



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

1 Introduction

1.1 On 13 February 2012, MAS issued a Consultation Paper inviting comments on the proposed regulation of OTC derivatives. The consultation closed on 9 April 2012.

1.2 MAS has carefully reviewed and considered the feedback received. As stated in MAS' first response published on 23 May 2012, we will issue our response to the feedback in phases, as some feedback requires further study and consideration. This second response by MAS addresses feedback on the proposals to mandate the central clearing and reporting of OTC derivatives. We note that international standard-setting bodies are still in the midst of developing standards pertaining to OTC derivatives reforms (e.g. margining requirements and standards for the legal entity identifier). MAS continues 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.

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

2 COMMENTS ON CONSULTATION PAPER SECTION 4: CLEARING MANDATE

A Scope of Clearing Obligation - Products

Top-down and bottom-up approaches

2.1 Most respondents agreed with the proposal to use both top-down and bottom-up approaches to identify products suitable for mandatory clearing. One respondent suggested that MAS should use the top-down approach sparingly, and instead allow industry to identify suitable products via the bottom-up approach. The respondent also suggested that other entities beside eligible central counterparties (CCPs) be allowed to submit applications to include products under the clearing obligation.

MAS' Response

2.2 While MAS recognises the key role that industry participants have to play in determining products to be centrally cleared, the top-down approach is nonetheless still appropriate under certain circumstances, e.g. where the product is systemically important and/or there are significant benefits to be derived from mandatory clearing. To incorporate industry input in the process, MAS will conduct a public consultation before prescribing any product for central clearing using the top-down approach.

2.3 On the type of entities that can submit applications to include products for central clearing under the bottom-up approach, CCPs are best placed to assess whether they can manage the risks associated with clearing certain products. It would not be appropriate for MAS to mandate central clearing of a product if there is no eligible CCP that can clear the product. Therefore, MAS will only accept applications under the bottom-up approach from eligible CCPs. Other interested parties can provide their input during the public consultation before MAS decides whether to prescribe the product for central clearing.

Operational issues

2.4 Respondents noted that they would need sufficient lead time to put operational arrangements in place for products that are mandated for central clearing. Some respondents suggested that MAS should ensure that there is a ready pool of CCPs licensed or authorised by MAS to provide clearing services to participants in Singapore before mandating central clearing.

MAS' Response

2.5 MAS notes respondents' concerns with regard to the operational aspects of central clearing. When determining products to include under the clearing obligation, MAS will consider the availability of CCPs as well as the robustness of their risk management frameworks. MAS will also take into account the industry's state of preparedness, and provide for appropriate transition periods during implementation.

Criteria for determining products to include under clearing obligation

2.6 Most respondents were supportive of the criteria proposed by MAS for determining whether a product is suitable for mandatory clearing. One respondent suggested that MAS conduct regular reviews of products included under the clearing obligation, as a product originally mandated for central clearing may later become unsuitable due to changing market conditions.

2.7 With regard to the feasibility of mandating central clearing for SGD Interest Rate Swaps (IRS), USD IRS and non-deliverable forwards (NDFs) in selected Asian currencies, some respondents noted that mandating IRS or NDFs as a product class may be too broad, and that MAS may wish to take into account the characteristics of specific contracts when determining products suitable for mandatory clearing.

MAS' Response

2.8 MAS agrees with the suggestion to periodically review the list of products mandated for central clearing, and will do so where appropriate.

2.9 On the preliminary proposal to require central clearing for USD IRS, SGD IRS and NDFs in selected Asian currencies, MAS is currently studying liquidity conditions across these products in greater detail in order to form a rigorous assessment of their suitability for central clearing. MAS will seek public feedback on the specific products to be included under the clearing obligation subsequently.

Complex products

2.10 A few respondents sought clarification on whether mandated products would need to be cleared if they are embedded in other derivatives or financial products.

MAS' Response

2.11 Whether the clearing obligation would apply to a mandated product embedded in other derivatives or financial products would depend on the structure of the product. For example, standardised derivative transactions conducted in the course of structuring a financial product (e.g. structured note) should be centrally cleared if they fall within the clearing obligation. In contrast, a complex derivatives transaction that cannot be easily disaggregated into its component elements would be less standardised and therefore be less amenable to central clearing.

Exemption for foreign exchange (FX) forwards and swaps

2.12 Respondents generally supported the proposal to exempt FX forwards and swaps. Some respondents sought clarification on whether FX spot transactions would be included, while one respondent sought clarification on whether the exemption for FX forwards and swaps is applicable only to deliverable forms of such transactions.

MAS' Response

2.13 MAS notes respondents' comments. FX spot transactions are currently not included in the proposal for mandatory clearing and reporting. The exemption for FX forwards and swaps is intended to apply only to deliverable forms of these transactions.

B Scope of Clearing Obligation – Contracts

Cross-border trades

2.14 Most respondents agreed with the proposal to subject derivatives contracts booked in Singapore to the clearing obligation. Some respondents requested MAS to provide an exemption in cases where a Singapore counterparty is trading with a foreign counterparty that is subjected to another jurisdiction's clearing obligation.

MAS' Response

2.15 To avoid possible overlapping or conflicting clearing obligations across multiple jurisdictions for cross-border trades, MAS proposes an equivalency approach as follows. Where a counterparty in Singapore enters into a derivatives contract with a foreign counterparty located in a jurisdiction that MAS considers to offer equivalent safeguards, the Singapore counterparty will be deemed to have

satisfied MAS' clearing obligation if it fulfils the requirements in the foreign jurisdiction.

Anti-evasion provision

2.16 While some respondents acknowledged the need for an anti-evasion provision in legislation, they suggested that MAS define the scope of anti-evasion carefully and not include trades which are conducted for legitimate purposes.

MAS' Response

2.17 MAS notes the respondents' feedback on the proposed anti-evasion provision and will exercise this power judiciously, taking into account the practice in other jurisdictions with similar provisions.

Voluntary clearing

2.18 One respondent sought clarification on whether counterparties to a trade that is not subjected to any clearing obligation in any jurisdiction can nonetheless voluntarily clear the trade via a CCP in Singapore.

MAS' Response

2.19 Counterparties to derivatives contracts that are not required to be centrally cleared may nonetheless voluntarily clear their trades with CCPs in Singapore as long as they satisfy the conditions set by these CCPs.

Validity of contracts

2.20 Some respondents were concerned that any failure to satisfy the clearing obligation regarding derivatives contracts mandated for central clearing may in turn affect the validity of these trades.

MAS' Response

2.21 In general, a failure to meet the clearing obligation represents a regulatory breach and should not affect the validity of a contract, unless it is specifically provided for in the terms and conditions of the said contract.

C Scope of Clearing Obligation - Entities

Entities to be subject to Clearing Obligation and Factors to consider when determining the Clearing Thresholds

2.22 Respondents generally supported MAS' proposal to include financial institutions and non-financial entities above specified thresholds under the clearing obligation. Some respondents suggested that MAS should review the clearing thresholds periodically. Others noted that the size of exposure alone may not be a good gauge of the risk undertaken by entities. Some market participants highlighted that there may be operational challenges in computing derivatives exposures (especially for non-financial entities) and in monitoring the derivatives exposures of counterparties.

MAS' Response

2.23 MAS agrees that there should be a process to review the clearing thresholds periodically to ensure that they remain relevant. For non-financial entities, the clearing thresholds will be based on the size of the entities' assets and their derivatives exposures. MAS is conducting further study with a view to proposing thresholds that are transparent and easy to compute and monitor. We will seek public feedback on the proposed clearing thresholds subsequently.

Hedging transactions

2.24 There were suggestions for MAS to allow both financial and non-financial entities to exclude hedging transactions when computing the clearing thresholds. Some respondents also proposed that MAS re-consider the definition of hedging to take into account dynamic portfolio hedging and developments in accounting standards.

MAS' Response

2.25 MAS does not agree that financial entities should be allowed to exclude their hedging transactions when computing the clearing thresholds. The exclusion of hedging transactions for non-financial entities is a concession that recognises that such corporations may need to enter into derivatives transactions to manage their risks. However, no jurisdiction has presently extended such treatment to financial entities, having regard to the systemic risks that they could pose. MAS' approach is therefore aligned with international practice. MAS notes the respondents' concerns on the scope of hedging transactions, and will consult on a proposed definition after further study.

Acting as agent

2.26 One respondent sought clarification on whether fund management companies entering into derivatives contracts on behalf of foreign-domiciled funds will be subjected to the clearing obligation.

MAS' Response

2.27 Entities that enter into derivatives contracts will be subjected to the clearing obligation if they are (a) specified entities; and (b) counterparties to the derivatives contracts. For example, a fund management company that enters into a derivatives contract as a counterparty to the trade in the course of managing a foreign-domiciled fund will be expected to comply with the clearing obligation. In contrast, if the fund management company served merely as an agent in the transaction and the counterparty to the derivatives contract is the foreign-domiciled fund, then the fund management company will not be subjected to the clearing obligation.

Exemption for certain public bodies

2.28 Respondents generally agreed with the proposal to exempt certain public bodies from the clearing obligation. Some respondents requested MAS to clarify that counterparties that enter into trades with exempted public bodies would also not be subject to the clearing obligation. Some respondents sought clarification on whether agents executing trades on behalf of exempted public bodies would be subjected to the clearing obligation.

MAS' Response

2.29 All counterparties that enter into derivatives trades with exempted counterparties (including exempted public bodies) will also be excluded from the clearing obligation in respect of those trades. On the other hand, if an entity enters into a trade on behalf of exempted entities or entities that are not subject to the clearing obligation, then it would be subjected to the clearing obligation only if the entity is (a) a specified entity; and (b) a counterparty to the trade.

Exemption for intra-group trades

2.30 While respondents generally agreed with the proposal to exempt intra-group trades from the clearing obligation, they expressed concern over subjecting these trades to collateralisation requirements. Some respondents suggested that MAS adopt the EU's approach of not requiring bilateral collateralisation if: (a) there is no current or foreseeable practical or legal impediment to the prompt transfer of own funds and payment of liabilities between the counterparties; and (b) the risk management procedures of the counterparties are adequately sound, robust and consistent with the level of complexity of the derivatives transaction. One respondent suggested that bilateral collateralisation should be limited to variation margin only. Another respondent suggested that derivatives contracts entered into by entities which are legally obliged to support one another financially or where a

parent entity is obliged to support both counterparties should be exempted from bilateral collateralisation.

MAS' Response

2.31 MAS notes respondents' comments, and will consider appropriate safeguards for intra-group trades, taking into account recent international proposals on margin requirements for uncleared trades¹. MAS will consult on these proposals at a later stage.

Exemption for pension schemes

2.32 Some respondents suggested that MAS could provide a temporary exemption for pension schemes, in line with the EU's approach. One respondent also pointed out that there could be other forms of pension schemes in Singapore besides the Central Provident Fund.

MAS' Response

2.33 MAS notes respondents' comments. We are reviewing this issue and will consult on the detailed treatment of pension schemes at a later stage, taking into account international developments in this area.

D Locational Requirements for Clearing

2.34 Most respondents supported the proposal not to require central clearing only through domestic CCPs. One respondent sought clarification on whether client clearing (i.e. via a clearing member of an eligible CCP) would be acceptable for the purpose of meeting the clearing obligation.

MAS' Response

2.35 Both direct and indirect (i.e. client) clearing would be allowed for the purposes of meeting the clearing obligation. MAS will consult on the specifics for client clearing at a later stage.

E Backloading of Outstanding Contracts

2.36 Most respondents expressed concerns with regard to the proposal on backloading. Some respondents argued that the economics of historical derivative

¹ Margin Requirements for Non-Centrally Cleared Derivatives, BCBS-IOSCO, 6 July 2012

contracts did not take into account clearing costs and that requiring retroactive clearing of these contracts could pose legal issues. Others suggested that capital and margining requirements for uncleared contracts would already provide strong incentives for market participants to backload existing contracts where appropriate, and that it would therefore not be necessary to mandate backloading of such contracts. Respondents also noted that the EU authorities, who had earlier proposed to require backloading, had decided not to include the requirement in their final rules.

MAS' Response

2.37 Taking into account the feedback received, and to avoid introducing a requirement that would not be consistent with international practice, MAS will not proceed with the backloading proposal.

3 COMMENTS ON CONSULTATION PAPER SECTION 4: REPORTING MANDATE

A Scope of Reporting Obligation - Products

3.1 Respondents generally supported MAS' proposal to implement the reporting obligation in phases. Some respondents requested for a sufficient transition period to implement necessary infrastructural changes. A few respondents suggested that MAS phase in the reporting obligation by product and participant type, taking into account the level of standardisation in each asset class, the asset classes subjected to the reporting obligation in other jurisdictions, and the readiness of the reporting infrastructure. Some respondents also requested that oil derivatives be excluded in the first phase of reporting, as a significant proportion of participants in the oil derivatives markets are commodity firms that are generally less familiar with such reporting requirements and may not have the necessary infrastructure.

MAS' Response

3.2 MAS notes respondents' concerns about potential operational challenges, and will provide for appropriate transition periods during implementation. MAS will also take into consideration the factors cited by respondents when prescribing the product/asset classes to be subject to the reporting obligation as well as the phase-in arrangements.

B Scope of Reporting Obligation - Contracts

3.3 Respondents generally agreed with the proposal to impose the reporting obligation on a booking basis, as the risk of a contract lies with the booking entity. However, some respondents expressed concern that defining the reporting obligation on a trading basis could result in duplicative reporting of the same trade. Some respondents also raised the issue of confidentiality laws in Singapore and other jurisdictions and suggested that MAS provide an exemption in cases where foreign laws do not permit trade reporting.

MAS' Response

3.4 MAS notes the respondents' concerns on defining the reporting obligation on a trading basis. However, MAS does not agree that reporting obligation should be applied solely on a booking basis. Trade reporting serves multiple, important objectives, including (a) assessing systemic risk and financial

stability; (b) conducting market surveillance and enforcement; (c) supervising market participants; and (d) conducting resolution activities. Some of these objectives require MAS to have access to data on derivatives contracts that are traded in but not necessarily booked in Singapore. MAS is mindful that the same trade may be subject to reporting obligations in different jurisdictions. To mitigate such concerns, MAS will align its reporting obligation with other jurisdictions' where appropriate, taking into consideration confidentiality/foreign laws where applicable, and allow entities to fulfil their reporting obligations efficiently.

C Scope of Reporting Obligation - Entities

Requiring reporting by all financial entities, as well as non-financial entities above a reporting threshold

3.5 Most respondents agreed with the proposal to require reporting by all financial entities, as well as non-financial entities above a reporting threshold. Some respondents sought clarification on whether trades conducted between a financial entity and a non-financial entity that falls below the reporting threshold would be subject to the reporting obligation. Some respondents suggested granting an exemption for trades conducted for hedging purposes or intra-group trades.

MAS' Response

3.6 Trades conducted between a financial entity and a non-financial entity that fall below the reporting threshold will still be subjected to the reporting obligation. However, the reporting obligation will fall on the financial entity only.

3.7 MAS does not agree with the suggestion to exempt trades conducted for hedging purposes or intra-group trades as this would not be consistent with the goal of improving transparency nor with international practice.

Reporting threshold

3.8 Respondents suggested using other criteria such as size of derivatives exposures in addition to asset size to determine the reporting threshold.

MAS' Response

3.9 MAS is reviewing the criteria to be considered when determining the reporting threshold, taking into account the comments received and international developments, and will seek public feedback on the specific reporting threshold to be applied.

Single-sided reporting and use of third party service providers

3.10 Respondents generally supported the proposal to allow for single-sided reporting and the use of third party service providers to fulfil reporting obligation. Some respondents suggested more clarity regarding the protocol for single-sided reporting. For instance, they requested that in the instance of two financial entities trading with each other, the reporting obligation be placed on the dealer. Other respondents suggested that the obligation to ensure accuracy of information should be placed on the third party service provider.

MAS' Response

3.11 We note respondents' comments with regard to the protocol for single-sided reporting when a transaction involves two financial entities. While the US authorities have placed the onus on swap dealers to report on behalf of other financial entities, MAS proposes to allow financial entities to elect amongst themselves the appropriate party to report, so as to provide some degree of flexibility. This is also aligned with the practices in other markets.

3.12 Engaging a third party service provider to report derivatives transactions is akin to an outsourcing arrangement. Ultimate responsibility for meeting the reporting obligation rests with the original party to the transaction and not the third party service provider. Therefore, the original party, and not the third party service provider, will be held responsible for the timeliness and accuracy of the information reported.

Exemption for certain public bodies

3.13 Respondents generally agreed with the proposal to exempt certain public bodies from the reporting obligation. Some respondents sought clarification on whether such trades should still be reported by the relevant counterparties.

MAS' Response

3.14 To preserve confidentiality, parties (whether a financial or non-financial entity) to a trade with an exempted public body would also be exempted from reporting that derivatives transaction.

D Scope of Reporting Obligation – Information to be reported

Data and aggregation standards

3.15 Respondents generally supported the proposal to adopt the data and aggregation standards recommended by the Committee on Payment and Settlement Systems (CPSS) and the Technical Committee of the International Organization of Securities Commissions (IOSCO). However, as some of these international standards are still in the process of being developed, some respondents suggested that MAS allow for sufficient flexibility when developing the reporting framework to take into account evolving changes.

MAS' Response

3.16 MAS notes the respondents' comments and will take into account relevant international standards when developing the reporting framework.

Adoption of Legal Entity Identifier (LEI)

3.17 Respondents agree with the proposal to adopt the LEI and a product classification system aligned with international standards. Some respondents suggested phasing in the reporting obligation to take into account developments regarding the LEI while others suggested using other identification systems in the interim period for smaller firms and corporates.

MAS' Response

3.18 MAS notes respondents' feedback, and will take into account developments regarding the LEI and the product classification system when designing and implementing the reporting framework.

E Timeliness of Reporting

3.19 Respondents generally supported the proposal to require reporting within one business day of the transaction. Some respondents suggested allowing more time to report complex trades while others cited concerns on time-zone differences and system capabilities. Some respondents also highlighted that locally-incorporated banks could face challenges in reporting group-wide transactions within one business day. Some respondents also sought clarification on the definition of one business day.

MAS' Response

3.20 MAS will take into account the respondents' comments and international practices when developing detailed guidance on the operational aspects of the reporting obligation. We wish to clarify that with regard to group-wide reporting for Singapore-incorporated banks, the reporting obligation will fall on the individual subsidiaries. Banks are not required to consolidate and report on behalf of their subsidiaries. In addition, MAS is of the view that the definition of one business day should take into account time-zone differences. We will consult on the proposed guidance subsequently.

F Backloading of Outstanding Contracts

3.21 Most respondents agreed with the proposal to backload existing derivatives contracts with remaining maturity of more than one year. However, some respondents felt that the operational costs and possible legal challenges outweigh the benefits of backloading. Some respondents requested that MAS provide sufficient lead time for entities to prepare for this requirement.

MAS' Response

3.22 Backloading is essential for regulators to form an accurate view of outstanding derivatives transactions in order to monitor systemic risks and supervise market participants. Having regard to the respondents' feedback, MAS will make appropriate transitional arrangements for implementation.

G Locational Requirements for Trade Repositories

3.23 Respondents generally agreed with the proposal. Some respondents requested for MAS to not impose the reporting obligation before any trade repositories are authorised by MAS.

MAS' Response

3.24 MAS notes the respondents' feedback, and will phase in the reporting obligation taking into account the authorisation of trade repositories.

MONETARY AUTHORITY OF SINGAPORE

3 Aug 2012

ANNEX

LIST OF RESPONDENTS TO SECTIONS 3 AND 4 OF THE CONSULTATION ON POLICY REFORMS ON REGULATION OF OTC DERIVATIVES

1. APG Asset Management
2. Ashurst LLP
3. Association of Corporate Treasurers (Singapore)
4. Aviva Investors Asia Pte Ltd
5. BP Singapore Pte Limited
6. Brightoil Petroleum (S'pore) Pte Ltd
7. CapitalTrack Ltd.
8. Cargill Asia Pacific Holdings Pte Ltd
9. CFA Institute
10. Chatham Financial Pte. Ltd.
11. Citibank Singapore Ltd
12. Citibank, N.A., Singapore Branch
13. Citicorp Investment Bank (Singapore) Limited
14. Citigroup Global Markets Singapore Pte. Ltd.
15. Citigroup Global Markets Singapore Securities Pte. Ltd.
16. City Index Asia Pte Ltd
17. Cleartrade Exchange Pte Ltd
18. CMC Markets Singapore Pte Ltd
19. CME Group Inc.
20. Ernst & Young LLP
21. European Chamber of Commerce (Singapore)
22. Financial Services Committee, European Chamber of Commerce (Singapore)
23. GFT Global Markets Asia Pte Ltd
24. Ginga Petroleum (Singapore) Pte Ltd
25. Global Foreign Exchange Division (GFXD) of the Global Financial Markets Association (GFMA)
26. Great Eastern Life Assurance Co Ltd
27. Groups A, F and G, International Corporate Finance Course 2012, Faculty of Law, National University of Singapore
28. ICAP AP (Singapore) Pte Ltd
29. IG Asia Pte Ltd
30. Intercontinental Exchange, Inc.
31. International Swaps and Derivatives Association, Inc.
32. KfW Bankengruppe
33. LCH Clearent Group Limited
34. Managed Funds Association
35. MarketAxess Europe Ltd.

36. MarkitSERV
37. Mizuho Corporate Bank, Ltd.
38. NOS Clearing ASA
39. OANDA Asia Pacific Pte Ltd
40. OCBC Bank
41. Phillip Futures Pte Ltd
42. Phillip Securities Pte Ltd
43. Rajah & Tann LLP
44. REGIS-TR
45. Schroder Investment Management (Singapore) Ltd
46. Securities Industry and Financial Markets Association
47. Shell Treasury Centre East (Pte) Limited
48. Singapore Mercantile Exchange
49. Singapore Money Brokers Association
50. State Street Bank and Trust Company
51. Sumitomo Mitsui Banking Corporation Singapore Branch
52. SWIFT Asia Pacific
53. TFS Currencies Pte Ltd
54. The Alternative Investment Management Association Limited – Singapore Branch
55. The Association of Banks in Singapore
56. The Depository Trust & Clearing Corporation
57. The Royal Bank of Scotland plc
58. Thomson Reuters
59. Tradition Singapore Pte Ltd
60. Trafigura Beheer B.V. Amsterdam
61. Trayport Limited
62. TriOptima AB
63. Vitol Asia Pte Ltd
64. Westpac Institutional Bank
65. Wong Partnership LLP
66. 12 other respondents who requested for confidentiality