

RESPONSE TO FEEDBACK RECEIVED

December 2016

Response to Feedback Received – Policy Consultation on Margin Requirements for Non- Centrally Cleared OTC Derivatives Contracts

MAS

Monetary Authority of Singapore

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1 Preface

1.1 On 1 October 2015, MAS issued a consultation paper on proposals to implement margin requirements for non-centrally cleared over-the-counter (“OTC”) derivatives contracts (“uncleared derivatives contracts”).¹ Margin requirements reduce counterparty credit risk from uncleared derivatives contracts and form part of the broader global reforms to make the trading of OTC derivatives safer.

1.2 The consultation period closed on 1 Nov 2015, and MAS would like to thank all respondents for their contributions. The list of respondents is in Appendix A and the full submissions are provided in Annex B².

1.3 The final Guidelines on Margin Requirements for Non-centrally Cleared OTC Derivatives Contracts (“Guidelines”) can be accessed via the following link:

- <http://www.mas.gov.sg/Regulations-and-Financial-Stability/Regulations-Guidance-and-Licensing/Securities-Futures-and-Funds-Management/Guidelines/2016/Guidelines-on-Margin-Requirements-for-NonCentrally-Cleared-OTC-Derivatives-Contracts.aspx>

1.4 The Guidelines incorporates feedback where MAS is in agreement with. Comments that are of wider interest, together with MAS’ responses, are set out below.

2 Product Scope

2.1 MAS sought views on the proposal to subject all OTC derivatives contracts that are not centrally cleared by a qualifying central counterparty (“QCCP”), except for physically-settled foreign-exchange (“FX”) forwards and swaps, to margin requirements.

(a) Definition of Non-Centrally Cleared OTC Derivatives

2.2 Respondents were generally supportive of the proposed product scope, but some viewed that excluding only OTC derivatives contracts cleared on a QCCP would be inconsistent with the margin rules of other jurisdictions that excluded OTC derivatives contracts cleared on any CCP.

2.3 Some respondents sought clarification on the definition of OTC derivatives contracts, such as whether equity options and forwards, and physically settled commodity

¹ The consultation paper can be accessed [here](#).

² Some names and submissions are omitted on request of confidentiality by the respondents.

derivatives would be caught within the definition and hence subject to margin requirements. A few respondents requested for further clarity on the treatment of cross-currency swaps and non-deliverable FX forwards (“NDFs”).

MAS’ Response

2.4 MAS notes that internationally, other jurisdictions have excluded OTC derivatives contracts cleared on any CCP from margin requirements. MAS also recognises that there are existing safeguards in place, such as higher risk charges on exposures to non-QCCPs under the MAS regulatory capital requirements for banks and merchant banks, that encourage MAS Covered Entities to appropriately manage their risk exposure to non-QCCPs. As such, we will remove the proposed QCCP requirement and exclude all OTC derivatives contracts cleared on any CCP from the margin requirements.

2.5 The definition of “derivatives contract” in section 2 of the Securities and Futures Act (“SFA”) applies to the Guidelines. Derivatives such as equity options and forwards which are “securities” under the SFA therefore do not fall within the definition of “derivatives contract”.³ MAS notes that some jurisdictions provide transitional arrangements to exempt equity options and forwards from margin requirements. While MAS has proposed legislative amendments to the SFA, including changes to the definitions of “securities” and “derivatives contract”, MAS will monitor developments in other jurisdictions and consider changes to the scope of “derivatives contract” in the Guidelines as necessary.

2.6 MAS understands that commodity derivatives contracts are commonly entered into for the purpose of fulfilling the day to day needs of business operations, such as entering into advance purchase schedules of raw materials for a manufacturing business. MAS has clarified in the Guidelines that such commodity derivatives contracts are excluded from margin requirements.

³ The public consultation and MAS’ response to the feedback received can be found [here](#). The Amendment Bill was moved in Parliament on 7 Nov 2016.

2.7 Consistent with the BCBS-IOSCO framework and other major jurisdictions, MAS has clarified in the Guidelines that physically settled FX forwards and swaps and fixed physically settled FX transactions associated with the exchange of principal of cross-currency swaps will be excluded from margin requirements. For the avoidance of doubt, all other risk components of the cross currency swap will still need to be subject to margin requirements.

(b) Treatment of Contracts Arising from Non-Material Amendments and Risk-Reducing Actions

2.8 Some respondents requested for new contracts arising from non-material amendments of uncleared derivatives contracts entered into before the commencement of margin requirements (“legacy trades”) or new contracts resulting from the novation or portfolio compression of legacy trades to be excluded from margin requirements.

MAS’ Response

2.9 We generally agree with the feedback that genuine amendments to legacy trades should be excluded from margin requirements and has clarified accordingly in the Guidelines. These include, for example, new transactions arising from portfolio compression (or other post-trade risk mitigation actions) of legacy trades. However, new transactions resulting from portfolio compression (or post-trade risk mitigation actions) of a mixed set of both legacy and post-margin transactions would not be considered as legacy trades, and hence subject to margin requirements. The application of margin requirements to novated trades should be considered in the context of the counterparty a trade is novated to e.g. whether it is intended for central clearing.

3 Entity Scope

3.1 MAS sought views on the proposals to adopt a phased approach to the implementation of margin requirements, on MAS licensed financial institutions (“FIs”) for uncleared derivatives contracts booked in Singapore, as well as the application of exemption thresholds on MAS Covered Entities.

(a) Entities Subject to Margin Requirements

3.2 Respondents were generally supportive for MAS to commence margin requirements starting with banks and merchant banks. Some respondents commented that the margin requirements should be implemented in a proportionate manner, taking into account the stages of market developments in this region. In addition, while the majority of respondents were supportive of the application of exclusion thresholds to non-bank FIs, some respondents cautioned that expanding the exclusion to smaller banks and merchant banks may create an unlevel playing field.

MAS' Response

3.3 MAS agrees that implementation of margin requirements should be proportionate, and hence the phased approach for banks and merchant banks, the application of margin requirements to trades booked in Singapore, and the exclusion of non-bank FIs from margin requirements for now. MAS continues to maintain oversight through consolidated supervision of local financial groups and will periodically review, as appropriate, the scope of entities that should be subject to margin requirements.

(b) Margin Requirements on Investment Funds

3.4 Respondents had differing views on how margin requirements should be imposed on investment funds. Some respondents felt that the obligation to ensure compliance with margin requirements should be placed on the fund manager, while others thought that the trustee to the fund was in a better position to administer the exchange of margins.

MAS' Response

3.5 MAS will review the phase-in of margin requirements for non-bank FIs including investment funds at a later stage and will consult on proposals to subject non-bank FIs to margin requirements accordingly.

4 Margin Obligations

4.1 MAS sought views on whether margin requirements should be imposed on a post-and-collect basis or a collect-only basis. Feedback was also sought on the proposed timing for settlement of margins as well as the various proposed thresholds – initial margin (IM) phase-in thresholds.

(a) “Post-and collect” vs “Collect-only” Requirements

4.2 A large number of respondents preferred the collect-only requirement as it was seen to address concerns relating to duplicative and/or conflicting margin requirements that may arise for cross-border transactions, and avoid risks associated with posting margins to counterparties in non-netting jurisdictions. Other respondents supported the “post-and-collect” requirement primarily because this approach would promote global consistency.

MAS’ Response

4.3 In view of the approach by major jurisdictions, MAS will adopt a “post-and-collect” requirement. MAS will also put in place measures to address concerns regarding the application to cross-border transactions separately that have been highlighted (see Section 9).

(b) Settlement period for margins exchange

4.4 Several respondents highlighted the operational challenges of exchanging margins within two business days due to the global nature of derivatives trading, and requested for a longer settlement period for margins to be exchanged.

MAS’ Response

4.5 In view of operational challenges, MAS agrees that margins can be exchanged within the standard settlement cycle for the relevant collateral type, but no later than three business days from the trade date or from the date of margins recalculation.

5 Margin Calculations and Methodologies

5.1 MAS sought views on the proposed framework for IM calculations and related requirements, such as the frequency of calculation, recalibration and back-testing of the IM model.

(a) Initial Margin: Model agreement and approval process

5.2 Several respondents requested for a simplification of the model approval process, by suggesting that a notification to MAS would be sufficient for the use of internal models and third party vendor models. A few also highlighted the administrative burden of the requirement for two counterparties to agree on the specific margin calculation method, the quantitative model to be used, the calibration data and the parameters for calculating IM.

MAS’ Response

5.3 Financial institutions supervised by MAS are all expected to establish a comprehensive risk management framework and adopt the practices set out in the Risk Management Guidelines. In relation to the use of IM models, we agree with the feedback that notification to MAS is sufficient and have clarified in the Guidelines accordingly. However, we continue to expect that MAS Covered Entities agree with counterparties on the margin method and model details prior to execution of transactions. This is important to avoid subsequent disputes.

(b) Initial Margin: Recalibration, Recalculation and Stress-Testing

5.4 Several respondents highlighted that a semi-annual recalibration of the IM model was too regular, and was stricter than other jurisdictions' proposed rules. A few respondents noted that a recalculation every 10 days was an operational challenge. Some respondents also requested that MAS drop the requirement to perform stress testing, as it would be stricter than what was required in the BCBS-IOSCO framework.

MAS' Response

5.5 In consideration of the operational demands highlighted by respondents, MAS has made the following clarifications in the Guidelines:

- (a) that MAS Covered Entities should have policies to cater for circumstances that necessitate recalibration of the IM model, such as in response to changing market conditions, and at the minimum recalibrate at least annually;
- (b) in evaluating the robustness of its IM quantitative models, MAS Covered Entities should assess the necessity of conducting additional stress tests.

5.6 Nevertheless, MAS views that a recalculation should be performed at least every 10 business days to ensure that the amount of IM exchanged remains commensurate with changes in measured potential future exposures. This is consistent with the practice in other jurisdictions.

(c) Broad Product Set for Margin Calculation

5.7 Respondents requested for flexibility in using a product set that is broader than the minimum product set subject to margin requirements under the Guidelines so as to facilitate their margin calculations with respect to cross-border uncleared derivatives contracts.

MAS' Response

5.8 MAS Covered Entities may include a broader product set for margining as long as the product set is able to comply with the margin requirements set out in the Guidelines.

In particular, the determination of the broader product set must be on a consistent basis and be subject to the same legally enforceable netting agreement.

6 Eligible Collateral and Haircuts

6.1 MAS sought views on the proposed range of eligible collateral and corresponding schedule-based haircuts to be applied to assets used for exchange of margins, and the haircut for FX mismatch.

(a) Scope of Eligible Collateral

6.2 Some respondents suggested expanding the scope of eligible collateral, while other respondents raised concerns about the liquidity of certain forms of non-cash collateral such as equities and lower quality debt securities. In respect of equity securities, one respondent suggested expanding the scope of eligible equity securities to include equities on main indices of exchanges beyond Group A exchanges. Clarification was also sought on the interpretation of “main index”.

6.3 Some respondents were of the view that it should not be mandatory for MAS Covered Entities to accept all instruments prescribed within the scope of eligible collateral for margining purposes.

MAS’ Response

6.4 MAS agrees with the feedback raised by respondents, and has made appropriate amendments to the Guidelines, in particular, to include collective investment schemes that invest only in instruments that qualify as eligible collateral, and to expand the scope of eligible equity securities to those listed on a main stock index of a regulated exchange. The Guidelines also explains the liquidity considerations for assessing if a stock index qualifies as a main stock index.

6.5 MAS agrees that it is not mandatory for MAS Covered Entities to accept all instruments prescribed within the scope of eligible collateral for margining purposes. MAS Covered Entities retain the discretion to exchange specific types of collateral within the scope of eligible collateral for margining purposes, subject to bilateral agreement between both counterparties.

(b) Use of Quantitative Haircut Models

6.6 Some respondents suggested the use of internal or third-party quantitative haircut models in determining applicable collateral haircuts.

MAS’ Response

6.7 MAS takes the view that the use of standardised schedule-based haircuts is most appropriate, as such haircuts are transparent and appropriately conservative to account for the potential volatility in the market value of collateral exchanged for margin purposes.

7 Treatment of Collateral

7.1 MAS sought comments on the proposed safe-keeping of IM collateral, including the need for collateral arrangements to be reviewed periodically with updated legal opinions to ensure that the arrangements continue to be legally enforceable.

(a) Availability of Initial Margin

7.2 Some respondents suggested that MAS require that IM collected be made available in a “timely manner” or within a “reasonable time frame” in the event of the posting party’s default.

MAS’ Response

7.3 MAS’ policy intent is that MAS Covered Entities should ensure that IM collected is available to the collecting party as soon as legally possible under the applicable laws in the event of the posting party’s default. We have clarified this in the Guidelines.

(b) Re-Hypothecation, Re-Pledge and Re-Use of Collateral

7.4 Respondents were mixed in their feedback on the proposal to permit a one-time re-hypothecation of non-cash IM collateral. Some respondents expressed implementation challenges, including the bans on the use of re-hypothecation in other jurisdictions, for not supporting this proposal. Other respondents cited the benefit of improved liquidity for supporting the proposal but acknowledged the implementation challenges and that the improvements on liquidity could be limited.

MAS’ Response

7.5 MAS notes the mixed feedback on this issue. To accord MAS Covered Entities the flexibility to determine the use of re-hypothecation based on their commercial considerations and operational capacity, MAS will retain our proposal to allow a one-time re-hypothecation of non-cash IM collateral, subject to meeting the requisite conditions. However, MAS will limit the use of one-time re-hypothecation to non-cash margins of buy-side financial firms or non-financial entities as set out by the BCBS-IOSCO framework.

8 Treatment of Intra-Group Transactions

8.1 MAS sought feedback on the proposal that intra-group transactions within the same consolidation group may be exempted from margin requirements, subject to the condition that the MAS Covered Entity comes under group-wide supervision by MAS or regulators in other jurisdictions.

8.2 While respondents were supportive of the proposal to exempt intra-group transactions, they requested for MAS to provide guidance on the application process for such exemptions. A number of the respondents also suggested that MAS remove the need to seek approval for such exemptions, as they felt it was unnecessary and administratively cumbersome.

MAS' Response

8.3 MAS has reviewed the feedback and will remove the requirement for MAS Covered Entities to seek MAS approval for intra-group exemptions. However, MAS will retain the condition that the exemption is only limited to transactions between MAS Covered Entities and entities that are fully accounted for in the consolidated financial statements of the holding company of the group of companies to which they belong (i.e. within the meaning of a consolidation group of the Singapore Financial Reporting Standards FRS 110: Consolidated Financial Statements or its equivalent accounting standards).

9 Treatment of Cross-Border Transactions

9.1 MAS sought views on the proposed treatment of cross-border transactions and the adoption of a deemed compliance approach.

(a) Transactions Involving Non-Netting Jurisdictions or Non-Enforceability of Safe-Keeping Arrangement for IM

9.2 The majority of respondents expressed concern over the treatment of transactions involving counterparties from non-netting jurisdictions or where the safe-keeping arrangement is questionable or non-enforceable. They commented that without enforceable netting or collateral safe-keeping arrangements there is a risk that the administrator of an insolvent counterparty may "cherry-pick" from the posted collateral to be returned in the event of insolvency or that an MAS Covered Entity may not be able to effectively foreclose on the margins in the event of a counterparty default.

MAS' Response

9.3 MAS notes respondents' concerns on imposing margin requirements on uncleared derivatives contracts where enforceability of the netting agreements or collateral arrangements are questionable. Posting margins to counterparties under such circumstances may lead to adverse outcomes. Instead, MAS would adopt a pragmatic approach by requiring that MAS Covered Entities manage the risk exposure to such counterparties through the adoption of appropriate risk management practices, for example by setting limits on exposure to such counterparties. In addition, uncollateralised or unmarginated exposures will be subject to higher risk charges under the MAS Capital Requirements for banks and merchant banks.

(b) Process for Comparability Assessment

9.4 Respondents were supportive of MAS' proposed outcomes-based approach in making our comparability assessment. However, they sought clarifications on the assessment criteria, application procedures and the expected timeline. Respondents also requested that MAS publish the list of jurisdictions whose margin requirements are assessed to be comparable with the Guidelines.

MAS' Response

9.5 Foreign margin requirements that are consistent with the BCBS-IOSCO framework would generally be assessed to be comparable. MAS is currently of the view that compliance with the margin requirements implemented by the BCBS-IOSCO Working Group on Margin Requirements member jurisdictions⁴ are comparable and deemed to be in compliance with the Guidelines. MAS intends to enter into comparability assessment discussions with other regulators in due course.

⁴ These jurisdictions are: Australia, Canada, the European Union, Hong Kong, India, Japan, Republic of Korea, Mexico, Russia, Singapore, Switzerland, and the United States.

10 Implementation Schedule

10.1 MAS sought views on the proposed phase-in schedule and transitional arrangements for margin requirements to apply to MAS Covered Entities. Respondents were supportive of the proposed provision of a 6-month transition period to allow MAS Covered Entities to address operational or teething issues in implementing the new regime. However, they sought clarification on MAS' expectations on MAS Covered Entities during the transition period. In particular, respondents sought confirmation on whether the Guidelines would retrospectively apply to new uncleared derivatives transactions entered into during the transition period.

MAS' Response

10.2 A 6-month transition period will apply from the commencement of the Guidelines (i.e. 1 March 2017), during which MAS Covered Entities will be expected to make progress to meet the Guidelines as soon as practicable. As and when the necessary documentation and arrangements with respect to a counterparty are in place during that period, MAS Covered Entities should start exchanging margins for contracts entered into with that counterparty from that point on. MAS will closely monitor the MAS Covered Entities' progress during this transitional period.

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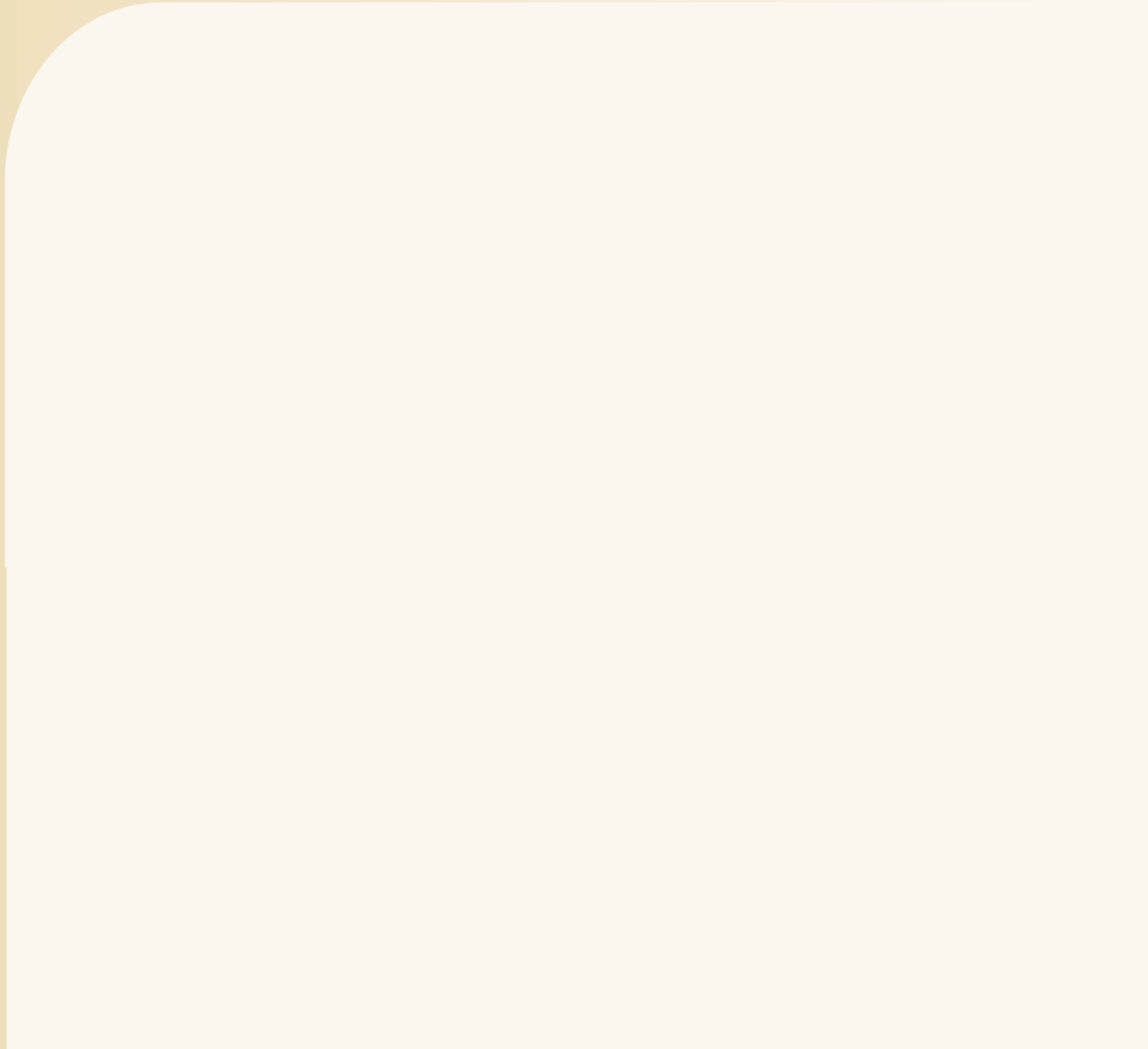
6 December 2016

**LIST OF RESPONDENTS TO THE POLICY CONSULTATION ON
MARGIN REQUIREMENTS FOR NON-CENTRALLY CLEARED OTC DERIVATIVES**

1. Aberdeen Asset Management Asia Ltd.
2. The Alternative Investment Management Association
3. Bank Julius Baer & Co. Ltd., Singapore Branch
4. BNP Paribas Trust Services Singapore Limited
5. The Bank of Tokyo-Mitsubishi UFJ, Ltd., Singapore Branch
6. Citigroup
7. CME Group Inc.
8. Credit Suisse AG
9. DBS Bank Ltd.; and DBS Trustee Ltd.
10. Deutsche Bank Ag
11. DNB Bank ASA, Singapore Branch
12. The Global Foreign Exchange Division of the Global Financial Markets Association
13. ICI Global
14. IG Asia Pte. Ltd.
15. Investment Management Association of Singapore
16. The International Swaps and Derivatives Association Inc.; and Asia Securities Industry & Financial Markets Association
17. Japanese Bankers Association
18. J Low Law Corporation
19. KPMG Services Pte. Ltd.
20. LCH.Clearent Group Ltd.
21. Markit
22. Malaysian Banking Berhad, Singapore Branch
23. Mizuho Bank, Ltd.
24. Moody's Investors Service Singapore Pte. Ltd.

25. NetOTC Services Ltd.
26. OCBC Bank
27. Philip Futures Pte. Ltd.; and Philip Securities Pte. Ltd.
28. Schroder Investment Management (Singapore) Ltd.
29. Standard Chartered Bank
30. WongPartnership LLP
31. Respondent A who requested for confidentiality of identity
32. Respondent B who requested for confidentiality of identity
33. Respondent C who requested for confidentiality of identity
34. Respondent D who requested for confidentiality of identity and submission
35. Respondent E who requested for confidentiality of identity and submission
36. Respondent F who requested for confidentiality of identity and submission
37. Respondent G who requested for confidentiality of identity and submission
38. Respondent H who requested for confidentiality of identity and submission
39. Respondent I who requested for confidentiality of identity and submission
40. Respondent J who requested for confidentiality of identity and submission
41. Respondent K who requested for confidentiality of identity and submission
42. Respondent L who requested for confidentiality of identity and submission
43. Respondent M who requested for confidentiality of identity and submission
44. Respondent N who requested for confidentiality of identity and submission

Please refer to Annex B for the submissions.



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