapore