MAS Monetary Authority of Singapore

RESPONSE TO FEEDBACK RECEIVED – INDUSTRY CONSULTATION ON ACCEPTABLE COLLATERAL & CONTRACTS FOR DIFFERENCES

1 General Comments

1.1 MAS issued a consultation paper last year to seek public comment on proposed changes to the list of acceptable collateral for securities financing activities and margin requirements for contracts for differences ("CFDs"). Following the close of the consultation, MAS met industry players several times to discuss their feedback and suggestions.

1.2 MAS thanks all respondents to the consultation and participants in the subsequent dialogue sessions for their comments. MAS has considered the feedback received and where it agreed with the comments, incorporated them into revised requirements. The comments that are of wider interest and MAS' responses are set out below.

EXPANDED LIST OF ACCEPTABLE COLLATERAL

2 Shareholders' Funds Requirement for Foreign Listed Shares

2.1 In the consultation paper, MAS retained the existing requirement that shares listed on a recognised Group A exchange must have shareholders' funds of at least S$200m. Respondents commented that the requirement unnecessarily restricts the universe of foreign securities for which they can accept as collateral for securities financing.

MAS' Response

2.2 The shareholders' funds requirement serves as a proxy to address concerns on the quality and liquidity of foreign listed shares held as collateral. Nonetheless, MAS notes the industry comments and recognises that such concerns would generally be less acute for index stocks. MAS will therefore waive the shareholders' funds requirement for foreign index shares. In other words, a share listed on a recognised Group A exchange will be considered acceptable collateral if (i) it is a constituent stock of a market index of that exchange, or (ii) it meets the shareholders' funds requirement. As proposed in the consultation paper, the applicable haircuts for index stocks and non-index stocks are 15% and 25% respectively.

3 Unrated or Below Investment-Grade Debt Securities

3.1 For consistency with the position at paragraph 2.2 above, MAS will apply a 15% haircut (instead of 25% previously proposed) to unrated or below investment-grade debt securities that are listed on a recognised Group A exchange and issued by a corporation whose shares are included in a market index of such exchange.

4 Collective Investment Schemes ("CIS")

4.1 The consultation paper proposed that at least 90% of the deposited property of a CIS must be invested in instruments that qualify as acceptable collateral before the CIS may be recognised as acceptable collateral. Respondents commented that this requirement was difficult to monitor and requested that MAS provide a list of acceptable CIS.

<u>MAS' Response</u>

4.2 The proposed condition was intended to prevent regulatory arbitrage whereby instruments that do not qualify as acceptable collateral are parked under a CIS that would then be recognised as acceptable collateral. However, in light of the industry feedback, MAS will waive the requirement for all MAS-

authorised CIS (except futures and options funds and hedge funds[1]), subject to a 25% haircut. All other CIS will be recognised if at least 90% of their deposited assets are invested in instruments that qualify as acceptable collateral. Where CMS licensees choose to look through to the underlying assets, they may avail themselves of the highest haircut applicable to the underlying assets (instead of the default 25% haircut).

5 Bonus Shares and Cash Dividends

5.1 Respondents highlighted that downward adjustments of share prices after the book closure date for bonus shares and cash dividends declared on share collateral pose some practical challenges in the valuation of margins deposited. This is because the value of the collateral may fall below the amount financed during the interim period between the book closure date and the crediting of the bonus shares/cash dividends, thereby triggering additional capital charges or margin calls. Respondents suggested that this technical issue can be avoided if the bonus shares and cash dividends are recognised as acceptable collateral during the intervening period.

MAS' Response

5.2 In light of industry feedback, MAS will allow (i) bonus shares entitlements of an ex-dividend share held as collateral to be counted towards acceptable collateral, and (ii) cash dividends declared and payable on an ex-dividend share held as collateral to offset the amount financed. This will be subject to the securities financier establishing legal certainty over the receipt and deposit of such bonus shares or cash dividends into its client's margin account.

6 Bank Guarantees, Letters of Credit and Fixed Deposits

6.1 Some respondents have suggested that MAS consider bank guarantees, letters of credit, and fixed deposits as acceptable collateral.

[1] Futures and options funds and hedge funds are excluded as they invest in instruments or adopt investment strategies that would generally pose significantly higher risk than other instruments that qualify as acceptable collateral.

MAS' Response

6.2 Bank guarantees ("BG") and letters of credit ("LC") are not generally recognised as collateral for the purposes of calculating counterparty exposure in the SF Regulations. Nor are they generally regarded as acceptable collateral for the purpose of calculating capital requirements for banks that provide collateralised loans. Collateral normally refers to a property or asset that is pledged as security for the repayment of a loan and that reduces the counterparty exposure. In contrast, BGs and LCs create contingent unfunded obligations from the third-party issuing bank to the beneficiary, thereby substituting the counterparty risk of a customer with that of the issuing bank, i.e. BGs and LCs do not eliminate nor reduce the counterparty exposure. However, while BGs and LCs will not be regarded as acceptable collateral, MAS recognises that such instruments provide some form of credit risk mitigation and will engage the industry further on developing a suitable framework to recognise the risk mitigation effects of BGs and LCs for the purposes of securities financing.

6.3 Fixed deposits held with third-party banks are typically subject to certain terms and conditions (e.g. withdrawal after a fixed term, early withdrawal penalties) imposed by such banks before they may be withdrawn. Until the terms and conditions of the deposit are duly complied with, the deposit does not become payable. This raises issues as to the legal certainty and enforceability of such collateral as the fixed deposit would neither be in the possession of the CMS licencee nor readily convertible into cash. Similarly, banks currently do not recognise fixed deposits placed with third-party banks (i.e. not the bank incurring the counterparty exposure) as eligible collateral for the purposes of calculating capital requirements.

7 Administrative Relief for Currency Mismatch Haircut

7.1 The consultation paper proposed an 8% currency mismatch haircut to address the foreign exchange risk arising from taking collateral denominated in a different currency from the exposure. While agreeing with the policy intent, some respondents argued that the requirement would pose significant implementation difficulties, particularly for multi-currency ledgers. Respondents also requested

that MAS waive this requirement for CMS licensees with insignificant mismatched exposures.

<u>MAS' Response</u>

7.2 The currency mismatch haircut is intended to encourage better risk identification and management, and is consistent with the practices for other financial institutions as well as across international markets. However, MAS notes the feedback that some players may have insignificant mismatched exposures. In order not to impose undue regulatory burden on such firms to track immaterial exposures, MAS will grant administrative relief from the currency mismatch requirement if the aggregate mismatched exposure of a CMS licensee is less than 2% of its free financial resources.

MARGIN REQUIREMENTS FOR CONTRACTS FOR DIFFERENCES

8 Margin Requirements

8.1 In the consultation paper, MAS proposed to formalise minimum margin requirements for CFDs based on (i) the margins prescribed by an exchange for a comparable contract subject to several conditions, or (ii) a default 20% initial margin and 15% maintenance margin if there is no comparable exchange-traded contract. In addition, any shortfalls in the margin account for CFDs must be met by the next business day.

8.2 Respondents commented that the proposed minimum margins were notably higher than the industry norms in established CFDs markets such as the UK and Australia, especially for non-equity CFDs that respondents plan to introduce in Singapore. On the proposed conditions for comparable contracts, some respondents disagreed with the comparison of CFDs to single stock futures, saying that it would be difficult to find an exchange-traded contract that exactly matches a CFD, and that there would be significant costs in ongoing monitoring. Some respondents also requested for margin calls to be met by T+2, citing practical difficulties.

MAS' Response

8.3 MAS maintains the view that minimum margin requirements are necessary to prevent excessive leverage by investors, and at the same time to institute a reasonable level of risk management within CMS licensees. This is especially so for the nascent CFDs market in Singapore. However, recognising the concerns over consistency with industry norms, MAS will revise the margin requirements for CFDs as follows. These changes have been discussed with industry players.

8.4 MAS will set differentiated minimum margin requirements for different types of CFDs, depending on the underlying instrument and the risk mitigation features embedded in the CFDs. In addition, there will only be a single-tier minimum margin requirement for each type of CFDs. With these changes, there will no longer be any requirement for comparable contracts. The revisions are set out in the table below:

Types of CFDs	Minimum Margins Requirements
Equity CFDs:	(i) 10% for index stocks, (ii) 20% for non-index stocks, where an index refers to the Straits Times Index, MSCI Singapore Index or a market index of a recognised Group A Exchange.
Index CFDs:	5% where an index refers to the Straits Times Index, MSCI Singapore Index or a market index of a recognised Group A Exchange.
Foreign Exchange CFDs:	2%
CFDs with non-guaranteed stop-loss: CFDs with guaranteed stop-loss:	Lower of: (i) Amount at risk + 30% of Standard Margin; or (ii) Standard Margin Lower of: (i) Amount at risk + 10% if CFD is subject to any adjustment for dividend, interest or commission; or (ii) Standard Margin where "amount at risk" refers to the maximum loss a customer may incur based on the difference between contract price and stop-loss price;

Types of CFDs	Minimum Margins Requirements
	"standard margin" refers to the minimum margin for the CFDs without stop-loss features; and "stop-loss" means a feature attached to an open CFD position to close the CFD if the price reaches a specified level.
Any other CFDs	20%

8.5 MAS will also allow margin calls to be met no later than 2 business days, i.e. T+2. This brings the requirement in line with the practice for futures business and minimises the compliance burden for futures brokers who also offer CFDs.

MONETARY AUTHORITY OF SINGAPORE
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