ISDA Safe, Efficient Markets

January 12, 2013

General Counsel's Office
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Dear Sir

Consultation Paper on Proposed Amendments to the Monetary Authority of Singapore Act

1. **Introduction**: In light of the submission deadline, the International Swaps and Derivatives Association, Inc. ("**ISDA**")[1] would like to raise the following preliminary concerns that its members have with the proposed amendments relating to the resolution regime[2] set out in the above Consultation Paper released by the Monetary Authority of Singapore Exchange ("**MAS**") on December 26, 2012. ISDA will continue to consult with ISDA's Singapore opinions counsel, Allen & Gledhill and our members and we look forward to an open and continuing dialogue with the MAS on the nature and extent of these concerns as well as any other concerns that might be identified.

2. **Netting of OTC derivatives exposures under the ISDA Master Agreement for regulatory capital purposes**:

2.1 Basel requires banks to set aside a prescribed minimum percentage of capital (that will increase significantly with Basel III) against their risk-weighted assets (counterparty credit exposure multiplied by a risk-weight percentage). If close-out netting under the ISDA Master Agreement is enforceable, under the Basel framework, counterparty credit exposure is treated as the sum of positive and negative replacement costs[3] of all the outstanding transactions between the bank and that counterparty. If close-out netting is not enforceable, counterparty credit exposure is treated as the sum of positive replacement costs (with negative replacement costs deemed to be zero). Thus, the ability of banks to net their counterparty credit exposures has a significant impact on their regulatory capital requirements and in turn, the price that they will have to charge the counterparty for entering into a transaction.

[1] ISDA's mission is to foster safe and efficient derivatives markets to facilitate effective risk management for all users of derivative products. ISDA has more than 800 members from 58 countries on six continents. These members include a broad range of OTC derivatives market participants: global, international and regional banks, asset managers, energy and commodities firms, government and supranational entities, insurers and diversified financial institutions, corporations, law firms, exchanges, clearinghouses and other service providers. For more information, visit www.isda.org.

[2] ISDA is not commenting and does not propose to comment on the proposed amendments relating to the issuance of book-entry securities by MAS and the introduction of a primary dealer framework for such securities and references to "proposed amendments" in this submission are only to the proposed amendments relating to the resolution regime.

[3] When a transaction is in-the-money for the bank, it has a positive replacement cost and when a transaction is out-of-the-money for the bank, it has a negative replacement cost.

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2.2 Under the current legislative and regulatory regime, with regard to a company incorporated in Singapore, or a registered Singapore branch of a foreign corporation, regardless of the nature of business being carried on by such company or branch and whether it is licensed or regulated by MAS, ISDA understands that legal experts in Singapore and market participants generally concur that enforceability of close-out netting (including in insolvency) is not an issue with regard to such entities. Thus, at present, ISDA understands that banks will treat close-out netting as being enforceable against such entities and net their counterparty credit exposures against such entities.

2.3 The proposed amendments go beyond replicating the current provisions in the Banking Act/Insurance Act. ISDA's Singapore opinions counsel has advised that if the proposed amendments are passed in their present form, they will have to include the appropriate qualifications in their updated close-out netting opinion to ISDA and its members. From their preliminary review, the contractual right of the counterparty under the ISDA Master Agreement to terminate outstanding transactions with a financial institution that is covered by the proposed amendments ("**Covered FI**") and to determine the net close-out amount either payable by or to the Covered FI could be enjoined or adversely impacted by the exercise of the broad powers given to MAS under the proposed Section 30AAM to issue directions to the Covered FI or by the invocation of the compulsory transfer of business provisions. They also note that Section 30AAM(2) requires compliance with such directions by the Covered FI "*notwithstanding any other duty imposed on the [Covered FI] by any rule of law, written law or contract*" and that Section 30AAM(3) provides that compliance with such directions by the Covered FI "*shall not … be treated as being in breach of any such rule of law, written law or contract*".

2.4 While the proposed compulsory transfer of business provisions are largely similar to those found in the Banking Act/Insurance Act, there are concerns over the reference in the Consultation Paper to these provisions empowering the "*sale or transfer of the assets and liabilities*" (emphasis added) of the Covered FI. The current interpretation of the compulsory transfer of business provisions in the Banking Act/Insurance Act is that it empowers the transfer of a particular business line or part of such business (for example, the retail banking business or the commercial lending business or the sales and trading business) of the Covered FI. The reference to "*assets and liabilities*" raises the specter that some but not all of the outstanding transactions of a counterparty with the Covered FI could be transferred.

2.5 The paper on *Key Attributes of Effective Resolution Regimes for Financial Institutions* of October 2011 ("**FSB KA Paper**") by the Financial Stability Board ("**FSB**") recognizes the need for any resolution regime to contain adequate safeguards to protect contractual termination and set-off rights and collateralization agreements. Any powers to stay such rights that may be granted by a resolution regime are to be subject to conditions (including those set out in Annex IV to the FSB KA Paper). Such conditions include the following:

(a) the stay should be strictly limited in time, for example, for a period not exceeding 2 business days;
(b) the power to stay should exist only in respect of contractual termination rights that arise by reason only of entry into resolution or in connection with the use of resolution powers and provided that the firm in resolution (or the resolution authority) continues to perform its substantive obligations under the contract, including payment and delivery obligations and provision of collateral;
(c) there should be no "cherry-picking" - if the resolution authority wishes to exercise its compulsory transfer powers, either all or none of the contracts of the firm in resolution with the same counterparty under the same netting agreement should be transferred.

2.6 In summary, ISDA and its members are of the view that the proposed amendments are overly broad and do not contain adequate safeguards to protect contractual termination and set-off rights and collateralization agreements as prescribed by the FSB KA Paper. The qualifications that ISDA's Singapore opinions counsel will have to make to their close-out netting and collateral opinions will result in counterparties subject to the Basel rules revisiting their regulatory capital treatment of their transactions with a Covered FI. This may lead to such counterparties charging more for their transactions with a Covered FI or even to the cessation of trading with a Covered FI. On the flip-side, this may disincentivize new firms from carrying on activities that would require them to be licensed, approved or regulated as a Covered FI. ISDA understands that Singapore has long been accepted as a "good" netting jurisdiction. To lose this cachet is a matter of no small consequence, particularly given the significance of Singapore as a financial centre.

3. **Collateral and regulatory capital**:

3.1 Basel allows banks to offset the adjusted collateral value against the adjusted exposure using the comprehensive approach where the collateral arrangements meet *inter alia* the general requirements for legal certainty.

3.2 Similar to the position on netting, ISDA understands that legal experts in Singapore and market participants generally concur that enforceability of collateral arrangements (including in insolvency) is not an issue with regard to the above-mentioned entities. Thus, at present, ISDA understands that banks will treat collateral arrangements as being enforceable against such entities and take the benefit of the collateral offset.

3.3 For the same reasons as above-mentioned, ISDA's Singapore opinions counsel has advised that if the proposed amendments are passed in their present form, they will have to include the appropriate qualifications in their updated collateral opinion to ISDA and its members. There is the added concern in this context that the 6-month validity period for the High Court-ordered moratorium provided for in the Banking Act/Insurance Act has been removed in the proposed Section 30AAO.

3.4 The above points in paragraphs 2.5 and 2.6 also apply in this context.

4. **Extension of the resolution regime to financial market infrastructures**:

4.1 The Committee on Payment and Settlement Systems ("**CPSS**") and the Board of the International Organization of Securities Commission ("**IOSCO**") published their *Consultative Report on the Recovery and Resolution of Financial Market Infrastructures* ("**FMIs**") on July 31, 2012 ("**CPSS-IOSCO RRP Report**"). The purpose of the CPSS-IOSCO RRP Report is to outline the features of effective recovery plans and resolution regimes for FMIs that are consistent with CPSS-IOSCO's *Principles for Financial Market Infrastructures* published in April 2012 ("**CPSS-IOSCO's FMI Principles**") and the FSB KA Paper. The CPSS-IOSCO RRP Report highlights the need for any resolution regime to take into account the special nature of an FMI, particularly an FMI such as a central counterparty ("**CCP**").

4.2 With FMIs, the focus should firstly be on recovery and continuity versus resolution. Thus, the powers and procedural requirements for FMIs should be quite different from the recovery and resolution procedures for financial institutions generally. Further, given the different structural and risk issues between FMIs, the regimes for FMIs which take on credit risk (such as CCPs) and those that do not (such as trade repositories) should also be differentiated. Thus, ISDA and its

members submit that instead of extending a generic resolution regime to FMIs that applies to a broad class of varied institutional types as per the proposed amendments, a separate holistic recovery and resolution regime should be implemented for FMIs and within such a regime, the appropriate differentiations be made between FMIs that take on credit risk and those that do not.

4.3 FMIs should be responsible for putting in place well-designed, comprehensive and substantive plans to recover from a range of extreme but plausible scenarios. Relevant regulatory authorities will need to ensure that such recovery plans are in place and oversee the execution of these plans. Should resolution be unavoidable, it is imperative that resolution arrangements are transparent, predictable and consistent with recovery arrangements in place at FMIs. Transparency and predictability is essential to maintaining confidence in an FMI and avoiding any incentives for FMI participants to rush for the exits at the first sign of trouble. In particular, the determination to initiate resolution should specifically take into account an FMI's recovery arrangements. An FMI should not be placed into resolution until its agreed and documented recovery arrangements have been implemented and given the opportunity to succeed. Unless this principle is adopted and stated clearly, the threat of resolution will jeopardize the recovery arrangements in place at FMIs and lead to their likely failure. In circumstances where a CCP's recovery process has not been successful, any resolution tools need to contain protections for netting and collateral arrangements, and should contain restrictions on the transfer of part only of a CCP's business in a way that interferes with participants' netting rights. Consistent with this approach, we note that MAS, in its Consultation Paper on Draft Regulations Pursuant to the Securities and Futures Act for Trade Repositories and Clearing Facilities issued on January 10, 2013 proposes to require approved clearing houses and licensed trade repositories to have in place a recovery and resolution plan.

4.4 A bank that is a clearing member of a qualifying CCP[4] (or that is a client of a clearing member of a qualifying CCP under an agency model) may calculate its exposures to the qualifying CCP on a net basis if inter alia it has a "good" netting opinion against the qualifying CCP, and may benefit from a 0% risk-weight being applied to collateral posted to the qualifying CCP if such collateral is bankruptcy remote from the qualifying CCP. The same concerns as set out in paragraphs 2 and 3 would apply in this context.

ISDA appreciates the opportunity to provide comments on the proposed amendments relating to the resolution regime in the MAS Consultation Paper. If you have any questions on this submission, please contact Jacqueline Low (jlow@isda.org, +65 6538 3879) or Keith Noyes (knoyes@isda.org, +852 2200 5909) at your convenience.

Yours faithfully,
For the International Swaps and Derivatives Association, Inc.

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[4] That is, a licensed CCP that is compliant with CPSS-IOSCO's FMI Principles.