

Singapore Consults on OTC Derivatives Regulation.

On 13 February 2012, the Monetary Authority of Singapore (“**MAS**”) released its *Consultation Paper on Proposed Regulation of OTC Derivatives* (“**OTC Consultation Paper**”) for public comment. The OTC Consultation Paper is Singapore’s response to the G20 leaders’ regulatory reform commitments to strengthen the international financial regulatory system in the wake of the global financial crisis in 2008.

The consultation period for the OTC Consultation Paper will end on 26 March 2012.

Key Proposals

- The OTC Consultation Paper contains the following key proposals:
- mandatory central clearing of OTC derivatives contracts;
- mandatory reporting of OTC derivatives contracts;
- licensing of derivatives market operators, clearing facilities and trade repositories; and
- licensing of market intermediaries for OTC derivatives.

Further details of such key proposals are discussed below. For comparison, click [here](#) to see our summary of the Hong Kong proposals in October 2011 on OTC derivatives regulation (“**Hong Kong Consultation**”).

“Derivatives Contracts” Definition

MAS proposes to implement the above changes by expanding the scope of the Securities and Futures Act (“**SFA**”), Chapter 289, to regulate OTC derivatives activities. This is proposed to be implemented by introducing into the SFA a new concept of “derivative contracts”, which will encompass the five major underlying assets classes of commodities, credit, equities, foreign exchange and interest rates. The overall approach is logical and easy to

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understand, and the proposal to specify the classes of underlying assets covered has the benefit of clarity. One possible issue however is in delineating the scope of “derivative contracts” (for example, such definition would seem to catch derivatives embedded in investments/deposits or other instruments?). Clarification of the exact scope of “derivative contracts” is left for a later stage.

MAS stated that it has considered amendments to relevant parts of the SFA arising from the regulation of OTC derivatives, and will make changes to align the treatment for OTC derivatives with that for securities and futures contracts where appropriate.

Mandatory Clearing

Under the OTC Consultation Paper’s proposals, an OTC derivatives contract would need to be cleared through a central clearing counterparty (“CCP”) if:

- the contract relates to any product that is required to be centrally cleared;
- at least one leg of the contract is booked in Singapore;
- at least one of the parties is resident or have a presence in Singapore; and
- both parties are either subject to the clearing mandate (see below) or, if it is not resident or does not have a presence in Singapore, would have been subject to the clearing mandate if it were resident or had a presence in Singapore.

The territorial scope (that the contract be booked in Singapore) seems to be more limited than the Hong Kong Consultation, which proposed to catch any contract originated or executed in Hong Kong. However, MAS has expressly reserved anti-evasion powers to require contracts not otherwise subject to the mandatory clearing obligation to be cleared. As the scope of such anti-evasion powers are not set out in the OTC Consultation Paper, it remains to be seen how such powers would be applied and whether they would widen the scope of the clearing mandate.

In respect of the location of CCPs, MAS proposes not to require clearing through domestic CCPs. Interestingly, there is no exemption for contracts required to be cleared under the rules of another jurisdiction. Presumably parties subject to mandatory clearing in both Singapore and another jurisdiction would have to clear their contracts through a CCP (whether in Singapore or overseas) that is recognised or approved by both Singapore

and that other jurisdiction (see further below on Singapore's proposed regulation of CCPs).

Products required to be centrally cleared

MAS has proposed a bottom-up, top-down approach, similar to that proposed in the US, EU and Hong Kong. The proposed criteria for approving a product for mandatory clearing also follows criteria proposed by other jurisdictions such as the US and Australia. Initial products that MAS are considering for mandatory clearing are SGD interest rate swaps ("**IRS**"), USD IRS and certain Asian currency none-deliverable forwards ("**NDFs**"). FX forwards and swaps (as opposed to currency options, NDFs and currency swaps) are expressly proposed to be excluded.

Entities covered

The clearing mandate is proposed to cover:

- all "financial entities" (i.e. financial institutions regulated by MAS) that exceed relevant thresholds, taking into account the size of its derivative exposure in aggregate or by product class; and
- all "non-financial entities" (i.e. persons resident or having a presence in Singapore that are not regulated by MAS) that exceed relevant thresholds, taking into account its total assets or its derivative exposure in aggregate or by product class. Hedging transactions by non-financial entities will be excluded from derivative exposure when determining whether non-financial entities have exceeded the threshold.

Certain entities and transactions are proposed to be exempt from the clearing mandate, namely: public bodies (i.e. central banks, central governments and supra-nationals organisations), intra-group transactions (but such transactions will be subject to collateralisation requirements similar to EU) and pension schemes.

Mandatory Reporting

Under the OTC Consultation Paper's proposals, a party subject to the reporting mandate (see below) would be required to report OTC derivatives contract to an eligible Trade Repository ("**TR**") (i.e. approved or recognised by MAS) within one business day of the contract being entered into or amended, if:

- the contract relates to any product that is required to be reported; and
- the contract is booked or traded in Singapore.

In comparison to the mandatory clearing obligation, the proposed mandatory reporting obligation seems to have a wider territorial scope and require contracts traded in Singapore to be subject to reporting as well. The meaning of trading is not clear, but it is certainly broader than booking, and may be closer to the concept of “origination or execution” under the Hong Kong Consultation. Nevertheless, it seems that the proposed Singapore mandatory reporting obligation is still narrower than that proposed in the Hong Kong Consultation, since Hong Kong has proposed that trades with a Hong Kong nexus should be also be reported while no equivalent requirement was proposed in Singapore. MAS has considered whether contracts with a Singapore-nexus should be reported, and appears to conclude that given practical impediments to MAS enforcing the reporting obligation on entities with no presence or residence in Singapore, it would instead rely on collaboration with overseas regulators to obtain the relevant data.

In respect of the location of TRs, MAS proposes not to require reporting through domestic TRs. This is in contrast to the Hong Kong Consultation which proposes that reporting be made to a domestic Hong Kong TR to be established by the Hong Kong Monetary Authority.

Products required to be reported

It is proposed that all OTC derivative contract asset classes will need to be reported, but MAS proposes to phase in the implementation of mandatory reporting and to prioritise the mandatory reporting of IRS, FX derivatives and oil derivatives first, given the significance of such products to the Singapore OTC derivatives market.

Entities covered

The reporting mandate is proposed to cover:

- all “financial entities” (as defined for mandatory clearing above); and
- all “non-financial entities” (as defined for mandatory clearing above) that exceed relevant thresholds taking into account its asset size. (Note that in comparison, the Hong Kong reporting threshold is proposed to be based on notional amount of transactions per product class rather than an entity’s asset size.)

Under the proposals, public bodies exempt from the mandatory clearing obligation would also be exempt from the mandatory reporting obligation, while Singapore-incorporated banks would need to report on a group-wide basis. It is proposed that a reportable transaction can be reported by just one of the parties to that transaction or by a third party such as a CCP.

MAS proposes to follow international standards on reporting, and supports the use of Legal Entity Identifiers (LEIs) and a product classification system, as recommended in the CPSS-IOSCO Data Aggregation Report.

No mandatory trading currently proposed

Instead of setting out proposals for the mandatory trading of OTC derivatives contracts on exchanges or electronic trading platforms (which is also a G20 objective), Singapore has opted to consult on mandatory trading at a later stage, after undertaking further study of local market conditions. This differs from the US and EU where discussions on mandatory trading are more advanced, but is similar to Hong Kong where regulators are also not imposing a mandatory trading obligation at the outset, pending further assessment of the local market.

Regulation of derivatives markets and derivatives market operators

Although no mandatory trading obligation is proposed, MAS nevertheless seeks views in the OTC Consultation Paper on the proposed regulation of trading platforms for derivatives contracts ("**derivatives markets**") and their operators ("**derivatives market operators**") under the SFA. In contrast, the Hong Kong Consultation Paper has not yet proposed regulation of derivatives markets and derivatives market operators.

MAS invites comments on the scope of the definition of derivatives markets and on the proposal to regulate derivatives market operators under the SFA's current two-tier regime of approved exchanges ("**AE**") and recognised market operators ("**RMO**"). Operators of systemically-important derivatives markets are proposed to be regulated as AEs while other derivatives market operators are proposed to be regulated as RMOs. MAS also proposes to refine the RMO regimes for locally-incorporated and overseas RMOs. The key difference between the two regimes is that MAS will rely on the regulator of an overseas RMO's home jurisdiction to supervise such overseas RMO.

Regulation of clearing facilities (including CCPs)

MAS proposes amending the definition of "clearing facility" in the SFA to include clearing and settlement of derivatives contracts. It also proposes to move from its current designation approach to a two-tier authorisation framework, which will require clearing facilities to be regulated as either an Approved Clearing House ("**ACH**") if it is systemically-important (this includes all local CCPs) or otherwise as a Recognised Clearing House ("**RCH**"). The

OTC Consultation Paper sets out in a high level the proposed requirements of an ACH or RCH under the regime and invites comments on the same.

Overseas clearing facilities (including overseas CCPs) are required to comply with the SFA and seek authorisation under the SFA regime as overseas RCHs if their acts are treated as carried out in Singapore for the purposes of section 339 (Extra-territoriality of Act) of the SFA. Significantly, MAS proposes to have the power to require an overseas RCH to set up a subsidiary in Singapore to be regulated as a locally-incorporated RCH or ACH and expects such power to be used in cases where it may not be sufficient to rely on an overseas RCH's home regulator. This suggests that although Singapore will rely on overseas regulators to supervise overseas clearing facilities, it will nevertheless retain the right to step in and require a clearing facility to be subject to Singapore's direct supervision if it believes that the overseas standards are less stringent than its own. Insolvency protection is proposed to be extended to all ACHs and RCHs, but no mention is made of insolvency protection for client clearing.

Regulation of TRs

MAS proposes to define a TR that is subject to regulation under the SFA as a facility for the collection and dissemination of data on derivative contracts that are subject to the reporting mandate. The reporting mandate can be fulfilled only by reporting to an authorised TR, so market participants reporting to a trading platform or clearing facility are not considered to have complied with the reporting mandate unless such trading platform or clearing facility is also authorised by MAS as a TR.

Regulation of TRs under the SFA is proposed to be a one-tier regime (i.e. there is no stricter regime for systemically-important TRs), but different provisions would apply for locally-incorporated TRs, which would be authorised as Approved TRs ("**ATRs**") and for overseas TRs, which would be recognised as Recognised Overseas TRs ("**ROTRs**"). It is proposed that the same standards would apply to ATRs and ROTRs, however MAS would rely on the regulator of the ROTR's home jurisdiction to supervise that ROTR's compliance with such standards.

Regulation of Capital Markets Intermediaries

The OTC Consultation Paper notes that derivatives activities of licensed banks under the Banking Act of Singapore are already regulated by the MAS, as part of MAS' supervision of banks. To align the regulation of banks and

non-bank intermediaries in the OTC derivatives market, it proposes that non-bank intermediaries (including fund managers) will also need to be licensed if they deal in derivative contracts where the underlying is equity, interest rate, foreign exchange, credit or commodity. End-users and brokers that satisfy certain conditions are proposed to be exempt from the derivatives licensing requirement. It is proposed that “dealing in derivative contracts” includes the following activities, whether conducted as principal or agent:

- making or offering to make with any person, or inducing or attempting to induce any person to enter into, or to offer to enter into any agreement in respect of a derivative contract; or
- soliciting or accepting any order for, or otherwise dealing in, a derivative contract.

The OTC Consultation Paper acknowledges that some derivatives activities of non-bank intermediaries are currently regulated if they fall within the licensing regime for securities, futures or leveraged foreign exchange trading, and that rationalisation of the different types of regulated activities will be required, but MAS has left such rationalisation for consultation at a later stage.

Regulatory Oversight of OTC commodity derivatives

As part of Singapore’s consultation on OTC derivatives regulations, it is also proposed that the regulatory oversight for commodity derivatives be transferred from the Commodity Trading Act, currently administered by the International Enterprise Singapore Board (“IE”), to the SFA. The proposed transfer is intended to align regulatory approaches across the major classes of OTC derivatives, and provide greater clarity to industry participants on the regulatory approach for commodity futures and other commodity derivatives. Such proposal is set out in the IE and MAS joint *Consultation Paper on Transfer of Regulatory Oversight of Commodity Derivatives from IE to MAS*, which is released on 13 February 2012.

Click [here](#) to view the full text of the OTC Consultation Paper and the IE-MAS joint consultation paper.

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