



Monetary Authority of Singapore

SECURITIES AND FUTURES ACT 2001:

**CAPITAL REQUIREMENTS
FOR HOLDERS OF A CAPITAL MARKET SERVICES LICENCE
(OTHER THAN MEMBERS OF SINGAPORE EXCHANGE
SECURITIES TRADING LIMITED OR SINGAPORE EXCHANGE
DERIVATIVES TRADING LIMITED)**

CONSULTATION PAPER

3 JULY 2002

EXECUTIVE SUMMARY

The Securities and Futures Act 2001 (SFA) will introduce a single licensing framework for securities and futures intermediaries. A single, modular capital markets services (CMS) licence will replace the existing 5 corporate licences under the Securities Industry Act (SIA) and Futures Trading Act (FTA).

2 A new regulatory capital regime will be introduced to complement the new licensing framework. This will be aligned with the modular nature of the CMS licence, which will permit an intermediary to provide one or different combinations of regulated activities with a single licence.

3 MAS had announced on 17 April 2002 the introduction of a risk-based capital framework for the category of CMS licence holders that are permitted to carry on business of dealing in securities or trading futures contracts and are members of the Singapore Exchange Securities Trading Limited (SGX-ST) or Singapore Exchange Derivatives Trading Limited (SGX-DT)¹. We would now like to seek comments on the proposed regulatory capital requirements for the remaining categories of CMS licence holders. These CMS licence holders will be referred to as "non-member CMS (NM-CMS) licence holders" in the rest of this consultation document.

¹ These refer to corporate clearing members and corporate non-clearing members of SGX-ST and SGX-DT.

4 The main proposals are summarised below.

a) To require all NM-CMS licence holders:

- i. to satisfy at entry and on an on-going basis a fixed dollar Base Capital Requirement, which will range from \$250,000 for venture capital/boutique fund management, to \$500,000 for advising on corporate finance and trading in futures contracts as an introducer, and to \$1 million for dealing in securities; trading futures contracts or fund management;
- ii. to satisfy a risk-based Financial Resources Requirement, which will reflect the financial risks undertaken by the licence holders. Depending on the types of regulated activities undertaken, a NM-CMS licence holder may have to set aside capital for a number of risks including counterparty risk, position risk, large exposure risk, underwriting risk and operational risk; and

b) To implement the new capital requirements in the Securities and Futures Regulations in two phases:

- i. **first phase:** to introduce the new capital regulations for NM-CMS licence holders that carry on business in the following regulated activities (solely or in combination): dealing in securities (restricted to dealing in collective investment schemes), fund management, securities financing, providing custodial services in securities and/or advising on corporate finance; and

- ii. **second phase:** to introduce the new comprehensive risk-based capital regime for NM-CMS licence holders that carry on business of dealing in securities (excluding holders restricted to dealing in collective investment schemes), trading in futures contracts and/or leveraged foreign exchange trading (including NM-CMS licence holders that also carry on business in any other regulated activities of fund management, securities financing, providing custodial services in securities and/or advising on corporate finance).

5 We also propose that NM-CMS licence holders that carry on business advising on corporate finance be required to have in-force a professional indemnity insurance policy with a sum assured of not less than \$1 million.

6 The proposed transitional grace period to be extended to all existing licence holders, to comply with the new capital requirements, is 12 months.

7 We are seeking comments on the proposed regulatory capital requirements. This consultation will close on 24 Jul 2002.

INTRODUCTION

1 Securities and futures intermediaries are currently licensed under two different Acts, the Securities Industry Act (SIA) or the Futures Trading Act (FTA) respectively. A dealer and an investment adviser are licensed under the SIA while a futures broker, a futures trading adviser and a futures pool operator, under the FTA. The holders of these 5 types of licences are subject to different capital requirements, depending on the licence type.

2 The 5 types of licences will be replaced by a single, modular capital markets services (CMS) licence under the Securities and Futures Act 2001 (SFA). A holder of a CMS licence will be permitted to carry on business in one or different combinations of the 7 regulated activities: dealing in securities; trading in futures contracts; leveraged foreign exchange trading; advising on corporate finance; fund management; securities financing and providing custodial services for securities.

3 A new regulatory capital regime will be introduced to complement the new licensing framework. This new regime will be aligned with the modular nature of the new CMS licence. It will take into account the legislative change that some previously unregulated activities have now become regulated activities, namely, securities financing and provision of custodial services for securities.

4 MAS had already announced on 17 April 2002 the introduction of a risk-based capital (RBC) framework for the category of CMS licence holders that carry on business of dealing in securities or trading futures contracts and are corporate members of the Singapore Exchange

Securities Trading Limited (SGX-ST) or Singapore Exchange Derivatives Trading Limited (SGX-DT). [Corporate members of SGX-ST or SGX-DT will be subject to this RBC framework and its implementation timeframe, even if they are non-members of SGX-DT or SGX-ST respectively, or if they are also carrying on business in any other regulated activities.]

5 This paper seeks comments on the proposed regulatory capital requirements for CMS licence holders that are not corporate members of SGX-ST or SGX-DT. (These licence holders will be referred to as "non-member CMS (NM-CMS) licence holders" in the rest of this paper). The proposed capital requirements for NM-CMS licence holders will replace existing capital requirements promulgated under the Securities Industry Regulations and Futures Trading Regulations.

PRINCIPLE UNDERLYING PROPOSED REGULATORY CAPITAL REQUIREMENTS

6 The proposed regulatory capital requirements are aimed at achieving our regulatory objectives of investor protection and reduction of systemic risk in an effective and equitable manner. Under the proposal, the financial resources of NM-CMS licence holders will be better aligned to their business risks.

7 NM-CMS licence holders should have adequate capital to carry out their regulated activities, discharge their financial obligations to customers when they fall due and in the event of insolvency, wind down their operations in an orderly manner. Consequently, in setting the new capital requirements, we have taken into account whether:

- a) the NM-CMS licence holder enters into creditor-debtor relationships with customers in carrying out a regulated activity; or
- b) the NM-CMS licence holder receives or holds customers' monies or assets, including those held in segregated accounts.

DETAILS OF THE PROPOSED REGULATORY CAPITAL REQUIREMENTS

INTRODUCTION

8 The proposed regulatory capital regime for NM-CMS licence holders comprises two key requirements:

- a) All NM-CMS licence holders will be required to meet a fixed dollar **Base Capital Requirement**. This is a minimum entry-level requirement to ensure that all licence holders have adequate financial resources to commence operations, carry out regulated activities and upon exit from the financial services industry, to wind down its operations in an orderly fashion.
- b) All NM-CMS licence holders will be required to meet a risk-based **Financial Resources Requirement**. This is a dynamic requirement that will require a NM-CMS licence holder to hold capital that is directly related to the business risks undertaken by the licence holder.

BASE CAPITAL REQUIREMENT

Minimum Requirement

9 All NM-CMS licence holders shall hold base capital of not less than the base capital requirement at entry and on an on-going basis.

10 The base capital requirement is scaled according to the type of regulated activities and details are set out in Appendix 1. It ranges from \$250,000 for NM-CMS licence holders that carry on business in venture capital fund management or boutique fund management, to S\$1 million for NM-CMS licence holders that carry on business in dealing in securities, trading in futures contracts, fund management, or providing custodial services for securities.

11 The base capital requirement will not be additive. A NM-CMS licence holder that conducts more than one regulated activity shall comply with the highest base capital requirements applicable to those regulated activities. For example, a NM-CMS licence holder that is permitted to carry on business of dealing in securities and advising on corporate finance shall be subject to a base capital requirement of \$1 million, being the higher of a) \$1 million, applicable to dealing in securities and b) \$500,000, applicable to advising on corporate finance.

Definition of "Base Capital"

12 "Base capital" is defined as the aggregate of the following items based on a NM-CMS licence holder's latest available audited financial statements:

- Paid-up ordinary share capital
- Irredeemable and non-cumulative preference share capital
- Share premium account
- Unappropriated profit/(loss)

Notification Requirement

13 A NM-CMS licence holder shall notify MAS immediately if it does not or believes it will not be able to comply with the base capital requirement.

Non-Compliance

14 A corporation shall not be permitted to hold a CMS licence if it does not comply with the base capital requirement, unless MAS grants the NM-CMS licence holder such extension to comply with the requirement.

Impact on Existing NM-CMS Licence Holders

15 The proposed base capital requirements are in most instances lower than or comparable to current paid-up capital and shareholders' fund requirements applicable to existing corporate licence holders under the SIA and FTA conducting comparable activities. The existing requirements range from \$300,000 in the case of an investment adviser restricted to providing investment advice only, to \$2 million in the case of a dealer that is a non-member of a securities exchange and \$8 million in the case of a futures broker that is a non-member of a futures exchange.

FINANCIAL RESOURCES REQUIREMENT

Minimum Requirement

16 All NM-CMS licence holders shall hold financial resources of not less than 100% of its total risk requirement on an on-going, daily basis.

Definition of "Financial Resources"

17 "Financial resources" is defined as the aggregate of the following items:

| |
|---|
| <p>Base Capital</p> <p>Add</p> <ul style="list-style-type: none">• Irredeemable and cumulative preference share capital• Redeemable preference share capital• Reserves• General Provisions <p>Add</p> <ul style="list-style-type: none">• Qualifying Subordinated Loans• Interim profit/loss account <p>Less</p> <ul style="list-style-type: none">• Adjustment |
|---|

Qualifying Subordinated Loans and Interim Profit/Loss Account

18 Only a NM-CMS licence holder that carries on business in dealing in securities (excluding holders restricted to dealing in collective investment schemes), trading in futures contracts or leveraged foreign exchange transactions shall be permitted to include qualifying subordinated loans as its Financial Resources and shall be required to include interim profit/loss.

Adjustment

19 All NM-CMS licence holders shall deduct any intangible asset they hold as an adjustment in the calculation of Financial Resources. A NM-CMS licence holder that carries on business of dealing in securities (excluding holders restricted to dealing in collective investment schemes), trading in futures contracts or leveraged foreign exchange transactions shall be required to make further adjustments, including deduction of any non-current asset and current asset that is unsecured or cannot be readily converted to cash within 30 days.

Total Risk Requirement

20 The total risk requirement of a NM-CMS licence holder is the sum of risk requirements described in the table below, and will be dependent on the regulated activities conducted by the NM-CMS licence holder.

21 NM-CMS licence holders that carry on business of dealing in securities (excluding holders restricted to dealing in collective investment schemes), trading in futures contracts or leveraged foreign exchange trading will calculate their total risk requirement on a comprehensive basis; while those NM-CMS licence holders that carry on business in dealing in securities (restricted to dealing in dealing in collective investment schemes), fund management, securities financing, providing custodial services or advising on corporate finance will calculate their risk requirement on a simplified basis.

22 There are 5 prescribed risk requirements, to mitigate financial losses which may arise from the following risks:

Counterparty Risk

The risk of financial loss associated with a settlement failure or the possibility that a counterparty may default on its contractual obligations, in whole or in part.

Position Risk

The risk of financial loss from an adverse movement in the market rates and prices used to value the financial instruments that are held by a licence holder as investments or as part of proprietary trading positions.

Large Exposure Risk

The risk of increased financial loss associated with a single counterparty or a single issuer arising from excessive exposure to the single counterparty or single issuer.

Underwriting Risk

The risk of financial loss from having to fulfil a commitment (to purchase the securities) under an underwriting agreement with a corporation issuing new securities

Operational Risk

The risk of financial loss arising from deficiencies in a licence holder's management information, support and control systems, legal risk and other risks that may arise from day-to day operations.

a) NM-CMS Licence Holders Dealing in Securities (excluding Holders Restricted to Dealing in Collective Investment Schemes), Trading in Futures Contracts, or Leveraged Foreign Exchange Trading

23 The total risk requirement of a NM-CMS licence holder that carry on business dealing in securities (excluding holders restricted to dealing in collective investment schemes), trading in futures contracts and/or in leveraged foreign exchange trading shall be computed on a comprehensive approach as the sum of the following risk requirements:

- a) counterparty risk requirement, in respect of:
 - i. agency securities transactions settled on a delivery-versus-payment or free-of-payment basis;
 - ii. transactions traded on a margined basis, including leveraged foreign exchange transactions;
 - iii. securities financing transactions;
 - iv. over-the-counter derivatives transactions; and
 - v. other counterparty exposures;
- b) position risk requirement, in respect of any principal position in securities, futures contracts, physical commodities, foreign exchange;
- c) large exposure risk requirement, in respect of a counterparty exposure or an issuer exposure arising from a principal position;
- d) operational risk requirement; and
- e) underwriting risk requirement.

24 MAS will be providing more details on the calculations of the respective risk requirements to existing non-member dealers (note: all futures broker's licence holders are presently members of SGX-DT) and

invite them to participate in a quantitative survey of the proposed financial resources requirement.

25 There are some existing non-member dealer's licence holders whose dealer's licence is subject to the licensing condition that their dealing activities be confined to the distribution of unit trusts. They would not incur most of the risks which regulatory capital is required to be computed under the comprehensive approach. We therefore propose that NM-CMS licence holders that are permitted to carry on business dealing in securities (restricted to dealing in collective investment schemes) be subject to a simplified capital regime, as described in paragraph 27.

b) NM-CMS Licence Holders Conducting Securities Financing

26 The total risk requirement for NM-CMS licence holders conducting securities financing is the sum of:

- a) counterparty risk requirement, in respect of securities financing transactions (Appendix 2);
- b) operational risk requirement (Appendix 3).

c) NM-CMS Licence Holders Carrying on Business in Dealing in Securities (Restricted to Dealing in Collective Investment Schemes), Fund Management, Providing Custodial Services for Securities, or Advising on Corporate Finance

27 The total risk requirement for NM-CMS licence holders carrying business in dealing in securities (restricted to dealing in collective investment schemes), fund management (including venture capital fund management and boutique fund management), providing custodial

services for securities or advising on corporate finance is its operational risk requirement (Appendix 3).

NM-CMS Licence Holders Carrying On Business In More Than One Regulated Activities

28 When a NM-CMS licence holder carries on business in more than one regulated activity, the licence holder shall comply with the highest Financial Resources Requirement applicable to those regulated activities.

29 For example, a NM-CMS licence holder that carries on business in 3 regulated activities: dealing in securities (not restricted to dealing in collective investment schemes), fund management and advising on corporate finance shall calculate its total risk requirement using the comprehensive approach described in paragraph 23. As another example, a NM-CMS licence holder that carries on business in securities financing and providing custodial services for securities should calculate its total risk requirement as prescribed for a licence holder carry on business in securities financing.

Position Risk Requirement And Large Exposure Requirement

30 NM-CMS licence holders that carry on business of dealing in securities (restricted to dealing in collective investment schemes), fund management securities financing, and/or providing custodial services for securities, may hold proprietary positions in financial instruments or assets denominated in foreign currencies. We recognise that it would be cost ineffective and do not propose to subject such proprietary positions or foreign exchange exposures to regulatory capital requirements if they are insignificant compared to the licence holder's core business in the regulated activities of dealing in

securities (restricted to dealing in collective investment schemes), securities financing, fund management or providing custodial services for securities².

31 Such licence holders shall be deemed to have a significant exposure to proprietary positions and shall be required to notify MAS immediately when the market value of its principal positions exceeds 20% of its base capital (Appendix 4) or when its foreign exchange exposure exceeds 20% of its base capital (Appendix 4). MAS may then require the licence holder to include a position risk requirement and a large exposure requirement in its calculation of the total risk requirement.

Notification (Early Warning Threshold)

32 To serve as an early warning of potential non-compliance, a NM-CMS licence holder shall notify MAS immediately if its financial resources are less than 120% of its total risk requirement.

33 If this state of affairs persists for 5 days or more, MAS may take appropriate supervisory actions. This could include directing the licence holder to submit more frequent financial reports, transfer customers' accounts to another licence holder, or cease new business.

Non-Compliance

34 The licence of a NM-CMS licence holder whose financial resources falls below 100% of its total risk requirements for 4 consecutive weeks shall lapse.

² The total risk requirement of a NM-CMS licence holder that is permitted to carry on business dealing in securities, trading in futures contracts or leveraged foreign exchange trading, in addition to fund management, securities financing, or providing custodial services in securities should be calculated using the comprehensive approach described in paragraph 23.

REPORTING REQUIREMENTS

35 All NM-CMS licence holders will be required to submit unaudited statements as at the end of each quarter on their base capital, financial resources and compliance with base capital and financial resources requirements.

PROFESSIONAL INDEMNITY INSURANCE REQUIREMENT FOR NM-CMS LICENCE HOLDERS ADVISING ON CORPORATE FINANCE

36 We are proposing that NM-CMS licence holders that carry on business of advising on corporate finance be required to have in-force a professional indemnity insurance policy³ with a sum assured of not less than \$1 million. This is to protect clients against any financial loss suffered as a result of the licence holder's negligence in carrying out its activities. This requirement may be substituted if the licence holder has a base capital of \$1 million over the base capital requirement of \$500,000. MAS may, upon application by a licence holder, permit combinations of professional indemnity sum assured and excess base capital amounts.

IMPLEMENTATION

37 The proposed comprehensive approach for calculation of total risk requirement for NM-CMS licence holders dealing in securities (excluding holders restricted to dealing in collective investment schemes), trading in futures contracts and/or leveraged foreign exchange trading is a relatively more complex framework. We intend to conduct quantitative surveys of the impact of the proposal, possibly on a reiterative basis, to assess the framework. For this reason, we intend to introduce the new capital regime for these NM-CMS licence holders in two phases, with the exact schedule for the introduction of the comprehensive approach to be announced at a later date.

³ The policy shall not have a policy deductible of more than 10% of the sum assured.

PHASE 1

38 In phase 1, the new capital requirements for NM-CMS holders that carry on business solely in or in a combination of the following regulated activities: dealing in securities (restricted to dealing in collective investment schemes), fund management, securities financing, providing custodial services in securities and/or advising on corporate finance will be introduced first in the Securities and Futures Regulations 2002, expected to come into effect by end September 2002.

Transitional Arrangement for Existing Licence Holders

39 An existing licence holder under the SIA or FTA migrating to a CMS licence without any variation in its activities and is unable to comply with the new capital requirements shall be given a grace period of 12 months (from the effective date of the new regulations) to comply with the new regulatory capital requirements.

40 During the 12-month grace period, the NM-CMS licence holder shall continue to comply with any existing capital requirements that it is subject to, including capital requirements imposed as a licensing condition.

PHASE 2

41 The proposed new capital requirements for NM-CMS licence holders permitted to carry on business dealing in securities (excluding holders restricted to dealing in collective investment schemes), trading in futures contracts and conducting leveraged foreign exchange trading (including NM-CMS licence holders that are also permitted to carry on business in one or more of the other regulated activities of fund management, securities financing, providing custodial services in

securities and advising on corporate finance) will be introduced as amendments to the Securities and Futures Regulations 2002 at a later date.

42 The phased introduction is necessary, to provide such licence holders with adequate time to review the comprehensive approach for calculation of their total risk requirements and to participate in quantitative surveys on the proposed capital requirements.

43 In the interim, existing capital requirements promulgated under the Securities Industry Regulations and Futures Trading Regulations will be migrated to the Securities and Futures Regulations in Sep 2002 and shall continue to apply this category of NM-CMS licence holders. This will be the case whether the holder is an existing licence holder that has migrated to the SFA, or is a new NM-CMS licence holder under the SFA.

CONSULTATION

44 We would like to seek comments on this consultation paper and would be grateful if your comments could reach us by 24 Jul 2002. You can send your comments to any one of the following addresses:

- a) email: sfdcapi@mas.gov.sg
- b) fax: (65) 6-2259766
- c) post: SFD Capital Working Group
Securities and Futures Department
Monetary Authority of Singapore
#24-00, MAS Building
10 Shenton Way
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45 If you have any queries relating to this consultation paper, please contact any one of the following persons:

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Appendix 1

**PROPOSED BASE CAPITAL REQUIREMENT AND FINANCIAL RESOURCES REQUIREMENT
FOR NON-MEMBER CAPITAL MARKETS SERVICES LICENCE HOLDERS**

| REGULATED ACTIVITY | EXISTING CAPITAL REQUIREMENTS | PROPOSED BASE CAPITAL REQUIREMENT | PROPOSED FINANCIAL RESOURCES REQUIREMENT |
|------------------------------------|--|-----------------------------------|--|
| DEALING IN SECURITIES | | | |
| Dealing in securities (non-member) | Shareholders' funds of not less than \$2m. | \$1,000,000 | <p>Financial Resources (FR) of at least 120% of Total Risk Requirement (TRR)</p> <p>TRR= Sum of (counterparty risk requirement, position risk requirement, large exposure requirement, underwriting risk requirement and operational risk requirement)</p> <p>For licence holders restricted to dealing in collective investment schemes, TRR= Operational Risk Requirement (Appendix 3)</p> |

| REGULATED ACTIVITY | EXISTING CAPITAL REQUIREMENTS | PROPOSED BASE CAPITAL REQUIREMENT | PROPOSED FINANCIAL RESOURCES REQUIREMENT |
|---|---|-----------------------------------|---|
| TRADING IN FUTURES CONTRACTS | | | |
| Trading in futures contracts (non-member) | Paid-up capital and shareholders funds of not less than \$8m each (in the case of a futures broker granted a futures broker's licence on or after 6 Jan 1995) | \$1,000,000 | FR of at least 120% of TRR TRR= Sum of (counterparty risk requirement, position risk requirement, large exposure requirement and operational risk requirement) |
| LEVERAGED FOREIGN EXCHANGE TRADING | | | |
| Leveraged foreign exchange trading | 1 As per futures broker's licence | \$1,000,000 | FR of at least 120% of TRR TRR= Sum of (counterparty risk requirement, position risk requirement, large exposure requirement and operational risk requirement) |

| REGULATED ACTIVITY | EXISTING CAPITAL REQUIREMENTS | PROPOSED BASE CAPITAL REQUIREMENT | PROPOSED FINANCIAL RESOURCES REQUIREMENT |
|-----------------------------|-------------------------------|-----------------------------------|---|
| SECURITIES FINANCING | | | |
| Securities financing | NA | \$1,000,000 | FR of at least 120% of TRR TRR = Sum of (counterparty risk requirement, operational risk requirement) <ul style="list-style-type: none"> – CRR is to be computed in accordance with Appendix 2 – Operational risk requirement is to be computed in accordance with Appendix 3. |

| REGULATED ACTIVITY | EXISTING CAPITAL REQUIREMENTS | BASE CAPITAL REQUIREMENT | FINANCIAL RESOURCE REQUIREMENT |
|---|---|--------------------------|--|
| FUND MANAGEMENT | | | |
| Fund management (except venture capital and boutique fund management) | <p>Paid-up capital and shareholders' funds of not less than \$1m each, in the case of an investment adviser which conducts fund management</p> <p>Paid-up capital and shareholders' funds of not less than <u>\$3m</u> each, in the case of a futures pool operator and a futures trading adviser which manages a portfolio on behalf of clients.</p> | \$1,000,000 | <p>FR of at least 120% of TRR</p> <p>TRR = Operational Risk Requirement (Appendix 3)</p> |
| Venture capital fund management | Initial paid-up capital of not less than \$250,000 and shareholders' funds of not less than \$250,000 | \$250,000 | |
| Boutique fund management | Initial paid-up capital of not less than \$250,000 and shareholders' funds of not less than \$500,000 (discretionary)/ \$250,000 (non-discretionary) | \$250,000 | |

| REGULATED ACTIVITY | EXISTING CAPITAL REQUIREMENTS | BASE CAPITAL REQUIREMENT | FINANCIAL RESOURCE REQUIREMENT |
|--|--|--------------------------|--|
| PROVIDING CUSTODIAL SERVICES FOR SECURITIES | | | |
| Providing custodial services for securities | NA | \$1,000,000 | FR of at least 120% of TRR TRR = Operational risk requirement (Appendix 3) |
| ADVISING ON CORPORATE FINANCE | | | |
| Advising on corporate finance | Paid-up capital and shareholders' fund of not less than \$300,000 each | \$500,000 | FR of least 120% of TRR TRR = Operational risk requirement (Appendix 3) Professional Indemnity Insurance of Sum Assured of not less than \$1m. |

Appendix 2

COUNTERPARTY RISK REQUIREMENT FOR NM-CMS LICENCE HOLDER CARRYING ON BUSINESS IN SECURITIES FINANCING

A NM-CMS licence holder that is permitted to carry on business in securities financing shall calculate its counterparty risk requirement in accordance with these paragraphs.

Definitions

2 For the purpose of this Appendix:

"*debit balance*" means the amount owed by a counterparty in his margin account and shall include:

- i. amounts to be financed by the NM-CMS licence holder in respect of open purchase contracts in the margin account of the counterparty, net of cash collateral and sale proceeds receivable from open sale contracts transacted in the margin account of the counterparty; and
- ii. all commission charges, interest and other related expenses payable by the counterparty to the NM-CMS licence holder;

"*equity*" means the sum of the current market value of securities bought and carried in the counterparty's margin account and the current market value of marginable securities lodged by the counterparty with the NM-CMS licence holder as margin collateral;

"*marginable securities*" mean securities as may be prescribed¹ by the Authority to be bought and carried in margin accounts of a NM-CMS licence holder; and

"*liquidation method*" means the method for determining the amount of the securities in the margin account, valued at current market value, which if liquidated would bring the equity-to-debit balance in the counterparty's margin account to a specified percentage.

Counterparty Risk Requirement

3 The "counterparty risk requirement" of a NM-CMS licence holder is the sum of all its "individual counterparty risk requirements".

Individual Counterparty Risk Requirement

4 A NM-CMS licence holder is required to calculate an "individual counterparty risk requirement" if it has a "counterparty exposure" to a counterparty that has a margin account with the NM-CMS licence holder. This is calculated as 100% of the "counterparty exposure".

¹ Cash, securities issued by the Government or a public body in Singapore, securities quoted on SGX-ST, securities quoted on CLOB International, and securities quoted by a recognised securities exchange where the securities are issued by companies with shareholders' funds of not less than \$200 million. A recognised securities exchange is an overseas securities exchange domiciled in one of the following countries: Australia, Austria, Belgium, Canada, France, Germany, Hong Kong SAR, Italy, Japan, Malaysia (except Labuan), Netherlands, New Zealand, South Korea, Spain, Sweden, Switzerland, Taiwan, United Kingdom, United States of America, and Thailand.

Counterparty Exposure

5 A NM-CMS licence holder shall calculate a "counterparty exposure" to a counterparty if an event described under paragraphs (a) or (b) occurs. This shall be calculated from the date of the event and on a liquidation method:

- (a) where the equity in the margin account is less than 130% but greater than 110% of the debit balance, as 100% of the amount that would restore the equity in a counterparty's margin account, to 130% of the debit balance; and
- (b) where the equity in the counterparty's margin account is 110% or less than 110% of the debit balance, as the sum of the following:
 - i. 200% of the amount that would restore the equity in a counterparty's margin account, to 110% of the debit balance; and
 - ii. 100% of the amount that would restore the equity in the counterparty's margin account, from 110% to 130% of the debit balance in the counterparty's margin account.

Appendix 3

OPERATION RISK REQUIREMENT FOR NM-CMS LICENCE HOLDERS CARRYING ON BUSINESS IN DEALING IN SECURITIES (RESTRICTED TO COLLECTIVE INVESTMENT SCHEMES), SECURITIES FINANCING, FUND MANAGEMENT, PROVIDING CUSTODIAL SERVICES AND/OR ADVISING ON CORPORATE FINANCE

A NM-CMS licence holder that is permitted to carry on business in dealing in securities (restricted to collective investment schemes) securities financing, fund management, providing custodial services for securities or advising on corporate finance shall calculate its operational risk requirement in accordance with these paragraphs.

Operational Risk Requirement

2 A NM-CMS licence holder shall calculate its operational risk requirement as 10% of its annual income based on its latest available audited financial statements. This should include revenue (commissions, fees, interests, dividends, etc) as well as gains that are recorded in the licence holder's profit and loss account, including unrealised gains that arise from revaluation of the licence holder's holdings of financial instruments held for trading.

3 A NM-CMS licence holder may, however, adjust the annual income in its audited financial statements by deducting:

- i. profit on the sale or termination of an operation; and
- ii. profit on disposal of a fixed asset.

Note:

Unavailability of Audited Financial Statement or Audited Financial Statement for Period less than 1 year

4 Where a new NM-CMS licence holder commences operations and does not have an audited annual financial statement or has audited financial statement for a period of less than 1 year, the NM-CMS licence holder shall calculate its operational risk requirement as 10% of its income for the preceding 12 months or such shorter period from the date of commencement of business to the date of calculation.

Illustration

Company ABC commences operations on 1 Feb 2002. Its fiscal year is 1 Jan to 31 Dec. The company will prepare its first audited financial statements for the period 1 Feb 2002 to 31 Dec 2002.

The company obtains a licence to carry on business advising on corporate finance with effect from 1 Jul 2002. The company is required to submit to the Authority Statement of Assets and Liabilities and Statement of Financial Resources and Total Risk Requirement on a quarterly basis for quarters ending 31 Mar, 30 Jun, 30 Sep and 31 Dec. Its first Statements will be due on 30 Sep 2002.

The company's operational risk requirements are as shown in the Table below.

| As at quarter ended | Income | For Period | Operational Risk Requirement |
|---------------------|---------|--|------------------------------|
| 30 Sep 2002 | \$1.50m | 1 Feb 2002 to 30 Sep 2002 ¹ | \$150,000 |
| 31 Dec 2002 | \$2.53m | 1 Feb 2002 to 31 Dec 2002 | \$253,000 |
| 31 Mar 2003 | \$2.90m | 1 Apr 2002 to 31 Mar 2003 ² | \$290,000 |
| 30 June 2003 | \$3.56m | 1 Jul 2002 to 30 June 2003 | \$356,000 |
| 30 Sep 2003 | \$4.56m | 1 Oct 2002 to 30 Sep 2003 | \$456,000 |
| 31 Dec 2004 | \$6.34m | 1 Jan 2003 to 31 Dec 2003 | \$634,000 |
| 31 Mar 2004 | \$7.79m | 1 April 2003 to 31 Mar 2004 | \$779,000 |
| 31 June 2004 | \$7.56m | 1 Jan 2003 to 31 Dec 2003 ³ | \$756,000 |

¹ The company's operational risk requirement is based on its accrued income from the date of commencement business, Feb 2002, to the date of calculation, Sep 2002. This will be the case until the company has been in operations for 12 months.

² The company's first audited financial statement is prepared for the period 1 Feb 2002 to 31 Dec 2002. This is for a period of less than 12 months. Therefore, the NM-CMS licence holder shall compute its operational risk requirement based on the preceding 12-month period, being 1 April 2002 to 31 Mar 2003.

³ The NM-CMS licence holder's second audited financial statement is prepared for the period 1 Jan 2003 to 31 Dec 2003. This is required to be submitted to the Authority within 5 months from the close of the financial year, ie 31 May 2004. The NM-CMS licence holder's audited financial statement is finalised in April 2004.

Appendix 4

PROPRIETARY POSITION AND FOREIGN EXCHANGE EXPOSURES

A NM-CMS licence holder that is permitted to carry on business of dealing in securities (restricted to dealing in collective investment schemes), fund management securities financing, and/or providing custodial services for securities shall calculate its proprietary position and foreign exchange exposures as follow:

Proprietary Position Exposure

2 The proprietary position exposure shall be the aggregate of all proprietary positions in equity securities, debt securities, physical commodities, including derivatives or off-balance sheet positions in these financial instruments, valued on a current market value basis. Netting of long and short positions (including notional or equivalent positions) is permitted provided these are positions in the same instrument.

Foreign Exchange Exposure

3 A licence holder shall first calculate its net open positions in each foreign currency¹. The net open position in a foreign currency is either a net short or net long position and is the aggregate of the following (preserving the signs):

- a. net spot position, being the amount of all assets² less all liabilities, including accrued interest and expenses

¹ Any currency other than the reporting currency of the licence holder's accounts

² Including receivables due from counterparties on open contracts

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- and option positions, denominated in the foreign currency;
- b. the aggregate amounts in the foreign currency to be received by the licence holder less the aggregate amounts in the foreign currency to be paid by the licence holder in relation to foreign currency positions arising from any futures contract, forward contract including a forward contract associated with cross-currency swaps or other derivatives;
 - c. net positions in non-foreign exchange products denominated in the foreign currency arising from any non-foreign exchange futures contract, forward contract and other derivatives;
 - d. net underwriting positions denominated in the foreign currency which is unplaced, unsold or unallotted from the day the underwriting arrangement ends but which shall be no later than the day after allotment or close of subscription, whichever is the later; and
 - e. any other off-balance sheet commitment that would result in an asset or liability denominated in a foreign currency.

4 A licence holder shall convert the net open position in each foreign currency to its reporting currency (preserving the sign) using the prevailing spot rate.

5 A licence holder shall then calculate its foreign exchange exposure as the absolute value of the higher of:

- (a) the aggregate of all its net short foreign currency positions;
and
- (b) the aggregate of all its net long foreign currency positions.