**Monetary Authority of Singapore**
10 Shenton Way MAS Building Singapore 079117 Telephone 65 6225 5577 Facsimile 65 6229 9229

Circular No: CMI 04/2020

18 February 2020

To: All holders of a capital markets services licence to deal in capital markets products that are securities and/or units in a collective investment scheme; and
All exempt financial institutions dealing in capital markets products that are securities and/or units in a collective investment scheme

# GOOD PRACTICES IN MANAGING CUSTOMERS' CREDIT RISKS

Contra trading[1] involves the trading of listed securities on unsecured credit by investors. The availability of contra trading may encourage speculative trading and increase the risks of investors taking on unhealthy levels of leverage. In the event of a sharp price movement or market downturn, investors with large contra exposures may incur significant losses, which they may not be able to bear. This could in turn lead to contagion risks to remisiers (where the investors are serviced by remisiers) and eventually the financial institutions which the investors trade through.

2 MAS notes that contra trading activities by retail investors have fallen over the past few years. MAS would however like to remind financial institutions of the importance of robust credit risk management. Financial institutions should continue to be vigilant and implement strong controls to address the credit risks arising from customers' or remisiers' trading activities. This circular outlines MAS' expectations in this regard.

## Credit Risk Management Policies and Processes

3 Financial institutions should establish, formalise and implement robust credit risk management policies and procedures to manage customers' and remisiers' credit risks. These include instituting appropriate pre-trade credit risk controls, and performing continual monitoring and periodic stress testing. Financial institutions should consider their ability (e.g. available capital resources, financial position) to withstand losses in setting their risk policies and limits. Financial

---

[1] Contra trading refers to the trading practice where:
(a) Customers do not have to put up any collateral for their trades;
(b) A buy transaction on trade day T is offset by a sale transaction of the same security within the settlement cycle of *T+2*, or vice versa; and
(c) The offsetting trades are settled on a net basis.

institutions should also ensure that their credit risk management functions are segregated from other functions which might pose potential conflicts of interest, such as the front office function[2].

## Pre-Trade Credit Risk Controls

4 Pre-trade credit risk controls may include, but are not limited to, the following:

(i) Setting appropriate trading limits for customers based on their creditworthiness. In cases where a customer has more than one trading account, the trading limit should be set at the customer (rather than account) level. A customer's creditworthiness should be based on clearly-defined measures, which may include but are not limited to the following:
- Employment status;
- Income level;
- Net worth;
- Liquid assets;
- Trading history/pattern (e.g. active contra trading, type of stocks traded, for instance, penny stocks versus blue chips);
- Payment (including default) history;
- Collateral placed with the financial institution, if any; and
- Customer relationship (e.g. walk-in customers may be granted a lower trading limit);

(ii) Setting appropriate trading limits for remisiers for financial institutions that hold remisiers liable for the losses incurred by their customers. A remisier's creditworthiness should be based on clearly-defined measures, which may include but are not limited to the following:
- Income;
- Net Worth;
- Liquid assets;
- Trading and payment history/pattern of the remisier's customers, including the level of customers' bad and doubtful debts;
- Total trading limits granted to the remisier's customers;
- Trading and payment history/pattern of the remisier, where the remisier is also trading for himself; and
- Collateral placed with the financial institution;

(iii) Setting appropriate trading limits on high-risk stocks, where appropriate, to reduce concentration risk for customers/remisiers trading in such stocks;

(iv) Setting aggregate trading limits for customers/remisers who have more than one trading account to ensure that the customers/remisiers' overall exposures are capped;

[2] This includes the front office function which is responsible for recruiting and retaining remisiers.

(v) Instituting proper processes to review and approve customers/remisiers' trading limits, including requests from customers/remisiers for adjustments to their limits. In approving temporary or permanent increases in trading limits, financial institutions should consider factors such as the purpose of the requests for increase, whether the customers/remisiers have any outstanding positions, or any outstanding or overdue trading losses, length of time for any temporary increase in limit, as well as the factors in sub-paragraph (i) or (ii); and

(vi) Requiring pre-funding or collateral (e.g. cash, liquid securities), where appropriate (e.g. for higher-risk accounts, accounts with high limits or trading activities).

5 Financial institutions should not allow any customer of a remisier to execute new trades if the remisier has fully utilised his trading limit, even if the customer's own trading limit has not been fully utilised. The bases for approval of all trading limits (including any increases in trading limits) should be properly documented.

**On-going Monitoring and Periodic Reviews**

6 Financial institutions should monitor their exposures to customers and remisiers continually (e.g. through daily, monthly reports) and identify higher-risk customers, remisers or accounts for further review and action. The monitoring of exposures to remisiers should include exposures to the remisers' customers. Examples of useful monitoring indicators include amounts and ageing of receivables (including contra losses) from customers/remisiers, customers/remisiers/accounts with high limit utilisation and customers/remisiers/accounts with frequent requests for temporary limit increases.

7 Financial institutions should also review the limits granted to customers and remisiers periodically and assess if the limits remain appropriate in light of their experience with the customers or remisiers, or other changes in the customers' or remisiers' creditworthiness.

8 Financial institutions should perform stress testing periodically. Financial institutions should simulate stress conditions or scenarios which they could encounter (e.g. economic or industry crises, sharp declines in asset and collateral values, market-risk events), estimate the range of losses they could incur in such situations, and consider if adjustments to their credit policies or processes are necessary.