

CONSULTATION PAPER

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Proposed Harmonisation of Securities Lending Rules

MAS

Monetary Authority of Singapore

PREFACE

MAS' regulatory requirements for securities lending are set out in MAS Notice 113 for insurers and regulation 45 of the Securities and Futures (Licensing and Conduct of Business) Regulations (the "Regulations") for CMS licensees, which also applies to banks, merchant banks, and finance companies¹. MAS proposes to harmonise the requirements for securities lending across all sectors regulated by MAS.

2 MAS invites interested parties to forward their views and comments on the proposals made in this paper. Electronic submission is encouraged. Please submit your written comments by 29 Jan 2010 to:

Prudential Policy Department
Monetary Authority of Singapore
10 Shenton Way
MAS Building
Singapore 079117
Fax: 62203973
Email: policy@mas.gov.sg

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

¹ As stated under Regulation 54 of the same Regulations.

1 BACKGROUND

1.1 MAS' regulatory requirements for securities lending are set out in MAS Notice 113 for insurers and regulation 45 of the Regulations for CMS licensees². There are no specific requirements under the Banking Act or the Merchant Banking Directives that apply to securities lending, but under regulation 54 of the Regulations, regulation 45 of the same Regulations also applies to banks, merchant banks, and finance companies.

1.2 While the risks of a securities lending transaction are applicable to all financial institutions, there are some differences in the regulatory requirements imposed on the different sectors, in terms of the agreements required for securities lending activities, the exemptions available and the types of assets that can be transferred by the borrower to the lender upon the securities being lent by the lender to the borrower ("Collateral") to satisfy the requirements set out in MAS Notice 113 and the Regulations.

2 PROPOSED HARMONISATION OF REQUIREMENTS FOR SECURITIES LENDING

2.1 MAS has decided to harmonise the requirements for securities lending across all sectors under MAS' purview. This will involve three main changes:

- (i) Requirement of minimum provisions in agreements for securities lending;
- (ii) Removal of the exemption for accredited investors; and
- (iii) Harmonisation of the Collateral requirements for securities lending under MAS Notice 113 and regulation 45 of the Regulations.

3 REQUIREMENT OF MINIMUM PROVISIONS IN AGREEMENTS FOR SECURITIES LENDING

3.1 Currently, MAS Notice 113 requires insurers to use a legally binding Master Agreement ("MA") with each borrower in establishing the basis for securities lending between two parties. Regulation 45 of the Regulations requires CMS licensees which borrow or lend securities to obtain a prior written agreement between lender and borrower.

² Any references to CMS licensees include banks, merchant banks and finance companies who have lodged under regulation 14(4)(a) of Regulations to carry on the regulated activity of dealing in securities.

3.2 MAS would like to standardise the requirements on agreements for securities lending by requiring all regulated entities to address the issues set out in para 3.3 in their agreements³. This proposed requirement seeks to ensure that the legal agreement between the lender and the borrower addresses certain key risks, before the parties engage in the transactions.

3.3 MAS proposes to require all regulated entities conducting securities lending to address the following issues in their agreements:

- (i) Capacities (i.e. principal or agent) in which the parties are acting;
- (ii) Transfer of the title and interest in the securities lent from lender to borrower and transfer of the title and interest in the Collateral from borrower to lender;
- (iii) Rights of the lender in relation to the Collateral and rights of the borrower in relation to the securities lent throughout the duration of the securities lending transaction, including the treatment of dividend payments, voting rights, and other rights in respect of the securities and the Collateral, and arrangements for dealing with corporate actions;
- (iv) Procedures for calculating the lending fee;
- (v) Marking-to-market of the securities lending transaction, including procedures for calculating margins;
- (vi) Procedures for calling securities and arrangements if called securities cannot be delivered;
- (vii) Termination clauses (including any early termination fee that the parties may be subject to);
- (viii) Rights of set-off of claims;
- (ix) Events of default and the consequential rights and obligations of the parties; and
- (x) Arbitration, governing law and jurisdiction for the agreement.

Proposal 1: To require all regulated entities conducting securities lending to address the issues set out in para 3.3 in their agreements.

³ Where MAs are adopted, financial institutions should ensure that the issues set out in para 3.3 are addressed in the MA.

4 REMOVAL OF ACCREDITED INVESTORS EXEMPTION FOR CMS LICENSEES

4.1 In recognition of the lesser need of accredited investors for regulatory protection, CMS licensees are presently exempted from regulations pertaining to securities lending when lending securities of a customer who is an accredited investor⁴ to a person who is an accredited investor or when borrowing securities from or lending securities to a person who is an accredited investor. In contrast, there are no such exemptions in MAS Notice 113 for insurers.

4.2 As a group, accredited investors, which tend to be larger in size, may pose greater systemic risk to CMS licensees than non-accredited investors in securities borrowing and lending. MAS would like to harmonise the regulatory treatment across the regulated sectors, and proposes to remove the exemption in regulation 45 of the Regulations. This will also bring us in line with the practice in other major financial centres.

Proposal 2: To remove the exemption in regulation 45 of the Regulations for accredited investors from the regulations on securities lending.

5 COLLATERAL REQUIREMENTS

5.1 The specified range of eligible assets as Collateral for CMS licensees is more extensive than that for insurers. (See Annex A) While both insurers and CMS licensees are allowed to recognise as Collateral assets such as cash and Singapore Government Securities, only CMS licensees are permitted to recognise as Collateral letters of credit and bank guarantees, marginable securities quoted on particular stock exchanges, as well as assets with certain characteristics, such as being liquid and readily convertible to cash, is in the possession of the holder, etc. The Collateral requirements for CMS licensees also state the characteristics of eligible assets as Collateral, while the Collateral requirements for insurers only state the specific types of eligible assets as Collateral.

⁴ An “accredited investor” is within the meaning of Section 4A(1) of the Securities and Futures Act.

5.2 The purpose of Collateral is to indemnify the lender should the borrower default. In order to fulfil this purpose, MAS seeks to ensure that the conditions imposed on the range of eligible assets as Collateral are such that the lender is able to take control and possession of the Collateral in the event of a borrower default.

5.3 Recognising that there are many types of eligible assets that can fulfil this need, MAS proposes to widen the range of assets available as Collateral to insurers by aligning the specified range of eligible assets as Collateral for insurers with those set for CMS licensees. This includes adopting the approach of stating both the characteristics of eligible assets as Collateral, as well as the specific types of eligible assets as Collateral, for insurers, as is presently done for CMS licensees.

5.4 For insurers, MAS Notice 113 currently states that the Collateral used to support 100% of the value of lent securities (“qualifying Collateral”) has to be marked-to-market daily. In order to provide greater clarity, MAS proposes to set out in both MAS Notice 113 and regulation 45 of the Regulations that insurers and CMS licensees are required to mark-to-market daily both securities borrowed/lent and Collateral.

5.5 The current MAS Notice 113 also clarifies that insurers are not precluded from requiring that lent securities are supported by additional Collateral over and above the qualifying Collateral and that the Collateral accepted as additional Collateral are not subject to the Collateral requirements. MAS proposes to similarly clarify in both MAS Notice 113 and regulation 45 of the Regulations that insurers and CMS licensees may obtain or deposit assets in addition to Collateral valued at not less than 100% of the market value of the securities lent or borrowed, and such additional assets need not be from the specified range of eligible assets. The Collateral requirements will apply to Collateral valued at up to 100% of the market value of the securities lent/borrowed.

Proposal 3: To widen the range of eligible assets as Collateral available to insurers by aligning the Collateral requirements in MAS Notice 113 with regulation 45 of the Regulations.

Proposal 4: To set out in both MAS Notice 113 and Regulation 45 of the Securities and Futures (Licensing and Conduct of Business) Regulations that insurers and CMS licensees are required to mark-to-market daily both securities borrowed/lent and collateral.

Proposal 5: To clarify in both MAS Notice 113 and regulation 45 of the Regulations that insurers and CMS licensees may obtain or deposit assets in addition to Collateral valued at not less than 100% of the market value of the securities lent or borrowed, and such additional assets need not be from the specified range of eligible assets. The Collateral requirements will apply to Collateral valued at up to 100% of the market value of the securities lent/borrowed.

6 IMPLEMENTATION

6.1 If implemented, the proposed harmonisation will be enacted through amendments of MAS Notice 113 for insurers and regulation 45 of the Regulations for CMS licensees. The drafts of the proposed revised MAS Notice 113⁵ and regulation 45 of the Regulations are set out in Annex B and Annex C respectively.

⁵ Apart from the proposed changes set out in the consultation paper, the reference to MAS Notice 109 that was previously in paragraph 5 of the existing MAS Notice 113 has also been deleted. As MAS Notice 109 applies to insurers independently of MAS Notice 113, it is unnecessary to duplicate the requirement in MAS Notice 113. The deletion does not affect the application of MAS Notice 109 and insurers are still required to comply with MAS Notice 109 when carrying out securities lending activities, where applicable.

Annex A

**CURRENT COLLATERAL REQUIREMENTS FOR
INSURERS AND CMS LICENSEES**

Extract from MAS Notice 113 for Insurers

“3. Insurers shall ensure that the lent securities are supported by suitable collateral (“Qualifying Collateral”). The Qualifying Collateral shall:

- (a) be marked to market on a daily basis;
- (b) be at least 100% of the value of the lent securities throughout the period the securities are lent; and
- (c) comprise one or more of the following:
 - (i) deposits with financial institutions with a minimum short-term rating of either Prime-1 by Moody's, A-1 by Standard & Poor's, F-1 by Fitch or TBW-1 by Thomson Bankwatch, or with Singapore incorporated financial institutions approved under the Central Provident Fund Investment Scheme (“the CPFIS”) to accept fixed deposits. If a Singapore-incorporated financial institution approved under the CPFIS to accept fixed deposits obtains a solicited shortterm rating, deposits may only be placed with that financial institution if it meets the requisite short-term rating cited in this paragraph;
 - (ii) Singapore Government Securities;
 - (iii) other debt securities which have a remaining maturity of not more than 366 calendar days and are rated at least either A2 by Moody's, A by Standard & Poor's, A by Fitch or A by Thomson Bankwatch; and
 - (iv) cash.”

4. For the avoidance of doubt, nothing in paragraph 3 shall preclude insurers from requiring that lent securities are supported by additional collateral over and above the Qualifying Collateral. The collateral that insurers may accept as additional collateral are not subject to the requirements stated in paragraph 3.”

Extract from regulation 45 of the Regulations for CMS Licensees

“(2) The holder shall deposit with the lender collateral for the purpose of borrowing securities from the lender.

(3) The holder shall obtain from the borrower collateral for the purpose of lending securities, including securities belonging to the holder's customer, to the borrower.

(4) For the purposes of paragraphs (2) and (3), the collateral deposited with the lender or obtained from the borrower, as the case may be, shall, throughout the period that the securities are borrowed or lent, have a value not less than 100% (or such higher percentage as agreed between the holder and the lender or borrower, as the case may be) of the market value of the securities borrowed or lent.

(5) Collateral deposited with the lender or obtained from the borrower, as the case may be, shall be in the form of –

- (a) cash;
- (b) Government securities;
- (c) marginable securities;
- (d) guarantees issued by banks licensed under the Banking Act (Cap. 19);
- (e) letters of credit;
- (f) any collateral that –
 - (i) is liquid and readily convertible into cash;
 - (ii) is in the possession or control of the holder;
 - (iii) is subject to a legally binding collateral agreement between the counterparty and the holder which is evidenced in writing, and the collateral agreement is irrevocable and enforceable against the counterparty and provides the holder with an unconditional right to apply the collateral, to sell the collateral or to otherwise convert the collateral into cash;
 - (iv) is not a security issued by the counterparty that gives rise to the counterparty exposure, nor issued by a related corporation of that counterparty; and
 - (v) is not a security that is prohibited from serving as collateral by a securities exchange, futures exchange or clearing house (as the case may be); or
- (g) such other instruments as the Authority may from time to time, by a guideline issued by the Authority, determine.”

Annex B

PROPOSED REVISED MAS NOTICE 113 FOR INSURERS

NOTICE ON SECURITIES LENDING ACTIVITIES

1. This Notice is issued pursuant to section 64(2) of the Insurance Act (Cap. 142) (the “Act”) and applies to all registered insurers.

2. A registered insurer shall ensure that securities lending activities are conducted in a prudent manner. The insurer shall have in place sound controls and complete records.

Definition

3. In this Notice, “Collateral” has the same meaning as in regulation 45(7) of the Securities and Futures (Licensing and Conduct of Business) Regulations (Rg 10).

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

Written agreement

5. A registered insurer who lends securities⁶ to a person (the “Borrower”) shall ensure that the terms and conditions of the lending is recorded in a prior written agreement entered into between the insurer and the Borrower or its duly authorised agent, as the case may be.

6. For the purpose of paragraph (5), the terms and conditions in the written agreement that apply to the lending of securities shall include:

- (a) the capacities in which the parties are entering into the agreement (whether as principal or agent);
- (b) the transfer of the title and interest in the securities lent from the registered insurer to the Borrower;

⁶ Please note that as provided in regulation 2 of the Insurance (Exemption) Regulations 2002, an insurer is exempted from compliance with section 20 of the Insurance Act when it engages in securities lending activities in the manner set out therein.

- (c) the transfer of the title and interest in Collateral from the Borrower to the registered insurer;
- (d) the rights of the registered insurer in relation to Collateral and rights of the Borrower in relation to the securities, throughout the period that the securities are lent, including the treatment of dividend payments, voting rights and any other rights, and arrangements for dealing with any corporate action;
- (e) the procedures for calculating the lending fees;
- (f) marking to market daily the securities lent and all Collateral in the form of securities, including procedures for calculating the margins;
- (g) the procedures for the registered insurer to request for the return of the securities lent, and the arrangements for dealing with the situation where such securities cannot be delivered;
- (h) the termination of the agreement, including any early termination fees which the party terminating the agreement may be subjected to;
- (i) any right of set-off of claims;
- (j) the events of default and the rights and obligations of the parties in such events of default; and
- (k) the law and jurisdiction governing the agreement.

7. A registered insurer shall obtain from the Borrower Collateral for the purpose of lending securities to the Borrower, which shall, throughout the period that the securities are lent, have a value not less than 100% of the market value of the securities lent.

8 A registered insurer shall apply the requirements in paragraphs 5 and 6 in respect of securities lending activities in relation to Collateral obtained from the Borrower valued at up to 100% of the market value of the securities lent.

9 Where a registered insurer has obtained from the Borrower Collateral valued at not less than 100% of the market value of the securities lent to the Borrower throughout the period which the securities are lent, the registered insurer may obtain from the Borrower, additional assets other than Collateral.

Effective Date

10. This Notice shall take effect on [date] and MAS 113 dated 1 August 2005 is cancelled with effect from [date].

Annex C

**PROPOSED REVISED REGULATION 45 FOR CMS
LICENSEES**

Securities borrowing and lending

45. (1) The holder of a capital markets services licence which -

- (a) borrows securities from an owner of those securities (referred to in this regulation as the lender); or
- (b) lends securities, including securities belonging to its customer, to a person (referred to in this regulation as the borrower),

in the ordinary course of its business for which it is licensed, shall ensure that the terms and conditions of the borrowing or lending, as the case may be, is recorded in a prior written agreement entered into between the holder and the lender or borrower or their duly authorised agent, as the case may be.

(1A) For the purpose of paragraph (1), the terms and conditions in the written agreement that apply to the borrowing or lending of securities, as the case may be, shall include:

- (a) the capacities in which the parties are entering into the agreement (whether as principal or agent);
- (b) the transfer of the title and interest in the securities lent, from the lender to the holder, or the holder to the borrower, as the case may be;
- (c) the transfer of the title and interest in to the Collateral, from the holder to the lender, or the borrower to the holder, as the case may be;
- (d) the rights of the lender or the holder, as the case may be, in relation to the Collateral, and rights of the holder or the borrower, as the case may be, in relation to the securities lent, throughout the period that the securities are borrowed or lent, as the case may be, including the treatment of dividend payments, voting and other rights and arrangements for dealing with any corporate action;
- (e) the procedure for calculating the lending or borrowing fees, as the case may be;

- (f) marking to market daily, the securities lent or borrowed, as the case may be, and all Collateral in the form of securities, including procedures for calculating the margins;
- (g) the procedures for the lender or the holder, as the case may be, to request for the return of the securities lent, and the arrangements for dealing with the situation where such securities cannot be delivered;
- (h) the termination of the agreement, including any early termination fee which the party terminating the agreement may be subjected to;
- (i) any right of set-off of claims;
- (j) the events of default and the rights and obligations of the parties in such events of default; and
- (k) the law and jurisdiction governing the agreement.

(2) The holder shall deposit with the lender Collateral for the purpose of borrowing securities from the lender.

(3) The holder shall obtain from the borrower Collateral for the purpose of lending securities, including securities belonging to the holder's customer, to the borrower.

(4) For the purposes of paragraphs (2) and (3), Collateral deposited with the lender or obtained from the borrower, as the case may be, shall, throughout the period that the securities are borrowed or lent, have a value not less than 100% of the market value of the securities borrowed or lent.

(5) The holder shall apply the requirements in paragraphs (1) and (1A) in respect of any borrowing or lending of securities in relation to Collateral deposited with the lender or obtained from the borrower valued at up to 100% of the market value of the securities lent.

(6) Where the holder has deposited with the lender or obtained from the borrower, as the case may be, Collateral valued at not less than 100% of the market value of the securities borrowed from the lender or lent to the borrower, throughout the period which the securities are borrowed or lent, the holder may deposit with the lender or obtain from the borrower, additional assets other than Collateral

(7) In this regulation -

“Collateral” means –

- (a) cash;

- (b) Government securities;
- (c) marginable securities;
- (d) guarantees issued by banks licensed under the Banking Act (Cap. 19);
- (e) letters of credit;
- (f) any asset that –
 - (i) is liquid and readily convertible into cash;
 - (ii) is in the possession or control of the holder or the borrower, as the case may be;
 - (iii) is subject to a legally binding agreement between the lender and the holder or the holder and the borrower, as the case may be, which is evidenced in writing, and the agreement is irrevocable and enforceable against the borrower or the holder, as the case may be, and provides the holder or the lender, as the case may be, with an unconditional right to apply the asset, to sell the asset or to otherwise convert the asset into cash;
 - (iv) is not a security issued by the borrower or the holder, as the case may be, that gives rise to exposure to the borrower or the holder, as the case may be, nor issued by a related corporation of that borrower or holder, as the case may be; and
 - (v) is not a security that is prohibited from serving as collateral by a securities exchange, futures exchange or clearing house (as the case may be); or
- (g) such other instruments as the Authority may from time to time, by a guideline issued by the Authority, determine;

"customer" means a person on whose behalf the holder of a capital markets services licence carries on any regulated activity, or any other person with whom the holder enters or will enter into transactions as principal for the sale or purchase of securities;

"marginable securities" means –

- (a) securities listed for quotation or quoted on the Singapore Exchange Securities Trading Limited;
- (b) in the case of an initial public offer, securities to be listed for quotation or quoted on the Singapore Exchange Securities Trading Limited, for which the holder of a capital markets services licence has received full payment from the borrower;
- (c) securities quoted on a recognized group A exchange, and issued by a corporation with shareholders' funds of not less than \$200 million or its equivalent in a foreign currency; or

- (d) such other securities as the Authority may approve and set out in a guideline issued by the Authority;

"market value", in relation to securities listed for quotation or quoted on a securities exchange or overseas securities exchange, means -

- (a) the last transacted price of the securities traded on the exchange on the preceding business day;
- (b) if there was no trading in the securities on the exchange on the preceding business day, then, subject to sub-paragraph (c), the lower of the last transacted price and the last bid price of the securities on the exchange;
or
- (c) if there was no trading in the securities on the exchange in the preceding 30 days, the value of the securities as estimated by the exchange or the holder and approved by the Authority;

"recognised group A exchange" has the same meaning as in regulation 2 of the Securities and Futures (Financial and Margin Requirements for Holders of Capital Markets Services Licences) Regulations (Rg 13).



Monetary Authority of Singapore