

MEMO# 29421

October 12, 2015

Monetary Authority of Singapore Issues Consultation Paper on Margin Requirements for Uncleared Derivatives

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TO: DERIVATIVES MARKETS ADVISORY COMMITTEE No. 72-15
ICI GLOBAL TRADING & MARKETS COMMITTEE No. 48-15
INTERNATIONAL MEMBERS No. 35-15 RE: MONETARY AUTHORITY OF SINGAPORE ISSUES
CONSULTATION PAPER ON MARGIN REQUIREMENTS FOR UNCLEARED DERIVATIVES

On October 1, the Monetary Authority of Singapore (“MAS”) published a policy consultation paper on proposals to implement margin requirements for non-centrally cleared OTC derivatives. [\[1\]](#) The policy proposals will be followed by draft regulations on which MAS will separately consult after considering feedback on the Consultation Paper. The Consultation Paper is generally consistent with the international final policy framework establishing minimum standards for margin requirements for non-centrally cleared derivatives adopted by the Basel Committee on Banking Supervision and the International Organization of Securities Commissions. [\[2\]](#)

The Consultation Paper describes policy proposals regarding the scope of the proposed margin requirements, the minimum amount of initial and variation margin, and the methodologies for calculating the minimum amount of margin. The Consultation Paper also outlines the collateral eligible for the exchange of margin and the methods for determining appropriate collateral haircuts. Comments on the Consultation Paper are due by November 1, 2015.

This memorandum briefly summarizes the Consultation Paper.

Scope of Requirements

Entities Subject to Margin Requirements

MAS proposes to impose margin requirements on certain financial counterparties (collectively termed “MAS Covered Entities”) conducting regulated activities under the Securities and Futures Act (“SFA”). MAS Covered Entities would include banks, merchant banks, and other licensed financial institutions. [\[3\]](#) MAS is considering and requesting

comment on whether to require Singapore domiciled investment funds with exposure to uncleared derivatives in excess of a certain threshold to comply with the margin requirements. MAS would look to an individual fund for purposes of calculating the threshold if the fund is a segregated pool of assets for the purposes of insolvency or bankruptcy and the fund is not collateralized or guaranteed by any other person.

Covered Products

MAS proposes to subject all OTC derivatives contracts that are not centrally cleared by a qualifying central counterparty (“CCP”) to margin requirements. MAS proposes to exempt physically-settled foreign exchange (“FX”) forward and swaps from the margin requirements. Counterparties, however, would be expected to manage appropriately the risks associated with these contracts.

Proposed Margin Requirements

MAS proposes to apply the margin requirements to MAS Covered entities when (i) an MAS Covered Entity is a legal counterparty [\[4\]](#) to the transaction; (ii) the transaction is booked in Singapore; and (iii) the transaction is with another MAS Covered Entity or an overseas regulated financial firm. Transactions booked in foreign subsidiaries or foreign branches of locally-incorporated MAS Covered Entities would not be subject to the margin requirements.

MAS is considering imposing a “collect-only” requirement on MAS Covered Entities under which these entities would be obligated to collect but not post margin to their counterparties. MAS is proposing this approach to address certain industry concerns with the operational challenges in effecting bilateral margin exchanges for cross-border transactions. MAS believes that a collect-only regime would achieve a bilateral exchange of margin if both counterparties are subject to margin requirements.

Under the Consultation Paper, all MAS Covered Entities would be required to calculate variation margin daily. The full amount of variation margin (i.e., a zero threshold) would be required to be exchanged (if MAS adopts a post-and-collect regime) or collected (if MAS adopts a collect-only regime) from counterparties within two business days following the execution of a new uncleared derivative contract. MAS Covered Entities also would be required to calculate the gross amount of initial margin obligations at least on a sufficiently regular basis to reflect changes in risk positions and market conditions. Initial margin must then be exchanged or collected from counterparties within two business days following the recalculation of the initial margin obligations.

Consistent with BCBS/IOSCO Standards, the Consultation Paper also proposes a minimum transfer threshold. An exchange of collateral would be only necessary if the change in the margin requirements exceeds S\$800,000. The Consultation Paper also proposes a threshold level of S\$80 million under which initial margin would not have to be exchanged.

Margin Methodology

The Consultation Paper prescribes the methods that counterparties may use to calculate initial margin requirements: the standardized method and initial margin models. The standardized initial margin schedule is set forth in Annex B of the Consultation Paper.

Alternatively, counterparties may use initial margin models that comply with the

requirements in the Consultation Paper. Initial margin models either may be developed by the counterparties or by a third-party agent, but any quantitative model that is used must be approved by MAS. Any quantitative portfolio margin model must capture all material risk drivers for the derivative contracts included in the netting set. The initial models must reflect variations in the value of the netting set at a confidence level of 99% with a risk horizon of at least 10 days. Models must be calibrated on a historical period of not more than five years, including a period of significant financial stress. The models must be subject to an initial validation, periodic back-tests, and stress testing.

Eligibility and Treatment of Collateral

The Consultation Paper provides the minimum eligibility criteria for collateral, including the haircuts to be applied, and discusses the treatment of collateral. The Consultation Paper includes a broad set of asset classes (e.g., cash, gold, government securities, debt securities, equities) as eligible collateral. MAS, however, expects MAS Covered Entities to establish and document internal policies and controls to ensure that the collateral collected is not overly concentrated in an individual issuer, issuer type, or asset type. Moreover, the Consultation Paper states that MAS Covered Entities should not accept securities issued by the counterparty or its related entities as collateral to ensure that the effectiveness of the protection offered by the collateral collected is not undermined.

To reflect potential market and FX volatility on the collateral, MAS proposes to require appropriate haircuts. MAS would allow the use of an internal model for the calculation of haircuts or the use of standardized haircuts (Annex C of the Consultation Paper). The Consultation Paper proposes an 8% haircut where there is a currency mismatch between the currency of the collateral and the settlement currency of the transaction.

Moreover, MAS would require MAS Covered Entities to safe-keep initial margin collected from counterparties to ensure that the margin collected is immediately available to the collecting party in the event of the posting party's default and the margin to be subject to legally enforceable arrangements that protect the posting party to the extent possible in the event that the collecting party enters bankruptcy.

Finally, the Consultation paper would allow the re-hypothecation, re-pledging, or re-use of initial margin only subject to certain conditions (Annex D of the Consultation Paper). Once non-cash initial margin has been re-hypothecated to a third party in accordance with Annex D, no further re-hypothecation of initial margin by the third party would be permitted. Cash and non-cash collateral collected as variation margin may be re-hypothecated without restrictions.

Treatment of Cross-Border Transactions

To avoid the application of duplicative or conflicting margin requirements on the same transaction, MAS proposes to deem MAS Covered Entities to have complied with MAS's margin rules when: (1) an MAS Covered Entity established under the laws of, or that has a place of business in, a foreign jurisdiction with comparable margin requirements is required to comply and has complied with the margin requirements of that relevant foreign jurisdiction; or (2) an MAS Covered Entity, trading with a foreign counterparty, is required to comply with and has complied with comparable home- or host- margin requirements imposed on the foreign counterparty. MAS intends to adopt a comparability assessment that is outcome-based focusing on whether the margin requirements of the foreign

jurisdiction achieve the same regulatory objectives as MAS' margin requirements. Although MAS does not intend to conduct a line-by-line comparison of the foreign regulatory rules, MAS is considering a requirement for MAS Covered Entities to collect the types of eligible collateral and hold them in a manner consistent with MAS' rules.

Phase-in of Requirements

The requirements would enter into force on September 1, 2016 and the requirements would be phased-in each year over a four-year period. Initially, any bank licensed under the Banking Act that conducts regulated activities under the SFA and that has an aggregate month-end average notional amount of non-centrally cleared derivatives exceeding S\$4.8 trillion would be subject to the requirements. From September 1, 2020 (at the end of the phase-in period), any MAS Covered Entity belonging to a group whose aggregate month-end average notional amount of non-centrally cleared derivatives exceeds S\$13 billion would be subject to the requirements. To avoid any retroactive effect, margin requirements would apply to new contracts not cleared by a CCP entered into after the relevant phase-in dates.

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endnotes

[1] Policy Consultation on Margin Requirements for Non-Centrally Cleared OTC Derivatives, Oct. 1, 2015, available at <http://www.mas.gov.sg/~media/MAS/News%20and%20Publications/Consultation%20Papers/Policy%20Consultation%20on%20Margin%20Requirements%20for%20NonCentrally%20Cleared%20OTC%20Derivatives%201Oct.pdf> ("Consultation Paper").

[2] Margin Requirements for Non-Centrally-Cleared Derivatives, Basel Committee on Banking Supervision and Board of the International Organization of Securities Commissions, September 2013, available at <http://www.iosco.org/library/pubdocs/pdf/IOSCOPD423.pdf> ("BCBS/IOSCO Standards").

[3] Licensed financial institutions would include entities licensed under the Finance Companies Act ("FCA"), Insurance Act ("IA"), SFA, and Trust Companies Act ("TCA"). Fund managers acting as legal counterparties to an uncleared derivative transaction also would be subject to MAS' proposed margin requirements.

[4] According to MAS, a legal counterparty is an entity that is a signatory to the ISDA master agreement and the collateral service agreement of the transaction.