CONSULTATION PAPER

P009 - 2020

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Proposed Amendments to the Capital Requirements for Locally Incorporated Recognised Market Operators

Monetary Authority of Singapore

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1 Preface

1.1 The Monetary Authority of Singapore ("MAS") sets out in this consultation paper the proposed capital requirements to be imposed on locally incorporated Recognised Market Operators ("RMOs").

1.2 MAS invites interested parties to provide their comments and feedback.

Please note that all submissions received will be published and attributed to the respective respondents unless they expressly request MAS not to do so. As such, if respondents would like their whole submission or part of it (but not their identity), or their identity along with their whole submission, to be kept confidential, please expressly state so in the submission to MAS. MAS will only publish non-anonymous submissions. In addition, MAS reserves the right not to publish any submission received where MAS considers it not in the public interest to do so, such as where the submission appears to be libellous or offensive.

1.3 Please submit written comments by **4 December 2020** to –

Markets & Infrastructure Supervision Division

Markets Policy & Infrastructure Department

Monetary Authority of Singapore

10 Shenton Way, MAS Building

Singapore 079117

Email: RMO_mailbox@mas.gov.sg.

1.4 Electronic submission is encouraged. We would appreciate that you use this format for your submission to ease our collation efforts.

2 Introduction

2.1 The primary regulated function of a market operator is to operate organised markets in a fair, orderly and transparent manner. This includes promoting price discovery through the linking up of sellers of financial products with buyers. Market operators typically do not take on counterparty risk as they do not guarantee trades and are not themselves a party to the trade. Neither do they hold customer monies. Accordingly, market operators such as RMOs typically pose little financial risk to other entities in the financial system. In the case of RMOs, given that their clientele is generally limited to financial institutions regulated by MAS, governmental entities, accredited investors and expert investors, and they are not permitted to serve retail customers, there is also little impact on the general public.

2.2 **The key risk posed by an RMO to the financial system is operational risk** – the risk that the RMO is unable to continue operating its organised markets, leaving participants of the RMO with the need to find alternative trading venues. The main objective of imposing capital requirements on RMOs therefore is to provide sufficient resources for the RMO to wind down its operations in an orderly fashion and provide time for participants to switch to alternative trading platforms.[1]

2.3 Since 2005 when capital requirements for RMOs were first introduced, there is now greater diversity in the entities that are seeking an RMO recognition. First, over-the-counter-derivatives ("OTCD") trading venues will now be regulated as organised markets, whereas the previous licensing regime for market operators was for exchange-listed products. Second, with the FinTech revolution, more start-ups are seeking to become RMOs, whereas in the past, typically only well-established players with a track record of operating markets (e.g. in other jurisdictions) would apply for a RMO recognition.

2.4 It is thus timely to review if the capital requirements imposed on RMOs continue to be appropriate for these new market operators, in addition to addressing the key risk that RMOs pose, and being comparable to the capital standards of international jurisdictions[2].

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[1] This is unlike financial institutions which pose prudential risks to their customers, for which capital requirements should also have an element to increase the prudential safety of the financial institutions for them to continue as going concerns.

[2] Given the cross-border nature of OTCD trading, it is important that participants from different jurisdictions continue to be able to trade with one another. Foreign regulators such as US Commodity and Futures Trading Commission and European Commission permit such cross-border trading where the overseas markets are regulated under a regime assessed to be achieving comparable regulatory outcomes with those in the US and EU regimes respectively.

3 Proposed Capital Requirements for Locally Incorporated Recognised Market Operators

Current Capital Requirements

3.1 Currently, RMOs hold financial resources that are at least the highest of (i) 18% of their annual operating revenue, (ii) 50% of their annual operating costs, and (iii) $500,000.

3.2 Financial resources presently comprise equity with deductions for illiquid assets (e.g. assets not convertible to cash within 30 days). There are also deductions for assets that are unlikely to be realisable on insolvency. These range from those that are extremely unlikely to be realisable (e.g. goodwill) to those that, while possible to be realised, are still at risk (e.g. unsecured loans and advances).

3.3 The current requirements thus seek to address (i) liquidity needs via the deductions for illiquid assets and (ii) solvency concerns by requiring equity (i.e. the amount of assets in excess of liabilities) to be above certain thresholds.

Proposed Introduction of a Liquidity Requirement

3.4 As mentioned above, the key risk that an RMO poses is that should it be wound down, its participants will need to search for an alternative trading venue and undergo the on-boarding process at the new venue. Capital requirements for RMOs should therefore be designed to give comfort that market operators have sufficient liquid assets to continue operations while their participants find alternative trading venues to trade on.

3.5 There are currently no direct liquidity requirements imposed on RMOs. While liquidity risk is addressed indirectly in the current capital requirements through the deduction from financial resources of assets not convertible to cash within 30 days, financial resources could still include components that are not available for immediate use to sustain their operations.

3.6 **MAS therefore proposes to introduce a direct liquidity requirement, which requires RMOs to hold cash and cash equivalents of at least 25% of their annual operating costs**. By requiring RMOs to hold liquid assets to cover operating costs for approximately three months, participants will have the time to source for and switch to alternative trading venues. Such an approach is similar to the approach in reputable international jurisdictions.

Question 1.	MAS seeks comments on the proposed introduction of a liquidity requirement.

Proposed Recalibration of the Solvency Requirement

3.7 Although RMOs pose little financial risks to their participants, we believe that a baseline solvency requirement is still necessary as a hygiene factor as market participants would generally want to deal with solvent (rather than insolvent) entities.

3.8 However, given that solvency is not a key area of concern, we believe that the current solvency requirement can be calibrated downwards. We therefore propose a revised solvency requirement for RMOs to hold eligible capital[3] of at least the higher of (i) 25% of their annual operating costs, or (ii) $250,000. The proposed recalibrated requirement is comparable to those in international jurisdictions.

3.9 As a separate liquidity requirement is proposed to be introduced, there is no need to deduct illiquid assets from eligible capital. Further, as RMOs pose little financial risks to their participants, we will confine the deductions from eligible capital only to assets that are more unlikely to be realisable upon insolvency of the RMO (e.g. prepaid expenses).

Question 2.	MAS seeks comments on the proposed recalibration of the solvency requirement.

[3] Eligible capital comprises equity, with deductions as set out in Annex B.

Improving Transparency of the Capital Requirements

3.10 To improve the transparency of the capital requirements for current and future entrants, MAS intends to issue a Notice which sets out details of the new capital requirements for RMOs instead of the current approach of imposing capital requirements via recognition conditions. The draft Notice is appended to this consultation paper in Annex B.

Question 3.	MAS seeks comments on the draft Notice in Annex B.

Annex A

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Question 2. MAS seeks comments on the proposed recalibration of the solvency requirement. 6

Question 3. MAS seeks comments on the draft Notice in Annex B. 7

Monetary Authority of Singapore