

CONSULTATION PAPER

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Consultation Paper on Enhancements to Regulatory Requirements on Protection of Customer's Moneys and Assets

MAS

Monetary Authority of Singapore

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1 Preface

1.1 The Monetary Authority of Singapore (“MAS”) proposes to enhance the regulatory regime governing the protection of client moneys and assets held by capital markets intermediaries. These proposed enhancements take into account the international standards promulgated by the International Organization of Securities Commission (“IOSCO”) and Financial Stability Board (“FSB”).

1.2 The proposals in this consultation paper will subsequently be effected via new rules, which MAS will consult on after considering feedback from this consultation. Please refer to Annex A for the list of questions for public feedback.

1.3 MAS invites interested parties to provide their views and comments on the policy proposals.

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 (i) their whole submission or part of it, or (ii) 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 19 August 2016 to –

Capital Markets Intermediaries Department III
Monetary Authority of Singapore
10 Shenton Way, MAS Building
Singapore 079117
Fax: (65) 62203973
Email: CMI-REPLY@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 The failure of a number of international financial institutions, such as Lehman Brothers and MF Global, during the global financial crisis underscored the importance of financial institutions having effective and robust arrangements in place for the identification and safeguarding of customer's moneys and assets. In addition to minimising the risk of loss or misuse of customer's moneys and assets during normal times, these arrangements facilitate the prompt return or transfer of customer's moneys and assets in the event of the default, resolution or insolvency of the financial institutions.

2.2 In Singapore, holders of a Capital Markets Services licence ("CMS licensees") conducting regulated activities under the Securities and Futures Act ("SFA") are required to take the necessary measures to safeguard customer's moneys and assets¹ as prescribed under the Securities and Futures (Licensing and Conduct of Business) Regulations ("LCB Regulations"). These institutions are required to, among other things, place customer's moneys and assets in trust or custody accounts maintained with regulated deposit-taking institutions or custodians, segregate their own moneys and assets from those of their customers, keep proper records of their customer's holdings, and furnish their customers with periodic statements of account. They are also not allowed to use their customer's moneys and assets unless it is for a purpose that is expressly permitted by the LCB Regulations.

2.3 MAS has undertaken a review of the requirements governing the protection of customer's moneys and assets and is proposing to enhance those relating to the safeguarding, identification and use of customer's moneys and assets, and disclosures to customers. In formulating these proposals, MAS has also considered the international standards promulgated by the IOSCO² and FSB³.

2.4 The proposals in this consultation paper do not apply to the non-centrally cleared OTC derivatives included under the [Consultation Paper on Margin Requirements for Non-Centrally Cleared OTC Derivatives, issued in October 2015](#). Interested parties should refer to the October 2015 consultation paper for the relevant requirements, including the safekeeping requirements for margins and charging or re-hypothecating of customer's assets arising from such non-centrally cleared OTC derivative contracts.

¹ Customer's moneys and customer's assets are defined in regulations 15(2) and (3) of the LCB Regulations, respectively.

² IOSCO's Report on Recommendations Regarding the Protection of Client Assets (January 2014).

³ FSB's Key Attributes of Effective Resolution Regimes for Financial Institutions (October 2011) and Annex on Client Asset Protection in Resolution (October 2014).

2.5 The proposed changes in this consultation paper will be effected primarily through amendments to the LCB Regulations. MAS will consult on the legislative amendments after considering the feedback on the proposals in this consultation.

3 Measures Relating to the Safeguarding, Identification and Use of Customer's Moneys and Assets

Definition of Customer's Moneys

3.1 Internationally, customer's moneys and assets are defined to include moneys and assets held by an intermediary for or on behalf of a customer in connection with the services provided by the intermediary to the customer and to which the customer has a proprietary or similar right to the return of those moneys and assets. These include:

- (a) Moneys held on behalf of or owed to a customer by an intermediary;
- (b) Financial instruments held for or on behalf of a customer;
- (c) Customer's collateral, that is, moneys or assets received from a customer and held by the intermediary for or on behalf of the customer to secure an obligation of the customer; and
- (d) Other contractual rights arising from transactions entered into by an intermediary on behalf of or with a customer (for example, mark-to-market accruals arising from the change in value of positions in futures contracts).

3.2 The definition of "customer's moneys" in the LCB Regulations currently covers only moneys received from or on account of the customer, but does not include contractual rights arising from transactions entered into by an intermediary on behalf of or with a customer. To ensure all customer's moneys received and held by CMS licensees are accorded the protection provided under the LCB Regulations, MAS proposes to expand the definition of "customer's moneys" to cover contractual rights arising from transactions entered into by the CMS licensees on behalf of a customer (e.g. futures contracts) or with a customer (e.g. contract for differences).

3.3 MAS is not proposing to change the definition of "customer's assets" in the LCB Regulations, which is currently defined as securities and other assets (other than money) that are beneficially owned by a customer. This is because mark-to-market accruals and other contractual rights owed by the CMS licensee to the customer are typically met with cash instead of assets.

Question 1. MAS seeks comments on the proposal to expand the definition of customer's moneys to include contractual rights arising from transactions entered into by the CMS licensee on behalf of a customer (e.g. futures contracts) or with a customer (e.g. contract for differences).

Due Diligence on Third Party Custodian

3.4 Regulation 29 of the LCB Regulations requires CMS licensees, prior to opening a custody account with a third party custodian to keep their customer's assets, to conduct due diligence on the suitability of the custodian for the CMS licensees' customer or class of customers.

3.5 However, there is currently no requirement for CMS licensees to conduct due diligence on the deposit-taking institution with whom the CMS licensees intend to open a trust account to safe-keep their customer's moneys. CMS licensees are also not required to carry out periodic reviews to assess whether the deposit-taking institution or custodian remains suitable.

3.6 To ensure that CMS licensees exercise due care and diligence in the selection of deposit-taking financial institutions and custodians, MAS proposes to:

- (a) require CMS licensees to conduct due diligence on the suitability of the deposit-taking financial institutions with whom CMS licensees intend to deposit their customer's moneys, prior to opening the trust account with the deposit-taking financial institution; and
- (b) require CMS licensees to carry out periodic reviews of the suitability of the deposit-taking financial institutions and custodians with whom they maintain the trust account and custody account to keep their customer's moneys and assets respectively.

3.7 In conducting due diligence on the suitability of the deposit-taking financial institutions or custodians, both at the time of account opening and as part of the periodic reviews, CMS licensees should consider, among other things, the following:

- (a) the legal requirements or market practices relating to the holding of customer's moneys and assets that could adversely affect customer's rights during business as usual and in the event of the default or resolution of the CMS licensee, the third party deposit-taking financial institution or custodian;

- (b) the financial condition, expertise and market reputation of the third party deposit-taking financial institution or custodian;
- (c) protection (or lack thereof) attendant upon the regulatory status of the third party deposit-taking financial institution or custodian; and
- (d) the need for diversification and mitigation of risks, where appropriate, by placing customer's moneys and assets with more than one third party deposit-taking financial institution or custodian.

Question 2. MAS seeks comments on the proposals to:

- (a) require CMS licensees to conduct due diligence for the selection and appointment of deposit-taking financial institutions with whom they maintain customer's trust accounts; and
- (b) require CMS licensees to carry out periodic reviews to assess whether the deposit-taking financial institutions and custodians with whom they maintain customer's trust accounts and custody accounts remain suitable.

Acknowledgement from Financial Institutions

3.8 Regulations 18 and 28 of the LCB Regulations require CMS licensees to obtain an acknowledgment from the domestic financial institutions⁴ with whom they keep customer's moneys and assets, confirming that (i) the accounts in which the customer's moneys and assets are deposited are designated as customer's trust accounts, (ii) the moneys and assets are held on trust for the customers and segregated from the CMS licensees' own moneys and assets, and (iii) the domestic financial institution will not use the moneys and assets in those accounts to set-off against any debt owed by the CMS licensee to the domestic financial institution. These regulations do not apply to situations where customer's moneys and assets are placed with overseas financial institutions.

3.9 To provide greater protection for investors, MAS is of the view that CMS licensees should similarly be required to obtain the requisite acknowledgment when they place their customer's moneys and assets with overseas financial institutions. Accordingly, MAS proposes to extend the applicability of Regulations 18 and 28 to situations where customer's moneys and assets are placed with overseas financial institutions.

⁴ These include banks, merchant banks, finance companies and depository agents.

Question 3. MAS seeks comments on the proposal to extend the applicability of Regulations 18 and 28 under the LCB Regulations to situations where customer's moneys and assets are placed with overseas financial institutions.

Information Requirement and Record Keeping

3.10 To facilitate the rapid transfer or return of customer's assets, it is important that CMS licensees maintain accurate and up-to-date records of customer's holdings. CMS licensees are currently required under Section 102 of the SFA and Regulations 39(1) and (2) of the LCB Regulations to maintain, for a period of not less than 5 years, a separate record for each customer stating:

- (a) the amount and description of each asset paid or deposited in the trust account and custody account, and the date of such deposit;
- (b) the date and quantity of each transfer of assets from or to the trust account and custody account arising from any asset borrowing or lending activity;
- (c) the date, amount and purpose of each withdrawal from the trust account or custody account; and
- (d) the date and amount of, and the reason for, each disposal of collateral from the trust account or custody account.

3.11 CMS licensees are also required to record, for each asset that does not belong to them, the following particulars (i) by whom and for whom the asset or the document of title to the asset is held, and (ii) the extent to which the asset is held for safe custody by a third party or mortgage, charged, pledged or hypothecated.

3.12 In addition to the above record keeping requirements, MAS intends to introduce a requirement for CMS licensees to maintain information systems and controls that can promptly produce, both in normal times and in the event of resolution or insolvency, and in a format understandable by an external party (such as a resolution authority or an administrator), information on the following:

- (a) the location of customer's moneys and assets, how the assets are held (that is, by the CMS licensee, its affiliate, or a third party deposit-taking financial institution or custodian) and the identity of all relevant depositories;
- (b) the type of segregation ("omnibus" or "individual") at all levels of a holding chain and the effects of the segregation on customer's ownership rights;

- (c) the applicable customer's moneys and assets protection rules, in particular where customer's moneys and assets are held in a foreign jurisdiction and will be subject to the customer's moneys and assets protection, and resolution or insolvency regime, of that foreign jurisdiction; and
- (d) outstanding loans of customer's securities arranged by the CMS licensee, including details of counterparties, contract terms and collateral received on behalf of the customers.

Question 4. MAS seeks comments on the proposal to require CMS licensees to maintain information systems and controls that can promptly produce, both in normal times and in the event of resolution or insolvency, salient information pertaining to their customer's moneys and assets.

Disclosure to Customers

3.13 The types of arrangements adopted by CMS licensees to hold customer's moneys and assets, including the existence of any holding chain, may have implications on the nature of claims and entitlements of the individual customer. For instance, where a CMS licensee places customer's moneys or assets in an omnibus account maintained with a financial institution or custodian, any shortfall in pooled moneys or assets arising from the insolvency of the financial institution or custodian may have to be borne by the individual customer. In cases where the CMS licensee places customer's moneys or assets with a foreign financial institution or custodian⁵, the customer may not receive the same level of protection available under Singapore law.

3.14 To provide transparency to customers on the manner in which the CMS licensees hold customer's moneys and assets and the attendant risks, MAS intends to require CMS licensees to disclose, in advance, to customers:

- (a) the manner in which the CMS licensees hold the customer's moneys and assets, including the type of segregation⁶ and the existence of any holding

⁵ For instance, where a customer transacts in overseas-listed investment products through a Singapore broker, the investment products would normally have to be held in a sub-custody account maintained by the Singapore broker with an overseas custodian.

⁶ Whether omnibus or individual segregation; and the effect of pooling of customer's moneys and assets in an omnibus customer account in the event of insolvency of the financial institution or the custodian, and how any shortfall in pooled moneys or assets will be allocated.

chain, and the risks associated with the arrangements adopted by the CMS licensees;

- (b) where the customer's moneys and assets are held in a foreign jurisdiction, the material differences between the customer's moneys and asset protection regimes in Singapore and that jurisdiction, and the potential consequences of such differences.

3.15 CMS licensees must also ensure that the disclosures required under paragraph 3.14 are presented in a clear and simple language that investors can easily understand.

Question 5. MAS seeks comments on the proposed disclosure requirements as set out in paragraphs 3.14 and 3.15.

Daily Computation of Trust Accounts and Custody Accounts

3.16 Under Regulation 37 of the LCB Regulations, a CMS licensee that trades in futures contracts or carries out leveraged foreign exchange trading is required to perform daily computation of the amount of its moneys and assets deposited in the customer's trust accounts or custody accounts. The daily computation requirement ensures proper accountability and reconciliation of moneys and assets held in trust by the CMS licensee on behalf of its customers.

3.17 Although the daily computation requirement only applies to CMS licensees that trade in futures or conduct leverage foreign exchange trading, MAS understands that in practice CMS licensees perform such computation on a daily basis for all moneys and assets deposited in trust accounts or custody accounts, regardless of the products traded by the customers. As regular reconciliation of customer's moneys and assets is a key control in ensuring that customer's moneys and assets are accounted for, MAS proposes to extend the daily computation requirement under Regulation 37 to all CMS licensees holding customer's moneys and assets⁷.

⁷ MAS had earlier consulted on proposals to extend the daily computation requirement to CMS licensees dealing in securities and OTC derivative contracts. For details, please refer to [Consultation Paper on Draft Regulations to Enhance the Regulatory Framework for Unlisted Margined Derivatives Offered to Retail Investors \(March 2014\)](#) and [Consultation Paper on Regulatory Framework for Intermediaries Dealing in OTC Derivative Contracts, Execution-related Advice, and Marketing of Collective Investment Scheme \(June 2015\)](#).

Question 6. MAS seeks comments on the proposal to extend the daily computation requirement under Regulation 37 of the LCB Regulations to all CMS licensees holding customer's moneys and assets.

Re-hypothecation and Other Use of Customer's Assets

3.18 Under Regulation 33 of the LCB Regulations, CMS licensees are required to provide risk disclosure⁸ to, and obtain consent from, their customers before they lend out the customer's securities. Regulation 33 however does not prescribe the content of the risk disclosure. This regulation also does not apply to situations where CMS licensees mortgage, charge, pledge or hypothecate their customer's assets.

3.19 To allow customers to make informed decisions on whether to allow CMS licensees to lend out or otherwise make use of their assets, MAS proposes to require CMS licensees to provide risk disclosure to, and obtain consent from, the customers prior to using the customer's assets, including the mortgaging, charging, pledging or re-hypothecating of the customer's assets. The risk disclosure should highlight, among others, how the grant of such rights by the customers to the CMS licensees to use their assets would affect the customer's rights over those assets as well the protection available to the customers under the LCB Regulations. For practical implementation, MAS will allow CMS licensees to provide the relevant risk disclosure in, and obtain the requisite consent through, the agreement governing the customer's account.

Question 7. MAS seeks views on the proposals to:

- (a) require CMS licensees to provide risk disclosure to, and obtain consent from, their customers prior to lending, mortgaging, pledging, charging or re-hypothecating the customer's assets; and
- (b) allow CMS licensees to provide the relevant risk disclosure in, and obtain the requisite consent through, the agreement governing the customer's account.

Statement of Account

3.20 Under Regulation 40 of the LCB Regulations, a CMS licensee is required to furnish its customers with monthly and quarterly statements of accounts, including information

⁸ The requirement to provide risk disclosure is not applicable where the customers are accredited investors.

such as the status of every asset held by the CMS licensee and the movement of money and every asset of the customers. The regulation does not apply in situations where:

- (a) there is no change to any of the particulars stated in the last statement of account; or
- (b) the customer is an accredited investor or a related corporation of the CMS licensee, and (i) the CMS licensee has made available to the customer on a real-time basis those particulars in the form of electronic records as consented by the customer or (ii) the customer has requested in writing not to receive the statement of account.

3.21 To ensure that customers have timely access to information about their moneys and assets kept with CMS licensees, MAS proposes to require CMS licensees to respond reasonably promptly to customers who make a request for their statements of accounts. While CMS licensees may impose a fee for such requests, the fee should be reasonable taking into account the costs of providing such a service.

Question 8. MAS seeks comments on the proposal to require CMS licensees to respond reasonably promptly to customers requesting for their statements of accounts.

Other Proposed Amendments to the LCB Regulations

3.22 Under Regulations 16(1)(b) and 26(2) of the LCB Regulations, CMS licensees are allowed to deposit customer's moneys and assets in a trust account or any other account directed by the customer. These regulations are intended to provide the flexibility to a customer to ask the CMS licensee to deposit his moneys or assets into an account of his choice (e.g. an account held by the customer with another bank). MAS has however observed that CMS licensees or other financial institutions will typically deposit the moneys or assets due to the customer (e.g. proceeds from the sale of shares) only into the bank account which had earlier been designated by the customer for such a purpose. Financial institutions will typically not allow the moneys or assets due to be paid into a different bank account, even if the customer has made such a request (unless the customer wishes to change his designated account, in which case the new designated account applies to all future transactions).

3.23 In addition, it is noted that some financial institutions have relied on these regulations to obtain the customer's direction, for instance by seeking the customer's consent via a clause in the account agreement for the financial institution to deposit the customer's moneys and assets in any account as determined by the financial institution. This is not the intent of the regulations. Particularly, it is unlikely that retail customers (i.e.

customers who are not institutional investors, accredited investors or expert investors) have applied their minds to, or fully appreciate, the implications of consenting to such a clause, especially when the clause is embedded among other terms and conditions in the account agreement. In this regard, MAS is considering to dis-apply Regulations 16(1)(b) and 26(2) to retail customers, to avoid the situation where retail customers inadvertently opt out of the protection provided under the LCB Regulations.

Question 9. MAS seeks feedback on whether Regulations 16(1)(b) and 26(2) should be dis-applied in the case of retail customers.

4 Application of the LCB Regulations to Banks, Merchant Banks and Finance Companies

4.1 The LCB Regulations governing the treatment and handling of moneys (“LCB Money Rules”) and assets (“LCB Asset Rules”) received from customers are also applicable to banks, merchant banks and finance companies (collectively referred to as “Exempt Financial Institutions” or “EFIs”) which conduct regulated activities under the SFA.

4.2 The LCB Money Rules and the LCB Assets Rules serve to protect customers, inter alia, against the default of the intermediary that they have contracted with by requiring that intermediary to deposit moneys and assets received from its customers into a trust account maintained with a bank licensed under the Banking Act, a merchant bank approved under the MAS Act or a finance company licensed under the Finance Companies Act (collectively, referred to as “specified financial institutions” or “SFIs”) and to keep such an account separate from any other account in which it deposits its own moneys. EFIs that are also SFIs may place customer’s moneys into a trust account maintained with themselves or another SFI. EFIs may only apply customer’s moneys for the specific purposes provided for under the LCB Regulations.

Customer’s Moneys

4.3 MAS notes that EFIs carrying out SFA-regulated activities would not generally make a determination upfront as to the purpose of the moneys received from their customers (i.e. whether the moneys are placed as savings to meet on-going or emergency liquidity needs, or for capital markets investments⁹). Instead, they would place all moneys

⁹ Where the moneys are meant for capital markets investments, the EFIs would have to keep these moneys in a trust account, separate from the customer’s deposit account.

received from a customer in a deposit account maintained in the name of the customer¹⁰. MAS recognizes that it may not be practical for EFIs to ask their customers the specific purpose of the moneys at the point of receipt. The customers may also not have applied their minds to the intended purpose of the moneys when they place the moneys with the EFIs. Separately, a requirement for EFIs to place customer's moneys in a trust account (as opposed to a deposit account) may change the nature of the protection accorded to customers¹¹.

4.4 In light of the foregoing, MAS proposes to dis-apply the LCB Money Rules for EFIs. The disapplication does not reduce the level of protection for customers given that the moneys would be held in a deposit account maintained under the customer's own name and cannot be withdrawn without the customer's express authorization. The proposal will also bring Singapore in line with the position in other major jurisdictions (e.g. United States, United Kingdom, Australia and Hong Kong) which do not apply their domestic customer's moneys rules to banks that carry out capital markets activities.

Customer's Assets

4.5 For the avoidance of doubt, MAS will continue to apply the LCB Asset Rules to EFIs. Unlike moneys which are fungible, customer's assets are clearly identifiable and EFIs are already able to identify the assets belonging to customers (e.g. EFIs will record the details of the securities belonging to each customer in an investment or custody account in the name of the customer) and comply with the LCB Asset Rules.

4.6 EFIs will thus continue to be subject to the LCB Assets Rules (including the proposed enhancements set out in paragraphs 3.4 to 3.23 when these are effected).

¹⁰ In practice, when the customer places an order to purchase capital market products (e.g. shares), the EFI will earmark the customer's deposit account by the amount of money required to settle the transaction. This sum of money will remain in the customer's deposit account until the settlement day when the EFI debits the customer's deposit account and transfers the money to the counterparty of that transaction.

¹¹ A customer who places moneys with a full bank or a finance company licensed in Singapore as deposits will be covered up to the amount provided for under the Deposit Insurance Scheme.

Question 10. MAS seeks views on the proposals to:

- (a) dis-apply the LCB Money Rules to EFIs; and
- (b) extend the proposed enhancements in paragraphs 3.4 to 3.23 (including Regulations 39(1) and (2), and Regulation 40 of the LCB Regulations) in respect of customer's assets to EFIs.

Annex A

LIST OF QUESTIONS

- Question 1.** MAS seeks comments on the proposal to expand the definition of customer's moneys to include contractual rights arising from transactions entered into by the CMS licensee on behalf of a customer (e.g. futures contracts) or with a customer (e.g. contract for differences).6
- Question 2.** MAS seeks comments on the proposals to:
- (a) require CMS licensees to conduct due diligence for the selection and appointment of deposit-taking financial institutions with whom they maintain customer's trust accounts; and7
- (b) require CMS licensees to carry out periodic reviews to assess whether the deposit-taking financial institutions and custodians with whom they maintain customer's trust accounts and custody accounts remain suitable.7
- Question 3.** MAS seeks comments on the proposal to extend the applicability of Regulations 18 and 28 under the LCB Regulations to situations where customer's moneys and assets are placed with overseas financial institutions.8
- Question 4.** MAS seeks comments on the proposal to require CMS licensees to maintain information systems and controls that can promptly produce, both in normal times and in the event of resolution or insolvency, salient information pertaining to their customer's moneys and assets.9
- Question 5.** MAS seeks comments on the proposed disclosure requirements as set out in paragraphs 3.14 and 3.15.10
- Question 6.** MAS seeks comments on the proposal to extend the daily computation requirement under Regulation 37 of the LCB Regulations to all CMS licensees holding customer's moneys and assets.11
- Question 7.** MAS seeks views on the proposals to:
- (a) require CMS licensees to provide risk disclosure to, and obtain consent from, their customers prior to lending, mortgaging, pledging, charging or re-hypothecating the customer's assets; and11
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