

RESPONSE TO FEEDBACK RECEIVED – CONSULTATION ON POLICY REFORMS ON REGULATION OF OTC DERIVATIVES

1 Introduction

1.1 On 13 February 2012, MAS issued the Consultation Paper on Proposed Regulation of OTC Derivatives (“Consultation Paper”) inviting comments on proposals relating to the regulation of over-the-counter (“OTC”) derivatives. The consultation closed on 9 April 2012.

1.2 MAS has carefully reviewed and considered the feedback received. We issued earlier responses to other proposals within the Consultation Paper in 2012.¹ This set of responses by MAS addresses feedback on remaining proposals within the Consultation Paper:

- (a) Section 2 – Proposal for expanding the scope of the SFA to regulate OTC derivatives;
- (b) Section 5 – Trading mandate;
- (c) Section 6 – Proposal for the regulatory framework for market operators; and
- (d) Section 9 – Proposal for the regulatory framework for capital markets intermediaries.

1.3 Comments which are of wider interest, together with MAS’ responses are highlighted below. MAS will continue to monitor developments in areas where international consensus is pending. We will take guidance from international standards where appropriate, and will consult again on these areas at a later stage.

1.4 The Annex lists the respondents who provided feedback on the above proposals. We thank all respondents for their comments.

¹ 23 May 2012 Response to Consultation on policy reforms on regulation of OTC Derivatives and 3 Aug 2012 Response to Consultation on policy reforms on regulation of OTC derivatives Part 2.

2 COMMENTS ON CONSULTATION PAPER SECTION 2: PROPOSAL FOR EXPANDING THE SCOPE OF THE SFA TO REGULATE OTC DERIVATIVES

A Expansion of Scope to Cover Derivative Contracts on Commodities, Credit, Equities, Foreign Exchange and Interest Rates

2.1 Most respondents agreed with the proposal to expand the SFA to cover derivative contracts on commodities, credit, equities, foreign exchange and interest rates. Greater clarity was requested on the scope of derivative contracts and whether specific contracts such as physically settled spot contracts with optionality features would be excluded.

MAS' Response

2.2 The scope of the SFA would be expanded to cover derivative contracts on the five asset classes. As for the scope of derivative contract, we will be excluding physically settled commodity forward contracts (including certain contracts with some form of optionality or embedded derivative) where the contracts are carried out for commercial purposes. The exclusion would be implemented via regulations and the drafting will be consulted on in due course. Please refer to the consultation on "Proposed Amendments to the Securities and Futures Act" for more details on the revised definition of "derivative contract".

3 COMMENTS ON CONSULTATION PAPER SECTION 5: TRADING MANDATE

A Implementation of Trading Mandate

3.1 Most respondents agreed that a trading mandate should not be imposed at this stage, with several respondents indicating that priority should be accorded to the implementation of mandatory reporting followed by mandatory clearing.

MAS' Response

3.2 In line with MAS' commitment to the implementation of OTC derivatives reforms, MAS agrees that the appropriateness of imposing a trading mandate should be studied carefully. MAS has assessed that it is not necessary to mandate a trading regime for OTC derivatives for now.

3.3 In the meantime, MAS intends to put in place the necessary legislative framework to implement a trading mandate. This will accord flexibility for MAS to be able to effect the trading mandate in a timely manner, if and when the appropriate conditions are in place. Recognising the impact any eventual proposal to implement a trading mandate could have on the industry, MAS will conduct the necessary detailed analysis and consultation with the industry before introducing a trading mandate.

B Costs and Benefits of Introducing a Trading Mandate

3.4 While some respondents noted that there would be benefits to the proposed trading mandate, the majority of respondents expressed concerns that the costs outweighed the benefits at this stage.

3.5 Several respondents were of the view that introducing a trading mandate would reduce liquidity if there were insufficient market participants or if contracts were not suitable for trading on an organised trading platform. Some respondents also indicated that the introduction of a trading mandate would reduce risk management capabilities as investors might have different risks such as non-standard maturity dates or trade sizes.

3.5 A few respondents commented that it was difficult to ascertain the benefits and costs of the trading mandate at this initial stage, and requested for further consultations to be conducted when there was more

clarity and consistency globally over the trading of derivative contracts on organised platforms.

MAS' Response

3.6 MAS agrees that a detailed study is required to determine the appropriate conditions for imposing a trading mandate. As mentioned in paragraph 3.3, we will consult the public further on any proposal to identify products for mandatory trading.

4 COMMENTS ON CONSULTATION PAPER SECTION 6: PROPOSALS FOR THE REGULATORY FRAMEWORK FOR MARKET OPERATORS

A Definition of “Derivative Market”

4.1 The majority of respondents supported the proposed scope of the definition of a “derivative market”.

4.2 Some respondents requested clarification on whether bulletin boards and independent software vendors (“ISVs”) of trading platforms would be considered market operators under the new regime, while one respondent sought clarification on whether firms providing quotes to potential counterparties for the purpose of transacting would be considered a “derivative market”. Another respondent opined that only platforms where trade execution took place should be regulated; platforms that merely facilitate trades, but where the trades are concluded outside the platform, should not be regulated.

4.3 One respondent was concerned about regulatory arbitrage if execution were to be allowed on single-dealer platforms in Singapore, as derivatives execution was required to take place on multilateral platforms under US and EU proposals.

4.4 Two respondents requested that any regulatory regime for derivatives be consistent with rules adopted in other key jurisdictions, such as the US and the EU. One respondent requested that markets which were not previously subject to regulation should be given a reasonable time frame to comply with the proposed derivative market regime.

MAS’ Response

4.5 To extend the existing definition of markets to trading platforms that facilitate the execution of derivative contracts, MAS will be introducing a new definition of “organised market”. The new definition will recognise the underlying function of facilitating the exchange, sale or purchase of all types of capital markets products as regulated under the SFA. This will replace the existing definitions of “securities market” and “futures market”, and will also include markets for the trading of derivative contracts.

4.6 Entities providing quotes to potential counterparties on a “one-to-many” basis will not be considered as “organised markets”. ISVs are also not intended to fall within the definition of organised markets. However, bulletin boards perform a price discovery function by facilitating the interaction of bids and offers of market makers. Where buyers and sellers can reasonably expect to transact based on information posted on a bulletin board, MAS considers such bulletin boards to fall within the definition of “organised market”.

4.7 In implementing the regime for “organised markets”, MAS will provide a reasonable transition period for entities to make any changes needed to comply with the new regulatory framework.

B Extension of Two-Tier Regime to Derivative Market Operators

4.8 The majority of respondents were supportive of the proposal to apply the current two-tier regime, where operators of systemically-important markets were regulated as approved exchanges and those of other markets as recognised market operators (“RMOs”), to derivative market operators. However, two respondents opined that derivative contracts were unique and a separate regulatory regime should be considered. One respondent asked if existing recognised market operators (“RMO”) offering derivative contracts would have to seek authorisation to continue doing so, and if so, whether transition time would be provided.

MAS’ Response

4.9 MAS will extend the existing two-tier regime for market operators to derivative market operators. However, we note that there may be some differences in the operation of markets for the trading of derivative contracts from traditional securities and futures contract markets. We therefore intend to study further the need for specific requirements particular to derivative markets. MAS will consult on regulations to implement these requirements accordingly.

C Proposed Refinements of the RMO Regime for Locally-Incorporated and Overseas RMOs

4.10 Most respondents were generally supportive of the proposed refinements to subject overseas RMOs to similar additional requirements as locally-incorporated RMOs.

4.11 Several respondents were concerned about the possibility of regulatory arbitrage if local RMOs were subject to stricter requirements than overseas RMOs. A few respondents suggested that the proposed extension should level the playing field between local and overseas market operators, and that overseas market operators should demonstrate that they are subject to comparable or equivalent standards with local market operators.

4.12 Some respondents were of the view that market operators' presence in Singapore should be a factor in determining whether they have to comply with regulations. For example, market operators with no physical presence in Singapore but that offer investors in Singapore electronic access to overseas markets should not be required to obtain RMO status. Overseas RMOs that have a significant presence in Singapore should be required to be locally incorporated or recognised as an approved exchange.

4.13 One respondent asked if the minimum base capital and financial requirements could be met by either the RMO or its parent company, in the case of an overseas RMO. Another respondent suggested that MAS rely on the home regulator's requirements instead of imposing additional requirements where a home regulator imposes an equivalent or higher base capital or financial requirement than MAS.

MAS' Response

4.14 MAS is of the view that overseas market operators should be subject to similar regulatory requirements as locally incorporated market operators. When assessing an overseas applicant, MAS will consider whether the operator is, in its home jurisdiction, subject to regulatory requirements and supervision comparable to that specified under the SFA.

4.15 MAS remains of the view that market operators that target Singapore investors should be subject to the rules and requirements under the SFA. This accords investors based in Singapore protection offered under the law. Regulation of overseas market operators as RMOs helps to ensure a level playing field between local and overseas operators.

4.16 The proposed capital and financial requirements are intended only for a locally incorporated RMO entity. For overseas RMOs, MAS will assess if the respective RMOs are subject to comparable requirements under their home regulatory regimes, and place reliance on the home supervisory regime as appropriate.

5 COMMENTS ON CONSULTATION PAPER SECTION 9: REGULATORY FRAMEWORK FOR CAPITAL MARKETS INTERMEDIARIES

A Regulation of non-bank intermediaries dealing in derivative contracts

5.1 Some respondents commented that as the OTC derivatives market is largely a sophisticated and institutional market with no retail participation, there is no need for investor protection and consequently regulation. They also pointed out that the regulation of OTC derivative intermediaries is not mandated under the G20 and Financial Stability Board (“FSB”) commitments on OTC derivative reforms.

MAS’ Response

5.2 MAS will proceed with the proposal to regulate non-bank intermediaries dealing in derivative contracts as CMS licensees under the SFA. Participants are often highly interconnected through a network of transactions. The default of an intermediary in the market may result in significant counterparty losses arising from exposures to the defaulting intermediary and trigger a chain of credit-related losses which could cause significant market disruptions. Regulation of OTC derivatives intermediaries is necessary to ensure a fair and efficient market.

5.3 MAS also notes that although the G20 and FSB commitments were silent on the regulation of OTC derivatives intermediaries, the International Organization of Securities Commissions (IOSCO) had recommended that intermediaries which are in the business of dealing, making a market or intermediating transactions in OTC derivatives should be subject to registration or licensing by the relevant market authority². The regulation of OTC derivatives intermediaries will thus bring Singapore in line with the international standard and regulatory regimes for capital markets intermediaries in the major jurisdictions.

B Scope of the regulated activity of dealing in derivative contracts

5.4 Most respondents were supportive of the proposed scope of the regulated activity of dealing in derivative contracts.

² Final Report on “International Standards for Derivatives Market Intermediary Regulation” issued by IOSCO in June 2012.

5.5 One respondent requested that MAS provides greater clarity on its licensing approach for OTC derivative intermediaries. The respondent also commented that MAS, in assessing whether an applicant has an “established track record”, should not look solely at the number of years that the applicant has been in the business but should also take into consideration the experience of the management team and dealers of the company.

MAS’ Response

5.6 MAS will proceed with the proposed scope of the regulated activity in respect of dealing in derivative contracts. To address overlap in scope between dealing in derivatives with other currently regulated activities³, MAS is proposing changes to rationalise the different regulated activities. Please refer to the consultation on “Proposed Amendments to the Securities and Futures Act” for more details on the proposed scope of the dealing in derivative contracts activity and how the different regulated activities will be rationalised.

5.7 MAS would like to clarify that in assessing an application for a CMS licence, MAS considers the applicant’s ability to meet the admission criteria as well as the experience of the applicant’s management team and key officers. MAS will separately consult on the admission criteria for the granting of a CMS licence in respect of dealing in derivative contracts. Following consultation, MAS will incorporate these admission criteria into the “Guidelines on Criteria for the Grant of a Capital Markets Services Licence”.

C Licensing exemption for certain derivative brokers

5.8 Most respondents were supportive of the proposed licensing exemption for derivative brokers that do not take on any principal position, do not hold any customer’s position, margin or account in their books, and deal only with institutional investors⁴.

³ These are the regulated activities in respect of dealing in securities, trading in futures contracts and leveraged foreign exchange trading.

⁴ In the consultation paper titled “Proposals to Enhance Regulatory Safeguards for Investors in the Capital Markets” (July 2014), MAS has proposed to expand the scope of “institutional investors” to include, among others, financial institutions licensed or regulated in foreign jurisdictions. MAS has also proposed that all investors, other than institutional investors, will be treated as retail investors by default. An investor who meets the criteria for an accredited investor, will have the choice of electing for retail investor or accredited investor status, after being informed of the consequence of the reduction in regulatory safeguards associated with accredited investor status.

5.9 Several respondents suggested broadening the licensing exemption and requested MAS to consider the following:

- a) Exempt persons dealing with accredited or expert investors;
- b) Extend the current licensing exemption for persons trading in futures contracts for their own account to OTC derivatives; and
- c) Extend the current licensing exemption for persons whose trading in futures contracts is incidental to their fund management activities to OTC derivatives.

MAS' Response

Dealing with accredited or expert investors

5.10 MAS will proceed with the licensing exemption for derivative brokers that do not take on any principal position, do not hold any customer's position, margin or account in their books, and deal only with institutional investors. Taking into account the feedback received and considering that the activities of such derivative brokers do not pose significant business conduct risks, MAS has decided to extend the licensing exemption to derivative brokers who deal with accredited investors⁵ which are corporations. As for expert investors, given that MAS has proposed to remove the "expert investor"⁶ class from the SFA, we have not considered the need to broaden the exemption in relation to expert investors for now.

5.11 However, in order for MAS to maintain some oversight over these brokers and have access to information about their business, MAS will require the brokers to register with MAS upon commencement of business and provide company information (e.g. details on CEO, directors and representatives) and business information (e.g. type of OTC derivatives handled) at registration and on an on-going basis. Please refer to the consultation on "Proposed Amendments to the Securities and Futures Act" for details of the licensing exemption and conditions.

Dealing on own account

5.13 Unlike futures contracts, OTC derivatives transactions are by nature typically undertaken on a principal-to-principal basis. Having a blanket exemption for persons dealing in derivatives contracts for their own account would mean that the market continues to be unregulated

⁵ As defined under section 4A of the SFA.

⁶ As set out in MAS' Consultation Paper on Proposals to Enhance Regulatory Safeguards for Investors in the Capital Markets (July 2014).

and would not be appropriate. However, MAS is proposing to grant an exemption for persons who deal in derivative contracts for their own account if certain conditions are met. Please refer to Section D on the exemption for end-users.

Dealing incidental to fund management

5.14 MAS agrees with the suggestion to exempt a person carrying out fund management activity from having to be licensed for dealing in derivative contracts if the dealing activity is incidental to the person's fund management activity. This approach is consistent with the existing licensing exemptions that are available to a person whose dealing in securities or trading in futures contracts is incidental to the person's conduct of fund management.

D End-Users

5.15 Respondents agreed with the proposal not to regulate end-users as CMS licensees. However, the majority of the respondents were of the view that the price-taker/price-maker concept was not appropriate for the purposes of determining whether a person is an end-user. The respondents pointed out that end-users are not necessarily price takers as OTC derivatives transactions are bespoke and subject to negotiations between the counterparties.

MAS' Response

5.16 MAS agrees with the feedback and will not adopt the price-taker/price-maker concept. Instead, MAS proposes to exempt a person from licensing if the person deals for his own account in derivative contracts with a financial institution regulated for dealing in derivative contracts, whether in Singapore or elsewhere, and the person does not receive a commission or other remuneration in return. Please refer to the consultation on "Proposed Amendments to the Securities and Futures Act" for details on this and other licensing exemptions available for persons dealing in derivative contracts.

MONETARY AUTHORITY OF SINGAPORE

11 February 2015

ANNEX

LIST OF RESPONDENTS TO SECTIONS 5 AND 6 OF THE CONSULTATION ON POLICY REFORMS ON REGULATION OF OTC DERIVATIVES

1. Ashurst LLP
2. Aviva Investors Asia Pte Ltd
3. BP Singapore Pte Limited
4. Brightoil Petroleum (S'pore) Pte Ltd
5. CapitalTrack Ltd.
6. CFA Institute
7. Citibank, N.A., Singapore Branch
8. City Index Asia Pte Ltd
9. Cleartrade Exchange Pte Ltd
10. CME Group Inc
11. Ernst & Young LLP
12. European Chamber of Commerce (Singapore)
13. Financial Services Committee, European Chamber of Commerce (Singapore)
14. Ginga Petroleum (Singapore) Pte Ltd
15. Global Foreign Exchange Division (GFXD) of the Global Financial Markets Association (GFMA)
16. Great Eastern Life Assurance Co Ltd
17. ICAP AP (Singapore) Pte Ltd
18. IG Asia Pte Ltd
19. Intercontinental Exchange, Inc.
20. International Swaps and Derivatives Association, Inc.
21. LCH Clearnet Group Limited
22. Mizuho Corporate Bank, Ltd.
23. OANDA Asia Pacific Pte Ltd
24. OCBC Bank
25. Phillip Futures Pte Ltd
26. Rajah & Tann LLP
27. Schroder Investment Management (Singapore) Ltd
28. Shell Treasury Centre East (Pte) Limited
29. Singapore Mercantile Exchange
30. Singapore Money Brokers Association
31. State Street Bank and Trust Company
32. The Alternative Investment Management Association Limited – Singapore Branch
33. The Association of Banks in Singapore

34. The London Metal Exchange
35. Thomson Reuters
36. Tradition Singapore Pte Ltd
37. Westpac Institutional Bank
38. Wong Partnership LLP

* This list includes only the names of respondents who did not request that their submissions be kept confidential.