

### **3.30 SINGAPORE**

By Colin YS Chen, DBS Bank & Chairman of the ECBC Global Issues Working Group and Franz Rudolf, UniCredit

#### **I. FRAMEWORK**

On 31 December 2013, the Monetary Authority of Singapore ("MAS") published its regulations regarding the issuance of covered bonds by banks incorporated in Singapore (MAS Notice 648)<sup>1</sup>. The regulations became effective 31 December 2013 and were amended in June 2015. The requirements set out in the notice are mandatory for Singapore's banks as MAS Notice 648 is part of The Banking Act in Singapore. The regulation outlines MAS' rules relating to the issuance of covered bonds by banks incorporated in Singapore and it will enable Singapore's banks to gain access to longer term, stable funding options as well as to facilitate the diversification of funding sources for the banking and financial markets in Singapore.

DBS Bank Ltd was the first to establish its USD10 Billion Covered Bond Programme under these new regulations on 16 June 2015 and on 30 July 2015, issued the inaugural Singapore covered bond, pricing USD1 Billion, fixed rate covered bonds due 2018. Following then, United Overseas Bank Ltd. also launched its USD8 Billion Covered Bond Programme on 23 November 2015. The first series of EUR500 Million fixed-rate covered bonds was subsequently issued on 3 March 2016. The third issuer was Oversea-Chinese Banking Corporation, which issued a EUR500 Million fixed rate covered bonds due 2022 on 15 March 2017, as part of its USD10 Billion Covered Bond Programme.

Singapore's covered bonds are based on contractual agreements and governed by the law of contracts under common law, which applies to all elements of the covered bond structure. This, together with the implemented specific covered bond regulations, creates a framework comparable with that of other European jurisdictions, e.g. in the UK, via a more prescriptive regulatory framework.

Singapore's legal system is similar to the legal system in the UK in that the covered bond structure is fundamentally based on statutes or acts, which have been formally enacted by the legislative authority of the Republic of Singapore. It is considered a primary authority and source of law and determines the applicable legislation. The MAS guidelines arising from the MAS Notice 648 and its amendment provide clarity on the characteristics of a Singapore covered bond.

Singapore covered bonds are direct and unconditional obligations of the issuer and in the event of a default or insolvency of the issuer, the covered bond investors will have dual recourse: an exclusive senior secured claim on the pool of cover assets and also a senior unsecured claim on the issuer. The cover pool assets will be held in a special purpose entity, which, in turn, will provide a guarantee in respect of the principal and interest payments under the covered bonds' outstanding. A bond/security trustee is appointed to hold the security over the cover pool for the benefit of the covered bond investors.

#### **II. STRUCTURE OF THE ISSUER**

In the MAS Notice 648 covered bonds are defined as "bonds, notes or other debentures issued by a bank or an SPV (Special Purpose Vehicle) where the payments of the liabilities to the holders of such covered bonds and any liabilities arising from the enforcement of the rights of the holders of the covered bonds are: (a) secured by a cover pool; and (b) recoverable from the bank whether or not the cover pool is sufficient to pay off such liabilities." This implies the dual recourse nature of covered bonds with a claim of covered bond holders against the cover pool as well as the issuing bank. The cover pool, in this context, comprises the eligible assets owned by the bank or an SPV for the purpose of securing the liabilities to the holders of the covered bonds only. MAS Notice 648 is applicable to all banks incorporated in Singapore. In order to issue covered bonds, the bank has to notify MAS at least one month prior to the issuance of covered bonds. In addition, issuers will have to submit to the MAS a Memorandum of Compliance, confirming that the guidelines with respect to the program and issuances for covered bonds have been adhered to and complied with.

<sup>1</sup> MAS Notices can be found on MAS website at [www.mas.gov.sg](http://www.mas.gov.sg).

### **III. COVER ASSETS**

The cover pool may consist of the following assets, according to Paragraph 6 of Notice 648:

- > Mortgage loans secured by residential property ("residential mortgage loans"), whether in Singapore or elsewhere (no geographic limitation to mortgage loans); the loan-to-value (LTV) limit is set at 80% ("soft limit"), taking into account the current market value of the residential property;
- > Any other loans secured by the same residential property as the residential mortgage loans;
- > Assets, including intangible properties, that form part of all the security provided for the residential mortgage loans, such as guarantees and indemnities;
- > Any interest held by the bank as trustee or a replacement trustee for the SPV in relation to the residential mortgage loans or the assets referred to in paragraphs (a) and (b);
- > Derivatives held for the purpose of hedging risks arising from the particular issuance of covered bonds;
- > Cash (including foreign currency);
- > Singapore Government Securities, and
- > MAS Bills.

The aggregate value of substitute collateral (cash, Singapore Government Securities and MAS Bills) is limited to 15% of the cover pool. The 15%-limit can be temporarily exceeded in order to allow the issuer to build up the necessary liquidity to meet payments in the upcoming 12 months or to account for operational timing differences.

MAS imposed to limit the amount of collateral in the cover pool at 4% of total assets of an issuer. Total assets of the bank include assets of the branches but does not include assets of the subsidiaries of the bank. For the purpose of determining the total assets of a bank, the bank shall exclude assets it uses to meet regulatory requirements under sections 38, 39 and 40 of the Banking Act, section 8 of the Deposit Insurance and Policy Owners' Protection Schemes Act and other regulatory requirements as may be prescribed or specified by MAS. Commercial mortgage loans or public sector loans are not eligible.

### **IV. VALUATION AND LTV CRITERIA**

The legal framework sets an 80% loan-to-value (LTV) limit for the eligibility of residential mortgage loans. The LTV limit is a soft limit, meaning that in case a mortgage loan exceeds 80%, the loan can still be included in the cover pool, but only the value up to 80% is given credit to when determining the value of the cover pool. The value of the underlying collateral is determined by the current market valuation of the residential property that is used to secure the residential mortgage loan. A valuation of residential properties used to secure the loans shall be conducted on an annual basis.

### **V. ASSET – LIABILITY MANAGEMENT**

MAS Notice 648 Paragraph 6(h) stipulates a mandatory minimum overcollateralisation (OC) of 3% on a nominal basis as "... the value of assets in a cover pool shall be at least 103% of the outstanding nominal amount of the covered bonds secured by the assets at all times." Covered Bond issuers shall in accordance with MAS Notice 648 Paragraph 8(a) perform regular asset coverage tests (ACTs) to ensure collateral quality and the proper level of overcollateralisation. In addition, regular stress tests on risks related to default, prepayment, currency, interest rate, counterparty and liquidity have to be performed. Details regarding these tests will be addressed in the respective covered bond programs of Singapore issuers.

### **VI. TRANSPARENCY**

Covered bond issuers shall disclose to the covered bond holders the results of asset coverage tests (ACTs) performed and cover pool characteristics on a regular basis and in any event, at least every quarter, according to MAS Notice 648 Paragraph 8(e).

## **VII. COVER POOL MONITOR AND BANKING SUPERVISION**

According to Paragraph 8(b), a cover pool monitor shall be appointed. The cover pool monitor, who has to be an external third party qualified to be an auditor under the Companies Act (Cap 50), has to verify the compliance of the covered bond issuer with Notice 648 regulations and report these to MAS. A certified report has to be submitted to the Authority annually in the first quarter following the end of the bank's financial year. The duties of the cover pool monitor explicitly include to:

- > Verify annually that the bank complies with covered bond-specific regulations (asset cap, eligible assets, LTV limits, overcollateralisation, et al. as defined in Paragraph 6(a) to (h));
- > Verify annually that the bank or SPV, as the case may be, keeps an accurate register of the assets in the cover pool;
- > Assess the adequacy of the bank's or SPV's, as the case may be, risk management process and internal controls relating to the covered bond program annually, including an independent review of ACTs performed by the bank or SPV, as the case may be;
- > Submit a certified report to MAS annually on compliance with covered bond regulations; and
- > Report to MAS immediately if it becomes aware that the bank or SPV has breached any of the conditions imposed.

Singapore's covered bond regulations stipulate that the issuing bank shall ensure adequate risk management processes and that internal controls are in place to manage the risks arising from the issuance of covered bonds, including appropriate governance arrangements and regular stress tests on risks arising from issuing covered bonds such as default, pre-payment, currency, interest rate, counterparty and liquidity risks. This also includes having governance processes in place with respect to the authority to approve any issuance of the covered bond. Finally, regulations state that the board and senior management of the issuer 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.

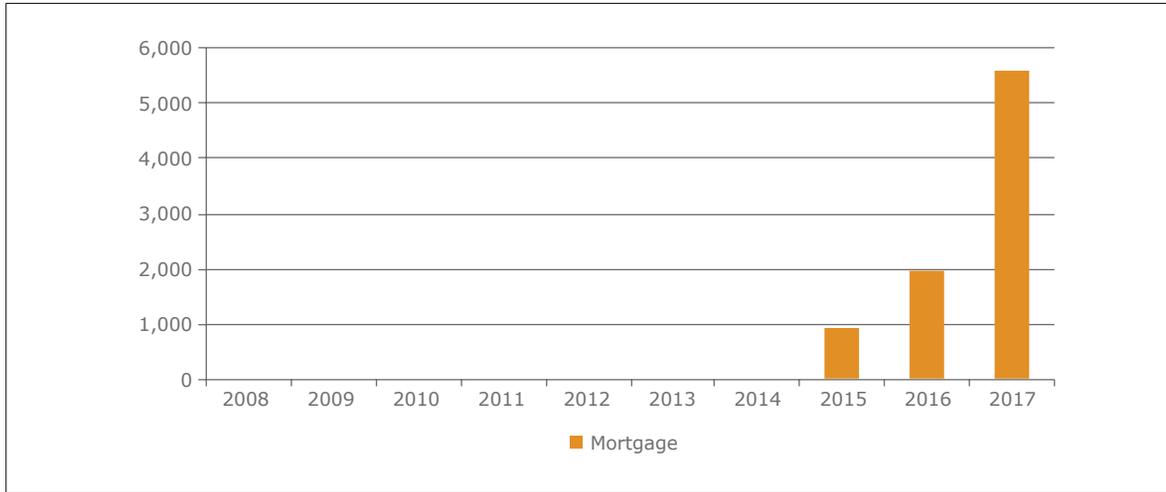
## **VIII. SEGREGATION OF COVER ASSETS AND BANKRUPTCY REMOTENESS OF COVERED BONDS**

Given that Singapore's legal system is based on Commonwealth Common Law, a similar structure applies as used for the issuance of covered bonds in the UK, Canada, Australia, or New Zealand. Thus, covered bonds will be issued by a bank, with the cover pool collateral sold by way of an equitable assignment or by declaring a trust over the collateral to a Special Purpose Vehicle (SPV). The covered bond will benefit from dual recourse on the issuer and the cover pool. This structure ensures the segregation of the cover assets from the insolvency estate of the issuer in the case of an issuer default. The contractual agreements for the issuance of covered bonds are structured within the general legislation in Singapore.

## **IX. RISK-WEIGHTING & COMPLIANCE WITH EUROPEAN LEGISLATION**

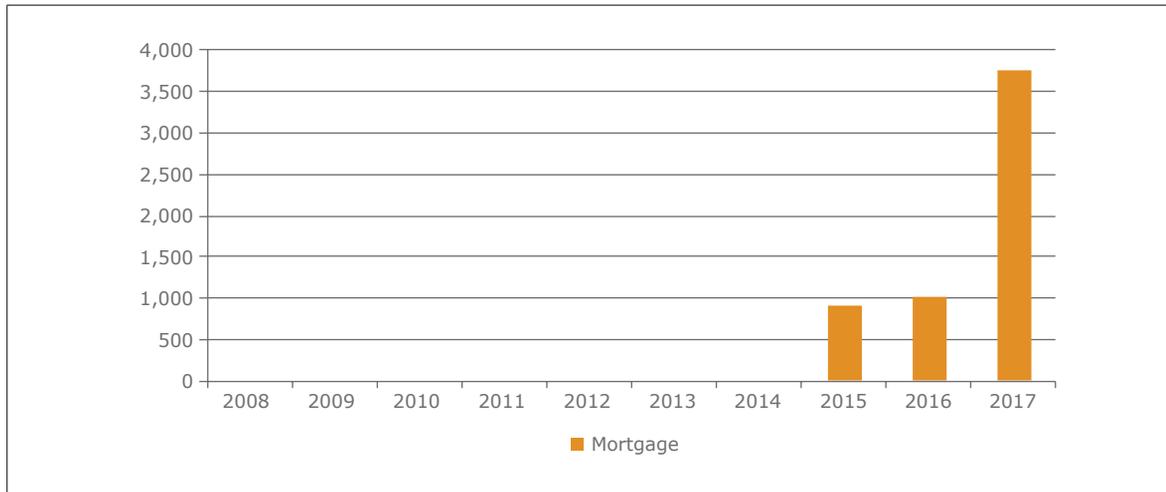
Singapore covered bonds are not UCITS 52(4) or CRR Article 129 compliant given that Singapore is not a Member State of the European Union. As such, it is unlikely that Singapore covered bonds will benefit from preferential risk weighting for regulatory capital purposes. However, given the revised release of the Basel III framework containing preferential risk weights explicitly for covered bonds and the definition of minimum standards, the framework could have a positive impact for covered bonds outside the European Union when it comes into force on 1 January 2022. Covered bonds are LCR eligible in Singapore if they have a long term credit rating of at least AA- from a recognised external rating agency, and have a proven record as a reliable source of liquidity in the markets even during stressed market conditions.

> FIGURE 1: COVERED BONDS OUTSTANDING, 2008-2017, EUR M



Source: EMF-ECBC

> FIGURE 2: COVERED BONDS ISSUANCE, 2008-2017, EUR M



Source: EMF-ECBC

**Issuers:** DBS Bank Limited, United Overseas Bank Limited, Oversea-Chinese Banking Corporation.

**ECBC Covered Bonds Comparative Database:** [http://www.ecbc.eu/framework/111/Singapore\\_Covered\\_Bonds](http://www.ecbc.eu/framework/111/Singapore_Covered_Bonds).



COVERED BOND LABEL: DBS Bank Ltd (1 pool), United Overseas Bank Limited (1 pool), Oversea-Chinese Banking Corporation Limited (1 pool).