

CONSULTATION PAPER

P009-2015
June 2015

Policy Consultation on Regulatory Framework for Intermediaries Dealing in OTC Derivative Contracts, Execution-Related Advice, and Marketing of Collective Investment Scheme

MAS

Monetary Authority of Singapore

PREFACE

On 11 February 2015, the Monetary Authority of Singapore (“MAS” or “the Authority”) issued a consultation paper (the “February Consultation Paper”) proposing amendments to the Securities and Futures Act (“SFA”) to complete the expansion of the scope of the SFA to regulate derivative contracts, including the expansion of the Capital Markets Services (“CMS”) licensing requirement to intermediaries dealing in OTC derivative contracts¹ (“OTC Intermediaries”).

2 Part A of this consultation paper seeks comments on the proposed regulatory framework for OTC intermediaries, and should be read in conjunction with the February Consultation Paper. Part B of this paper seeks comments on other proposed amendments to the SFA and the Financial Advisers Act (“FAA”). One of the proposals is to refine the rules governing execution-related advice² under the FAA. The proposals are grouped into the following sections:

Part A REGULATORY FRAMEWORK FOR OTC INTERMEDIARIES

Section 2: Admission criteria

Section 3: Business conduct requirements

Section 4: Capital and financial requirements

Section 5: Representative notification requirement

Section 6: Transitional arrangements

Section 7: Paragraph 9 of the 3rd Schedule to the SFA and Paragraph 11 of the 1st Schedule to the FAA

Part B OTHER PROPOSED AMENDMENTS

Section 8: Execution-related advice

Section 9: Marketing of collective investment scheme

¹ With the expansion, OTC derivative contracts with equity, debt, credit, foreign exchange and commodity as their underlying will be included as “capital markets products” under the SFA and “investment products” under the Financial Advisers Act (“FAA”). Intermediaries dealing in and advising on OTC derivative contracts will be regulated as CMS licensees under the SFA and financial advisers under the FAA respectively.

² “Execution-related advice” is defined under the Guidelines on Conduct of Business for Execution-Related Advice (FAA-G08) as advice provided by persons who are exempt from holding a financial adviser’s licence under section 23(1)(a), (b), (d), or (e) of the FAA and their representatives which is solely incidental to the execution activities of such person and where no discrete fee is charged for the advice rendered.

3 MAS invites interested parties to provide their views and comments on the proposals. Written comments should be submitted to:

Capital Markets Intermediaries Department III
Monetary Authority of Singapore
10 Shenton Way
MAS Building
Singapore 079117
Email: cmi-reply@mas.gov.sg

4 We encourage respondents to provide their feedback via email.

5 MAS requests that all comments and feedback be submitted by 3 July 2015. Please note that any comments received may be made public unless confidentiality is specifically requested.

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1 INTRODUCTION

1.1 MAS has proposed to expand the scope of the SFA to cover OTC derivative contracts, including the expansion of the CMS licensing requirement to OTC Intermediaries, in the February Consultation Paper. MAS has also proposed changes to the regulated activities under the SFA. The current regulated activities of “dealing in securities”, “trading in futures contracts” and “leveraged foreign exchange trading”, plus the new activity of dealing in OTC derivative contracts, will be collapsed under a new regulated activity called “dealing in capital markets products”. The current and revised regulated activities under the SFA are shown in Table 1. An applicant for a CMS licence to deal in capital markets products will be required to indicate the specific class of capital markets products which it intends to deal in.

Table 1. Current and Proposed Regulated Activities

Current Regulated Activities	Proposed Regulated Activities
<ol style="list-style-type: none"> 1. Dealing in securities 2. Trading in futures contracts 3. Leveraged FX trading 4. Advising on corporate finance 5. Securities financing 6. Fund management 7. Providing custodial services for securities 8. Real estate investment trust management 9. Providing credit rating services 	<ol style="list-style-type: none"> 1. Dealing in capital markets products in respect of: <ol style="list-style-type: none"> (i) Securities (ii) Units in a Collective Investment Scheme (“CIS”) (iii) Exchange-traded derivative contracts (iv) OTC derivative contracts (v) Spot FX contracts for the purposes of leveraged FX trading 2. Advising on corporate finance 3. Securities, securities-based derivative contracts and CIS financing 4. Fund management 5. Providing custodial services in relation to securities, securities-based derivative contracts and units in a CIS 6. Real estate investment trust management 7. Providing credit rating services

1.2 Accordingly, OTC Intermediaries will be required to hold a CMS licence to deal in capital markets products – OTC derivative contracts, unless exempted³. This paper sets out the proposed capital, business conduct and other requirements for OTC Intermediaries which are required to hold a CMS licence. The business conduct and other requirements are also applicable to persons exempt under section 99(1)(a), (b) and (c) of the SFA (e.g. licensed banks) when they conduct the activity of dealing in OTC derivative contracts under the SFA.

1.3 MAS recognises that there are differences between the traditional securities market (where equities and futures contracts are traded) and the OTC derivative market, including the roles that intermediaries play in these markets. The main differences include:

- a) **Clientele:** Unlike the traditional securities market, the OTC derivative market is dominated by sophisticated and institutional players with very little retail participation.
- b) **Relationship with clients:** In a share purchase or futures contract transaction, the obligations between an intermediary and a client are largely discharged after the share is delivered or futures position is liquidated and the corresponding payments are made. In contrast, an OTC Intermediary's obligations with its counterparty may last for many years, depending on the duration of the OTC derivative contract. If the OTC Intermediary were to default, it is also more difficult for the counterparty to replicate the same position with another person, particularly if the original contract was bespoke.
- c) **Standardisation:** Equities and futures markets are largely standardised with defined terms and well-established processes that support trading, trade confirmation and clearing. In contrast, the OTC derivative market, particularly the non-centrally cleared segment, tends to be characterised by privately negotiated transactions between two counterparties where the contractual terms may not always be fully and properly documented. Participants in this market may also not have access to platforms that support trade confirmation and clearing.

1.4 MAS has developed the proposed regulatory framework for OTC Intermediaries, taking into account the distinct characteristics of the OTC derivative

³ MAS has proposed certain licensing exemptions for OTC intermediaries. Please refer to Annex 4 of the February Consultation Paper.

market and the regulatory requirements in major financial jurisdictions. The proposed regulatory framework is set out in Part A of this paper.

1.5 Separately, MAS has received industry feedback on:

- a) the application of the FAA to execution-related advice; and
- b) certain requirements and exemptions under the SFA and FAA for marketing of CIS.

MAS has proposed changes to address the feedback, which are set out in Part B of this paper.

PART A: REGULATORY FRAMEWORK FOR OTC INTERMEDIARIES

2 ADMISSION CRITERIA

2.1 Applicants for a CMS licence are required to meet the admission criteria set out in MAS' Guidelines on Criteria for the Grant of a Capital Markets Services Licence other than for Fund Management (SFA04-G01) (the "Licensing Guidelines"). The key admission criteria are base capital, corporate track record, and fitness and propriety of the applicant's shareholders, officers and employees.

2.2 MAS proposes to subject OTC Intermediaries to the admission criteria in the Licensing Guidelines save for the requirement relating to corporate track record.

2.3 Currently, an applicant for a CMS licence (other than for fund management) is required to have at least five years of track record in respect of the regulated activity to be conducted or in a related field. In the case of an applicant for a CMS licence in respect of fund management⁴, the minimum five-year track record requirement applies only if the applicant intends to manage funds for retail investors. This approach recognises that accredited and institutional investors are generally more sophisticated or better resourced and may not require the same level of protection as retail investors.

2.4 Consistent with the approach adopted for CMS licensees in respect of fund management, MAS proposes to require intermediaries dealing in OTC derivative contracts to meet the minimum five-year track record requirement only if they serve retail (i.e. non-accredited, institutional or expert) investors.

2.5 In addition, given the futurisation of OTC derivative contracts, MAS proposes to apply the same criterion to intermediaries dealing in exchange-traded derivative contracts such as futures contracts. This will allow OTC Intermediaries dealing in OTC derivative contracts to apply for the necessary licence from MAS to continue to deal in these contracts should they be converted to exchange-traded or futures contracts.

⁴ As prescribed in the SFA Guidelines on Licensing, Registration and Conduct of Business for Fund Management Companies (SFA04-G05).

Question 1. MAS seeks views on the proposed admission criteria for OTC Intermediaries.

Question 2. MAS seeks views on the proposal to require intermediaries dealing in exchange-traded derivative contracts to have a minimum five-year track record only if they serve retail investors.

3 BUSINESS CONDUCT REQUIREMENTS

3.1 CMS licensees are required to comply with the business conduct requirements set out in the Securities and Futures (Licensing and Conduct of Business) Regulations (“SF(LCB)R”). MAS has identified the suite of business conduct requirements under the SF(LCB)R that are relevant and should be applied to OTC Intermediaries (see paragraphs 3.2 to 3.17). MAS also proposes to introduce a set of risk mitigation requirements for OTC Intermediaries that deal in non-centrally cleared OTC derivative contracts (see paragraphs 3.18 to 3.30).

Business Conduct Requirements Under SF(LCB)R

(a) Risk Management and Controls

3.2 Regulation 13 of the SF(LCB)R requires a CMS licensee to have in place proper risk management systems and controls to manage its operations and activities. Among other things, a CMS licensee is required to:

- a) implement effective written policies on all operational areas;
- b) put in place compliance function and arrangements to protect investors and reduce the risk of incurring legal or regulatory sanctions;
- c) identify, address and monitor the risks associated with its trading or business activities;
- d) ensure that its business activities are subject to adequate internal audit; and
- e) ensure effective controls and segregation of duties to mitigate potential conflicts of interest.

3.3 MAS recognises that it is similarly important for OTC Intermediaries to have in place robust risk management system and controls, and thus, proposes to subject OTC Intermediaries to Regulation 13 of SF(LCB)R.

(b) Requirements relating to Advertisements

3.4 Regulation 46 of the SF(LCB)R governs the presentation and contents of advertising materials that are published or circulated by a CMS licensee. In particular, Regulation 46 stipulates that advertising materials must not contain any inaccurate or misleading statement or presentation, or any exaggerated statement or presentation that is calculated to exploit an individual’s lack of experience or knowledge. To ensure that the advertising materials published or circulated by OTC

Intermediaries present a fair and balanced view of the OTC derivative products, MAS proposes to extend Regulation 46 to OTC Intermediaries.

Question 3. The Authority seeks views to extend the following business conduct requirements to OTC Intermediaries:

- (i) Regulation 13 of the SF(LCB)R on risk management and controls; and**
- (ii) Regulation 46 of the SF(LCB)R on the presentation and contents of advertisement.**

(c) Risk Disclosure

3.5 Regulation 47E of SF(LCB)R requires a CMS licensee dealing in futures contracts or leveraged FX contracts to provide a risk disclosure document (in the form prescribed by MAS) to its customers prior to account opening. In addition, the SFA Notice on the Sale of Investment Products (SFA 04-N12) requires a CMS licensee to furnish a risk warning statement (in the form prescribed by MAS) to customers and obtain their acknowledgement of the statement prior to allowing them to transact in overseas-listed investment products.

3.6 It is a basic principle that investors or counterparties understand the risks associated with the financial transactions that they undertake. MAS thus proposes to require risk disclosure for all capital markets products under the SFA, including OTC derivative contracts. Specifically, MAS proposes to require a CMS licensee dealing in capital markets products to disclose to its customers (i) the material risks (e.g. counterparty, market, liquidity, leverage risks) of the product, and (ii) whether it is acting as a principal or an agent. The risk disclosure will have to be furnished to and acknowledged by the customer or counterparty in writing prior to the CMS licensee entering into a contractual relationship with the customer.

3.7 MAS recognises that retail investors are likely to benefit most from such risk disclosure and where appropriate, may prescribe the specific form of the risk disclosure document. To date, MAS has prescribed the specific risk disclosure documents for futures contracts, leveraged FX contracts and overseas-listed investment products.

3.8 MAS does not intend to prescribe the form of the risk disclosure for OTC derivative contracts such as swaps which are transacted primarily with non-retail counterparties. Where there are established industry standards for risk disclosure⁵, CMS licensees may rely on such documents provided their contents are consistent with the proposed risk disclosure requirement.

3.9 The proposed risk disclosure requirement will not apply when CMS licensees deal with their related entities or with licensed financial institutions. Related entities within the same group and financial institutions should possess the necessary knowledge or experience in trading in capital markets products, given that they are in the business of dealing in capital markets products themselves.

Question 4. MAS seeks views on the proposals:

- (i) To require CMS licensees dealing in capital markets products to disclose (i) the material risks of the product, and (ii) whether the CMS licensee is acting as a principal or an agent to the customer or counterparty; and**
- (ii) Not to apply the risk disclosure requirement when CMS licensees deal with their related entities or licensed financial institutions.**

(d) Handling of Customers' Moneys and Assets

3.10 Parts III and IV⁶ of the SF(LCB)R set out requirements governing the handling and treatment of moneys and assets that a CMS licensee receives from its customers. These requirements serve to protect the customers against the default of the CMS licensee that they have a direct relationship with, by requiring the CMS licensee to deposit moneys or assets received from its customers in a trust or custody account maintained with a regulated bank or finance company and to keep such an account separate from any other account in which the CMS licensee deposits its own moneys or assets. There are also requirements governing the lending, re-hypothecation and withdrawal of customers' moneys and assets.

⁵ For instance the ISDA DF Disclosure documents developed by the International Swaps and Derivatives Association ("ISDA") if the licensee has assessed that such documents meet the MAS proposed risk disclosure requirements.

⁶ SF(LCB)R Regulation 39 on Books of Holder of CMS Licence; Regulation 40 on Provision of Statement of Account to Customers; Regulation 45 on Securities Borrowing and Lending.

3.11 MAS proposes to extend Parts III and IV of the SF(LCB)R to OTC Intermediaries that deal in centrally-cleared OTC derivative contracts.

3.12 For non-centrally cleared OTC derivative contracts, the Basel Committee on Banking Supervision and the International Organization of Securities Commissions (“BCBS-IOSCO”) have in September 2013 jointly issued a set of recommendations on margin requirements, including the treatment of the margins collected, and provided a four-year phased-in implementation period commencing September 2016. MAS is currently reviewing the BCBS-IOSCO’s recommendations, and will separately consult on the requirements pertaining to treatment of customers’ moneys and assets in respect of non-centrally cleared OTC derivative contracts.

Segregation of Customers’ Moneys and Assets

3.13 On the segregation of customers’ moneys and assets for centrally-cleared OTC derivatives, MAS already requires clearing houses to ensure that their members (which include CMS licensees) offer the choice of an omnibus segregation model or an individual client segregation model to customers⁷. Although the individual client segregation model accords customers more protection in the event of a member default, it is likely to be more costly. In this regard, MAS proposes to require a CMS licensee, when offering the individual client segregation model, to disclose to customers the costs associated with and the level of protection accorded by individual client segregation vis-à-vis omnibus segregation.

3.14 The CMS licensee will, however, not be required to deposit the moneys or assets of customers who have opted for individual client segregation in a trust account separate from other customers who have not opted so. The segregation of moneys and assets belonging to customers who have opted for different types of segregation at the intermediary level would not significantly increase the level of protection for customers, as the moneys and assets will be passed to the clearing house and be operationally commingled in the same bank account at the clearing house level.

⁷ Regulation 35 of the Securities and Futures (Clearing Facilities) Regulations 2013.

Question 5. The Authority seeks views on the following proposals:

- (i) To extend Parts III and IV of the SF(LCB)R to CMS licensees dealing in centrally-cleared OTC derivative contracts;**
- (ii) Where a CMS licensee offers individual client segregation, to require the CMS licensee to disclose to its customers the costs associated with and the level of protection accorded by individual client segregation vis-à-vis omnibus segregation; and**
- (iii) Not to require CMS licensees to deposit moneys or assets of customers who have opted from individual client segregation into a trust account separate from other customers who have not opted so.**

(e) Record Keeping

3.15 CMS licensees that carry out dealing in securities, trading in futures contracts or leveraged FX trading are required to keep proper records of the transactions that they undertake for their customers. Proper record keeping is equally important for OTC derivative transactions as it ensures that there is a sufficient audit trail of such transactions conducted by CMS licensees and facilitates timely resolution of disputes with customers or counterparties.

3.16 MAS proposes to require CMS licensees to maintain the following information, in respect of their OTC derivative transactions:

- a) Customer identification information and other documents relating to the establishment of business relation;
- b) Information necessary to reconstruct the derivative transaction, including:
 - (i) Pre-execution information (e.g. quotes, bids, offers, instructions, date and time of quotations provided to and received from counterparty);
 - (ii) Execution information (e.g. terms of swap, time and price of execution, name of counterparty, date of swap agreement, fees, commission and other expenses); and
 - (iii) Post-trade information (e.g. confirmation, time of confirmation, reconciliation, netting, compression, valuation, margining, collateralisation, central clearing);
- c) Payments and interest received on the derivative transaction;
- d) Daily value of each outstanding derivative transaction;

- e) Daily initial and variation margin payable or receivable;
- f) Daily value of all collateral held by or posted by CMS licensee, including transfer of collateral; and
- g) All charges against and credits to each counterparty's account (e.g. funds deposited/withdrawn, unrealised gains/losses).

3.17 In line with the current retention requirements⁸, CMS licensees will be required to maintain the records for:

- a) A period of five years following the termination of the business relation, in respect of the information referred to in paragraph 3.16(a);
- b) A period of five years following the completion of the transaction in respect of the information referred to in paragraph 3.16(b) to (g) (with the exception of oral communication relating to pre-execution information); and
- c) A period of one year in respect of oral communication relating to pre-execution information.

Question 6. The Authority seeks views on the following record keeping requirements in relation to OTC derivative transactions:

- (i) **To maintain the records set out in paragraph 3.16 for each OTC derivative transaction; and**
- (ii) **To maintain the records for the retention periods set out in paragraph 3.17.**

Risk Mitigating Requirements for Non-Centrally Cleared Derivatives

3.18 MAS notes that there are some OTC derivative transactions which are not standardised and hence not suitable for central clearing. Unlike centrally-cleared transactions, such non-standardised, privately negotiated transactions, may not always be fully and properly confirmed, documented or reconciled between the counterparties. It is therefore important for OTC Intermediaries to adopt appropriate risk mitigation techniques for such transactions.

3.19 IOSCO has, in January 2015, issued a report which sets out nine standards aimed at mitigating the risks that intermediaries face when transacting in non-

⁸ Section 102(3) of the SFA.

centrally cleared OTC derivatives⁹. The report highlighted the benefits of adopting the risk mitigation techniques, including promoting legal certainty and facilitating timely dispute resolution; facilitating the management of counterparty credit and other risks; and increasing the overall financial stability.

3.20 Consistent with IOSCO's recommendations, MAS proposes to impose requirements on trading relationship documentation, trade confirmation, and portfolio reconciliation and compression on CMS licensees dealing in non-centrally cleared OTC derivatives.

(f) Trading Relationship Documentation

3.21 Trading relationship documentation helps to reduce the legal and other risks that can result from undocumented material terms of non-centrally cleared OTC derivative transactions. MAS notes that in practice, participants in the non-centrally cleared OTC derivative market will normally enter into written agreements that govern their relationships with their counterparties.

3.22 MAS proposes to require CMS licensees to have policies and procedures to execute written trading relationship documentation with their counterparties prior to or contemporaneously with executing a non-centrally cleared OTC derivative transaction. Such documentation should include all material terms governing the trading relationship between the counterparties, and should be executed in writing or through other equivalent non-rewritable, non-erasable electronic means.

Question 7. The Authority seeks views on the proposed trading relationship documentation requirement in paragraph 3.22.

(g) Trade Confirmation

3.23 Transactions should be confirmed as soon as practicable after the parties have executed the transaction. Given the importance of timely confirmation, MAS proposes to require CMS licensees to execute trade confirmation for non-centrally cleared OTC derivative transactions within a specific timeframe, taking into account the status of the counterparty as follows:

⁹ The IOSCO report on "Risk Mitigation Standards for Non-Centrally Cleared OTC Derivatives" can be found at: <http://www.iosco.org/library/pubdocs/pdf/IOSCOPD469.pdf>

- a) Where the counterparty is a licensed financial institution¹⁰, MAS will require the CMS licensee to execute a two-way confirmation by T+1 for trades that are executed before 4pm Singapore time. In the event that the counterparty resides in a different time zone which does not allow for confirmation by the stipulated deadline, the deadline can be extended by one business day; and
- b) For other counterparties, MAS will require the CMS licensee to (i) provide an acknowledgement (i.e. one-way confirmation) to counterparties by T+1; and (ii) have in place written policies and procedures that would facilitate, on a best effort basis, the execution of a two-way confirmation by T+2. MAS recognises that it may not be feasible to mandate a two-way confirmation where the counterparty is not a licensed financial institution as the latter is not subject to oversight by a financial regulator, and the CMS licensee may not be able to compel the non-licensed counterparty to execute a two-way confirmation.

3.24 The terms confirmed should include those necessary to promote legal certainty to the transaction. MAS proposes to require trade confirmation of the terms listed in Annex 1. These terms are broadly in line with the data fields required to be reported under MAS' and US CFTC's trade reporting requirements¹¹.

3.25 The trade confirmation requirements will be effected in phases, to provide time for the industry to develop the necessary infrastructure and capabilities to implement the requirements. As a start, the requirements will be imposed on the more mature classes of derivative contracts (i.e. interest rates and credit derivative contracts). The proposed phase-in timeline is set out in Table 2.

Table 2. Phase-in implementation timeline

Asset Class	Confirmation Deadline	Effective date
(i) For two-way confirmation to be executed with counterparties who are licensed financial institutions, or acknowledgement to be sent to other counterparties		
Interest Rate Swap, Credit Default Swap	By (T+1)	The date that the trade confirmation requirement is effected (D)

¹⁰ The term "licensed financial institutions" refers to financial institutions that are licensed by MAS or any other financial regulatory authority.

¹¹ US CFTC has prescribed a minimum set of Primary Economic Terms, which are required to be included in a trade confirmation and form part of the data required to be reported under US CFTC's reporting requirements.

Other	By (T+2)	(D + 6 months)
	By (T+1)	(D + 12 months)
(ii) To have policies and procedures that facilitate, on a best effort basis, a two-way confirmation to be executed with other counterparties		
Interest Rate Swap, Credit Default Swap	By (T+3)	D
	By (T+2)	(D + 12 months)
Other	By (T+4)	(D + 6 months)
	By (T+2)	(D + 12 months)

Question 8. The Authority seeks views on:

- (i) **The confirmation deadlines set out in paragraph 3.23;**
- (ii) **The terms required to be included in a confirmation set out in Annex 1; and**
- (iii) **The phased-in implementation timeline set out in Table 2.**

(h) Portfolio Reconciliation and Dispute Reporting

3.26 MAS proposes to require CMS licensees to undertake portfolio reconciliation of non-centrally cleared OTC derivative contracts with their counterparties. Similar to trade confirmation, MAS proposes that a distinction be made for portfolio reconciliation depending on whether the counterparty is a licensed financial institution. Where the counterparty is a licensed financial institution, MAS will require the CMS licensee to agree in writing with the counterparty on the terms of the portfolio reconciliation. Where the counterparty is not a licensed financial institution, MAS will require the CMS licensee to have in place policies and procedures that facilitate, on a best effort basis, portfolio reconciliation between the CMS licensee and the counterparty.

3.27 The proposed frequencies of the portfolio reconciliation are set out in Table 3, and calibrated based on the volume of outstanding OTC derivative contracts and the type of counterparty.

Table 3. Frequency of Portfolio Reconciliation

No. of Outstanding Contracts with a Counterparty	Frequency of Reconciliation
<i>(i) For reconciliation with counterparties which are licensed financial institutions</i>	
≥ 500	Daily
51 - 499	Weekly
≤ 50	Quarterly
<i>(ii) For reconciliation with other counterparties</i>	
> 100	Quarterly
≤ 100	Annually

3.28 On the scope of portfolio reconciliation, MAS considers it important that material terms and valuation be covered. In this regard, MAS proposes that the portfolio reconciliation should cover minimally the terms listed in Annex 2. The list is based on the 2013 EMIR Portfolio Reconciliation Operational Guidance Note issued by ISDA, and is commonly used by OTC derivative market participants.

3.29 One of the key purposes of portfolio reconciliation is to allow for early identification of disputes relating to material terms. To enable MAS to monitor disputes involving significant amounts that may cause disruptions to the market, MAS proposes to require CMS licensees to report promptly material disputes, i.e. those exceeding S\$25 million that remain unresolved beyond 15 business days.

Question 9. The Authority seeks views on the proposals to require CMS licensees to:

- (i) Enter into portfolio reconciliation agreements or arrangements with counterparties as set out in paragraph 3.26;**
- (ii) Perform portfolio reconciliation according to the frequencies set out in Table 3;**
- (iii) Include the terms set out in Annex 2 in the portfolio reconciliation; and**
- (iv) Report promptly material disputes to the Authority as set out in paragraph 3.29.**

(i) Portfolio Compression

3.30 Portfolio compression serves to reduce counterparty risk exposure and operational risks of maintaining unnecessary transactions by terminating and replacing economically-equivalent transactions. Given the benefits of portfolio compression, MAS proposes to require CMS licensees dealing in non-centrally cleared OTC derivative contracts to undertake portfolio compression, where appropriate.

Question 10. The Authority seeks views on the proposal to require CMS licensees to engage in portfolio compression of non-centrally-cleared OTC derivative contracts, where appropriate.

Banks, Merchant Banks and Finance Companies

3.31 To maintain a level playing field, persons exempt from holding a CMS licence under section 99(1)(a), (b) and (c) (i.e. banks, merchant banks and finance companies licensed in Singapore) of the SFA are required to comply with the relevant business conduct requirements in their conduct of regulated activities under the SFA. With the expansion of the SFA to regulate OTC derivative contracts, such exempt persons will thus be required to comply with the proposed business conduct rules set out in paragraphs 3.2 to 3.30.

Question 11. The Authority seeks views from banks, merchant banks and finance companies on the business conduct requirements for dealing in OTC derivatives set out in paragraphs 3.2 to 3.30.

4 CAPITAL AND FINANCIAL REQUIREMENTS

Base Capital

4.1 All CMS licensees are required to maintain a minimum level of capital to ensure that they are sufficiently capitalised to support their business activities. The proposed base capital requirements for CMS licensees dealing OTC derivative contracts are shown in Table 4. The proposed requirements are consistent with the existing requirements for CMS licensees trading in futures contracts.

Table 4. Proposed Base Capital Requirements

Regulated Activity	Base Capital Requirement
The entity deals in capital markets products in respect of OTC derivative contracts and is a member of a designated clearing house	\$5m
The entity deals in capital markets products in respect of OTC derivative contracts and is not a member of a designated clearing house	\$1m

On-going Financial Requirements

4.2 Besides base capital, CMS licensees are subject to ongoing risk-based capital (“RBC”) requirements under the Securities and Futures (Financial and Margin Requirements) Regulations (“SF(FMR)R”), where the amount of financial resources required varies depending on the volume and profile of their business. Similarly, MAS proposes to require CMS licensees dealing in OTC derivative contracts (other than those dealing only with non-retail investors) to comply with the RBC requirements under the SF(FMR)R. On CMS licensees dealing in OTC derivative contracts only with non-retail investors, MAS will continue to monitor international developments¹² before finalising the capital requirements for such licensees.

¹² For example, US authorities have not finalised the capital requirements for swap dealers.

Question 12. The Authority seeks views on subjecting CMS licensees dealing in OTC derivative contracts to:

- (i) The base capital requirements set out in Table 4; and**
- (ii) The RBC requirements under the SF(FMR)R, other than CMS licensees dealing in OTC derivative contracts only with non-retail investors.**

5 REPRESENTATIVE NOTIFICATION REQUIREMENT

5.1 Under the SFA and FAA, a person who acts as a representative in respect of any regulated activity under the SFA or FAA is required to be an appointed representative, provisional representative or temporary representative¹³ in respect of that activity. To be appointed as a representative, a person must:

- a) have the support of his principal company, which is either a CMS licensee, or person exempt under section 99(1)(a), (b) or (c) of the SFA or section 23(1)(a), (b), (c), (d) or (e) of the FAA (as the case may be);
- b) be fit and proper;
- c) be at least 21 years old;
- d) satisfy the minimum academic qualification requirements under the SFA or FAA; and
- e) pass the requisite Capital Markets and Financial Advisory Services (“CMFAS”) examination modules.

5.2 MAS will extend the representative notification requirement, including those in paragraph 5.1(a) to (e) to persons who act as representatives in respect of dealing in or advising on OTC derivative contracts.

5.3 Following from the expansion of the SFA to regulate OTC derivative contracts, and redefinition of capital market products and regulated activities in the February Consultation Paper, MAS intends to review the CMFAS examination requirements and will consult on any proposed changes in due course. MAS intends however to grandfather two groups of existing representatives:

- a) Persons who are currently dealing in or advising on OTC derivative contracts and intend to continue doing so (“Existing OTC Reps”) will need to be appointed as representatives of their principal companies under the new regime¹⁴. Given that Existing OTC Reps should have the necessary knowledge and experience, and should be familiar with the workings of OTC derivative markets, MAS proposes to grandfather them in relation to the minimum academic qualifications and CMFAS examination requirements. However, a grandfathered OTC representative who has left the industry for a continuous period of more than one year will be required to take the relevant CMFAS examinations should he wish to return to the industry. This is

¹³ The concept of temporary representative is not applicable under the FAA.

¹⁴ Excluding persons who deal in or advise on OTC derivatives which are already caught under the existing regime in the SFA and/or FAA (e.g. equity derivatives, leveraged foreign exchange). These persons are already required to be appointed representatives of their principal companies under the existing regime in the SFA and/or FAA.

because such a person is unlikely to have kept pace with market developments during his absence from the industry.

- b) The redefinition of capital market products and regulated activities will also affect persons who are appointed representatives of their principal companies in respect of the current regulated activities under the SFA or FAA (“Existing Appointed Reps”). The names of the current regulated activities which Existing Appointed Reps conduct will be changed to reflect the appropriate new regulated activities shown in Table 1. MAS would like to clarify that such Existing Appointed Reps will not be required to comply with additional CMFAS examination requirements if there is no change to the scope of their activities under the new regime (e.g. an appointed representative who trades in futures contracts for his principal company under the current regime and continues to do so under the new regime will not have to pass any additional CMFAS module, although the regulated activity which he conducts will be changed to “trading in exchange-traded derivatives”).

Question 13. The Authority seeks views on the proposals to:

- (i) Extend the representative notification requirement to persons who act as representatives for dealing in or advising on OTC derivative contracts as set out in paragraph 5.2; and**
- (ii) Grandfather existing representatives as set out in paragraph 5.3.**

6 TRANSITIONAL ARRANGEMENTS

6.1 MAS recognises that there are already entities and their representatives who are dealing in or advising on OTC derivative contracts, although such activities do not fall within the ambit of the current SFA or FAA. When the new regime is effected, these entities and their representatives will be required to hold a CMS licence or be notified to MAS (as the case may be) in order to continue with their OTC derivative activities. In this regard, MAS is proposing a one-year transitional period, from the date that the new regime is effected, for the entities to submit the relevant applications or notifications to MAS. Entities which submit the requisite applications or notifications with MAS within the transitional period will be allowed to continue with their OTC derivative activities until such time that MAS decides on the application or notification. The transitional arrangements are detailed below.

Group 1: Holders of a CMS licence and their representatives

6.2 CMS licensees which also deal in OTC derivative contracts will be required to submit an application for variation of their CMS licence to add the requisite derivative contracts to their licence. CMS licensees will also need to submit notifications for the appointment of their representatives dealing in these derivative contracts.

Group 2: Holders of a Financial Adviser (“FA”) licence and their representatives

6.3 Licensed FAs which also advise on OTC derivative contracts will be required to submit an application for variation of their FA licence to add the requisite derivative contracts to their licence. Licensed FAs will also need to submit notifications for the appointment of their representatives advising on these derivative contracts.

Group 3: Persons exempt under section 99(1)(a), (b) and (c) of the SFA or section 23(1)(a), (b), (c), (d) and (e) of the FAA and their representatives

6.4 If such persons also deal in or advise on OTC derivative contracts, they will be required to notify MAS of the requisite class of OTC derivative contracts that they and their representatives are dealing in or advising on.

Group 4: Holders of a Commodity Broker's ("CB") licence under the Commodity Trading Act and their representatives

6.5 Unless exempted¹⁵, holders of a CB licence will be required to apply for a CMS licence for dealing in capital markets products in respect of OTC derivative contracts and submit notifications for the appointment of their representatives. For avoidance of doubt, holders of a CB licence are required to maintain their CB licences until such time that their CMS licences are issued.

Group 5: Other entities and their representatives

6.6 Unless exempted¹⁶, entities dealing in or advising on OTC derivative contracts but do not fall into any of the aforementioned groups will be required to submit a CMS or FA licence application. They will also need to submit notifications for the appointment of their representatives.

Group 6: New entrants and their representatives

6.7 The transitional arrangements do not apply to entities and their representatives who commence dealing in or advising on OTC derivative contracts only after the new regime comes into effect. Such entities and their representatives may only commence their OTC derivative activities after their CMS or FA licence applications or notifications (as the case may be) have been approved or published by MAS.

Question 14. The Authority seeks views on the proposed transitional arrangements set out in paragraphs 6.2 to 6.7.

¹⁵ Refer to Annex 4 of the 2015 Consultation Paper for the proposed licensing exemptions.

¹⁶ Refer to Annex 4 of the 2015 Consultation Paper for the proposed licensing exemptions.

7 PARAGRAPH 9 OF THE 3RD SCHEDULE TO THE SFA (“PARA 9”) AND PARAGRAPH 11 OF THE 1ST SCHEDULE TO THE FAA (“PARA 11”)

7.1 Currently, a foreign company whose conduct of an SFA-regulated activity is effected under an arrangement between the foreign company and its related corporation, which is a CMS licensee or an exempt CMS licensee under section 99(1)(a), (b) or (c) of the SFA, approved by the Authority under Para 9, is exempt from the requirement to hold a CMS licence in respect of that regulated activity. Similarly, a foreign company whose provision of any FA service is effected under an arrangement between the foreign company and its related corporation, which is a licensed FA or an exempt FA under section 23(1)(a), (b), (c), (d) or (e) of the FAA, approved by the Authority under Para 11, is exempt from the requirement to hold an FA licence in respect of the provision of that FA service.

7.2 MAS will extend the application of Para 9 and Para 11 to dealing in and advising on OTC derivative contracts respectively.

7.3 Existing approvals granted by MAS under Para 9 and Para 11 in respect of current regulated activities will not be affected by the redefinition of capital market products and regulated activities in the February Consultation Paper.

Question 15. The Authority seeks views on the application of Para 9 and Para 11 to dealing in and advising on OTC derivative contracts respectively.

PART B: OTHER PROPOSED AMENDMENTS

8 EXECUTION-RELATED ADVICE

8.1 “Execution-related advice”¹⁷ (“ERA”) is a type of financial advisory service regulated under the FAA. To provide ERA, dealers¹⁸ need to comply with the relevant business conduct rules under the FAA, including having a reasonable basis for the recommendation made, taking into consideration the customer’s investment objectives, financial situation and particular needs.

8.2 MAS has received feedback from the broking industry that it is operationally challenging to comply with the current requirements for the following reasons. First, customers who open trading accounts for execution services typically do not regard their dealers as financial planners. As such, they are often unwilling to provide information on their investment objectives, financial situation and particular needs to enable the dealer to assess the suitability of the products recommended. For such cases, the ERA provided will not take into account the customer’s financial needs and situation, and will not be subject to a needs analysis of the customer. In such an event, the dealer is required to document the decision of the customer and highlight to the customer that it is his responsibility to ensure suitability of the product recommended. Second, even if customer information is available, due to the time-sensitive nature of ERA, it is difficult for the dealer to perform a proper suitability assessment each time the customer asks for trading ideas. Third, unlike a financial planner or wealth manager, dealers do not typically offer personalised financial advice. In ERA, the advice provided is primarily based on the merits of the investment product¹⁹ and not tailored to the customer’s needs, circumstances and risk profile.

¹⁷ “Execution-related advice” is defined under the Guidelines on Conduct of Business for Execution-Related Advice (FAA-G08) as advice provided by persons who are exempt from holding a financial adviser’s licence under section 23(1)(a), (b), (d), or (e) of the FAA and their representatives which is solely incidental to the execution activities of such person and where no discrete fee is charged for the advice rendered.

“Execution activities” refers to any or all of the following activities as defined in section 2(1) of the SFA:

- (a) dealing in securities (other than collective investment schemes) quoted on a securities exchange, overseas securities exchange or recognised market operator;
- (b) trading in futures contracts;
- (c) foreign exchange trading; and
- (d) leveraged foreign exchange trading.

¹⁸ “Dealers” is defined under FAA-G08 to mean persons exempt from holding a financial adviser’s licence under section 23(1)(a), (b), (c), (d) or (e) of the FAA and their representatives in respect of their carrying on the business of providing execution-related advice.

¹⁹ For instance, advice based on technical or fundamental analysis does not take into consideration the financial needs and personal situation of the customer.

8.3 Having considered the industry's feedback, MAS proposes to exempt the provision of ERA in respect of listed Excluded Investment Products²⁰ ("EIPs") from the FAA, subject to appropriate safeguards. Specifically, the dealer shall, when providing ERA:

- a) Provide the customer with a written warning at account opening that the ERA does not take into account the customer's investment objectives, financial situation and particular needs, and highlight to the customer that it is his responsibility to ensure the suitability of the product recommended; and
- b) Ensure that it states the rationale for the ERA provided to the customer. This is so that the customer can make an informed assessment on whether to act on the dealer's advice.

8.4 We propose to limit the scope of the exemption to listed EIPs. An investor wishing to invest in unlisted EIPs and Specified Investment Products²¹ ("SIPs") should continue to be accorded the relevant safeguards under the FAA, such as requiring the dealer to have a reasonable basis for any recommendation provided. In the case of unlisted EIPs such as plain vanilla collective investment schemes and life policies, these are usually long term investments sold as part of financial or retirement planning. As for SIPs, investors wishing to invest in such products should be allowed to request for advice, or continue to receive advice if they do not have the relevant knowledge and experience to invest in complex products. Accordingly, the provision of ERA on unlisted EIPs and SIPs would continue to be subject to the existing requirements under the FAA.

Question 16. The Authority seeks views on:

- (i) The proposal to exempt ERA in relation to listed EIPs from the FAA; and**
- (ii) The proposed safeguards as set out in paragraph 8.3, as well as other safeguards that could be introduced.**

²⁰ These refer to Excluded Investment Products as defined in the Notice on Recommendations on Investment Products (FAA-N16), which are listed for quotation or quoted on a securities exchange, overseas securities exchange or recognised market operator. These will include listed collective investment schemes such as exchange-traded funds that meet the EIP definition.

²¹ These refer to any investment product other than an EIP.

9 MARKETING OF COLLECTIVE INVESTMENT SCHEMES (“CIS”)

9.1 “Dealing in securities”²² is an existing regulated activity under the SFA. As the term “securities” includes units in a CIS, any person carrying on business in dealing in units of CIS is required to hold a CMS licence in respect of dealing in securities. “Marketing of CIS”, on the other hand, is an activity regulated under the FAA. Any person carrying on business in the marketing of CIS is required to hold a FA licence. Although not defined in the FAA, “marketing” is generally regarded as a process that includes the advertising and sale of a product, and which has as its ultimate goal the selling of the product to customers. As marketing efforts would invariably involve an element of inducement, “marketing of CIS” may be regarded as a sub-set of “dealing in securities”.

9.2 Under paragraph 2 of the Second Schedule to the SF(LCB)R, a licensed financial adviser or an exempt finance adviser under section 23(1)(a), (b), (c), (d) or (e) of the FAA (collectively called “Financial Advisers”) which markets CIS is exempt from the requirement to hold a CMS licence for dealing in securities (“SFA Dealing Exemption”) when it markets or redeems units in a CIS. Under section 23(1)(d) of the FAA, a CMS licensee is exempt from the requirement to hold an FA licence when it markets CIS.

9.3 The current approach of regulating “marketing of CIS” under two separate activities in the SFA and FAA could result in entities being subject to different business conduct requirements for the conduct of similar activities. For instance, CMS licensees which market CIS under their dealing licence are prohibited from withholding any customer’s order for the benefit of itself or of any other person²³ under the SF(LCB)R, but this requirement does not apply to Financial Advisers carrying out marketing of CIS under the FAA.

9.4 MAS has also received industry feedback that the SFA Dealing Exemption is too narrow as it allows Financial Advisers to facilitate only the subscription or redemption²⁴ of unlisted CIS by their customers. Financial Advisers cannot rely on the same exemption to help their customers transact in listed CIS (e.g. exchange-traded funds or listed real estate investment trusts).

²² “Dealing in securities” is defined as “(whether as principal or agent) making or offering to make with any person, or inducing or attempting to induce any person to enter into or to offer to enter into any agreement for or with a view to acquiring, disposing of, subscribing for or underwriting in unit of securities”.

²³ Regulation 47(1) of the SF(LCB)R – Trading Standards.

²⁴ The term “redemption” refers to the act of exchanging units in a CIS directly with the fund manager for the asset held by the CIS or for cash.

9.5 To ensure a level playing field for all entities marketing CIS, and allow Financial Advisers to provide better services to customers, MAS proposes to:

- a) remove the regulated activity of marketing of CIS under the FAA. This is consistent with the position that marketing of CIS is already included under the scope of “dealing in securities” under the SFA; and
- b) expand the SFA Dealing Exemption to allow Financial Advisers to help customers transact in both listed and unlisted CIS if such dealing is incidental to their advisory activities. Dealing by the Financial Adviser is considered incidental if the Financial Adviser has made a recommendation to the customer in respect of a particular CIS, the customer accepts the recommendation and the Financial Adviser proceeds to help the customer transact in the CIS in accordance with the recommendation.

9.6 With these changes, dealing in CIS (which includes marketing of CIS) will be regulated only under the SFA. As such, MAS will port the relevant business conduct requirements on marketing of CIS, in particular regulation 19 of the Financial Advisers Regulation (“FAR”) on treatment of customers’ moneys to the SF(LCB)R. Some of the business conduct requirements applicable to dealing in CIS, including those currently residing in SF(LCB)R are as follows:

- a) Priority of customers’ orders under regulation 44 of SF(LCB)R;
- b) Advertisement under regulation 46 of SF(LCB)R;
- c) Prohibited representations under regulation 46A of SF(LCB)R;
- d) Trading standards under regulation 47 of SF(LCB)R;
- e) Dealing as principal under regulation 47B of SF(LCB)R; and
- f) Treatment of customers’ money under regulation 19 of FAR, which will be ported to the SF(LCB)R.

9.7 To ensure a level playing field, Financial Advisers and their representatives relying on the SFA Dealing Exemption will not be required to hold a CMS licence or be appointed representatives under the SFA but will be required to comply with the relevant business conduct requirements for dealing in CIS (where applicable to their business model). For example, if a Financial Adviser does not deal in CIS for its own account, regulations 44 and 47B of the SF(LCB)R would not be applicable.

9.8 MAS would also like to clarify the treatment for fund management companies (“FMCs”). Fund managers which hold a CMS licence (“LFMCs”) are exempt financial advisers under section 23(1)(d) of the FAA when they market any CIS. Registered FMCs (“RFMCs”) are exempt under regulation 32A of the FAR from holding a FA licence when they market CIS which are managed by themselves. Following from the proposed changes, LFMCs and RFMCs which market CIS will be deemed to be dealing in securities under the SFA. LFMCs are currently exempt from holding a CMS licence for dealing in securities where such dealing is incidental to their fund management activity. This exemption will be retained. In addition, MAS proposes to exempt both LFMCs and RFMCs from holding a CMS licence for dealing in securities when marketing CIS which are managed by the FMCs themselves or their related corporations.

Question 17. The Authority seeks views on the proposals to:

- (i) Remove the regulated activity of “marketing of CIS” from the FAA;**
- (ii) Expand the scope of the SFA Dealing Exemption to allow Financial Advisers to deal in both listed and unlisted CIS if such dealing is incidental to their advisory activities;**
- (iii) Require Financial Advisers and their representatives relying on the SFA Dealing Exemption to comply with the applicable business conduct rules as set out in paragraph 9.7; and**
- (iv) Exempt licensed and registered FMCs that market CIS managed by themselves or their related corporations from holding a CMS licence for dealing in securities.**

Annex 1 – Proposed Terms for Trade Confirmation

General fields
Unique Transaction Identifier
Unique Product Identifier
Contract Type
Identifier of the non-reporting party
Identifier of the reporting counterparty
Start date
Maturity, termination or end date
Settlement method
Settlement or expiration date
Delivery type
The price
Quantity
Execution timestamp
Execution Venue
Indication of collateralization
Block trade indicator
Option type
Option premium
Option Style
Clearing indicator
Clearing Venue
An indication that the swap will be allocated
Asset Class: Credit/ Equity
Indication of the counterparty purchasing protection
Indication of the counterparty selling protection
Information identifying the reference entity
Notional amount
Currency in which the notional amount is expressed
Amount of upfront payment (where applicable)
Currency/ currencies in which upfront payment is expressed in (where applicable)
Payment frequency of the reporting counterparty
Payment frequency of the non-reporting counterparty
Asset Class: Interest Rate
Notional amount (Leg 1)
Notional currency (Leg 1)

Notional amount (Leg 2)
Notional currency (Leg 2)
Direction (For swaps, whether the principal is paying or receiving the fixed rate. For non-swap instruments and swap options, indicate the instruments that was bought or sold)
Payer (fixed rate), i.e. is the reporting party a fixed rate payer? Yes/No/NA.
Payer of Leg 1
Payer of Leg 2
Day Count Convention
Rate of Leg 1 (where applicable)
Day count of Leg 1 (where applicable)
Floating rate index name/ rate period
Payment frequency of Leg 1 (where applicable)
Reset frequency period of Leg 1 (where applicable)
Asset Class: Commodity
Buyer
Seller
Quantity unit
Quantity frequency
Total Quantity
Price unit
Price currency
Buyer pay index
Buyer pay averaging method
Seller pay index
Seller pay averaging method
Grade
Hours from through
Hours from through time zone
Days of week
Load Type
Asset Class: Foreign Exchange
Currency 1
Currency 2
Notional Amount 1
Notional Amount 2
Exchange rate

Annex 2 – Proposed Terms to be included in Portfolio Reconciliation

- a) Trade ID
- b) Legal Entity Name
- c) Counterparty Legal Entity Name
- d) Current Notional/Quantity
- e) Trade currency
- f) 2nd Notional/Quantity (if applicable)
- g) 2nd Notional currency (if applicable)
- h) Underlier/Product ID
- i) Trade Date
- j) End Date
- k) Mark-to-market (MTM) valuation, including the unmatched trade details leading to the valuation break
- l) MTM currency
- m) MTM date



Monetary Authority of Singapore