

CONSULTATION PAPER

P004 - 2004
April 2004

Annex 3

New Part II, Part III

and Part IIIA of the

Securities and Futures Act

MAS

Monetary Authority of Singapore

NEW PART II, PART III AND PART IIIA OF THE SECURITIES AND FUTURES ACT

1 To implement the policy reforms relating to markets and clearing facilities set out in its consultation paper issued in September 2003 [“Sep-03 consultation paper”] and in its response to the comments received from the consultation [“Mar-04 response document”], MAS proposes to repeal and replace Part II (Markets) and Part III (Clearing Facilities) of the Securities and Futures Act (“the Act”). The revised Part II and Part III will:

- (a) clarify the regulatory framework for markets;
- (b) move towards a more risk-focused regulatory regime for markets;
and
- (c) introduce a designation approach for the regulation of clearing facilities;

in line with our proposed policy reforms. MAS will also shift the provisions for exchange holding companies to a new Part IIIA (Approved Holding Company). This Annex provides a brief introduction to the revised Part II and Part III, and the new Part IIIA.

Clarifying the Regulatory Framework for Markets

2 The amendments to Part II of the Act will clarify the two-tier regulatory framework for markets. Under this framework, any person who wishes to establish or operate a market will require MAS’ approval as an approved exchange, or recognition as a recognised market operator (sections 6 and 7).

3 The two tiers – approved exchange and recognised market operator – will correspond to different levels of regulatory oversight. Approved exchanges will be subject to a higher degree of regulatory oversight by MAS than recognised market operators. Approved exchanges will be required to comply with a more comprehensive range of statutory obligations (Division 2 of Part II) than that required of recognised market operators (Division 3 of Part II).

4 The proposed section 9 will allow MAS to promulgate regulations on the criteria for determining whether a market operator should be regulated as an approved exchange or a recognised market operator. As a general principle, persons operating markets that are systemically-important or of system-wide importance will be regulated by MAS as approved exchanges.

Persons operating other markets may be regulated as recognised market operators. MAS will consider a market to be systemically-important or of system-wide importance if a disruption in its operations may trigger, cause or transmit further systemic disruptions to financial institutions, capital markets or the financial system, or affect public confidence in financial institutions, capital markets, or the financial system. In determining whether a market satisfies this general criterion, MAS will consider the:

- (a) size and structure of the market;
- (b) nature of the services to be provided by the market;
- (c) nature of the securities or futures contracts traded through the market;
- (d) nature of the investors or participants who may use or have an interest in the market;
- (e) parties who may be affected in the event that the market runs into difficulties; and
- (f) interests of the public.

MAS envisages that Singapore Exchange Securities Trading Limited and Singapore Exchange Derivatives Trading Limited will be regulated as approved exchanges.

5 MAS will provide market operators with a degree of choice over the tier of regulatory treatment. Though an entity may be operating, or wish to operate, a market that is not systemically-important or not of system-wide importance, and hence need only be regulated as a recognised market operator, the entity can choose to be regulated as an approved exchange. MAS will permit this provided that the entity can meet the statutory obligations that are imposed on approved exchanges. However, operators of markets that are systemically-important or of system-wide importance must be regulated as approved exchanges. They cannot opt to be regulated as recognised market operators.

6 MAS recognises that a recognised market operator may grow overtime to become systemically-important or of system-wide importance. In such cases, MAS may initiate a review of the market operator's regulatory status under the proposed section 10(4). Such reviews will be conducted in consultation with the recognised market operator.

7 To help provide potential applicants with a more seamless application process, the proposed amendments will allow MAS to consider an application for recognition as a recognised market operator as an application for approval

as an approved exchange if MAS is of the view that the applicant is more appropriately regulated as an approved exchange taking into account the criteria prescribed under section 9, and vice versa (section 8(1B)). This would only be done with the consent of the applicant (section 8(1B)). Such a process will eliminate the need for the re-submission of new applications and payment of additional application fee. We also expect this to improve the speed at which applicants can commence operations.

8 The provisions in Part II have also been re-ordered in a more user-friendly manner. We have consolidated and re-grouped similar provisions, and inserted new headings to assist users in locating provisions. The amendments are also aimed at providing greater transparency on the:

- (a) objectives of MAS' regulation of markets (section 5);
- (b) circumstances under which MAS may refuse to approve an exchange or recognise a market operator (section 8(5)); and
- (c) statutory obligations of approved exchanges and recognised market operators (Divisions 2 and 3 of Part II, respectively).

Moving Towards a More Risk-Focused Regime for Markets

9 The current framework for regulating alternative trading platforms or recognised trading system (ReTS) providers in Division 4 of Part II of the Act was established to provide MAS with the flexibility to apply regulatory requirements that are tailored to the risk profile of ReTS providers. However, in some instances the statutory obligations placed on ReTS providers are inappropriate for new business models that have emerged. For example, the current section 36(4)(d) and (e) presume a business model where members play an intermediating role between investors, much as brokers play an intermediating role between investors for trades done on traditional exchanges. Many alternative trading systems do not operate on a membership-intermediation model, but instead operate on a model where sophisticated investors are direct participants who transact with one another for their own accounts.

10 We have refined the provisions relating to the ReTS regime, taking into account the emergence of these new business models, and have renamed ReTS providers as recognised market operators. The provisions relating to recognised market operators are contained in the new Division 3 of the revised Part II. These amendments will reduce the regulatory hurdles for new and innovative trading platforms to operate in Singapore.

Introducing a Designation Approach for Regulating Clearing Facilities

11 The amendments to Part III of the Act introduces a new approach for regulating clearing facilities that would achieve MAS' objective of reducing systemic risk in a more focused manner. The new approach is also less intrusive for clearing facilities that do not pose significant risks to the stability of the financial system.

12 As set out in the Sep-03 consultation paper, MAS believes that not all clearing facilities pose threats to MAS' regulatory objectives of minimising systemic risk and maintaining confidence in key markets. Only facilities that pose such risks need to be regulated and supervised by MAS. Persons establishing a clearing facility will, therefore, no longer be required to obtain MAS' prior approval. Instead, such persons need only notify MAS at least 60 business days prior to the commencement of operations (section 53). This approach will enable such businesses to start their operations faster and reduce their compliance costs.

13 MAS will only regulate clearing facilities that meet the conditions set out in the section 58. Persons operating such facilities will be designated and regulated in accordance with the provisions in Division 3 of Part III. Such persons will be known as designated clearing houses (section 2). MAS expects to designate the Central Depository (Pte) Ltd and the Singapore Exchange Derivatives Clearing Limited, both of which are already regulated by MAS.

14 Pursuant to section 56, MAS proposes to exempt the following classes of persons, by regulations, from the requirement to notify MAS prior to commencing activity as a clearing facility:

- (a) banks licensed under the Banking Act (Cap. 19);
- (b) merchant banks approved as a financial institution under the Monetary Authority of Singapore Act (Cap. 186); and
- (c) holders of capital market services licences.

Shifting Holding Companies Provisions to New Part IIIA

15 The provisions relating to exchange holding companies have been moved to the new Part IIIA of the Act. Exchange holding companies have been renamed as approved holding companies. These changes are intended to make transparent that the provisions in Part IIIA apply to holding companies of approved exchanges as well as designated clearing houses.

Other Significant Amendments

Notification of Non-Market/Clearing Business

16 Sections 19(1)(c) and (d) and sections 63(1)(b) and (c) will require approved exchanges and designated clearing houses to notify MAS if they seek to carry on a business, or acquire a corporation that carries on a business other than the business of operating a market/clearing facility or a business incidental to operating a market/clearing facility.

17 Approved exchanges and designated clearing houses are systemically-important financial institutions. A disruption in the operations of such institutions could cause systemic disruptions or undermine public confidence in capital markets or Singapore’s financial system. Approved exchanges and designated clearing houses that engage in non-market/clearing activities will be taking on the business risks of these other activities. Sections 19 and 63 will not prohibit such activities per se, but it will give MAS powers to regulate the risks arising from the non-market/non-clearing activities of approved exchanges and designated clearing houses where such risks threaten MAS’ regulatory objectives.

“Fair, Orderly and Transparent Markets” and “Safe and Efficient Clearing Facilities”

18 The current sections 9 and 36 require exchanges and ReTS providers, respectively, to operate “orderly, informed and fair” markets. MAS proposes to replace “informed” with “transparent” in the new sections 18 and 40 because an obligation to operate an “informed” market could be read to require the exchange and ReTS providers to ensure a particular state of mind of the investor, which could be difficult to achieve and enforce. We also propose to replace “the obligation to maintain orderly, fair and expeditious clearing facilities” (current section 51) with “safe and efficient clearing facilities” in the new section 62, an obligation that is used in standards formulated by the International Organisation of Securities Commissions (IOSCO) and the Committee on Payments and Settlement Systems (CPSS).

Fair Access

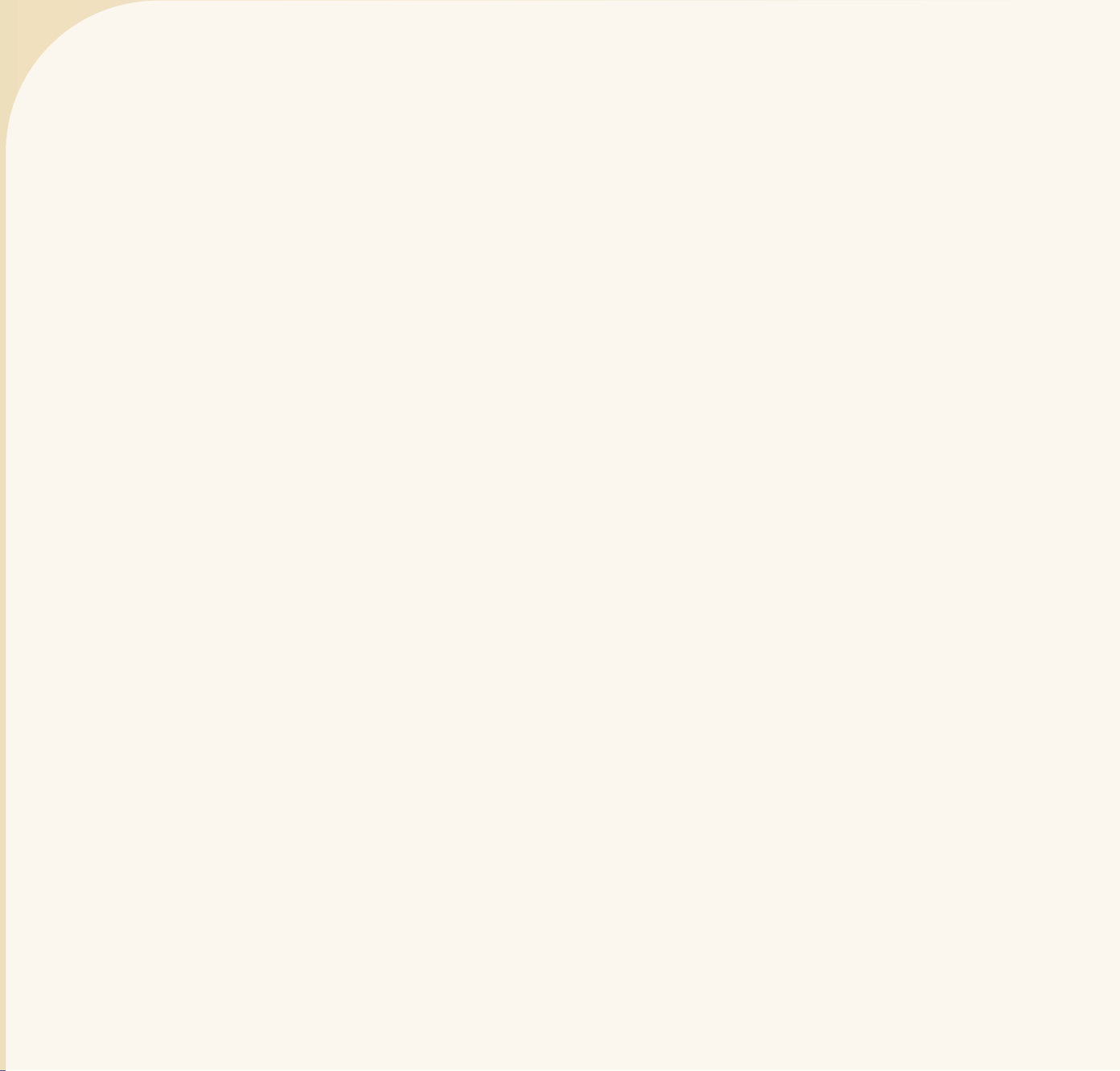
19 Approved exchanges and designated clearing houses operate key trading and clearing infrastructure in Singapore. MAS proposes to require approved exchanges and designated clearing houses to provide access to their facilities in a fair and objective way, and in accordance with criteria designed to ensure the orderly functioning of the facilities and protect the interests of the investing public (sections 18(1)(d) and 62(1)(d)).

Proper Records

20 MAS proposes to introduce a new obligation for approved exchanges, recognised market operators and designated clearing houses to maintain records of all transactions effected through their facilities (sections 20, 42 and 65). This will create an audit trail of transactions for our supervisory purposes and for the tracking of proceeds of criminal activities.

Procedures for Rule Amendments

21 MAS proposes to shift the procedures for making amendments to the business and listing rules of exchanges and clearing houses (the current sections 17 and 59) to the regulations. We will consult interested parties on the amendments to these procedures.



Monetary Authority of Singapore