CONSULTATION PAPER

P006 - 2012
March 2012

Covered Bonds Issuance by Banks Incorporated in Singapore

MAS
Monetary Authority of Singapore

PREFACE

This consultation paper outlines MAS' proposed rules relating to the issuance of covered bonds by banks incorporated in Singapore. Covered bonds are debt obligations issued by a bank secured by a pool of assets.

2 MAS proposes that banks incorporated in Singapore may 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. The proposed requirements are set out in the draft Notice to Banks in Annex A.

3 MAS invites interested parties to submit their views and comments on the proposals. Electronic submission is encouraged. Please submit your written comments by 10 Apr 2012 to:

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

Fax: (65) 6220 3973
Email: policy@mas.gov.sg

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

1 Covered bonds are debt obligations issued by a bank secured by a pool of assets ("cover pool"), such as residential mortgage loans. Covered bonds typically have the following characteristics:

- The assets that back covered bonds are ring-fenced and used to protect covered bond holders should the issuer become insolvent.
- Covered bond holders have dual recourse, both to the bank issuing the covered bonds and to the assets in the cover pool.
- The bank issuing the covered bonds must maintain a cover pool in excess of the notional value of the covered bonds ("over-collateralisation") at all times.
- The assets in the cover pool must meet underwriting criteria specified by the bank issuing the covered bonds. If the quality of an asset in the cover pool deteriorates, it will have to be replaced with other qualifying assets.

2 Covered bonds provide an additional source of longer-term funding to an issuing bank. Internationally, various jurisdictions[1] have allowed banks to issue covered bonds. Covered bonds that meet criteria established by the Basel Committee on Banking Supervision may also be considered as liquid assets under the liquidity standards in Basel III.

3 Covered bonds, however, introduce risks because they increase the level of asset encumbrance[2] of issuing banks. This reduces the quantum of assets available to the deposit insurance scheme and depositors in the event of the resolution of an issuing bank.

4 To mitigate this risk, MAS proposes that banks incorporated in Singapore may 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. This will

[1] These jurisdictions include Australia, Canada, France, Germany, the UK and the US.

[2] Asset encumbrance occurs when a bank's assets are tied to a particular obligation. If the bank fails, these assets will be used to satisfy the obligation to secured investors outside the bankruptcy estate, and will typically only be available to unsecured creditors and depositors after these claims have been satisfied.

keep risks contained while allowing banks to tap an additional source of longer-term funding[3]. In addition, it is proposed that the bank notifies MAS prior to the issuance of covered bonds, and appoints an independent cover pool monitor. The cover pool monitor should certify annually to MAS that the bank has complied with the proposed 2% cap and other regulatory requirements on covered bonds. These proposed requirements are set out in the draft Notice to Banks in Annex A.

5 MAS may also impose additional requirements on any bank in Singapore issuing covered bonds, should MAS take the view that such issuance increases risks to depositors or where MAS considers it necessary in the circumstances of the case.

[3] In comparison, Australia restricts the combined value of assets in the cover pools securing covered bonds issued by an authorised deposit-taking institution ("ADI") to 8% of the value of the ADI's assets in Australia while Canada limits covered bond issuance by deposit-taking federally regulated financial institutions to 4% of total assets.

Annex A

MAS XXX

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NOTICE TO BANKS
BANKING ACT, CAP 19

ISSUANCE OF COVERED BONDS BY BANKS INCORPORATED IN SINGAPORE

1 This Notice is issued pursuant to section 55 of the Banking Act (Cap. 19) and is applicable to all banks incorporated in Singapore.

2 MAS Notice 628 on Securitisation shall not apply to a bank incorporated in Singapore in relation to its issuance of covered bonds in accordance with the requirements in this Notice. For the avoidance of doubt, all requirements of MAS Notice 628 shall continue to apply to such a bank incorporated in Singapore in respect of its other securitisation activities.

Definition

3 In this Notice,

"Covered bonds" means any bonds, notes or other debentures issued by a bank or an SPV where the liabilities to the holders of such covered bonds are:

(a) recoverable from the bank; and
(b) secured by a cover pool.

"Cover pool" in relation to covered bonds, means the assets beneficially owned by the bank or an SPV for the purpose of securing the liabilities to the holders of the covered bonds only.

"SPV" means any special purpose vehicle incorporated in Singapore, wholly owned by the bank, set up for the purpose of issuing covered bonds or holding the cover pool in relation to such bonds or both.

"Memorandum of Compliance" means a memorandum complied by the bank setting out how the bank has complied with each of the requirements in paragraph 5(a)-(g) of this Notice.

4 The expressions used in this Notice shall, except where expressly defined in this Notice or where the context otherwise requires, have the same respective meanings as in the Banking Act.

5 When issuing covered bonds, a bank incorporated in Singapore shall comply with the following conditions:

(a) 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. For the purpose of determining the total assets of the bank, the bank shall exclude assets which the bank uses to meet regulatory requirements under sections 38, 39 and 40 of the Banking Act, and other regulatory requirements as may be prescribed or specified by the Authority[4];

(b) only mortgage loans secured by residential property ("residential mortgage loans") and derivatives held for the purpose of hedging risks arising from issuing covered bonds shall be included in the cover pool;

(c) a 80% loan-to-value ("LTV") limit (as determined by the most recent valuation of the residential property that is collateral for the residential mortgage loan referred to in (b) shall be applicable to residential mortgage loans[5]. If the LTV limit exceeds 80%, the value

4 For the avoidance of doubt, a bank in Singapore shall continue to hold capital against assets included in the cover pool in accordance with MAS Notice 637 on Risk Based Capital Adequacy Requirements for Banks Incorporated in Singapore.

5 For the avoidance of doubt, a bank in Singapore shall continue to comply with the LTV limits set out in MAS Notice 632 on Residential Property Loans for the purposes of granting any credit facility for the purchase of residential property to a borrower or any credit facility otherwise secured by residential property to a borrower who is an individual or a vehicle set up by any individual solely to invest in residential property.

of the loan for the purpose of determining the value of the loan as an asset to be part of the cover pool shall be reduced by the amount of the excess if the loan is to be included in the cover pool;

(d) the value of assets in a cover pool shall be at least 103% of the face value of the covered bonds secured by the assets at all times;

(e) the bank shall not issue covered bonds through foreign incorporated entities;

(f) the bank shall put in place adequate risk management processes and internal controls to manage the risks arising from the issuance of covered bonds. 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 shall ensure that its board and senior management are responsible for conducting due diligence in assessing the risks associated with issuing covered bonds and ensuring that risk management processes that are put in place for covered bonds are adhered to; and

(g) the bank shall appoint an external third party, qualified to be an auditor under the Companies Act (Cap 50), as the cover pool monitor to:

   (i) verify annually that the bank keeps an accurate register of the assets in the cover pool;

   (ii) verify annually that the bank complies with paragraph 5(a) to (e);

   (iii) assess the adequacy of the bank's risk management process and internal controls relating to the covered bond programme annually;

(iv) submit a certified report to the Authority annually on paragraph 5(g)(i) to (iii) no later than the last day of the third month immediately following the end of the bank's financial year; and

(v) report to the Authority immediately if it becomes aware that the bank has breached any of the conditions imposed.

For the avoidance of doubt, the Authority may at any time add to, vary or revoke any condition or requirements imposed under this Notice.

6 A bank shall notify the Authority in writing 1 month prior to the issuance of new covered bonds, providing at the minimum, information on the size, tenor and terms of the issuance, and the type and amount of assets used to back the covered bonds. The bank shall also at the same time submit a Memorandum of Compliance to the Authority prior to the issuance of the covered bonds. The bank shall submit any additional information, as requested by the Authority, relating to its application and issuance of the covered bonds.

7 This Notice shall take immediate effect.

Monetary Authority of Singapore