ANNEX B

REPORT OF THE EQUITY DERIVATIVES AND STRUCTURED PRODUCTS TASKFORCE

27 JUNE, 2006

SINGAPORE

INTRODUCTION

1. The Singapore Investment Banking Association ("SIBA") together with the Monetary Authority of Singapore ("MAS") have set up a taskforce to undertake a study of issues and impediments relating to the development of the equity derivatives and structured products market in Singapore ("the Taskforce"). The Taskforce comprised of three sub-committees that were responsible for reviewing the following market segments:
   a) Investment products ("IP"): products that are sponsored, issued, marketed or supported by a specific financial institution and sold to the retail and high net worth ("HNW") market;
   b) Exchange traded products ("ETP"): products that are listed and traded on the Singapore Exchange Limited ("SGX") excluding Structured Warrants as these have been addressed by the IP sub-committee; and
   c) Over-the-counter products ("OTC"): unlisted deals between financial institutions and intermediaries.

2. Details of the members of the Taskforce and the sub-committees are set out in Appendix I to this report.

3. The terms of reference for the Taskforce was to consider the current and future environment for the topics below and propose recommendations that will continue the development of the equity derivatives and structured products market in Singapore:
   a) Overview of the market including existing and future products, market size and potential, as well as key drivers of demand and supply;
   b) Market participants and their location;
   c) Current regulatory and tax framework and their conduciveness to market development;
   d) Manpower requirements such as skill or training gaps; and
   e) Infrastructure including front, middle and back office as well as exchange, clearing and settlement functions.

4. The listed equity derivatives markets in particular warrants, have experienced significant recent growth in the number of issues and trading volume. Furthermore, the development of the unlisted structured products market has progressed with increasingly innovative and differentiated products introduced to target the private banking and retail markets. This growth demonstrates increased investor appetite for derivatives and structured products in Singapore. However, the Taskforce believes significant opportunities exist to develop the domestic markets further as well as allow Singapore to expand its position as an important international financial centre.

5. The Taskforce recommends that three objectives need to be achieved for the continued development of the equity derivatives and structured products markets. Firstly, the medium- and long-term sustainability of the markets need to be addressed, particularly the education and informed participation of retail and institutional investors. Secondly, liquidity for existing and new products is critical to the success of the markets. Lastly, for Singapore to continue to be an important regional financial centre, innovation has to be supported and cultivated. In order to realise these objectives, the Taskforce has formulated a series of recommendations

which address various subject areas including market structures, incentives and regulations that need to be introduced, adjusted and/or removed.

6. The Taskforce views this report as an important step to achieving a sustainable, liquid and innovative market in Singapore. The contents of this report consist of the recommendations from each of the above sub-committees as well as general recommendations that overlap across all sub-committees. The Taskforce would like to acknowledge the participation and assistance of MAS and SGX in engaging in active discussions on the recommendations.

7. A summary of the recommendations of the Taskforce is attached below, with more detailed discussions in the sections following.

8. SIBA welcomes any feedback on this report or its recommendations. Please send your enquiries / suggestions to SIBA on Tel: (65) 6532 7565.

SUMMARY OF RECOMMENDATIONS

Feedback	Recommendations
▪ The investing public has to be protected from potential misrepresentation. ▪ Issuers need to be guided on which products are allowed on a securities exchange.	▪ **Recommendation 1:** The Taskforce recommends that guidance be issued on the marketing and promotion of warrants; that broader classes of products be permitted to be listed and guidance issued to assist issuers understand which products are permitted to be listed; and that a streamlined and transparent process be adopted for approving the listing of new product types.
▪ Issuers would like to introduce perpetual certificates and longer dated warrants.	▪ **Recommendations 2:** The Taskforce recommends that the removal or extension of the three year limit on the tenure of warrants under section 508(6) of the Listing Rules as well as revisions of the Listing Rules to allow different types of investment products such as capital guaranteed products.
▪ Products with similar risk profiles but alternate legal forms are regulated differently with varying approvals and disclosure requirements.	▪ **Recommendations 3:** The Taskforce recommends that the regulatory regime should treat investment products consistently and based on underlying risks rather than legal form.
▪ High net worth ("HNW") individuals who do not wish to disclose their wealth and priority banking clients are interested in investing in prospectus exempted products.	▪ **Recommendation 4:** The Taskforce recommends that the minimum investment under the "accredited investors" exemption for prospectus requirements be lowered from $200,000 for each transaction to $50,000.
▪ The body of knowledge on derivatives products and applications residing in market professionals such as advisors, brokers and salespeople needs to be raised to a higher level to ensure investors receive adequate guidance when investing and trading in equity derivatives.	▪ **Recommendations 5:** The Taskforce recommends that the coverage of Capital Markets and Financial Advisory Services ("CMFAS") examinations be enhanced to include structured products and equity derivatives for new Trading Representatives ("TR"). For existing TRs, structured products and equity derivatives education should be incorporated as part of their continuing education.
▪ SGX fees are fixed and relatively high by international standards.	▪ **Recommendations 6:** The Taskforce recommends that all fees associated with listing and trading warrants be brought in line with other international exchanges to encourage market development and better reflect the value proposition of listing.

▪ Warrants are increasingly introduced to take advantage of event-driven liquidity.	▪ **Recommendations 7:** The Taskforce recommends that timing for approving and setting up a new warrants program should be accelerated to allow issuers to take advantage of event-driven liquidity.
▪ A recognised error trade may result in systemic impacts and compromise the exchange for equitable, systematic and transparent trading.	▪ **Recommendations 8:** The Taskforce recommends that refinements to the trading system and technology be implemented on SGX-ST along with clarifications and guidelines on how to 'bust' error trades (such as those already in effect on SGX-DT) in order to promote a fair, transparent and orderly market.
▪ Funding is required from the industry and MAS to support retail investor education.	▪ **Recommendations 9:** The Taskforce recommends that the industry, MAS, SGX and other organisations establish and co-finance a structured fund for retail investor education.
▪ Education materials should be distributed to reach the optimum number of interested people and in the most effective manner.	▪ **Recommendation 10:** The Taskforce recommends that the combined platforms of SGX, SIAS, 'MoneySENSE',SIBA and other appropriate channels be collectively utilised for derivatives and structured product content delivery including electronic, audio-visual and print dissemination to investors.
▪ An impartial information source is required to assist investors.	▪ **Recommendation 11:** The Taskforce recommends that an independent source of information should be established in order to assist investors to make an informed investment decision.
▪ The level of knowledge and sophistication of participants should be improved.	▪ **Recommendation 12:** The Taskforce recommends that Singapore should position itself to host seminars and lectures from leading international speakers as well as regional conferences and roundtables.
▪ With a significant pool of funds in Singapore, institutions should be educated on the benefits and risks of investing in and trading with derivatives and structured products.	▪ **Recommendation 13:** The Taskforce recommends that institutional education programs should be designed and conducted by industry bodies to introduce and educate fund managers, insurance companies , private banks, independent financial advisers ("IFAs") and securities houses on equity derivatives and structured products.

▪ Investors should be allowed to hedge or leverage their Central Provident Fund ("CPF") portfolio within acceptable limits.	▪ **Recommendation 14:** The Taskforce recommends that CPF members should be allowed to invest in index and single stock futures and options to better hedge their portfolio.
▪ Incentives should be expanded to encourage market makers and traders for new exchange traded derivative products.	▪ **Recommendation 15**: The Taskforce recommends that a concessionary tax incentive be introduced for income derived on single stock derivatives as well as additional benefits to attract market makers to Singapore which should be promoted and implemented effectively.
▪ The opportunity exists to build links between Singapore and its regional markets to enhance each other's markets and liquidity.	▪ **Recommendation 16:** The Taskforce recommends that the continued linkages between SGX with the bourses around ASEAN be continued to ensure mutual development of each other's markets.
▪ OTC transactions are riskier than exchange traded markets due to counter-party, settlement and inconsistent documentation risks	▪ **Recommendation 17:** The Taskforce recommends continued support for the SGX initiative to assess the development of an OTC clearing and settlement capability for financial derivatives.
▪ Singapore has a low 'free float' market capitalisation and retail participation rates relative to its competing markets.	▪ **Recommendation 18:** The Taskforce recommends that the 'free float' of the underlying equity markets should be increased along with the level of share ownership amongst the investing public.
▪ With increased globalisation of products, more overseas expertise and resources are required in supporting industries.	▪ **Recommendation 19:** The Taskforce recommends the deregulation of the legal market to allow foreign law firms to provide legal services in relation to Singapore law.
▪ The profile of the industry as a preferred career route should be increased in order to attract talent and future manpower resources	▪ **Recommendation 20**: The Taskforce recommends raising the awareness of the industry in order to attract the required manpower resources.
▪ The recommendations of the Taskforce should be implemented effectively and an ongoing dialogue should be established.	▪ **Recommendation 21:** The Taskforce recommends SIBA establish a standing committee focusing on equity derivatives and structured products to continue dialogue between the industry, SGX and MAS.

INVESTMENT PRODUCTS

9. The Taskforce has tasked the IP sub-committee with the responsibility to examine equity derivatives and structured products that are sponsored, issued, marketed and/or supported by one or a number of specific financial institutions. These products may be listed or unlisted, and are sold primarily by securities firms or banks to the HNW individuals or the retail market. Examples of IP include listed warrants and unlisted equity linked notes.

10. The Taskforce is of the view that necessary changes are required in areas of regulations, training of intermediaries, market structures and retail investor education. Within these areas, selected issues are presently hindering the development of the IP market and need to be addressed as priority by MAS and SGX.

A) REGULATIONS

11. The Taskforce is of the view that a clear, transparent and consistent regulatory framework is required to encourage sustainable growth and innovation of the IP market. Thus far, amendments to the Securities and Futures Act ("SFA") and SGX Listing Rules have played an integral role in assisting industry growth. The expansion of the prospectus exemption for warrants under SFA in 2003, as well as the change in requirements and introduction of market making under the Listing Rules in 2002, contributed to the recent growth of the warrants market. The Taskforce commends MAS and SGX for having implemented these changes and recommends that additional adjustment be made to the regulatory regime in the immediate and medium term.

Clear and transparent definitions and guidance

12. Equity derivatives and structured products are sold to the investing public and therefore, the benefits and risks associated with these products need to be clearly identified and disclosed for consumers to make an informed decision. In addition, the method in which products are marketed, represented and sold to the retail market plays an equally important role, as it ensures that investors are not misled or misinformed about the risk-return profiles of various products.

13. The Taskforce considers the disclosures under the current warrants regime effective in providing consumers with sufficient information in order to make an informed investment decision. In addition, the process required for approvals of listing documents and applications is efficient and expedient.

14. To further enhance the warrants regime, the Taskforce is of the view that more guidance be issued concerning the marketing and promotion of warrants - to establish 'good business practice' standards for issuers and distributors as well as to protect investors from misrepresentation.

15. The Taskforce also recommends that MAS should assist to define the scope of products which are allowable on a securities exchange. Under SFA, the definition of "securities" includes amongst others, debentures, stocks and shares as well as any right, option or derivatives attached to these asset classes, and excludes futures contracts and certificates of deposit. Given that SGX takes the view that only "securities" can be traded on SGX, this prohibits the introduction of new investments products as well as warrants on other asset classes such as commodities and foreign exchange on the SGX. For example in more developed markets such as Australia and Germany, there are warrants on various asset classes including commodities and foreign exchange, and with different risk-return profiles such as certificates which track the price of an index at a defined ratio. The Taskforce believes that the SGX could look into broadening the classes of products to be listed because the opportunity exists for additional listed investment products and equity derivatives to be introduced in Singapore which will strengthen SGX as a leading listed market in Asia. The Taskforce recommends for further collaboration between MAS and SGX to explore the possibility of listing products that are not "securities", and issue guidance to help issuers understand which categories of products can be listed.

16. The Taskforce recommends for a more streamlined and transparent process for seeking clearance on a new product type from SGX and/or MAS. At present, such applications may be delayed because it is unclear whether MAS and/or SGX has responsibility for considering such applications.

Recommendation 1 – The Taskforce recommends that guidance be issued on the marketing and promotion of warrants; that broader classes of products be permitted to be listed and guidance issued to assist issuers understand which products are permitted to be listed; and that a streamlined and transparent process be adopted for approving the listings of new product types.

<u>Revised listing rules</u>

17. The Taskforce recognises that the regulatory regime under Chapter 5 of the Listing Rules was designed to specifically address structured warrants and its application is sufficiently flexible as to allow warrants to be issued on underlying securities both listed on SGX or other acceptable exchanges. However, in order to enhance market development and to encourage the listing of investment products, the Taskforce suggests that the three year limit on the tenure of warrants under Section 508(6) be removed or extended in order to allow the introduction of investment certificates as well as longer term warrants. The Taskforce also recognises the potential demand from investors for different styles of warrants, for example, Capital Guaranteed investment products as issued on the domestic exchange in Australia.

Recommendation 2 – The Taskforce recommends that the removal or extension of the three year limit on the tenure of warrants under section 508(6) of the Listing Rules as well as revisions of the Listing Rules to allow different types of investment products such as capital guaranteed products.

Consistent regulations and treatments

18. The Taskforce notes that structured products are regulated under SFA based on its legal form rather than the potential underlying risks of the product. For example, an equity-linked product may be structured as a debenture, investment-linked life insurance, collective investment scheme, endowment policy or structured deposit with varying levels of information disclosure and approval processes. This is broadly similar to the present regulatory position in Hong Kong and the United Kingdom, where different product types attract different regulatory consequences. The result is that there are inconsistencies in treatment and gaps have emerged such as in the area of structured deposits where guidelines were issued by MAS on 7 October 2004 to assist in improving disclosure and practise standards.

19. The Taskforce suggests that a medium-term solution should be found where products are regulated based on their underlying risks, regardless of their legal form. Regulators in Hong Kong and the United Kingdom appear to be moving in the same direction: The Hong Kong Securities and Futures Commission published a consultation paper in August 2005 seeking views on whether to harmonise the legal and regulatory treatment of investment instruments having similar characteristics. Similarly, the Financial Services Authority published a discussion paper in June 2005 that considered whether to move from a regulatory approach based on product structure to one based on the investment strategy and risk of the product.

Recommendation 3 – The Taskforce recommends that the regulatory regime should treat investment products consistently and based on their underlying risks rather than legal form.

Lower marketing limits

20. The Taskforce is of the opinion that the prospectus exemptions for products (excluding warrants) are relatively high. In particular, the exemption for "accredited investors" under sections 4A, 275 and 305 of SFA require that an individual have net personal assets in excess of $2 million or income in the last 12 months of not less than $300,000, or be required to make an minimum investment of $200,000 for each transaction. This particular exemption was designed to enable products to be marketed and sold to HNW individuals who are believed to be sufficiently sophisticated, have considerable wealth and ought to have received professional financial advice without the requirement of a prospectus.

21. The Taskforce understands that a substantial portion of HNW individuals may not be willing to disclose their personal wealth position for confidentiality reasons. In addition, the Taskforce observes the emergence of the priority banking segment where individuals who generally have above $200,000 in net assets but less than the "accredited investor" level, receive professional advice and are looking to invest in sophisticated products. In both cases, these individuals do not directly qualify as "accredited investor" and in order for them to access exempted products, they are required to make a minimum $200,000 investment which is a substantial portion of their wealth. By way of comparison, in the United Kingdom and other European jurisdictions, there is an exemption from public offer rules where the minimum subscription amount for an

investment is €50,000. The Taskforce recommends that the minimum investment be lowered from $200,000 for each transaction to $50,000.

Recommendation 4 – The Taskforce recommends that the minimum investment under the "accredited investors" exemption for prospectus requirements be lowered from $200,000 to $50,000 for each transaction.

B) TRAINING OF INTERMEDIARIES

22. The SFA requires that all licensed financial advisers, licensed representatives and individuals who are exempted to hold a representative's licence under section 23(1) and (2) be required to pass the selected modules of the Capital Markets and Financial Advisory Services ("CMFAS") exams depending on the regulated activity in which an individual is involved with. Structured products and derivatives knowledge are currently not tested under Module 6 and 7 of the CMFAS exams. The Taskforce recommends that such knowledge should be incorporated under CMFAS exams to ensure that licensees have the required basic knowledge of products.

23. Market and finance professionals need to raise their level of knowledge on derivatives products and application of such products to modify the risk-return characteristics of one's portfolio (whether short term trading or long term investment in nature). These include for example advisors, brokers and sales people (whether in banks or securities houses) who are involved in the sales and advisory process on using derivatives. Incorporating derivatives and structured products knowledge into CMFAS exams can help establish a minimum expected knowledge base benchmark for professionals. In turn, investors are expected to benefit from the adequate guidance when investing and trading in equity derivatives, and avoid entering derivatives positions unsuited to their investment objectives.

24. Structured products and derivatives content is recommended for inclusion into Continuing Education ("CE") programs conducted by The Institute of Banking and Finance ("IBF") and Society of Remisiers. In addition the list of program providers needs to be expanded beyond these two by allowing affiliation of selected program providers with IBF or SGX, or accreditation under Financial Industry Competency Standards ("FICS"), so that licensed Trading Representatives can earn their necessary annual credits by attending programs of their choice, at their level of sophistication, at a provider of their choice. Additional providers such as Wealth Management Institute ("WMI"), Investment Management Association of Singapore ("IMAS") or SSFA can conduct suitable training for market professionals, including analysts (who are traditionally untrained in a derivatives mindset

Recommendation 5 – The Taskforce recommends that the coverage of Capital Markets and Financial Advisory Services ("CMFAS") examinations be enhanced to include structured products and equity derivatives for new Trading Representatives ("TR"). For existing TRs, structured products and equity derivatives education should be incorporated as part of their continuing education.

C) MARKET STRUCTURES

25. The Taskforce considers that the structures and processes involved in the operation and administration of the IP market should be modified to ensure that Singapore remains internationally competitive.

Flexible and competitive fees

26. The Taskforce regards the fees involved in listing and trading an issuer-sponsored product in Singapore relatively high compared to other international markets except Hong Kong. On 10 November 2005, SGX announced the revision of its listing fees for companies in order to better reflect the value of listing and bring its levels in line with other international exchanges. Given this, the Taskforce recommends that listing and Central Depositary (Pte) Limited ("CDP") fees for issuer sponsored products should also be assessed and brought in line with international standards.

27. The Taskforce suggests that flexibility be incorporated into the fee structures with various methods of payment explored as alternatives to the current one-off listing fee per issue. The Taskforce praises the SGX on its ability to grant a six-month waiver on listing fees on new types of warrants issued in order to support new product development. Given that the lead time to generate investor interest in any new product type may extend over six months, the Taskforce recommends that a lower fee level be applied after the initial waiver period in order to further consolidate the market for new products. Furthermore, the Taskforce proposes that SGX examine and adopt a comparable fee structure to Deutsche Börse where issuers are charged an annual fee with a cap on total fees per year. Such a structure would encourage issuance of multiple and different products. The Taskforce also suggests the SGX consider capping the fees applicable for SGX Access. SGX Access fees may be more significant than the clearing fees because the former is uncapped, and increases execution costs for firms who trade in larger sizes. Specifically, uncapped SGX Access fees impact market makers who are able to execute large delta trades in a single underlying, or a single warrant in a day, thereby increasing their cost of providing liquidity to the market and discouraging higher trading volumes both for market makers as well as investors and traders.

28. In addition, issuers frequently introduce a series of warrants at varying strike prices in a single batch. In such instances, the Taskforce recommends that listing fees should be charged per batch of issues rather than on a per issue basis. Further flexibility would also be required when considering the listing of various warrants and investment products. For example, for a perpetual investment certificate or a close-dated warrant, a monthly fee could be used to better reflect the value of its listing status.

Recommendation 6 – The Taskforce recommends that all fees associated with listing and trading warrants be brought in line with other international exchanges to encourage market development and better reflect the value proposition of listing.

Accelerated timing

29. The Taskforce views that timing to market will play an increasingly important role as warrants will be introduced to take advantage of liquidity driven by specific events. For example, corporate actions such as announcement of merger and acquisition activities may cause volatility in the underlying share price, resulting in interest in warrants with the appropriate features such as strike price and expiry period.

30. The Taskforce welcomes the significant improvement in timing for the approval process by SGX for new warrants. In order to take advantage of event-driven liquidity, the Taskforce recommends the target turnaround for a listing application should ideally be overnight, where an application is able to be submitted at 5pm with the issue approved and systems ready for trading by 8:30am the following day to coincide with the start of the trading day. Moreover, the taskforce recommends the SGX consider minimising the documentation required for issuance and listing of warrants.

Recommendation 7 – The Taskforce recommends that timing for approving and setting up a new warrants program should be accelerated to allow issuers to take advantage of event-driven liquidity.

Structural and technological refinements

31. The Taskforce acknowledges the proactive efforts of SGX to upgrade its technology and welcomes the impending arrival of the next phase of trading engines and systems for the SGX Quotation and Execution System ("QUEST"). The SGX is considering an industry consultation paper to invite industry feedback on issues such as tick sizes. The Taskforce notes that smaller tick sizes will encourage higher trading volumes, lower hedging costs for issuers, and narrower spreads quoted by market makers on listed derivatives such as structured warrants. The Taskforce also recommends that the trading systems functionalities and trading screen layout can be improved for optimum user friendliness by obtaining feedback from professional traders. For example, traders are unable to view every listed structured warrant on a single screen, which hampers their efficient choice of instruments. Therefore it may be helpful to group products by types such as structured warrants, discount certificates and exotic (non-plain vanilla) warrants in separate groupings or classifications.

32. Trading screens should include key data that directly impact derivative valuations for users to make informed decisions, such as live price data on all underlyings on which warrants were issued, including currencies and commodities. Retail investors without ready access to the underlying price -will not be able to access the price in which the warrant should trade at. This is particularly important given warrant players are not long term investors, hence intraday price feeds are critical.

33. The Taskforce notes that a 'bust' rules applies on the futures exchange of SGX where clear error trades are able to be cancelled and withdrawn. It is unclear if such a rule exists for the warrants market and the Taskforce recommends that the SGX explore the introduction of such

a rule and clarify its application as it would serve to protect participants and promote fair and orderly trading. For example, the incident on Tokyo Stock Exchange ("TSE") on 13 December 2005 where a miskeyed, aberrant order from Mizuho Securities on a single stock led to frenzied trading across the market and the third biggest daily fall of the year. Events such as this may affect the reputation of an exchange and compromise it as a forum for equitable, systematic and transparent trading particularly given the increased risk of error resulting from the use of Direct Market Access electronic connectivity. In addition, should such errors occur on the derivatives markets, the effect would be compounded by the leveraged nature of these products which may create systemic risks.

Recommendation 8 – The Taskforce recommends that refinements to the trading system and technology be implemented on SGX-ST along with clarifications and guidelines on how to 'bust' error trades (such as those already in effect on SGX-DT) in order to promote a fair, transparent and orderly market.

D) RETAIL INVESTOR EDUCATION

34. The Taskforce considers retail investor education and training critical to the sustainability and growth of the market. The Taskforce is of the opinion that the trading volume for warrants is predominantly from the retail segment. Given that Singapore is at the early stages of the development of its warrants market, common misunderstandings have surfaced among many retail investors such as the relationship between the underlying share price movements and the warrant premium, the time decay of warrants and the risks involved in a leveraged position, as well as the market makers' obligation on deep out-of-the-money and in-the-money warrants regarding bid-offer sizes and spreads.

35. The Taskforce recommends an integrated retail education and training approach. Continuing education in derivatives needs to be targeted at retail investors through multiple including non-industry distribution channels to achieve optimum reach in a cost effective manner. Initially, general awareness and understanding of equity derivatives and structured products should be encouraged among the investing public. In addition, any participation of investors should be supported with sufficient information. Lastly, increasing the level of trading sophistication of market participants is crucial. These initiatives should be supported and funded by MAS, SGX and the industry.

Structured education funding

36. The Taskforce recommends that a pool of funds be established to support retail education. This is in consideration of the significant funding and resources required to develop, print and/or distribute education brochures, booklets and seminars as well as to set up and operate an independent source of information such as a website. In addition, funding may be provided to partly defray the costs of attracting leading international speakers and conferences to Singapore and allow for the investing public to participate at subsidised rates. Ad hoc projects

that are supported by industry which assist in retail education should be also considered for funding.

37. The Taskforce further recommends that the organised funding initiative be established and supported by the industry, MAS, SGX and other organisations. In Australia, the domestic stock exchange channels a portion of warrant listing fee revenues into investor education. The Taskforce recommends that SGX consider a similar model for the education of equity derivatives and structured products. In addition, the Taskforce believes that MAS should consider allocating a specific amount to co-fund a comparable level of funding and resources to any industry and SGX contributions.

Recommendation 9 – The Taskforce recommends that the industry, MAS, SGX and other organisations establish and co-finance a structured fund for retail investor education.

Expanded distribution platforms

38. The Taskforce observes that there is significant interest from the investing public and media outlets in trading with equity derivatives and investing in structured products. However, occasional misconceptions of such products and their benefits and risks remain amongst the public. Therefore, the challenge for an education campaign is to reach the optimum number of individuals interested in purchasing these products in the most effective manner.

39. The Taskforce recommends that existing platforms and networks should be utilised to build general awareness and understanding of the IP market amongst the investing public. Platforms such as 'MoneySENSE' and Securities Investors Association (Singapore) ("SIAS") have a wide access and reach to the intended target audience for a proposed education campaign. In addition, leveraging these channels would minimise costs whilst optimising exposure to the target segment.

40. The distribution reach of 'MoneySENSE', SGX and/or SIAS may be used to distribute educational materials such as brochures and information booklets. In particular, - 'MoneySENSE''s access to community centres as well as media outlets will assist in educating the investing public on the benefits and risks of investing in equity derivatives and structured products.

Recommendation 10 – The Taskforce recommends that the combined platforms of SGX, SIAS, 'MoneySENSE',SIBA and other appropriate channels be collectively utilised for derivatives and structured product content delivery including electronic, audio-visual and print dissemination to investors.

Independent information source

41. The Taskforce recognises the need for the investing public to access impartial information from an independent source in order for potential investors to better make an informed

investment decision. At present, most product issuers operate proprietary websites and sources which provide information on equity derivatives and structured products. However, given that these information sources are developed and supported by issuers, there may be an inherent conflict of interest.

42. The Taskforce suggests that a dedicated and independent industry information source should be established where any potential investors will be able to access this information for free and without any perceived bias or an inherent conflict of interest. The information available should be useful in introducing investors to equity derivatives and structured products as well as offer detailed insights about how to value these instruments, how to choose the most appropriate products given a certain risk-return profile, questions to ask a product distributor, products that are currently available and investment strategies to employ. The key focus for the proposed information source is for investors to obtain a sufficient level of knowledge to enable them to make an informed decision as to whether or not they should participate in the IP markets.

43. The Taskforce proposes for a mandatory description and link to the proposed independent information source - in all listing documents and term sheets of warrants and structured products to be listed on SGX, and that all issuers are required to include a link on the opening page of their proprietary website to promote their products in Singapore. A similar link from this independent website to all SGX issuers will be mutually established.

Recommendation 11 – The Taskforce recommends that an independent source of information should be established in order to assist investors to make an informed investment decision.

Targeted conferences and speakers

44. The Taskforce observes that significant interest exists amongst retail warrant participants to improve their level of knowledge and sophistication. The Taskforce recommends that international speakers who are recognised as leaders in their respective fields should be encouraged to visit Singapore and offer lectures and seminars.

45. In addition, industry conferences and roundtables held regularly to promote and raise the international profile of the equity derivatives and structured product industries bring together leading industry players and provide the opportunity to share knowledge and develop relationships between all participants. The Taskforce recommends that Singapore should position to host these leading regional conferences or roundtables as it will increase its reputation as a listed market.

Recommendation 12 –The Taskforce recommends that Singapore should position itself to host seminars and lectures from leading international speakers as well as regional conferences and roundtables.

C) EXCHANGE TRADED PRODUCTS

46. The Taskforce has assigned ETP sub-committee with responsibility to analyse and suggest recommendations in relation to exchange traded derivative products. The scope of the sub-committee included to review exchange traded funds, index futures and options, and single stock futures and options that are presently listed and potentially available to be launched on SGX.

Institutional education

47. Singapore is an established base for the funds management, private banking and hedge fund industries. In order to tap this ready pool of investments, the Taskforce suggests that the SGX, MAS, IMAS and other industry bodies focus on educating financial institutions in Singapore on the equity derivatives and structured products market. Roadshow presentations to leading fund managers, insurance companies, Government-linked companies and private banks should be organised to introduce the markets including how derivatives work as well as the risks involved and benefits of using these products. These roadshows will coincide with information seminars by leading industry speakers to educate users on how to use derivatives for efficient portfolio management, hedging and advanced trading strategies.

Recommendation 13 – The Taskforce recommends that institutional education programs should be designed and conducted by industry bodies to introduce and educate fund managers, insurance companies , private banks, independent financial advisers ("IFAs") and securities houses on equity derivatives and structured products.

Expanded CPF investments

48. The CPF is designed for members to decide for themselves on how to invest their savings, and the risks to accept, and exercise prudence and care when investing their CPF savings to ensure their financial well-being after retirement. Whilst the Taskforce recognises that equity derivatives are generally higher risk due to their leveraged nature, the Taskforce believes that subject to appropriate limits, the introduction of certain ETPs as an allowable investment category for the Ordinary Account balance of CPF members ("CPFIS-OA") would assist investors in familiarising themselves with the ETP market. The Taskforce believes that an expansion of the permissible investible assets to include other equity derivatives and structured products will allow investors to better hedge their portfolio risks and 'lock in' returns .

49. At present, exchange traded funds is the only asset class of ETP that is allowed as investments for CPF members. The Taskforce recommends that index and single stock derivatives futures and options be introduced as an investment class under CPFIS-OA. In order to ensure that these products are used appropriately, the Taskforce recommends that the notional exposure of these derivatives to be limited to only 10% of total CPF savings, a comparable level to gold investments.

Recommendation 14 – The Taskforce recommends that CPF members should be allowed to invest in index and single stock futures and options to better hedge their portfolio.

Effective incentives

50. MAS has existing concessionary tax incentives targeted at futures trading and OTC derivatives. The Taskforce believes that a new incentive should be introduced to encourage trading in ETP, particularly single stock derivatives. Specifically, the Taskforce is of the opinion that a concessionary tax incentive should be established for a limited period for income derived by financial institutions from single stock futures and options. The Taskforce believes that the value-add and positive spin-offs from incentivising increased activities in the single stock derivatives market could outweigh any potential loss in tax contributions. The suggested incentives may include tax exemption for income generated as a result of premium obtained from the sale of covered calls and/or the offsetting premium paid when purchasing puts to hedge out risk on a long portfolio. These examples of hedging are a form of enhancing portfolio returns through efficient capital management and are meant to complement existing business strategies.

51. The Taskforce believes that a crucial element to the success of a single stock derivatives market will be the role of market makers. An incentive structure which encourages market makers to participate in new products such as single stock derivatives should be encouraged. MAS has existing incentives which provide limited support for overseas institutions with trading or market making experience and are SGX corporate members that intend to set up proprietary facilities in Singapore. The Taskforce suggests that additional benefits be introduced to support market makers.

52. In order to ensure that the above suggested incentives are promoted and marketed effectively, the Taskforce recommends for a campaign to target the leading banks and securities houses in Singapore and overseas financial institutions. High profile industry events should be conducted to ensure that the target audience is reached and is aware of the overall package and its benefits and conditions. Furthermore, government agencies such as the Inland Revenue of Singapore ("IRAS") should be involved in any education process in order to ensure that the incentives are properly implemented.

Recommendation 15 – The Taskforce recommends that a concessionary tax incentive be introduced for income derived on single stock derivatives as well as additional benefits to attract market makers to Singapore which should be promoted and implemented effectively.

Linkages with regional stock exchanges

53. The Taskforce believes that the successful development of the ETP market in Singapore will provide an opportunity to roll-out similar products into regional equity markets. Traditionally, our adjacent ASEAN and Indian markets have higher volatility, and therefore provide more

opportunities to hedge and trade in derivatives. Linkages to the regional bourses, such as the recently announced Memorandum of Understanding between SGX and the Stock Exchange of Thailand to explore a derivatives link starting with the SET50 index futures contract as well as previous announced linkages with the Jakarta Stock Exchange and Bursa Malaysia, are positive steps to develop both Singapore and its neighbouring markets. The Taskforce believes that a long-term goal should be established to allow for full integration of the ASEAN equity markets for underlying and derivative products including for exchange traded products to be fully fungible across the different stock exchanges as well as instantaneous price feeds.

54. The Taskforce believes that rapid progress is being made in the development of execution technology including Direct Market Access ("DMA") and algorithmic programming, resulting in the increased ability to facilitate trade across markets which in turn lowers costs and improves the speed of execution. Therefore, the Taskforce considers the SGX has the opportunity to establish Singapore as a regional derivatives hub should it be able to capture the cross-border opportunities presented from these technologies.

Recommendation 16 – The Taskforce recommends that the continued linkages between SGX with the bourses around ASEAN be continued to ensure mutual development of each other's markets.

OVER-THE-COUNTER PRODUCTS

55. The Taskforce has appointed the OTC sub-committee to review and suggest recommendations on the broker/dealer market which consists of transactions between financial institutions that occur outside a recognised stock exchange.

OTC clearing and settlement

56. The Taskforce observes that a significant amount of equity derivatives and structured products occur as OTC transactions because of the inherent need to hedge risks in the market and the need for product customisation due to the lack of listed alternatives. Because OTC transactions are bilateral in nature, parties in such transactions are subject to each other's counterparty credit quality.

57. Counterparties to OTC transactions execute master International Swaps and Derivatives Association, Inc. ("ISDA") and Credit Support Annexe ("CSA") contracts with one another to facilitate the documentation of trades. Signed ISDA and CSA contracts are critical to increasing the number of dealing counterparties in the OTC markets. However, the number of such bilateral contracts increases exponentially with increasing number of counterparties.

58. OTC derivative trades typically also have complex post-trade processing requirements. These requirements include the settlement of cash flows between counter-parties during the life-cycle

of the trade, regular valuations with pricing from calculation agents, mark-to-market and exposure calculation, novation, market event and disruption handling, counter-party credit exposure monitoring, etc. Currently, these processes are handled on a bilateral basis between counter-parties (with brokers providing these services to end-users by arrangement). The bilateral approach to these processes and the manual nature of the work-flows that are used mean that post-trade processing is not standardized and not scalable.

59. The recent growth in OTC derivative trading volumes now appears to be outpacing the ability of the current manual and bilateral approach to always adequately process these trades, at times causing severe processing challenges for many firms. This in turn increases the potential for risk in a number of areas such as operational risk; market risk; business risk; payment, valuation and settlement risk; and cost risk.

60. SGX has announced plans to launch an OTC clearing facility for energy derivatives and forward freight agreements in 2006. The introduction of a centralised OTC clearing and settlement facility for financial derivatives would be welcomed by the Taskforce as it would reduce risk, increase operational efficiency and provide additional benefits resulting from standardised settlement netting, margining and Central Counter Party novation.

Recommendation 17 – The Taskforce recommends continued support for the SGX initiative to assess the development of an OTC clearing and settlement capability for financial derivatives.

GENERAL RECOMMENDATIONS

61. The Taskforce noted that there were issues and recommendations that were discussed which overlapped across the three sub-committees. As these issues and recommendations transcended the scope and terms of references of each sub-committee, the Taskforce has decided to address these issues and recommendations separately.

Improved free float and share ownership

62. Financial derivatives are instruments which derive their value from the value of an underlying security or an index. Therefore, by its intrinsic nature, any successful liquid derivative instrument is determined by the interest and liquidity of the underlying asset. Liquidity is defined in the financial industry as the ease with which an asset can be bought or sold (converted to cash) with the key components of liquidity comprising of large numbers of buyers and sellers and a high volume of trading activity as well as the ability of the market to absorb either a large buy or a large sell order without a significant price change in an asset.

63. The size of a security's 'free float', that is the number of securities not held by corporate insiders that are freely tradable in the public market, is a key determinant of liquidity as it will

determine the level of securities that can be traded and therefore, any derivative of that security. Compared to other international markets including developed markets in Asia, the Singapore equity markets have a low ‘free float’ market capitalisation.

63. Retail participation in the Singapore equity and derivatives markets should be encouraged further. For example, in other markets such as Hong Kong and Australia, share ownership increases as a significant portion of any share disposals have been allocated to retail investors. The Taskforce acknowledges that Temasek and GLCs have been divesting their publicly listed shares in Singaporean companies and recommends that this trend should accelerate as it would improve the liquidity of the underlying equity markets and hence, the liquidity of any equity derivative instrument. Furthermore, disposals via retail offering would encourage share ownership and retail participation in Singapore which increases the pool of domestic investors.

Recommendation 18 – The Taskforce recommends that the ‘free float’ of the underlying equity markets should be increased along with the level of share ownership amongst the investing public.

Deregulated legal market

64. The Taskforce is of the view that the level of the supporting industries including legal, accounting and tax advisers for equity derivatives and structured products in Singapore are professional and knowledgeable on domestic matters. However, with globalisation, equity derivatives and structured products are increasingly becoming more complex, often with similar product types and structures marketed across various markets. As a result, local supporting industries require an increased understanding of recent international industry and product.

65. Subject to conditions and requirements, foreign law firms can only provide legal services in relation to Singapore law through a Joint Law Venture (“JLV”) or Formal Law Alliance with a Singapore law firm. Although JLVs have not been universally successful, most have contented that relationships with any new partnerships will be unlikely in the near future. This is in contrast to Hong Kong and Australia where foreign law firms are able to provide legal services in relation to domestic law by themselves without the need of a local law firm partner subject to certain qualifications. Therefore, in order to bring more overseas expertise and resources into Singapore and improve the overall knowledge base of our supporting industries, the Taskforce recommends to adapt our legal market regime to the competing overseas jurisdictions.

Recommendation 19 – The Taskforce recommends that the deregulation of the legal market to allow foreign law firms to provide legal services in relation to Singapore law.

Manpower Resources and Location

66. The Taskforce understands that financial institutions prefer to locate their structuring and trading personnel for equity derivatives and structured products closer to the centres for trading volume and activity. As a result, most structuring and trading teams are located in Hong Kong where liquidity for the underlying equity and derivatives is higher than the other markets in Asia. However, with the development of our funds management, hedge funds and private banking industries, there is a trend for financial institutions to expand sales personnel in Singapore to access this pool of monies, and in the longer term, explore locating their structuring personnel here as well. At present, the Taskforce notes that there is no significant manpower or skills shortage but recommends that the profile of the industry as a preferred career route be increased in order to attract talent and future resources.

Recommendation 20 – The Taskforce recommends raising the awareness of the industry in order to attract the required manpower resources.

On-going dialogue

67. The Taskforce is of the opinion that a continuous dialogue between the industry, SGX and MAS is required to sustain the development of the market as well as discuss and implement any agreed recommendations in an effective and efficient manner. SIBA is recommended to take a leading role in this initiative through the setting up of a formal standing committee concentrating on the development of equity derivatives and structured products in Singapore. The Taskforce recommends that this committee will be responsible to discuss industry issues and co-ordinate initiatives as well as review and propose regulatory reforms.

68. The Taskforce suggests that the proposed SIBA standing committee will comprise of various industry participants from banks, securities firms, SGX and MAS with a revolving chair appointed to lead and manage the group. This standing committee should meet on a quarterly basis with forums conducted in a focus group to facilitate discussions on key industry issues and implement any initiatives.

Recommendation 21 – The Taskforce recommends SIBA establish a standing committee focusing on equity derivatives and structured products to continue dialogue between the industry, SGX and MAS.

APPENDIX I – MEMBERS OF THE TASKFORCE

MAIN COMMITTEE

Members	Title
1. Mr. Ken Sue (Chair)	Head of Investment Products, Deutsche Bank
2. Mr. George Lee (SIBA Chair)	Executive Vice President, OCBC Bank
3. Mr. Kola Luu	Executive Director, Monetary Authority of Singapore
4. Mr. Matthew Long	Division Director, Macquarie Bank
5. Mr. Mark Bowden	Head of Equity Singapore, Merrill Lynch
6. Mr. Martin Cher	Managing Director, Goldman Sachs
7. Mr. Samuel Lin	Senior Vice President, OCBC Bank
8. Ms. Sabrina Chew	Vice President, Singapore Exchange
9. Ms. Lim Eng Ai (secretariat)	Executive Secretary, Singapore Investment Banking Association
10. Ms. Ong Puay See (secretariat)	Deputy Director, Monetary Authority of Singapore
11. Mr. Donald Chan (secretariat)	Deputy Director, Monetary Authority of Singapore
12. Ms. Jean Tan (secretariat)	Assistant Director, Monetary Authority of Singapore

(I) INVESTMENT PRODUCTS SUB-COMMITTEE

Members	Title
1. Mr. Matthew Long (Chair)	Division Director, Macquarie Bank
2. Mr. T K Yap (Co-chair)	Executive Director, OCBC Securities
3. Mr. Samuel Lin	Senior Vice President, OCBC Bank
4. Mr. Lee Yan Zhan	Director, Credit Suisse First Boston
5. Mr Justin Crawford	Division Director, Macquarie Bank
6. Ms. Sandra Lee	Vice President, Deutsche Bank
7. Mr. Peter Hu	Director, Barclays Capital
8. Mr. Eugene Ong	Associate Director, Barclays Capital
9. Ms. Fiona Wong	Director, ABN AMRO
10. Mr. Jeffrey Goh	Senior Vice President, Kim Eng
11. Mr. Francis Mok	Partner, Allen & Gledhill
12. Ms. Sabrina Chew	Vice President, Singapore Exchange
13. Ms. Ong Hui Han	Assistant Vice President, Singapore Exchange

(II) EXCHANGE TRADED PRODUCTS SUB-COMMITTEE

Members	Title
1. Mr. Mark Bowden (Chair)	Head of Equity Singapore, Merrill Lynch
2. Mr. Ray McGregor	Director, Credit Suisse First Boston
3. Mr. Pasquele Rombola	Executive Director, Morgan Stanley
4. Mr. Benny Goodman	Vice President, JP Morgan
5. Mr. Andreas Cesaro	Associate Director, BNP Paribas Peregrine
6. Ms. Jeanne Chow	Assistant Director, Investment Management Association of Singapore
7. Ms. Sabrina Chew	Vice President, Singapore Exchange
8. Ms. Ong Hui Han	Assistant Vice President, Singapore Exchange

(III) OVER-THE-COUNTER PRODUCTS SUB-COMMITTEE

Members	Title
1. Mr. Martin Cher (Chair)	Managing Director, Goldman Sachs
2. Mr. William K Lee	Managing Director, JP Morgan
3. Mr. Benny Goodman 4. Mr. Ray McGregor	Vice President, JP Morgan Director, Credit Suisse First Boston
5. Mr. Rohit Jaisingh	Director, UBS
6. Ms. Mita Natarajan	Senior Vice President, Singapore Exchange
7. Ms. April Tan	Assistant Vice President, Singapore Exchange