

MAS RELEASES CONSULTATION PAPER ON PROPOSED AMENDMENTS TO THE SECURITIES AND FUTURES ACT - AMENDMENTS ARISING FROM OTC REFORMS

Posted on April 1, 2015

Category: [CNPupdates](#)

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Date Published: 1 April 2015

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MAS released a consultation paper on 11 February 2015, as part of its expansion of amendments to regulate over-the-counter (“**OTC**”) derivatives following the 2012 amendments to the Securities and Futures Act (“**SFA**”) in relation to the reporting and clearing of OTC derivative transactions and regulation of OTC derivative trade repositories and clearing facilities.

The consultation period closed on 24 March 2015. The consultation paper can be accessed [here](#).

Amendments to Part I (Preliminary) of the SFA

Derivative contract

“Derivative contract” introduced in 2012 will be changed to a principles-based definition to constitute two main elements:

1. the discharge of obligations at some future time by a party to the contract; and
2. the value of such obligations is determined with reference to any underlying asset (i.e. equity, interest rate, foreign exchange, credit or commodity).

Securities

The definition of “securities”, which currently follows a list-based approach, will be simplified to comprise either equity instruments or debt instruments. As a result, a new “securities-based derivative contract” definition will be introduced as a subset of the definition “derivative contract”. Collective Investment Schemes (“**CIS**”) would be defined by reference to “capital markets products” rather than “securities” and other heads of a definition of a CIS will be added.

Capital Markets Products

“Capital markets products”, a catch-all definition for regulated products in the SFA, will be amended to include derivative contracts.

Organised Market

Introduction of the definition for “organised market” to replace the existing definitions of “market”, “securities market” and “futures market” under the First Schedule to the SFA. The new definition will define a market by its underlying function of facilitating exchange, sale or purchase of specified products,

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including derivative contracts.

Amendments to Part II (Markets) of the SFA

Introduction

Part II (Markets) of the SFA sets out the regulations required to promote fair, orderly and transparent markets, facilitate efficient markets for the allocation of capital and transfer of risks and to reduce systemic risks.

Extending regulations to OTC trading

Part II will be amended to extend the existing regulatory regime for market operators to entities which intend to establish or operate facilities for the trading of OTC derivatives.

The new regulations will require corporations that seek to trade securities, derivative contracts or units in a Collective Investment Scheme in Singapore, to require approval as either an Approved Exchange (“**AE**”) or a Recognised Market Operator (“**RMO**”).

Under the new proposed framework, a locally incorporated corporation operating organised markets that are systemically important will be regulated as an AE and other corporations, including foreign corporations, will be regulated as RMOs.

Changes to RMO regime

The existing RMO regime under Part II, Division 3 of the SFA will be enhanced to align it with international requirements. MAS will conduct further consultations on the details of these new requirements which will include requiring RMOs to:

1. ensure appropriate governance procedures are in place:
2. provide assurance that non-compliance with business rules would not affect the RMO’s participants’ rights

Voice assisted and telephone assisted OTC trading

MAS noted there are transactions in OTC derivatives through voice/telephone assisted means instead of through an electronic order-booked-based system for processing requests for quotes or indications-of-interests.

Such voice/telephone assisted transactions do not necessarily entail trading pursuant to the rules of an organised market.

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MAS considers transactions in OTC derivatives through voice/telephone assisted means to be a form of a broking service and accordingly, persons facilitating such transactions solely through voice/telephone means will be regulated as capital market intermediaries and not market operators.

Amendments to Part VIA (Reporting of Derivative Contracts) of the SFA

Introduction

Part VIA deals with the reporting of information on a specified derivative contract, by a specified person, who acts as an agent of a party to that contract (where that party is not a specified person).

Reporting of contracts not traded in Singapore

MAS proposes to amend Part VIA so that if the contracts are booked in Singapore, even if they are not traded in Singapore, they would have to be reported. This allows MAS to oversee the OTC derivatives market and all specified derivative contracts which are booked in Singapore.

Confidentiality issues

However, MAS also recognised that due to the confidentiality laws under Section 47 of the Banking Act and Section 49 of the Trust Companies Act, it may not be possible to meet the reporting obligations.

MAS is, therefore, proposing to lift banking confidentiality in the SFA to permit financial institutions to report customers' information for the purposes of complying with MAS and specified foreign jurisdictions' trade reporting obligations.

New Part VIC (Trading of Derivative Contracts) of the SFA

The new Part VIC will put in place the legislative framework required to implement a trading mandate if it is deemed appropriate.

While a key component of the OTC derivatives reforms is to implement mandatory trading of all standardised transactions on exchanges or electronic trading facilities, MAS noted that the appropriateness of imposing a trading mandate will need to be carefully studied.

The new Part VIC will empower MAS to identify derivative contracts that will be subject to a trading mandate and provide for powers to request for information from relevant persons to facilitate the process of determining the products and entities to be subjected to the trading mandate.

Amendments to Part IV and the Second Schedule to the SFA and the Second

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Schedule to the Securities and Futures (Licensing and Conduct of Business) Regulations (“SF(LCB)R”)

Dealing in Capital Market Products

Current regulated activities such as “dealing in securities”, “trading in futures contracts” and “leveraged foreign exchange” and now dealing in OTC derivatives will be grouped under “dealing in capital market products”.

A Capital Markets Service (“CMS”) Licence holder will be required to indicate the specific class of capital markets products it will be dealing in. A CMS Licensee which intends to expand into dealing with another product class will need to seek MAS approval by applying for a variation of the licence. Section 90 of the SFA will be amended in relation to the variation of a CMS Licence.

Consequential amendments to the definitions of “securities financing” and “providing custodial services for securities” will also be made.

Licensing Exemptions

MAS is proposing to exempt certain persons, including those:

1. who deal for their own account in OTC derivatives with a regulated financial institution and do not receive, commission, spread or other remuneration in return; and
2. who deal in OTC derivatives but do not take on any principal position in OTC derivatives, do not hold any customer’s position, margin or account in their books and deal only with accredited or institutional investors.

MAS intends to maintain as far as possible the scope of the existing licensing exemptions and will make the consequential amendments to the licensing exemptions accordingly.

Fund Management

Due to the proposed amendment to the definition of “derivative contract”, persons managing CISs that invest in derivatives of physical assets will now be subject to the provisions of the SFA regulating fund management. MAS intends to regulate managers of CIS that invest in physical assets only if the CIS is offered to retail investors.

Existing CIS managers will need to obtain the necessary licences or exemptions before they offer additional units of their existing CIS or offer any new CIS.

Additional safeguards when CIS managers appoint unregulated persons to provide custody services for physical assets could include the following proposed measures:

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1. minimum financial or capital requirements;
2. insurance coverage for the custodised assets; and
3. segregation of assets under custody.

Consequential amendments to the remaining parts of SFA, the Financial Advisers Act (“FAA”) and the CTA

Existing requirements applying to “futures contracts” will now apply to all “derivative contracts”.

It is proposed to merge Section 143 and 144 so that a single provision setting out MAS’ supervisory powers in relation to “capital markets products” can be achieved.

It is proposed that existing market conduct provisions will now cover “capital markets products” in general.

As a result of the inclusion of a “securities-based derivative contract” in Part XIII of the SFA, prospectus requirements will extend to cash-settled derivative contracts with securities as the underlying. Some of these contracts will include structured warrants, extended settlement securities contracts and securities-based contracts-for-differences (CFDs). MAS will look to provide the necessary exemptions of existing contracts that are exempted from the prospectus requirements, such as CFDs.

Conclusion

Modern derivative markets find their intellectual roots in the 1970s research of Black, Scholes, and Merton. Although the use of the “Black Scholes Model” for option pricing is still very much relevant today, the derivative markets had advanced so rapidly, with the advent of financial Information technology supercharging trades and the ever-increasing use of derivatives for risk-management purposes in multinationals and major trading houses.

The OTC derivative market in Singapore ranks 8th globally based on total trading volume. Singapore accounts for 5% of total OTC derivative trades in the world. With the continuous growth of the country as a financial hub, more such trades will originate or pass through Singapore. It is thus timely that the amendments to the SFA replace the outdated and limited definition of “derivative contract” to a principles-based definition of derivative contract that can account for the constant innovation in the industry.

MAS is taking the opportunity to broaden the regulation of CIS while at the same time providing some flexibility for foreign CIS to be recognised in Singapore. Also, amendments and clarifications are being proposed to reverse certain judicial decisions, such as clarifying that there is no requirement for “material price impact” before a contravention of Section 199 can be established and the test of “reasonable investor” under Section 215 and 216 is equivalent to that set out in *Public Prosecutor v Chua Seng Huat* 3 MLJ 305.

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The totality of the amendments should result in helping ensure the SFA remains current in light of market and global developments. Some of the devils will be in the detail. Currently, the scope of the “principles-based” approach to regulation of derivative contracts seems to cast a wide net and it would seem there will need to be carve-outs from regulation under the SFA to prevent it encroaching into areas of business that may not merit it.

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