



THE MONETARY AUTHORITY OF SINGAPORE

SECURITIES AND FUTURES ACT (CAP. 289)

GUIDELINES ON THE REGULATION OF CLEARING FACILITIES

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1 PURPOSE OF THESE GUIDELINES

1.1 These *Guidelines on the Regulation of Clearing Facilities* (the “Guidelines”) are issued by the Monetary Authority of Singapore (the “MAS”) pursuant to section 321 of the *Securities and Futures Act (Cap. 289)* (the “SFA”). These Guidelines aim to provide financial market participants with a better understanding of how MAS will administer the legislative provisions relating to clearing facilities, which are contained in Part III of the SFA.

1.2 These Guidelines should be read in conjunction with the provisions of Part III of the SFA and the *Securities and Futures (Clearing Facilities) Regulations 2005* (the “SF (CF) Regs”), and where relevant, other provisions of the SFA.

2 OBJECTIVES OF REGULATION OF CLEARING FACILITIES

2.1 As set out in section 47 of the SFA, MAS' objectives in regulation of clearing facilities are:

- (a) *to promote the safety and efficiency of clearing facilities that support systemically-important markets or form an integral part of the financial infrastructure; and*
- (b) *to reduce systemic risk.*

2.2 These objectives support MAS' objectives of supervision set out in the "*Objectives and Principles of Financial Supervision in Singapore*" Monograph¹. They are also in line with the public policy objectives set out by international standard-setting bodies, such as the CPSS-IOSCO Taskforce on Securities Settlement Systems².

2.3 The following paragraphs provide guidance on the key concepts encapsulated in MAS' regulatory objectives.

Safety

2.4 The safe operation of clearing facilities allows participants in financial market activities to discharge their obligations on a timely basis and provide confidence for the participants to trade in the financial market. The failure of a clearing facility may seize up financial flows, undermine the fulfilment of obligations and transmit shocks from one financial institution to another. The safety of clearing facilities is therefore essential to preserve the stability of the financial system.

¹ The monograph is available on the website of MAS at "<http://www.mas.gov.sg/>".

² The CPSS-IOSCO Taskforce on Securities Settlement Systems is a joint working group established under the auspices of the Bank for International Settlements ("BIS") Committee on Payment and Settlement Systems ("CPSS") and the Technical Committee of the International Organisation of Securities Commissions ("IOSCO"). The Taskforce has published three reports: *Recommendations for Securities Settlement Systems*, *Assessment Methodology for "Recommendations for Securities Settlement Systems"*, and *Recommendations for Central Counterparties*. For copies of the reports, please refer to the CPSS and IOSCO websites at "<http://www.bis.org/>" and "<http://www.iosco.org/>".

2.5 Persons operating clearing facilities take on risks that should be properly managed. These risks may include counterparty credit risk, liquidity risk, principal or delivery risk, and operational risk. A safe clearing facility requires an understanding of the risks that arise from the clearing and settlement processes. To improve the safety of clearing facilities, these risks should be effectively managed by the operator and participants of clearing facilities.

Efficiency

2.6 Clearing facilities should also be efficient in helping to reduce costs and maximise the economic benefits of financial intermediation. Promoting the efficient operation of clearing facilities requires an understanding of the design and cost structure of the clearing facilities. The design of a clearing facility should provide for appropriate systems, controls and procedures such that the clearing facility operates reliably and has appropriate and adequate capacity to handle both current and potential activity.

2.7 The design of a clearing facility should also give due regard to the needs of the participants of the clearing facility and the costs imposed on them. For example, a clearing facility may standardise processes or implement consolidated system interfaces so that participants' interfaces with the clearing facility are simplified, while keeping costs reasonable to permit fair access.

Systemic risk

2.8 The objective of reducing systemic risk in the regulation of clearing facilities is essential because systemically-important clearing facilities may potentially undermine stability or public confidence in the financial system. The systemic importance of a clearing facility is predicated on one of two factors – the systemic importance of the market it supports, or its position as a key component of the financial market infrastructure.

2.9 A market is systemically-important if disruptions to the functioning of the market can trigger or transmit further disruptions among financial market participants. Clearing facilities that support such markets are more likely to be systemically-important, as disruptions to their safe and

efficient functioning may cause disruptions to the systemically-important markets.

2.10 Clearing facilities streamline the functioning of financial markets by concentrating transaction flows and establishing market standards for clearing and settlement processes. They can be key nodes in financial market infrastructure, providing services that underpin significant financial market activities. Disruptions to the safe and efficient functioning of such clearing facilities may cause widespread disruptions among financial market participants, and may even result in instability of the financial system. Clearing facilities with the ability to do so are considered systemically-important.

2.11 In order for MAS to achieve its regulatory objectives, it is essential for MAS to assess the systemic importance of clearing facilities and to be cognisant of the risks posed by such systemically-important facilities. MAS therefore subjects systemically-important clearing facilities to appropriate regulation, thereby promoting the safe and efficient functioning of such facilities.

3 SCOPE OF REGULATION OF CLEARING FACILITIES

3.1 The definitions of the terms “clearing facility” and “clearing or settlement” are contained in Part II of the First Schedule to the SFA.

3.2 Primarily, a clearing facility refers to any form of infrastructure that is set up to carry out the clearing or settlement of transactions in securities or futures contracts. Under the SFA, MAS may also prescribe other clearing or settlement facilities to fall within the scope of Part III of the SFA to meet MAS’ regulatory objectives.

Clearing or settlement

3.3 Clearing or settlement, as defined in Part II of the First Schedule to the SFA, comprises the entire chain of activities immediately following the execution of transactions in securities or futures contracts between transacting parties to the point where the obligations between the transacting parties are discharged. There are four main categories of activities in the chain as set out below:

- (a) *information relating to the terms of those transactions are verified by a person operating a facility with a view to confirming the transactions*

This refers generally to the process of post-trade verification of trade details by a person operating a facility, with transacting parties agreeing on the terms of the transactions. This is usually the first step in the clearing and settlement process.

- (b) *parties to those transactions substitute, through novation or otherwise, the credit of a person for the credit of the parties*

This refers generally to a person operating a facility taking up the role of a central counterparty (“CCP”) to transacting parties, i.e. becoming the buyer to every seller and the seller to every buyer. By substituting itself as the counterparty to the trades, the person operating a facility assumes the credit

and liquidity risks of the transacting parties. This process can be done through novation or otherwise.

“Novation” refers to a process through which the original obligation between a buyer and seller is discharged through the substitution of the CCP as the seller to the buyer and the buyer to the seller, creating two new contracts. Another process by which a person operating a facility may take on the role of a CCP is the “open offer” process, in which a CCP extends an "open offer" to act as counterparty to all participants and is thereby interposed between participants at the time a trade is executed.

- (c) *the obligations of parties under those transactions are calculated, whether or not such calculations include multilateral netting arrangements*

This refers generally to the calculation of obligations by a person operating a facility to determine the obligations of the transacting parties to deliver or pay on the settlement date. Such calculations may take into account multilateral netting arrangements, resulting in net obligations. For derivatives transactions, this process could involve the marking-to-market of open positions of the participants.

- (d) *parties to those transactions meet their obligations under such transactions, including the obligation to deliver, the transfer of funds or the transfer of title to securities between the parties*

This refers generally to a person operating a facility providing an arrangement, process, mechanism or service to aid or simplify the settlement of obligations between transacting parties. For settlement of securities transactions, this may involve the transfer of title to securities and a corresponding fund transfer between the transacting parties. In derivatives transactions, this usually refers to the settlement of obligations arising from margin calls or settlement variations or physical delivery of a commodity. However, it is not the intent of MAS to include the activities

of persons that merely carry out the instructions to make payments or transfer securities within the definition of “clearing or settlement”.

3.4 MAS sees the four main categories of activities as complementary, with each playing a distinct role in the chain of clearing and settlement activities. The failure of any clearing facility to carry out any of these activities may lead to a delay in the settlement of the transactions, and increase counterparty risks for the participants involved. Any facility carrying on any one of the four main categories of activities in relation to transactions in securities or futures contracts is therefore deemed as a “clearing facility” under the SFA and may be subject to regulation by MAS under Part III of the SFA.

3.5 The definition of the term “clearing or settlement” in the SFA also specifically excludes the back office operations of parties to the transactions as well as custodial activities. Parties to the transactions include such entities as end-investors, the intermediaries through whom the end-investors trade, and the intermediaries through whom their transactions are cleared or settled. Due to the rapid developments in clearing and settlement activities, MAS is mindful of activities that do not give rise to regulatory concerns falling within the regulatory ambit of Part III of the SFA. The SFA thus empowers MAS to exclude from the definition of the term “clearing or settlement” any other arrangement, process, mechanism or service by way of prescription via Regulations.

Transactions in securities or futures contracts

3.6 Part III of the SFA is intended to apply to all clearing facilities that engage in clearing or settlement of transactions in securities or futures contracts. This applies regardless of –

- (a) whether the market where the transactions cleared through the clearing facility are traded has a presence in Singapore;
- (b) whether the clearing facility clears or settles other transactions in addition to securities or futures contracts; or
- (c) whether the person operating the clearing facility operates other businesses that do not constitute clearing or settlement

of transactions in securities or futures contracts under the SFA.

3.7 The terms “securities” and “futures contract” are defined in section 2(1) of the SFA. As defined, futures contracts do not include over-the-counter contracts, to the extent that the terms and conditions of these contracts, relating to the discharge of obligations or otherwise, are not determined by the business rules or practices of a futures market.

Power to prescribe other clearing facilities

3.8 The SFA also empowers MAS, under Part II of the First Schedule to the SFA, to prescribe other clearing or settlement facilities, or class of clearing or settlement facilities, to fall within the definition of the term “clearing facility” under the SFA. MAS would however exercise this power sparingly, and in any event, only if MAS deems it necessary to achieve its regulatory objectives.

4 APPLICATION OF SECTION 339 OF THE SFA (EXTRA-TERRITORIALITY)

4.1 Section 339 of the SFA provides for the circumstances in which an act conducted partly or wholly outside Singapore constitute an offence of any provision of the SFA. In respect of Part III of the SFA, if a person operating a clearing facility outside of Singapore falls within the ambit of section 339(1) or (2) of the SFA, it will be required to comply with Part III of the SFA and the person operating the clearing facility outside of Singapore will have to notify MAS of its operation under section 49 of the SFA.

4.2 The *Guidelines on the Application of Section 339 (Extra-Territoriality) of the Securities and Futures Act*³ set out the general principles underlying how MAS would apply section 339 of the SFA to the various parts of the SFA, including Part III. Part 4 of these Guidelines provides additional guidance specifically for persons operating clearing facilities outside of Singapore.

Application of section 339(2) of the SFA

4.3 In addition to the factors set out in the *Guidelines on the Application of Section 339 (Extra-Territoriality) of the Securities and Futures Act*⁴, in determining if an act of a person operating a clearing facility outside Singapore has a substantial and reasonably foreseeable effect in Singapore, MAS also considers whether the clearing or settlement carried out by the person operating a clearing facility outside Singapore, for persons in Singapore, arises from the clearing or settlement activities that it carries out for an operator of an overseas market that falls within the ambit of section 339(1) or (2) of the SFA.

4.4 As the operator of an overseas market that falls within the ambit of section 339(1) or (2) of the SFA is required to comply with Part II of the SFA, it is not MAS' policy intent to regulate both the overseas market and the clearing facility operating outside Singapore which clears or

³ Guideline No. SFA 15-G01 issued 27 Feb 2004 (Last revised on 1 Jul 2005) can be found at the website of MAS at "http://www.mas.gov.sg/masmcm/bin/pt1SFA_Guidelines.htm".

⁴ Guideline No. SFA 15-G01 issued 27 Feb 2004 (Last revised on 1 Jul 2005).

settles transactions traded on that overseas market. MAS deems it sufficient to achieve its regulatory objectives through regulation of the operator of the overseas market.

4.5 Accordingly, persons operating clearing facilities outside Singapore are not considered to have substantial and reasonably foreseeable effects in Singapore where their clearing facilities clear or settle transactions traded on overseas markets operated by approved exchanges, recognised market operators or exempt market operators.

Non-applicability of section 339(2) of the SFA

4.6 Regulation 29 of the SF (CF) Regs provides that section 339(2) shall not apply to persons operating clearing facilities outside of Singapore who have established clearing linkages with a person operating a clearing facility in Singapore under certain circumstances. Accordingly, such persons do not fall within the regulatory ambit of Part III of the SFA, to the extent that they also do not fall within the ambit of section 339(1) of the SFA.

4.7 The “clearing linkage” referred to in regulation 29 of the SF (CF) Regs is generally an arrangement between persons operating clearing facilities where either of the following two main characteristics is present:

- (a) some integration exists between the systems of the clearing facilities (for example, a clearing linkage exists where two or more clearing facilities operate a common clearing platform or infrastructure used by the clearing facilities and their members); or
- (b) as a result of an arrangement between clearing facilities, the positions of a member of one clearing facility may be held at another clearing facility (for example, a clearing linkage exists where a position held by a member of a clearing facility may be transferred to another clearing facility and thereafter held at that clearing facility).

4.8 MAS notes that there may be forms of clearing linkages where –

- (a) the integration between the systems of the linked clearing facilities is not significant; and
- (b) the positions held at the linked clearing facility outside of Singapore are not significant.

4.9 For example, a clearing linkage, which is set up through the establishment of communication protocols between the existing systems of the clearing facilities, will not be considered to involve significant integration. The existence of a common clearing platform utilised by the clearing facilities would, however, indicate significant integration of systems. As another example, a clearing linkage will not be considered to involve significant positions in a case where positions are held at a clearing facility outside of Singapore by virtue of an arrangement between the linked clearing facilities, but –

- (a) the volume of positions held (open interest) at that linked clearing facility outside of Singapore is insignificant vis-à-vis the positions held at the clearing facility in Singapore; or
- (b) the market contracts, in respect of which positions are held at that linked clearing facility outside of Singapore, are not significantly cleared or settled by the clearing facility in Singapore.

4.10 The forms of clearing linkages that do not result in significant integration of systems between clearing facilities and significant positions held at the clearing facility outside of Singapore are not likely to lead to material impact on the risks to a clearing facility in Singapore. In such cases, section 339(2) of the SFA shall not apply to the person operating the linked clearing facility outside of Singapore. To the extent that such a person does not fall within the ambit of section 339(1), the person will not fall within the regulatory ambit of Part III of the SFA.

5 REGULATORY REGIME FOR CLEARING FACILITIES

5.1 A person intending to engage in the clearing or settlement of securities or futures contracts does not need to obtain the prior approval of MAS. Instead, pursuant to section 49(1) of the SFA, a person seeking to establish or operate a clearing facility in Singapore need only notify MAS of its intent at least 60 business days prior to the establishment, or commencement of operation, of the clearing facility. The person may proceed to establish, or commence operations of, the clearing facility after the stipulated notification period, unless MAS orders the person not to establish or commence operation of a clearing facility pursuant to section 54(1) of the SFA.

5.2 All notifications by persons seeking to establish or operate clearing facilities in Singapore have to be lodged with MAS in the manner and form as stipulated in regulations 3 and 6(1) of the SF (CF) Regs. A person may apply to reduce the notification period required prior to the establishment or commencement of clearing facilities. Where MAS does not have cause to be concerned over the shorter period of notification, MAS may determine such period as appropriate, pursuant to section 49(2) of the SFA.

5.3 Entities specified in regulation 8 of the SF (CF) Regs are not subject to the notification requirements under sections 49, 50 and 51 of the SFA. These entities are already regulated under other legislation administered by MAS and are required under such legislation to provide similar information. It is not the intent of MAS to subject such entities to dual notification and reporting requirements.

Designation approach to regulation

5.4 MAS recognises that not all clearing facilities that engage in clearing or settlement pose threats to its regulatory objectives. Part III of the SFA therefore introduces a designation approach to the regulation of clearing facilities, in order to avoid imposing unnecessary regulatory burden on persons operating clearing facilities that do not pose threats to MAS' regulatory objectives.

5.5 Under this approach, MAS may regulate clearing facilities that are of systemic importance to the financial markets of Singapore. If, following an assessment of the nature and extent of the risks posed by a clearing facility, MAS deems that the safe and efficient functioning of that clearing facility is essential to maintain stability or public confidence in the financial markets of Singapore, MAS may designate the person operating that clearing facility as a designated clearing house (“DCH”).

5.6 While a designation approach translates to a higher level of statutory obligations for a DCH to comply with, as compared to that for a person who operates a clearing facility which is not designated, this is commensurate with the higher level of systemic importance of the clearing facility operated by the DCH and the higher regulatory concern over the operations of the DCH. The intent of MAS is to subject DCHs to obligations only as necessary to achieve its regulatory objectives. As such, section 81C of the SFA empowers MAS to exempt a DCH from any of the obligations under Part III of the SFA if it is satisfied that non-compliance by such DCH from such obligations does not detract from the regulatory objectives of MAS.

Factors in assessing notification

5.7 Upon receipt of a notification to establish or commence operations of a clearing facility, MAS shall consider whether the person operating the clearing facility should be designated as a DCH, by assessing the notification based on considerations set out in sections 55(1) and 57 of the SFA. In particular, MAS may take into consideration the following:

- (a) *the size and structure, or proposed size and structure, of the clearing facility*

Consideration of size includes the consideration of factors such as the volume and value of transactions cleared through the clearing facility, the number of investors served and the number of participants. The larger the volume or value of transactions, and the larger the number of investors or participants, the more likely it would be that the clearing facility is systemically-important.

Consideration of structure includes considerations as to whether the services of the clearing facility are offered as part of a network of related clearing facilities and the design of the clearing or settlement system in place in the facility.

- (b) *the nature of the services provided, or to be provided, by the clearing facility*

The type of clearing or settlement undertaken by the clearing facility, such as the verification of post-trade details with transacting parties to agree on the terms of the transactions or calculation of obligations, is also a factor MAS may consider. A facility that carries out the whole chain of activities set out in paragraph 3.3 of these Guidelines is more likely to be systemically-important than one that carries out only one of the four categories of activities in that chain, e.g. the verification of post-trade details.

- (c) *the nature of the transactions cleared, or to be cleared, by the clearing facility*

The factors for consideration include –

- (i) the specific type of transactions cleared by the clearing facility, whether they are transactions in securities or futures contracts (e.g. warrants, options, single stock futures, etc.) or other financial instruments, and whether the transactions fall within the ambit of the SFA; and
- (ii) the range of transactions cleared by the clearing facility which fall within the ambit of the SFA.
- (d) *the market where the transactions cleared through the clearing facility are traded or to be traded*

The factors for consideration include whether the market where the transactions cleared through the clearing facility are traded is systemically-important. For example, a clearing facility that clears transactions traded on a market

operated by an approved exchange regulated under Part II of the SFA is more likely to be systemically-important than one that clears transactions traded on a market operated by an exempt market operator.

Other factors for consideration include whether the market is in Singapore, whether the market is served only by that clearing facility and the number of markets served by that clearing facility.

- (e) *the nature of the investors or participants, or proposed investors or participants, who may use or have an interest in the clearing facility*

Factors for consideration include the level of sophistication of the investors or participants of the clearing facility, the systemic importance of the participants and the impact of any failure of the clearing facility on the investors or participants and the broader financial sector.

- (f) *whether the person operating the clearing facility is otherwise regulated by MAS under the SFA or any other written law*

If the person operating the clearing facility is already regulated under the SFA or other written law administered by MAS, MAS will assess if its regulatory objectives can be achieved via such other regulatory ambit. For example, if the holder of a capital market services licence operates a clearing facility, MAS may choose not to designate the holder as a DCH, but may instead impose additional requirements in relation to its operation of the clearing facility.

- (g) *whether the clearing facility takes on counterparty risks, through novation or otherwise, in the clearing or settlement of transactions*

If the clearing or settlement undertaken by a clearing facility include those pertaining to its role as a CCP, thus resulting in the person operating the clearing facility taking on counterparty risks of transacting parties, the clearing facility is more likely to be systemically-important.

- (h) *the parties who may be affected in the event that the clearing facility runs into difficulties*

MAS will consider the nature of the parties who may be affected in the event that the clearing facility runs into difficulties, for example in events such as the default of a participant or the failure of the clearing facility itself. Where the parties affected may extend beyond the investors or participants of the clearing facility, in particular, when the facility is operated by a person who also operates an existing market or another clearing facility, the clearing facility is more likely to be systemically-important.

- (i) *the interests of the public*

MAS may consider if it is in the interests of the public to designate the person operating the clearing facility as a DCH. Such interests may arise if the designation of the person operating the clearing facility may be beneficial towards advancing the development of the financial sector, leading to gains in efficiency or reductions in systemic risk in the financial system of Singapore.

- (j) *any other circumstances that MAS may deem relevant.*

MAS retains the flexibility to include other circumstances as it may deem relevant, in recognition of the developments in the clearing and settlement landscape.

Designation of person intending to establish a clearing facility

5.8 Where MAS assesses the clearing facility to be systemically-important and will be designating the person intending to establish, or commence operation of, the clearing facility as a DCH, MAS

shall inform the person before the end of the 60 business day notification period. If the person intends to proceed to establish, or commence operation of, the clearing facility, the person shall comply with the obligations specified in Part III of the SFA pertaining to a DCH before establishing, or commencing operation of, the clearing facility.

Designation of person operating an existing clearing facility

5.9 The systemic importance of an existing clearing facility may evolve with the development of the facility. MAS will therefore continue to assess the nature and extent of risks posed by any clearing facility and will engage the person operating the relevant clearing facility in consultation should there be major developments such that the operations of the clearing facility reach a level of systemic importance.

5.10 If MAS informs a person operating a clearing facility of its decision to designate the person as a DCH after the establishment, or commencement of operation, of the clearing facility, MAS shall allow the person a reasonable period, at the discretion of MAS, to comply with the relevant obligations of a DCH.

Withdrawal of designation

5.11 Conversely, the operations of a DCH may evolve in such a way that its clearing facility ceases to pose a threat to MAS' regulatory objectives, for example, when the operations of a DCH in Singapore are scaled down. In such instances, MAS, may, pursuant to section 58 of the SFA, withdraw the designation of a DCH.

Holding out as a DCH

5.12 No person shall hold himself out to be a DCH unless he is so designated by MAS. In the case where MAS informs a DCH of a withdrawal of its DCH status, such a person, if he has held himself out to be a DCH, shall immediately cease to do so.

6 OBLIGATIONS OF PERSONS OPERATING CLEARING FACILITIES

6.1 In applying the regulatory regime for clearing facilities, MAS requires timely access to information in order to achieve its regulatory objectives. MAS may gather such information as is relevant to supplement its understanding of developments among clearing facilities, and also to aid MAS in ensuring the relevance of the regulatory regime for clearing facilities to the changing nature of clearing and settlement systems.

6.2 Sections 50, 51 and 52 of the SFA empower MAS to gather information from persons operating clearing facilities. Persons operating clearing facilities (excluding DCHs) are obliged to comply with these sections, in addition to section 49 of the SFA.

6.3 In the course of administering Part III of the SFA, MAS may gather information of the following nature from a person operating a clearing facility, in particular –

- (a) annual reports, as prescribed in regulation 7(1) of the SF (CF) Regs;
- (b) notices of changes of its chief executive officer and of the address of the principal place of business, as set out in section 51(1)(a) and (b) of the SFA;
- (c) notices of material changes in the business of the clearing facility, as set out in section 51(1)(c) of the SFA, including changes in the nature of the business (e.g. the size and structure of the facility and services provided by the facility) and the establishment of any clearing linkage, clearing arrangement or co-operative arrangement with another clearing facility;
- (d) notices of intention to cease operations of the clearing facility, as set out in section 51(1)(d) of the SFA; and

- (e) information relevant in aiding MAS to assess the systemic importance of the clearing facility, including information regarding the nature and extent of risks posed by the clearing facility.

7 OBLIGATIONS OF DESIGNATED CLEARING HOUSES

7.1 The obligations imposed on the DCH under the SFA shall apply to all clearing facilities operated by the DCH for the clearing or settlement of transactions in securities or futures contracts. Pursuant to section 59(3) of the SFA, MAS may however exempt any clearing facility operated by a DCH from all or any of the obligations, as well as any of the provisions of the SFA, if MAS is satisfied that such exemption would not detract from its regulatory objectives.

7.2 A DCH is required to comply with the list of general obligations contained in section 59 of the SFA, which are elaborated here –

- (a) *as far as is reasonably practicable, operate a safe and efficient clearing facility*

The DCH shall conduct its business in a manner complementing the safe and efficient functioning of the clearing facility and shall not engage in activities or businesses that may conflict with the safe and efficient functioning.

- (b) *manage any risks associated with its business and operations prudently*

The DCH is expected to –

- (i) ensure that adequate and appropriate systems and controls are in place to identify, assess, monitor and manage risks relating to its clearing or settlement business and operations;
- (ii) comply with regulation 10(1) of the SF (CF) Regs, which obliges the DCH to seek the approval of MAS prior to making any changes to the financial resources that are available to the DCH to support a default of its member. Changes to financial resources include such circumstances as –

- (A) changes in the total value of financial resources, or value of each form of financial resource, available to the DCH to support the default of a member;
 - (B) changes in the manner in which each form of financial resource is held; and
 - (C) any other changes that may affect the size or liquidity of financial resources available to the DCH;
- (iii) ensure that adequate and appropriate emergency procedures and business continuity plans, as described in regulation 13 of the SF (CF) Regs, are in place;
 - (iv) ensure that there is periodic testing or review of its systems and controls, including its business continuity plans;
 - (v) comply with regulation 15 of the SF (CF) Regs and ensure that appropriate and adequate controls, such as position limits in respect of any futures contract cleared by a member of the DCH, are established, as well as ensure that appropriate and adequate criteria or methodology is established in order to determine position limits in respect of any futures contract cleared by a member of the DCH.

Where the DCH also conducts businesses and operations other than that of a clearing facility, the DCH is expected to segregate the risks associated with such businesses and operations from that of its clearing or settlement business or operations.

- (c) *in discharging its obligations under the SFA, not act contrary to the interests of the public, having particular regard to the interests of the investing public*

The DCH, with regard to the interests of the investing public, is obliged not to engage in activities that may compromise its ability to operate a safe and efficient clearing facility or lead to an increase in systemic risk in the financial system of Singapore.

- (d) *ensure that access for participation in its clearing facility is subject to criteria that are fair and objective, and are designed to ensure the safe and efficient functioning of its facility and to protect the interests of the investing public*

The DCH is obliged to ensure that access for participation in its clearing facility is based on criteria that are not unnecessarily restrictive and access is not limited other than on grounds of risks to the safe and efficient functioning of its clearing facility.

- (e) *maintain business rules that make satisfactory provision for –*
(i) *the clearing facility to be operated in a safe and efficient manner; and*
(ii) *the proper regulation and supervision of its members*

The DCH is obliged to maintain business rules in compliance with regulation 21 of the SF (CF) Regs. This is further elaborated in Part 9 of these Guidelines.

- (f) *enforce compliance by its members with its business rules*

The DCH is obliged to have an adequate and appropriate surveillance and enforcement program in place to effectively monitor compliance by its members with its business rules, enforce its rules and discipline its members in a fair and objective manner.

- (g) *have sufficient financial, human and system resources –*
 - (i) *to operate a safe and efficient clearing facility;*
 - (ii) *to meet contingencies or disasters; and*
 - (iii) *to provide adequate security arrangements*

The DCH is obliged to give regard to the level of resources available to support the activities of its clearing facility in varying operating conditions, commensurate with the needs of its business and operations.

- (h) *ensure that it appoints or employs fit and proper persons as its chairman, chief executive officer, directors and key management officers.*

The duties or functions of these persons are elaborated in regulation 27 of the SF (CF) Regs.

8 CUSTOMERS' MONEY AND ASSETS HELD BY DESIGNATED CLEARING HOUSES

8.1 Section 62 of the SFA obliges the DCH to account for any money or assets deposited with or paid to it by its members, in respect of or in relation to the contracts of customers of such members, on an aggregated basis, segregated from other types of money and assets received by the DCH from the members. Such money or assets are to be held in trust for the customers of the members, and disposed of or used only in respect of contracts of the customers of the members.

8.2 This requirement serves to provide confidence for investors to trade in the financial market, to assure investors that their money and assets are protected from the losses of the members with whom their assets are put up. For example, where margins are collected to support a trade cleared or settled by the DCH, the DCH should ensure that all client positions are margined separately from those of the proprietary positions of members. This design should ensure that customer transactions do not offset the proprietary liabilities of the member in the event of a default and that client positions may be closed out or transferred to a non-defaulting member expeditiously by the DCH.

8.3 The DCH is permitted to use any customers' money and assets held by the DCH in the circumstance provided for in section 63 of the SFA. Specifically, when a member fails to meet its obligations to the DCH, the DCH is permitted to use the member's customers' money or assets held with the DCH if the DCH has reasonable grounds for forming an opinion that –

- (a) the failure of the member to meet its obligations is directly attributable to the failure of any of its customers to meet that customer's obligation under any market contract; and
- (b) failure to use the money or assets to meet the obligations of the member may jeopardise the financial integrity of the DCH.

8.4 The conditions in paragraph 8.3(a) and (b) ensure that the DCH does not use customers' money and assets indiscriminately. In events

such as where a customer's default leads to a member's consequent default, it is not MAS' intent to delay or otherwise obstruct the appropriate use of customers' money and assets for the purposes of meeting the obligations of such a defaulting member. Where it is established that there are reasonable grounds for forming an opinion on the matter stated in paragraph 8.3(a), and the DCH has reasonable grounds to form an opinion that its financial integrity may be jeopardised (whether because its capital may be required to be utilised to meet the obligations of a defaulting member or otherwise), the DCH may utilise customers' money and assets as provided for in section 63.

8.5 As provided for in section 64, a DCH is also allowed to invest customers' money and assets held by the DCH in classes of investments as prescribed by MAS. These classes of investments are prescribed in regulation 18 of the SF (CF) Regs. The DCH is obliged to seek MAS' approval before undertaking any such investments. Pursuant to section 64(4) of the SFA, MAS may grant its approval subject to such conditions or restrictions as it may think fit.

8.6 To ensure that a DCH has discharged its obligations as regards customers' money and assets held with it, regulation 20 of the SF (CF) Regs requires a DCH to cause its auditors to certify that the DCH has handled the customers' money and assets held in a manner consistent with the SFA requirements. The DCH is required to cause its auditors to submit a report to MAS on a bi-annual basis, in accordance with the requirements prescribed in regulation 20 of the SF (CF) Regs. Such a report should be submitted to MAS within one month after the auditors have verified the compliance of the DCH with the requirements.

9 BUSINESS RULES OF DESIGNATED CLEARING HOUSES

9.1 Section 71(1) of the SFA empowers MAS to prescribe the matters that a DCH shall make provision for in its business rules. The business rules of a DCH are also statutorily deemed to be a binding contract between the DCH and each participant and issuer of securities under section 72(1) of the SFA, thereby playing a key role in establishing the powers of the DCH and the obligations of its participants in the clearing and settlement process. This not only provides the legal basis for actions taken by the DCH in the management of its risks, but also provides for clarity and transparency in the operations of the DCH.

9.2 As set out in regulation 21 of the SF (CF) Regs, a DCH is to make provision to the satisfaction of MAS for the following:

- (a) admission of members as well as continuing requirements for members

The rules of a DCH shall make clear the criteria for access for participation in its clearing facility. The rules shall also set out the continuing requirements for its members to enable the DCH to manage its risk exposure to such members. Examples of such criteria include financial requirements applicable to the members of the DCH, the internal control and risk management procedures that members should put in place, as well as whether the members have the necessary resources to carry out those requirements.

- (b) the classes of products that may be cleared or settled on the clearing facility that it operates and the terms and conditions under which these products will be cleared or settled

The rules of the DCH should clearly list all classes of products that it clears or settles. The clearing and settlement procedures of the DCH shall also be clearly articulated, so that they are transparent to all participants.

(c) matters relating to risk

A DCH needs to have in place proper measures to manage risks. Risk management tools and the obligations of the members in relation to such tools, e.g. margin collections, should be clearly articulated in the business rules of the DCH.

Other matters, such as the finality of settlement and the calculation (including netting) of obligations, should also be provided for in the business rules where relevant.

(d) the handling of defaults

In the event of the default of a member, the DCH has to react quickly to isolate the defaulting member and minimise the impact of the default on its other members. The broad framework for the actions of the DCH should be provided in the its rules.

The rules shall also set out the financial resources available to support the default of a member, including the forms of resources available and the order in which the different forms are available to the DCH. The circumstances under which positions of the customers of a member can be liquidated or transferred should also be set out clearly.

Amendments to the business rules

9.3 In regulation 22 of the SF (CF) Regs, a DCH which proposes to amend its business rules shall consult its participants, unless the proposed amendment would only have limited impact on its participants. When considering the impact that a proposed rule amendment would have on its participants, the DCH should consider the likely effect that the amendment would have on the rights, obligations, operations and systems of its various participants.

9.4 Generally, MAS would also expect the DCH to consult the public on rule amendments to the business rules that the DCH considers likely to affect the interests of the general investing public.

9.5 When undertaking a consultation, the DCH should provide potential respondents with a reasonable opportunity to comment on the proposed amendment, including providing an adequate period of notice and an appropriate avenue to provide feedback. When considering the length of period that should be provided to potential respondents, the DCH should take into account the complexity and impact that the proposed amendment would have. Generally, the DCH should provide a notice period of at least 10 business days, with longer periods for proposed amendments that are relatively more complex or are likely to have more impact.

9.6 Where the DCH has undertaken a consultation, it should provide MAS with a summary of the comments received together with its reasons for accepting or rejecting such comments when submitting a notification under regulation 22(1) of the SF (CF) Regs. This is in addition to the information required under regulation 22(1)(a) to (c) of the SF (CF) Regs.

9.7 To the extent reasonably possible, the DCH should allow for a reasonable period between the time it publishes the final text of the amendment and the effective date of the amendment. This would allow its participants to put in place any changes necessary to allow the participants to comply with the amended business rules. When considering the length of period that should be provided, the DCH should take into account the impact that the proposed amendment would have.

9.8 MAS recognises that there is a possibility that in urgent situations, a DCH may need to propose and bring into effect rule amendments within a very short period of time, in order for the DCH to maintain safe and efficient clearing facilities. In such situations, MAS may exercise its power to exempt the DCH from the requirement to consult its participants under regulation 22(2), pursuant to section 35 of the SFA.

10 CLEARING FEES OF DESIGNATED CLEARING HOUSES

10.1 MAS's objective is to promote the efficient pricing of key clearing and settlement services in a manner that facilitates fair access to these services. In most cases, this objective can be achieved through the operation of a competitive market, without the need for regulation. However, MAS has promulgated regulation 16 of the SF (CF) Regs, under section 81S of the SFA, to require certain DCHs to obtain MAS' approval for certain matters pertaining to its clearing fees.

10.2 Only a DCH that is specified in Part I of the Second Schedule to the SF (CF) Regs will be required to comply with regulation 16. Such a DCH would be one that is the sole or dominant provider of clearing or settlement services that form part of Singapore's key financial infrastructure. A DCH would be considered to be part of Singapore's key financial infrastructure if the clearing facility that it operates is necessary for the provision of financial services by trading platforms, financial intermediaries or other like service providers, and such facility is so costly or difficult to replicate that a new trading platform, financial intermediary or like service provider would not be able to provide its services without fair access to such facility.

Factors in determining application of regulation 16

10.3 The factors that MAS may take into account in determining whether a DCH should be specified in Part I of the Second Schedule to the SF (CF) Regs, and hence be subject to regulation 16 of the SF (CF) Regs, include –

- (a) the level of competition in, or the contestability of –
 - (i) the market for clearing or settlement services provided by the DCH; or
 - (ii) where relevant, markets where the securities or futures contracts cleared through the DCH are traded;
- (b) the ability of trading platforms, financial intermediaries or other like service providers to establish or operate in

Singapore without fair access to the clearing or settlement services provided by the DCH; and

- (c) the role of the DCH in Singapore's financial services industry.

Fees requiring approval

10.4 Clearing fees, as defined in regulation 16(12) of the SF (CF) Regs, are subject to the approval requirement in regulation 16(1). The DCH shall apply to MAS in the form and manner as prescribed in regulation 16(2). MAS recognises that a DCH may not be dominant in providing clearing and settlement services in every class of securities or futures contracts that it provides clearing and settlement services for. Where appropriate, MAS may exempt such a DCH from the approval requirement in regulation 16(1) for specific classes of securities or futures contracts.

10.5 Under regulation 16(10) of the SF (CF) Regs, a DCH subject to regulation 16 is required to charge clearing fees approved by MAS for the service or services in respect of which it was approved. These clearing fees will be excluded from the application of the Competition Act 2004 (Act 46 of 2004) under paragraph 2 of the Third Schedule to the Competition Act (when this comes into operation), which excludes conduct to the extent to which it is engaged in order to comply with a legal requirement. For the avoidance of doubt, other fees that a DCH charges, or other conduct that it may undertake, which are not pursuant to compliance with a legal requirement will fall within the scope of application of the Competition Act and may be reviewed by the Competition Commission in the course of discharging its duties.

Actions requiring approval

10.6 As an illustrative and non-exhaustive guide, MAS considers the following actions by a DCH specified in Part I of the Second Schedule to require approval under regulation 16(1) of the SF (CF) Regs:

- (a) an introduction of a new clearing fee;
- (b) an increase or decrease in the quantum of an existing clearing fee;

- (c) a change in the basis for calculating an existing clearing fee;
- (d) a levy of an additional fee for an activity or service whose cost or fee was previously covered or included in an existing clearing fee;
- (e) an inclusion of an additional service which cost or fee was not previously covered or included in an existing clearing fee;
- (f) a removal of a service which cost or fee was previously covered or included in an existing clearing fee; or
- (g) a rebate or discount from an existing clearing fee.

Criteria for approval

10.7 Regulation 16(7) of the SF (CF) Regs sets out the general matters that MAS may take into account in determining whether to approve or refuse an application referred to in regulation 16(2). In particular, MAS will consider the following matters:

- (a) competition in the financial services industry of Singapore and access to clearing or settlement services in Singapore

Clearing and settlement is an essential part of the process of executing a trade on some organised markets, such as the market for listed securities in Singapore. Industry players along the value chain, such as market operators, trading platforms and brokers, are likely to require access to clearing and settlement services in order to operate in Singapore. In considering the effect of the proposed clearing fee on competition and access to clearing or settlement services, MAS may consider whether the clearing fee will –

- (i) be applied in a discriminatory manner that is not based on objective differences in the nature of the services provided;

- (ii) be applied in a manner that does not distinguish between services that are objectively different in nature;
 - (iii) be predatory towards, or limit access to, the clearing or settlement services provided by competitors;
 - (iv) be conditional on the acceptance by the purchaser of supplementary obligations which, by their nature or according to commercial usage, have no connection with the subject of the contract; or
 - (v) otherwise restrict, prevent or distort competition.
- (b) cost of providing the service referred to in the application

In considering whether to approve a proposed clearing fee, MAS may have regard to the cost of providing the service, including the cost of infrastructure investments necessary for the service. Factors that MAS may consider include the impact of the decision of MAS on the financial soundness of the DCH and whether the proposed clearing fee will –

- (i) be commensurate with reference to the cost of providing the service;
 - (ii) enable the DCH to recover the cost of providing the service; and
 - (iii) offer appropriate incentives to encourage future investments in clearing or settlement infrastructure.
- (c) cost and efficiency of trading, clearing and settlement in Singapore of the securities or futures contracts specified in Part II of the Second Schedule to the SF (CF) Regs

MAS may also have regard to the effect of the application on the cost and efficiency of trading, clearing and settlement in Singapore relative to that in comparable markets or clearing facilities. In this regard, MAS may consider the fees levied on similar services by clearing facilities in comparable jurisdictions outside Singapore. MAS may also consider the impact of the proposed fee on the attractiveness of trading, clearing and settlement in Singapore. In this regard, MAS may take into account the scope, comprehensiveness and outcomes of public or industry consultation undertaken by the DCH.

- (d) sound and progressive financial services sector.

Aside from the matters listed in regulation 16(7)(a), (b) and (c) of the SF (CF) Regs, regulation 16(7)(d) empowers MAS to consider, more broadly, the effect of the clearing fee on the objective of MAS to foster a sound and progressive financial services sector under section 4(c) of the Monetary Authority of Singapore Act (Cap. 186).

Extension of period of review

10.8 MAS is likely to exercise its discretion under regulation 16(5) of the SF (CF) Regs to extend the period for the completion of its review up to 35 business days from the receipt of the completed application where MAS consults the Competition Commission and any person or representative of a person affected by the proposed fee. In determining whether to consult, the parties to consult and the mode of consultation, MAS may take into account the likely impact of the proposed fee. Extending the time period would provide MAS sufficient time to review and respond to feedback received from such consultation.

10.9 MAS may extend the period for the completion of its review beyond 35 business days in some cases, but it will provide the DCH an opportunity to be heard prior to doing so.