

**Comments by the International Swaps and Derivatives
Association, Inc. on the Consultation Paper on Proposed
Amendments to SGX-DC Clearing Rules for: 1. Client Clearing
in OTCF Contracts; and 2. Enhanced Customer Collateral
Protection issued by the Singapore Exchange Derivatives
Clearing Limited**

November 7, 2012

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Singapore Exchange Limited
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Attention: Jeth Lee
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Dear Sirs

Proposed Amendments to SGX-DC Clearing Rules for:

- 1. Client Clearing in OTCF Contracts; and**
- 2. Enhanced Customer Collateral Protection**

1. **Introduction:** The International Swaps and Derivatives Association, Inc. (“**ISDA**”)¹ welcomes the opportunity to respond to the Consultation Paper on Proposed Amendments to SGX-DC Clearing Rules for: 1. Client Clearing in OTCF Contracts; and 2. Enhanced Customer Collateral Protection (“**SGX-DC Consultation Paper**”) issued by the Singapore Exchange Derivatives Clearing Limited (“**SGX-DC**”) on October 3, 2012.

2. **General Comments:** Before responding to the specific questions posed in the SGX-DC Consultation Paper, we would like to make the following general comments:

2.1 **Client Clearing:** We fully support SGX-DC’s plan to extend client clearing services to OTC financial derivative contracts (“**OTCF Contracts**”). Over 80% of the global OTC derivatives market consists of interest rate swaps. Currently, only 50% of interest rate swaps globally are cleared but as between the G14 dealers, 90% of their interest rate swaps with each other are already being cleared. Thus, to have a significant increase in the volume of cleared interest rate swaps, end-users including non-G14 dealers will have to start clearing their swaps. End-users are unlikely to become direct clearing members of a clearing house (as they may not satisfy the criteria for membership and/or may not wish to take on the liabilities and obligations of a clearing member) and will thus have to make use of client clearing services. The ability to meet the G20 commitment to clear standardized OTC derivative contracts will thus hinge upon the implementation of successful client clearing initiatives.

2.2 **Client Clearing Model:** There are presently two operating models of OTC derivatives client clearing - the *Principal* or *SCM* model² and the *Agency* or *FCM* model³. The

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 In the *Principal* or *SCM* model, the clearing member is described as being the principal to the client’s transactions, and the clearing member enters into “back-to-back” transactions between it and the clearing house. The clearing house does not deal directly with the client and, for the most part, recognizes only the clearing member in relation to the cleared transactions.

³ In the *Agency* or *FCM* model, the clearing member is described as being the agent of the client, so that the client deals with the clearing house through the agency of the clearing member. The two principals to these dealings are described to be the clearing

Agency model is implemented in the US and the Principal model is implemented outside the US (including in Singapore for SGX-DC’s existing client clearing service for OTC commodities contracts (“**OTC Contracts**”)). Regardless of the model, the key consideration is to ensure that the client is protected in the event of the default of its clearing member and such protection hinges upon the robustness of the segregation⁴ and portability⁵ arrangements. In the Principal model, segregation and portability have been achieved through contractual arrangements between the parties⁶. Conversely, in the Agency model, segregation and portability depends upon various US statutes, namely, the Commodity Exchange Act, the Commodity Futures Trading Commission Regulations and the Bankruptcy Code.

2.3 We note that the SGX-DC Consultation Paper does not prescribe the model to be adopted for client clearing of OTCF Contracts. We agree that SGX-DC should not take a prescriptive approach to the client clearing model but should instead leave it to market participants to choose. Any amendments to the SGX-DC Clearing Rules (as well as to the Securities and Futures Act (“**SFA**”) or any other legislation) to strengthen the robustness of the segregation and portability arrangements should apply regardless of the client clearing model that is implemented.

2.4 **Credit Rating:** We note that SGX-DC proposes to replace the requirement of a long term rating of “A” and financial strength rating of “C” with a long term rating indicating strong creditworthiness and a rating indicating adequate intrinsic safety and soundness (excluding external credit support). While we agree with the approach of SGX-DC itself assessing and monitoring the creditworthiness and intrinsic safety and soundness of its clearing members, we would like to better understand the credit evaluation framework and criteria that will be applied by SGX-DC, including the frequency of evaluation by SGX-DC and the consequences if SGX-DC observes a deterioration in the credit profile of a clearing member. In addition, given that SGX-DC has currently stipulated margin multipliers based on external credit ratings, please advise on the corresponding amendments that will be made to the margin framework.

3. **Response to Proposals:** We set out below our responses to the questions raised in the SGX-DC Consultation Paper (capitalized terms used below but not defined have the meaning given to such terms in the SGX-DC Consultation Paper):

Proposal	Response
1. SGX-DC seeks your views on its proposal to require:	
(a) a minimum share capital of S\$50 million for all Clearing Members clearing OTCF Contracts;	Although the minimum share capital requirement is a necessary criteria, we do not consider this to be the critical criteria for clearing membership. Of greater importance is the risk management and operational capability of the clearing member,

house and the client. The clearing member is not described as being a principal counterparty to those dealings. However, to ensure the stability of the clearing system, the clearing member guarantees its client’s performance to the clearing house.

⁴ Segregation is the separation (legally and/or operationally) of the collateral provided by a client to its clearing member from the collateral provided by any other client of the clearing member, and the property of the clearing member itself.

⁵ Portability refers to the transfer of the client’s positions and collateral from the client’s clearing member to another clearing member, in particular upon the default of the client’s clearing member.

⁶ Though in the UK for example, there are plans to buttress the contractual protections via amendments to Chapter VII of the UK Companies Act.

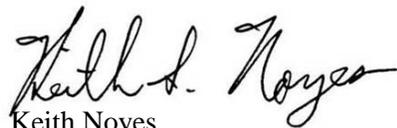
	<p>including its ability to participate in the default management process of the clearing house, and other measures by the clearing house to ensure that the risk exposure introduced by the clearing member to the clearing house is suitably mitigated (including through default fund contributions and margin requirements). As such, we do not disagree with a minimum share capital requirement of S\$50 million for all Clearing Members clearing OTCF Contracts. However, we would like to understand if SGX-DC plans to stipulate any risk-based limit structures (e.g. risk limits based on the amount of capital of the clearing member) or any other financial requirements.</p>
<p>(b) the capital requirements of BCMs clearing OTCF Contracts or its parent banks (if applicable), and of parent banks of GCMs clearing proprietary or proprietary and customer OTCF Contracts, to be based on capital requirements in the Banking Act and home regulations, as opposed to a minimum share capital of S\$1 billion; and</p>	<p>For the same reasons as set out above, we do not disagree with this proposal.</p>
<p>(c) all Clearing Members clearing OTCF Contracts to institute appropriate default management processes in accordance with the Rules.</p>	<p>We fully support this measure as we consider this to be a key indicia of the risk management and operational capability of the clearing member. However, a clearing member should be allowed to outsource this requirement to its affiliate on the basis that the clearing member remains fully responsible for complying with this requirement. We would also like to better understand the criteria that will be applied by SGX-DC in evaluating the default management capability of its clearing members.</p>
<p>2. SGX-DC seeks your views on the proposed Enhanced Customer Collateral Protection model and the corresponding margining framework.</p>	<p>We support the proposal to give clients the option of Enhanced Customer Collateral Protection. However, we seek clarification of how the “higher margin rate” will be computed for clients that opt for Enhanced Customer Collateral Protection. If this is seen as being onerous, it will discourage clients from opting for Enhanced Customer Collateral Protection. We would also like to better understand SGX-DC’s plans in regard to the management of the positions and collateral of clients that opt for Enhanced Customer Collateral Protection in the event of a default by their clearing member. For example, if there is a need for a variation margin call to be made post-default, will this be made individually on each Applicable Customer Account holder or across all Applicable Customer Account holders whose collateral is physically commingled in an</p>

4. We would like to seek confirmation/clarification of the following:
- (a) that “parent” bank (and “parent” entity in relation to a GCM clearing client trades only) is not confined to the immediate parent only.
 - (b) the definition of a “bank”. For example, would it include a US bank holding company?
 - (c) the definition of a “financial authority”. For example, would it include an authority such as the International Enterprise Singapore Board?
 - (d) that the requirement to be “licensed and regulated” by a financial authority would not be satisfied where the relevant entity is exempted from licensing under the relevant statute.
5. We have no comments on the proposed amendments to the SGX-DC Clearing Rules other than that the above confirmations/clarifications should be incorporated.

ISDA appreciates the opportunity to provide comments on the SGX-DC 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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