ISDA Safe, Efficient Markets

By E-mail

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July 31, 2015

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Dear Sirs and Madams

Consultation Paper on Draft Regulations for Mandatory Clearing of Derivatives Contracts

Introduction

The International Swaps and Derivatives Association, Inc. (**ISDA**)[1] welcomes the opportunity to provide comments on the Consultation Paper on Draft Regulations for Mandatory Clearing of Derivatives Contracts (**Consultation Paper**) issued by the Monetary Authority of Singapore (**MAS**) on July 1, 2015. Individual ISDA members may have their own views on the Consultation Paper, and may therefore provide their comments to MAS directly.

ISDA and its members strongly support the overarching goal of reducing systemic risk in the OTC derivatives markets, thereby making markets safer and more efficient, by introducing an obligation to clear certain eligible classes of OTC derivatives in central counterparties (**CCPs**). As such, ISDA appreciates MAS' efforts in this area and in particular, supports MAS' considered approach in identifying, among others, the appropriate type of OTC derivatives contracts to be cleared, the circumstances under which clearing is mandatory and the persons who are subject to or exempt from clearing obligations.

We hope that our comments in this submission will assist MAS with the preparation of the Securities and Futures (Clearing of Derivatives Contracts) Regulations (**SF(CDC)R**) which we note will set out the implementation details of the initial set of products and persons subject to clearing obligations under the Securities and Futures Act (Cap. 289) (**SFA**). ISDA hopes to continue the constructive ongoing dialogue

[1] Since 1985, ISDA has worked to make the global over-the-counter (OTC) derivatives markets safer and more efficient. Today, ISDA has over 800 member institutions from 67 countries. These members include a broad range of OTC derivatives market participants including corporations, investment managers, government and supranational entities, insurance companies, energy and commodities firms, and international and regional banks. In addition to market participants, members also include key components of the derivatives market infrastructure including exchanges, clearinghouses and repositories, as well as law firms, accounting firms and other service providers. Information about ISDA and its activities is available on the Association's web site: www.isda.org.

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between MAS and derivatives market participants to consider, for instance, the practical concerns and risks surrounding the implementation of the clearing obligation in Singapore.

General Comments

We have set out certain general observations and comments which we hope would be useful in providing the necessary context to our more specific responses as well as provide you with an idea as to certain key concerns which we may have. We sincerely hope that MAS will also consider these general comments.

Responses to specific questions

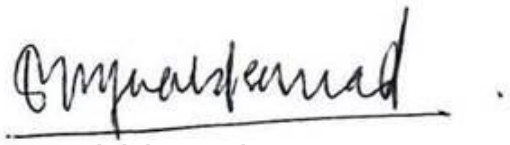
We also set out our detailed responses to questions raised in the Consultation Paper in the template provided by MAS. This is set out in Appendix 1 to this submission. Any terms not defined in Appendix 1 are as defined in the Consultation Paper.

ISDA thanks MAS for the opportunity to respond to the Consultation Paper and welcomes further dialogue with MAS on any of the points raised. Please do not hesitate to contact Keith Noyes, Regional Director, Asia Pacific at (knoyes@isda.org, at +852 2200 5909) or Erryan Abdul Samad, Counsel, Asia at (eabdulsamad@isda.org, at +65 6653 4170) if you have any questions.

Yours sincerely,

For the International Swaps and Derivatives Association, Inc.

Keith Noyes
Regional Director, Asia-Pacific



Erryan Abdul Samad
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ISDA®

Appendix 1

RESPONSE TO CONSULTATION PAPER

Please note that all submissions received will be published and attributed to the respective respondents unless they expressly request MAS not to do so. As such, if respondents would like (a) their whole submission or part of it, or (b) their identity, or both, to be kept confidential, please expressly state so in the submission to MAS. In addition, MAS reserves the right not to publish any submission received where MAS considers it not in the public interest to do so, such as where the submission appears to be libellous or offensive.

Consultation topic:	Consultation Paper on Draft Regulations for Mandatory Clearing of Derivatives Contracts
Name[1]/Organisation: [1]if responding in a personal capacity	The International Swaps and Derivatives Association, Inc. (**ISDA**)
Contact number for any clarifications:	Keith Noyes, Regional Director, Asia Pacific at (+852 2200 5909) or Erryan Abdul Samad, Counsel, Asia at (+65 6653 4170)
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Confidentiality	
I wish to keep the following confidential:	Not Applicable *(Please indicate any parts of your submission you would like to be kept confidential, or if you would like your identity to be kept confidential. Your contact information will not be published.)*

General comments:

As noted in our cover letter, we appreciate and support MAS' considered approach in identifying, among others, the appropriate type of OTC derivatives contracts to be cleared, the circumstances under which clearing is mandatory and the persons who are subject to or exempt from clearing obligations. Before going into our specific responses to the individual questions below, we have set out here certain general comments and observations which we hope MAS will consider. Any terms not defined in Appendix 1 are as defined in the Consultation Paper.

Cross-border harmonization

Whilst we welcome MAS' decision to limit the extraterritorial scope of the clearing mandate due to concerns relating to progress of international efforts to resolve issues relating to the conflict and overlap of extraterritorial rules relating to OTC derivatives, our members are concerned that with respect to, for instance, international dealers, the scope of the clearing mandate as defined by MAS will conflict or overlap with equivalent rules from other jurisdictions which are, or soon will be, binding on such international dealers, including requirements under the European Market Infrastructure Regulation (**EMIR**) and Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act (**Dodd-Frank**), where applicable.

We believe it is essential, and in line with the expectations on cross-border harmonization of the Financial Stability Board (**FSB**), the International Organization of Securities Commissions (**IOSCO**) and the OTC Derivatives Regulators Group (**ODRG**), that all jurisdictions introducing OTC derivatives reforms should seek to address such conflicts and overlaps by introducing rules that clearly provide for a mechanism of substituted compliance, mutual recognition or equivalence that would allow market participants to attain compliance by clearing in line with equivalent rules on clearing from another jurisdiction. Our members hope that MAS will consider and include such a mechanism in its proposals. Whilst we note that MAS has stated in the Consultation Paper that their clearing mandate will not result in any irresolvable conflicts on the basis of, among others, Singapore Exchange Derivatives Clearing Limited (SGX-DC) (which is regulated as an approved clearing house (**ACH**) by MAS being registered as a derivatives clearing organization (**DCO**) with the Commodity Futures Trading Commission (**CFTC**) as well as Singapore being accorded equivalence for the purposes of EMIR Article 25 by the European Securities and Markets Authority (**ESMA**), we strongly believe however that it is not desirable to clear through a single local clearing house and that this does not adequately address the potential for regulatory conflict and overlap. We are encouraged that MAS intends to recognize more ACHs or recognized clearing houses (**RCH**) clearing services, but suggest that a substituted compliance regime would better address the issue of eligible clearing services.

We also understand that the wider interest rate swaps market as a whole and the major international dealers in particular are currently clearing only a very small proportion of their USD-LIBOR or SGD-SOR interest rate swaps (**IRS**) through SGX-DC. If MAS' clearing mandate has the effect of limiting major international dealers to clear certain swaps through only SGX-DC, then this is likely to lead to the unintended consequences of reducing the volume of in-scope IRS that international dealers may choose to book locally in Singapore as well as artificially bifurcating the existing swap market between swaps that are to be cleared through SGX-DC (which will necessarily be a much smaller proportion of the whole) and swaps that may be cleared outside Singapore at venues which may attract larger volumes and greater volume related efficiencies.

We also note that international dealers are strongly incentivized by Basel III capital rules to concentrate their clearing activity in a small number of CCPs in order to maximize the benefit of netting (and

associated capital) efficiencies The margin and clearing rules at SGX-DC also differ from those of established major IRS CCPs in European Union (**EU**) and the United States (**U.S.**), as such that swap transactions cleared on these different venues may be priced differently even before taking into account, for instance, liquidity considerations. A mandate may have the unintended effect of artificially bifurcating trading activity, thereby resulting in pricing differences becoming more pronounced. This was an effect of the swap execution facility (SEF) trading mandate under Dodd-Frank. It may therefore be possible that a smaller section of the market which will be required to clear through SGX-DC as a result of the clearing mandate would experience wider spreads arising from the relatively reduced liquidity in that part of the market. These wider spreads may ultimately impact the cost at which end-users in Singapore who rely on the banks for hedging can expect to hedge their risk.

We therefore very much hope that MAS considers and provides for a mechanism of substituted compliance, mutual recognition or equivalence and we consider it of utmost importance that MAS approves or recognizes a much broader range of international CCPs as ACHs or RCHs before the commencement of the clearing mandate to ensure that the aforementioned unintended consequences are avoided. We would urge MAS to consider approving such ACHs and RCHs that would comprise all of the major CCPs in the EU, U.S. and Japan where the vast majority of IRS clearing activity is currently taking place. We note from MAS' comments in the Consultation Paper that MAS recognizes the need to expand the list of RCHs and ACHs. In this regard, we would commend MAS' thinking and would further impress upon MAS the importance of doing so. We would also point out that the list of RCHs and ACHs needs to remain flexible to address unforeseen events at any particular CCP and allow for the future development of the market.

Other considerations

Members would welcome an exemption from the clearing requirements for derivative transactions that are created as part of either a multilateral trade compression cycle or bilateral trade compression process. New and amended derivative transactions that result from systemically risk-reducing processes such as compression should not be subjected to the clearing mandate if the original trades were themselves not subject to the clearing mandate. If these post-trade risk reduction derivative transactions are not exempted this would act as a significant disincentive for market participants to participate in such compression exercises and introduce new pricing risks for market participants. In addition it would have the effect of undermining the risk mitigation requirements currently proposed by MAS in its Consultation Paper on Regulatory Framework for Intermediaries Dealing in OTC Derivative Contracts, Execution-Related Advice, and Marketing of Collective Investment Schemes released in July 2015 and the requirements already faced by foreign firms under EMIR and Dodd-Frank.

Question 1: MAS seeks views on the proposal to subject, at a minimum, SGD fixed-to-floating SOR IRS and USD fixed-to-floating LIBOR IRS to clearing obligations.

ISDA and its membership are, subject to certain considerations, supportive of subjecting SGD fixed-to-floating SOR IRS and USD fixed-to-floating LIBOR IRS to clearing obligations. As noted in our general comments, we would urge MAS to consider and include a mechanism for substituted compliance, mutual recognition or equivalence. It is essential that MAS approves or recognises a much broader range of international CCPs as ACHs or RCHs before the commencement of the clearing mandate.

Also as noted in our general comments, we commend MAS' recognition of the need to expand the list of RCHs and ACHs and therefore would reiterate the importance of doing so in order to prevent the unintended consequences outlined above. A mandate that forces clearing via a specific CCP may

potentially result in a bifurcation of liquidity across global markets and the break-up of existing netting sets. This may ultimately pose liquidity concerns in Singapore and have pricing implications for end-users.

We are encouraged that MAS recognizes in the Consultation Paper that the interaction of jurisdictions' rules on cross-border transactions remains an ongoing concern and that MAS continues to participate actively in international discussions to resolve this matter. We would support MAS' efforts to provide a mechanism for substituted compliance, mutual recognition or equivalence, especially where MAS' clearing mandate includes products which may already be subject to other international mandates. We would support MAS approving or recognizing the list of international CCPs as ACHs or RCHs to include such CCPs in E.U., U.S. and Japan.

As a general point, we would respectfully request that MAS only subjects products to the clearing mandate that are: (i) standardized; (ii) liquid; and (iii) already voluntarily cleared on multiple CCPs recognised as ACHs or RCHs. As such we welcome MAS limiting the current mandate to swaps not containing any optionality or special features included to address idiosyncratic risks (e.g. forward starts, amortizing nationals).

We also respectfully request that in determining its own mandate MAS considers and refers to the way certain product parameters have been defined in E.U. or U.S. mandates. By way of example, we request that MAS aligns the minimum maturity criteria with EU and US regulations (for instance, including a minimum maturity for SGD and USD Fixed-to-Floating IRS of 28D).

Members have also queried the treatment of complex or package structures under the clearing obligations. For instance, it is not uncommon for a fixed/floating IRS trade to form one leg of a complex structured transaction that also comprises of legs made up of products that cannot be cleared. In many cases, breaking up such trades into component parts and subjecting only one part to mandatory clearing increases risk and reduces efficiency. An example would be the instance where two counterparts enter into an IRS trade to exchange the initial delta on a swaption transaction. The IRS and swaption legs are naturally offsetting transactions that reduce counterparty credit exposure. Separating the two legs of the trade makes each riskier and results in considerably higher capital requirements as the IRS leg needs to be independently margined at the clearing house and the swaption leg has to be collateralized on a bilateral basis. Going forward, members welcome further consultation on this point.

Question 2: MAS seeks views on whether it would be appropriate to mandate clearing of EUR, GBP and JPY IRS.

In addressing the issue as to whether it would be appropriate to mandate the clearing of EUR, GBP and JPY IRS, we would urge MAS to, at the first instance, consider and provide a mechanism for substituted compliance, mutual recognition or equivalence. In such a scenario, we submit that it may then be appropriate to consider mandating such products, in order to address systemic risk in Singapore. However, we do not believe it is appropriate to mandate EUR, GBP or JYP IRS for clearing simply for the purpose of aligning its mandate with the scope of mandates in the EU and the U.S.

We also respectfully request that the industry be consulted and have the opportunity to provide comments on any future expansion of the scope of the mandatory clearing regime prior to its issuance and request that each additional clearing obligation be subject to a similar notice or phase-in period of at least 6 months.

Question 3: MAS seeks views on whether subjecting more types of SGD, USD, EUR, GBP and JPY IRS products, such as basis swaps, forward rate agreements overnight index swap, to clearing obligations, would result in margining efficiencies for market participants.

We respectfully submit that margining efficiencies should not be the sole determining factor in considering which products to mandate for clearing. A key factor to consider is whether such a mandate would address systemic risk concerns in Singapore.

In mandating whether the clearing of the listed IRS products would address systemic risk concerns in Singapore, it is vital MAS considers and provides a mechanism for substituted compliance, mutual recognition or equivalence and expands the list of CCPs recognised as ACHs or RCHs. This will prevent the inadvertent creation of margining inefficiencies through bifurcation across markets. It should also be noted that the choice of clearing venue is critical to allow entities sufficient flexibility to avoid the build up of directional exposures and achieve margining efficiencies.

We note that not all of the products listed are subject to clearing obligations in other jurisdictions. For example, the clearing of JPY forward rate agreements are not mandated by the European regulatory authorities and MAS should therefore consider whether it would be appropriate to mandate this product for clearing within Singapore.

Question 4: In relation to the IRS proposed for clearing (see Section 3), MAS seeks views on subjecting transactions that are booked in the Singapore-based operations of both transacting counterparties, i.e. a Singapore-incorporated company or a Singapore branch of a foreign entity, to clearing obligations.

We commend MAS' proposal that clearing obligations should be imposed in relation to IRS trades in which both transacting counterparties have booked in their Singapore-based operations, i.e. a Singapore-incorporated company or a Singapore branch of a foreign entity. Clearing obligations should primarily be imposed on risks that are booked and hence residing in the Singapore system. We believe that this is the correct approach.

Question 5: MAS seeks views on the proposed exemptions from clearing obligations approach: (a) all banks from mandatory clearing as long as they do not exceed a maximum threshold of S$20 billion gross notional outstanding derivatives contracts booked in Singapore for each of the last four quarters; and (b) all other specified persons that are not banks.

Members welcome the inclusion of the S$20 billion threshold (**threshold**) but request that calculation parameters be defined as clearly as possible to avoid any confusion and uncertainty in the market. In particular members have requested that MAS clarify its intention regarding the following points:

1) In respect to paragraph 7 of the Second Schedule, we respectfully seek MAS' clarification whether it is MAS' intention that if a bank fails to meet the threshold for any one of the past four consecutive quarters that it will be an exempt bank until it exceeds the threshold for four quarters in a row.

2) Given that the definition of a "derivatives contract" is presently under review as part of MAS' consultation on proposed amendments to the Securities and Futures Act (Cap.289) issued in February 2015, members have also queried which definition of "derivatives contract" MAS is expecting entities to base their threshold calculations on. Members would welcome confirmation

from MAS that it intends the threshold to be calculated based on OTC derivative contracts only, as currently defined.

We also kindly request that MAS specifically excludes intra-group transactions from the calculation of the clearing threshold.

We also wish to highlight a crucial point here: Banks in scope for mandatory clearing will also need to know which of their counterparties are in-scope. We recommend that MAS maintains and publishes a list of in-scope counterparties for the purpose of reliance. For instance, members also seek clarity as to when a bank or counterparty should inform MAS that it has exceeded the threshold. In terms of timing of notification, should an entity inform MAS once it has crossed the threshold for the past four consecutive quarters or only after the passing of a relief period. Members suggest that a list of in-scope counterparties should also include a start date, where relevant, for a particular counterparty. This takes into account that the industry will need to be informed when a particular counterparty is subject to the clearing obligation. We will be happy to discuss this further with MAS.

Members also support the proposed exemption for all other specified persons that are not banks.

Question 6: MAS seeks views on the approach to exempt intra-group transactions and public bodies from clearing obligations.

ISDA supports the proposal to exempt intra-group transactions from clearing obligations. MAS correctly notes in the Consultation Paper that such transactions do not transfer risks in or out of a corporate group and are best left to such groups to manage their group-wide risks in a manner most appropriate for their corporate structure.

We also support the proposal to exempt public bodies from clearing obligations for the time being as this is consistent with regulatory directives in the other major financial centres.

Question 7: MAS seeks views on the proposed approach for the commencement of clearing obligations.

We understand that the proposed commencement of the clearing obligation is likely to in the middle to latter part of second quarter (Q2), 2016. ISDA members are supportive of this time frame on the basis that MAS, prior to the commencement date, has expanded the list of CCPs approved or recognised as ACHs and RCHs in line with those authorised and recognised under EU and US regulations to capture venues where the majority of global volumes are currently being cleared through. We are supportive of the proposal that only in-scope derivative transactions which are entered on or after the effective date of the clearing mandate will be required to be cleared. It is essential to ensure the smooth application of the clearing mandate that there is no backloading requirement.

MAS highlights that the clearing proposal provides at least six months' notice before the clearing obligation takes effect. However, we wish to highlight that the current drafting is not clear on this point. Assuming the clearing commencement date will be 6 months after the date the Regulations, being the SF(CDC)R, come into effect, we would propose that the initial clearing mandate applies to market participants (i) exceeding the clearing threshold as at the last day of each of the calendar quarters preceding the date the Regulations come into effect (bearing in mind that there will be a gap between the finalization of the Regulations and when the clearing obligation becomes effective); and (ii) who remains above the clearing threshold as at the clearing commencement date.

In addition we note and are concerned that Regulation 5(2) appears to be proposing that where a market participant becomes an in-scope market participant after the clearing commencement date that it will have to "backload" into clearing all in-scope transactions it has entered into after the clearing commencement date with other in-scope market participants.

We do not believe such a proposal will ensure the smooth application of the clearing obligation as its retroactive effect has the potential to cause pricing uncertainty, market disruption as well as have a negative impact on financial stability. Given that the relevant derivative transactions entered into by such a market participant may not have been cleared originally, they will need to be re-priced in order for them to be cleared. Even if these transactions were cleared under EMIR or Dodd-Frank, the CCP which they were cleared on and priced for may not be recognised or approved for the purposes of MAS' clearing mandate.

Members therefore strongly request that MAS amends Regulation 5(2) such that where a market participant becomes in-scope after clearing commencement date that it is given 6 months to put in place the necessary infrastructure to comply with the regulations and only after the end of the 6 month period is it required to clear new derivative transactions it enters into with other in-scope market participants. This will give market participants pricing and contractual certainty at point of trade.

Question 8: MAS seeks views on proposed considerations in expanding the scope of our mandatory clearing regime.

We are supportive of expanding the scope of the mandatory clearing regime on a phased basis, to the extent that MAS considers such expansion scope to be appropriate to address systemic risk in Singapore as well as the concerns outlined in this submission.

In considering any other products, we urge MAS to take into account factors such as (i) product liquidity; (ii) product standardization; (iii) the number of CCPs approved or recognized as ACHs or RCHs which are able and willing to clear the product; (iv) industry readiness; and (v) international developments which should also be taken into account when considering to include any new products in the clearing mandate. We request that the industry be allowed to provide comments on any future expansion of the scope of the mandatory clearing regime prior to its issuance. We also respectfully request that each additional clearing obligation be subject to a similar notice/phase-in period of at least 6 months.

In respect to the proposal to expand the clearing mandate to foreign exchange (**FX**) products such as NDFs we would highlight to MAS the detailed feedback already provided to EU and U.S. regulators by the industry on this topic. In particular we urge MAS to consider the concerns raised by the industry that the clearing of FX NDFs is significantly less developed than with respect to other OTC derivative classes.

We believe that the current S$20 billion threshold is already a reasonably low maximum threshold and do not see the systemic risk benefit to lowering it further. Bringing non-bank financial institutions OTC derivatives trading within scope would be a more efficient way to reduce systemic risk and increase clearing and netting efficiencies. However, we believe that a policy move in this regard should be predicated upon the development of a robust client clearing service industry and note that currently, smaller buy side financial institutions are struggling globally to find clearing service providers. It may be that global regulatory impediments to client clearing, such as the Basel Supplemental Leverage Ratio, need to be resolved before expanding the clearing mandate to non-bank financial institutions. We believe that corporate end-user exemptions that are the norm in other jurisdictions should also be the norm in Singapore.

Our members do not support the proposal to widen the clearing mandate to include "nexus" transactions. Our members are concerned and believe that such an approach would represent an inappropriate and unnecessary extraterritorial reach by MAS leading to conflict and overlap as correctly pointed out by MAS in the Consultation Paper . The systemically important financial institutions transacting actively in Singapore will also be subject to home country clearing obligations and it is most appropriate that the relevant clearing obligation is that of the jurisdiction where the derivative risk is booked. Therefore, more clarity is required as to the definition of "cross-border transaction."

Question 9: MAS seeks views on the draft SF(CDC)R attached in the Annex B.

Booked in Singapore

We note that MAS proposes to commence clearing obligations in relation to IRS trades in which both transacting counterparties have booked in their Singapore-based operations, i.e. a Singapore-incorporated company or a Singapore branch of a foreign entity. Therefore, clearing obligations should primarily be imposed on risks that are booked and hence residing in the Singapore system.

We refer to the draft Securities and Futures (Clearing of Derivatives Contracts) Regulations 2015 (**SF(CDC)R**). We note that Regulation 2(1) sets out, among others, the definition of "booked in Singapore". This is set out below:

""booked in Singapore", in relation to a derivatives contract, means the entry of the derivatives contract on the balance sheet or the profit and loss accounts of a person –

(a) who is a party to the derivatives contract; and
(b) whose place of business for which the balance sheet or the profit and loss account, as the case may be, relates to is in Singapore;"

We have considered this against the definition of "booked in Singapore", as provided for in the Securities and Futures (Reporting of Derivatives Contracts) Regulations 2013 (**SF(RDC)R**). This particular definition here is set out below:

""booked in Singapore", in relation to a derivatives contract, means the entry of the derivatives contract on the balance sheet or the profit or loss accounts of a person whose place of business is in Singapore;"

For consistency, notwithstanding the slight difference in drafting, we submit that the concept of "booked in Singapore" should be similarly used for both the reporting and clearing obligation. We also note that the definition of "booked in Singapore" as set out in the SF(CDC)R provides more detail. We would like to therefore clarify that the concept of "booked in Singapore" as used in the SF(CDC)R is consistent with that in SF(RDC)R and the same population of transactions.

Specified Persons subject to Clearing Obligations

We note that MAS proposes to subject only banks that have a certain level of OTC derivatives activities to the clearing obligations and that MAS proposes to exempt all banks from clearing obligations as long as they do not exceed a maximum threshold of S$20 billion gross notional outstanding derivatives contracts booked in Singapore for each of the last four calendar quarters. All other specified persons that are not banks will also be initially exempted from clearing obligations.

We note that Regulation 5 of the SF(CDC) R provides, among others, that a "specified person" in section 129B of the Securities and Futures Act (Cap, 289) (SFA) must commence clearing a specified derivatives contracts as set out in the First Schedule, where both parties to the specified derivatives contract are specified persons referred to in Section 129B of the SFA, on the clearing commencement date.

As noted in Question 5, banks in scope for mandatory clearing will also need to know which of their counterparties are in scope. We recommend that MAS should maintain and publish a list of in-scope counterparties for the purpose of reliance. We support the proposed exemption for all other specified persons that are not banks. We would be happy to discuss this further with MAS.

Regulation 4(b) of the SF(CDC)R

We would also respectfully request that MAS considers the following drafting amendments (as underlined) to be made to Regulation 4(b) for clarity:

"4(b) it is not entered into between (i) a person who is party to the specified derivatives contract for his own account, or an account belonging to and maintained wholly for the benefit of a related corporation, and (ii) a ~~another~~ related corporation of the person in (i)."