

Unofficial Translation

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Notification of the Bank of Thailand

No. FPG. 12/2558

Re: Regulations on Derivative Transactions for Commercial Banks

1. Rationale

The Bank of Thailand has allowed commercial banks to engage in certain types of derivative transactions including market derivatives, credit derivatives, structured products e.g. structured notes and inflation linked notes, in which commercial banks shall comply with the Bank of Thailand's regulations on risk management for derivative transactions and minimum requirements on treatment of clients for engaging in derivative transactions. Given the greater market fluctuation and global financial integration, derivatives market in Thailand has continuously developed. Moreover, the change in regulatory and economic environment tend to contribute toward wider variety of financial products provided by commercial banks e.g. relaxation of exchange control regulations and measures to prevent Thai Baht speculation according to the Capital Account Liberalization Master Plan Phase II, which has been implemented by the Bank of Thailand in order to promote diversification of Thai investors to include overseas investments and to stimulate the development of Thai financial markets. All of these factors have raised the market participants' demand for derivative transactions as hedging tools and yield enhancement products as evidenced by the increasing volume of derivative transactions and the number of applications of new derivative transactions of commercial banks.

In this regard, the Bank of Thailand has amended the regulations relevant to permission for commercial banks to engage in derivative transactions, risk management for derivative transactions and minimum requirements on treatment of clients for engaging in derivative transactions, by expanding the scope of permitted derivative transactions in respond to current market development. Thus, this helps promoting efficiency for commercial banks and allowing greater flexibility for market participants based on their sophistication to enter into derivative transactions. However, maintaining stability in financial system and economy remain a priority. Furthermore, the amendment takes into account consistency with related regulations

of the Office of the Securities and Exchange Commission, which will reduce operational burden of commercial banks to comply with the regulations of both agencies and create a more level playing field among market participants.

This Notification has specified the principles and frameworks in granting permissions for commercial banks to engage in derivative transactions as well as regulations of related concerns, for instance, prevention of impacts on economic and financial stability, accounting treatment and disclosure, as well as data reporting and document keeping. It provides the overview of regulations on supervision of derivative transactions for commercial banks.

2. Statutory Power

By virtue of Section 36, Section 39 and Section 71 of the Financial Institution Business Act B.E.2551 (2008), the Bank of Thailand hereby allows commercial banks to engage in derivative transactions in accordance with the frameworks and regulations as prescribed herein.

3. Scope of Application

This Notification shall apply to all commercial banks according to the law on financial institution business except retail banks.

4. Content

4.1 Definition

In this Notification

“Commercial bank” means a commercial bank under Section 4 of the Financial Institution Business Act B.E.2551 (2008) except retail banks.

“Derivative transaction” means market derivatives according to Notification of the Bank of Thailand on Permissions for Commercial Banks to Engage in Market Derivatives, credit derivatives according to Notification of the Bank of Thailand on Permissions for Commercial Banks to Engage in Credit Derivatives, and structured products according to Notification of the Bank of Thailand on Permissions for Commercial Banks to Engage in Structured Products.

“Investor” means institutional investors, high net worth investors, and retail investors as specified in the attachment of this Notification.

4.2 Principle

The Bank of Thailand allows commercial banks to engage in derivative transactions in accordance with 5 principles for banking supervision as follows:

4.2.1 Promoting market efficiency and bank competition

Derivative transactions shall satisfy market participants' demand and consistent with market development.

4.2.2 Encouraging good governance and transparency of financial institutions

Commercial banks shall have organisational structures which encourage good governance and transparency when engaging in derivative transactions.

4.2.3 Maintaining the stability of financial institutions and banking system (Micro-prudential)

Commercial banks shall be competent to efficiently manage risks and have adequate level of capital to cover risks arising from engaging in derivative transactions. In addition, commercial banks shall comply with other relevant regulations as prescribed by the Bank of Thailand.

4.2.4 Maintaining the stability of economy and financial system

Commercial banks shall not engaging in derivative transactions that would affect the stability of financial system, economic, and banking systems, for instance, offering derivatives transactions by being an intermediary that allow client to access foreign financial market or foreign exchange market in a manner that violates relevant policies or regulations of the Bank of Thailand causing damages to domestic stability of financial system and banking system.

4.2.5 Encouraging financial institutions to provide financial services with fairness

Commercial banks shall be aware of the fundamental rights of clients who engage in derivative transactions in the same manner as other financial products and shall have operating systems in place to facilitate (1) Right to be informed, (2) Right to choose, (3) Right to be heard, and (4) Right to redress where the commercial banks must perform client suitability assessment, inform

and disclose all material information and details of the products in accordance with principles and minimum requirements as prescribed by the Bank of Thailand.

4.3 Permission frameworks and supervision of derivative transactions

Since there are a number of related regulations for supervision of derivative transactions of commercial banks, the Bank of Thailand hereby issues this Notification which prescribes the overview of regulations on supervision of derivative transactions, the principles of permission and regulatory frameworks of derivative transactions. For details of regulation with respect to each type of derivatives transactions and relevant prudential requirements, commercial banks shall comply with the following 5 Notifications:

(1) Notification of the Bank of Thailand on Permission for Commercial Banks to Engage in Market Derivatives

(2) Notification of the Bank of Thailand on Permission for Commercial banks to Engage in Credit Derivatives

(3) Notification of the Bank of Thailand on Permission for Commercial banks to Engage in Structured Products

(4) Notification of the Bank of Thailand on Risk Management for Derivative Transactions

(5) Notification of the Bank of Thailand on Minimum Requirements on Treatment of Clients for Engaging in Derivative Transactions

4.4 Scope and types of derivative transactions

4.4.1 Market derivatives

The Bank of Thailand allows commercial banks to engage in market derivatives that are consistent with the principles as prescribed in 4.2 in order that investors can use them as hedging tools for market risk, or as investment alternatives for yield enhancement as prescribed in Notification of the Bank of Thailand on Permission for Commercial Banks to Engage in Market Derivatives. For market derivatives that the structures are not complicated and widely-known, commercial banks can engage in such derivative transactions according to the type of transactions, reference variables and counterparties as prescribed in that Notification. On the other hand, for other market derivatives which have characteristics, reference variables

and counterparties beyond those prescribed in the Notification, commercial banks shall submit the details of the transactions for the Bank of Thailand's consideration whether it is consistent with the principles of permission prior to engaging in such derivative transactions.

4.4.2 Credit derivatives

The Bank of Thailand allows commercial banks to engage in credit derivatives that are consistent with the principles as prescribed in 4.2 in order that investors can use them as hedging tools for credit risk, or as investment alternatives for yield enhancement as prescribed in Notification of the Bank of Thailand on Permission for Commercial Banks to Engage in Credit Derivatives, For credit derivatives that have standard structures and widely-known, commercial banks can engage in such derivative transactions according to the type of transactions, reference obligations and counterparties as prescribed in that Notification. On the other hand, for credit derivatives which type, reference obligations and counterparties are beyond those prescribed in the Notification, commercial banks shall submit the details of the transactions for the Bank of Thailand's consideration whether it is consistent with the principles of permission prior to engaging in such derivative transactions.

4.4.3 Structured products

The Bank of Thailand allows commercial banks to engage in structured products that are consistent with the principles as prescribed in 4.2 to increase investment alternatives and to satisfy investors' demand as prescribed in Notification of the Bank of Thailand on Permission for Commercial Banks to Engage in Structured Products. Commercial banks can engage in structured products which features, reference variables and counterparties as prescribed in that Notification. For structured products that the features, reference variables and counterparties are beyond those prescribed in the Notification, commercial banks shall submit the details of the transactions for the Bank of Thailand's consideration whether it is consistent with the principles of permission prior to engaging in such derivative transactions.

4.5 Risk management

Commercial banks shall effectively manage risks arising from derivative transactions. The risk management shall be consistent with characteristic, volume, and complexity of derivative transactions and shall comply with the requirements, for instance, preparing product programs which shall be approved by the board of

directors, not engaging in derivative transactions that cannot be reliably measured their fair values or cannot be effectively managed risks, as well as maintaining adequate level of capital to cover risks that may arise from changes in market, credit quality, inflation rate, counterparty credit risk or other related factors. For the compliance, commercial banks shall follow the risk management requirements for derivative transactions as prescribed in Notification of the Bank of Thailand on Risk Management for Derivative Transactions.

4.6 Treatment of clients for engaging in derivative transactions

Commercial banks shall have manual and processes on treatment of clients for engaging in derivative transactions to ensure that clients are fairly treated, both in term of client suitability assessment and disclosure, in order to reduce the possibility that the clients may engage in derivative transactions that have high risks or more complicated beyond clients' level of sophistication, and result in a large amount of losses. Consequently, this could affect the trustworthiness of commercial banks. Moreover, the commercial banks shall establish clients' complaint and resolve processes in case of unfair treatment occurs from engaging in derivative transactions. Also, commercial banks shall establish internal control systems which shall be consistent with requirements on treatment of clients for engaging in derivative transactions, and shall have staffs that have an expertise on derivative transactions. For the compliance, commercial banks shall follow the requirements on treatment of clients for derivative transactions as prescribed in Notification of the Bank of Thailand on Minimum Requirements on Treatment of Clients for Engaging in Derivative Transactions.

4.7 Other related regulations and supervisions

4.7.1 Prevention of impact on economic and financial stability

Engaging in permitted derivative transactions or in those approved by the Bank of Thailand under 4.4, commercial banks shall comply with law on exchange control, Notifications/Circulars of the Competent Officer and measures to prevent Thai baht speculation of the Bank of Thailand, including the following laws, regulations and circulars:

- (1) Notification of the Competent Officer on Regulation and Procedures Regarding Investment in Foreign Securities and Derivatives

(2) Circular on Engaging in Derivative Transactions, Structured Deposits or Structured Notes, and Credit Derivatives Linked to Foreign Currency-Denominated Assets

(3) Circulars on Measures to Prevent Thai Baht Speculation

4.7.2 Accounting treatment and disclosure

Commercial banks that engage in derivative transactions shall correctly classify and record derivative transactions, as well as disclose information in accordance with related Thai Accounting Standards. However, in case where there is no relevant Thai accounting standard, commercial banks shall comply with relevant international accounting standards. In this regard, commercial banks shall establish processes regarding classification and recognition of the transactions, and also file related documents or evidences for auditing by external auditors and examination by the Bank of Thailand, or submit them to the Bank of Thailand upon request.

4.7.3 Data reporting and document keeping

(1) Data reporting

For the purpose of monitoring development of derivatives market and impact on commercial banks' financial positions after engaging in derivative transactions, commercial banks shall keep and submit data regarding derivative transactions in electronic forms in accordance with the reporting forms and requirements as prescribed in related regulations.

(2) Document keeping

Commercial banks engaging in derivative transactions shall file documents or evidences regarding engagement in derivative transactions within their offices for an examination by the Bank of Thailand or submit copies of those to the Bank of Thailand upon request.

4.7.4 Other related regulations

Commercial banks engaging in derivative transactions shall comply with related regulations as prescribed by the Bank of Thailand regarding Notification of the Bank of Thailand on Supervision of Capital for Commercial Banks, Notification of the Bank of Thailand on Supervision of Market Risk and Capital Requirements for Market Risk for Financial Institutions, Notification of the Bank of

Thailand on the Calculation of Credit Risk-Weighted Assets for Commercial Banks, Notification of the Bank of Thailand on the Calculation of Counterparty Credit Risk-Weighted Assets for Derivative Transactions, Notification of the Bank of Thailand on Single Lending Limit, Notification of the Bank of Thailand on Investment Regulations for Financial Institutions, Notification of the Bank of Thailand on Foreign Exchange Positions for Commercial Banks excluding Retail Banks. For structured derivatives which compose of more than one component, commercial banks shall decompose those derivatives into sub-components and apply the aforementioned regulations accordingly.

4.8 Other requirements

4.8.1 To engage in derivative transactions, commercial banks shall ensure that an agreement is legally enforceable and does not conflict with other related laws or regulations. Furthermore, the agreement shall be regularly reviewed as deemed appropriate.

4.8.2 The Bank of Thailand reserves the right to amend frameworks or regulations regarding engaging in derivative business, or related prudential requirement both in case of permissible and prior approved derivative transactions, as deemed appropriate. The Bank of Thailand may withhold, limit transactions volume, change approval conditions, require additional reserve, or impose any other measures in the case where the Bank of Thailand find that commercial banks do not comply with the requirements prescribed above, or carelessly or inefficiently engaging in derivative transactions; this includes the cases that engaged derivative transactions are inconsistent with the principles as prescribed in 4.2, or any changes from when the permissions are granted that may significantly increase the associated risks or may be inconsistent with market condition.

5. Effective Date

This Notification shall come into force as from the day following the dates of its publication in the Government Gazette.

Announced on 25th September 2015

(Mr. Prasarn Trairatvorakul)
Governor
Bank of Thailand

Types and definitions of investors

The Bank of Thailand determines types and definitions of investors so that derivative transactions of commercial banks are consistent with client's knowledge, proficiency and risks tolerance level, as follows:

1. Institutional investors, namely:

- 1.1 Bank of Thailand;
- 1.2 commercial banks;
- 1.3 retail banks;
- 1.4 specialised financial institutions established under specific law;
- 1.5 finance companies;
- 1.6 credit foncier companies;
- 1.7 securities companies;
- 1.8 non-life insurance companies;
- 1.9 life insurance companies;
- 1.10 mutual funds;
- 1.11 private funds managed by securities companies for investment of investors under 1.1 – 1.10 or 1.12 – 1.26 or high net worth investors;
- 1.12 provident funds;
- 1.13 Government Pension Fund;
- 1.14 Social Security Fund;
- 1.15 National Savings Fund;
- 1.16 Financial Institutions Development Fund;
- 1.17 derivatives business operators under the Derivatives Act;

- 1.18 futures trading business operators under the Agricultural Futures Trading Act;
- 1.19 international financial institutions;
- 1.20 Deposit Protection Agency;
- 1.21 Stock Exchange of Thailand;
- 1.22 juristic persons in the category of statutory corporation;
- 1.23 juristic persons whose shares are held by person under 1.1 - 1.22, in aggregate, exceeding seventy five percent of all shares with voting rights;
- 1.24 foreign investors having similar characteristics to investors under 1.1 - 1.23;
- 1.25 fund managers whose name is registered as a qualified fund manager under the Notification of the Office of the Securities and Exchange Commission Governing Rules, Conditions and Procedures for Appointment and Conducts of Fund Manager;
- 1.26 derivatives fund managers whose name is registered as qualified derivatives fund managers under the Notification of the Office of the Securities and Exchange Commission Governing Rules, Conditions and Procedures for Appointment and Conducts of Derivatives Fund Manager;

2. High net worth investors, namely:

- 2.1 juristic persons having any of the following characteristics:
- 2.1.1 having shareholder's equity stated in the latest financial statement audited by auditor of one hundred million Baht or greater;
- 2.1.2 having investments in securities or derivative transactions stated in the latest financial statement audited by auditor of twenty million Baht or greater
- 2.2 individual when combining with spouse having any of the following characteristics:
- 2.2.1 having net assets value of fifty million Baht or greater, providing that value of property which is a permanent residences of such individual shall not be included;

2.2.2 having annual income of four million Baht or greater;

2.2.3 having investments in securities or derivative transactions of ten million Baht or greater

3. Retail investors, namely:

Other investors not qualified as institutional investors and high net worth investors as specified above