

APAC Monthly Update

October 2012

APAC Monthly Update summarizes important regulatory developments, meetings, committee activities and conferences in the region.

Regulatory Activities

Australia:

On October 17, ISDA met with RBA, Australian Securities and Investments Commission (ASIC), Australian Prudential Regulation Authority (APRA) and the Treasury to discuss the submission papers to RBA and ASIC, the ISDA protocols, the ISDA/FOA client clearing addendum, the differences in CCP models and the BCBS IOSCO paper on margin for non centrally cleared swaps, ISDA's response paper to the BCBS IOSCO paper on margin for non centrally cleared swaps, ISDA's response to CFTC's no action letters and ISDA's letter to asian regulators on trade reporting and privacy law issues.

On October 17, Steve O'Connor, ISDA Chairman and ISDA staff visited ASIC Chairman Greg Medcraft and ASIC Commissioner Greg Tanzer. ISDA provided an update on global regulatory developments and their impact on Australian financial markets. ASIC discussed some of its initiatives related to IOSCO work on establishing global regulatory standards.

Committee/Working Group Activities

Asian Steering Committee

The Asian Steering Committee held a twice yearly meeting in Singapore on October 23. Issues discussed included: 1) Clearing member resignation procedures at CCIL, CPSS-IOSCO compliance issues, and mandatory clearing deadlines in India, 2) industry concerns around Korean CCP issues, including KRX's risk waterfall not being EMIR compliant and the need for KRX to have a living will to meet CPSS-IOSCO standards, 3) Efforts to make possible re-hypothecation of KGB collateral, 4) BCBS-IOSCO proposed margin rules for un-cleared swaps, and 5) Execution of Dodd Frank and FATCA protocols with Asian end clients.

North Asia L&R

On October 30, ISDA held its L&R Members' meeting in Hong Kong. Topics discussed included the Implementing Rules of the Interim Measures on Overseas Investments by Insurance Companies and the Interim Measures on Insurance Funds' Participation in Financial Derivatives Trading issued by the China Insurance Regulatory Commission, Basel III implementation in Hong Kong and Korea, ISDA's Sydney trip and meeting with the Australian regulators, ISDA's submission on netting in India, and SGX's consultation paper on Client Clearing in OTCF Contracts and Enhanced Customer Collateral. ISDA also updated members on ISDA's letter to APAC regulators highlighting potential conflicts with local laws arising from the mandatory reporting of transactions under the DFA, the district court ruling on ISDA/SIFMA position limits lawsuit, the SEC proposed margin and capital rule for security-based swap

dealers and major security-based swap participants and the CFTC's series of No Action Letters, staff interpretations and Q&A-type documents.

South Asia L&R

On October 25, ISDA held its L&R Members' meeting in Singapore. Topics discussed included ISDA's Sydney trip and meeting with the Australian regulators, an update on FEDAI clarification on CSAs, ISDA's submission on the Draft Guidelines relating to Management of Intra-group Transactions and Exposures, ISDA's submission on Netting, the Indian FSLRC Approach Paper, an update on the 2012 Annual Asia Pacific Conference in Singapore, MAS response to Feedback received on the Consultation paper II on Proposed Amendments to the Securities and Futures Act on Regulation of OTC Derivatives and SFA (Amendment) Bill 2012, SGX's consultation paper on Client Clearing in OTCF Contracts and Enhanced Customer Collateral. ISDA also updated members on ISDA's letter to APAC regulators highlighting potential conflicts with local laws arising from the mandatory reporting of transactions under the DFA, the district court ruling on ISDA/SIFMA Position Limits Lawsuit, the SEC proposed margin and capital rule for security-based swap dealers and major security-based swap participants and the CFTC's series of No Action Letters, staff interpretations and Q&A-type documents.

Operations/Market Infrastructure

On October 4, ISDA held its APAC Interest Rates Derivatives Operations Working Group meeting to discuss the addition / amendment of floating rate options / matrices, the electronic confirmation format for CNH IRS product and the confirmation template for compounding and in-arrears Asian NDS.

On October 17, ISDA held its APAC Equity Derivatives Operations Working Group meeting to address the documentation of Taiwan swap and AEJ Variance Swap, the group also discussed the AEJ reference price source matrix.

Regulatory Developments

China: CIRC rules on insurance companies

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On October 12, the China Insurance Regulatory Commission (CIRC) issued two important documents. The long-awaited Implementing Rules of the Interim Measures on Overseas Investments by Insurance Companies (the Implementing Rules, promulgated in 2007). The Implementing Rules broadened the scope of permissible overseas investment by domestic insurance companies and set out detailed qualification and ratio requirements in relation to overseas investments.

Qualified domestic insurance companies are now permitted to enter into interest rate forwards, interest rate swaps, interest rate futures, FX forwards, FX swaps, stock index futures transactions, or purchase index options and other types of derivatives for hedging purposes. When conducting derivatives transactions, the insurance companies are required to comply with certain requirements which include signing an ISDA Master Agreement with each of their counterparties. Although the Implementing Rules require that the agreement between a domestic insurance company and its asset manager/custodian be governed by Hong Kong law or the PRC law, there is no such requirement in respect of the ISDA Master Agreement. The Implementing Rules prohibit insurance companies from entering into any speculative derivatives transactions or commodity (including precious metal) related derivatives transactions.

On the same day, CIRC also issued the Interim Measures on Insurance Funds' Participation in Financial Derivatives Trading (the Interim Measures). According to the Interim Measures, PRC-incorporated

insurance group (holding) companies, insurance companies and insurance assets management companies (together known as "insurance institutions") are allowed to enter into derivatives transactions in the domestic market for hedging purposes.

The Interim Measures set out the qualification criteria and risk management requirements for the insurance institutions which wish to engage in financial derivatives trading. The insurance institutions are required to submit a report to CIRC before commence trading and afterwards report to CIRC certain information of their derivatives transactions periodically.

India:

RBI requires OTC derivative transactions reported to CCIL

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On October 12, the Reserve Bank of India issued circular entitled Reporting Platform for OTC Foreign Exchange and Interest Rate Derivatives. The circular states that with effect from November 5, 2012, certain interbank OTC derivative trades should be reported to a platform developed by the Clearing Corporation of India Limited (CCIL):

- Inter-bank OTC foreign currency (excluding USD)-INR forward and FX swap trades should be reported in hourly batches within 30 minutes of completion of the hour;
- OTC foreign currency forward, FX swap and option trades that do not involve the INR should be sent to CCIL in a single daily report by 5:30 PM;
- AD banks are also required to foreign currency forwards, FX swaps and option trades with overseas counterparties, including their branches and parent. These trades will not be matched on the CCIL platform since overseas counterparties are not required to report/confirm trade details;
- Outstanding inter-bank OTC foreign exchange (excluding USD)-INR forwards, FX swaps and foreign currency forwards, FX swaps and options prior to the November 5 commencement of reporting date must be reported to CCIL by November 30;
- Reporting will cover transactions in 14 currencies (USD, EUR, GBP, JPY, AUD, CAD, CHF, HKD, DKK, NOK, NZD, SGD, SEK and ZAR) with the intention to extend to more currencies at a later date.

CCIL will make available detailed operational guidelines.

Hong Kong: HKMA publishes subsidiary banking rules in gazette

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On October 19, HKMA released a notice that three rules were published in the Gazette:

- The Banking (Amendment) Ordinance 2012 (Commencement) Notice 2012 amends the powers of HKMA, enabling them to make rules prescribing capital and disclosure requirements for authorized institutions (AIs) incorporated in HK. The notice also prescribes the procedures for remedial action upon contravention of these requirements;
- The Banking (Capital) (Amendment) Rules 2012 introduces the amendments to the Banking (Capital) Rules to implement the first phase of the Basel III requirements. The new rules will revise the capital requirements for locally incorporated authorized institutions which are scheduled to take effect in Jan 2013. Under the revised framework, a bank will need to maintain a Common Equity Tier 1 (CET1) capital ratio of 405%, a Tier 1 ratio of 6% (both Tier 1 and CET1 to be phased in from January 1, 2013 to January 1, 2015) and a total capital of 8% from January 1, 2013.
- The Banking (Specification of Multilateral Development Bank) (Amendment) Notice 2012 amends the Banking (Specification of Multilateral Development Bank) to include the Multilateral

Investment Guarantee Agency (MIGA), which is a member of the World Bank, to the list of multilateral development banks to enable it to be eligible for preferential risk-weighting under the Basel capital framework.

These three pieces of subsidiary legislation were tabled today before the Legislative Council for negative vetting. Subject to the views of the Legislative Council, the subsidiary legislation should come into operation on January 1, 2013.

Singapore:

SGX consults on SGX-DC clearing rules for client clearing

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On October 3, Singapore Exchange (SGX) released a consultation paper on the proposed amendments to the SGX-DC clearing rules for client clearing of OTCF contracts and enhanced customer collateral protection.

Clearing of OTCF contracts:

- a. A minimum capital requirement of SGD50 million for all Clearing Members clearing OTC financial derivative contracts (“OTCF Contracts”), whether house or client trades;
- b. Bank Clearing Members (or their parent bank) and parent banks of General Clearing Members clearing both house and client trades will no longer be subject to the minimum SGD1 billion share capital requirement but must instead comply with capital standards prescribed by the Singapore Banking Act or their home regulator;
- c. General Clearing Members clearing client trades only must be a capital markets services license holder, guaranteed by a parent entity licensed and regulated by a financial authority/regulator and the GCM’s parent entity must comply with capital requirements imposed by its home regulator;
- d. Bank Clearing Members (or their parent bank) and parent banks of General Clearing Members clearing both house and client trades must have a long term rating indicating strong creditworthiness and a rating indicating adequate intrinsic safety and soundness (excluding external credit support) instead of the current long term rating of ‘A’ and financial strength rating of ‘C’. The parent entity of a General Clearing Member clearing client trades only must have a long term rating indicating strong creditworthiness;
- e. All Clearing Members must demonstrate to SGX-DC that they have the requisite default management capabilities in place;
- f. All Clearing Members will be subject to such further capital and financial requirements as may be prescribed by SGX-DC from time to time.

Enhanced Customer Collateral Protection for OTC Contracts and OTCF Contracts:

- a. By virtue of the statutory trust imposed by Section 62 of the Securities and Futures Act, SGX-DC holds customer collateral on trust and separate from its own funds and Clearing Members’ collateral for both OTC commodities contracts (“OTC Contracts”) and OTCF Contracts. Customer collateral is therefore protected against the risk of insolvency of the Clearing Member and SGX-DC;
- b. However, customer collateral is not protected against “fellow customer risk” as SGX-DC’s Rules permit SGX-DC to have recourse to customer collateral in the case of a “double default” where a Clearing Member defaults due to the default of one of its customers;
- c. The proposed Enhanced Customer Collateral Protection gives customers the option of electing to ring-fence their collateral from “fellow customer risk” and is based on the US LSOC model;

- d. SGX-DC's portability arrangements under Rule 7A.02.1.1 will continue to apply to all customers whether or not they opt for the Enhanced Customer Collateral Protection.

SGX states that it intends to implement an OTCF Client Clearing framework by the first half of 2013. Submission deadline is October 24.

MAS response on comments on SFA Bill amendments

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MAS has released its response to the feedback received on Consultation Paper II. The Securities and Futures (Amendment) Bill 2012 was tabled before Parliament on October 15.

The highlights of MAS's response include:

1. MAS agrees that the specified parties should not be prevented from entering into derivatives contract in the event that a clearing house is not available for or capable of clearing and will amend the relevant section accordingly.
2. MAS agrees that the anti-avoidance provision could create undue uncertainty for participants in the OTC derivatives market. On balance, having regard to other avenues available to detect avoidance of the clearing obligation as well as to international practice, MAS has decided to remove this provision.
3. While MAS acknowledges the concerns raised regarding foreign mandatory reporting and Singapore banking secrecy laws, MAS notes that the Banking Act allows banks to seek customers' consent for the purposes of reporting trades to the trade repository without breaching banking confidentiality. Therefore, on balance, MAS is not inclined to amend the domestic confidentiality provisions.
4. MAS will retain the requirement for reporting by an agent but clarifies that this is targeted at a fund management company in Singapore acting as an agent in the transaction and the counterparty to the transaction is the fund which it manages. MAS will consult on the definition of "agent" at a later stage.
5. MAS will retain the accountability of the specified party for accurate reporting notwithstanding single-sided or third-party reporting.
6. MAS agrees on the need to calibrate the level of penalties to ensure that they are commensurate with those in other jurisdictions, as well as the severity of the contravention involved. The penalty for contravention of the reporting obligation will be amended to \$50,000, and \$5,000 for every day or part thereof if the offence continues after conviction.
7. MAS agrees that the imprisonment term for the contravention of the provision for MAS to obtain information may be too harsh and will remove the imprisonment term. MAS will also incorporate the restrictions on self-incriminatory statements and the carve-outs for immunities into this provision.

Submission:

October 12: ISDA submission to Reserve Bank of India on Consistency of netting application to spur financial market growth.

October 16: ISDA submission to Reserve Bank of India on Management of Intra-Group Transactions and Exposures

October 18: ISDA submission to Reserve Bank of Australia regards to the Consultation on New Financial Stability Standards

October 19: ISDA submission to Australian Securities Investments Commission regards to Consultation Paper 186 on Clearing and Settlement Facilities: International Principles and Cross-Border Policy (Update to RG 211)

Upcoming committee and working group meetings/conferences

Meetings:

APAC IRD Operations Meeting	Nov 1
APAC Collateral Management Operations Meeting	Nov 2
APAC Implementation Group Meeting	Nov 5
APAC Credit Operations Meeting	Nov 14
APAC Equity Operations Meeting	Nov 15
Legal Regulatory Advisory Group Meeting	Nov 26
North Asia L&R Meeting	Nov 27
South Asia L&R Meeting	Nov 29

Conferences:

Understanding the ISDA Master Agreements Conference Including Overview of Local Regulatory Requirements on OTC Derivative Market Participants – Singapore	Nov 20
Understanding Collateral Arrangements and the ISDA Credit Support Documents Conference Including Close-outs under the ISDA Credit Support Annex (Transfer) and Impact of Global OTC Derivatives Regulatory Reforms on Collateral Arrangements – Singapore	Nov 21

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Please direct comments and questions about APAC Monthly Update to Donna Chan, dchan@isda.org
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