

CONSULTATION PAPER

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Draft Regulations for Mandatory Clearing of Derivatives Contracts

MAS

Monetary Authority of Singapore

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1 PREFACE

1.1 The Securities and Futures (Amendment) Act 2012 was passed by Parliament on 15 November 2012 which gave effect to policy proposals, among others, relating to regulation of over-the-counter (“OTC”) derivatives. These proposals involve –

- (a) introducing a new regulatory regime for trade repositories;
- (b) extending the regulatory regime for clearing facilities to OTC derivatives;
and
- (c) mandating reporting and clearing of OTC derivatives.

1.2 In line with the G20 objectives and FSB recommendations on OTC derivatives reforms, MAS is now consulting on the proposed regulations for the mandatory clearing of OTC derivatives. The draft Securities and Futures (Clearing of Derivatives Contracts) Regulations (“SF(CDC)R”) sets out the implementation details of the initial set of product and persons subject to clearing obligations under the Securities and Futures Act (Cap. 289) (“SFA”).

1.3 MAS invites interested parties to provide their comments on the SF(CDC)R.

Please note that all submissions received will be published and attributed to the respective respondents unless they expressly request MAS not to do so. As such, if respondents would like (a) their whole submission or part of it, or (b) their identity, or both, to be kept confidential, please expressly state so in the submission to MAS. In addition, MAS reserves the right not to publish any submission received where MAS considers it not in the public interest to do so, such as where the submission appears to be libellous or offensive.

1.4 Please submit written comments by 31 July 2015 to:

Capital Markets Policy Division
Markets Policy & Infrastructure Department
Monetary Authority of Singapore
10 Shenton Way
MAS Building
Singapore 079117
Fax: (65) 6225 1350
Email: derivatives@mas.gov.sg

1.5 Electronic submission is encouraged. We would appreciate that you use this suggested format for your submission to ease our collation efforts. You can access the template [here](#).

2 INTRODUCTION

2.1 MAS proposes the draft SF(CDC)R which will effect Part VIB of the SFA on the mandatory clearing of OTC derivative contracts. The following sections set out MAS' policy considerations on key aspects of the mandatory clearing regime: type of OTC derivative contracts to be cleared and circumstances under which clearing is mandatory, persons who are subject to or exempt from clearing obligations, and other implementation details. The draft SF(CDC)R is set out in the Annex.

3 SPECIFIED DERIVATIVES CONTRACTS TO BE CLEARED

3.1 MAS assesses the OTC derivative contracts that should be subject to mandatory clearing based on factors set out in section 129G(2) of the SFA. These factors include the level of systemic risks posed by the product, the depth and liquidity of the product. We have also taken into account the availability of Central Counterparties ("CCPs") regulated by MAS as approved clearing houses ("ACHs") or recognised clearing houses ("RCHs"). Market participants have to clear on ACHs or RCHs to meet our clearing mandate.

3.2 MAS intends to commence mandatory clearing by asset class, beginning with interest rate derivative contracts, which are about 50% of all derivatives booked in Singapore (by gross notional amount outstanding). The clearing of interest rate swaps ("IRS"), which constitutes more than 90% of interest rate derivative contracts booked in Singapore (by gross notional amount outstanding), would significantly reduce systemic risks in the Singapore financial system.

3.3 IRS are also highly standardised contracts. They pose minimal operational concerns for clearing unlike more complex and exotic products. MAS also notes the industry commitments to meet high degree of standardisation of electronic execution and confirmation of OTC interest rate derivatives¹, and that market participants have already begun clearing some IRS on CCPs.

¹ In June 2013, the Singapore Foreign Markets Committee ("SFEMC") achieved the following targets for major interest rate derivatives:

(a) Processing of 95% of OTC interest rate derivatives trades with G14 Members on electronic platforms, with 98% of these trades processed within 2 days from the date of execution; and

(b) Processing of 75% of OTC interest rate derivatives trades with all other counterparties on electronic platforms, with 90% of these trades processed within 2 days of the date of execution.

3.4 MAS proposes to subject, at a minimum, the Singapore-dollar (“SGD”) fixed-to-floating swaps based on the Swap Offer Rate (“SOR”) and the U.S. dollar (“USD”) fixed-to-floating swaps based on London Interbank Offered Rate (“LIBOR”) to clearing obligations. They are the most liquid IRS traded in Singapore and comprise about 50% of gross notional of IRS trades booked in Singapore. In terms of availability of clearing facilities, the Singapore Exchange Derivatives Clearing Limited (“SGX-DC”), an ACH, currently offers the clearing of SGD and USD IRS. Going forward, MAS expects to approve or recognise more CCPs as ACHs or RCHs that are also able to clear IRS, before commencement of the clearing obligations.

3.5 MAS is considering subjecting IRS denominated in Euro (“EUR”), Pound Sterling (“GBP”) and Japanese Yen (“JPY”) to mandatory clearing obligations. Excluding the SGD and USD IRS, the total EUR, GBP and JPY IRS booked in Singapore form a significant proportion relative to IRS denominated in other currencies. Internationally, major jurisdictions such as the US, Europe, and Australia, have mandated or are proposing to subject EUR, GBP and JPY IRS to mandatory clearing.

3.6 Requiring a wider range of contract specifications for interest rate swaps to be cleared may allow market participants to achieve greater margining efficiencies. Therefore, MAS is seeking feedback on whether subjecting more types of SGD, USD, EUR, GBP and JPY IRS – such as basis swaps, forward rate agreements or overnight index swap to clearing obligations, would, on balance, would allow market participants to achieve greater margin efficiencies.

3.7 The proposed minimum contract specifications of the IRS described in paragraphs 3.4 – 3.5 are set out in the tables below:

Table 1: Contract specifications for SGD and USD IRS

Settlement Currency	Reference Index	Types	Maturity	Optionality	Notional Type
SGD	SOR	Fixed-to-floating	Up to 30 years	No	Constant
USD	LIBOR	Fixed-to-floating	Up to 30 years	No	Constant

Table 2: Contract specifications for EUR, GBP and JPY IRS

Settlement Currency	Reference Index	Types	Maturity	Optionality	Notional Type
Euro	EURIBOR	Fixed-to-floating	Up to 50 years	No	Constant
GBP	LIBOR	Fixed-to-floating	Up to 50 years	No	Constant
JPY	LIBOR	Fixed-to-floating	Up to 40 years	No	Constant

Question 1. MAS seeks views on the proposal to subject, at a minimum, SGD fixed-to-floating SOR IRS and USD fixed-to-floating LIBOR IRS to clearing obligations.

Question 2. MAS seeks views on whether it would be appropriate to mandate clearing of EUR, GBP and JPY IRS.

Question 3. MAS seeks views on whether subjecting more types of SGD, USD, EUR, GBP and JPY IRS products, such as basis swaps, forward rate agreements or overnight index swap, to clearing obligations, would result in margining efficiencies for market participants.

4 CIRCUMSTANCES UNDER WHICH CONTRACTS ARE TO BE CLEARED

4.1 IRS are predominantly traded in Singapore by local banks and local branches of foreign banks. MAS proposes to commence clearing obligations in relation to IRS trades in which both transacting counterparties have booked in their Singapore-based operations, i.e. a Singapore-incorporated company or a Singapore branch of a foreign entity. Clearing obligations should primarily be imposed on risks that are booked and hence residing in the Singapore system.

4.2 This approach addresses trades whose risks reside in Singapore, but with due consideration that not many jurisdictions other than US, Japan and EU² have put in place mandatory clearing regimes at this stage. As such, foreign counterparties may not be obliged to and hence may not be ready to clear their OTC derivative trades. This also avoids potentially creating conflicting requirements should other jurisdictions also commence clearing obligations.

4.3 The interaction of jurisdictions' rules on cross-border transactions remains an ongoing concern. MAS continues to participate actively in international discussions to resolve this matter. A successful resolution would require a common understanding of approaches across jurisdictions.

4.4 In relation to cross-border transactions with US or EU persons that may be subject to their respective clearing obligations, our proposed clearing mandate will not result in any conflicts. SGX-DC, regulated by MAS as an ACH, is registered as a Derivatives Clearing Organisation with the U.S. Commodity Futures Trading Commission ("CFTC"). It is also recognised as an equivalent third country CCP by the European

² US and Japan have commenced mandatory clearing; the EU has put in place its mandatory clearing regime which has yet to commence.

Securities and Markets Authority (“ESMA”). As highlighted earlier, MAS also expects to approve or recognise more CCPs that meet CFTC’s or ESMA’s requirements on mandatory clearing. Thus, we believe US or EU persons will be able to meet both MAS’ proposed requirements on mandatory clearing, and CFTC’s or ESMA’s requirements, respectively, on mandatory clearing.

4.5 In relation to transactions which were traded in Singapore but booked elsewhere such as foreign subsidiaries or foreign branches of local banks, MAS maintains oversight of such operations through its consolidated supervision of local banking groups. MAS engages banks regularly on their policies regarding booking of OTC derivative contracts and appropriate risk controls as part of banking supervision. MAS will also assess the risk based on trade data reported to our licensed trade repositories, which includes OTC derivative contracts booked or traded in Singapore.

Question 4. In relation to the IRS proposed for mandatory clearing (see Section 3), MAS seeks views on subjecting transactions that are booked in the Singapore-based operations of both transacting counterparties, i.e. a Singapore-incorporated company or a Singapore branch of a foreign entity, to clearing obligations.

5 SPECIFIED PERSONS TO BE SUBJECT TO CLEARING OBLIGATIONS

5.1 Under section 129B of the SFA, all banks and other financial institutions such as insurers and capital markets services licence holders are specified persons subject to clearing obligations upon commencement of our mandatory clearing regime. However, it may not be appropriate at this stage to impose clearing obligations on all specified persons. For a start, MAS therefore proposes to subject only banks that have a certain level of OTC derivatives activities to our clearing obligations. These would address the largest counterparty credit risks in our OTC derivative markets.

5.2 MAS has also reviewed the accessibility and operational feasibility of specified persons entering into client clearing arrangements or taking up direct clearing membership on CCPs. We note that currently, few members of OTC derivatives CCPs offer client clearing arrangements; smaller financial institutions including banks with low levels of OTC derivatives activities may not find it commercially feasible to take up direct clearing membership.

5.3 MAS proposes to exempt all banks from clearing obligations as long as they do not exceed a maximum threshold of S\$20 billion gross notional outstanding derivatives contracts booked in Singapore for each of the last four calendar quarters. The threshold is calibrated to subject the most active major global banks, regional or domestic banks

trading OTC derivatives, to clearing obligations. All other specified persons that are not banks will also be initially exempted from clearing obligations.

Question 5. MAS seeks views on the proposed exemptions from clearing obligations approach: (a) all banks from mandatory clearing as long as they do not exceed a maximum threshold of S\$20 billion gross notional outstanding derivatives contracts booked in Singapore for each of the last four calendar quarters; and (b) all other specified persons that are not banks.

6 EXEMPTIONS FROM CLEARING OBLIGATIONS

6.1 In line with other jurisdictions such as the US, EU, and Japan, MAS proposes to exempt intra-group transactions from the scope of clearing obligations. Such transactions do not transfer risks in or out of a corporate group and are best left to such groups to manage their group-wide risks in a manner most appropriate for their corporate structure.

6.2 MAS also proposes to exempt public bodies from clearing obligations, including all central banks and governments, as well as international multilateral organisations such as the Bank for International Settlements, the International Monetary Fund and the World Bank. The policy functions of public bodies may require them to maintain flexibility to respond to a variety of circumstances, which may be constrained if they are subject to clearing obligations.

Question 6. MAS seeks views on the approach to exempt intra-group transactions and public bodies from clearing obligations.

7 IMPLEMENTATION OF CLEARING OBLIGATIONS

7.1 MAS intends to issue the SF(CDC)R by the end of 2015, and will provide at least six months' notice before the clearing obligations take effect. Once the obligations under the SF(CDC)R take effect, banks that exceed the maximum threshold will be required to clear contracts subject to mandatory clearing which are entered on or after the effective date.

7.2 Following the commencement of clearing obligations, MAS will continue to review when it may be appropriate to expand the scope of our mandatory clearing regime, taking into consideration factors such as industry readiness as well as international developments. Primarily, MAS will consider the following options, amongst others:

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- (a) increase the range of products subject to clearing obligations, possibly with the most liquid products in the next largest asset class i.e. foreign exchange OTC derivatives;
 - (b) lower the maximum threshold for exemption from clearing obligations and/or include the more active non-banks financial institutions trading OTC derivatives; and/or
 - (c) to widen the nexus for OTC derivative contracts subject to clearing obligations, including cross-border transactions with transacting counterparties that do not book their trades in Singapore-based operations.

Question 7. MAS seeks views on the proposed approach for the commencement of clearing obligations.

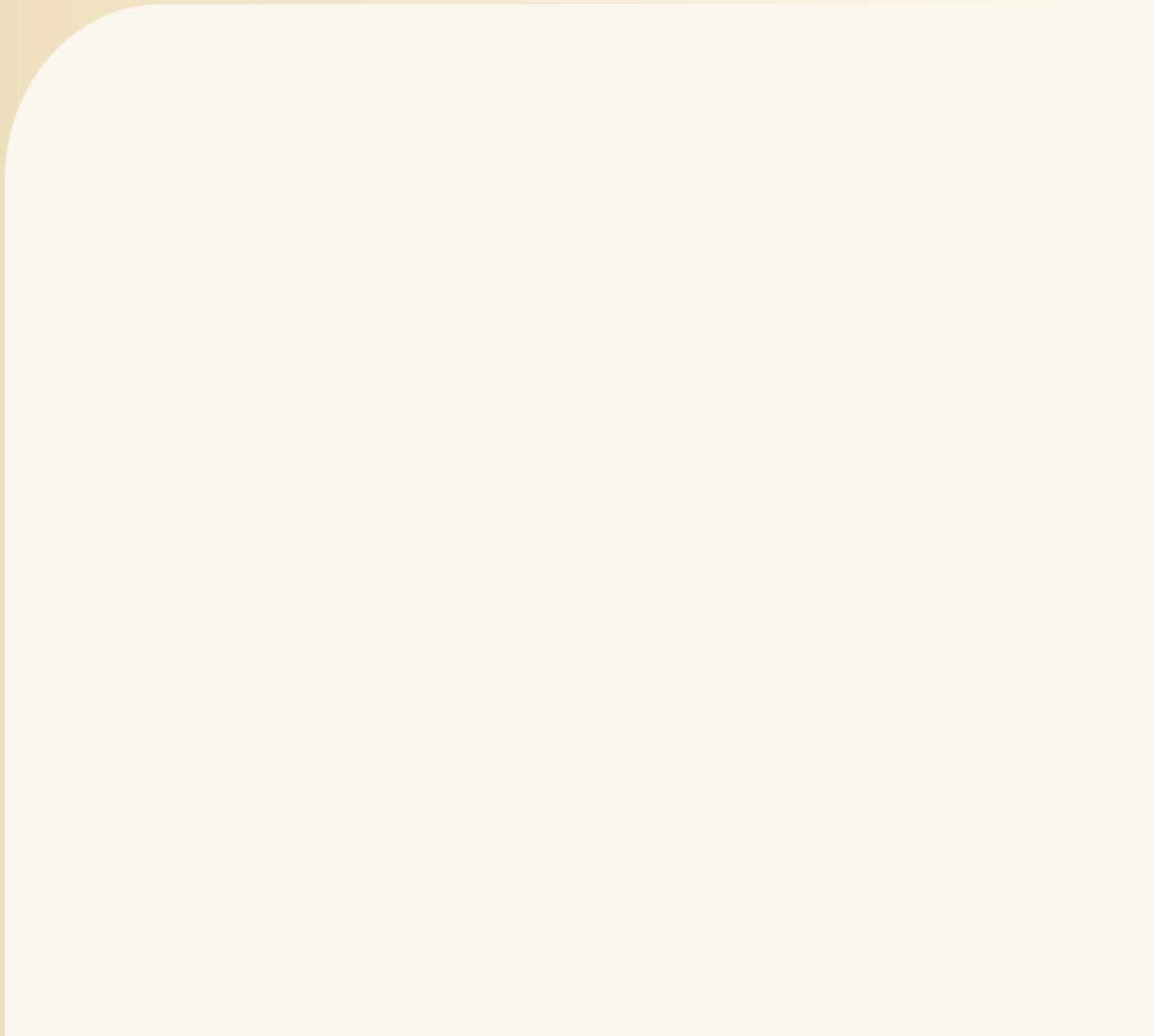
Question 8. MAS seeks views on proposed considerations in expanding the scope of our mandatory clearing regime.

Question 9. MAS seeks views on the draft SF(CDC)R attached in the Annex B.

Annex A

LIST OF QUESTIONS

- Question 1.** MAS seeks views on the proposal to subject, at a minimum, SGD fixed-to-floating SOR IRS and USD fixed-to-floating LIBOR IRS to clearing obligations.6
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