

## Asia-Pacific Regulatory Profiles

March 2019

This collection of profiles lists key institutions, regulatory milestones, key developments and ISDA submissions for the OTC derivatives markets in the following jurisdictions:

- Australia
- China
- Hong Kong
- India
- Indonesia
- South Korea
- Malaysia
- New Zealand
- Philippines
- Singapore
- Taiwan
- Thailand
- Vietnam

Please visit the Appendix section for profiles from 2009 to 2016.

For information about ISDA's work in the APAC region, please visit:

<http://www2.isda.org/regions/asia-pacific/> or contact Keith Noyes, [knoyes@isda.org](mailto:knoyes@isda.org)

# AUSTRALIA

## AT A GLANCE

Central Bank:	Reserve Bank of Australia (RBA) <a href="http://www.rba.gov.au">http://www.rba.gov.au</a>
Bank Regulators:	RBA Australian Prudential Regulation Authority (APRA) <a href="http://www.apra.gov.au">http://www.apra.gov.au</a>
Fin. Mkts Regulator:	Australian Securities & Investments Commission (ASIC) <a href="http://www.asic.gov.au">http://www.asic.gov.au</a>
Associations:	Australian Financial Markets Association (AFMA) Australian Banking Association (ABA)
Master Agreement:	ISDA
Legal Opinions:	Netting, collateral (including collateral taker and provider), client clearing (clearing members reliance, client reliance and FCM clearing members reliance) and e-contracts opinions by King & Wood Mallesons
CCP/TR Status:	<p>The Australian Securities Exchange (ASX) offers clearing services for OTC interest rate derivatives, including inter-dealer interest rate swaps (IRS), single-currency basis swaps and overnight index swaps (OIS) in AUD, and IRS and OIS in NZD.). It also offers client clearing.</p> <p>LCH.Clearnet provides clearing services for OTC interest rate swaps through its SwapClear service. LCH. Clearnet is also licensed to clear for the FEX commodities and energy exchange.</p> <p>DTCC Data Repository (Singapore) Pte Ltd (DDRS) and Chicago Mercantile Exchange Inc (CME) are both licensed as Australian Derivative Trade Repositories for all 5 asset classes.</p> <p>The European Securities and Markets Authority (ESMA) recognised ASX Clear (Futures) Pty Limited and ASX Clear Pty Limited as third country CCPs on April 27, 2015, thus allowing them to provide clearing services to clearing members or trading venues established in the EU.</p> <p>The US Commodity Futures Trading Commission (CFTC) issued an order of exemption to ASX Clear (Futures) Pty Limited from registration as a derivatives clearing organization (DCO) on August 18, 2015. This permits it to clear proprietary swap positions for its US clearing members.</p> <p>The Bank of England (BoE) added ASX Clear Futures and ASX Clear to the interim list of third-country CCPs that will offer clearing services and activities in the UK under the Temporary Recognition Regime (TRR) if the UK leaves the EU with no implementation period.</p>
Margin requirements:	The APRA margin and risk mitigation requirements for non-centrally cleared OTC derivatives came into effect on March 1, 2017, with a 6-month transitional period. for variation margin.

## Key Regulatory Milestones

### 1. APRA Developments

- On January 16, 2017, APRA released a discussion paper proposing changes to the Economics and Financial Statistics (EFS) collection. This had involved an increase in the amount of data collected from large institutions, and a substantial decrease in the amount of data collected from small institutions. The proposals also included new data standards on repurchase agreements and securities lending to meet new reporting requirements introduced by the Financial Stability Board (FSB), and introduced a new form for the reporting of both over-the-counter (OTC) and exchange-traded derivatives.

The formal consultation provided the industry with an opportunity to provide detailed cost information on the proposed changes. The comment period ended on April 18.

- On October 17, 2018, APRA released an information paper to assist authorised deposit-taking institutions (ADIs) to meet their obligations under the Banking Executive Accountability Regime (BEAR). The BEAR, which establishes heightened standards of accountability among ADIs and their most senior executives and directors, came into force for the largest banks from 1 July 2018. It will apply to all other ADIs from 1 July 2019. The regime was established under legislation and is administered and enforced by APRA.

The information paper, based on APRA's experience in implementing the regime for the largest banks, is aimed at assisting all other ADIs prepare to implement the BEAR, and helping the largest ADIs refine and embed the regime. It clarifies APRA's expectation of how an ADI can effectively implement the accountability regime on matters including:

- identifying and registering accountable persons;
- creating and submitting an accountability statement for each accountable person, and an accountability map for the ADI;
- establishing a remuneration policy requiring that a portion of accountable persons' variable remuneration be deferred for a minimum of four years, and reduced commensurate with any failure to meet their obligations; and
- notifying APRA of any accountability-related changes or breaches of accountability obligations.

The information paper also includes questions and answers based on some of the issues commonly raised by ADIs during implementation. APRA will address enforcement-related issues, including the disqualification of accountable persons and civil penalties under the BEAR, in a subsequent paper.

- On November 7, 2018, APRA released the final version of its prudential standard focused on information security management. The new Prudential Standard CPS 234 Information Security will shore up APRA-regulated entities' resilience against information security incidents (including cyber-attacks), and their ability to respond swiftly and effectively in the event of a breach. CPS 234 requires APRA-regulated entities to:

- clearly define information-security related roles and responsibilities;
- maintain an information security capability commensurate with the size and extent of threats to their information assets;
- implement controls to protect information assets and undertake regular testing and assurance of the effectiveness of controls; and
- promptly notify APRA of material information security incidents.

APRA first released a discussion paper in March 2018 outlining the intended requirements of the new prudential standard. Following extensive consultation with industry, APRA also published a Response to Submissions paper outlining the final form of the standard.

- On November 8, 2018, APRA announced proposed changes to the application of the capital adequacy framework for ADIs to support orderly resolution in the unlikely event of failure. The proposed changes are a significant step towards building APRA's resolution capability.

These proposals would ensure ADIs have adequate financial resources available to support orderly resolution in the highly unlikely event of failure. This will be achieved by adjusting, where appropriate, an ADI's Total Capital requirement.

APRA proposes an approach on loss-absorbing capacity that is simple, flexible and designed with the distinctive features of the Australian financial system in mind, and has been developed in collaboration with the other members of the Council of Financial Regulators. The key features of the proposals include:

- for the four major banks – increasing Total Capital requirements by four to five percentage points of risk-weighted assets (see the illustrative example attached); and
- for other ADIs – likely no adjustment, although a small number may be required to maintain additional Total Capital depending on the outcome of resolution planning.

As ADIs will be able to use any form of capital to meet increased Total Capital requirements, APRA anticipates the bulk of additional capital raised will be in the form of Tier 2 capital. The proposed changes are expected to marginally increase each major bank's cost of funding – incrementally over four years – by up to five basis points based on current pricing. This is not expected to have an immediate or material effect on lending rates.

APRA proposes that the increased requirements will take full effect from 2023, following relevant ADIs being notified of adjustments to Total Capital requirements from 2019. In addition to the proposals outlined in this discussion paper, APRA intends to consult on a framework for recovery and resolution in 2019, which will include further details on resolution planning.

## **2. Margin Requirements**

- On May 9, 2017, APRA commenced its public consultation on substituted compliance for margin requirements for non-centrally cleared derivatives. APRA proposes to recognise substituted compliance with respect to margin requirements of seven jurisdictions, subject to a condition for intra-group requirements for certain jurisdictions. The seven jurisdictions include Canada, the

European Union, Hong Kong, Japan, Singapore, Switzerland and the US. APRA also proposes to better align eligible collateral with the international framework. Comments on the consultation are due by June 6.

- On August 7, 2017, APRA released the final revised standard for margining and risk mitigation for non-centrally cleared derivatives, which permits substituted compliance with respect to the margin requirements of regulators of Canada, the European Union, Hong Kong, Japan, Singapore, Switzerland and the US. APRA also made a number of clarifications on the application of substituted compliance with respect to transaction scope, risk mitigation requirements and deference provision.

### **3. Benchmarks reform**

- On June 26, 2017, the Australian Treasury released a consultation on draft legislation to implement the reform of the regulation of financial benchmarks, which will require administrators of significant benchmarks to obtain a benchmark administrator licence and comply with a number of new regulatory requirements. The reforms are proposed to commence on January 1, 2018.

There are two bills that establish the overarching framework for the regulatory regime for consideration, as well as accompanying explanatory materials.

The government and ASIC will continue to consult on the regulatory regime, with this detail to be included in subsequent draft ASIC rules. The submission process on the draft bills and explanatory materials will close on July 24, 2017.

- On July 17, 2017, ASIC released a consultation on proposed ASIC rules for the administration of licensed financial benchmarks and regulatory guidance on how it would administer the proposed financial benchmark regulatory regime. ASIC's consultation is about the licensing regime for administrators of significant benchmarks and ASIC's rule-making powers in the event the amendments to the Corporations Act are passed by Parliament. This early consultation and preparation will help Australia's financial benchmark regulatory regime to be implemented more expediently.

Together, the draft legislation and ASIC's proposals will help to ensure the robustness and reliability of financial benchmarks in the Australian economy in line with the IOSCO Principles for Financial Benchmarks. The proposals are also designed to facilitate equivalence assessments under overseas regimes including the European Benchmarks Regulation. The consultation paper attaches:

- Draft ASIC Financial Benchmark (Administration) Rules 2017 which impose certain key obligations on licensed benchmark administrators and require contributors to licensed benchmarks to cooperate with ASIC;
- Draft ASIC Financial Benchmark (Compelled) Rules 2017 which enable ASIC to require, by written notice, the continued administration of a significant benchmark or compelled submissions to a significant benchmark; and

- A proposed regulatory guide setting out how we would administer the licensing regime, our expectations on compliance with ASIC Financial Benchmark Rules and when we may use our compulsion powers in relation to significant benchmarks.

ASIC is seeking the views of users, contributors and administrators of financial benchmarks and other interested parties. Submissions to CP 292 are due by August 21, 2017.

- On October 10, 2017, ASIC and the RBA welcomed the publication of the ASX BBSW Trade and Trade Reporting Guidelines, which provide guidance on the trading of bank bills during the rate set window, and set out how these trades should be reported to the ASX to support the timely calculation and publication of the bank bill swap rate.

The bank bill swap rate is the major interest rate benchmark for the Australian dollar, and is widely referenced in financial contracts. A major concern over recent years has been the low trading volumes during the rate set window, the time of day that the rate is measured. In response, the methodology is being strengthened to enable the benchmark to be calculated directly from a wider set of market transactions. ASX has been consulting market participants on this new methodology with the support of ASIC and the RBA.

ASIC and the RBA expect all bank bill market participants, including banks that issue bank bills and the participants that buy them, to adhere to the guidelines and support the new methodology. The rate set window should be the most liquid part of the day in the bank bills market, and market participants are likely to get the best outcomes for their institutions and their clients by trading during this period.

- On March 28, 2018, the Treasury Laws Amendment (2017 Measures No. 5) Bill 2017 passed the Australian Senate. On April 11, 2018, the bill received royal assent. This bill includes the financial benchmark reforms previously consulted on, amends the Corporations Act 2001 and establishes a new licensing regime requiring administrators of designated significant financial benchmarks to obtain a benchmark administrator license from ASIC. It also enables ASIC to make rules imposing a regulatory framework for licensed benchmark administrators and related matters. The bill also creates offences and penalties for manipulation of financial benchmarks.
- On May 21, 2018, ASIC and the RBA welcomed the new bank bill swap rate (BBSW) calculation methodology, which commenced on that day.

Previously, the BBSW was calculated from the best executable bids and offers for prime bank securities. The new methodology calculates the benchmark directly from market transactions during a longer rate-set window and involves a larger number of participants, anchoring the benchmark to real transactions at traded prices. The ASX, the administrator of the BBSW, had consulted market participants on this new methodology and conducted a successful parallel run of the new methodology against the existing method.

This change follows the passage of legislation in Parliament in March that put in place a framework for licensing benchmark administrators. Consistent with the approach taken in a number of other jurisdictions, the methodology also made manipulation of any financial benchmark, or products used to determine such a benchmark, a specific offense and subject to civil and criminal penalties.

ASIC intends to make financial benchmark rules, on which ASIC consulted on in 2017. ASIC also expects to declare the BBSW, and a number of other financial benchmarks, as ‘significant benchmarks’ in Australia and to license the administrators of those significant benchmarks.

- On June 12, 2018, ASIC finalized and published benchmarks rules, a significant benchmarks declaration and a regulatory guide as further measures towards establishing a comprehensive regulatory regime for financial benchmarks.

This follows the establishment of a robust licensing regime for financial benchmarks through the recent legislation that passed in Parliament. The actions by ASIC include:

- Declaring certain financial benchmarks to be significant;
- Writing rules to support the implementation of a licensing regime for the administrators of significant benchmarks; and
- Allowing ASIC to, by written notice, require the continued administration of a significant benchmark or compel submissions to a significant benchmark.

The measures are important in aligning financial benchmarks in the Australian economy with the International Organization of Securities Commissions principles for financial benchmarks. The rules are expected to facilitate equivalence assessments under overseas regimes, including the European Benchmarks Regulation.

These steps follow the legislation that passed in Parliament in March, which provide for a robust licensing framework for significant benchmark administrators in Australia. These legislative reforms make manipulation of any financial benchmark, or products used to determine such a benchmark, a specific offense and subject to civil and criminal penalties.

This follows the implementation of the new bank bill swap rate methodology, with the benchmark now calculated directly from market transactions during a longer rate-set window and involving a larger number of participants.

#### **4. APRA crisis management powers**

- On August 18, 2017, the Australian Treasury released its exposure draft of the Financial Sector Legislation Amendment (Crisis Resolution Powers and Other Measures) Bill 2017, as well as the accompanying explanatory memorandum.

The bill is intended to provide APRA with an enhanced suite of crisis resolution powers applicable to prudentially regulated authorised deposit-taking institutions, general insurers and life insurance companies and certain group entities.

The bill proposes to amend various pieces of key legislation and seeks to, among others, enhance APRA’s statutory and judicial management regimes to ensure their effective operation in a crisis, enhance the scope and efficacy of APRA’s existing directions powers, enhance stay provisions and ensure that the exercise of APRA’s powers does not trigger certain rights in the contracts of entities within the same group, as well as enhance APRA’s ability to respond when an Australian branch of a foreign regulated entity (foreign branch) may be in distress. This consultation is the latest step in a process that began with the Treasury consultation in 2012 on strengthening APRA’s crisis

management toolkit in relation to the entities APRA regulates. The deadline for submissions is September 8.

- On October 19, 2017, the Financial Sector Legislation (Crisis Resolution Powers and Other Measures) Bill 2017 was introduced to the Australian Parliament. The bill was released together with an explanatory memorandum. This bill follows the Australian Treasury's release of its exposure draft of the bill on August 18. It strengthens the powers of APRA to facilitate the orderly resolution of an ADI or insurer in order to protect the interests of depositors and policy-holders, and to protect the stability of the financial system.

The bill amends key existing legislation by enhancing APRA's statutory and judicial management regimes and the scope and efficacy of the APRA's existing directions powers and stay provisions, as well as enhancing APRA's ability to respond when an Australian branch of a foreign regulated entity may be in distress. It also ensures APRA has powers to set appropriate prudential requirements and take action in relation to resolution planning so that ADIs and insurers are better prepared for resolution.

- On November 16, 2017, the provisions of the Financial Sector Legislation Amendment (Crisis Resolution Powers and Other Measures) Bill 2017 were referred to the Economics Legislation Committee for inquiry and report by February 9, 2018. The reasons for referral are set out in Appendix 3 of Report No. 13 of 2017. The exposure draft of the Bill was realized for consultation on August 18, and the Bill was introduced to the Australian Parliament on October 19. The Bill is intended to provide APRA with an enhanced suite of crisis resolution powers applicable to prudentially regulated authorised deposit-taking institutions, general insurers, life insurance companies and certain group entities.
- On February 9, 2018, the Australian Senate Economics Legislation Committee handed down its report on the Financial Sector Legislation Amendment (Crisis Resolution Powers and Other Measures) Bill 2017. The committee's views are set out in Chapter 2 of the report. The committee believes that:
  - The bill will ensure the protection and stability of Australia's financial system;
  - The enhancement of the Australian Prudential Regulation Authority's (APRA) powers to plan for and execute the resolution of a failing authorised deposit-taking institution (ADI) or insurer is a vital part of Australia's crisis management toolkit; and
  - The reforms proposed in the bill are consistent with the Financial Stability Board's key attributes and will bring Australia's crisis resolution framework in line with best practice.

The committee recommended that the bill be passed.

- On February 15, 2018, the Financial Sector Legislation Amendment (Crisis Resolution Powers and Other Measures) Bill 2017 passed both houses of the Commonwealth Parliament.
- On March 5, 2018, the Financial Sector Legislation Amendment (Crisis Resolution Powers and Other Measures) Bill 2017 received Royal Assent. The Bill amended the Payment Systems and Netting Act 1998 and a number of other Acts to, among others:

- provide for enhanced stay provisions and amendments to ensure that the exercise of APRA's powers does not trigger certain rights in the contracts of entities within the same corporate group (i.e., stays on certain cross-default triggers);
- provide for a statutory management proceeding (which previously applied only to an Australian ADI) to apply to, among others, a life company or a general insurer;
- provide enhancements to the statutory management proceeding to which an Australian incorporated ADI may be subject; and
- facilitate the judicial management of the Australian business assets and liabilities of an eligible foreign life insurance company or foreign general insurer.

## **5. ASIC Market Integrity Rules**

- On January 24, 2017, ASIC released a consultation paper proposing to consolidate and clarify Australia's market integrity rules (MIRs).

There are currently 14 market integrity rule books that set out obligations and prohibitions applying to activities and conduct on eight licensed financial markets. ASIC proposes to consolidate 13 of the 14 market integrity rule books into four. In consolidating the rules, ASIC also proposes to clarify the existing obligations for management requirements and responsible executives, dealing 'as principal', block trades and large portfolio trades, disclosures to wholesale clients about derivatives market contracts, and record-keeping requirements for market operators. Submissions are due by March 7, 2017.

- On November 17, 2017, ASIC announced that it has made MIRs, which create a common set of rules for securities markets and futures markets. ASIC has also published a report setting out feedback from its consultation on changes to the MIRs.

ASIC clarified obligations in the market integrity rules for participants' management requirements and responsible executives, dealing 'as principal', block trades and large portfolio trades, and record-keeping requirements for market operators.

Most market operators and market participants will have to comply with the consolidated MIRs from May 7, 2018. Before then, ASIC will reissue all class rule waivers and individual rule waivers that remain in force, and update its regulatory guides to reflect consolidation of the market integrity rules and provide enhanced guidance on ASIC's expectations about management structures.

## **6. ASIC relief for foreign financial services providers**

- On March 29, 2017, ASIC announced that it has temporarily remade a class order that continues to provide licensing relief for a period of 18 months to foreign entities with limited connection to Australian wholesale clients, in a new instrument. The instrument has been remade following public consultation in September 2016, which highlighted the importance of the interrelationship between the class order and the suite of 'passport' relief provided to foreign providers under ASIC Corporations (Repeal and Transitional) Instrument 2016/396 on September 27, 2018. The existing class order was due to expire on April 1, 2017.

This extension of relief will allow ASIC to undertake a comprehensive review of the underlying policy settings applicable to all foreign providers relief. In particular, ASIC will carry out a consultation in the next 12 months seeking detailed information from the industry about the use of the class order and the impact of a repeal, including the types of products and services offered, the jurisdictions involved and the number of clients affected. Without that engagement and information to review, ASIC's expectation is that it is likely the class order will be repealed at the end of the rollover period.

- On April 3, 2017, ASIC announced it has extended a class order for foreign collective investment schemes for a further two years, which was due to expire on April 1, 2017.

The class order provides relief for foreign collective investment schemes from the requirement to register as a managed investment scheme or obtain an Australian financial services licence, where the relevant overseas regulatory regime delivers regulatory outcomes sufficiently equivalent to its own regulatory regime. ASIC has extended this relief for two years in order to review and consult on the policy settings of its relief in light of other regulatory developments. ASIC will consult publicly on its relief for foreign collective investment schemes before April 1, 2019.

- On June 1, 2018, ASIC released a consultation paper proposing a modified licensing regime for foreign financial service providers carrying on a financial services business in Australia with wholesale clients. These foreign providers are global investment banks or wholesale managed funds. This approach would provide ASIC with a broader range of tools to regulate the activities of foreign providers in Australia.

The consultation proposes to enable foreign providers to apply for a modified form of an Australian financial services license (foreign AFS license). Currently foreign providers of services to wholesale clients are not required to hold an AFS license in some circumstances under ASIC relief. Providers holding a foreign AFS license will be exempt from certain licensee provisions under the Corporations Act. This is on the basis that there are similar regulatory outcomes achieved through the regime applying to the foreign provider in its home jurisdiction.

This follows ASIC's review of the regulatory settings behind the foreign providers relief. The review identified some supervisory and regulatory concerns about the operation of the relief. ASIC considers that it is important for foreign providers to adhere to fundamental conduct obligations in its AFS licensing regime that govern how financial services are provided to Australian wholesale clients and promote market integrity.

The current foreign provider licensing relief is due to end on September 27, 2018. ASIC will extend the current relief for 12 months until September 30, 2019 while it consults with stakeholders. The consultation paper proposes a further transition period of 12 months to September 30, 2020 if ASIC proceeds with foreign AFS licensing. The deadline for submissions was July 31, 2018.

- On September 21, 2018, ASIC announced that it has extended licensing relief for foreign financial services providers (FFSPs) to September 30, 2019, allowing them to provide financial services to Australian wholesale clients without needing to hold an Australian financial services license. The licensing relief that is extended by ASIC is in:
  - ASIC Corporations (Repeal and Transitional) Instrument 2016/396 and ASIC Corporations (CSSF-Regulated Financial Services Providers) Instrument 2016/1109: FFSPs relying on this relief can provide specified financial services to Australian wholesale clients if their home regulatory regime has been assessed by ASIC as sufficiently equivalent to the Australian financial services licensing regime; and
  - ASIC Corporations (Foreign Financial Services Providers—Limited Connection) Instrument 2017/182: This provides licensing relief for FFSPs limited to inducing an Australian wholesale client to use the provider's financial services.

The extension of this relief is contained in ASIC Corporations (Amendment) Instrument 2018/807. The instruments had been due to expire in late September 2018, and ASIC previously indicated that it would extend the relief for an additional 12 months allowing time to consult on the FFSPs regulation proposals.

CP 301 also proposes a further transition period of 12 months to September 30, 2020 if ASIC proceeds with the modified licensing regime.

## 7. ASIC Developments

- On March 27, 2017, ASIC released a regulatory guide to responsible entities on their existing obligation under the Corporations Act 2001 to maintain adequate risk management systems. The guide is aimed at ensuring that the risk management systems of responsible entities, including minimum procedures and practices, are adaptable to changing market conditions and remain effective in identifying and managing risks on an ongoing basis.

The guidance promotes the early identification and management of risks by responsible entities and includes expectations for responsible entities to have overarching risk management systems in place, processes for identifying and assessing risks, and processes for managing risks.

Responsible entities that are registrable superannuation entity licensees are subject to APRA requirements on risk management. The guidance is intended to act in unison with APRA's requirements, and has been prepared in consultation with APRA to ensure consistency in the policy position.

As responsible entities are also subject to the ongoing obligation to maintain adequate risk management systems, ASIC has not provided any formal transition period for compliance with the guidance. ASIC's intention is to take a constructive and facilitative approach to any breaches of the guidance for a period of 12 months, if a responsible entity can show it is taking steps to bring its risk management system into compliance with the guidance.

- On April 11, 2017, ASIC released a consultation paper on its proposal to develop and implement a financial services panel.

The panel would add an element of peer review to ASIC's administrative decision-making processes. ASIC proposes that the panel would be responsible for determining whether it should ban individuals from the financial services and credit industries for misconduct. ASIC would select matters and refer them to the panel where they are significant, complex or novel.

Over time, the range of matters on which the panel will make decisions may expand. The panel would comprise financial services and credit industry participants and non-industry participants (eg, lawyers or academics) with relevant expertise, and at least one ASIC staff member. The panel would sit alongside ASIC's existing administrative structures and processes. Submissions to the consultation paper are due by May 23.

- On May 26, 2017, ASIC released a report promoting better behaviour in spot FX. It sets out ASIC's observations on key behavioural drivers of conduct arising from recent ASIC investigations into the wholesale spot FX businesses of the major Australian financial institutions and illustrates the behavioural drivers of conduct that, in ASIC's view, are likely to lead to poor conduct if not adequately managed. The report also describes a number of good practice principles for managing these drivers to more effectively prevent, detect and respond to inappropriate practices.

The release of ASIC's report coincides with the release of Phase Two of the FX Global Code of Conduct (FX Global Code). The report makes reference to related principles of the FX Global Code and encourages market participants to adhere to high standards of market practice. ASIC will use this report as a reference point for its surveillance of the FX markets and, where appropriate, the broader wholesale over-the-counter markets.

- On June 15, 2017, ASIC welcomed the passage of legislation enabling a new funding model for regulation of the Australian corporate sector. Effective from July 1, 2017, ASIC's regulatory costs will be recovered from all industry sectors regulated by ASIC through annual levies. Those who create the need for and benefit from regulation will bear the costs.

The industry funding model, initiated by the Federal Government in April 2016 and subject to extensive stakeholder consultation, was designed to provide greater stability and certainty in ASIC's funding to ensure sufficient resources to carry out its regulatory mandate.

- On June 30, 2017, ASIC released a consultation proposing guidance on managing conflicts of interest and handling material, non-public information by AFS licensees that provide sell-side research.

The proposed guidance looks at the key stages of a capital raising transaction and provides specific guidelines on what AFS licensees should do to appropriately manage conflicts of interest at each stage of the process. It also sets out general guidelines for AFS licensees in the identification and handling of material, non-public information and for the structure and funding of research teams. Specifically, feedback is sought on proposals related to:

- Identification and handling of material, non-public information;
- Management of research conflicts during the capital-raising process, including the preparation and production of investor education reports; and
- Structure and funding of research departments.

Responses to the consultation are due by August 31, 2017.

- On July 11, 2017, ASIC released a consultation paper proposing to make new client money reporting rules for Australian financial services (AFS) licensees that hold ‘derivative retail client money’ within the meaning of the Corporations Act.

The proposed rules will impose record keeping, reconciliation and reporting requirements on all derivative retail client money received by an AFS licensee, unless the client money relates to a derivative that is traded on a fully licensed domestic market, such as the ASX 24.

The proposals follow the passage of reforms preventing AFS licensees from withdrawing derivative retail client money and using it for a wide range of purposes, including as the AFS licensee's own working capital. It also gives ASIC the power to make new client money reporting rules to ensure greater transparency in relation to an AFS licensee's receipt and use of this money.

The client money rules are proposed to commence on April 4, 2018, which is when other client money reforms will take effect.

- On July 20, 2017, ASIC released a consultation on proposals to refine and update ASIC’s regulatory guidance on the licensing regime for financial markets. It proposed introducing a two-tiered market licence regime based on a risk-based assessment. The second tier licence will be able to facilitate a range of market venues, including specialised and emerging market venues. The consultation paper also:
  - Proposed updating and clarifying the guidance regarding how licensees may comply with specific licence obligations;
  - Proposed consolidating Regulatory Guide 177 (overseas market licensees) into the updated Regulatory Guide 172;
  - Set out the relevance of the proposals for secondary trading in shares of eligible crowd sourced funding companies; and
  - Addressed implementation and transition matters.
- The proposals follow the passage of the Corporations Amendment Act 2017 (Crowd Sourced Funding Act), which amended Chapter 7 of the Corporations Act 2001 relating to the market licence regime.
- On September 6, 2017, the Treasury consulted on ASIC’s power to ban senior officials in the financial sector.

The Taskforce positions on reform seek to enhance ASIC’s banning power by ensuring that it may take appropriate action to ban senior managers from managing financial services businesses. The need to enhance ASIC’s banning power in the financial services and credit sectors was flagged in the final report of the Financial System Inquiry (FSI). The FSI considered that enhanced banning powers would

improve accountability of managers and corporate culture. Comments on the positions outlined in this paper are due by October 4, 2017.

- On October 10, 2017, ASIC released finalised client money reporting rules. These impose record-keeping, reconciliation and reporting obligations on AFS licensees that hold 'derivative retail client money' within the meaning of the Corporations Act, unless the client money relates to a derivative that is traded on a fully licensed domestic market, such as ASX 24. This follows the passage of legislative amendments that will prevent AFS licensees from withdrawing client money provided by retail derivative clients, and using it for the wide range of purposes currently permitted under the Corporations Act, including as the AFS licensee's own working capital.

The final client money rules incorporate some changes in response to industry consultation and feedback. ASIC has also responded to the submissions it received during the consultation, and released an information sheet to assist AFS licensees comply with their obligations.

The client money rules will commence on April 4, 2018 at the same time the other client money reforms take effect. This gives AFS licensees a six-month transition period to ensure they have the necessary systems, policies and procedures for complying with the client money rules.

- On November 8, 2017, the Australian Treasury released a consultation on ASIC's directions powers.

When it grants a licence, ASIC can require that a licensee put internal systems in place or restrict its activities. However, after a licence is granted, imposing such requirements or restrictions is slow and difficult, and has three shortcomings. First, the resources and procedural requirements necessary to impose additional conditions, or to suspend or cancel a licence, can result in delay between concerns arising and ASIC achieving a protective outcome. Second, applying for an injunction to a court involves significant time, resources and costs in investigating and preparing a case to the required standard to commence court proceedings. Third, enforceable undertakings must be agreed to by a licensee and are generally negotiated as an alternative to ASIC exercising its administrative powers or initiating court proceedings. This requires acknowledgment by the licensee of ASIC's concerns.

Particular difficulties arise where a licensee has taken some steps to rectify identified compliance concerns, but ASIC remains concerned that those steps are not sufficient to ensure that there will not be further breaches by the licensee of its obligations, or additional measures are required to ensure that the impact on clients or former clients is identified and, where necessary, remediated. The consultation paper considers that ASIC should be able to require compliance with licence obligations in real time, and that it should be given powers to direct licensees to take or refrain from taking actions where appropriate for this purpose. The closing date for submissions is November 20.

- On April 4, 2018, ASIC released updated guidance for Australian financial services (AFS) licensees that hold client money for trading in OTC derivatives.

The guidance coincides with the start of ASIC's client money reporting rules and other client money reforms enacted under the Treasury Laws Amendment (2016 Measures No. 1) Act 2017 and the Corporations Amendment (Client Money) Regulations 2017. ASIC Regulatory Guide 212 Client

money relating to dealing in OTC derivatives (RG 212) has been updated to reflect the changes to the law as a result of these reforms.

The changes mean that the circumstances in which an AFS licensee may use 'derivative retail client money', within the meaning of the Corporations Act, have been significantly restricted. In particular, AFS licensees can no longer withdraw derivative retail client money from the client money account and use it for a wide range of purposes, including as the licensee's own working capital.

The reforms also impose new record-keeping, reconciliation and reporting requirements on AFS licensees that hold derivative retail client money (unless the client money relates to a derivative that is traded on a fully licensed domestic market, such as ASX 24).

- On April 17, 2018, the Australian Treasury announced that it is seeking stakeholder views on the draft Corporations Amendment (Client Money Reporting Rules Enforcement Powers) Regulations 2018. These regulations complete the government's client money reform agenda, which is designed to strengthen the protection of retail clients of financial services. It proposes to give ASIC necessary tools to enforce client money reporting rules and gives ASIC alternatives to civil proceedings, namely the ability to issue infringement notices and enter into enforceable undertakings with licensees. Feedback on the exposure draft was due by April 26, 2018.
- On May 4, 2018, ASIC announced it had updated its regulatory guidance on the licensing regime for financial markets.

Regulatory Guide 172, titled Financial markets: Domestic and overseas operators (RG 172), introduces a two-tiered market license regime by applying a risk-based assessment. ASIC will now determine if each market venue should be designated as Tier 1 or Tier 2. Tier 1 market venues are, or are expected to become, significant to the Australian economy or the efficiency and integrity of, and investor confidence in, the financial system. Tier 2 licenses will be able to facilitate a range of market venues, including specialized and emerging market venues.

The updated RG 172 incorporates and supersedes two existing regulatory guides.

- On May 4, 2018, ASIC published Regulatory Guide 265, titled Guidance on ASIC market integrity rules for participants of securities markets (RG 265), and Regulatory Guide 266, titled Guidance on ASIC market integrity rules for participants of futures markets (RG 266), which consolidate and replace seven guides for securities and futures markets participants.

ASIC had merged guidance from the various regulatory guides, made minimal changes to reflect updated market integrity rule references, removed information that is purely descriptive or no longer relevant, introduced new guidance on management structures, and tailored information to make guidance market neutral or, where required, more appropriately relate to relevant markets and participants. A number of existing regulatory guides will also be retired.

- On June 22, 2018, ASIC announced that it had become one of the first signatories to the IOSCO Enhanced Multilateral Memorandum of Understanding Concerning Consultation and Cooperation and

the Exchange of Information (EMMoU), an enhanced standard for cross-border enforcement cooperation.

By signing the EMMoU, ASIC had highlighted its power to assist foreign regulators by compelling physical attendance for testimony, obtaining and sharing audit work papers, communications and other information relating to the audit and review of financial statements, and provide guidance on freezing of assets. The EMMoU also provides the framework for ASIC to request reciprocal assistance of this nature from fellow EMMoU signatories.

The IOSCO EMMoU builds upon the IOSCO Multilateral Memorandum of Understanding Concerning Consultation and Cooperation and the Exchange of Information (MMoU), the global benchmark for international cooperation in the enforcement of securities and derivatives laws and regulations which ASIC has been a signatory to since its inception in 2002. There are currently 118 signatories to the MMoU from across the world, six of which have also successfully attained EMMoU signatory status to date.

- On June 28, 2018, ASIC released a statement calling on participants in the retail OTC derivatives sector to improve their practices. The products offered by retail OTC derivatives issuers in Australia include binary options, margin foreign exchange and contracts for difference (CFDs).

A recent review of 57 retail derivatives issuers identified a number of risks associated with products offered to retail investors, finding that client losses in retail OTC derivatives trades seemed high, with the percentage of unprofitable traders being up to 80% for binary options, 72% for CFD traders and 63% for margin FX traders. ASIC will examine this area further as part of an ongoing focus on the sector.

The most concerning practices ASIC identified during its supervision of the sector and highlighted in recent reviews include:

- Actual client profits being inconsistent with marketing materials;
- A lack of transparency on pricing;
- Risk management practices that relied on the use of client money were outdated and needed to be reviewed;
- Some referral arrangements that may be in breach of conflicted remuneration requirements and referral selling prohibitions; and
- Some issuers that were providing wholesale services or allowing third parties to ‘white label’ their products did not have adequate risk management practices and operational capital to supervise counterparties and support their exposures.

Binary options may be the least transparent in terms of underlying pricing, strike prices and payout structures.

To address these risks, ASIC has called on issuers to review and update their risk management and client money practices, and assess whether their arrangements with counterparties and referrers meet their AFS license obligations.

- On July 31, 2018, ASIC released a suite of seven new and updated regulatory guides to provide comprehensive guidance to the fund management industry. The guidance brings all of ASIC's fund management policies up to date to help promote industry-wide consistency. It has been updated due to changes arising from the Asia Region Funds Passport and to help the fund management industry access it. The passport is designed to provide investors with access to funds from participating economies throughout the Asia region.

The updates are comprehensive, including both administrative and substantive issues, and include, providing:

- information on ASIC's decision-making process for registering a managed investment scheme or passport fund; and
- good practice examples and case studies on a range of compliance issues, including previous ASIC decisions on relief.

ASIC will make a range of less substantive amendments to other regulatory guides. These amendments will reflect the consequential amendments that will be made to the Corporations Act to accommodate these new regimes.

- On July 31, 2018, ASIC announced that it had approved the Australian Banking Association's (ABA) new Banking Code of Practice.

ASIC's approval of the code follows extensive engagement with the ABA, following a comprehensive independent review and extensive stakeholder consultation. The ABA made additional significant changes to the code in order to meet ASIC's criteria for approval. This is the first comprehensive broad-based industry code that ASIC has approved under its relevant powers

The code will commence operation from July 1, 2019, and includes:

- Significant new protections for small business;
  - Expanded protections for consumers; and
  - Monitoring and enforceability.
- On September 25, 2018, ASIC released a report identifying serious, unacceptable delays in the time taken to identify, report and correct significant breaches of the law among Australia's most important financial institutions.

The law requires all Australian financial services licensees to report a 'significant breach' to ASIC within 10 business days of becoming aware of it. The report further examined the breach reporting processes of 12 financial services groups. Key findings from the report include:

- Financial institutions are taking too long to identify significant breaches, with the major banks taking an average time of 1,726 days;
- There were delays in remediation for consumer loss. It took an average of 226 days from the end of a financial institution's breach investigation and first payment to impact consumers. This is on top of the average of 1,517 days before the breach is discovered and the time taken to start and complete an investigation;
- The significant breaches caused financial losses to consumers of approximately \$500 million, with millions of dollars of remediation yet to be provided;
- The process from the start of an investigation to lodging a breach report with ASIC also takes too long, with major banks taking an average of 150 days;
- Once a financial institution has investigated and determined that a breach has occurred and that it is significant, the law requires that the breach be reported to ASIC within 10 business days. One in seven significant breaches were reported later than the 10-business day requirement.

ASIC will be regularly placing ASIC staff on site in major financial institutions to closely monitor their breach management, governance and compliance with laws. This new program is called Close and Continuous Monitoring. ASIC is also actively considering enforcement action for failures to report breaches on time. The review underscores the need for law reform of the breach reporting requirements, which the government has committed to in principle following ASIC Enforcement Review.

- On November 16, 2018, ASIC reported on its latest review of the impact of high-frequency trading in the Australian equity and Australian-US dollar cross-rate markets. The review builds on ASIC's 2013 and 2015 analysis of high-frequency trading.

Notable findings from the review, outlined in Report 597 High-frequency trading in Australian equities and the Australian-US dollar cross rate (REP 597) are:

- High-frequency traders are responsible for a quarter of all market transactions in equities and the AUD/USD cross rate, and it is trending down.
- Traders continue to invest in faster technologies and are accessing markets more quickly. They are undertaking less arbitrage and more position taking, with less intraday trading and longer holding times.
- High-frequency traders contribute positively to price formation, benefiting all investors in the market. They also provide important liquidity during market stress or peak demand.
- There is a cost to natural market users from high-frequency trader intermediation, but this cost is small, and it is trending down.

## 8. Fintech

- On March 20, 2017, ASIC released an information sheet on distributed ledger technology (DLT). The information sheet sets out an assessment tool for evaluating DLT-based services comprising six broad questions. These are the questions that ASIC is likely to ask when it assesses whether the use of DLT by a service provider or infrastructure operator would allow the person to meet their regulatory

obligations.

- On May 26, 2017, ASIC announced that it will establish a new regulatory technology (regtech) industry liaison network, conduct a number of new technology trials using regtech applications and establish a 'hackathon' later this year to help identify roadblocks to the successful and rapid take-up of the sector. The initiatives are among a range of proposals covered in a new report covering ASIC's approach to regtech and inviting feedback from the sector and wider industry.

The report also gives an update on the work of ASIC's Innovation Hub, launched in March 2015, to help innovative financial technology (fintech) businesses navigate the regulatory framework. It comes as ASIC's regulatory sandbox begins to take shape, with the first entity able to make use of the class waiver fintech licensing exemption from mid-May.

ASIC also continues to grant tailored waivers to fintech firms to reduce red tape without fundamentally compromising consumer protections. This follows on from the regulator's regtech roundtable event held in Sydney and Melbourne in February this year.

- On June 13, 2017, ASIC and the Hong Kong Securities and Futures Commission (SFC) announced they have signed a cooperation agreement that provides a framework to support and understand financial innovation in each economy.

The agreement will enable the SFC and ASIC to refer innovative fintech businesses to each other for advice and support via ASIC's Innovation Hub and its Hong Kong equivalent, the SFC's Fintech Contact Point, which offer assistance to fintech businesses to understand the regulatory regimes in each of the jurisdictions. It also provides a framework for information sharing between the two regulators. This is the fourth fintech referral agreement ASIC has entered into, following on from agreements with the UK, Singapore and Ontario.

- On September 15, 2017, ASIC released its response to industry feedback on ASIC's Innovation Hub and its approach to regulatory technology. Responses were generally very supportive of ASIC's Innovation Hub and its approach to regtech. However, there were differences of opinion on our proposed new initiatives, particularly the regtech liaison group and regtech problem-solving event. Overarching themes from consultation are:
  - Respondents were in favour of ASIC being ambitious in the regtech area.
  - There are complex questions of policy surrounding ASIC's role in regtech, and ASIC must consider how best to balance its role as both a regulator and as a technology user, and
  - ASIC should consider where and how it might improve transparency across the board in its engagement with the regtech industry.
- On October 24, 2017, the Australian Treasury released a consultation package introducing a legislative framework for an enhanced regulatory sandbox to enable new and innovative fintech products and services to be tested in Australia. This will extend the scope of activities and the time frame beyond that of the regulatory sandbox launched by the Australian Securities and Investments Commission in December 2016.

The bill extends regulation-making powers to enable an exemption from obtaining an Australian financial services licence and/or an Australian credit licence under certain conditions for the purposes of testing financial and credit services and products. The regulations contain the policy design details for the licensing exemptions, including the eligibility criteria, the eligible types of products and services, and the conditions that must be met by those using the exemption.

The consultation on the exposure draft legislation (and accompanying explanatory memorandum) is open until November 3. The consultation on the exposure draft regulations (and accompanying explanatory statement) is open until December 1.

- On March 7, 2018, APRA released a package of measures aimed at shoring up the ability of APRA-regulated entities to repel cyber adversaries, or respond swiftly and effectively in the event of a breach. The key measures include assuring the cyber capabilities of third parties, such as service providers, and enhancing entities' ability to respond to and recover from cyber incidents.

Comments on the package were due by June 7, 2018. APRA intends to finalise the proposed standard towards the end of 2018. Implementation is expected for July 1, 2019.

- On March 23, 2018, the United Kingdom's Financial Conduct Authority (FCA) and ASIC announced that they signed an Enhanced Cooperation Agreement between their Innovation Hubs to extend their existing agreement of cooperation and coordination on fintech innovation. This agreement forms part of the broader Fintech Bridge signed by the UK Chancellor of the Exchequer and the Australian Treasurer.

In this enhanced agreement, the FCA and ASIC have agreed to explore ways to quicken the licensing process in terms of the authorisation of innovative businesses that are already authorised in the other jurisdiction. Where a business is a participant in either Authority's regulatory sandbox and would like to enter the other's, ASIC and the FCA will endeavour to facilitate that participation.

ASIC and the FCA will also look to co-host fintech and regtech events, conduct joint policy work, research and experimentation and explore secondment opportunities. They will work to raise topics or approaches of common interest at an international level to promote greater levels of international cooperation on financial innovation.

- On August 8, 2018, ASIC announced that it is in collaboration with 11 international financial regulators, and related organisations consulting on the proposed creation of the Global Financial Innovation Network (GFIN).

The proposed network will seek to provide a more efficient way for innovative firms to interact with regulators, helping them navigate between countries as they look to scale new ideas. It would also create a new framework for co-operation between financial services regulators on innovation related topics, sharing different experiences and approaches.

The collaborative effort, involving regulators from around the world, also issued a joint consultation paper on the proposed role the GFIN should play in delivering its objectives, including the tools it will use.

- On September 24, 2018, APRA released updated information on the use of shared computing services, such as cloud, by APRA-regulated entities.

The new paper updates information on prudential considerations and key principles issued to APRA-regulated entities in July 2015. It has been developed in response to the growing use of the cloud by APRA-regulated entities for higher inherent risk activities, and observed areas of weakness in how entities approach and manage these risks. In addition, many applicants for restricted ADI licenses seek to use the cloud for critical systems. The new paper acknowledges that advancements in cloud computing service offerings over the past three years have improved the ability of APRA-regulated entities to manage the risks involved. However, it also emphasizes the need for entities to be mindful of the differing levels of responsibility for operating and managing these arrangements.

APRA-regulated entities should note that while this information paper does not constitute formal regulation, APRA intends to incorporate the better practices described in the paper into prudential standards and practice guides in the future. Any such changes will be subject to APRA's normal processes of consultation.

- On October 4, 2018, ASIC and the Luxembourg Commission de Surveillance du Secteur Financier (CSSF) signed a Cooperation Agreement which provides a framework for cooperation to understand financial innovation in each jurisdiction.

The Agreement provides a framework for information sharing between the two regulators on fintech and regtech. It complements the existing close relationship between ASIC and the CSSF.

- On October 5, 2018, ASIC and the US Commodity Futures Trading Commission (CFTC) signed an arrangement to cooperate and support innovation through each other's financial technology initiatives – CFTC's LabCFTC and ASIC's Innovation Hub.

The Cooperation Arrangement on Financial Technology Innovation (FinTech Arrangement) focuses on information-sharing regarding fintech market trends and developments. It also facilitates referrals of fintech companies interested in entering the others' market, and sharing information and insight derived from each authority's relevant sandbox, proofs of concept, or innovation competitions.

The FinTech Arrangement supports both authorities' efforts to facilitate market-enhancing fintech innovation and ensures international cooperation on emerging regulatory best practices.

## 9. Reform of Australia's Insolvency Framework and its Ipso Facto Laws

- On March 28, 2017, the Australian Government released draft legislation and an accompanying draft explanatory statement to reform Australia's insolvency laws.

As part of the reforms, draft amendments had been included to make ipso facto clauses unenforceable if an entity becomes subject to voluntary administration or certain events related to compromises and arrangements under Part 5.1 of the Corporations Act. Currently, ipso facto clauses allow contracts to be terminated solely due to an insolvency event. The aim is to prevent these types of clauses from reducing the scope for a successful restructure or preventing the sale of the business as a going concern.

The government also provided clarification on types of contracts and contractual rights that are expected to be excluded from the broad stay on the operation of ipso facto clauses. These excluded contract types and rights are expected to be formalised through forthcoming regulations. The stay on ipso facto clauses is expected to become effective on January 1, 2018.

- On June 1, 2017, the Treasury Laws Amendment (2017 Enterprise Incentives No. 2) Bill 2017 was presented and read for the first time in the Australian parliament. The bill is intended to promote entrepreneurship and innovation, as well as drive business growth. The bill amends the Corporations Act 2001 and Netting Act 1998, among others, to make certain contractual rights unenforceable while a company is restructuring under certain formal insolvency processes. In particular, it also contains reforms that are intended to make ipso facto clauses unenforceable if any entity becomes subject to voluntary administration or certain events related to compromises and arrangements.
- The Treasury Laws Amendment passed both houses of the Commonwealth Parliament on September 12, 2017, and was assented to on September 18, 2017.
- On December 21, 2017, the Australian Treasury published a consultation on an exposure draft of the Treasury Laws Amendment (Design and Distribution Obligations and Product Intervention Powers) Bill 2018, which implements:
  - Design and distribution obligations for financial products to ensure they are targeted at the right people; and
  - A temporary product intervention power for the Australian Securities and Investments Commission when there is a risk of significant consumer detriment.

These measures form part of the government's response to the Financial System Inquiry.

- On April 16, 2018, the Australian government released the exposure draft of the Corporations Amendment Regulations 2018 and the Corporations Declaration 2018 for comment.

These are intended to support the reforms contained in the Treasury Laws Amendment (2017 Enterprise Incentives No. 2) Act 2017 (the Act), which received royal assent on September 18, 2017. The relevant part of the Act came into force on July 1, 2018. The draft regulations exclude certain contracts from the stay on the enforcement of ipso facto clauses as outlined in the act and its declaration similarly excludes certain types of contractual rights.

Explanatory statements on both the draft regulations and the declaration have been released. The exemptions outlined in both the regulations and the declaration recognise that in some circumstances it is necessary or desirable for ipso facto clauses to continue to operate, for example, where there is an established market mechanism already in place or where it would be a commercial nonsense for an ipso facto clause to be stayed. Comments on the draft regulations and declaration were due by May 11, 2018. The Corporations Amendment (Stay on Enforcing Certain Rights) Regulations 2018 which commenced on July 1, 2018, exclude contracts, agreements and arrangements that is, or is directly connected with, a derivative or a securities financing transaction, and close-out netting contracts, from the ipso facto stay provisions.

## 10. Basel III & Capital

- On January 16, 2017, APRA released its annual information paper on the countercyclical capital buffer (CCyB). The paper contains an update on the setting of the countercyclical capital buffer and core indicators of systemic risks associated with the financial cycle, including credit growth and asset prices, which are used to guide decision-making. APRA is maintaining the countercyclical capital buffer at 0%.

APRA will continue to closely monitor developments, including but not limited to movements in the core risk indicators, and will adjust the buffer level if conditions warrant it in future. An announcement to increase the buffer may have up to 12 months' notice before the new buffer comes into effect; a decision to reduce the buffer will generally be effective immediately.

- On February 2, 2017, APRA released a consultation on proposed revised reporting standards on securitization.

Following on from the updated Prudential Standard APS 120 Securitisation (APS 120) that was released on November 10, 2016, in this consultation, APRA consulted on revisions to associated reporting requirements for securitisation. It is envisaged that the revised reporting requirements will take effect from January 1, 2018. APRA proposed to streamline statistical reporting for securitisation activities to ensure they capture the most meaningful data, and are aligned with the revised APS 120.

In doing so, APRA proposed to consolidate the three current reporting standards into two, and also intends to consult on reporting requirements for covered bonds as part of its review of liquidity reporting in the coming months. Submissions on the proposed reporting requirements were due by March 31.

- On March 6, 2017, APRA sent a letter to all ADIs, informing them of an updated timetable for implementation of the Basel Committee on Banking Supervision's (BCBS) standardised approach for measuring counterparty credit risk exposures (SA-CCR) and capital requirements for bank exposures to central counterparties – final standard.

On September 15, 2016, APRA released for consultation a package of documents outlining its proposed implementation. This included a proposal that the new requirements in the draft new prudential standard APS 180 capital adequacy: counterparty credit risk (APS 180) would commence

on January 1, 2018, with an additional option that an ADI with immaterial counterparty credit risk exposure could apply for approval to implement the requirements by January 1, 2019.

In light of consultation feedback, as well as consideration of the timetable for adoption in other jurisdictions, APRA has advised affected ADIs that the new requirements will not take effect until January 1, 2019 at the earliest. Prior to finalising these requirements, APRA intends to release an additional consultation package in 2017 on counterparty credit risk, including the associated reporting requirements, and will give further consideration to a simple, alternative methodology for ADIs with an immaterial level of exposure to counterparty credit risk.

- On March 21, 2017, APRA sent a letter to all ADIs, which advises those affected by the Basel Committee on Banking Supervision's Fundamental Review of the Trading Book (FRTB) that it does not envisage a new market risk standard being finalised until the beginning of 2020 at the earliest.

Once the standard is finalised, ADIs will have 12 months before it comes into effect. APRA decided to take this approach to allow for further consideration of the complexities associated with implementation and the alignment between the FRTB and related reforms. APRA will continue to discuss policy settings with ADIs and monitor international developments, and will aim to provide an update regarding its implementation of the FRTB within 12 months.

- On March 24, 2017, APRA released a letter to ADIs on proposed revisions to a reporting standard on liquidity, in order to align the reporting requirements with the revised prudential standard on liquidity, finalised in December 2016.

APRA is proposing to introduce a new reporting form for the net stable funding ratio (NSFR) requirement. In addition, APRA will ask all locally incorporated ADIs subject to the liquidity coverage ratio that are subject to the NSFR to complete an Excel version of the proposed NSFR form in place of the Basel quantitative impact study NSFR form for the end-March 2017 quarter, on a best endeavours basis. Informal reporting of the proposed form on this basis will inform APRA's determination of the final reporting form and instructions.

APRA is also taking this opportunity to make amendments to the current liquidity reporting forms to ensure they are better aligned with the prudential standard on liquidity and to streamline the current statistical reporting. Given the materiality of liquidity risk for ADIs, APRA further proposes that data collected under the revised reporting standard is subject to audit testing, in order to promote appropriate discipline in the reporting of liquidity data.

The revised reporting requirements will take effect at the same time as the revised prudential standard, on January 1, 2018.

- On April 12, 2017, APRA released a discussion paper setting out proposed revisions to its prudential framework on large exposures for ADIs. The proposed revisions are intended to strengthen the supervisory framework for large exposures, reduce system-wide contagion risk, and maintain alignment with the Basel Committee on Banking Supervision's large exposures standards.

The consultation package includes a draft revised prudential standard, associated reporting standards, reporting forms and reporting form instructions. It also proposes revisions to large exposure requirements, including:

- The limit to an unrelated ADI and its subsidiaries be reduced from 50% of total capital to 25% of Tier 1 capital;
- A new limit of 15% of Tier 1 capital be applied to exposures to a bank designated as a global systemically important bank, and to exposures between banks designated by APRA as domestic systemically important banks; and
- New criteria apply to identifying a group of connected counterparties and measuring large exposure values.

APRA invites written submissions on the proposals by July 5. APRA expects to release a response paper, its final revised prudential standard and the associated reporting package in the second half of 2017. APRA's intention is that the revised large exposure requirements will come into effect from January 1, 2019, in line with the internationally agreed timetable.

- On June 14, 2017, APRA released a response to submissions to its February 2017 consultation on minor amendments to the reporting framework for securitisation and the CCyB. For each proposal, APRA received one submission. Minor amendments have been made to the reporting forms and instructions in response to the submission about the securitisation measures, including the renumbering of the reporting standards from those issued for consultation. The submission about the CCyB reporting requirement was fully supportive of the proposed change.
- On July 7, 2017, APRA published a response to submissions on its March 2017 consultation on amendments to its liquidity reporting standard to align with the revised prudential standard on liquidity. The amendments relate primarily to the introduction of a new reporting form on the NSFR, as well as other changes to streamline the current statistical reporting.

APRA confirmed that it expects all ADIs to commence reporting under the revised reporting standard from January 1, 2018, with the first data submission due for the quarter ending March 31, 2018. APRA has also released the final revised standard that incorporates the amendments.

- On July 19, 2017, APRA announced its assessment and released an information paper on the additional capital required for the Australian banking sector to have capital ratios that are considered 'unquestionably strong'. APRA has focused on the appropriate calibration of common equity Tier 1 (CET1) capital requirements, recognising that CET1 is the highest quality capital. In its analysis, APRA has also distinguished between those authorised deposit-taking institutions (ADIs) using the more conservative standardised approach to capital adequacy, and those banks that are accredited to use internal models to determine their capital requirements.

In parallel with this build up in capital strength, APRA intends to release a discussion paper on proposed revisions to the capital framework later in 2017. It will outline the direction of APRA's implementation of the forthcoming Basel III changes to risk weights as well as measures to address Australian ADIs' structural concentration of exposures to residential mortgages. Following the discussion paper, APRA expects to consult on draft prudential standards giving effect to the new

framework in late 2018. Final prudential standards are to be released in 2019, and are anticipated to take effect in early 2021.

APRA considers that ADIs should, where necessary, initiate strategies to increase their capital strength to be able to meet these capital benchmarks by January 1, 2020 at the latest. APRA expects that ADIs meet the capital benchmarks outlined in the information paper by 2020, a year ahead of the expected effective date of the new prudential standards. APRA also encourages ADIs to consider whether they can achieve the capital benchmarks more quickly.

The increases outlined in the information paper will complete a significant strengthening of risk-based capital ratios within the Australian banking system in recent years.

- On August 3, 2017, APRA released a consultation package setting out APRA's proposed implementation of the BCBS' SA-CCR and capital requirements for bank exposures to central counterparties. The package includes:
  - A discussion paper setting out APRA's response to submissions on its September 2016 discussion paper on counterparty credit risk for ADIs, and a number of revised proposals for further consultation;
  - Revised drafts of two prudential standards on capital adequacy, which incorporate changes to APRA's proposed new counterparty credit risk requirements for ADIs; and
  - Three draft reporting standards that set out proposed revisions to the corresponding reporting requirements, as well as proposed reporting requirements on margining for non-centrally cleared derivatives.

APRA has modified aspects of the SA-CCR proposals in response to issues raised in submissions to the September 2016 consultation. It proposes that an ADI with approval to use an internal ratings-based approach to credit risk must use SA-CCR to measure its counterparty credit risk exposures, while all other ADIs may continue to use the current exposure method, subject to appropriate recalibration.

Written submissions on its proposals were due by September 29. The new prudential and reporting requirements for counterparty credit risk will take effect no earlier than January 1, 2019.

- On February 14, 2018, APRA released a consultation paper on proposed revisions to the capital framework for ADIs. The consultation includes proposed revisions to the capital framework resulting from the BCBS finalising the Basel III reforms in December 2017, as well as other changes. During the process of consultation, APRA will undertake further analysis of the impact of these proposed changes on ADIs. This analysis will include a quantitative impact study, which will be used to, where necessary, calibrate and adjust the proposals.

APRA continues to propose an implementation date of January 1, 2021 for all revised measures, including the full risk weighted assets floor, but invites feedback on the merits of aligning with the BCBS timetable and deferring implementation until January 1, 2022.

- On July 2, 2018, APRA released a consultation on changes to requirements for authorised deposit-taking institutions (ADIs) in managing risks from associations with related parties. The prospective changes seek to update and streamline longstanding requirements and ensure Prudential Standard APS 222 Associations with Related Entities aligns with last year's changes to Prudential Standard APS 221 Large Exposures. APRA's proposals to modernize the framework include:

- Broadening the definition of related entities to include substantial shareholders, individual board directors and other related individuals;
- Explicitly addressing 'step-in risk' by incorporating guidance from the Basel Committee on Banking Supervision;
- Tightening certain limits on exposure to related entities in line with limits on exposures to unrelated entities in the revised APS 221 (which deals with exposures to unrelated parties);
- Removing the ability for certain overseas subsidiaries to be consolidated with the standalone ADI for prudential purposes; and
- Updating existing reporting requirements to align with the changes to the framework.

Submissions to the consultation were due by September 28, 2018. Subject to feedback received during the consultation period, APRA envisages that the finalized framework will be implemented from January 1, 2020.

- On July 4, 2018, ASIC released a consultation on changes to the capital requirements for market participants, which prescribe the minimum amount of capital a participant must hold. Consultation Paper 302 (CP 302) sets out proposals to improve and simplify the capital requirements, including further consolidating two market integrity capital rule books into a single capital rule book (ASIC Market Integrity Rules (Capital) 2018).

ASIC proposes that futures market participants be required to comply with a risk-based capital regime instead of a net tangible asset requirement, and must hold core capital of at least \$1,000,000 at all times. Another proposal would increase the minimum core capital requirement for securities market participants to \$500,000, as well as introducing new rules, such as an underwriting risk requirement. At the same time, ASIC proposes to remove redundant rules and forms and more closely align capital requirements with the financial requirements of the Australian financial services licensing regime.

These proposals follow ASIC's review of the adequacy of its capital regime. The review identified elements of the capital requirements that were outdated and not able to adequately address the risks of operating a market participant business today. Submissions to CP 302 were due by August 15, 2018.

- On August 14, 2018, APRA issued a consultation paper proposing changes to the capital framework for Australian ADIs to make capital ratios more transparent, comparable and flexible. The consultation paper proposes two general approaches designed to aid ADIs represent and communicate their capital strength.
  - Under the first approach, ADIs would continue using existing definitions of capital and risk-weighted assets. However, APRA would develop a methodology allowing them to improve the credibility and robustness of internationally comparable capital ratio disclosures.

- Under the second approach, APRA would change the way ADIs calculate capital ratios to use internationally harmonized definitions of capital and risk-weighted assets. To maintain the strength and risk sensitivity of the capital framework, there would need to be corresponding increases in minimum ratio and/or capital buffer requirements.

APRA is open to considering these approaches independently or in combination, or retaining its current methodology. Separately, the consultation paper also proposes measures to make the capital framework more flexible in times of stress, including by increasing the size of regulatory capital buffers relative to minimum regulatory capital requirements.

Depending on the outcome of this consultation, APRA expects to consult further on draft revised prudential standards on credit and operational risks in 2019, which would include any aspects discussed in this consultation paper that APRA proposes to adopt. APRA expects final prudential standards will be released by mid-2020, with requirements commencing from January 1, 2021, keeping in mind the Basel III implementation timetable.

Comments on the consultation paper were due by November 2, 2018.

- On September 21, 2018, APRA published frequently asked questions (FAQs) on the large exposures framework. These FAQs provide further information to assist regulated entities in the interpretation of the relevant prudential and reporting standards for large exposures. The FAQs focus on structured vehicle requirements and trading book and settlement exposures. These FAQs do not provide an exhaustive list of examples and regulated entities are encouraged to contact APRA on any questions regarding the interpretation of the relevant prudential standards.
- On November 27, 2018, APRA released revised draft minimum leverage ratio requirements for ADIs, reflecting comments received from the discussion paper that was released in February 2018. APRA also announced that it is proposing to align the implementation of revisions to the capital framework for ADIs, including the proposed minimum leverage ratio, with the timeline set out in the Basel III framework.

Based on feedback received on the proposed minimum leverage ratio requirements, APRA proposes to:

- Revise the minimum leverage ratio requirement for ADIs using the internal ratings-based approach (IRB ADIs) at 3.5%, rather than the proposed 4%;
- Retain the minimum leverage ratio for ADIs that use the standardized approach to determine capital adequacy (standardized ADIs) at 3%;
- Allow standardized ADIs to use Australian accounting standards to calculate certain parts of the ratio; and
- Require IRB ADIs to largely follow the Basel III methodology to calculate their leverage ratios.

The revised leverage ratio requirements are outlined in the draft amended prudential standard. APRA is seeking industry feedback on the draft amended standards and invites comments by February 22, 2019.

APRA is also proposing that revisions to the broader capital framework, initially outlined in February 2018, will come into effect from January 1, 2022 – the internationally agreed implementation date set by the Basel Committee on Banking Supervision.

## **11. RBA bilateral currency swap agreements**

- On April 3, 2018, the Reserve Bank of Australia announced that it has extended its bilateral local currency swap agreement with the People's Bank of China (PBoC) for a further three years. The agreement, which can be activated by either party, allows for the exchange of local currencies between the two central banks of up to A\$40 billion or CNY 200 billion. An initial swap agreement between the two central banks had been signed in 2012, with a subsequent agreement executed in 2015 for a further period of three years.

The main purposes of the agreement are to support trade and investment between Australia and China, particularly in local-currency terms, and to strengthen bilateral financial cooperation..

- On August 9, 2018, the Reserve Bank of Australia and Bank Indonesia announced that they have come to an agreement to renew their Bilateral Local Currency Swap Agreement, which is due to expire in December 2018. As with the existing facility, the agreement will span a period of three years and allow for the exchange of local currencies between the two central banks of up to A\$10 billion or IDR 100 trillion.

The agreement is designed to promote bilateral trade, and in particular, help to ensure that trade between the two countries can be settled in local currency even in times of financial stress. It reflects the strong ongoing financial cooperation between Australia and Indonesia.

## **12. Treasury releases draft legislation on misconduct penalties**

- On September 26, 2018, the Australian Treasury announced that the government is seeking public comment on draft legislation to strengthen penalties for corporate and financial sector misconduct. The draft legislation seeks to:
  - Update the penalties for certain criminal offences in ASIC-administered legislation, including: increasing the maximum imprisonment penalties for certain criminal offences; introducing a formula to calculate financial penalties for criminal offences; and removing imprisonment as a penalty and increasing the financial penalties for all strict and absolute liability offences;
  - Introduce ordinary criminal offences that sit alongside strict and absolute liability offences;
  - Significantly increase the financial penalties for civil contraventions and give courts discretion to strip contraveners of their ill-gotten gains in civil penalty proceedings;
  - Modernize and expand the civil penalty regime by making a wider range of offences subject to civil penalties;
  - Harmonize and expand the infringement notice regime;
  - Introduce a new test that applies to all dishonesty offences under the Corporations Act 2001; and
  - Ensure the courts prioritize compensating victims over ordering the payment of financial penalties.

The reforms implement some of the recommendations of ASIC Enforcement Review Taskforce. The taskforce was established to review ASIC's enforcement regime. It provided its recommendations in a report to the government in December 2017.

## **ISDA Submissions**

April 21, 2017: [ISDA submission to Treasury on Improving corporate insolvency law – ipso facto reforms.](#)

June 5, 2017: [ISDA submission to APRA consultation on Substituted compliance for margin requirements for non-centrally cleared derivatives.](#)

July 24, 2017: [ISDA submission to the Treasury consultation on reform of the regulation of financial benchmarks.](#)

August 21, 2017: [ISDA submission to ASIC consultation on Implementing the financial benchmark regulatory regime.](#)

September 8, 2017: [ISDA submission to Treasury consultation on APRA's crisis management powers.](#)

September 27, 2017: [ISDA submission to APRA consultation on revisions to counterparty credit risk for ADIs.](#)

December 15, 2017: ISDA submission to the Senate Economics Legislation Committee on the Financial Sector Legislation Amendment (Crisis Resolution Powers and Other Measures) Bill 2017. This submission is not yet public.

23 March 2018: [ISDA and AFMA joint submission to ASIC on AUD Forward Rate Agreement \(FRA\) Mandatory Clearing – Request to the Australian Securities and Investments Commission \("ASIC\) for Extension of Relief](#)

11 July 2018: [ISDA submission to ASIC on ASIC Reporting - Proposal to Shift to 'Lifecycle' Reporting for CFDs, Margin FX & Equity Derivatives](#)

31 July 2018: [ISDA, AFMA and GFXD joint submission to ASIC on the importance of maintaining the exemptions found in ASIC Corporations \(Derivative Transaction Reporting Exemption\) Instrument 2015/844](#)

# CHINA

## AT A GLANCE

Central Bank:	People's Bank of China (PBOC) <a href="http://www.pbc.gov.cn">http://www.pbc.gov.cn</a>
Banking and Insurance Regulator:	China Banking and Insurance Regulatory Commission (CBIRC, previously known as "CBRC") <a href="http://www.cbirc.gov.cn/chinese/newIndex.html">http://www.cbirc.gov.cn/chinese/newIndex.html</a>
Securities Regulator:	China Securities Regulatory Commission (CSRC) <a href="http://www.csrc.gov.cn">http://www.csrc.gov.cn</a>
Other Regulators:	State Administration of Foreign Exchange (SAFE) <a href="http://www.safe.gov.cn">http://www.safe.gov.cn</a> State-owned Assets Supervision and Administration Commission of the State Council (SASAC) <a href="http://www.sasac.gov.cn">http://www.sasac.gov.cn</a>
Associations:	National Association of Financial Market Institutional Investors (NAFMII, a self-regulatory organization on China's interbank market supervised by PBOC) Securities Association of China (SAC, a self-regulatory organization of securities companies supervised by CSRC) China Futures Association (CFA, a self-regulatory organization of futures companies supervised by CSRC) Asset Management Association of China (AMAC, a self-regulatory organization that represents the mutual fund industry of China and is supervised by CSRC)
Master Agreement:	Onshore transactions: NAFMII Master Agreement is mandatory for OTC derivatives transactions linked to currency, rate, bond, credit and gold entered into between participants of China's interbank bond market. SAC/CFA/AMAC Master Agreement is mandatory for certain types of domestic OTC derivatives transactions entered into by securities companies, futures companies and asset management companies. Cross-border transactions: ISDA Master Agreement for cross border trades
Legal Opinions:	Memorandum on enforceability of close-out netting of OTC derivatives transactions under the ISDA Master Agreement issued by King & Wood Mallesons Netting opinion in respect of PBOC, SAFE and MOF issued by King & Wood Mallesons Memorandum on enforceability of the ISDA credit support documents issued by King & Wood Mallesons
CCP/TR Status:	Shanghai Clearing House (SCH) was established in 2009 to provide clearing services for financial market participants in China. According to the authorization of PBOC, SCH will provide centralized and standardized clearing services for spot and derivatives transactions in RMB and foreign currencies as well as RMB cross-border transactions approved by PBOC. According to a circular issued by PBOC in January 2014, mandatory central clearing (including both direct and client clearing) of onshore RMB IRS transactions between financial institutions commenced on July 1, 2014. On January 24, the China Securities Regulatory Commission (CSRC) recognized Dalian Commodity Exchange, China Financial Futures Exchange, Shanghai Futures Exchange, Zhengzhou Commodity Exchange and Shanghai International Energy Exchange as qualifying central counterparties (QCCPs). The exchanges have been performing the function of central counterparties in futures trading.

## Key Regulatory Milestones

### 1. Shanghai Clearing House applies for ESMA recognition and CFTC exemption

- On April 18, 2017, the European Securities and Markets Authority (ESMA) updated its list of central counterparties (CCPs) established in non-European Economic Area countries that have applied for recognition under Article 25 of the European Market Infrastructure Regulation to include Shanghai Clearing House.
- On May 16, 2017, the Commodity Futures Trading Commission (CFTC) extended its no-action relief to Shanghai Clearing House allowing it to continue to clear certain swaps subject to mandatory clearing in China for the proprietary trades of its clearing members that are US persons or affiliates of US persons. Shanghai Clearing House had submitted a petition to the CFTC requesting an order of exemption from registration as a derivatives clearing organization (DCO) pursuant to Section 5b(h) of the CEA on November 22, 2016. The relief was extended until the earlier of November 30, 2017, or the date on which the CFTC exempts Shanghai Clearing House from the DCO registration requirement.
- On November 20, 2017, the CFTC extended its no-action relief on Shanghai Clearing House that was due to expire on 30 November. The relief expires on February 28, 2018, or the date on which the CFTC exempts Shanghai Clearing House from DCO registration. The CFTC also stated in the relief that due to the time that passed since the initial submission of the petition, Shanghai Clearing House submitted updated and revised petition documents to the CFTC on October 26, 2017.
- On July 31, 2018, the CFTC's division of clearing and risk issued a no-action letter extending the relief provided to the Shanghai Clearing House (SHCH). The no-action relief will expire at the earlier of: (i) July 31, 2021; or (ii) the date on which the CFTC exempts the SHCH from registration as a derivatives clearing organization. Under this relief, the SHCH is permitted to clear certain swaps subject to mandatory clearing in China for the proprietary trades of the SHCH clearing members that are US persons or affiliates of US persons

### 2. CBIRC's reply to legislators about enforceability of close-out netting and UK-China Netting Working Group

A netting legislation proposal was tabled before the Financial and Economic Affairs Committee of the National People's Congress in March 2017. The banking regulator, CBIRC responded to the legislative proposal on July 4, 2017. Significantly, the CBIRC stated the following:

- despite any remaining uncertainty in China's judicial procedures, the Enterprise Bankruptcy Law does not, in principle, conflict with close-out netting. While the CBIRC acknowledges that Chinese courts have the right to set aside a termination under the close-out netting provisions, it goes on to state its view that the purpose of this right is to invalidate close-out netting exercised in 'bad faith' and such rights of the judiciary do not conflict with the relevant provisions of the ISDA Master Agreement.

- CBIRC is currently working on the draft Rules on the Resolution of Commercial Banks (the “Rules”). To provide sufficient protection for a quick and orderly resolution of a bank in financial difficulties, the Rules will be drafted in accordance with the requirements set out in Key Attributes of Effective Resolution Regimes for Financial Institutions issued by the Financial Stability Board and will give adequate consideration to the suspension of the right to close-out netting in respect of financial contracts governed by ISDA Master Agreement during a resolution procedure. In addition, CBIRC will further coordinate with the legislative department to promote the support and protection of close-out netting. In the meantime, CBIRC and ISDA will continue to communicate with each other on the establishment of close-out netting arrangements for China’s commercial banks and fully exchange views with commercial banks.
- CBIRC acknowledges the effect of netting in capital measurement and other areas. For example, pursuant to Appendix 6 of the Measures for Administration of Capital of Commercial Banks (Trial Implementation), netting may be adopted as a capital risk mitigation measure for the purposes of internal rating method. At present, CBIRC is amending the measurement system for counterparties’ credit risk exposure and credit valuation adjustment, which also fully recognise the use of netting in risk hedging.

While the CBIRC reply doesn’t represent a legal change that would confirm the enforceability of close-out netting, the comment is significant.

As part of the Policy Outcomes of the 9th UK -China Economic and Financial Dialogue, a UK-China Netting Working Group led by CBIRC and China Banking Association along with ASIFMA and ISDA was established in February 2018. The Working Group had two meetings in 2018 which were attended by Chinese legislators, financial regulators, and some UK and Chinese banks as well as the trade associations. ISDA has prepared a draft judicial interpretation on the Bankruptcy Law based on ISDA’s Model Netting Act for CBIRC and the Supreme People’s Court to consider.

### **3. China issues rules regarding China-Hong Kong Bond Connect**

- On June 21, 2017, the People’s Bank of China (PBOC) issued interim administrative measures on the connection cooperation for the mainland and Hong Kong bond markets, which set out the fundamental legal structure for the bond connect programme. The measures apply to the north-bound trading link – i.e., overseas institutional investors investing in China’s interbank bond market.

On June 22, 2017, the PBOC issued a set of Q&As to clarify certain issues in respect of these measures. These state that:

- The scope of eligible overseas investors under the Bond Connect programme is consistent with the scope of the investors having direct access to the China interbank bond market (CIBM) under previous PBOC circulars – namely, foreign central banks, international financial organisations and sovereign wealth funds under PBOC Circular [2015] No.220 and overseas institutional investors under PBOC Announcement [2016] No.3.

- Overseas investors have access to all kinds of bonds traded in CIBM through the north-bound trading link. At this stage, north-bound overseas investors may only trade cash bonds. Other types of products, such as bond repo, bond lending, bond forwards, interest rate swaps and forward rate agreements, will be made available in the future.
- Overseas investors investing in the CIBM through Bond Connect should trade through trading platforms recognised by the PBOC and hold their bonds through a nominee account structure. For the time being, Tradeweb is the only recognised offshore electronic trading platform. Other trading platforms may also get access to the north-bound trading link when they are ready. China Foreign Exchange Trade System (CFETS) is the sole onshore electronic trading platform.
- North-bound trading will adopt a multi-tier depository system. The bond depository and custody institution recognised by the Hong Kong Monetary Authority (HKMA) should open nominee account(s) with the onshore bond depository and custody institution(s) recognised by the PBOC to record the aggregate bond balance held under this nominee holding structure. Currently, the Central Moneymarkets Unit of HKMA (CMU) is the offshore custody institution; the China Central Depository & Clearing Co., Ltd. (CCDC) and the Shanghai Clearing House (SCH) are the onshore custody institutions. CMU will handle bond depository and custody for the overseas bond holders that open nominee bond account(s) and/or proprietary bond account(s) with it.
- The exercise of creditor rights by the overseas investors as beneficial owners of the bonds should be in accordance with Hong Kong law regarding nominee holders. Beneficial owners of the bonds purchased through the north-bound trading link should exercise their rights.
- Against the bond issuers via the nominee holder – i.e., CMU – overseas investors can invest in either RMB or foreign currencies. For investments in foreign currencies, the relevant RMB purchase and sale activities should be handled through the Hong Kong RMB clearing bank and Hong Kong overseas RMB business participating banks.

Subsequent to the publication of the interim rules, SCH and CCDC issued their respective bond depository and custody rules, and CFETS issued trading rules in respect of north-bound trading under the bond connect programme.

#### **4. Merger of CBRC and CIRC and expansion of PBOC's responsibilities**

- In March 2018, China announced plans to merge CBRC and CIRC, creating a new body with enhanced oversight of its banking and insurance industries. Certain CBRC and CIRC functions, including drafting key financial and prudential regulations, will be moved to the central bank, PBOC.

#### **5. New master agreements for OTC derivative transactions in China's futures and securities markets**

- On December 27, 2018, the Securities Association of China (SAC), the China Futures Association (CFA) and the Asset Management Association of China (AMAC) jointly issued the Master Agreement for Derivatives Transactions in the China Securities and Futures Markets which replaced another master agreement issued in 2014. On the same day, the three associations, the Shanghai Stock Exchange and the Shenzhen Stock Exchange jointly issued the Master Agreement for Derivatives Transactions in the China Securities and Futures Markets (Special Version for Credit Protection

Contracts)(the "SV Master Agreement") which applies to credit derivative transactions referencing RMB bonds listed or traded on the exchanges. The 2018 Master Agreement applies to certain types of OTC derivatives entered into by securities companies, asset management companies and futures companies other than credit derivatives transactions. On January 18, 2019, the Shanghai Stock Exchange and the Shenzhen Stock Exchange jointly issued the Administrative Rules on Credit Protection Instrument (Trial) to regulate trading of credit derivatives transactions referencing RMB bonds listed or traded on the exchanges.

#### **6. PBOC, CBIRC and CSRC issue broad guideline on supervision of systemically important financial institutions (SIFIs)**

- On November 27, 2018, PBOC, CBIRC and CSRC jointly issue the Guiding Opinions on Improving Supervision of Systemically Important Financial Institutions. The guideline aims to improve China's framework for supervising systemically important financial institutions, prevent systemic risks and maintain the prudent performance of the financial system.

The guideline also made clear the definition and scope of such financial institutions, including those in the banking, securities and insurance sectors, as well as the evaluation procedure and method.

SIFIs refer to those that will have major negative impacts on the financial system and real economy and may lead to systemic risks in the case of failing to continue operations due to the occurrence of major risk events. They will be subject to special supervision requirements to enhance the capability of sustained operations and reduce major risks.

Regulators led by PBOC will shortlist financial institutions accounting for at least 75 percent of total assets in their respective sectors, or at least 30 banks, 10 securities firms and 10 insurance companies as potential SIFIs for a review each year. Financial regulators will evaluate the impact of a potential failure of the short-listed institutions and submit an initial list of SIFIs to the State Council's Financial Stability and Development Committee, which will make the final decision on the list.

SIFIs will be asked to comply with additional regulatory requirements on capital such as leverage ratios, liquidity and large exposure risks, corporate governance, risk management and information system.

PBOC, CBIRC, CSRC, Ministry of Finance and other relevant regulators will also create a crisis management team to ensure immediate action is taken to prevent systemic risks in the event a SIFI fails.

#### **7. CSRC issues guideline on the Investment of Publicly Offered Securities Investment Funds in Credit Derivatives**

- On January 18, 2019, CSRC issued the guideline regarding investment of credit derivatives by publicly offered funds. The guideline provides that publicly offered funds may only enter into credit derivatives for hedging purposes. Money market funds are prohibited from trading any credit derivatives. Fund managers are required to decide the investment size and tenure of credit derivatives

and strengthen risk management of counterparty credit risk. A publicly offered fund is requested to provide detailed disclosure on use of credit derivatives in its periodical reports and prospectus. The guideline also requests publicly offered funds value their credit derivatives exposure according to guidance issued by the relevant industry bodies.

## **ISDA Submissions**

May 10, 2017: [ISDA and ASIFMA joint submission to the governor of SAFE on close-out netting enforceability under Chinese law](#)

May 2017: ISDA's technical paper submitted to PBOC on close-out netting and its impact on Chinese financial institutions (this submission is not public)

September 2018: draft judicial interpretation on the Bankruptcy Law based on ISDA's Model Netting Act (this submission is not public)

## HONG KONG

### AT A GLANCE

Central Bank:	Hong Kong Monetary Authority (HKMA) <a href="http://www.hkma.gov.hk">http://www.hkma.gov.hk</a>
Bank Regulator:	HKMA
Securities Regulatory:	Securities and Futures Commission (SFC) <a href="http://www.sfc.hk">http://www.sfc.hk</a>
Other Regulators:	Financial Services and Treasury Bureau (FSTB) <a href="http://www.fstb.gov.hk">http://www.fstb.gov.hk</a>
Association:	Treasury Markets Association (TMA) The Hong Kong Association of Banks (HKAB)
Master Agreement:	ISDA
Legal Opinions:	Netting, collateral, client clearing (clearing members reliance, client reliance and FCM clearing members reliance) and e-contracts opinions by Linklaters CRR Article 305(2)(c) opinions by Allen & Overy
CCP/TR Status:	<p>The mandatory reporting regime applicable to certain interest rate swaps and non-deliverable forwards came into effect on July 10, 2015. Interim reporting requirements for certain OTC derivatives transactions between licensed banks became effective in August 2013, and have been in full force since February 4, 2014 after expiration of the transitional arrangements. The expanded reporting obligations applicable to all OTC derivatives came into effect on July 1, 2017.</p> <p>Mandatory clearing obligations for certain fixed-to-floating swaps, basis swaps and overnight index swaps in G4 + HKD currencies came into effect on July 1, 2017.</p> <p>Four CCPs in Hong Kong were recognised by ESMA as third country CCPs on April 27, 2015, and thus can provide clearing services to clearing members or trading venues established in the EU.</p> <p>On August 31, 2016, the SFC designated four CCPs for the purposes of the Hong Kong mandatory clearing obligation.</p> <p>The US Commodity Futures Trading Commission (CFTC) issued an order of exemption to OTC Clearing Hong Kong Limited (OTC Clear) from registration as a derivatives clearing organization (DCO) on December 21, 2015. This permits it to clear proprietary swap positions for its U.S. clearing members.</p> <p>The Bank of England (BoE) added four CCPs in Hong Kong to the interim list of third-country CCPs that will offer clearing services and activities in the UK under the Temporary Recognition Regime (TRR) if the UK leaves the EU with no implementation period.</p>
Margin requirements:	The HKMA margin and risk mitigation requirements for non-centrally cleared OTC derivatives came into effect on March 1, 2017, with a 6-month transitional period for variation margin.

## Key Regulatory Milestones

### 1. Memoranda of understanding (MoU)

- On January 19, 2017, the SFC announced that it has agreed on a memorandum of understanding (MoU) with the US Securities and Exchange Commission (SEC).

The MoU covers exchanges and other trading venues, market intermediaries, investment funds or companies, clearing agencies and credit rating agencies. Through the MoU, the SFC and the SEC express their willingness to cooperate with each other in the interest of fulfilling their respective regulatory mandates.

- On July 10, 2017, the SFC and the Autorité des Marchés Financiers (AMF) announced they have signed an MoU on France-Hong Kong mutual recognition of funds, which will allow eligible Hong Kong public funds and French UCITS funds to be distributed to retail investors in each other's market through a streamlined authorisation process.

The MoU is the first agreement between Hong Kong and a member of the EU that establishes the regulatory framework for distribution of eligible Hong Kong and French funds, which currently include general equity funds, bond funds and mixed funds. It also stipulates a mechanism for regular dialogue and regulatory cooperation, enabling the SFC and the AMF to fulfil their respective supervisory and regulatory mandates.

- On July 20, 2017, the SFC announced that it has entered into an MoU with the UK Financial Conduct Authority (FCA) providing for consultation, cooperation and exchange of information in connection with the supervision and oversight of regulated entities that operate on a cross-border basis in Hong Kong and the United Kingdom.

The MoU, which came into effect on July 7, covers financial market participants and other entities that are regulated by the SFC or the FCA. It enables the SFC and the FCA to cooperate with each other in the interest of fulfilling their respective regulatory mandates.

- On February 26, 2018, the SFC entered into an agreement with the Swiss Financial Market Supervisory Authority (FINMA) to establish a framework for cooperation on financial technology.

Under the agreement, the SFC and FINMA will cooperate to share information on emerging Fintech trends, developments and related regulatory issues as well as on organisations which promote innovation in financial services. In addition, the agreement provides for a bilateral mechanism for referrals of innovative firms seeking to enter one another's markets.

- On March 9, 2018, the HKMA and the Polish Financial Supervision Authority (KNF) exchanged a MoU to enhance fintech collaboration between the two authorities, with a view to strengthening co-operation between the two places in promoting innovative financial services.

The MoU was signed between Mr Howard Lee, Deputy Chief Executive of the HKMA and Mr Marek Chrzanowski, Chairman of the KNF today in Hong Kong. Under the MoU, the HKMA and the KNF will collaborate on joint research projects, information exchange, mutual consultations and expertise sharing.

- On May 11, 2018, the SFC announced that it has become one of the first signatories to the Enhanced Multilateral Memorandum of Understanding Concerning Consultation and Cooperation and the Exchange of Information (EMMoU) of the International Organization of Securities Commissions (IOSCO) for cross-border enforcement cooperation.

The EMMoU, approved by IOSCO in March 2017, is built upon the current Multilateral Memorandum of Understanding Concerning Consultation and Cooperation and the Exchange of Information to which the SFC has been a signatory since March 2003. The EMMoU provides IOSCO members who are signatories with additional tools to meet the challenges of combating financial misconduct. Under the EMMoU's framework for mutual assistance and exchange of information, securities regulators can obtain and share audit working papers, telephone and internet records, compel attendance at interviews and provide guidance on freezing of assets.

- On June 1, 2018, the SFC announced that it has entered into a MoU with the German Bundesanstalt für Finanzdienstleistungsaufsicht (BaFin) providing for consultation, cooperation and exchange of information in connection with the supervision and oversight of cross-border regulated entities in Hong Kong and Germany.

The MoU, which covers financial market participants and other entities that are regulated by the SFC or the BaFin, enables the SFC and the BaFin to cooperate with each other in the interest of fulfilling their respective regulatory mandates.

- On June 6, 2018, the SFC announced that it has entered into a cooperation agreement with the Abu Dhabi Global Market (ADGM) Financial Services Regulatory Authority (FSRA) to establish a framework for cooperation on financial technology.

Under the agreement, the SFC and the FSRA will cooperate on information sharing, potential joint innovation projects and referrals of innovative firms seeking to enter one another's markets.

- On June 8, 2018, the China Banking and Insurance Regulatory Commission (CBIRC) and the SFC announced that they have entered into a MoU regarding the cooperation and exchange of information in connection with the supervision and oversight of regulated entities of the CBIRC or the SFC that operate on a cross-boundary basis in Hong Kong and Mainland (Cross-Boundary Regulated Entities).

The MoU facilitates the CBIRC and the SFC to cooperate with each other in the interest of fulfilling their respective mandates, particularly in the areas of investor protection, promoting the competence and integrity of Cross-Boundary Regulated Entities, fostering market and financial integrity, reducing systemic risk and maintaining financial stability.

- On September 10, 2018, the HKMA and the Central Bank of Brazil (BCB) announced that they had signed a Co-operation Agreement to enhance collaboration between the two central banks involving fintech issues, with a view to encouraging and enabling innovation in financial services in both markets, and supporting innovative financial businesses in expanding to each other's jurisdictions. Under the Co-operation Agreement, the HKMA and BCB will collaborate on the referral of innovative businesses, information and experience sharing, and joint innovation projects.
- On December 3, 2018, the China Securities Regulatory Commission (CSRC) and the SFC announced that they have entered into a MoU regarding the cooperation and exchange of information in connection with the supervision and oversight of regulated entities of the CSRC or the SFC that operate on a cross-boundary basis in Hong Kong and Mainland (Cross-Boundary Regulated Entities).

The MoU facilitates the CSRC and the SFC to cooperate with each other in the interest of fulfilling their respective mandates, particularly in the areas of investor protection, promoting the integrity and financial prudence of Cross-Boundary Regulated Entities, fostering fairness of markets, reducing systemic risk and maintaining financial stability.

- On December 18, 2018, the SFC and the CSRC held the seventh regular high-level meeting in Hong Kong recently to discuss a range of matters concerning cross-boundary enforcement cooperation.

The two regulators conducted in-depth discussions on market surveillance workflows and procedures, updated each other on the progress of high-priority cases, and discussed important cross-boundary enforcement policies. At the meeting, both sides also explored ways to further strengthen cross-boundary enforcement cooperation, including:

- enhancing a coordinated investigation mechanism for emerging types of cross-boundary illegal activity;
- discussing a notification and evidence sharing mechanism for cases involving dual listed companies in both markets; and organising further joint training and case study workshops.

Both regulators acknowledged that their long-standing close cooperation and collaboration on enforcement work has played a crucial role in combating cross-boundary market misconduct and maintaining the smooth and orderly operation of the Mainland-Hong Kong mutual market access programme.

## **2. Basel III & Capital**

- On January 27, 2017, the HKMA announced that the countercyclical capital buffer (CCyB) for Hong Kong will increase to 1.875% with effect from January 1, 2018, from the current 1.25%. This increase is consistent with the Basel III phase-in arrangements.
- On April 13, 2017, the HKMA issued a consultation outlining proposals for the leverage ratio framework, in line with the BCBS consultative document. The consultation outlines:

- The general approach to implementing the leverage ratio in Hong Kong with regards to the implementation date under the Basel III transitional arrangement (January 1, 2018), while the 2016 proposed revisions are still being finalised for the final leverage ratio framework to be published by the BCBS.
  - Proposals for the legislative approach to implementing the leverage ratio as a statutory minimum requirement.
  - Consequential changes required by leverage ratio implementation in respect of ongoing supervisory monitoring, regulatory reporting and disclosure.
  - The proposed implementation timeline for bringing the leverage ratio into effect starts on January 1, 2018.
- On June 23, 2017, the HKMA published a consultation paper on interest rate risk in the banking book (IRRBB). IRRBB refers to the current or prospective risk to a bank's capital and earnings arising from adverse movements in interest rates that affect banking book positions. Excessive IRRBB can pose a significant threat to a bank's current capital base and/or future earnings if not managed appropriately. The draft guidelines require the banks to compute and disclose the changes in economic value of equity under a set of prescribed interest rate shock scenarios using the standardised framework. Banks that have IRRBB exposures of more than 15% of their Tier 1 capital are identified as 'outliers' and considered as potentially having undue IRRBB and subject to review. In addition, banks are required to disclose their IRRBB exposures to the public on a regular basis.

These draft guidelines are based on the standards on IRRBB published by the BCBS in April 2016. Following the close of this consultation, the HKMA will refine its proposals, taking into account the feedback received. The HKMA intends to publish the final guidelines in the third quarter of 2017, with the revised framework being effective from January 1, 2018. Comments on these draft guidelines are due by August 11.

- On June 23, 2017, the HKMA issued a circular revising the timeline for the local implementation of minimum capital requirements for market risk, also known as the Fundamental Review of the Trading Book (FRTB). Given the number of practical implementation questions have arisen, the HKMA has decided that implementation of the new standards in Hong Kong shall be no earlier than January 1, 2020.

The HKMA plans to issue consultation papers on the standardised approach later in 2017, and another one focusing on the internal models approach in 2018. The HKMA will keep the industry updated on further developments to the implementation timeline.

- On September 26, 2017, the HKMA issued a circular revising the timeline for the local implementation of IRRBB. Based on responses received during the consultation period, it highlighted the concerns on the relatively tight implementation timeline and the practical implementation challenges with the original implementation date of January 1, 2018. The HKMA has decided that implementation of the new IRRBB standards in Hong Kong shall be revised to January 1, 2019. Banks should be ready to measure and report their IRRBB exposures using the proposed standardised framework in 2019, with the first report based on data as at December 31, 2018.
- On October 20, 2017, the HKMA announced that the Banking (Capital) (Amendment) Rules 2017 (BCAR), the Banking (Liquidity) (Amendment) Rules 2017 (BLAR) and the Banking (Specification

of Multilateral Development Bank) (Amendment) Notice 2017 (Amendment Notice) were published in the Gazette.

The amendments contained in the BCAR are to implement three Basel III-related capital standards. These include the revised securitisation framework, the leverage ratio framework, and the interim capital treatment of expected loss provisions under the new International Financial Reporting Standard 9.

The amendments contained in the BLAR deal with implementation of the Basel III net stable funding ratio and a new local core funding ratio, to ensure that the assets of authorised institutions are financed with a sufficiently stable source of funding.

The Amendment Notice implements a decision of the of the Basel Committee on Banking Supervision in November 2016 to allow banks to apply a 0% risk weight to claims on the International Development Association as a multilateral development bank (MDB) under the standardised approach for credit risk. The Chinese names of certain MDBs are also incorporated under this notice.

The three pieces of subsidiary legislation will be tabled before the Legislative Council for negative vetting on October 25. Subject to the views of the Legislative Council, the subsidiary legislation should come into operation on January 1, 2018. HKMA will provide a notification once the negative vetting process has been completed.

- On November 28, 2017, the HKMA announced that further to the announcement from October 20 and the recent negative vetting process of the Legislative Council, the BCAR, BLAR, and Amendment Notice will come into effect on January 1, 2018.
- On December 14, 2017, the HKMA announced a revised timeline for the implementation of the Fundamental Review of the Trading Book (FRTB). The HKMA has decided to align local implementation of the FRTB with the revised BCBS timeline of January 1, 2022. The HKMA has also indicated it is going to defer the originally intended publication of consultation papers on the local implementation of FRTB until there is more clarity on the expected revisions to the FRTB text later in 2018. In addition, the HKMA will consider its local implementation approach for the other components of the Basel III reform package in the coming months.
- On December 18, 2017, the SFC released a consultation on proposed amendments to the Code on Unit Trusts and Mutual Funds, to update the regulatory regime for SFC-authorised funds and address risks posed by financial innovation and fast-moving market developments.

Key proposals include strengthening requirements for key operators (management companies, trustees and custodians), providing greater flexibility and enhanced safeguards for funds' investment activities (particularly to derivatives, securities lending, and repo and reverse repo transactions), and introducing new fund types (including active ETFs). The proposals are made in view of international regulatory and local market developments. Consequential amendments are also proposed to relevant provisions of various SFC codes.

Comments on the consultation are due by March 19, 2018.

- On December 29, 2017, the HKMA announced the completion of its annual assessment of the list of domestic systemically important authorised institutions (D-SIBs). Based on the assessment results, Industrial and Commercial Bank of China (Asia) Limited has been added to the list, and the overall number of D-SIBs has increased to six. The updated list of D-SIBs, which will take effect on January 1, 2018, is shown in the annex.

Under the D-SIB framework, each of the authorised institutions designated as a D-SIB will be required to include a higher loss absorbency (HLA) requirement in the calculation of its regulatory capital buffer within a period of 12 months after the formal notification of its designation. In line with the phase-in arrangements in the frameworks issued by the Basel Committee for assessing D-SIBs and global systemically important banks (G-SIBs), the full amount of the HLA requirement will be phased-in from 2016 to 2019, in parallel with the capital conservation buffer and countercyclical capital buffer. Ultimately, the HLA requirement applicable to a D-SIB will range between 1% and 3.5% (depending on the assessed level of the D-SIB's systemic importance). Under the phase-in provisions, the levels of HLA requirement for 2019 will be increased to the range of 1% to 3.5% (from a range of 0.75% to 2.625% in 2018).

- On January 10, 2018, the HKMA announced that the CCyB for Hong Kong will increase to 2.5% with effect from 1 January 2019, from the current 1.875%.
- On January 17, 2018, the HKMA launched a two-month public consultation on a set of proposed rules relating to loss-absorbing capacity requirements for authorised institutions under the Financial Institutions (Resolution) Ordinance (Cap. 628) (the Ordinance).

The Ordinance established a cross-sectoral resolution regime for financial institutions that is fully compliant with international standards. It confers on the Monetary Authority, as the resolution authority for the banking sector, statutory responsibilities and powers to enable it to manage any future failure of an authorised institution in an orderly manner that avoids disruption to financial stability and minimises the risk to public funds.

The consultation launched today sets out detailed proposals on minimum LAC requirements for authorised institutions. The proposals are designed to be aligned with the international standards on loss-absorbing capacity set by the Financial Stability Board in its Total Loss-absorbing Capacity Term Sheet. In drawing up the proposed rules, the HKMA has taken these standards into account, and made reference to the approaches adopted in comparable overseas jurisdictions.

Subject to the outcome of the public consultation, the intention is to introduce the rules as subsidiary legislation under the Ordinance into the Legislative Council for negative vetting later in 2018.

- On April 26, 2018, the HKMA issued a consultation outlining its proposals for implementing requirements on the regulatory capital treatment of banks' investments in total loss-absorbing capacity

(TLAC) instruments. The HKMA's proposals are in line with the Basel Committee on Banking Supervision guidelines published on October 12, 2016.

In devising the proposals, the HKMA considered related proposals in its consultation on rules prescribing loss-absorbing capacity (LAC) requirements issued on January 17. Some adjustments to the proposals in this consultation paper may be necessary pending finalization of the related LAC requirements. Comments on the consultation are due by May 28, 2018.

- On May 2, 2018, the HKMA announced a further revision in the timeline for the local implementation of IRRBB. The HKMA initially announced a revised implementation date of January 1, 2019. Given a relatively advanced timeline and further concerns about challenges in implementing the new standards, the HKMA has decided to delay implementation of the new IRRBB standards in Hong Kong by an additional six months. Banks should be ready to measure and report their IRRBB exposures using the proposed standardized framework by July 1, 2019, with the first report based on data as at June 30, 2019.
- On May 4, 2018, The Banking (Disclosure) (Amendment) Rules 2018 and the Banking (Specification of Multilateral Development Bank) (Amendment) Notice 2018 were gazetted to implement some recent international standards on banking regulation in Hong Kong.

The Disclosure Rules seek mainly to implement the latest disclosure requirements issued by the Basel Committee on Banking Supervision (BCBS) in March 2017 to enhance the requirements in terms of transparency, comparability and user-relevance of bank disclosures.

The Amendment Notice reflects a BCBS decision in October 2017 to specify the Asian Infrastructure Investment Bank as a multilateral development bank to which banks' exposures will be eligible for preferential capital and liquidity treatment.

The Disclosure Rules and the Amendment Notice will be tabled before the Legislative Council at its sitting on May 9, 2018 (Wednesday) for negative vetting, and will come into operation on June 30, 2018.

- On May 18, 2018, The Banking (Amendment) Ordinance 2018 (Commencement) Notice 2018 and the Banking (Exposure Limits) Rules were gazetted to modernise section 87 of the Banking Ordinance in relation to a prescribed limit on equity exposures incurred by authorised institutions.

Enacted by the Legislative Council in January 2018, the Banking (Amendment) Ordinance seeks to incorporate into local legislation the latest standards promulgated by the Basel Committee on Banking Supervision in relation to concentration of financial exposures of authorised institutions, by empowering the Monetary Authority to prescribe rules on financial exposure limits.

The Banking (Exposure Limits) Rules modernise section 87 of the Banking Ordinance by capturing equity exposures more comprehensively and recognising certain risk mitigation techniques commonly used in the industry in measuring equity exposures. The relevant provisions in the Banking

(Amendment) Ordinance 2018 will have to commence operation to allow new rules to be made to replace section 87 of the Banking Ordinance.

- On July 6, 2018, the HKMA published a consultation paper reviewing certain aspects of the liquidity coverage ratio (LCR) and the net stable funding ratio (NSFR). The consultation paper:
  - Outlines the HKMA's proposals for expanding the scope of level 2B assets under the LCR and that of liquefiable assets under the liquidity maintenance ratio; and
  - Outlines the HKMA's proposal of implementing a required stable funding charge of 5% on total derivative liabilities under the NSFR and core funding ratio.

The HKMA will seek to finalize the proposed amendments after receiving industry comments. The HKMA expects to make the relevant liquidity amendment rules and revise the returns and guidelines for industry consultation over the course of 2019, with the aim to have the amendments come into operation starting from 2020 or earlier. Comments on the consultation paper are due by August 6, 2018.

- On July 26, 2018, the HKMA announced a revision in the timeline for the implementation of the amended Banking (Exposure Limits) Rules (BELR). The amendments to the BELR include the local implementation of the supervisory framework for measuring and controlling large exposures issued by the Basel Committee on Banking Supervision, and other local exposure limits currently contained under the Banking Ordinance.

The HKMA anticipates the negative vetting of the amendments by the Legislative Council to be completed around the end of the year. By that time, the HKMA also expects to publish the details on the grouping of linked counterparties. In light of this tight implementation timeline, the HKMA has decided to extend the implementation date of the amended BELR by six additional months to July 1, 2019.

- On August 2, 2018, the Hong Kong SFC issued a circular indicating that they intend to facilitate the adoption of an internal models approach to be used by licensed corporations (LCs) where appropriate to calculate the capital requirements for market risk for proprietary investments.

The SFC intends to do this through amending the Securities and Futures (Financial Resources) Rules (FRR). The proposed changes were discussed in a July 2017 consultation and based on feedback, the SFC decided that the internal models approach would be introduced into the FRR in a manner which reflects the latest Basel Committee on Banking Supervision standards.

The SFC proposes to use its existing supervisory power in considering the need to adopt the internal models approach for market risk on a case-by-case basis. The SFC will benchmark its requirements to the Revisions to the Basel II market risk framework issued in July 2009, pending an update to the Fundamental Review of the Trading Book (FRTB) by the Basel Committee.

Under this framework, the SFC will assess the readiness of an LC to adopt the internal models approach for market risk by focusing on the following areas:

- Fulfilment of principles-based general criteria (including appropriateness of risk management system and models, adequacy and competence of staff, and soundness of stress testing program);
- Compliance with qualitative standards in relevant areas (including board and senior management oversight, market risk management processes, and other controls and infrastructure related to market risk management); and
- Adherence to quantitative standards for the calculation of market risk capital charges based on individual component, namely value at risk (VAR), stressed VAR and incremental risk charge (including calculation and aggregation of individual components, the determination of capital multipliers, risk measurement parameters, specification of risk factors across risk categories, and back-testing of VAR against trading outcomes and a traffic light approach to interpret results).

The SFC will also consider each LC's unique circumstances, for example, a history of proven use of the models by the LC's overseas parent or group company. Although not mandatory, approval granted by a peer regulator of the models for regulatory capital purposes will also be taken into account. LCs that would like to move to the internal models approach can contact the SFC to discuss further.

- On August 10, 2018, the HKMA announced proposed draft amendments to its bank capital rules to implement the standardized approach for measuring counterparty credit risk (SA-CCR), and the capital requirements for bank exposures to central counterparties (CCPs) in Hong Kong. The HKMA is aiming to implement these standards sometime in the first half of 2020, subject to the outcome of the consultation and the legislative process. Comments on the draft amendments are due by September 11, 2018.
- On August 31, 2018, the HKMA announced a review of the scope of application for the local implementation of IRRBB. Based on feedback received from industry participants and analysis conducted by the HKMA, the HKMA has decided to exempt authorised institutions (AIs) incorporated outside Hong Kong from the new local IRRBB framework in cases where the parent group of the AI is not additionally represented in Hong Kong through a locally incorporated AI. The exempted AIs will continue to be subject to the existing local standards on interest rate risk and will be expected to manage their IRRBB together with their parent groups based on the IRRBB standards of their home jurisdictions. The HKMA will reserve the discretion to require any exempted AIs to implement the new local IRRBB framework and to meet the corresponding reporting standards with a reasonable notice period, for any reason that may be relevant for the HKMA to exercise their key functions.

The HKMA will provide further details on this exemption later this year in the final version of the IRRBB policy documents and in its response to feedback received.

- On October 19, 2018, the HKMA announced that the minimum LAC requirements for authorised institutions have been published as the Financial Institutions (Resolution) (Loss-absorbing Capacity Requirements - Banking Sector) Rules by the government in the Gazette. These rules are subsidiary legislation under the Financial Institutions (Resolution) Ordinance and are aligned with the Financial Stability Board's and international standards on LAC requirements.

The HKMA conducted a public consultation at the beginning of 2018 on the approach to implementing LAC requirements in Hong Kong and a subsequent industry consultation on the draft text of the rules.

Feedback from both consultations have been reflected in the final rules.

The rules will be tabled before the Legislative Council at its sitting on October 24 and will come into operation on December 14 upon negative vetting by the Legislative Council.

- On November 16, 2018, the HKMA announced that the Banking (Exposure Limits) Rules (BELR), Banking (Capital) (Amendment) Rules 2018 (BCAR) and the Banking (Disclosure) (Amendment) (No.2) Rules 2018 (BDAR) were published in the Gazette.

The purpose of the BELR is to replace the existing exposure limits in the Banking Ordinance, as well as implement the 2014 BCBS standards for measuring and controlling large exposures. The amendments contained in the BCAR are mainly to incorporate the 2016 BCBS standards on TLAC holdings, which set out the regulatory capital treatment of banks' holdings of TLAC liabilities. In addition, the BCAR incorporates capital treatment to address concentration risk in sovereign exposures supplementary to the implementation of the BELR, and the internal assessment approach of the 2014 BCBS revisions to the securitization framework. The BDAR adjusts the definition of 'capital requirements' to align with the amendments in the BCAR.

The three pieces of subsidiary legislation will be tabled before the Legislative Council for negative vetting on November 21. Subject to the views of the Legislative Council, the subsidiary legislation should come into operation respectively on:

- January 11, 2019 for amendments in the BCAR other than those in relation to TLAC holdings and concentration risk in sovereign exposures;
- April 1, 2019 for amendments in the BCAR in relation to TLAC holdings; and
- July 1, 2019 for the BELR, the BDAR, and amendments in the BCAR in relation to concentration risk in sovereign exposures.

The HKMA will provide a notification once the negative vetting process has been completed.

### 3. Resolution regime for financial institutions

- On March 17, 2017, the HKMA announced that a resolution office will be established in the HKMA on April 1, a major step toward the implementation of the Financial Institutions (Resolution) Ordinance (**FIRO**) enacted in June 2016. The office will work to ensure the Hong Kong resolution regime is operational for banks. Its priorities will be to establish resolution policy standards for banks, define resolution strategies and conduct resolvability assessments of banks, work with banks to remove impediments to their orderly resolution, and develop the operational capability necessary to execute orderly resolution.
- On April 6, 2017, Hong Kong regulators published their conclusions to a consultation paper on protected arrangements regulation (PAR) under the FIRO. The PAR is designed to provide certainty in respect of the treatment of specified protected arrangements in resolution, while affording a resolution authority a sufficient degree of flexibility to execute an orderly resolution.

Hong Kong regulators hope to submit the draft PAR to the Legislative Council in the second quarter of 2017, with a view to bringing the FIRO and the PAR into operation shortly after completion of the negative vetting procedure within 2017.

- On May 12, 2017, the Hong Kong government published the commencement notice of the FIRO and its subsidiary legislation, the PAR, both of which will come into effect on July 7.

The FIRO establishes a cross-sector resolution regime for financial institutions and is designed to meet the international standards set by the Financial Stability Board. The PAR imposes constraints on resolution authorities in dealing with certain financial arrangements (including clearing and settlement systems arrangements, netting arrangements, secured arrangements and title transfer arrangements) to safeguard their economic effect.

- On July 7, 2017, the FIRO and the PAR commenced operation, and the HKMA was designated as the lead resolution authority for 25 cross-sectoral groups. The HKMA also published three Code of Practice chapters to provide guidance on: (i) the HKMA's approach to resolution planning for authorised institutions (AIs) (chapter RA-2); (ii) resolution planning core information requirements for AIs (chapter CI-1); and (iii) operational independence of the HKMA as resolution authority (chapter RA-1).
- On July 25, 2018, the HKMA released a conclusion on its consultation paper relating to LAC rules for authorised institutions (AI), proposed to be made as subsidiary legislation under the Financial Institutions (Resolution) Ordinance.

The proposed rules require certain AIs to have sufficient LAC in order to facilitate the orderly use of stabilization options by the HKMA if such AIs fail. LAC comprises regulatory capital and certain other liabilities that can readily bear loss in resolution.

The conclusion provides more details on the HKMA's intended approach to how entities would be classified as resolution entities or material subsidiaries and the relevant LAC requirements. Based on the proposed implementation timeline, the classification of resolution entities and material subsidiaries will be made in 2019. AIs will then have to start meeting their LAC requirements by no later than 24 months after classification (i.e., by January 1, 2022).

The HKMA intends to further consult the industry on the text of the draft LAC rules and draft LAC code of practice chapter later this year, before introducing them as subsidiary legislation for negative vetting in the fourth quarter of 2018.

#### **4. Bond Connect and Stock Connect**

- On May 16, 2017, the People's Bank of China (PBOC) and the HKMA announced approval for China Foreign Exchange Trade System & National Interbank Funding Centre, China Central Depository & Clearing Co., Ltd, Shanghai Clearing House (mainland financial infrastructure institutions), together with Hong Kong Exchanges and Clearing Limited and Central Moneymarkets Unit (Hong Kong

financial infrastructure institutions) to collaborate in establishing mutual bond market access between Hong Kong and mainland China (Bond Connect).

Bond Connect is an arrangement that will enable mainland and overseas investors to trade bonds available in the China and Hong Kong bond markets via a connection between the mainland and Hong Kong financial infrastructure institutions.

Regulators of the Hong Kong and mainland bond markets will enter into a memorandum of understanding on supervisory cooperation to establish effective supervisory cooperation arrangements and liaison mechanisms in order to maintain financial market stability and fair trading. Bond Connect will be formally launched after relevant rules and system development have been finalised, market participants' practical needs have been addressed, relevant regulatory approvals have been granted and all other necessary preparations have been completed.

- On August 24, 2018, the Hong Kong SFC announced an agreement with the China Securities Regulatory Commission (CSRC) to implement an investor identification regime for northbound trading under Mainland-Hong Kong Stock Connect.

The investor identification regime will facilitate more effective monitoring and surveillance by the CSRC and Mainland stock exchanges to safeguard market integrity. The Stock Exchange of Hong Kong Limited will soon issue an announcement to provide more information about the launch of the new regime.

In November 2017, the SFC and the CSRC agreed on a reciprocal basis to introduce a similar investor identification regime for southbound trading to assist one another in performing their regulatory functions under Stock Connect. The investor identification regime for southbound trading will be implemented as soon as practicable.

## **5. SFC concludes consultation on position limits**

- On March 21, 2017, the SFC published conclusions to a consultation to expand the scope of the position limits regime.

After considering market feedback, the SFC has concluded that the proposals as set out in the consultation will be implemented. These include a 300% cap on the excess position limit that may be authorised by the SFC, a statutory position limit of 150,000 contracts for stock options, as well as new excess position limits for index arbitrage activities, asset managers and market-makers of exchange-traded funds. In light of market responses, the minimum assets under management requirement applicable to asset managers will be lowered from \$100 billion to \$80 billion. Subject to the legislative process, the SFC plans for the amended rules to come into effect on June 1.

## **6. SFC Securities and Futures (Financial Resources) Rules regime**

- On July 24, 2017, the SFC issued consultation conclusions and a further consultation on the proposed changes to the Securities and Futures (Financial Resources) Rules (FRR).

The document also includes draft amendments to the FRR for implementing technical changes that are not specific to OTC derivative activities. In this further consultation, the SFC seeks view on the following new proposals:

- Lower capital requirements for ‘OTCD central dealing desk dealer’;
  - A new definition of ‘non-freely floating foreign currency’ (with a 1.5% foreign exchange risk charge of one side of the matched positions); and
  - A licensed corporation has to provide liquid capital related to market risks of proprietary transactions of its affiliate if it has a trading loss sharing agreement with such affiliate.
- On October 19, 2018, the SFC released conclusions to the further consultation on proposed amendments to update the FRR. After considering the comments received, the SFC will implement the proposed changes, the main purpose of which is to update the computation basis of the financial resources requirements in response to market developments and to facilitate the business operation of licensed corporations.

Key changes include relaxing the treatment for foreign currencies subject to exchange control, clarifying the treatment for non-freely floating foreign currencies, introducing and updating haircut percentages for certain types of securities and investments and refining the treatments for amounts receivable arising from securities transactions. A number of futures and stock exchanges will also be added to the list of specified exchanges in the FRR.

The proposed amendments, will be submitted to the Legislative Council for negative vetting. Subject to the legislative process, the amended rules will come into effect on 1 April 2019, with the exception of amendments related to a new accounting standard which will take effect on 1 January 2019, the effective date of the new standard.

## **7. CPMI-IOSCO releases PFMI implementation monitoring report**

- On May 24, 2017, the CPMI-IOSCO released a report with conclusions drawn from a Level 2 assessment. The report assesses whether, and to what degree, the legal, regulatory and oversight frameworks, including rules and regulations, any relevant policy statements, or other forms of implementation applied to systemically important financial market infrastructures in Hong Kong, are complete and consistent with the CPMI-IOSCO principles for financial market infrastructures.

The work on the Level 2 assessment was carried out as a peer review from August 2016 to March 2017, and reflects the status of Hong Kong's legal, regulatory and oversight framework as of July 15, 2016. The assessment concluded that the legal, regulatory and oversight frameworks in Hong Kong are complete and consistent with the principles.

## 8. G20 OTC derivatives commitments

- On January 16, 2017, the HKMA announced that, in order to improve the transparency of the OTC derivatives market, the Hong Kong Trade Repository (HKTR) has prepared for public disclosure two sets of monthly reports: the outstanding positions report and the turnover report. Reports have been published on a monthly basis from July 2015, and the HKTR will publish these reports on a regular interval, on the 16th of every month, for data from the previous month.

These reports will cover certain interest rate and foreign exchange derivatives products, mandated for reporting under the Securities and Futures (OTC Derivative Transactions - Reporting and Record Keeping Obligations) Rules.

- On January 27, 2017, the HKMA and the SFC released a set of updates and clarifications on the Supplementary Reporting Instructions (SRI) for OTC derivative transactions published on November 25, 2016.

The document provides updates and clarifications, following an industry meeting on December 8 and a technical briefing on December 13, 2016, to address the questions and issues raised by reporting entities subsequent to the publication of the SRI 1 and SRI 2 on November 25, 2016.

- In February 2017, the HKMA and the SFC released a set of further updates and clarifications on the SRI for OTC derivative transactions published on November 25, 2016, providing further clarification on reporting of novation dates and backloading of FRAs.
- On April 27, 2017, the HKMA and the SFC issued a joint consultation on the prescription of additional markets and clearing houses, and the prescription of Delta One Warrants, for the purpose of the OTC derivatives regulatory regime. This consultation is in response to a recent request from market participants that certain products be excluded from the upcoming second phase of mandatory reporting.

The proposed prescriptions seek to address the concerns raised by excluding the following products from the definition of “OTC derivative product”, and consequently from the mandatory reporting obligation:

- products traded on, and cleared through, the additional markets and clearing houses proposed to be prescribed; and
- Delta One Warrants, a certain type of warrant with a strike price set at zero or near zero.
- On June 27, 2017, the HKMA and the SFC published conclusions on the joint consultation paper that proposed adjusting the scope of ‘OTC derivative product’ under the OTC derivatives regulatory regime.

The proposed adjustments proscribe certain additional markets and clearing houses so that products traded and cleared through them will not be regarded as OTC derivative products, and exclude delta-one warrants from the definition.

After taking market feedback into account, the HKMA and SFC have concluded that the proposed adjustments should be implemented. The conclusions paper also provides further clarification as to how delta-one warrants will be defined. The HKMA and SFC will work with the Department of Justice on drafting the necessary legislative amendments to implement these changes.

- On June 30, 2017, the HKMA and the SFC published further updates and clarification on the SRI (SRI 1 and SRI 2 were published on November 25, 2016) for OTC derivatives transactions. These provide further updates to previously issued instructions for reporting transactions to the HKTR, taking into account comments received from the industry and latest international developments.
- On October 6, 2017, the HKMA and the SFC published an updated version of the frequently asked questions on the mandatory reporting regime, which are intended to help market participants better understand their obligations and responsibilities under the OTC derivatives regime so they are able to prepare for implementation and ensure compliance.
- On March 27, 2018, the HKMA and SFC issued a joint consultation on further enhancements to the OTC derivatives regulatory regime in Hong Kong

The consultation includes a proposal to mandate the use of the legal entity identifier (LEI) for the reporting obligation. To align with global standards, all entities contained in a transaction report to be submitted to the HKMA would be required to be identified by their LEI. The timeline for implementation will be staggered for different types of entities.

In addition, as the second phase of the OTC derivatives clearing regime, the regulators propose to expand the clearing obligation to specified standardised interest rate swaps denominated in Australian dollars. The consultation paper also sets out proposed factors for determining which products would be appropriate for a platform trading obligation in Hong Kong. Responses to the consultation are due by April 27, 2018.

- On March 27, 2018, the HKMA and SFC issued conclusions to a joint consultation on further enhancements to the OTC derivatives regulatory regime in Hong Kong.

Based on market feedback, the mandatory use of LEIs in trade reporting will only apply to the identification of entities that are on a reporting entity's side of a transaction. This requirement will apply to the reporting of new transactions and daily valuation information beginning 1 April 2019.

Reporting entities should continue to identify their counterparties in transaction reports in accordance with a waterfall of identifiers specified in the Supplementary Reporting Instructions for OTC Derivative Transactions. Meanwhile, reporting entities are expected to establish a process to request LEIs from their clients. Regulators will maintain close dialogue with reporting entities and keep in view international development to assess the need for further requirements in this area.

The HKMA and the SFC will proceed with their proposals for Phase 2 Clearing with some fine tuning. The clearing obligation will be expanded to include specified standardised interest rate swaps denominated in Australian Dollars and the list of Financial Services Providers will be revised.

The regulators have also adopted the trading determination process proposed in the joint consultation paper and are currently using the process to determine for which products it may be appropriate for Hong Kong to introduce a platform trading obligation.

- On April 13, 2018, the Hong Kong Trade Repository (HKTR) announced that the Reference Manual of the Reporting Service of the HKTR had been updated. The changes are mainly for reflecting the cessation of the Matching and Confirmation Service, revised HKTR fees and revised outage hours of the HKTR system.
- On December 7, 2018 the Hong Kong government gazetted the SFC (Over-the-counter (OTC) Derivative Transactions—Clearing and Record Keeping Obligations and Designation of Central Counterparties) (Amendment) Rules 2018 (Clearing Amendment Rules). The Clearing Amendment Rules provide for eight new calculation periods and their corresponding clearing thresholds and prescribed days. The first new calculation period is March 1, 2019 to May 31, 2019.

Subject to negative vetting by the Legislative Council, the Clearing Amendment Rules will be effective on March 1, 2019.

## **9. HKMA welcomes PBoC announcement on increased RQFII**

- On July 4, 2017, the HKMA welcomed an announcement by the PBoC that the State Council has approved an increase of Hong Kong's renminbi qualified foreign institutional investor (RQFII) quota from RMB270 billion to RMB500 billion.

Hong Kong is the first place for a pilot implementation of the RQFII scheme. The RQFII quota for Hong Kong had been expanded twice to RMB270 billion in 2014, and has already been fully allocated.

## **10. Fintech**

- On May 9, 2017, the SFC launched a two-month consultation on proposals to reduce and mitigate hacking risks associated with internet trading. The proposals incorporate new guidelines that set out baseline cybersecurity requirements for internet brokers to address hacking risks and vulnerabilities, and to clarify expected standards of cybersecurity controls. Some of these requirements already feature in the Code of Conduct or SFC circulars and are being elaborated and consolidated into the proposed guidelines. The SFC also proposes to expand the scope of cybersecurity-related regulatory principles and requirements that now apply to electronic trading of securities and futures on exchanges to cover the internet trading of securities that are not listed or traded on an exchange, including authorised unit trusts and mutual funds.

The consultation follows the SFC's recent thematic review of Hong Kong's broker resilience to hacking risks. In formulating its proposals, the SFC considered local and overseas market practices and regulatory requirements, the effectiveness and relevance of a variety of controls, implementation costs and potential implications for the user experience. Submissions to the consultation are due by July 7, 2017.

- On September 29, 2017, the SFC issued a circular announcing the launch of a SFC regulatory sandbox to provide a confined regulatory environment for qualified firms to conduct regulated activities utilising financial technologies.

The sandbox aims to enable qualified firms, through close dialogue with and supervision by the SFC, to identify and address any risks or concerns associated with their regulated activities before their services can be provided to the wider public in Hong Kong. To minimise risk exposure to investors, the SFC may impose licensing conditions, such as limiting the types of clients these firms serve or each client's maximum exposure. In addition, they are expected to have adequate investor protection measures in place.

The circular emphasises that the sandbox should not be viewed as a means to circumvent legal and regulatory requirements. If the SFC considers that a firm operating in the sandbox is not fit and proper to remain licensed, its licence may be revoked.

The SFC also issued a separate circular to clarify its approach in assessing the relevant industry experience requirement for individuals including those with technology expertise applying to be responsible officers.

- On October 25, 2017, the HKMA announced a number of new developments on its Smart Banking initiatives to foster the healthy development of fintech ecosystem in Hong Kong. In his welcoming remarks at the HKMA Fintech Day, Mr Norman Chan, Chief Executive of the HKMA, announced the progress made in two important areas: cross-border collaboration and enhanced research.
- On January 11, 2018, the HKMA issued a consultation on Open API framework, setting out the HKMA's intended approach to Open Application Programming Interfaces (API) for the banking industry in Hong Kong. The HKMA now invites relevant parties in the industry to provide comments on the consultation paper.

The formulation of the Open API framework is one of the seven initiatives announced by the HKMA in September 2017 to prepare Hong Kong to move into a New Era of Smart Banking. The proposed Open API framework set out in the consultation paper comprises a selection of Open API functions and deployment timeframe, technical standards, third-party service provider governance, facilitation measures and the maintenance models.

- On February 6, 2018, the HKMA published a revised guideline on authorisation of virtual banks for public consultation.

As part of the package of initiatives announced in September 2017, the HKMA will facilitate the establishment of virtual banks in Hong Kong and will carry out a review of the guidelines on authorisation of virtual banks first issued in 2000. These guidelines set out the principles the HKMA will take into account in deciding whether to authorise virtual banks to conduct banking business in Hong Kong. The HKMA considers that the basic principles contained in the guidelines from 2000 remain applicable, however, some updates or refinements are necessary.

While the revised guidelines are still under consultation, the HKMA encourages applicants to review them and make preparations when submitting an application. The HKMA has set up a dedicated team to answer enquiries of applicants and provide assistance during the application process. In evaluating the applications received, the HKMA will give due regards to the extent to which the authorisation of the applicant will promote fintech and innovation, new customer experience and financial inclusion in Hong Kong. Comments to the consultation are due by March 15. The HKMA will issue the revised guidelines in May 2018.

- On May 30, 2018, the HKMA published a revised guideline on the authorization of virtual banks following the completion of a public consultation.

All respondents supported the introduction of virtual banking in Hong Kong. Most of them agreed that virtual banks should be subject to the same supervisory requirements applicable to conventional banks. No respondents raised objection to allowing both financial and non-financial firms to operate a virtual bank in Hong Kong and there was broad support for virtual banks to operate in the form of a locally-incorporated entity with no physical branches.

A number of respondents requested the HKMA to elaborate on some of the principles contained in the guideline. The HKMA has taken on board many of these comments and has made changes to the relevant paragraphs in the guideline. The HKMA has also taken the opportunity to respond to other matters raised in the consultation.

Since the HKMA announced its intention to encourage virtual banking in Hong Kong last September, it has received enquiries and indications of interests from over 50 companies. While it is unclear at this stage how many of these companies will eventually put in applications to operate a virtual bank, they should appreciate that the vetting and approval process entails extensive resources and efforts by both the applicants and the HKMA.

For those companies that have not been able to submit a substantially complete application to the HKMA by August 31, 2018, they are most unlikely to be included in the first batch of virtual bank applications to be processed by the HKMA. Priority will be given by the HKMA to those applicants that can show that: they have sufficient financial, technology and other relevant resources to operate a virtual bank; they have a credible and viable business plan that would provide new customer experience and promote financial inclusion and fintech development; they have developed or can develop an appropriate IT platform to support their business plan; and they are ready to commence operation soon after a license is granted.

- On July 18, 2018, the HKMA published the Open Application Programming Interface (API) Framework (Framework) for the Hong Kong banking sector. At the same time, the HKMA announced the launch of Open API on its official website on 23 July 2018 to provide convenient access by the public.

The formulation of the Open API Framework is one of the seven initiatives announced by the HKMA in September 2017 to prepare Hong Kong to move into a new era of Smart Banking. Open API can help to ensure the competitiveness of the banking sector, encourage more parties to provide innovative and integrated services that improve customer experience, and keep up with worldwide development on the delivery of banking services.

- On November 1, 2018, the SFC issued a statement setting out a new approach that aims to bring virtual asset portfolio managers and virtual asset fund distributors under its regulatory net. It also sets out a conceptual framework for the potential regulation of virtual asset trading platforms.

The SFC will adopt new measures within its regulatory remit to protect those who invest in virtual asset portfolios or funds. It will also impose licensing conditions on firms that manage portfolios investing in virtual assets, irrespective of whether the virtual assets meet the definition of "securities" or "futures contracts". In an accompanying circular, the SFC provides detailed guidance and reminds firms that distribute funds investing in virtual assets that they should be registered with or regulated by the SFC and comply with its regulatory requirements, including the suitability obligations.

Under this framework, the SFC will explore whether virtual asset trading platforms are suitable for regulation in the SFC Regulatory Sandbox. If it is decided that it is appropriate to regulate platform operators, the SFC would then consider granting a license and putting them under its close supervision. Alternatively, it may take the view that the risks involved cannot be sufficiently addressed and no license shall be granted as protection for investors cannot be ensured.

- On December 7, 2018, the HKMA provided an update on the processing of virtual banking applications, announcing earlier that around 30 applications had been received as at the end of August 2018. About one-third of these applicants did not submit sufficient information on certain critical aspects of authorization criteria. Subsequently, the HKMA has informed these applicants that their applications will not be further processed.

As for the remaining applications, the HKMA will shortlist about one-third of them for the next stage of assessment. This batch of applicants should be more promising or better-equipped than others in terms of their business models, technology platforms and financial capability, etc., rendering them better positioned to meet the policy objectives of the HKMA in introducing virtual banking. Such objectives include promoting fintech development, providing new customer experience and promoting financial inclusion.<sup>1</sup> The HKMA will endeavour to start granting virtual banking licence(s) in the first quarter of 2019. The HKMA does not set any specific number for virtual banking licences, and the actual number of licences to be granted ultimately will be subject to the HKMA's further assessment and due diligence process.

## 11. SFC consultation on OTC derivatives and conduct risks

- On December 20, 2017, the Hong Kong SFC launched a consultation on OTC derivatives and conduct risks. The consultation includes the following proposals:
  - Refinement of the scope of regulated activities to provide more clarity about the OTC derivatives licensing regime;
  - Proposals related to risk mitigation, client clearing and record-keeping requirements for OTC derivatives transactions; and
  - Proposals related to conduct requirements for OTC derivatives transactions (ie, requirements for licensed corporations to properly manage their financial exposures to group affiliates and other connected persons according to the same risk management standards they would apply to independent third parties).
- On January 30, 2018, the Hong Kong SFC issued a circular setting out guidance on the standards of conduct and internal controls the SFC expects of licensed corporations (LCs) in delivering best execution. This follows a thematic review of selected LCs, which assessed the effectiveness and adequacy of arrangements for delivering best execution.

The circular reminds LCs that they should execute client orders on the best available terms, as delivering best execution is fundamental to market integrity and the protection of investors who rely on LCs to act in their best interests. The SFC expects that LCs should put in place arrangements, including controls, monitoring and management supervision, to obtain the best available terms and should subject these arrangements to periodic review to ensure best execution is delivered consistently.

- On the same day, the SFC also issued a report on the thematic review of best execution, which provides detailed observations from the thematic review and highlights good industry practices for LCs to take into consideration. On December 12, 2018, the SFC released consultation conclusions on proposals to enhance the OTC derivatives regime and to address conduct risks posed by dealings with group affiliates and other connected persons.

Under the proposals, which the SFC will implement, licensed corporations that are contracting parties to non-centrally cleared OTC derivative transactions or are licensed for Type 9 (asset management) regulated activity will be subject to risk mitigation requirements. LCs providing client clearing services for OTC derivative transactions will be subject to segregation, portability and disclosure requirements.

In addition, LCs which have dealings with group affiliates and other connected persons will be subject to conduct requirements to ensure that risks are properly managed, they act in clients' best interest and appropriate risk disclosure is provided.

The risk mitigation requirements will become effective on 1 September 2019, while the client clearing requirements will become effective when the new Types 11 and 12 regulated activities take effect. The conduct requirements to address risks posed by group affiliates and other connected persons will become effective six months after the gazettal of the Code of Conduct amendments.

- On December 12, 2018, the SFC released consultation conclusions on proposals to enhance the OTC derivatives regime and to address conduct risks posed by dealings with group affiliates and other connected persons.

Under the proposals, which the SFC will implement, licensed corporations that are contracting parties to non-centrally cleared OTC derivative transactions or are licensed for Type 9 (asset management) regulated activity will be subject to risk mitigation requirements. Licensed corporations providing client clearing services for OTC derivative transactions will be subject to segregation, portability and disclosure requirements.

In addition, licensed corporations which have dealings with group affiliates and other connected persons will be subject to conduct requirements to ensure that risks are properly managed, they act in clients' best interest and appropriate risk disclosure is provided.

The amendments to the Code of Conduct will be gazetted on 14 December 2018. The risk mitigation requirements will become effective on 1 September 2019, while the client clearing requirements will become effective when the new Types 11 and 12 regulated activities take effect. The conduct requirements to address risks posed by group affiliates and other connected persons will become effective six months after the gazettal of the Code of Conduct amendments.

## **12. Margin requirements for non-centrally cleared derivatives**

- On June 19, 2018, the SFC launched a two-month consultation on proposed margin requirements for non-centrally cleared OTC derivatives for licensed corporations (LCs). The key requirements include:
  - The proposed variation margin (VM) requirements apply to an LC as a contracting party where the average aggregate notional amount (AANA) of non-centrally cleared OTC derivatives of the LC or its group exceeds HK\$15 billion.
  - The proposed initial margin (IM) requirements apply to an LC where the AANA on a group basis exceeds HK\$60 billion.
  - VM requirements do not apply to physically-settled FX forwards and swaps, except when an LC is transacting with certain types of financial counterparty (including another LC, an authorised institution or an entity that carries on banking, securities, derivatives or asset management business outside of Hong Kong).
  - Subject to certain exceptions on asset eligibility, SFC considers the HKMA current margin requirements to be comparable to its proposed requirements. SFC also proposes to allow substituted compliance for regimes for which the SFC or HKMA has issued a comparability determination or Working Group on Margining Requirements jurisdictions until a comparability assessment is completed by the SFC/HKMA.
  - IM requirements are to be phased in from September 1, 2019, starting from a threshold of HK\$6 trillion and becoming permanent from September 1, 2020 with a threshold of HK\$60 billion.
  - VM requirements will take effect from September 1, 2019.

### **13. Statement of Commitment to the Foreign Exchange Global Code**

- On May 28, 2018, the HKMA issued today the Statement of Commitment (Annex) to the Foreign Exchange Global Code. By issuing the Statement, the HKMA demonstrates its commitment to adhering to the Code when acting as a market participant in the foreign exchange market.

### **14. SFC consults on money laundering and counter-terrorism guidelines**

- On July 5, 2018, the SFC launched a consultation on proposals to amend its guideline on anti-money laundering and counter-terrorism financing to keep it in line with international standards.

The proposed amendments expand the types of politically exposed persons to include customers who have been entrusted with a prominent function by an international organization. The SFC has also proposed to streamline the identification and verification processes for onboarding customers to allow flexibility for licensed corporations to adopt reasonable risk-based measures and determine the extent to which each individual's identification information would need to be verified. Licensed corporations may use appropriate technology for non-face-to-face account opening if they can ensure and demonstrate that there are adequate safeguards against impersonation risk.

Comments on the consultation are due by August 9, 2018.

### **15. SFC concludes consultation on amendments to the Code on Unit Trusts and Mutual Funds**

- On December 6, 2018, the SFC released consultation conclusions on proposed amendments to the Code on Unit Trusts and Mutual Funds (UT Code).

The SFC will implement the proposals set out in the consultation paper with some modifications and clarifications. These include modifications to the calculation method for funds' derivatives investments and clarification of the enhanced obligations of trustees and custodians. Consequential amendments to other SFC Codes will also be implemented, with appropriate modifications. The revised Codes will become effective after gazettal, tentatively on 1 January 2019. The SFC will publish frequently asked questions to provide further guidance to the industry regarding the implementation and transition arrangements for the revised UT Code.

### **ISDA Submissions**

January 20, 2017: [ISDA submission to HKMA Consultation on an Effective Resolution Regime for Financial Institutions in Hong Kong: Regulations on Protected Arrangements](#)

March 31, 2017: [ISDA submission to HKMA and SFC requesting relief in relation to OTC derivative reporting obligations in respect of Delta One Warrants, and additional entries in the Securities and Futures \(Stock Markets, Futures Markets and Clearing Houses\) Notice.](#)

May 15, 2017: [ISDA submission to Hong Kong Monetary Authority in relation to Consultation Paper on Implementation of Basel III Leverage Ratio Framework](#)

May 26, 2017: [ISDA response to HKMA and SFC consultation on the Prescription of Additional Markets and Clearing Houses and Prescription of Delta One Warrants under the OTC Derivatives Regulatory Regime.](#)

July 3, 2017: ISDA response to SFC Soft Consultation on Proposed Requirements on Risk Mitigation, Client Clearing and Record Keeping. This submission is not yet public.

August 24, 2017: [ISDA submission to SFC Further consultation on Proposed Changes to the Securities and Futures \(Financial Resources\) Rules](#)

August 30, 2017: [ISDA submission to Australian Securities and Investments Commission / Hong Kong Monetary Authority in relation to Implementation of an APAC Unique Transaction Identifier \(UTI\)](#)

October 13, 2017: ISDA response to SFC Soft Consultation on Proposed Margin Requirements on Non-Centrally Cleared OTC Derivative Transactions. This submission is not yet public.

16 January 2018: [ISDA submission to the HKMA and SFC on Phase 2 reporting issues](#)

20 February 2018: [ISDA submission to the SFC on OTC derivatives regime and conduct risk requirements](#)

27 April 2018: [ISDA submission to the joint HKMA-SFC consultation on further enhancements to the OTC derivatives regime in Hong Kong](#)

17 August 2018: [ISDA submission to SFC on the OTC derivatives regime for Hong Kong – Proposed margin requirements for non-centrally cleared OTC derivative transactions](#)

# INDIA

## AT A GLANCE

Central Bank:	Reserve Bank of India (RBI) <a href="http://www.rbi.org.in">http://www.rbi.org.in</a>
Bank Regulator:	RBI
Securities/Futures/ Commodity Regulator:	Securities and Exchange Board of India (SEBI) <a href="http://www.sebi.gov.in">http://www.sebi.gov.in</a>
Associations:	Fixed Income Money Market and Derivatives Association (FIMMDA) Foreign Exchange Dealers' Association of India (FEDAI) Primary Dealers Association of India (PDAI)
Master Agreement:	ISDA
Legal Opinions:	Netting and collateral (including collateral taker and collateral provider), client clearing (clearing members reliance) and e-contracts opinions by Juris Corp  Opinion on transactions entered into electronically and electronic records by Juris Corp
CCP/TR Status:	<p>The Clearing Corporation of India Ltd , CCIL clears inter-dealer USD-INR FX spots and forwards, INR interest rate swaps (IRS), and forward rate agreements (FRA). FX forwards mandatory clearing began in June 2014.</p> <p>Reporting to CCIL of inter-dealer INR IRS, FRA and credit default swap (CDS) trades and INR and foreign currency FX forwards, swaps and currency options is required. Reporting of client trades in FX forward and options above a reporting threshold is also required.</p> <p>The European Securities and Markets Authority (ESMA) recognised CCIL as a third country CCP on March 29, 2017., thus allowing CCIL to provide clearing services to clearing members or trading venues established in the EU.</p> <p>ESMA recognised Indian Clearing Corporation Limited (ICCL), NSE Clearing Limited (NSCCL) and Metropolitan Clearing Corporation of India Limited (MCX-SXCCL) as third country CCPs on September 27, 2017, thus allowing them to provide clearing services to clearing members or trading venues established in the EU.</p> <p>The US Commodity Futures Trading Commission (CFTC) issued a letter of no-action relief to CCIL pending an application for exemption from registration as a derivatives clearing organization (DCO) on August 18, 2014, valid until December 31, 2014. On December 18, 2014, the no-action relief was extended until December 31, 2015. CCIL has applied for DCO-exemption, which is pending as of date.</p> <p>The Bank of England (BoE) added CCIL and MCX-SXCCL to the interim list of third-country CCPs that will offer clearing services and activities in the UK under the Temporary Recognition Regime (TRR) if the UK leaves the EU with no implementation period.</p>

## Key Regulatory Milestones

### 1. CCIL Developments

- On January 2, 2017, the Clearing Corporation of India Limited (CCIL) issued a consultation paper to discuss risk containment measures related to settlement bank default risks, and proposals for how the residual settlement risks, if any, will be mutualised among members and CCIL for the USD-INR

segment. This development is in line with the Principles for Financial Market Infrastructures requirement for central counterparties to monitor and manage the concentration of credit and liquidity exposures to their commercial settlement banks.

CCIL had proposed the following risk management measures for the USD-INR segment:

- Use multiple settlement banks simultaneously;
- Explore the option of insurance cover to meet losses on account of settlement bank failures; and
- Use a portion of CCIL's 'skin in the game' to meet losses on account of settlement bank failures.

CCIL had also proposed the methodology for allocation of losses on account of settlement bank failure under the following scenarios:

- Settlement bank fails before the net obligations for the settlement day are computed;
  - Settlement bank fails after the net obligations for the settlement day are computed and advised to members, and before INR settlements are completed;
  - Settlement bank fails after the net obligations for the settlement day are computed and advised to members, INR settlements are completed and USD pay-outs have not commenced yet; and
  - Settlement bank fails after the net obligations for the settlement day are computed and advised to members and after INR settlements are completed and USD pay-outs have commenced.
- On January 6, 2017, CCIL issued a consultation paper on optimising segmental default fund contributions.

The consultation paper proposes to create a structure where member default fund shortfalls are covered by CCIL by optimising the movement of cash or securities from members to CCIL for meeting their default fund obligations. There will be no change in the existing model of segregated default funds in different segments. However, the structure will provide for the deficit in the default fund for a segment to be met using the surplus in the default fund from any other segments.

For segments other than the collateralised borrowing and lending obligation (CBLO) segment, it also provides for meeting such shortfall using the surplus balance, if any, in the securities segment settlement guarantee fund (SGF). If the shortfall is observed in the default fund for the CBLO segment, it may also be adjusted by accessing the surplus unencumbered collateral deposited by such member towards the initial margin or borrowing limit.

In case of a shortfall in the default funds of more than one segment, this will be replenished from the surplus balances in the default funds of other segments. However, depending on market contingencies, such surplus balance may also be utilised to meet the shortfall in the default fund of specific segments only. This allotment will be done as soon as a shortfall is encountered in the default fund, and the utilisation of excess balance from the other default fund will be released if additional securities or cash is made available over and above the actual requirement in the default fund that had the shortfall.

- On February 14, 2017, CCIL issued a consultation paper on recovery tools at the end of the prefunded default waterfall. It proposes recovery tools to replenish the default fund when default fund resources are exhausted. These recovery tools include:

- Auction (first round) with prefunded resources;
- Cash call in proportion to default fund contributions;
- Auction (second round) with contributed resources;
- Forced allocation of residual positions of the defaulter to non-defaulters; and
- Tear up of all positions of members who failed to honor the margin obligations on account of forced allocation.

Comments on these proposals were due by March 15.

- On August 22, 2017, CCIL announced that, effective from September 25, it will allow USD settlement through multiple settlement banks simultaneously for the foreign exchange (FX) settlement segment. This approach reduces the exposure on a single settlement bank and will allow members to settle in the settlement bank of their preference.

CCIL will use the two existing settlement banks and members will be advised as and when new settlement banks are added. The revised settlement process under the multiple settlement bank model is as follows:

- Members should identify one settlement bank for the purpose of USD settlement in the specified format by September 20;
  - Members having USD pay-in obligations with CCIL should remit their USD funds to the settlement account identified once the net obligations are calculated; and
  - Members having USD pay-out obligations with CCIL will also receive their USD funds in their nostro account from CCIL's settlement account. CCIL will initiate the USD payouts on receipt of INR settlement confirmation from the Reserve Bank of India.
  - The FX settlement segment regulations have been changed to reflect this multiple settlement bank model.
- On April 17, 2018, CCIL issued a consultation paper proposing:
    - Revisions to the methodology for sizing of the default fund in the rupee derivatives and the forex forwards segments; and
    - Restructuring the composition of collateral towards the default fund in all segments.

The proposals include moving from a 'cover 1' requirement to a 'cover 2' requirement for sizing the default fund for the rupee derivatives and FX forwards segments, in a phased manner over a two year period. CCIL's skin-in-the-game (SIG) for these segments will be pegged at 25% of the member contributed default fund, subject to the total SIG requirement across all clearing segments not exceeding the balance in the settlement reserve fund.

CCIL also proposes to introduce a minimum cash contribution requirement of 5% of the default fund requirements for all segments. The balance default fund contribution can be held in the form of securities from amongst a list of eligible securities notified by CCIL. Members have the option to maintain their entire default fund contribution in the form of cash.

Comments on the consultation were due by May 31, 2018.

- On April 17, 2018, CCIL issued a consultation paper proposing the introduction of concentration margin in the rupee derivatives and the FX forwards segments. CCIL proposes to charge concentration margin to participants having initial margin (IM) requirements greater than a pre-determined threshold. CCIL proposes to set this threshold level at 10%, and it will be reviewed on a semi-annual basis. At the end of each month, this threshold will be applied on the average daily total (market wide) IM requirement of all members in the segment in the month, to arrive at the absolute threshold level applicable for the next month.

CCIL proposes that the concentration margin be charged as a percentage of IM, initially 15% of the IM on breaching the threshold level. The concentration margin will be released when the IM requirement for the participant falls below the second threshold level, which is proposed to be 8% of the average daily total of market wide IM. These rates will be reviewed by CCIL on a semi-annual basis. Comments on the consultation were due by May 31, 2018.

- On September 28, 2018, CCIL announced that, following relevant approvals from the RBI, a number of amendments have been made to the regulations for all market segments. These amendments include:
  - Revision to the default fund and default waterfall mechanism;
  - Provision for loss mutualization in the event of settlement bank failure; and
  - Changes to the default handling procedure to maintain uniformity across all segments.

These amendments are effective on October 29, 2018.

## **2. RBI Developments**

- On January 17, 2017, the Reserve Bank of India (RBI) issued the Master Directions on Access Criteria for Payment Systems, which update all the instructions issued before December 31, 2016.
- On February 2, 2017, the RBI published revised draft directions on commercial papers (CPs). The revised guidelines broaden access to CPs, strengthen disclosure requirements by issuers of CPs, review the role of issuing and paying agents (IPAs), and put in place an information dissemination mechanism. Comments on these revised guidelines were due by February 24, and the final guidelines will be issued after taking into account the feedback received.
- On February 2, 2017, the RBI issued a circular permitting non-resident Indians (NRIs) access to the exchange-traded currency derivatives (ETCD) market. At present, NRIs are permitted to hedge their Indian rupee currency risk through OTC transactions with authorised dealer banks. The amendments to the applicable regulations have been notified in the Official Gazette, and are effective on February 2.
- On February 16, 2017, the RBI issued a circular withdrawing the requirement for banks to submit the fortnightly return on forward rate agreements (FRA) and interest rate swaps (IRS). Banks are no longer required to send a hardcopy of this return to the RBI. However, the existing procedure for reporting OTC foreign exchange and interest rate derivative transactions to the trade repository hosted by the CCIL will continue.

- On March 21, 2017, the RBI issued final guidelines to provide greater flexibility for hedging the currency risk arising from current account transactions of Indian subsidiaries of multinational companies. The final guidelines apply to all over-the-counter or exchange-traded currency derivatives that the Indian subsidiary is eligible to undertake under the Foreign Exchange Management Act, 1999 (FEMA 1999).

These final guidelines are further to the draft guidelines issued on November 4, 2016. The relevant schedules of FEMA 1999 have been amended to reflect these hedging guidelines, effective immediately.

- On April 6, 2017, the RBI released a statement on the progress of various developmental and regulatory policy measures announced by the RBI, and set out new measures for further refining the liquidity management framework, strengthening banking regulation and supervision, broadening and deepening financial markets, and extending the reach of financial services by enhancing the efficacy of the payment and settlement systems. The measures include:
  - Countercyclical capital buffer: this was put in place by the RBI under guidelines issued in February 2015, where it was advised it would be activated as and when the circumstances warranted it. Based on the review, it is not necessary to activate the buffer at this point in time.
  - Simplified hedging facility for forex exposure: draft guidelines were published on August 25, 2016. The RBI announced a scheme to permit resident and non-resident entities exposed to exchange rate risk to undertake hedging transactions with simplified procedures up to a limit of \$30 million at any given time.
  - Draft guidelines on the proposed scheme are to be issued by mid-April 2017 for public feedback.
- On April 7, 2017, the RBI released a discussion paper on wholesale and long-term finance banks. The discussion paper explores the scope for setting up such banks in the context of having issued in-principle approvals and licences to set up differentiated banks, such as payments banks and small finance banks.

These banks will focus primarily on lending to the infrastructure sector and small, medium and corporate businesses. They will also mobilise liquidity for banks and financial institutions directly, through securitisation of priority sector assets and actively dealing in them as market-makers. They may also act as market-makers in securities, such as corporate bonds, credit derivatives, warehouse receipts and take-out financing. Comments on the discussion paper were due by May 19.

- On April 11, 2017, the RBI released a draft framework for the introduction of tri-party repo. Tri-party repo will enable market participants to use underlying collateral more efficiently, and will facilitate development of the term repo market in India. The draft framework allows the introduction of tri-party repo on both government securities and corporate bonds.
- On April 12, 2017, the RBI released draft guidelines for a simplified hedging facility for residents and non-residents. The facility permits dynamic hedging of currency risk and streamlines the procedure for booking hedge contracts. Under the draft guidelines, the facility will be available to resident entities with foreign currency exposures and non-resident entities with Indian rupee exposures, other than

individuals, arising out of transactions permitted under the Foreign Exchange Management Act, 1999 (FEMA, 1999), of up to US\$30 million or the equivalent, in order to hedge underlying exchange rate risk. Comments on the draft guidelines were due by May 5.

- On August 2, 2017, the RBI released a statement on developmental and regulatory policies. It reviewed the progress of various developmental and regulatory policy measures and also sets out new measures. These included:
  - Amendment to liquidity coverage ratio (LCR) guidelines: The LCR guidelines have been amended to recognise cash reserves, in excess of the reserve requirement, held by banks incorporated in India with a foreign central bank as a level one high-quality liquid asset (HQLA).
  - Simplified hedging facility: The simplified hedging facility was first announced by the RBI in August 2016, and the draft guidelines were released in April 2017. This facility aims to simplify the process for hedging exchange rate risk by reducing the documentation requirements and avoiding prescriptive stipulations regarding products, purpose and hedging flexibility. The circular to operationalise the facility will be released after the relevant foreign exchange regulations are amended.
  - Separate limit on interest rate futures (IRFs) for foreign portfolio investors (FPIs): RBI proposes to allocate FPIs a separate limit of INR 5,000 crore for long positions in IRFs. The limits prescribed for investment by FPIs in government securities will then be exclusive of IRFs. FPI access to IRFs for hedging purposes will continue as before. The circular for these changes will be issued after consultation.
  - Tri-party repo: Tri-party repo will likely contribute to better liquidity in the corporate bond repo market, thereby providing markets an alternate repo instrument to government securities repo. The draft guidelines on the introduction of tri-party repo were released in April 2017, and the feedback has been reviewed. The final circular on tri-party repo is expected to be issued in mid-August 2017.
- On August 10, 2017, the RBI issued final guidelines for the use of tri-party repos by eligible participants. Tri-party repo may be traded over-the-counter (OTC), including on electronic platforms or on stock exchanges, using any trading process authorised by the RBI. All tri-party repos should be reported within 15 minutes of the trade for public dissemination to the Clearing Corporation of India Limited, CCIL, or to exchanges or any other reporting platform authorised by the RBI.

All tri-party agents need prior authorisation from the RBI. Commercial banks, recognised stock exchanges and clearing corporations of stock exchanges, or clearing corporations authorised under the Payment and Settlement Systems Act (PSS Act) are eligible to be tri-party agents. Other entities regulated by the RBI or SEBI are eligible, subject to meeting certain criteria. Participants should enter into standard bilateral master repo agreements unless the agent provides a multilateral trading platform. Separate agreements between a participant and a tri-party agent will be required, to be prescribed by the tri-party agent. These guidelines are effective immediately.

- On October 12, 2017, the RBI announced that it has decided to permit non-resident importers and exporters entering into Indian rupee (INR) invoiced trade transactions with residents to hedge their INR exposures through their centralised treasury or group entities with authorised banks in India. The authorised banks can opt for either the existing model I or model II outlined by the RBI. This initiative broadens the scope of the previous initiative announced in March 2017, which permitted non-resident

centralised treasuries of multinational companies to hedge the INR risk on current account transactions of their Indian subsidiaries.

- On October 12, 2017, the RBI released a discussion paper on a proposed foreign exchange trading platform for retail participants. The discussion paper proposes developing a foreign exchange platform for retail participants, along the lines of the FX-Clear platform of , CCIL, in order to encourage transparent and fair pricing in the retail foreign exchange market.

The proposed platform would provide retail market participants access to an electronic trading platform where bids and offers from customers and banks can be matched anonymously and automatically. This is likely to provide transparency while enhancing competition, leading to better pricing for all types of customers without differentiating them on the basis of order size. Direct execution by the customer is also likely to bring down the cost of transactions, as there is no market risk to the customer's bank apart from settling the interbank trade through the settlement system. Banks may charge their customers a fee towards processing expenses, which should be public. Comments on the discussion paper were due by January 1, 2018.

- On October 12, 2017, the RBI released draft directions for a framework for authorising electronic trading platforms (ETPs) for financial market instruments regulated by the RBI. These directions are intended to have the following broad objectives:
  - Development of the market through transparent trading, safe settlement systems and standardisation of instruments;
  - Promoting fair, equitable, orderly and non-discriminatory access to markets;
  - Preventing market abuse and ensuring financial integrity through effective monitoring and surveillance; and
  - Improving dissemination of trading information and thereby reducing information asymmetry.

The draft directions cover the following areas:

- Definitions of an ETP, ETP operator, eligible instruments and approval;
- Eligibility criteria for entities owning and operating ETPs, including general and financial criteria, experience and technological criteria;
- Systems, controls and risk management;
- Authorisation for clearing and settlement services;
- Information technology and information security requirements;
- Data reporting, usage and preservation;
- Termination of operation; and
- Application procedure for authorisation.

The draft directions also indicate that an ETP operator authorised under these directions may be granted exemption, for a period as decided by the RBI, from any one or more of the provisions of these directions if the RBI is satisfied that the need for such exemption is justified from the point of view of market development. Comments on these draft directions were due by November 10, 2017.

- On November 9, 2017, the RBI issued final guidelines on the simplified hedging facility. This follows the draft guidelines that were issued in April 2017 for public consultation, and are being introduced to

simplify the process for hedging exchange rate risk by reducing documentation requirements and avoiding prescriptive stipulations regarding products, purpose and hedging flexibility. Under the final guidelines, the facility will be available to resident and non-resident entities, other than individuals, wishing to hedge exchange rate risk on contracted or anticipated transactions permitted under the Foreign Exchange Management Act, 1999, of up to \$30 million or its equivalent. Hedging is permitted through any over-the-counter derivatives or exchange-traded currency derivative permitted under the act. These guidelines are effective January 1, 2018.

- On November 16, 2017, the RBI released the working group report on hedging of commodity price risk. The report reviews the existing guidelines for hedging commodity price risk by residents in overseas markets, and suggests broad principles and a modified framework for overseas hedging of commodity risks. The recommendations include:
  - Removing differentiated access based on whether an entity is engaged in domestic or international trade and move to a risk-based framework;
  - A 'positive list' of commodities that can be hedged in the overseas markets by all residents, with the eventual aim of letting any resident entity hedge the price risk of any commodity to which it is exposed;
  - Inventory hedging be permitted to all entities exposed to price risk for any commodity on the 'positive list' if they meet the following conditions: both the cost of the input and the price of the output are variable, and the output price is linked to international prices;
  - Price fix hedging be permitted in addition to offset hedging to entities that are faced with a variable price on either input or output, but not both;
  - Allow hedging in overseas commodity exchanges due to transparency in pricing. However, if the risk profile so warrants, hedging in the over-the-counter overseas market may be allowed, but only with regulated entities, preferably banks, as counterparties operating in acceptable jurisdictions specified by RBI;
  - In view of the complexity involved in assessing the indirect commodity risk of the user, hedging of only direct commodity price risk may be allowed for now;
  - Hedging by domestic buyers/sellers of the currency risk resulting from their overseas commodity hedging may be permitted as it will enable effective and complete hedging of international commodity price risk;
  - Residents who hedge their commodity price risk in overseas market should be encouraged to partly and progressively hedge their risks on domestic exchanges; and
  - With respect to the domestic sale or purchase of commodities in the 'positive list', unlisted entities may be permitted to hedge commodity risk overseas with the approval of their bank. Subsequently, if and when banks are permitted by RBI to deal in commodity derivatives, unlisted entities may hedge with the banks as the counterparty.

The report also discusses the role of banks in commodity hedging, and recommends that domestic banks and/or their subsidiaries active in capital markets be allowed to offer commodity hedging, initially on a back-to-back basis. Eventually, banks may be allowed to run a book in commodity derivatives within the umbrella limit of 20% of net owned funds applicable for investment in equities, venture capital funds and equity linked mutual funds. Comments on the report were due by December 15, 2017.

- On January 12, 2018, the RBI issued draft directions on the hedging of commodity price risk and freight risk in overseas markets for public consultation. The draft directions provide operational

guidelines for hedging direct and indirect commodity price risk and exposure to freight risk in overseas markets by authorised banks. It also propose that permitted instruments include exchange traded futures and options and over-the-counter derivatives. The draft directions also delegate the decision regarding the quantity and tenor to be hedged to the client (subject to the satisfaction of the authorised bank), and introduces a facility for hedging of indirect commodity price risk for selected metals.

- On February 7, 2018, the RBI released a statement on developmental and regulatory policies. It reviews the progress of various developmental and regulatory policy measures and also sets out new measures.

This includes:

- With a view to ease the access of non-residents to the onshore market for their foreign exchange hedging requirements, the RBI proposes to allow them to dynamically hedge their currency and interest rate exposures onshore using any permitted instruments. The circular to this effect will be released after the necessary changes to the Foreign Exchange Management Act, 1999 regulations have been notified by the government.
- In order to encourage further participation in the exchange traded currency derivatives (ETCD) market, it is now proposed to merge position limits across all currency pairs and provide a single limit of \$100 million per user (both resident and non-resident) across all ETCD, combined across all exchanges. The circular to this effect will be released shortly.

Financial Benchmarks India Limited will be responsible for standardising the valuation of government securities and be responsible for computing and disseminating the daily reference rate for spot USD/INR and other major currencies against the INR, which is currently being done by the RBI. The effective dates for implementation of these two functions will be indicated by Financial Benchmarks India and the Reserve Bank.

- On February 26, 2018, the RBI announced revisions in limits for the exchange-traded currency derivatives (ETCD) market. The RBI will now permit resident Indians and foreign portfolio investors to take long or short positions up to a single limit of \$100 million or its equivalent, without having to establish the underlying exposure. This limit is combined across all currency pairs involving INR and combined across all exchanges. These limits will be monitored by the exchanges and any breaches may be reported to the RBI.
- On March 1, 2018, the RBI announced a revision in the limits for investment in interest rate futures (IRFs) for foreign portfolio investors (FPIs). To facilitate market development and to ensure that FPIs continue to have access to the IRF market, FPIs will now have a separate limit of INR 5,000 crores for long positions in IRFs. The current limits for FPI investment in government securities remain unchanged and will now be exclusive to investment in government securities.

The relevant RBI directions have been amended to reflect this change. The detailed operational guidelines for this revision will be issued separately by the Securities and Exchange Board of India.

- On March 12, 2018, the RBI issued final directions on hedging of commodity price risk and freight risk in overseas markets. The final directions provide guidelines for hedging direct and indirect commodity price risk and exposure to freight risk in overseas markets by authorised banks.

Hedging of direct commodity price risk may be undertaken for all commodities (except gold, gems, and precious stones), while hedging of indirect commodity price risk may be undertaken for selected metals, which will be reviewed annually. Permitted instruments include exchange traded products, over-the-counter derivatives and structured products. Other operational guidelines are also included in the final directions. These final directions are effective on April 1, 2018.

- On June 6, 2018, the RBI released a statement on developmental and regulatory policies. It reviews the progress of various developmental and regulatory policy measures and also sets out new measures. This includes:
  - Increase in the liquidity coverage ratio (LCR) carve-out from statutory liquidity ratio (SLR): Banks will now be permitted to use government securities held by them as Level 1 high quality liquid assets (HQLAS) up to an additional 2% of their NDTL under the facility to avail liquidity for liquidity coverage ratio (FALLCR), for the purpose of computing LCR. The total carve-out from SLR available to banks will now be 13% of their NDTL. There are no changes to other LCR guidelines.
  - Market abuse regulations: The RBI proposes to introduce regulations to prevent market abuse that are in line with global best practices. Draft regulations for consultation will be issued by the end of August 2018.
  - Policy framework for central counterparties (CCPs): In order for CCPs to function in an efficient and effective manner, the RBI will develop a framework for the recognition of foreign CCPs, as well as the capital requirements and governance framework for all CCPs. These regulations will be issued by the end of July 2018.
- On June 14, 2018, the RBI announced it will permit interest rate swaptions in Indian rupees. This decision is in line with the RBI statement on developmental and regulatory policies issued in April, and will provide market participants better flexibility to hedge their interest rate risk. The relevant directions on interest rate options have been updated accordingly, and became effective June 15, 2018.
- On August 1, 2018, the RBI released a statement on the progress of various developmental and regulatory policies, including a:
  - Review of the Foreign Exchange Management (Foreign Exchange Derivative Contracts) Regulations, 2000 (FEMA 25): The RBI proposes to undertake a comprehensive review in consultation with the Government of India in order to reduce the administrative requirements for derivative transactions, allow dynamic hedging and allow Indian multinationals to hedge the currency risks of their global subsidiaries from India. A draft circular of the revised guidelines will be released for public comment by the end of September; and
  - Review of market timings: Based on requests received from market participants to extend the market timings for certain market segments, the RBI proposes to set up an internal group to

review the timings of various markets and the necessary payment infrastructure for supporting the recommended revisions. The group will submit a report by the end of October 2018.

- On October 5, 2018, the RBI released a statement on developmental and regulatory policies that reviews the progress of various developmental and regulatory policy measures and also sets out new measures. Such new measures include the regulation of financial benchmarks. To improve the governance of the benchmark process, the RBI proposes to introduce a regulatory framework for financial benchmarks. This framework will apply initially to benchmarks issued by Financial Benchmarks of India Ltd. Draft regulations will be issued by the end of October 2018.
- On October 5, 2018, the RBI released the final directions for authorizing electronic trading platforms (ETPs) to transact in eligible instruments, to encourage trading on electronic platforms to enhance pricing transparency, processing efficiencies, and risk control. This follows the draft directions that were released for public comment in October 2017. The final directions cover the following areas:
  - ETPs will mean any electronic system, other than a recognised stock exchange, on which transactions in eligible instruments are undertaken;
  - Eligible instruments will mean securities, money market instruments, foreign exchange instruments, derivatives, or other instruments that may be specified by the RBI under section 45W of the Act, 1934;
  - No entity shall operate an ETP without obtaining prior authorization from the RBI under these ETP directions; and
  - Electronic trading platforms operated by banks for their customers (acting as users) on a bilateral basis are exempt from the provisions of these ETP directions, provided that such platforms do not extend direct or indirect access to market makers in any market for eligible instruments, which would include, for the purpose of foreign exchange transactions, authorised dealers.

These directions became effective on October 5, 2018. ETPs existing and operating on or before the commencement of these directions should make an application for authorization within a period of six months from the date of these directions.

### **3. SEBI Developments**

- On January 20, 2017, the Securities and Exchange Board of India (SEBI) issued a proposal to revise the relevant stock exchanges and clearing corporations' regulations to facilitate the launch of commodity derivatives, including options.

One of the main proposals being considered is options with commodity futures contracts as underlying and the option to settle by devolving into the commodity futures contracts on expiry. This form of a "derivative of a derivative" has not been tried in the Indian derivatives market so far, however, it is most prevalent and accepted with commodity derivatives exchanges globally. While this proposal seems to be most suitable for agricultural commodities in India, where cash settlement is not appropriate due to the lack of availability of robust spot market prices of the underlying commodity, there is a need to assess whether the Indian commodity derivatives markets are ready for such complex products.

- On January 20, 2017, SEBI issued a circular outlining the framework for the eligibility, retention and re-introduction of derivative contracts on commodities. This framework has been developed based on the recommendation of the Commodity Derivatives Advisory Committee (CDAC) and in consultation with stakeholders, and is summarised below:
  - Eligibility criteria for allowing derivative contracts on commodities: This includes basic parameters such as commodity fundamentals, trade factors, ease of doing business and risk management.
  - Applicability of the template on the commodities presently being traded: The eligibility criteria above should be applied to all commodities that are currently being traded on exchanges, and the results submitted to SEBI within three months.
  - Criteria for retention and reintroduction of derivative contracts on commodities: For any commodity to continue to be eligible for futures trading on an exchange, it should have an annual turnover of more than INR 500 crore across all national commodity derivatives exchanges in at least one of the last three financial years. Once a commodity becomes ineligible for derivatives trading due to not satisfying the retention criteria, the exchanges shall not reconsider such a commodity for re-launching contracts for a minimum period of one year. In addition, a commodity which is discontinued or suspended by an exchange from derivatives trading shall not be reconsidered by the exchange for re-launching contracts for a minimum period of one year.

These provisions became effective on January 20, except for the third provision above, which came into effect on April 1, 2017.

- On February 20, 2017, SEBI issued a circular permitting mutual funds to access the derivatives market.

For mutual funds whose scheme information documents do not currently envisage investments in derivatives, the requirement of obtaining positive consent from majority of unit holders shall no longer be applicable based on the recommendations of the Mutual Fund Advisory Committee. However, prior to the mutual fund scheme commencing participation in derivatives, all investors of such schemes shall be given exit option with no exit load for 30 days. This circular is applicable immediately.

- On February 28, 2017, SEBI issued a circular announcing that foreign portfolio investors (FPIs) are now permitted to invest in unlisted corporate debt securities and securitised debt instruments meeting certain criteria. Investment by FPIs in these unlisted corporate debt securities and securitised debt instruments should not exceed INR 35,000 within the corporate debt limit. Furthermore, investment by FPIs in securitised debt instruments shall not be subject to the minimum three-year residual maturity requirement.

All other existing terms and conditions for FPI investments in corporate debt securities shall continue to apply. This circular is effective immediately.

- On April 18, 2017, SEBI issued a circular reviewing the framework of position limits for interest rate futures contracts. The circular clarifies that the position limit linked to open interest for interest rate futures shall be applicable at the time of opening a position. Such positions will not be required to be

unwound immediately by the market participant in the event of a drop in total open interest in interest rate futures contracts within the respective maturity bucket. However, market participants will not be allowed to increase their existing positions or create new positions in the interest rate futures contracts of the respective maturity bucket until they comply with the applicable position limits.

Notwithstanding the above, stock exchanges may direct market participants to bring down their positions to comply with the applicable position limits, in view of risk management or surveillance concerns.

- On April 26, 2017, SEBI held a board meeting, and announced the following amendments to regulations:
  - In order to enable commodity derivatives exchanges to allow the trading of options, SEBI has approved a proposal to amend the relevant provisions of Securities Contracts (Regulation) (Stock Exchanges and Clearing Corporations) Regulations, 2012. Detailed guidelines for trading in options on commodity derivatives exchanges will be issued by SEBI in due course. In order to enable commodity derivatives exchanges to allow the trading of options, SEBI has approved a proposal to amend the relevant provisions of Securities Contracts (Regulation) (Stock Exchanges and Clearing Corporations) Regulations, 2012. Detailed guidelines for trading in options on commodity derivatives exchanges will be issued by SEBI in due course.
  - SEBI has amended SEBI(Foreign Portfolio Investor) Regulations, 2014, to include a provision that prevents resident Indians and non-resident Indians, or the entities that are beneficially owned by resident Indians or non-resident Indians, from subscribing to offshore derivatives instruments.
  - Under the existing Securities Contracts (Regulation) Rules, 1957 (SCR Rules) and SEBI (Stock Brokers and Sub-brokers) Regulations, 1992 (Stock Brokers Regulations), a stock broker or clearing member dealing in commodity derivatives cannot deal in other securities or vice versa, except by setting up of a separate entity. SEBI has approved the proposal to remove this restriction by amending stock-broker regulations, and to also recommend to the government to amend these rules accordingly.
- On May 31, 2017, SEBI issued a discussion paper on the draft code of conduct for index providers. The draft code of conduct has been prepared by a SEBI working group comprising market participants, and is broadly based on the International Organization of Securities Commissions (IOSCO) framework for adoption in India. The draft code prescribes a framework of standards that index providers should follow to promote the reliability of the index administration process, and to address governance, quality, transparency and accountability issues. Comments on the draft code of conduct are due by June 20.
- On June 13, 2017, SEBI announced guidelines with regard to the product design and risk management framework to be adopted for trading in options on commodity futures. These guidelines cover:
  - Product design – underlying, settlement methods, exercise style, minimum strikes, exercise mechanism, trading hours and position limits.
  - Risk management framework – exchanges should adopt risk management frameworks consistent with the Committee on Payments and Market Infrastructures and the IOSCO Principles for

Financial Market Infrastructures, including margining models and initial margin, margining for clients, computation of margin and mark to market.

SEBI also highlighted the criteria for the selection of underlying commodity futures for options, which are:

- The underlying futures contract on the corresponding commodity should be among the top five futures contracts in terms of total trading turnover value of the previous 12 months; and
- The average daily turnover of underlying futures contracts of the corresponding commodity during the previous 12 months shall be at least INR 200 crore for agricultural and agri-processed commodities, and INR 1000 crore for other commodities.

In addition, on a pilot basis, each exchange shall be allowed to launch options on futures of only one commodity that meets the criteria prescribed above. Commodity derivatives exchanges should take prior approval from SEBI prior to launching these contracts. These guidelines are effective immediately.

- On June 21, 2017, SEBI held a board meeting, and announced the following proposed changes to the foreign portfolio investors (FPI) regulations:
  - Expansion of eligible jurisdictions for grant of FPI registration by including countries having diplomatic tie-ups with India;
  - Simplification of broad-based requirements;
  - Rationalisation of fit and proper criteria; and
  - Permitting FPIs operating under the multiple investment managers structure and holding foreign venture capital investor registration to appoint multiple custodians.

There will be a public consultation process before finalising these proposals.

SEBI has also decided to levy a regulatory fee of \$1000 on each offshore derivative instruments (ODI) subscriber. The regulatory fee is to be collected and deposited by the FPI issuing the ODI for each ODI subscriber once every three years, starting from April 1, 2017. The relevant FPI regulations will be amended to reflect this fee. SEBI has also decided to prohibit ODIs from being issued against derivatives, except on those that are used for hedging purposes.

- On June 21, 2017, SEBI announced that category III alternative investment funds (AIFs) will be allowed to participate in the commodity derivatives market, subject to the following conditions:
  - AIFs may participate in all commodity derivatives products that are being traded on the commodity derivatives exchanges as clients, and will be subject to all the rules, regulations and position limit norms applicable to clients issued by SEBI and the exchanges;
  - AIFs can invest not more than 10% of the investable funds in one underlying commodity;
  - AIFs may engage in leverage or borrow subject to consent from the investors in the fund and subject to a maximum limit;
  - AIFs should disclose their investment in commodity derivatives in private placement memorandum issued to investors. The consent of existing investors should be taken if the AIF intends to invest in commodity derivatives, and an exit opportunity should be provided to dissenting investors;

- AIFs should also comply with the relevant RBI guidelines under the Foreign Exchange Management Act, 1999;
- AIFs will be subject to reporting requirements specified by SEBI; and
- Participation of AIFs in the commodity derivatives market will be subject to their compliance with the relevant SEBI regulations.

These changes are effective immediately.

- On June 28, 2017, SEBI issued a circular permitting non-resident Indians (NRIs) to participate in the exchange-traded currency derivatives (ETCD) market in order to hedge currency risk arising from investments in India under the Foreign Exchange Management Act (FEMA). This circular is in line with the Reserve Bank of India's RBI circular on the same topic issued on February 2, 2017.

NRIs are permitted to participate in the ETCD market subject to the following conditions:

- NRIs shall designate an authorised bank that is also a clearing member of the stock exchange or clearing corporation for the purpose of monitoring and reporting their combined positions in the OTC and ETCD segments;
- NRIs may take positions in the ETCD market to hedge the currency risk on the market value of their permissible INR investments (under FEMA) in debt and equity, and dividend due and balances held in NRI accounts; and
- The onus of complying with the relevant provisions of the RBI circular shall rest with the NRI. The NRI is liable to any action that may be warranted by RBI as per the provisions of FEMA 1999.

The position limits for NRIs in the permitted currency pairs are as follows:

- USD/INR: Gross open position across all contracts shall not exceed 6% of the total open interest or \$10 million, whichever is higher.
- EUR/INR: Gross open position across all contracts shall not exceed 6% of the total open interest or €5 million, whichever is higher.
- GBP/INR: Gross open position across all contracts shall not exceed 6% of the total open interest or £5 million, whichever is higher.
- JPY/INR: Gross open position across all contracts shall not exceed 6% of the total open interest or ¥200 million, whichever is higher.

This circular is effective immediately.

- On June 28, 2017, SEBI issued a consultation paper proposing amendments to the relevant SEBI regulations to ease access norms for investment by foreign portfolio investors (FPIs). The proposals include:
  - Expansion of eligible jurisdictions to grant FPI registration by including countries that have diplomatic relations with India and are Foreign Exchange Management Act compliant;
  - Simplifying the "broad based" requirements and "fit and proper" criteria;
  - Discontinuing requirements to seek prior approval from SEBI in case of a change in local custodian or designated depository participant (DDP), and relying on the due diligence of the previous DDP in case of a change of custodian or DDP by FPIs;

- Exempting FPIs that have a multiple investment managers (MIM) structure from seeking prior approval from SEBI in case of a free-of-cost transfer of assets;
  - Simplifying the process for addition of share class;
  - Permitting FPIs operating under the MIM structure or as foreign venture capital investors to appoint multiple custodians; and
  - Expanding the eligible entities that are considered
- On July 7, 2017, SEBI issued a circular outlining guidelines for the issuance of offshore derivative instruments (ODIs) with derivatives as underlying. Effective from July 7, ODI-issuing foreign portfolio investors (FPIs) will have to comply with the following conditions:
    - FPIs cannot issue ODIs with derivatives as underlying, with the exception of those derivatives positions entered into for hedging the equity shares held, on a one-to-one basis. In the case of the existing ODIs that have been issued with derivatives as underlying, if the underlying derivatives positions are not hedging the equity shares held by it, the ODI-issuing FPI has to liquidate such ODIs by the date of maturity of the ODI instrument or by December 31, 2020, whichever is earlier. However, ODI-issuing FPIs should endeavour to liquidate such ODI instruments prior to this timeline.
    - If the FPI is issuing fresh ODIs with derivatives as underlying, a certificate has to be issued by the compliance officer (or equivalent) of the issuing FPI, certifying that the derivatives position on which the ODI is being issued is only for hedging the equity shares held by it on a one-to-one basis. This certificate should be submitted along with the monthly ODI reports.
    - SEBI has also clarified that the term 'hedging of equity shares' means taking a one-to-one position in only those derivatives that have the same underlying as the equity share.
  - On July 25, 2017, SEBI announced that it is revising the framework for the determination of the numerical value of overall client level open position limits for agricultural commodity derivatives. The framework is as follows:
    - Categorisation of commodities: Agricultural commodities will be classified into three categories (sensitive, broad, and narrow) based on production data, import data, and other factors that influence the trading in derivatives.
    - Deliverable supply: The deliverable supply for an agricultural commodity will be defined as the production plus imports.
    - Client level numeric position limits: The numerical value of the overall client level open position limits for each commodity will be calculated from the deliverable supply available in a particular year, and will range from 0.25% of the deliverable supply to 1% of the deliverable supply depending on the category of commodity.
    - Annual categorization of commodities and computation of position limits: All the national commodity derivatives exchanges will jointly classify agricultural commodities into the three categories defined above on an annual basis. There are also certain conditions for the re-categorisation of commodities. The market should be notified of these changes by July 31 of every year, and the revised limits will become applicable with effect from September 1 of every year.
    - There is no change to the existing member level position limits or exchange wide position limits for agricultural commodities. There is also no change to the near month position limits, computation of open positions, monitoring of position limits, or any other guidelines that have been notified by SEBI for position limits. These changes are effective immediately.

- On August 31, 2017, SEBI issued a circular modifying the dynamic price bands for the EUR-INR, GBP-INR and JPY-INR cross-currency options contracts, in order to bring uniformity to the computation. The modifications are:
  - Stock exchanges should implement a dynamic price band mechanism based on the theoretical price of contracts to determine price bands for currency options;
  - Stock exchanges should implement a uniform mechanism for the computation and relaxation of dynamic price bands for currency options contracts;
  - Stock exchanges should take into consideration factors such as movement in the underlying price, volatility in the price of the underlying, any news on the concerned currency and its likely impact, movement of the price of the underlying at other stock exchanges, etc., while relaxing such price bands; and
  - Stock exchanges should ensure that the mechanism for relaxation of dynamic price bands are not misused by market participant for manipulation in options.
  - Stock exchanges and clearing corporations should submit a proposal to SEBI for approval for the launch of currency options on the EUR-INR, GBP-INR and JPY-INR cross-currency pairs. The proposal should include the details of contract specifications, risk management framework, surveillance systems, and other requirements specified in this circular and earlier related SEBI circulars.
- On September 7, 2017, SEBI issued an addendum to the discussion paper on the growth and development of the equity derivatives market in India, which was originally issued on July 12. The addendum discusses the need for physical settlement of stock derivatives contracts and whether physical settlement should be carried out in a phased manner. The deadline for comments on the discussion paper was extended to September 25.
- On September 21, 2017, SEBI announced that the relevant securities contract and stock broker regulations have been amended to allow the integration of broking activities in equity and commodity derivative markets under a single entity. As per the existing procedure under the single registration mechanism, a one-time certificate of registration as stock broker or clearing member will be granted by SEBI, and subsequent permissions to act as a stock broker or clearing member of other stock exchanges or clearing corporations shall be granted by the respective stock exchange or clearing corporation, after due diligence.

In addition, to facilitate integration between stock brokers, SEBI has clarified that client accounts may be transferred between stock brokers with the express consent of the client, and continuing with the existing set of broker-client documentation.

- On September 27, 2017, SEBI issued a circular reviewing requirements for the participation of mutual funds in the derivatives market.

To reduce interest rate risk in a debt portfolio, mutual funds may hedge the portfolio or a part of the portfolio on a weighted average modified duration basis by using interest rate futures (IRFs). The maximum short position that may be taken to hedge the portfolio is defined by a formula specified by SEBI. If the IRF is used for hedging the interest rate risk that has different underlying securities than the position being hedged, it would result in imperfect hedging.

Imperfect hedging using IRFs may be considered to be exempted from the gross exposure, up to a maximum of 20% of the net assets of the scheme, subject to certain conditions. In addition, the basic characteristics of the scheme should not be affected by hedging the portfolio based on the weighted average modified duration, and the interest rate hedging of the portfolio should be in the interest of the investors. Mutual funds will also be subject to certain disclosure requirements.

- On October 16, 2017, SEBI announced, in consultation with the Commodity Derivatives Advisory Committee (CDAC), the following broad guidelines for deciding the settlement mode for commodity derivative contracts:
  - The first preference of settlement type shall always be physical delivery;
  - Cash settlement of commodity derivatives contracts may be considered only in certain scenarios, with a proper justification. These scenarios include difficulty in implementing physical delivery due to the nature of the commodity, lack of storage infrastructure, a lack of transport and logistics infrastructure, or there is a reliable benchmark price of the commodity that can be used as reference for settlement price; and
  - Subject to the above conditions, both cash settled and physically settled derivative contracts on the same commodity may also be considered for trading, in case the basis of price discovery of the proposed contracts is different.
  - These guidelines are effective immediately.
- On December 7, 2017, SEBI released a consultation paper proposing to permit mutual funds (MFs) and portfolio managers (PMs) to participate in the exchange-traded commodity derivatives market, as well as to determine the appropriate regulatory framework.

In addition to seeking feedback on participation in the commodity derivatives market, the consultation paper also highlights certain matters for consideration. These include:

- The appropriate route for MF participation;
- The extent to which the existing assets under management can be invested in commodity derivatives;
- Whether investment restrictions should be placed on MF schemes that invest only in commodity futures;
- Whether PMs should be permitted to leverage the portfolio of their clients for investing in commodity derivatives;
- Whether PMs can be permitted to pool investments in commodity derivatives; and
- In case portfolio leveraging and pooling of commodity derivatives is permitted, should the participation in commodity derivatives be restricted only to the clients beyond a certain threshold?

Comments on the consultation paper were due by December 31, 2017.

- On February 15, 2018, SEBI announced a series of changes to existing regulations to ease access for investments by foreign portfolio investors (FPIs). These measures include:
  - Discontinuing the requirement of prior approval from SEBI in case of a change in the local custodian or designated depository participant (DDP);

- Rationalising the procedure for the submission of declarations and undertakings, and investor grouping requirements, for the continuance of registration of FPIs;
- Relying on the due diligence carried out by the old DDP with respect to a change in the custodian or DDP of FPIs;
- Exempting FPIs having a multiple investment managers (MIM) structure from prior approval from SEBI in case of a free of cost (FOC) transfer of assets;
- Simplifying the process for addition of share class;
- Allowing FPIs operating under the MIM structure to appoint multiple custodians; and
- Allowing regulated private or merchant banks to invest on their behalf, as well as on behalf of their clients.

The relevant FAQs and circulars have been updated to reflect these changes.

- On May 2, 2018, SEBI announced additional risk management measures for the equity derivatives segment, based on recommendations of the Risk Management Review Committee. These measures include:
  - Including initial margin, exposure margin or extreme loss margin, calendar spread margin, and mark-to-market settlements in the client margin collected; and
  - Calculating the liquid net worth by deducting initial margin and the exposure margin or extreme loss margin from the liquid assets of the clearing member.

These revisions are effective June 1, 2018.

- On May 4, 2018, SEBI announced that, effective October 1, exchanges are now permitted to allow trading in equity derivatives until 11:55 PM local time, provided that appropriate risk management systems and other infrastructure are in place to support the extended trading hours. Exchanges will need prior approval from SEBI for the extended trading hours.
- On May 18, 2018, SEBI issued a consultation paper that proposes to permit foreign entities that have exposure to the Indian commodity markets to participate in the domestic commodity derivatives market, and to determine the appropriate regulatory framework.

SEBI proposes that foreign entities intending to hedge exposure to physical markets in India should have either import or export exposure to any of the commodities that are traded on Indian commodity derivatives exchanges. These entities are to be known as eligible foreign entities. The regulatory framework proposed outlines the eligible commodities, eligibility and jurisdiction, registration requirements, risk management requirements and disclosures by the commodity derivatives exchanges. Comments on the consultation were due by June 18, 2018.

- On September 21, 2018, SEBI reviewed the eligibility conditions for foreign portfolio investors (FPIs) following a board meeting held on September 18. Based on the feedback received, the beneficial ownership criteria in the relevant prevention of money laundering rules will only be applicable for the purpose of know your customer, and not for determining the eligibility of FPIs. Accordingly, SEBI introduced a separate set of eligibility conditions for FPIs where non-resident Indians, overseas citizens of India and resident Indians are constituents. Any amendments in the relevant FPI regulations will be notified separately.

Existing FPIs and new applicants will be given two years from the date the amended regulations come into force or from the date of registration, whichever is later, in order to satisfy these eligibility conditions. In case of a temporary breach, FPIs will get 90 days to ensure compliance with the revised eligibility conditions.

- On October 9, 2018, SEBI announced a framework for the participation of eligible foreign entities (EFEs) in the Indian commodity derivatives market. This framework follows from the consultation paper that was issued in May 2018, and permits foreign entities having actual exposure to Indian commodity markets to participate in the commodity derivatives segment of recognised stock exchanges for hedging their exposure. The framework outlines the eligible commodities, eligibility and jurisdiction, registration requirements, risk management requirements and disclosures by the commodity derivatives exchanges. This framework became effective on October 9, 2018.
- On November 27, 2018, SEBI announced broad guidelines for operationalizing an interoperable framework among CCPs. It will allow participants to consolidate their clearing and settlement functions at a single CCP, regardless of the stock exchange on which the trade is executed. The framework will be applicable to all recognised CCPs, excluding those operating in the International Financial Services Centre. All products available for trading on the stock exchanges with the exception of commodity derivatives will be eligible under the interoperability framework. The guidelines also cover the interoperable links among CCPs, inter-CCP collateral and settlement, the default handling process, and legal and dispute resolution requirements.

All stock exchanges and CCPs are required to operationalize these interoperability requirements by June 1, 2019.

- On November 30, 2018, SEBI announced an extension in the trade time within which stock exchanges can set their trading hours for their commodity derivatives segment. The revised trade timings for non-agricultural commodities will be from 9 AM Indian Standard Time (IST) to 11:30 PM IST (after start of US daylight savings), or 11:55PM (after end of US daylight savings). The revised trade timings for agricultural and agri-processed commodities will be 9AM IST to 9PM IST.

The extension of the trade timing will be subject to the stock exchanges putting in place adequate risk management, surveillance and infrastructure to account for the increased trading hours. The extended trading hours will come into effect from December 30.

- On December 17, SEBI announced a review of the risk management framework for equity derivatives. In order to align the Margin Period of Risk (MPOR) more closely with the Principles for Financial Market Infrastructures (PFMI) requirements, SEBI recommends that the MPOR be increased to 2 days from the existing MPOR of 1 day. Exchanges and CCPs should estimate the appropriate MPOR for each equity derivative product based on liquidity, and scale up the initial margins and exposure margins accordingly. Additionally, in order to make the risk management framework more robust, the payment of the mark-to-market will now be made on a T+0 basis, i.e. before the start of trading on the next day. These changes are effective January 21, 2019.

#### 4. Basel III & Capital

- On February 2, 2017, the RBI published draft guidelines on interest rate risk in banking book (IRRBB). IRRBB refers to the current or prospective risk to a bank's capital and earnings arising from adverse movements in interest rates that affect banking book positions. Excessive IRRBB can pose a significant threat to a bank's current capital base and/or future earnings if not managed appropriately.

These draft guidelines are based on the standards on IRRBB published by the Basel Committee on Banking Supervision in April 2016. Comments on these draft guidelines are due by March 3.

- On February 2, 2017, the RBI amended the criteria for inclusion of perpetual debt instruments (PDIs) in additional Tier 1 capital, under Basel III. The amendments allow banks to use profits brought forward from previous years and/or their reserves representing appropriation of net profits, including statutory reserves, to pay out coupons on PDIs if their current-year profit, balances and revenue reserves are insufficient. The accumulated losses and deferred revenue expenditure, if any, shall be netted off to arrive at the available balances for the payment of coupon.

Statutory reserves may be used only if the aggregate of profits in the current year, profits brought forward from the previous years and permissible reserves are less than the amount of the coupon. In such cases, banks are required to report to the RBI within 21 days from the date of such appropriation, in compliance with the Banking Regulation Act, 1949.

Payment of coupons on PDIs from the reserves is subject to the issuing bank meeting minimum regulatory requirements for core equity Tier 1, Tier 1 and total capital ratios (including the additional capital requirements for domestic systemically important banks) at all times, and subject to the restrictions under the capital buffer frameworks. These amendments are effective from February 2.

- On June 7, 2017, the RBI announced that it has decided to reduce the statutory liquidity ratio (SLR) from 20.5% to 20% of net demand and time liabilities with effect from the fortnight beginning June 24, 2017. This is in order to give banks greater flexibility in complying with the liquidity coverage ratio (LCR) requirement of 100% by January 1, 2019. Notwithstanding the reduction in the SLR, the ceiling on the amount of SLR securities that can be held under the held-to-maturity category remains unchanged.
- On September 4, 2017, the RBI released a list of domestic systemically important banks (D-SIBs) for 2017. In addition to the State Bank of India (SBI) and ICICI Bank, the RBI has also identified HDFC Bank as a D-SIB under the same bucketing structure as last year. The additional common equity Tier 1 (CET1) capital requirement for D-SIBs has already been phased-in from April 1, 2016 and will become fully effective from April 1, 2019. The additional CET1 capital requirement will be in addition to the capital conservation buffer.
- On October 4, 2017, the RBI announced a reduction in the statutory liquidity ratio (SLR) from 20% to 19.5% of net demand and time liabilities with effect from the fortnight beginning October 14, 2017. This is in order to give banks greater flexibility in complying with the liquidity coverage ratio requirement of 100% by January 1, 2019. In order to align the ceiling on SLR holdings under the held-

to-maturity category with the mandatory SLR, the RBI has also decided to reduce the ceiling from 20.5% to 19.5% in a phased manner by March 31, 2018.

- On May 17, 2018, the RBI issued final guidelines for the net stable funding ratio (NSFR). The NSFR is applicable for Indian banks at the solo and consolidated level. For global banks operating as branches in India, the NSFR is applicable on a standalone basis (for Indian operations only). The final guidelines outline the calculation methodology for available stable funding (ASF) and required stable funding (RSF), the NSFR disclosure standards and a minimum NSFR requirement of 100%. The final guidelines will be applicable from a date to be announced in due course.
- On November 29, 2018, the RBI announced that net stable funding ratio (NSFR) requirements will be effective April 1, 2020. The final NSFR guidelines were issued in May 2018, and are applicable at the solo and consolidated level for Indian banks, and on a standalone basis (for Indian operations only) for global banks operating as branches in India.

## **5. Trade Reporting**

- On June 23, 2017, CCIL issued trade repository rules for over-the-counter (OTC) derivatives. CCIL is a designated trade repository for OTC derivatives, authorised by the RBI under the Payment and Settlement Systems Act, 2007. These trade repository rules are directed towards regulating and governing the trade reporting requirements under the relevant RBI regulations, directives, and international standards. These rules are effective from July 24.
- On September 21, 2017, the RBI announced that, with effect from October 3, the present threshold of US \$1 million for reporting foreign exchange forwards trades between authorised banks and their clients to the trade repository hosted by the Clearing Corporation of India Limited, CCIL will be removed. As a one-time measure, in order to update the outstanding balances in the trade repository, authorised banks are advised to report the relevant historical over-the-counter currency forwards and options transactions to CCIL by October 6. They are also required to ensure that outstanding balances between their books and the trade repository are reconciled on an ongoing basis.

## **6. Fintech**

- On August 3, 2017, SEBI announced the formation of the Committee on Financial and Regulatory Technologies (CFRT). The members of the CFRT are experts from areas such as digital payments, e-brokerages, financing and investment platforms, data analytics, and e-commerce. The CFRT will examine and advise SEBI on an ongoing basis on the following:
  - Trends in fintech developments in securities markets globally;
  - Opportunities and challenges from new fintech solutions, and the impact on the Indian securities market;
  - Fintech solutions for widening and deepening of the Indian securities market;
  - The approach and framework for a regulatory sandbox to facilitate the adoption of fintech and promote financial innovations;

- Preparing the regulatory framework to adopt to new fintech solutions while promoting market integrity, market development, consumer protection and managing change, business models and market disruptions;
- Assessing technological solutions for the regulatory functions of SEBI in information management and data mining, risk management including cyber security, intermediary supervision, and consumer protection through the application of new technological solutions; and
- Technology capacity building by the Indian securities market in general, and SEBI in particular.

## 7. Legal Entity Identifier

- On June 1, 2017, the RBI announced the implementation of legal entity identifiers (LEI) for all participants in the over-the-counter (OTC) markets for Indian rupee interest rate derivatives, foreign currency derivatives and credit derivatives. Implementation will be in a phased manner, based on the following timelines:
  - Phase 1: Entities regulated by Indian supervisory agencies and corporates with a net worth above INR 10000 million – August 1, 2017
  - Phase 2: Corporates with a net worth between INR 2000 and 10000 million – October 1, 2017
  - Phase 3: Corporates with a net worth between INR 700 and 2000 million – December 1, 2017
  - Phase 4: Corporates with a net worth of INR 700 million and below – March 31, 2018

The LEI may be obtained from Legal Entity Identifier India Limited (LEIL). LEIL has been recognised by the RBI as the issuer of LEIs under the Payment and Settlement Systems Act, 2007, and is accredited by the Global Legal Entity Identifier Foundation (GLEIF) as the local operating unit in India for the issuance and management of LEIs. Entities should ensure that the LEI is renewed as per GLEIF guidelines, as lapsed LEIs will not be valid for trade reporting.

- On November 2, 2017, the RBI issued a circular introducing legal entity identifier (LEI) requirements for large corporate borrowers. The circular requires that banks advise their existing large corporate borrowers who have total exposures of INR 50 crore and above to obtain an LEI as per the schedule below:

Total Exposure	LEI to be obtained by
INR 1000 crore and above	Mar 31, 2018
Between INR 500 crore and INR 1000 crore	Jun 30, 2018
Between INR 100 crore and INR 500 crore	Mar 31, 2019
Between INR 50 crore and INR 100 crore	Dec 31, 2019

Corporate borrowers who do not obtain an LEI as per the schedule above will not have their credit facilities granted or renewed. A separate schedule for corporate borrowers having exposures between INR 5 crore and up to INR 50 crore will be issued in due course. Banks should also encourage large corporate borrowers to obtain an LEI for their parent entity as well as all subsidiaries and associates.

Entities can obtain an LEI from any of the local operating units (LOUs) accredited by the Global Legal Entity Identifier Foundation (GLEIF). In India, the LEI code may be obtained from Legal Entity Identifier India Ltd, a subsidiary of the Clearing Corporation of India Limited, which has been recognised by the RBI as the issuer of LEI under the Payment and Settlement Systems Act, 2007 and

is accredited by the GLEIF as the LOU in India for the issuance and management of LEIs. After obtaining an LEI, banks should also ensure that borrowers renew the LEI as per GLEIF guidelines.

- On June 20, 2018, the RBI issued draft directions on LEI requirements for participation in non-derivatives markets. This is further to the previous RBI announcement, which required the use of LEI's for the OTC derivatives markets.

The RBI proposes to introduce LEI requirements for all non-derivatives markets regulated by the RBI. Implementation will be phased-in based on the net worth of the entity. For government securities and money markets, implementation will be between October 31, 2018 and July 31, 2019. For foreign exchange markets, implementation will be between January 31, 2019 and October 31, 2019. Transactions on recognised stock exchanges are outside the purview of the LEI requirements. LEI's are also not required for transactions in foreign exchange markets involving an amount less than \$100,000 or its equivalent.

Entities that are operating trading and reporting platforms in these markets are required to capture the LEI code of the transacting participants. Entities can obtain an LEI from any of the local operating units (LOUs) accredited by the Global Legal Entity Identifier Foundation. In India, the LOU is Legal Entity Identifier India Ltd. Comments on the draft directions are due by June 30, 2018.

- On November 29, 2018, the RBI announced requirements for the phasing-in of legal entity identifier (LEI) requirements for all non-individual participants undertaking transactions in markets regulated by RBI – namely, the government securities markets, money markets and non-derivative forex markets. These entities will need to obtain an LEI in a phased manner, as per the schedule below:
  - For total exposure of INR 10,000 million and above, LEI to be obtained by April 30, 2019;
  - For total exposure of between INR 2,000 million and INR 10,000 million, LEI to be obtained by August 31, 2019;
  - For total exposure of up to INR 2,000 million, LEI to be obtained by March 31, 2020.

Transactions on recognised stock exchanges will not require an LEI. In the case of non-derivatives forex transactions, all interbank transactions will be subject to LEI requirements. However, client transactions will require an LEI only for transactions involving an amount equivalent to or exceeding \$1 million or the equivalent in other currencies. Furthermore, non-resident entities undertaking financial transactions in these relevant markets will also require an LEI. Those entities that are not legal entities in their country of incorporation (such as funds operated by a non-resident parent or management company that are each registered as a foreign portfolio investor) should use the LEI code of the parent or management company.

Entities can obtain an LEI from any of the local operating units accredited by the Global Legal Entity Identifier Foundation (GLEIF). In India, the LEI code may be obtained from Legal Entity Identifier India Ltd. Entities should ensure that their LEI is considered current under the rules of GLEIF. Expired LEI's will be invalid for transactions in markets regulated by RBI.

## 8. Resolution Powers and the Financial Resolution and Deposit Insurance Bill

- On May 22, 2017, the RBI outlined enhancements to the Banking Regulation (Amendment) Ordinance, 2017. The amendments introduced through the ordinance empower the RBI to issue directions to banking companies to initiate insolvency resolution processes in respect of a default, under the provisions of the Insolvency and Bankruptcy Code, 2016.

The Oversight Committee (OC) will be reconstituted under the RBI, and will be expanded from the existing two members. The scope of cases referred to the OC will also be expanded. The RBI is also working on a framework to facilitate an objective and consistent decision-making process for cases that may be determined for resolution. The current guidelines on restructuring are being reviewed for modifications that may be needed to resolve large stressed assets in the banking system. With a view to prevent rating shopping or any conflict of interest, the RBI is exploring the feasibility of rating assignments being determined by the RBI itself, to be paid for from a fund to be created out of contributions from banks and the RBI. The RBI will consult with the relevant stakeholders on coordination for these enhanced measures.

- On August 10, 2017, the Financial Resolution and Deposit Insurance Bill, 2017 (FRDI Bill, 2017) was introduced in parliament. The bill provides for the resolution of certain categories of financial service providers in distress, deposit insurance to consumers of such financial service providers, designation of systemically important financial institutions, and the establishment of a resolution corporation for protection of consumers and of public funds of such financial service providers, for ensuring the stability and resilience of the financial system. The bill has been referred to a joint committee of both the houses of parliament, consisting of 30 members. The joint committee will make a report in the first week of the next session of parliament.
- On December 15, 2017, the joint committee requested an extension of time until the last day of the 2018 Budget Session of Parliament to present their report on the bill. The speaker granted the extension required.
- Based on a report submitted by the joint parliamentary committee, the Financial Resolution and Deposit Insurance (FRDI) Bill, 2017 was withdrawn from the Indian Parliament on August 1, 2018. A notice of the motion for withdrawal of the bill, along with a statement of reasons for the withdrawal, was given by the finance minister on July 23.

The main reason for the withdrawal was that stakeholders raised concerns about some aspects of the bill, such as the use of bail-in to resolve a failing bank, the adequacy of deposit insurance cover and the need to revise the insurance limit substantially, and the application of the resolution framework to public sector banks. The report states that the bill is being withdrawn to enable further comprehensive examination and reconsideration of these concerns.

## 9. International Financial Service Centres

- On April 10, 2017, the RBI amended existing circulars related to the permissible activities of international financial services centres banking units (IBUs). These amendments include:

- With the prior approval of their board of directors, IBUs may undertake derivatives transactions, including structured products that the banks operating in India have been allowed to undertake as per existing RBI directions. However, IBUs shall obtain the RBI's prior approval for offering any other derivatives products. Prior to seeking the RBI's approval, banks should ensure that their IBUs have the necessary expertise to price, value and compute the capital charge and manage the risks associated with the products or transactions intended to be offered, and should also obtain their board of directors' approval for undertaking such transactions.
- An IBU can be a trading member of an exchange in the IFSC for trading in interest rate and currency derivatives segments that the banks operating in India have been allowed to undertake as per the extant RBI directions. An IBU can also become a professional clearing member (PCM) of the exchange in the IFSC for clearing and settlements in any derivatives segments, subject to certain conditions.

These amendments are effective immediately.

- On April 13, 2017, SEBI issued a circular permitting stock exchanges operating in international financial services centres (IFSCs) to list equity derivatives, subject to the prior approval of SEBI. SEBI-registered foreign portfolio investors (FPIs) and eligible entities operating in IFSCs will be eligible to trade in equity derivatives. Trading will be subject to a market-wide position limit (MWPL) equal to 10% of the number of shares held by non-promoters in the relevant underlying security (ie, free-float holding). This will be separate from the MWPL in domestic markets, but the MWPL at IFSCs will not be allowed to exceed 50% of the MWPL (in value terms) in the domestic market.
- On May 17, 2017, the SEBI issued guidelines on cross-currency futures and options contracts (not involving the Indian rupee) on exchanges in international financial services centres (IFSC). The position limits for eligible market participants, per currency pair per stock exchange, will be:
  - Trading members (for proprietary and client positions): Gross open position across all contracts not to exceed 15% of the total open interest or \$1 billion equivalent, whichever is higher.
  - Institutional investors: Gross open position across all contracts not to exceed 15% of the total open interest or \$1 billion equivalent, whichever is higher.
  - Eligible foreign investors: Gross open position across all contracts not to exceed 15% of the total open interest or \$1 billion equivalent, whichever is higher.
  - Other clients: Gross open position across all contracts not to exceed 6% of the total open interest or \$100 million equivalent, whichever is higher.
  - Exchanges will impose penalties for violation of these position limits.
- On August 3, 2017, the SEBI announced that the two exchanges that have been set up in the International Financial Service Centre (IFSC) will now be allowed to start trading in additional derivatives contracts on Indian stocks.

India INX will be permitted to offer derivatives contracts on 33 stocks, while NSE IFSC can launch derivatives contracts on 52 additional stocks. With this change, exchanges in the IFSC have been permitted to offer trading in a diversified range of products spanning various asset classes, including Indian index derivatives, derivatives on Indian stocks, derivatives on foreign stocks, currency derivatives, and commodity futures on gold, silver and base metals.

- On September 26, 2017, SEBI announced that in consultation with the Government of India and RBI, foreign portfolio investors (FPIs) will be permitted to participate in commodity derivative contracts traded on exchanges in international financial service centres (IFSCs), subject to the following conditions:
  - Participation will be limited to derivatives contracts in non-agricultural commodities only;
  - Contracts will be cash settled on the settlement price determined on overseas exchanges; and
  - All transactions should be denominated in currencies other than the Indian rupee.
  - These changes are effective immediately.

## 10. CCP recognition

- On March 20, the European Securities and Markets Authority (ESMA) updated its list of recognised central counterparties (CCPs) based in third countries. The following six non-EU central counterparties were recognised:
  - Clearing Corporation of India Ltd , CCIL;
  - Dubai Commodities Clearing Corporation (DCCC);
  - Nasdaq Dubai Ltd;
  - Japan Commodity Clearing House Co., Ltd (JCCH);
  - BM&FBovespa S.A., Brazil; and
  - Nodal Clearing LLC, USA.
- On July 20, 2017, the SEBI announced that it has established a MoU with the European Securities and Markets Authority under the European Markets Infrastructure Regulation (EMIR). The MoU establishes cooperation arrangements, including the exchange of information regarding central counterparties that are regulated by SEBI and that have applied for recognition under EMIR. The MoU is effective as of June 21.
- On October 9, 2017, the European Securities and Markets Authority (ESMA) updated its list of recognised CCPs based in third countries. The following three non-EU central counterparties were recognised:
  - Indian Clearing Corporation Limited;
  - National Securities Clearing Corporation Limited; and
  - MCX-SX Clearing Corporation.
- On October 15, 2018, RBI released directions relating to the capital requirements and governance framework of central counterparties (CCPs). These directions also provide a framework for the recognition of foreign CCPs for their operations in India. These directions will apply to a domestic CCP authorised to operate in India under the Payment and Settlement Systems Act, 2007 (PSS Act 2007), and foreign CCPs recognised by the RBI under the PSS Act, 2007 for their operations including clearing and settlement in India.

The directions cover broad principles underlying governance of domestic CCPs, specific requirements on sufficient net worth, as well as requirements for the recognition of foreign CCPs which are in line

with international developments on recognizing CCPs operating in multiple jurisdictions.

These directions became effective on October 15, 2018.

## **11. Exchanges announce licensing revisions**

- On February 9, 2018, the National Stock Exchange of India, the Bombay Stock Exchange and the Metropolitan Stock Exchange announced revisions to the licensing arrangements for Indian indices and market data with foreign exchanges and/or trading platforms.

Under these revisions, the exchanges will not license or provide Indian index or securities market data to any foreign exchange or trading platforms for trading or settling derivatives in a foreign jurisdiction.

The exchanges, either directly or through third party data vendors, will not license or provide market data to:

- Any exchange or trading or settling venue outside India for trading or settling products including derivatives;
- Any index provider or its licensee for the creation of indices or products based on such indices, which in part (weightage of 25% or more on Indian securities) or in full are based on prices of securities or indices listed in India or are benchmarked to Indian indices; and
- Any licensee, either directly or through a third party data vendor, for the purpose of trading or settling derivative products on any foreign exchange or foreign trading platforms. Such entity is also not permitted to use the market data for issuing overseas derivatives instruments or structured products on exchange traded derivative contracts on Indian securities traded on foreign exchanges or trading platforms.

These conditions, however, are not applicable for:

- Products or indices traded on any exchange or trading venue in any International Financial Services Centre operating in India, subject to prior written permission.
- Issuance of any exchange traded funds or exchange traded notes or similar products by any entity, subject to prior written permission.

The existing licensing agreements affected by these changes will be terminated with immediate effect, subject to the notice period mentioned in the respective licensing agreements.

## **12. Benchmarks reform**

- On June 11, 2018, the Financial Benchmarks India Limited (FBIL) announced that they will take over the calculation and publication of the daily reference rate for spot USD/INR and other major currencies against the INR, which is currently being done by the RBI. This transition is in line with earlier policy statements made by the RBI. The FBIL has also consulted with market participants and the RBI on an updated methodology for the calculation of the reference rates.

**ISDA Submissions**

January 31, 2017: [ISDA submission to Clearing Corporation of India Limited in relation to Consultation Paper on Optimizing Segmental Default Fund Contributions](#)

January 31, 2017: [ISDA submission to Clearing Corporation of India Limited in relation to Consultation Paper on Loss Mutualisation on Settlement Bank Default \(USD-INR Segment\)](#)

March 15, 2017: [ISDA and FIA joint submission to Clearing Corporation of India Limited in relation to Consultation Paper on Recovery tools at the end of the prefunded default waterfall](#)

21 July, 2017: [ISDA presentation for RBI on update on global initiatives on CCP recovery and resolution](#)

14 May, 2018: [ISDA submission to RBI on netting & margin requirements](#)

31 August, 2018: [ISDA & FIMMDA follow-up submission to RBI on netting & margin requirements](#)

# INDONESIA

## AT A GLANCE

Central Bank:	BI <a href="http://www.bi.go.id">http://www.bi.go.id</a>
Bank Regulator:	BI
Capital &	
Fin. Mkts Regulator:	Otoritas Jasa Keuangan (OJK) <a href="http://www.ojk.go.id">http://www.ojk.go.id</a>
Associations:	Indonesia Foreign Exchange Markets Committee (IFEMC) <a href="http://www.ifemc.org">http://www.ifemc.org</a> Persatuan Bank-Bank Umum Nasional (Perbanas) <a href="http://www.perbanas.org">http://www.perbanas.org</a> Foreign Banks Association of Indonesia (FBAI) <a href="http://www.fbai.or.id">http://www.fbai.or.id</a>
Legal Opinions:	Netting and collateral opinions by Ali Budiardjo, Nugroho, Reksodiputro (ABNR)
Master Agreement:	ISDA with local language translation appended
CCP/TR Status:	Looking to set up a CCP. No announced plans for TR.

## Key Regulatory Milestones

### 1. Enforceability of close-out netting & financial market development

- On January 31 2018, Bank Indonesia (BI) issued a press release to reiterate their support for strengthening the legal basis for financial market development, including providing legal certainty for close-out netting for derivative transactions.

### 2. Resolution

- On April 5, 2017, the Otoritas Jasa Keuangan (OJK) issued three regulations covering the application of policies on crisis management in the financial sector. These regulations are a follow-up to Law No. 9 of 2016 on Prevention and Management of Financial System Crisis (PPKSK law). These regulations comprise:
  - Rules on how to manage issues faced by systemic banks or other types of banks. The regulation establishes that bank supervision status consists of three stages – namely: normal, intensive, and special supervision. This regulation is related to the PPKSK law, as this revamped regulation focuses on management of solvency issues for systemic banks. This includes the activation of recovery plan implementation, the Deposit Insurance Corporation's (LPS) early entry into the management of bank solvency issues, and handover mechanisms of banks that the LPS is not able to restructure.
  - Rules on the procedures for establishing, operating and liquidating bridge banks. The LPS is the only institution authorised to establish and own bridge banks.
  - Rules on banks' obligations to make preparations for preventing and dealing with possible financial problems by designing recovery plans. This regulation includes the rule that recovery plans have to include a requirement for the controlling shareholder and/or other parties to increase the bank's capital and convert specific types of debt into equity. With this rule, systemic banks are required to resort to bail-in to solve their financial problems, in accordance with the recovery

plans that they have devised.

### 3. Basel III & Capital

- On May 19, 2017, BI announced its decision to hold the countercyclical capital buffer (CCB) unchanged at 0%. BI performs an assessment of the CCB at least once every six months. The credit-to-GDP gap, as the main CCB indicator, has not shown any signs of excessive credit growth that could prompt systemic risk, the central bank said.
- On August 18, 2017, the Otoritas Jasa Keuangan (OJK) announced a survey and quantitative impact study (QIS) on standards for Interest Rate Risk in the Banking Book (IRRBB). The objective of this survey and QIS is to undertake early analysis on IRRBB management practices in the Indonesian banking sector. They also intend to identify gaps between the IRRBB measurement practices of banks with the Basel Committee on Banking Supervision IRRBB standards, as stated in OJK's consultative paper on the IRRBB issued on June 22 (Bahasa Indonesia only). The survey and data are to be provided in the specified format (Bahasa Indonesia only).

### 4. Fintech

- On June 16, 2017, the OJK announced the inauguration of a fintech advisory forum, which is expected to facilitate and ensure coordination between various agencies, ministries, and fintech start-up players. Duties of the fintech advisory forum include:
  - Discussing the latest issues related to fintech and the future direction for the industry's development;
  - Facilitating coordination between agencies, ministries, and other related parties to ensure that the fintech potential is optimised; and
  - Ensuring that the participation and communication between relevant ministries, agencies, and fintech start-ups take place in a regular, consistent, and constructive manner.

### 5. Benchmarks reform

- On August 1, 2018, BI announced the introduction of Bank Indonesia Regulation (PBI) No. 20/7/PBI/2018.

With this regulation, two types of money market benchmark rates will be used as a reference for financial transactions: the Indonesia Overnight Index Average (IndONIA) and the Jakarta Interbank Offered Rate (JIBOR). IndONIA is set by the BI based on overnight unsecured transactions in the interbank money market and can be used as a reference for short-term interest rate derivative (IRD) transactions. JIBOR is set by the BI based on indicative interest rate quotations submitted by contributor banks and is typically used as a reference for long-term IRD transactions.

IndONIA was launched on August 1, while the overnight JIBOR will be published in parallel until December 31. This transition period aims to introduce IndONIA as a new overnight money market

benchmark rate, as well as to provide sufficient time for contracts that currently use the overnight JIBOR to be adjusted using IndONIA.

Effective January 2, 2019, the BI will no longer publish the overnight JIBOR. JIBOR will only be applicable to five tenors (namely one week, one month, three months, six months and 12 months).

## **6. BI Developments**

- On September 21, 2018, BI issued Regulation number 20/10/PBI/2018 on domestic non-deliverable forward transactions, as well as frequently asked questions. The measures contained in the regulation are intended to increase the use of these instruments in Indonesia as well as provide confidence to the market. Certain conditions must be met before these transactions may be carried out. These include, among others, an underlying transaction must be in existence and requisite documentation relating to the underlying transaction must be provided. English translations are not yet available.
- On November 14, 2018, BI issued Regulation No. 20/13/PBI/2018 on Rupiah Interest Rate Derivative Transactions. This regulation provides information on these transactions by clarifying certain key aspects including:
  - classification of investors who may enter into these transactions;
  - requirement to consider and follow certain market conventions;
  - requirement for a bank to do periodic analysis;
  - settlement and close-out netting upon default is expressly allowed; and
  - providing for non-mandatory trading through BI-Electronic Trading Platform (not mandatory)

## SOUTH KOREA

### AT A GLANCE

Central Bank:	Bank of Korea (BOK) <a href="http://www.bok.or.kr">http://www.bok.or.kr</a>
Bank Regulator:	Financial Services Commission (FSC) (policy-making) <a href="http://www.fsc.go.kr">http://www.fsc.go.kr</a> Financial Supervisory Service (FSS) (execution of financial market supervision) <a href="http://english.fss.or.kr">http://english.fss.or.kr</a>
Securities Regulators:	Financial Services Commission (FSC) Financial Supervisory Service (FSS)
Other Regulators:	Ministry of Strategy and Finance (MOSF) <a href="http://english.mosf.go.kr">http://english.mosf.go.kr</a>
Associations:	Korean Financial Industry Association (KOFIA) Korean Federation of Banks (KFB) Foreign Banks Association
Master Agreement:	ISDA (an "ISDA Lite" Korean version is commonly used between Korean banks and domestic corporate for documenting FX transactions but is not mandated)
Legal Opinions: Chang	Netting, collateral, client clearing (clearing members reliance) opinions by Kim & E-contracts opinion by Lee & Ko
CCP/TR Status:	On March 5, 2013, the Revision Bill of the Financial Investment Services and Capital Markets Act (FSCMA) passed the plenary session of the National Assembly, following approval by the Legislation and Judicial Committee of the National Assembly the previous day. The legislation creates central counterparty clearinghouses (CCPs), to deal with clearing for OTC transactions in financial investment products. On September 11, 2013, KRX was authorised as a CCP in Korea for OTC clearing services by the FSC. Mandatory clearing of Korean Won interest rate swap commenced on June 30, 2014.  The US Commodity Futures Trading Commission (CFTC) issued an order of exemption from registration as a derivatives clearing organization (DCO) to KRX on October 26, 2015. The European Securities and Markets Authority (ESMA) granted KRX the third-country (non-EU) CCP recognition on April 22, 2016.  On August 17, 2015, the FSC announced that KRX had been designated as a TR. On July 26, 2018, the FSC released a public consultation on its proposed amendments to the Regulations on Financial Investment Business to implement trade reporting requirements and designate a TR in Korea. On November 19, 2018 KRX published its proposal on detailed reporting requirements and reporting data elements subordinate to regulations consulted by the FSC. KRX plans to commence trade reporting by the second quarter of 2020.  The Bank of England (BoE) added KRX to the interim list of third-country CCPs that will offer clearing services and activities in the UK under the Temporary Recognition Regime (TRR) if the UK leaves the EU with no implementation period.
Margin requirements:	The FSS margin guidelines for non-centrally cleared OTC derivatives came into effect on March 1, 2017, with a 6-month transitional period for variation margin.

## Key Regulatory Milestones

### 1. Trade Reporting

- On July 26, 2018, the Financial Services Commission (FSC) opened for consultation its proposed amendments to the Regulations on Financial Investment Business to implement trade reporting requirements and designate a trade repository (TR) in Korea.

The proposed rules include:

- Criteria for the designation and withdrawal of designation of a TR;
- Obligations to the financial investment entities to report prescribed derivatives transaction information by T+1;
- Delegation of reporting duties to a third party;
- Exemptions from the reporting obligation; and
- Disclosure and access to information.

Comments were due by September 4, 2018.

- On November 19, 2018, Korea Exchange (KRX) published its proposal on detailed reporting requirements and reporting data elements subordinate to regulations consulted by the Financial Services Commission (FSC). KRX plans to commence trade reporting by the second quarter of 2020.

The proposal states:

- Phased-in implementation by asset class: (1) interest rate and FX; (2) equity and credit; (3) commodities, as the FSC prescribes;
- Entity scope: financial investment companies authorised or registered by the FSC;
- Product scope: OTC derivatives;
- Reporting timeline: T+1 15:00;
- Counterparty identification: LEI will be mandated for financial investment companies;
- Unique Transaction Identifiers (UTI) will be mandated to be shared and paired;
- Unique Product Identifiers (UPI) will be mandated when the UPI service provider is selected by the FSB;
- Reporting format: CSV and FpML will be accepted.

### 2. Margin requirements for non-centrally cleared derivatives

- On February 27, 2017, the South Korean Financial Supervisory Service (FSS) issued its final guidelines on margin requirements for non-centrally cleared OTC derivatives. Variation margin requirements for financial companies with an aggregate month-end average notional amount equal to or above KRW 10 trillion come into effect on March 1, with a six-month transitional period.
- On March 23, 2017, the FSC issued final amendments on securities lending for collateral posting purposes, allowing rehypothecation of securities posted as collateral under this framework. The amended Financial Investment Business Regulation prescribes the following conditions:

- Securities lending must be for the purposes for posting collateral for transactions under a Master Agreement;
  - Eligible securities: Korean Treasury bonds and monetary stabilization bonds;
  - Re-use is permitted only for the purpose of repurchase agreements or for posting margin;
  - Counterparties must consent to the re-use of posted collateral;
  - Collateral must be returned to the provider except for an occurrence of event of default under the Master Agreement; and
  - Securities lending for the purposes of posting initial margin for an over-the-counter derivatives transaction is prohibited.
  - The new rules take effect on March 31, 2017.
- On February 23, 2018, the FSS published its updated guidelines on margin requirements for non-centrally cleared OTC derivatives transactions that will apply from March 1, 2018 to February 28, 2019. The revisions allow market participants to agree on separate minimum transfer amounts each for initial margin and variation margin, provided that their sum does not exceed KRW 1 billion.

### 3. Basel III & Capital

- On October 13, 2017, the FSC proposed amendments to the Regulation on Supervision of Banking Business to implement the net stable funding ratio (NSFR) and leverage ratio set out in Basel III reforms by the Basel Committee on Banking Supervision. These rules will not apply to branches of foreign banks.

The minimum NSFR for banks will be set at 100%, and the minimum leverage ratio is to be set at 3%.

Public comments on the proposed rule changes were due by November 19, 2017. The FSC indicates plans to implement the revised rules as of January 31, 2018.

- On October 26, 2017, the FSS published draft amendments to the Detailed Regulation on Supervision of Banking Business to adopt Basel III standards and to clarify the calculation of market risk under the adoption of IFRS 9.

The draft rules apply the current exposure method for derivatives transactions in the leverage ratio framework and specify the conditions for bilateral netting to be applied. The rules also specify the calculation methodology for available stable funding and required stable funding ratios in the net stable funding ratio (NSFR). These rules will not apply to branches of foreign banks.

In addition, the draft rules propose revisions to the calculation of risk-weighted assets in securitization exposures framework. The revisions aim to move away from the standardized external ratings based approach to the internal ratings based approach. Comments on the draft rules were due by December 4. The final rules are to be implemented on January 31, 2018.

- On June 27, 2018, four bank holding companies(BHC), one bank and BHC's subsidiary banks were designated by the FSC as domestic systemically important banks (D-SIBs) for 2019: Shinhan Financial Group, Hana Financial Group, KB Financial Group, NH Financial Group, Woori Bank, Shinhan bank, Jeju bank, KEB Hana bank, KB Kookmin bank and NH bank.

#### 4. Benchmarks reform

- On June 18, 2018, the FSC published a public consultation for the draft legislation on the administration of financial benchmarks. The main points include:
  - The FSC may designate financial benchmarks considered to significantly impact the financial market as “important benchmarks”;
  - Administrators of important benchmarks shall be required to register with the FSC, with adequate methods of calculation, transparent framework for disclosing and managing the calculation methodology, internal policies against conflicts of interest and governance procedures over reference data submission;
  - Users of important benchmarks shall provide the counterparty of a financial transaction referencing the important benchmark with the explanatory document on the benchmark published by the administrator, and have plans to protect the counterparty in case of a cessation of the benchmark reflected in the contract;
  - Code of conduct requirements for reference data submitters on important benchmarks; and
  - Equivalence and substituted compliance framework for foreign administrators of important benchmarks.

Comments on the draft legislation were due by July 30, 2018.

#### 5. FSC regulations

- On November 13, 2017, the FSC finalized the amendments to its regulations on outsourcing from financial institutions by the approval of the Commission. The draft amendments were announced in May for public comments until June 17, 2017. The amendments exempt reporting requirements on outsourcing of purely business support operations such as HR, administrative functions, legal and IT support, that are irrelevant to the principal financial business or are simple carry-outs of already approved policies. They also expand the conditions where reporting after-the-fact is allowed: if the operation is outsourced to the same entity for an extended amount of time, it may be reported after-the-fact. The amendments also included provisions to allow regulatory sandbox for fintech. It allows financial companies to delegate its authorised operations to designated fintech companies for testing.
- On January 29, 2018, the FSC announced its policy plans for 2018, which include:
  - Implement strengthened regulations on benchmarks, including internal controls on administrators and contributors and requirements for fallback arrangements, that comply with international principles by the second half of 2018;
  - Adopt recovery and resolution framework for financial institutions in line with the Financial Stability Board recommendations by the second half of 2018;
  - Convene task force meetings during the first quarter of 2018 and hold public consultations in the third quarter of 2018 to implement Basel III requirements within the proposed timeline (January 1, 2022);
  - Encourage regulatory sandbox on fintech; and
  - Implement anti-money laundering guidelines on cryptocurrencies.

- On December 6, 2018, the FSC announced that it has become one of a signatory to the Enhanced Multilateral Memorandum of Understanding Concerning Consultation and Cooperation and the Exchange of Information (EMMoU) of the International Organization of Securities Commissions (IOSCO) for cross-border enforcement cooperation.

## **6. FSS regulations**

- On July 9, 2017, the FSS extended the administrative guidance on intragroup transactions of global financial companies to July 8, 2018. The FSS initially issued the guidance on September 17, 2007, and the existing guidance was due to expire on July 8, 2017. The administrative guidance aims to set out the best practice principles a Korean entity of a global financial company should comply with when transacting with other entities in its financial group.

## **7. KRX developments**

- On February 8, 2017, Korea Exchange (KRX) announced rules to designate overheated securities short-selling and requiring pre-delivery of securities if in violation of short-selling rules. Stocks showing extraordinary increases in short selling with sharp falls in prices will be designated as overheated short-selling stocks after the market close and prohibited from short-selling the following day. The new rules are planned to go into effect on March 27, 2017, after its subordinate enforcements rules are amended.
- On March 3, 2017, KRX announced amended enforcement rules detailing the criteria to designate overheated short-selling securities in KOSPI, KOSDAQ and KONEX markets. The rules will take effect on March 27, 2017. KRX also announced detailed rules to implement 30-minute periodic call auctions on issues with abnormally soaring prices in KOSPI, KOSDAQ and KONEX markets, effective March 13, 2017.
- On September 20, 2017, KRX announced the implementation of clearing member margin requirements in its securities and revised collateral management criteria for all clearing services from September 25, 2017. Clearing member margin requirements will be introduced on securities with a T+2 settlement cycle and exchange-traded products listed on KOSPI, KOSDAQ and KONEX markets. Repo and bonds will be excluded from this requirement. It will also implement new eligibility criteria, haircut ratios and concentration limits on securities collateral in securities and derivatives clearing.

## **ISDA Submissions**

- January 2, 2017: ISDA submission to the draft FSS guidelines on margin requirements for non-centrally cleared derivatives ([English](#), [Korean](#))
- February 2, 2018: ISDA submission to the proposed extension and amendment to the FSS guidelines on margin requirements for non-centrally cleared derivatives
- July 30, 2018: ISDA submission to the FSC Draft Bill for the introduction of regulatory framework for financial benchmarks
- September 3, 2018: ISDA submission to the proposed FSC regulations to implement trade reporting requirements

## MALAYSIA

### AT A GLANCE

Central Bank:	Bank Negara Malaysia (BNM) <a href="http://www.bnm.gov.my">http://www.bnm.gov.my</a>
Bank Regulator:	BNM
Fin. Mkts Regulator:	Securities Commission, Malaysia (SC) <a href="http://www.sc.com.my">http://www.sc.com.my</a>
Associations:	Association of Banks in Malaysia (ABM) Malaysian Investment Banking Association (MIBA) Association of Islamic Banking Institutions Malaysia (AIBIM)
Master Agreement:	ISDA
Legal Opinions:	Netting, collateral, client clearing (clearing members reliance) and e-contracts opinions by Shearn Delamore & Co Netting on the ISDA/IIFM Tahawwut Master Agreement opinion by Zaid Ibrahim & Co.
CCP/TR Status:	The Capital Markets and Services (Amendment) Act 2011 provides the legislative framework for trade reporting but this will come into force at earliest in October 2013. The SC, Perbadanan Insurans Deposit Malaysia (PIDM) and BNM issued a joint consultation paper on trade reporting requirements in November 2013. As of 2018, TR has not come into force.

### Key Regulatory Milestones

#### 1. BNM Developments

- On January 20, 2017, Bank Negara Malaysia (BNM) published an exposure draft outlining the proposed regulatory requirements on credit risk management for licensed persons, prescribed development financial institutions and financial holding companies. The proposals seek to ensure that BNM's key expectations and requirements on credit risk management remain effective moving forward. The proposals:
  - Clarify and reinforce expectations and requirements on board-level governance arrangements and the risk management function, particularly within the context of credit decision-making;
  - Introduce requirements to strengthen the management of exceptional credits;
  - Prescribe a minimum standard for credit loss estimation; and
  - Enhance expectations on the management of concentration risk, country and transfer risk, as well as group-wide credit risk oversight.

This policy document came into effect on July 1, 2017 and has transitional arrangements for certain types of institutions until July 1, 2018. Comments on these proposals were due by March 31.

- On March 14, 2017, BNM announced that it held a roundtable discussion on domestic bond market developments on March 10. The key highlights of the roundtable discussion were on bond market liquidity, participation of non-resident holdings in Malaysian bonds, the introduction of new initiatives

for the bond market, and enhancing transparency and surveillance of the bond market.

- On January 22, 2018, BNM issued a policy document on credit risk. This revised policy document is a culmination of BNM's comprehensive review of the existing regulatory framework. It aims to further elevate credit risk management practices across the industry, taking into account developments in the size and diversity of product offerings, greater internationalisation of the financial system, and the growing role of domestic capital markets as an alternative source of financing.

This policy document also addresses requirements that will support the effective implementation of the Malaysian Financial Reporting Standards 9: Financial Instruments by financial institutions, and promote alignment with prudential objectives. Key changes to the revised policy document include:

- Clarity on governance expectations in respect of the involvement of the board and the risk management function in credit decision-making, management of problem credits, and the independent credit review function;
- Expanded requirements on the management of exceptional credits and concentration risk;
- Strengthened requirements on credit risk measurement to promote greater sophistication in loss estimation approaches; and
- New expectations for the management of country risk, transfer risk, and group-wide credit risk oversight.

The policy document took effect at the beginning of July 1, 2018 for banks on an entity basis and July 1, 2019 on a consolidated basis.

- On March 20, 2018, BNM released the list of financial institutions under the appointed overseas office framework. The list is available by banking group and by country.
- On August 17, 2018, BNM issued a supplementary notice on changes to the foreign exchange administration (FEA) regulations, aimed at facilitating operational efficiencies and better risk management. These measures include:
  - Greater flexibility in the management of export proceeds: Exporters are allowed to automatically transfer export proceeds into their trade foreign currency accounts maintained with onshore banks, to meet up to six months of foreign currency obligations or 25% of the export proceeds (whichever is higher) without the need to first convert the proceeds into MYR;
  - Flexible hedging of foreign currency obligations: Residents now have greater flexibility to hedge foreign currency obligations beyond six months, as well as foreign currency exposures arising from invoices issued in foreign currencies for domestic trade in goods and services; and
  - Wider access for non-residents to the onshore market financial market: Non-resident corporations are now allowed to trade in MYR-denominated interest rate derivatives via the approved overseas office framework, subject to back-to-back arrangements with onshore banks.

This supplementary notice became effective on August 17, 2018. The FAQs have also been updated to reflect these changes.

- On December 5, 2018, BNM and Dubai Financial Services Authority (DFSA) signed a MoU on supervisory cooperation for effective supervision of banking and insurance/takaful/reinsurance institutions operating in both countries.

The MoU signifies continuous efforts to promote financial stability in both jurisdictions. It also provides a strong foundation for further development of effective supervisory systems in accordance with the principles set out in the Basel Core Principles for Effective Banking Supervision, International Association of Insurance Supervision for Insurance Core Principles and the Financial Action Task Force Recommendations on Anti-Money Laundering. The MoU outlines cooperation and coordination between the authorities in the areas of exchange of information, facilitation of consolidated and cross-border on-site supervision, issuance of licenses and combating money laundering and terrorism financing.

## **2. IOSCO launches Asia Pacific hub**

- On March 14, 2017, the International Organization of Securities Commissions (IOSCO) launched its first regional hub in Malaysia, hosted by the Malaysian Securities Commission. At the request of IOSCO Growth and Emerging Markets Committee members, representing 75% of IOSCO's membership, IOSCO launched this hub in Asia-Pacific under the supervision of the IOSCO secretary general. The hub will deliver capacity building activities to its members within the Asia-Pacific region.

## **3. NDF market developments & initiatives to develop the onshore hedging market**

- On February 27, 2017, BNM announced that it conducted a workshop on onshore foreign exchange hedging for non-resident investors. The workshop focused on onshore hedging, liquidity in the FX market, and operational arrangements for investments by fund managers. BNM clarified the differences between passive hedging and the newly introduced dynamic hedging frameworks during the workshop. For further information, please view the presentations and FAQs.
- On March 1, 2017, BNM released the list of financial institutions under the Appointed Overseas Office (AOO) framework. The list is available by banking group and by country.
- On April 13, 2017, the Financial Markets Committee (FMC), in collaboration with Bank Negara Malaysia (BNM), announced a number of initiatives to promote a fair and effective financial market, improve bond market liquidity, ease hedging activities, and enhance transparency and market information. These measures are designed to promote a fair and effective financial market, greater liquidity in the bond market, additional hedging flexibility for market participants, and a stronger financial infrastructure.
- On May 2, 2017, BNM issued a supplementary notice to promote the development of Malaysian financial markets that sets out the following:
  - Dynamic hedging framework for institutional investors. A non-resident institutional investor registered with BNM is allowed to enter into forward contracts to sell ringgit up to 100% of its invested underlying ringgit-denominated asset, enter into forward contracts to buy ringgit up to 25% of its invested underlying ringgit-denominated asset, or unwind the forward contracts

described above without documentary evidence with a licensed onshore bank or an appointed overseas office, for the purpose of managing its ringgit exposure.

A resident institutional investor registered with BNM is allowed to enter into forward contracts to buy ringgit up to 100% of its invested underlying foreign currency denominated asset, or unwind the forward contracts described above without documentary evidence with a licensed onshore bank, for the purpose of managing its foreign currency exposure.

- Hedging framework for corporate entities. A non-resident entity registered with BNM is allowed to unwind up to 100% of its forward contracts entered with a licensed onshore bank or an appointed overseas office for underlying ringgit-denominated asset, ringgit-denominated borrowing, or current account transactions in ringgit with a resident for the purpose of managing its ringgit exposure.

A resident entity registered with BNM is allowed to unwind up to 100% of its forward contracts entered with a licensed onshore bank for underlying foreign currency denominated asset, foreign currency denominated borrowing, or current account transactions in foreign currency with a non-resident for the purpose of managing its foreign currency exposure.

- Hedging without documentary evidence. A resident is allowed to hedge its foreign currency exposure and cancel its hedging position for USD/MYR, CNH/MYR, GBP/MYR, EUR/MYR and JPY/MYR currency pairs with a licensed onshore bank without documentary evidence up to an aggregate net open position limit of MYR6 million per licensed onshore bank.

A resident is only allowed to sell ringgit on spot or a forward basis with a licensed onshore bank up to its six-month foreign currency obligations. This supplementary notice takes effect immediately.

- On August 9, 2017, BNM issued a press release indicating that the recent introduction of Malaysia ringgit (MYR) futures on offshore markets is inconsistent with Malaysia's foreign exchange administration (FEA) policy and rules. The MYR is a non-internationalised currency, and therefore offshore trading of MYR in any form outside of Malaysia is against Malaysia's policy. BNM reminded all market participants to observe the existing FEA rules, and that contravention of the FEA is an offence under the Financial Services Act 2013 and Islamic Financial Services Act 2013. BNM stated that appropriate action under the law will be taken if the prevailing rules and regulations are not complied with. Foreign participants should access the onshore ringgit foreign exchange market to meet their financial needs, either directly with onshore licensed financial institutions or through their appointed overseas office, BNM added.
- On September 8, 2017, BNM released the list of financial institutions under the Appointed Overseas Office (AOO) framework. The list is available by banking group and by country.
- On September 11, 2017, BNM issued a supplementary notice on foreign exchange administration (FEA) rules to promote the development of the Malaysian financial markets. The supplementary notice provides measures to further facilitate foreign exchange risk management for forward hedges of crude palm oil futures (FCPO) and options on crude palm oil futures (OCPO) contracts.

A non-bank, non-resident market participant registered with BNM is allowed to enter into forward contracts with a licensed onshore bank or an appointed overseas office up to the net open position of its Malaysian ringgit-denominated FCPO or OCPO contracts undertaken on Bursa Malaysia Derivatives, for the purpose of managing its Malaysian ringgit exposure arising from the FCPO or OCPO contracts. The market participant should unwind the excess forward contracts with the same licensed onshore bank or appointed overseas office in the event the notional value of such forward contracts exceeds the net open position of the underlying FCPO or OCPO contracts. This supplementary notice is effective September 11.

#### **4. Basel III & Capital**

- On March 2, 2017, BNM announced that it had reissued the Capital Adequacy Framework and the Capital Adequacy Framework for Islamic banks. Both policy documents have been reissued to include revised requirements on the use of internal estimates for effective maturity under the foundation internal rating based approach.
- On May 3, 2017, BNM announced that banking institutions are no longer required to maintain a reserve fund. The policy document on capital funds has been updated to reflect this revised requirement. Since 2016, Malaysian banks have begun a four-year phase-in to maintain a capital conservation buffer based on the Basel standards. With the phasing in of the Basel capital conservation buffer, the need for banks to maintain the reserve fund is no longer necessary given that both requirements are intended for the same purpose.

The reserve fund requirement is different from the statutory reserve requirement, which still remains in place. This change is effective immediately.

- On August 16, 2017, BNM issued an exposure draft that outlines BNM's proposals for the leverage ratio framework as part of the Basel III regulatory reforms. The exposure draft proposes a minimum leverage ratio of 3%, and outlines the proposals for the calculation methodology for total leverage ratio exposure, derivative exposures, securities financing transaction exposures, off-balance-sheet exposures, and the reporting requirements.

These proposals are to take effect from January 1, 2018. Comments on these proposals were due by September 16.

- On September 6, 2017, BNM announced that the Capital Adequacy Framework and the Capital Adequacy Framework for Islamic banks policy documents were reissued effective August 4.

Both policy documents have been reissued to incorporate the loss absorption mechanism via write-off for additional Tier 1 and Tier 2 Islamic capital instruments that are structured using equity-based shariah contracts such as Wakalah, Musyarakah or Mudarabah.

- On September 27, 2017, BNM issued an exposure draft that outlines BNM's proposals for the net stable funding ratio (NSFR) framework as part of the Basel III regulatory reforms. The NSFR requires banking institutions to maintain a stable funding profile in relation to the composition of their assets

and off-balance sheet activities. This standard complements the liquidity coverage ratio, which has been phased in since 2015.

The exposure draft proposes a minimum NSFR of 100% and outlines the proposed calculation methodology for available stable funding and required stable funding ratios. It also outlines the criteria for interdependent assets and liabilities, off-balance sheet exposures and derivative liabilities.

BNM intends to implement the NSFR no earlier than January 1, 2019, acknowledging that there is considerable uncertainty in the implementation schedule and divergence from the internationally agreed timeline of January 1, 2018. Comments on these proposals were due by November 27.

- On December 8, 2017, BNM issued a policy document outlining the leverage ratio framework for banking institutions. Banking institutions are required to comply with a minimum leverage ratio of 3% beginning January 1, 2018. BNM also released the reporting template, response to feedback received and FAQs.

## 5. SC Developments

- On April 13, 2017, Securities Commission Malaysia (SC) announced new guidelines to allow the regulated short selling of corporate bonds in the Malaysian capital market. Under the revised guidelines, principal dealers are now permitted to conduct regulated short selling of corporate bonds, expanding the range of bonds that can be short sold. The guidelines aim to provide certainty as to the parties that would be permitted to conduct short selling of corporate bonds, as well as the requirements involved. These guidelines were effective from April 13.
- On June 23, 2017, the SC introduced amendments to its regulatory framework to include clearing for securities and derivatives as a new regulated activity.  
This framework will decouple clearing and trading functions into two distinct regulated activities, allowing intermediaries to specialise their services. The entrance of new standalone execution and clearing intermediaries, including foreign-owned entities, will transform the competitive dynamics of the capital market, and enhance cost efficiency for trading and clearing activities.

The operationalisation of the new framework will take a phased approach, and will start with the derivatives market. These changes are outlined in the updated licensing handbook.

- On August 20, 2018, the SC and the Ministry of Finance of the People's Republic of China signed a MoU for cross-border regulatory cooperation on accounting and audit matters under their respective oversight.

## 6. Fintech

- On November 6, 2017, the SC announced, at its flagship fintech event, SCxSC Digital Finance Conference 2017, that it is embarking on a pilot project to explore the usage of Digital Ledger Technology in the unlisted and OTC markets space. The findings from the pilot will form the basis of an industry blueprint. At the same time, SC is reviewing relevant regulations and guidelines to

facilitate functional and effective use cases of digital assets in the capital market, including secondary market trading of established crypto currency and digital assets.

- On September 26, 2018, the the United Nations Capital Development Fund (UNCDF), BNM, and Malaysia Digital Economy Corporation (MDEC) partnered together to launch the Inclusive Fintech Accelerator Program, a program aimed at solving specific financial inclusion pain points in Malaysia, surrounding four key areas which are spending, saving, borrowing and financial planning. The Inclusive Fintech Accelerator Program will be the first of a series of accelerator programs to be organised jointly by UNCDF, BNM and MDEC. Fintech start-ups were invited to share their interest to participate in the upcoming accelerator programs and other activities to be organised via the hub.
- On November 28, 2018, the SC urged financial services providers to embrace technology to develop a more inclusive, innovative and efficient capital market, in line with the government's agenda to support the growth of the digital economy.

The SC Chairman also outlined the progress of the SC's Digital Markets Strategy. The SC has received strong interest from new and existing capital market players to offer automated discretionary portfolio management services under the Digital Investment Management (DIM) framework. While the first DIM licence was awarded in mid-October, the regulator has yesterday granted another approval-in-principle, with more applications currently under assessment.

The SC also unveiled details of Project Castor with the accompanying industry blueprint entitled "Capital Market Architecture Blueprint in a Decentralised World", which explored the technical implementation and feasibility of using Distributed Ledger Technology as the underlying market infrastructure for unlisted and OTC markets.

- On December 6, 2018, the SC and BNM issued a joint press statement to provide clarity on the regulatory approach for the offering and trading of digital assets in Malaysia.

The SC will regulate issuances of digital assets via initial coin offerings (ICO) and the trading of digital assets at digital asset exchanges in Malaysia. Regulations are currently being put in place to bring digital assets within the remit of securities laws to promote fair and orderly trading and ensure investor protection.

ICO issuers and digital asset exchanges which are involved in the issuance or dealing of digital assets with a payment function will need to comply with relevant BNM laws and regulations relating to payments and currency matters. In addition, ICO issuers and digital asset exchanges are subject to the SC's Guidelines on Prevention of Money Laundering and Terrorism Financing.

**ISDA Submissions**

September 15, 2017: [ISDA submission to Bank Negara Malaysia in relation to Exposure Draft on Leverage Ratio](#)

November 24, 2017: [ISDA submission to Bank Negara Malaysia in relation to Exposure Draft on Net Stable Funding Ratio](#).

## NEW ZEALAND

### AT A GLANCE

Central Bank:	Reserve Bank of New Zealand (RBNZ) <a href="http://www.rbnz.govt.nz">http://www.rbnz.govt.nz</a>
Bank Regulator:	RBNZ
Fin. Mkts Regulator:	Financial Markets Authority (FMA) <a href="http://www.fma.govt.nz">http://www.fma.govt.nz</a>
Bank Associations:	New Zealand Bankers Association (NZBA) New Zealand Financial Markets Association (NZFMA)
Master Agreement:	ISDA
Legal Opinions:	Netting, collateral and client clearing (clearing members reliance and FCM clearing members reliance) opinions by Bell Gully
CCP/TR Status:	The European Securities and Markets Authority (ESMA) recognised New Zealand Clearing Limited as a third country CCP on May 24, 2017, thus allowing it to provide clearing services to clearing members or trading venues established in the EU.

### Key Regulatory Milestones

#### 1. New Zealand's response to foreign margin requirements

- On July 13, 2017, the Reserve Bank of New Zealand (RBNZ) and the Ministry of Business, Innovation and Employment (MBIE) released a public consultation which among others, identifies specific potential impediments under New Zealand law to compliance with foreign requirements on margin for uncleared derivatives. The consultation proposed a number of targeted legislative amendments to address these impediments and sought views on the scope of the issues identified and the adequacy and the effect of the amendments proposed. Issues identified in the consultation include, among others, whether current New Zealand law is a significant potential barrier to the ability of New Zealand entities to effectively and efficiently provide margin and whether on balance, a targeted approach to amending existing legislation would be preferable to a standalone Netting Act in New Zealand in addressing these potential impediments.

At that stage, RBNZ, as New Zealand's prudential regulator, did not yet intend to impose margin requirements on its regulated entities. The consultation closed on August 24, 2017.

#### 1. RBNZ and FMA Developments

- On March 7, 2017, the RBNZ announced that it will review the framework for bank capital requirements over the coming year, with the aim of enhancing the soundness and efficiency of the New Zealand banking system. The review will cover banks' definition of capital, risk measurement and minimum capital requirements. The RBNZ will outline specific areas to be addressed in an issue paper to be released in April 2017, and detailed policy positions and options for changes to the capital

framework will be outlined in consultation papers during the year. The RBNZ aims to conclude the review by the first quarter of 2018.

- On April 3, 2017, the FMA confirmed that businesses selling short-duration derivatives need to be licensed. The Financial Markets Conduct Act had introduced licensing for derivatives issuers in December 2014.

The FMA has been reviewing how it regulates short-duration derivatives products, such as binary options and contracts-for-difference (CFDs), including through discussions with the sector. From December 2017 onwards, any company making regulated offers of short-duration derivatives products to New Zealanders that settle within three days, whether they are based here or abroad, will require a licence. The FMA expects all currently unlicensed providers to apply for a licence by August 1, 2017.

The FMA sought feedback on whether to use its designation power to declare that spot FX contracts physically settled by delivery of an amount of currency within three working days are not derivatives for the purposes of the Financial Markets Conduct Act, to ensure that actual exchanges of foreign currency, settled within three working days, are not classified as derivatives.

- On May 4, 2017, the RBNZ announced that cabinet had agreed to a new legislative framework to improve regulation of payment systems and other financial market infrastructures (FMIs). The new framework comes after a detailed review by the Reserve Bank of FMI regulation, which included three public consultations in the past four years.

The new framework builds upon the existing regulation of payment and settlement systems, and will be jointly administered by the RBNZ and FMA in most respects. It also aims to ensure that regulation of FMIs is proportionate to the risks they pose. An exposure draft of proposed legislation will be open for public consultation before it is introduced into parliament.

- On May 9, 2017, the RBNZ announced that the International Monetary Fund (IMF) has declared New Zealand's banking system to be resilient, but nevertheless recommended ways to improve the strength of the country's financial sector and the regulatory framework.

In releasing the findings from its Financial Sector Assessment Programme (FSAP), the IMF said that the banking system is well placed to manage risks and vulnerabilities associated with current developments in the housing sector, the high level of household debt, and low dairy prices. The FSAP included a range of stress tests of the large New Zealand banks. The report states that New Zealand has a good institutional framework for macro-prudential policy and that loan-to-value ratio restrictions have generated financial stability benefits, although it could be strengthened further.

Recommendations for improvements include increasing the intensity of supervision for both the banking and insurance sectors, within the RBNZ's three-pillar approach to prudential regulation that is based on self, market and regulatory discipline. The IMF has endorsed the RBNZ's current legislative proposal to improve the regulation and oversight of financial market infrastructures, as well as the importance of reviewing the bank capital framework.

- On June 28, 2017, the RBNZ published its Statement of Intent for 2017-20.

The RBNZ's nine strategic priorities are framed around three themes: enhancing the Bank's policy frameworks; continuing to strengthen the Bank's internal and external engagement; and improving infrastructure and reducing enterprise risk. The Bank will also review the macro-prudential policy framework in line with the five-year requirement set out in the Memorandum of Understanding between the Bank and the Minister of Finance. As well as working to complete the implementation of replacements for the Exchange Settlement Account System (ESAS) and the securities settlement and depository system (NZ Clear) – both enhancements to the payments system – the Bank will also be implementing the roadmap for best-practice management of its balance sheet and finances.

The SOI outlines other key projects, including improving the resilience of the Bank's operations and developing a plan for the future custody and distribution of currency.

- On November 17, 2017, the RBNZ published a consultation paper proposing an enhanced mortgage bond standard aimed at supporting confidence and liquidity in the financial system. This paper follows a review of domestic and international mortgage bond collateral standards. The proposed standard is consistent with international policy guidelines aimed at promoting simpler and safer secured bonds.

Mortgage bonds are not generally traded in New Zealand. The RBNZ believes that a more standardized and transparent framework for mortgage bonds would improve their quality and make them more marketable. It has developed a proposed new format for mortgage bonds, called residential mortgage obligations (RMO). The RBNZ believes the standard would improve the risk position of the Reserve Bank by promoting the use of higher quality and potentially more liquid, mortgage bonds as collateral in the Bank's lending operations, support New Zealand market lenders by creating an additional funding instrument for residential mortgages, and promote a deeper capital market. The RBNZ is seeking feedback on the terms under which it should accept mortgage bonds as collateral and the proposed new RMO standard. Submissions to the consultation are due by February 16, 2018.

- On June 7, 2018, the RBNZ announced that the Finance Minister had released the terms of reference for Phase 2 of the Review of the Reserve Bank Act. It will be organized around a series of key topics and will consider the following:
  - The institutional arrangements for prudential regulation and supervision;
  - Objectives, setting processes, and alignment with government policy and risk appetite;
  - Statutory functions and powers;
  - Role clarity for the Minister of Finance, Board and Governor;
  - The strengths of current legislation, including its flexibility;
  - The balance between primary, secondary and tertiary legislation, including setting policy;
  - Coordination across government;
  - Alignment with the domestic regulatory management system;
  - Procedural approaches, fairness and safeguards; and
  - International experience and best practice.

The Treasury and RBNZ will jointly carry out the Phase 2 work in conjunction with the Independent Expert Advisory panel. The panel will provide separate advice to the Minister as appropriate. There

will be further public consultation once the review team has developed a work program to progress the key topics identified in the terms for Phase 2.

- On August 24, 2018, the RBNZ announced that new data on the financial health of New Zealand registered banks was published on the Bank Financial Strength Dashboard. This is the first quarterly update of key metrics on banks since the dashboard was launched in May 2018.

The dashboard makes it easy for customers and investors to compare banks on a range of financial information, such as how much capital they have in reserve, whether they are taking risks by concentrating lending too much on one area and non-performing loans. The aim is to improve the public understanding of banks and to increase incentives for banks to operate soundly.

The next quarterly update is scheduled for November 26, 2018.

- On September 10, 2018, the RBNZ announced that the team undertaking Phase 2 of the government's review of the Reserve Bank Act has released the outline of how Phase 2 will proceed. Consultation will run from November 2018 until late January 2019 to seek initial stakeholder views on the following topics set out in the terms of reference released by the Minister of Finance in June:

- Overarching objectives of the Reserve Bank set out in legislation;
- Institutional governance and decision making;
- The case for and against separation of prudential supervision from the Reserve Bank;
- The case for and against depositor protection (including the option of deposit insurance); and
- Reconsidering the regulatory perimeter of 'bank' regulation.

Two further consultation periods are planned and will cover the remaining topics along with detailed policy options developed following the first consultation. The next of these consultations is expected for the first half of 2019 with a final consultation expected later in the year.

- On November 5, 2018, the FMA and the RBNZ announced that they have completed a joint review into the conduct and culture of 11 New Zealand banks. The review is the first of its kind in New Zealand.

The regulators identified significant weaknesses in the governance and management of conduct risks, resulting in a number of issues that require remediation. Banks' lack of proactivity in identifying and remediating conduct issues and risks means vulnerabilities remain. The FMA and RBNZ conclude that the overall standard of banks' approaches to identifying, managing and dealing with conduct risk needs to improve. However, based on their findings, the FMA and RBNZ do not consider that widespread misconduct or poor culture issues currently exist across banks in New Zealand.

While the principal responsibility for developing strong governance and management frameworks for conduct risk remains with banks, the current regulatory settings do not provide sufficient scope for regulators to hold banks to account for their conduct. The report therefore sets out a number of options the government could consider to address these issues.

## 2. Basel III & Capital

- On May 1, 2017, the RBNZ published an issues paper that seeks views about the regulation of capital adequacy for banks. The RBNZ is conducting a broad ranging capital review, as foreshadowed in a speech by Deputy Governor Grant Spencer in March. The review aims to identify the most appropriate capital adequacy framework, taking into account experience with the current framework and international developments.

The review will consider the definition of regulatory capital, the measurement of risk-weighted exposures, and the minimum capital ratios that apply to locally incorporated banks. The issues paper marks the first public consultation as part of the review. The RBNZ is seeking feedback about the topics covered by the issues paper. Responses for the consultation close on 9 June 2017.

- On July 14, 2017, the RBNZ opened a public consultation about what type of financial instruments should qualify as bank capital.

Important considerations for regulations about bank capital include: the Reserve Bank's regulatory approach; the resolution regime in the event of a bank facing difficulties; international standards issued by the Basel Committee on Banking Supervision; the Reserve Bank's experience with the current capital regime; and the fact that dominant participants in the New Zealand banking market are subsidiaries of overseas banks. The consultation paper discusses these issues and outlines five options for reforming existing regulations.

The Bank's proposed reforms to capital regulations aim to reduce the complexity of the regulatory regime; provide greater certainty about the quality of capital that banks hold; and reduce the scope for regulatory arbitrage.

The consultation closes on Friday 8 September, 2017.

- On July 6, 2018, the RBNZ published their in-principle decisions on capital requirements for registered banks. This is part of a thorough review of capital adequacy in the New Zealand banking system. The in-principle decisions announced are designed to bolster how much capital banks need to hold, make it easier for investors to assess capital adequacy, and to minimise any unintended competitive advantages.

The in-principle decisions announced today will require the four largest banks to report using both their own risk models as well as the standardised frameworks the other banks use. This will help shine light on whether the big bank's risk estimates are appropriate.

The next phase of the Capital Review will be a quantitative impact study of the in-principle decisions made so far by the Reserve Bank. The final phase will address the setting of minimum capital ratios. The Reserve Bank aims to conclude the key elements of the Capital Review in 2018.

- On July 6, 2018, the RBNZ published an overview of how stress tests are used to monitor the stability of the financial system, along with detailed results from the latest exercise.

As part of their role in monitoring financial stability, stress tests are adapted over time to investigate new or emerging risks. The latest test includes a previously unexplored scenario, where losses related to mortgage misconduct coincide with a macroeconomic downturn.

- On December 14, 2018, the RBNZ published a consultation paper seeking feedback on proposed reforms to the amount of regulatory capital required for locally incorporated banks. The proposed reforms include:
  - A Tier 1 capital ratio requirement of 16 percent for domestic systemically important banks (D-SIBs), which includes a conservation buffer of 7.5 percent, countercyclical capital buffer of 1.5 percent, and a D-SIB buffer of 1 percent;
  - A Tier 1 capital ratio requirement of 15 percent for banks that are not D-SIBs, which includes a conservation buffer of 7.5 percent and countercyclical capital buffer of 1.5 percent; and
  - A question on whether Tier 2 capital requirements should be retained.

RBNZ has proposed a 5 year transitional period to allow banks to meet these higher capital requirements, and to address technology and operational requirements.

The current RBNZ capital framework does not include a leverage ratio requirement. This consultation paper does not propose detailed leverage ratio requirements at this stage, but rather seeks views on the general question of whether leverage ratio requirements should be included in the RBNZ framework. The proposed options for a leverage ratio requirement include:

- No leverage ratio requirements (no change);
- A requirement to disclose a leverage ratio, but not set a minimum requirement; or
- Disclosure and minimum leverage ratio requirements.

Further consultation will follow on leverage ratio requirements if it is decided that they should be included in the RBNZ framework. Comments on the proposed reforms are due by March 29, 2019, and RBNZ expects to make final decisions by June 2019.

### **3. Benchmarks reform**

- On June 16, 2017, the RBNZ published an article in the Reserve Bank Bulletin providing an overview of the importance of benchmarks.

The article noted the need for financial market benchmarks to be reliably measured, transparent and supported by strong governance arrangements. It explores the way that regulators worldwide are implementing reforms for interest rate benchmarking systems and processes. It also noted that significant work has been undertaken in recent years to improve the reliability, transparency and governance in New Zealand's key short-term interest rate benchmark, BKBM.

The article noted that significant declines in volumes traded during the BKBM rate set in recent years have raised concerns about the reliability of the BKBM as a benchmark rate. The Bulletin article

discussed this trend as well as potential solutions for a recovery in the efficiency and liquidity of the New Zealand bank bill market.

- On October 11, 2017, the FMA published guidance on conduct and an overview of bank bill benchmark rate (BKBM) and closing rates. The FMA had also published an overview of BKBM and benchmarks, their purpose and how they are regulated.

The guidance sets out what the FMA is looking for when assessing trading conduct, its expectations and further sources of guidance. It also makes clear that should the FMA see evidence of trading that has been undertaken for the purpose of moving the BKBM or another rate, the FMA will take appropriate and proportionate action.

The FMA also advised that it has not found evidence of systemic trading in bank bills that was not for legitimate purposes. However, it will continue to engage with banks and overseas regulators on this topic.

### **ISDA Submissions**

August 24, 2017: [ISDA submission to the RBNZ consultation on a New Zealand Response to Foreign Margin Requirements for OTC Derivatives](#)

6 June 2018: [ISDA submission to Reserve Bank of New Zealand on Authorisations for the use of restricted words by overseas banks \(April 2018\)](#)

## PHILIPPINES

### AT A GLANCE

Central Bank:	Bangko Sentral Ng Philipinas (BSP) <a href="http://www.bsp.gov.ph">http://www.bsp.gov.ph</a>
Bank Regulator:	BSP
Securities Regulator:	Securities and Exchange Commission (SEC) <a href="http://www.sec.gov.ph">http://www.sec.gov.ph</a>
Associations:	Bankers Association of the Philippines
Legal Opinions:	Netting, collateral and client clearing (clearing members reliance) opinions by SyCip Salazar Hernandez & Gatmaitan
Master Agreement:	ISDA
CCP/TR Status:	No announced plans

### Key Regulatory Milestones

#### 1. Basel III & Capital

- On December 29, 2016, the Monetary Board of Bangko Sentral Ng Philipinas (BSP) deferred by one year the full adoption of the Basel III leverage ratio in view of recent revisions by the Basel Committee on Banking Supervision (BCBS). Universal and commercial banks and their subsidiaries had been scheduled to wind-up the monitoring period and begin adhering to the 5% minimum leverage ratio by January 1, 2017.

In relation to this, the Monetary Board also extended the monitoring period for the leverage ratio until December 31, 2017.

- On January 26, 2017, BSP issued the circular extending the Basel III leverage ratio monitoring period, following the Monetary Board resolution on December 29, 2016. Covered banks shall be required to submit the Basel III leverage ratio reporting template semi-annually until December 31, 2017.

During the monitoring period, the BSP shall continue to assess the calibration as well as the treatment of the components of the leverage ratio. Final guidelines shall be issued in view of the changes to the framework as well as migration from monitoring of the leverage ratio to a Pillar 1 requirement starting from January 2018.

- On February 2, 2017, the Monetary Board of BSP approved the amendments to the Manual of Regulations for Banks and the Manual of Regulations on Foreign Exchange Transactions (FX Manual) to liberalize certain liquidity metrics in view of the improvements in banks' risk management systems, including the adoption of the Liquidity Coverage Ratio for universal and commercial banks beginning January 1, 2018.

Authorised government depository banks other than the BSP, and authorised private banks shall, inclusive of the required reserves against deposits and/or deposit substitutes, maintain a 50% liquidity

floor with respect to deposits of, borrowings from, and all other liabilities to, the Government and government entities, until December 31, 2017, in the form of transferable government securities which represent direct obligations of the National Government. Effective January 1, 2018, universal and commercial banks shall be subject to 0% liquidity floor.

- On October 30, 2017, BSP announced that the Monetary Board approved the revisions to the guidelines on liquidity risk management for banks and quasi-banks.

The BSP states that the revisions of the guidelines, which would largely impact complex and quasi-banks, are those on:

- Foreign currency management, which requires banks to identify and monitor positions in significant currencies;
- Intraday liquidity management, which emphasizes the need for banks to measure and anticipate the timing of intraday inflows and outflows so that they may contribute to the smooth functioning of payments and settlements systems;
- Intragroup liquidity management, which sets out the expectation for supervised institutions that belong to a financial group to manage and control exposures across legal entities within the group and assess the possibility that a problem in one entity may spread to other entities because of market perception;
- Collateral management, which recognises the growing utilization of repo markets as a source of funds and the requirement for financial institutions to post margins for their derivatives transactions; and
- Stress testing and contingency funding plans, which relate the design of stress tests to banks' specific circumstances and activities and require greater consistency between the scenarios assumed in stress tests and the sources of funding identified in the contingency plan.

The implementing circular will give covered supervised institutions until September 2018 to develop or revise their policies and procedures and ensure that these are in accordance with the requirements of the revised guidelines. The BSP also stated that issuances on the implementation of the NSFR and intraday liquidity reporting requirements will follow.

- On January 4, 2018, BSP issued a circular on guidelines on the conduct of stress-testing exercises as part of its manual of regulations for banks.

Banks are expected to develop sound assumptions generally depicting events or scenarios that may result in significant losses, and to assess the impact of these scenarios on the bank's performance or capital and liquidity positions. The issuance provides that the board of directors should consider the results of stress-testing exercises in capital and liquidity planning, in setting risk appetite, in planning for business continuity management, and, in the case of domestic systemically important banks, in developing recovery plans. BSP grants banks a period of two years from the effective date of the issuance to gradually progress from their existing stress-testing practices to fully meet the expectations in the circular.

- On January 15, 2018, BSP announced that the Monetary Board approved the adoption of a minimum leverage ratio requirement for universal banks, commercial banks and their subsidiary banks and

quasi-banks. Beginning 1 July 2018, covered institutions must maintain a leverage ratio no lower than 5%.

When effective, covered banks and quasi-banks must submit the Basel III leverage ratio report along with the Basel III capital adequacy ratio report quarterly on both a solo and consolidated basis. In addition, covered financial institutions are required to disclose their leverage ratio in their published balance sheets and annual reports.

- On January 22, 2018, BSP issued the extension of the monitoring period of the Basel III Leverage Ratio Framework amending the Manual of Regulations for Banks/Manual of Regulations for Non-Bank Financial Institutions (MORB/MORNBFI).
- On June 4, 2018, BSP announced that its Monetary Board approved the adoption of the net stable funding ratio (NSFR) for universal and commercial banks. Beginning January 1, 2019, the covered institutions shall maintain an NSFR of 100% on both solo and consolidated bases.

BSP is adopting an observation period of six months from July 1 to December 31, 2018. During this period, the covered institutions that will not meet the prescribed minimum ratio are required to submit a funding plan or actions that will be taken to improve their funding profile and comply with the requirement.

- On December 6, 2018, BSP announced that its Monetary Board approved the adoption of the Basel III countercyclical capital buffer (CCyB).

The CCyB will be set at zero percent, subject to upwards adjustment to a rate determined by the Monetary Board when systemic conditions warrant, but not to exceed two and a half percent. Any increase in the CCyB rate shall be effective 12 months after its announcement. Decreases shall be effective immediately.

Other provisions have been amended to reflect the Common Equity Tier 1 requirement of the CCyB.

## **2. BSP regulations**

- On February 8, 2017, BSP issued a memorandum on cross-border derivatives transactions subject to margin requirements, advising Philippine banks and quasi-banks to assess the potential impact of the margin requirements and their readiness to comply. BSP advised that Philippine banks' derivatives transactions with foreign counterparties are most likely to be subject to variation margin requirements by March 1, 2017 and initial margin requirements by September 1, 2020.

Banks and quasi-banks must inform the BSP of any significant concerns arising from the implementation of the margin requirements.

- On February 24, 2017, BSP announced that its Monetary Board approved the enhanced Supervisory Policy on Granting of a Licence/Authority (Licensing Policy) to provide more consistency in how risk-focused supervision is applied to the licensing process. The enhanced policy sets out BSP's

expectations and criteria in granting licences and/or authorities, as well as the right to reject applications that do not meet the criteria and/or deploy appropriate enforcement actions against financial institutions supervised by the BSP that no longer meet the criteria or standards.

- On March 20, 2017, BSP issued its guidelines on business continuity management for BSP-supervised financial institutions (BSFIs) and amendments in the Manual of Regulations for Banks and Manual of Regulations for Non-Bank Financial Institutions. The guidelines aim to promote sound management of business continuity risks, and shall apply to BSFIs which include banks, non-banks with quasibanking function (NBQB), non-bank electronic money issuers and other non-bank institutions which under existing Bangko Sentral rules and regulations and special laws are subject to Bangko Sentral supervision and/or regulation. Moreover, subject guidelines shall also apply to BSFIs with offshore data processing as may be appropriate to their situation.
- On June 28, 2017, BSP issued a circular setting out its expectations on banks to establish an effective reporting system that will enable them to comply with the BSP's reporting standards.

Under the circular, banks are expected to ensure that reports submitted to the BSP are complete, accurate, consistent, reliable and timely. This should be done independent of any validation process that the BSP may conduct prior to accepting a report as compliant with the standards. As such, an effective governance process over the bank's reporting system must be established by the bank's board of directors. These include written policies and procedures, as well as defined processes for periodic review, enhancements and reporting to its board and senior management. This should be supported by a management information system and technology infrastructure that is commensurate to the bank's level of activity and complexity.

In cases of non-compliance with the reporting standards, the circular introduces a combination of enforcement actions that are intended to bring about an improvement in behaviour. In addition to rationalising the monetary penalties currently being imposed on banks, non-monetary sanctions for habitual incurrence of reporting violations as determined through a demerit system are also introduced. Formal corrective measures may also be required to be undertaken by the bank should there be significant deficiencies noted during the assessment of its reporting system.

Full implementation of the circular will take effect beginning January 1, 2018. For the remaining months of 2017, banks are expected to make the necessary changes to their systems and processes to comply with the requirements of the circular.

- On July 7, 2017, BSP announced the exclusion from the single borrower's limit the short-term exposures of banks and quasi-banks to clearing and settlement banks arising from payment transactions pertaining to fund transfer services, check clearing, foreign exchange trades, security trades, security custody services, and other short-term payment transactions. To be eligible for exclusion, a clearing and settlement account shall be maintained with a designated local settlement bank, or a foreign settlement bank. Banks and quasi-banks shall enter into a formal agreement with the settlement bank, stipulating that the account is opened and maintained exclusively for short-term payment transactions, and shall adopt internal control mechanism appropriate to these transactions, including proper segregation of accounts.

- On August 3, 2018, BSP approved the guidelines on the adoption of Philippine Financial Reporting Standards (PFRS) 9 - Financial Instruments for Bangko Sentral supervised financial institutions (BSFIs). The policy sets out the supervisory expectations in classifying and measuring financial instruments and in recognizing impairment to promote prudence and transparency in financial reporting.
- On November 15, 2018, BSP issued enhanced rules on marking to market of debt and equity securities to align BSP regulations with international accounting standards and in response to the adoption of a valuation methodology for peso denominated government securities by a benchmark administrator authorised by the SEC.

The revised guidelines provide the bases for the valuation at market prices of debt and equity securities. Specifically, for peso-denominated government securities the market prices provided by either a third party pricing service or calculating agent should be used as reference provided that the same, including the valuation methodology, is recognised by the SEC. The BSP also expects BSP-Supervised Financial Institutions to have adequate governance structures and control processes to ensure that valuations are prudent and reliable for risk management and financial reporting purposes. These valuation practices should be consistently applied across the institution and embedded within the overall governance framework and risk management systems.

The revised marking-to-market guidelines are anchored on the provisions of the Philippine Financial Reporting Standards (PFRS) 13 on Fair Value Measurement.

### **3. SEC regulations**

- On January 16, 2017, the SEC posted the proposed rules and regulations governing the registration and trading of structured warrants. It includes, among others, capitalisation requirements for the issuer, risk management practices, sales and marketing practices and registration requirements. Comments are due by February 10, 2017.
- On November 9, 2018, the SEC issued its 2018 Guidelines on Anti-Money Laundering and Combating the Financing of Terrorism for SEC Covered Institutions (“2018 AML/CFT Guidelines”). Under the Guidelines:
  - All covered institutions as defined in this 2018 AML/CFT Guidelines are required to amend their respective Money Laundering and Terrorist Financing Prevention Program (MLPP) to conform to the Guidelines.
  - All covered institutions shall within six months from the effectivity of these Guidelines, submit their revised MLPP to the SEC.

The circular took effect 15 days after its publication in two national newspapers of general circulation and its posting in the SEC website.

- On August 22, 2018, the SEC published rules on the administration of government benchmarks. The rules contain general and miscellaneous provisions, as well as provisions concerning:
  - the authorisation, registration and supervision of administrators,
  - governance,
  - quality of the benchmark,
  - quality of the methodology, and
  - accountability.

#### **4. Repo Reporting**

- On June 28, 2017, BSP issued a memo setting out reporting guidelines for repo agreements of banks and quasi banks. This template and guidelines are pursuant to BSP Circular No. 923 dated August 31, 2016, which requires a monthly report on repo agreements to be filed, commencing with the period ending June 30, 2017. A pilot run was conducted on November 30, 2016.

#### **5. Cyber Security**

- On November 3, 2017, BSP announced that its monetary board has approved the guidelines on information security management. The amendments highlight the role of the board and senior management of Bangko Sentral supervised financial institutions (BSFIs), and mandate BSFIs to manage information security risks and exposures within acceptable levels.

BSFIs are given one year from the effectivity date of the circular to fully comply with the provisions therewith. Further, plan of actions with specific timelines, as well as the status of initiatives being undertaken to achieve full compliance, should be readily available upon request starting December 2017.

- On October 31, 2018, BSP issued the amendments to existing regulations that tighten the reporting regime for BSP supervised financial institutions (BSFIs) on cyber-related incidents and operational disruptions.

The amendments include:

- BSFIs will be required to report major cyber-related incidents and disruptions of financial services and operations within two hours from discovery of the incident;
- After the initial notification, the affected BSFIs are mandated to submit a follow-up report within 24 hours from the incident containing information such as the manner and time of initial detection, impact of the incident and initial remedial response;
- The BSP shall closely monitor the situation, coordinate with the concerned BSFI and undertake appropriate supervisory actions if warranted, until full resolution of the incident; and
- The BSP may swiftly issue appropriate advisories, security bulletins, and/or policies to prevent recurrence of the incident and promote enterprise and industry-wide operational resilience.

The amendments took effect 15 calendar days after its publication either in the Official Gazette or in a newspaper of general circulation in the Philippines.

## 6. Fintech

- On January 19, 2017, the Monetary Board of BSP approved the rules and regulations governing operations of virtual currency exchanges in the Philippines as part of its Manual of Regulations for Non-Bank Financial Institutions (MORNBFI). The BSP states that it aims to regulate virtual currencies when used for delivery of financial services, particularly, for payments and remittances, which have material impact on anti-money laundering (AML) and combating the financing of terrorism (CFT), consumer protection and financial stability. The regulations shall govern the operations and reporting obligations of virtual currency exchanges in the Philippines.
- On November 16, 2017, BSP and the Monetary Authority of Singapore (MAS) signed a FinTech Co-operation Agreement to promote innovation in financial services in their respective markets. The CA provides a framework for co-operation and collaboration between the two authorities relating to FinTech. The authorities will be able to refer promising FinTech firms to each other, share emerging FinTech trends and developments, and facilitate work on FinTech projects together. These projects could involve tapping on new financial technologies, like distributed ledgers, to provide innovative solutions to industry problems, such as facilitating faster cross-border payments and streamlining “know-your-client” (KYC) processes.
- On August 2, 2018, the SEC has released, for public comment, the proposed rules to govern the registration of initial coin offerings (ICOs). The proposed rules include:
  - The proposed rules shall cover the conduct of ICOs wherein convertible security tokens are issued by start-ups and/or registered corporations organized in the Philippines, and start-ups and/or corporations conducting ICOs targeting Filipinos, through online platforms;
  - All ICOs conducted within the Philippines or by Philippine startups or corporations shall be required to undergo an initial assessment by submission of initial assessment request and attached documents (including the proposed whitepaper) wherein said startup or corporation shall have the burden to prove that the tokens are not security tokens; The SEC shall have 20 days upon receipt of complete documents for initial assessment to determine whether the tokens are security tokens or not.
  - If it finds that the tokens are indeed security tokens, and unless the ICO falls under the exemptions from registration provided under the rules or conducted exclusively through crowdfunding portals under the proposed rules for crowdfunding, the issuer must register the security tokens (registration proper) before the start of the pre-sale.
- The comments were due by August 31, 2018

## 7. Benchmark reforms

- On August 23, 2018, the SEC of the Philippines issued rules on the administration of government securities benchmarks. The SEC states that the purpose of the rules is to deliberate on the calculation

of credible Philippine peso-denominated government securities reference rates in order to enhance transparency and pricing. This is inlinein line with the recent global benchmark reform initiatives and the IOSCO principles for interest benchmark design.

The rules set out:

- Authorization, registration, licensing of an administrator;
- Governance, conflicts of interest and control framework for the administrator;
- Requirements to ensure the quality of the benchmark and its methodology; and
- Compliance, audit requirements, applicable sanctions and penalties to the administrator.

The rules took effect 15 days after the date of the last publication in two newspapers of general circulation in the Philippines.

- On October 29, 2018, the Bureau of the Treasury announced the launch of a new trading platform for the domestic fixed income market and the changeover to a more robust government securities benchmarking methodologies.

The Bloomberg Fixed Income Quote replaces the existing trading platform and is interlinked with the National Registry of Scripless Securities. Bloomberg Valuation for benchmarking and valuation will offer a more robust methodology that is aligned with the International Organization of Securities Commissions principles.

## SINGAPORE

### AT A GLANCE

Central Bank:	Monetary Authority of Singapore (MAS) <a href="http://www.mas.gov.sg">http://www.mas.gov.sg</a>
Bank Regulator:	MAS
Securities/Futures Regulator:	MAS
Associations:	Singapore Foreign Exchange Markets Committee (SFEMC) Association of Banks in Singapore (ABS) Singapore Investment Banking Association (SIBA)
Master Agreement:	ISDA
Legal Opinions:	Netting (including netting on the ISDA/IIFM Tahawwut Master Agreement), collateral (including collateral taker and collateral provider), client clearing (clearing members reliance, client reliance and FCM clearing members reliance) and e-contracts opinions by Allen & Gledhill
CCP/TR Status:	<p>SGX launched the first platform in Asia for central clearing of OTC derivatives in November 2010. The first products to be cleared were USD and SGD interest rate swaps. This was extended to non-deliverable Asian FX forwards in October 2011. The currencies cleared are CNY, IDR, INR, KRW, MYR, PHP and TWD. Clearing for USD interest rate swaps was discontinued in 2015. SGX is closing their OTC clearing in April 2019</p> <p>LCH.Clearnet currently clears Singapore Dollar-denominated interest rate swaps as well as commodity futures, including freight, iron ore, and steel, executed on Cleartrade Exchange (CLTX), the MAS-regulated trading venue. LCH.Clearnet also has a number of Singapore-based clients clearing interest rate derivatives and commodities via clearing brokers.</p> <p>DTCC Data Repository (Singapore) Pte Ltd (DDRS) is a Licensed Foreign Trade Repository (LFTR) that supports reporting of OTC derivatives trades under the jurisdiction of MAS.</p> <p>The Securities and Futures Act (SFA) was amended in November 2012 to introduce the legislative framework for the regulation of OTC derivatives trade repositories and clearing facilities and to empower MAS to implement mandatory reporting and clearing of OTC derivatives.</p> <p>The European Securities and Markets Authority (ESMA) recognised Singapore Exchange Derivatives Clearing (SGXDC) and ICE Clear Singapore (ICESG) as third country CCPs on April 27, 2015 and September 24, 2015 respectively, thus allowing SGXDC and ICSG to provide clearing services to clearing members or trading venues established in the EU.</p> <p>The US Commodity Futures Trading Commission (CFTC) registered SGXDC as a derivatives clearing organization (DCO) on December 27, 2013.</p> <p>The Bank of England (BoE) added SGXDC and ICESG to the interim list of third-country CCPs that will offer clearing services and activities in the UK under the Temporary Recognition Regime (TRR) if the UK leaves the EU with no implementation period.</p>
Margin requirements:	The MAS margin requirements for non-centrally cleared OTC derivatives came into effect on March 1, 2017, with a 6-month transitional period for variation margin.

## Key Regulatory Milestones

### 1. Securities and Futures Act Amendments

- On January 9, 2017, Parliament passed the Securities and Futures (Amendment) Act 2017 (Act). The Act was gazetted on February 16, 2017. The Act introduces provisions intended to enhance regulatory safeguards for retail investors, strengthen the enforcement regime against market misconduct and enhance credibility and transparency of the capital markets. The Act also introduces a new regulatory framework for financial benchmarks.

The Act provides amendments relating to OTC derivatives reforms, including:

- Operators of organised trading facilities for OTC derivatives products are to be authorised by the Monetary Authority of Singapore (MAS);
- OTC intermediaries are to be regulated by MAS; and
- Commodity derivatives market operators under the SFA are to be regulated by MAS (previously administered by IE Singapore under the Commodity Trading Act).
- MAS conducted two public consultations on draft regulations supporting the implementation of legislative amendments introduced by the Securities and Futures (Amendment) Act 2017:
  - MAS issued the first consultation paper on April 28, 2017. The draft regulations are intended to provide details on the extension of the markets regime to OTC derivatives, the regulation of financial benchmarks and the changes to the collective investment scheme regime, in particular, on funds, including real estate investment trusts.
  - On May 26, 2017, MAS issued the second consultation paper. The paper proposes draft regulations to introduce certain licensing exemptions and business conduct requirements for dealing in OTC derivatives contracts, the enhanced requirements on protection of customers' moneys and assets as well as consequential amendments to support the changes to product and regulated activities definitions under the Act. MAS also intends to introduce a new regulation on offer of investments which is intended to consolidate previous regulations relating to shares and debentures and business trusts separately.

MAS intends to operationalise these amendments by 2018.

- The Act was implemented primarily in two phases. On October 1, 2018, the provisions in the Act which set out the legislative framework for the disclosure of short sell orders and reporting of short sell positions came into force. Other key changes came into effect on October 8, 2018. These include:
  - Extension of the regulatory regime of operators of organized markets is extended to the operators of organised markets for the trading of OTC derivatives. The Act provides a new definition of “organised market”. This definition is based on the definition of “securities market” but extends to derivatives contracts, securities and units in a collective investment scheme (CIS) and also includes prescribed facilities;
  - Various definitions of investment products and regulated activities have been streamlined. These include the definition of “securities” as well as the categories for “regulated activities” for capital markets services licence holders;

- The classification of non-retail investor has been refined; and
  - A legislative framework for regulation of financial benchmarks was also established.
- On October 1, 2018, MAS issued its response to feedback received on its draft regulations pursuant to the Securities and Futures Act (SFA), which were consulted on in 2017. The response covers the amendments made to the Securities and Futures (Licensing and Conduct of Business) Regulations that introduced, among others, business conduct and licensing exemptions for over-the-counter derivative contracts. The MAS also introduced the new Securities and Futures (Offer of Investments) (Securities and Securities-based Derivatives Contracts) Regulations, which combines requirements under the two other regulations previously issued.

The regulations came into force on October 8. The MAS also issued a circular on the commencement of other regulations on October 8 issued pursuant to the Act.

## 2. Basel III & Capital

- On January 10, 2017, MAS published a consultation paper on proposed amendments to the capital framework for securitisation exposures and interest rate risk in the banking book (IRRBB) in MAS Notice 637.

The proposed amendments to the securitisation framework will take effect from January 1, 2018. It will strengthen capital standards for securitisation exposures while providing a preferential capital treatment for simple, transparent and comparable securitisations. The proposed amendments suggest criteria on what constitutes significant credit risk transfer.

The proposed framework for IRRBB will take effect from December 31, 2017. It sets out Pillar 2 requirements for the identification, measurement, monitoring and control of IRRBB, as well as disclosure requirements under prescribed interest rate shock scenarios. In accordance with Basel Committee guidelines, the proposed amendments also include the International Development Association in the list of multilateral development banks. Comments on these proposals are due by February 10.

- On July 10, 2017, MAS issued MAS Notice 652, which incorporates the NSFR standard for domestic systemically important banks (D-SIBs). The notice outlines the calculation methodology for available stable funding (ASF) and required stable funding (RSF), and the criteria for interdependent assets and liabilities and off-balance sheet exposures. D-SIBs are required to calculate the NSFR returns at the last calendar day of each quarter, and submit the NSFR returns to MAS no later than 30 calendar days immediately after the last day of each quarter. These standards are applicable from January 1, 2018.
- On July 25, 2017, MAS issued a consultation paper proposing amendments to risk-based capital requirements for Singapore-incorporated banks in MAS Notice 637. It proposes introducing a minimum leverage ratio of 3%, as well as enhancements on the capital treatment of equity investments and the definition of default under the internal ratings based approach for credit risk.

Consistent with the Basel Committee standard published in 2016, MAS proposes to implement a

minimum leverage ratio requirement of 3% for Singapore-incorporated banks, to be met with Tier 1 capital.

MAS also proposes amendments to enhance clarity on the treatment of equity investments in funds held in the banking book, and to make technical adjustments to the capital requirements for private equity and venture capital investments, and investments in unconsolidated major stake companies that are not financial institutions. These amendments are proposed to take effect from January 1, 2018. Comments on these proposals are due by August 25.

- On December 20, 2017, MAS announced amendments to MAS Notice 652 to delay implementation of the required stable funding (RSF) add-on for derivative liabilities until further notice. These amendments take into account the Basel Committee on Banking Supervision's announcement on October 6, 2017 to allow national discretion on the RSF add-on for derivative liabilities. Accordingly, MAS will review the requirement and delay its implementation until a date to be specified by MAS. The effective date for the rest of the MAS Notice 652 remains January 1, 2018.
- On December 20, 2017, MAS issued a consultation proposing amendments to MAS Notice 637 on risk-based capital adequacy requirements for banks incorporated in Singapore, to revise the list of eligible collateral that may be recognised for credit risk mitigation purposes. MAS proposes to:
  - Recognise commodities as eligible physical collateral for banks using the foundation internal ratings-based approach for credit risk;
  - Widen the scope of eligible equity securities to those listed on any regulated exchange; and,
  - In relation to eligible equity securities included in a main index that qualify for a 15% haircut, clarify the definition of main index as one that is referenced by futures or options traded on a regulated exchange.

Comments on the consultation are due by January 19, 2018.

- On December 28, 2017, MAS announced amendments to MAS Notice 637 on risk-based capital adequacy requirements for banks incorporated in Singapore to introduce a minimum leverage ratio requirement of 3%, effective January 1, 2018.

Other amendments include revisions to disclosure requirements, clarification on the capital treatment of equity investments, the definition of default under the internal ratings-based approach for credit risk, and the scope of insurance subsidiaries that are not consolidated for capital requirements at the group level. Technical amendments are also made in consideration of the new accounting treatment of provisions.

- On January 3, 2018, MAS issued a consultation proposing revisions to the regulatory framework for large exposures of Singapore-incorporated banks. The proposed revisions take into account relevant aspects of the supervisory framework for measuring and controlling large exposures published by the Basel Committee on Banking Supervision in April 2014, and aims to strengthen the requirements for measuring and limiting concentration and contagion risks arising from exposures of Singapore-incorporated banks. The proposals are intended to be implemented from January 1, 2019. Comments on the consultation were due by February 12.

- On April 9, 2018, MAS issued a consultation proposing amendments to MAS Notice 637 on risk-based capital adequacy requirements for banks incorporated in Singapore. The proposed amendments implement the relevant requirements on the regulatory capital treatment of banks' investments in total loss-absorbing capacity (TLAC) and pari passu instruments, in line with the Basel Committee on Banking Supervision guidelines published on October 12, 2016. The proposed amendments seek to limit contagion within the financial system if a global systemically important bank were to enter resolution, and are intended to take effect from January 1, 2019. Comments on the consultation were due by May 9, 2018.

### **3. Bankruptcy, insolvency and resolution regimes**

- On February 27, 2017, the Ministry of Law issued its response to feedback received on its public consultation on the draft Companies (Amendment) Bill 2017 to strengthen Singapore as an international centre for debt restructuring.

The revised bill will:

- Empower the Minister of Law to exclude companies or classes of companies (for example, financial institutions, from the new scheme of arrangement provisions and judicial management);
  - Allow the minister to prescribe certain types of arrangements, including set-off or netting arrangements, to be excluded from the scheme and judicial management moratoriums. The list of excluded entities and excluded transactions will be provided in subsidiary legislation.
- On March 10, 2017, the amended Companies Bill 2017 was passed in Parliament. This follows the response issued by the Ministry of Law on February 27, which contained feedback received after its public consultation on the bill to strengthen Singapore as an international centre for debt restructuring. The bill was tabled in Parliament for a first reading on February 28. The bill allows for:
    - A new set of provisions to support creditor schemes of arrangement that implement debt restructuring proposals;
    - Companies to apply for a judicial management order with greater ease; and Resolution of cross-border insolvencies
  - On May 8, 2017, the Monetary Authority of Singapore (Amendment) Bill 2017 was tabled for first reading in Parliament. MAS had previously consulted on significant policy changes and proposed legislative amendments between 2015 and 2016 to strengthen MAS's powers to resolve distressed financial institutions, among other things. The key provisions in the bill include a framework for and key provisions relating to recovery and resolution planning, a temporary stay on termination rights, a statutory bail-in regime, cross-border recognition of resolution actions, creditor compensation and resolution funding arrangements. In addition to the bill, MAS also released its response to feedback received on its previous consultation on proposed legislative amendments to enhance the resolution regime for financial institutions in Singapore.
  - On May 23, 2017, Sections 22 to 34, 40, 41, 43, 45, 49, 50, 53(3) and (6) and 54 of the Companies (Amendment) Act 2017 came into operation. These provisions cover amendments to judicial management, schemes of arrangement and cross-border insolvency, and are intended to position

Singapore as an international centre for debt restructuring. The amendments also cover existing insolvency and pre-insolvency procedures, and have been constructed taking into account features from other insolvency regimes including the US Title 11 regime. The Companies (Prescribed Arrangements) Regulations 2017 and the Companies (Prescribed Companies and Entities) Order 2017 also came into effect on May 23.

- On October 31, 2017, the Ministry of Finance issued the Companies (Prescribed Arrangements) (Amendment) Regulations 2017 expanding the scope of the protected financial transactions. The regulations were initially issued in May 2017 to carve-out security arrangements in respect of certain securities contracts, derivatives contracts, master netting agreement and securities lending and repurchase agreements from the judicial management moratorium and new creditor scheme moratorium under the Companies Act. The Amendment Regulations now extend the protection to cover derivative contracts referencing weather, economic performance or conditions, emission and real property. The regulations came into effect on November 1.
- On July 16, 2018, MAS released a consultation paper on proposed regulations to enhance the resolution regime for financial institutions in Singapore. Certain sections of the Monetary Authority of Singapore (Amendment) Act 2017 have also come into force.

In the consultation, the MAS proposes to amend the Monetary Authority of Singapore (Control and Resolution of Financial Institutions) Regulations 2013 and issue new regulations under the Deposit Insurance and Policy Owners' Protection Schemes Act. The proposed changes include:

- Temporary stays on termination rights (includes excluded entities and contractual recognition requirement for contracts governed by foreign law);
- Statutory bail-in regime;
- Creditor compensation framework;
- Safeguards on covered bond programs; and
- Resolution funding arrangements.

The MAS consulted in July 2015 on its proposed enhancements to the resolution regime for financial institutions in Singapore and then again in June 2016. Comments on the consultation paper were due by August 16, 2018.

- On October 29, 2018, certain provisions of the Monetary Authority of Singapore (MAS) (Amendment) Act came into operation. These provisions relate to the reverse transfer of business and onward transfer of business, bail-in powers and termination rights, as well as recognition of foreign resolution, resolution funding and compensation.

The MAS (Control and Resolution of Financial Institutions) Regulations 2013 were also revoked and two new sets of separate regulations, the MAS (Control of Financial Institutions) Regulations 2018 and the MAS (Resolution of Financial Institutions) Regulations 2018 (Resolution Regulations) were issued.

The MAS (Safeguards for Compulsory Transfer of Business, and Exemption from Moratorium Provisions) Regulations 2018 were also revoked and the relevant provisions were incorporated into the Resolution Regulations. These regulations came into force on October 29.

In addition, the MAS issued a response to the feedback received on these proposed regulations. The MAS clarified its position on temporary stays on termination rights and the scope of the statutory bail-in regime, the creditor compensation framework and resolution funding arrangements. The MAS indicated that it will engage the industry further on the scope and application of the contractual recognition requirement.

#### 4. Fintech

- The Insolvency, Restructuring and Dissolution Bill was read in Parliament on September 10, 2018 and was passed on October 1, 2018. This is an omnibus piece of legislation which combines the bankruptcy legislation in the Bankruptcy Act, Chapter 20 of Singapore with the corporate insolvency legislation in the Companies Act, Chapter 50 of Singapore. The Bill is expected to come into force in 2019. Supporting subsidiary legislation is also expected to be released in 2019.
- On February 13, 2017, MAS announced the formation of a new Data Analytics Group (DAG) with effect from 15 March 2017. The move is part of MAS' broader efforts to help position itself and the financial sector for the digital economy of the future. DAG will lead MAS' efforts to harness the power of data analytics to unlock insights, enhance the supervision of financial institutions, make regulatory compliance more efficient for financial institutions, and improve work efficiency across the organisation.

DAG will comprise three units: the Data Governance & Architecture Office ("DGA"), the Specialist Analytics & Visualisation Office ("SAV") and the Supervisory Technology Office.

- On March 9, 2017, MAS announced the successful conclusion of the proof-of-concept project to conduct domestic inter-bank payments using DLT. The project, in partnership with R3 and a consortium of financial institutions, was first announced on 16 November 2016.

The project has achieved the objectives of producing a digital representation of the Singapore dollar for interbank settlement, testing methods of connecting bank systems to a DLT, and making the MAS Electronic Payment System (MEPS+) interoperate with the DLT for automated collateral management.

MAS has plans for two spin-off projects that will leverage the lessons of the inter-bank payments project. The first project, driven by SGX, focuses on making the fixed income securities trading and settlement cycle more efficient through DLT. The second project focuses on new methods to conduct cross border payments using central bank digital currency.

MAS is in the early stages of discussions to develop links from Singapore to other countries using DLT to allow cross-border payments to settle directly using central bank accounts.

- On May 23, 2017, MAS announced that it has signed a memorandum of cooperation with the International Finance Corporation, agreeing to work together to establish and develop the ASEAN Financial Innovation Network (AFIN). The network aims to facilitate broader adoption of fintech innovation and development, and enhance economic integration within the Association of South East Asian Nations region. Through AFIN, IFC and MAS plan to establish a regional network to help financial institutions, fintech firms and regulators address issues of connectivity, local compliance and cross-border compatibility. AFIN will also evaluate options to create an industry ‘sandbox’ to provide a cloud-based testing environment through which banks and fintech players can develop, test and refine digital finance and inclusion solutions.
- On June 7, 2017, MAS released a consultation paper on proposals to facilitate the provision of digital advisory services (also known as robo-advisory services) in Singapore. The proposals seek to support innovation in financial services by recognising the unique characteristics of digital platforms. To make it easier for entities offering digital advisory services to operate in Singapore, MAS intends to refine the licensing and business conduct requirements.

First, digital advisers that operate as fund managers under the SFA will be allowed to offer their services to retail investors even if they do not meet the track record requirement, provided they meet certain safeguards. Second, digital advisers that operate as financial advisers under the FAA will be allowed to assist their clients to execute their investment transactions (e.g. passing their trade orders to brokerage firms) and re-balance their clients’ investment portfolios in collective investment schemes without the need for an additional licence under the SFA. This licensing exemption will also be made available to non-digital advisers. Third, digital advisers can seek exemption from the FAA requirement to collect the full suite of information on the financial circumstances of a client, such as income level and financial commitments, if they can satisfactorily mitigate the risks of providing inadequate advice based on limited client information. While facilitating new business models, MAS will require providers of digital advisory services to manage the new technology risks associated with these activities.

MAS has set out expectations on the governance and management oversight to be adopted by digital advisers, including the need to put in place a robust framework governing the design, monitoring and testing of algorithms. This includes having adequate board and senior management oversight and compliance arrangements to monitor the quality of advice provided.

The public consultation ended on 7 July 2017.

- On October 5, 2017, MAS and ABS announced that the consortium which they are leading has successfully developed software prototypes of three different models for decentralised inter-bank payment and settlements with liquidity savings mechanisms.

The project, conducted together with 11 financial institutions and five technology companies<sup>1</sup>, is the Phase 2 of Project Ubin, which explores the use of DLT, for clearing and settlement of payments and securities. The three software models developed are amongst the first in the world to implement decentralised netting of payments in a manner that preserves transactional privacy.

- On November 14, 2017, the industry consortium led by the MAS and ABS released the report and source-codes on distributed ledger prototypes for inter-bank payments. The report describes the prototypes developed on three DLT platforms and shares the findings and observations from the project.

The source-codes and technical documentation of the three successful DLT based prototypes developed in Project Ubin Phase 22 have also been released for public access. Central banks, financial institutions, as well as academic and research institutions can now tap on the open source-codes to facilitate their experiments, research and innovation. Academics can use the available resources to perform additional research on areas relating to DLT. Financial Institutions can reference the privacy-preservation models for internal projects. In addition, the resources enable central banks to reuse the prototypes to conduct internal trials on domestic inter-bank payments.

- On November 15, 2017, the Hong Kong Monetary Authority (HKMA) and the MAS exchanged a Memorandum of Understanding (MoU) in Singapore to jointly develop the Global Trade Connectivity Network (GTCN), a cross-border infrastructure based on DLT, to digitalise trade and trade finance between the two cities and potentially with an aim to expanding the network in the region and globally.

The GTCN is the first strategic joint innovation project arising from the Co-operation Agreement signed by the two authorities. The goal of the project is to build an information highway using DLT between the Hong Kong Trade Finance Platform and the National Trade Platform in Singapore, which will make cross-border trade and financing cheaper, safer, and more efficient.

A Joint Working Committee comprising the HKMA, MAS, Hong Kong Interbank Clearing Limited and the National Trade Platform Programme Office (Singapore) will lead the project at the start. The Joint Working Committee will invite other markets to participate after finalising the governance structure and implementation plan. The two authorities also commenced a joint discussion with major DLT solution providers to develop business and technical models for the GTCN, which is expected to conclude in Q1 2018. The GTCN is expected to go live by early 2019, to tie in with the targeted go-live dates of the Hong Kong Trade Finance Platform and the Trade Finance Modules on the National Trade Platform in Singapore.

- On November 16, 2017, MAS, International Finance Corporation (IFC) and ASEAN Bankers Association (ABA) introduced an industry fintech sandbox for financial institutions and fintech firms as part of the AFIN. AFIN aims to support financial services innovation and inclusion in less developed markets within the ASEAN region and to provide a platform for collaboration and innovation for financial institutions and fintech firms.

AFIN will provide an integrated platform for collaboration between ASEAN banks, microfinance institutions, non-banking financial institutions (NBFI) and regional fintechs. The platform will facilitate development and experimentation of innovative digital financial products and services. It will support an array of financial service functions and solutions such as customer onboarding, credit scoring, merchant payments and compliance solutions amongst others.

- On February 14, 2018, MAS and the Central Bank of Egypt (CBE) signed an agreement to strengthen FinTech cooperation between the two countries on 6 February 2018. The Cooperation Agreement was signed at Seamless North Africa 2018 (under the patronage of the CBE), a conference focused on Payments, FinTech and eCommerce.

The agreement allows both parties to refer FinTech companies to each other so that the companies would be able to tap on the support to better understand the regulatory regime in each country. It also sets forth a framework under which MAS and CBE can explore potential joint innovation projects and share information on emerging FinTech trends.

- On February 26, 2018, MAS and the Government of Maharashtra (GoM) announced that they had signed a Memorandum of Understanding (MoU) on 18 February 2018 to strengthen cooperation in promoting FinTech innovation in the two markets.

The agreement provides opportunities for FinTech start-ups in Singapore to set-up and build business relationships with FinTech companies at the Mumbai FinTech hub. As part of the agreement, the Government of Maharashtra and MAS will co-develop educational programmes on FinTech and explore potential joint innovation projects on the application of key technologies such as digital and mobile payments, blockchain, and big data. The Government of Maharashtra will also facilitate the creation of a marketplace for FinTech solutions developed in Singapore and at the Centre of Excellence (COE) in Mumbai. Under the MoU, the Government of Maharashtra and MAS have also agreed to exchange information relating to FinTech trends and discuss regulatory approaches to encourage innovation in the financial sector.

- On March 14, 2018, MAS unveiled the roadmap to transform its data collection approach from financial institutions. The roadmap includes measures to progressively reduce duplication and automate data submission by financial institutions. This will help financial institutions reduce the resources and preparation time needed to produce data requested by MAS. It will also make it more efficient for MAS to process and analyse the data collected. The measures will take effect from 31 March 2018.
- On March 14, 2018, MAS and the Bank of Lithuania announced that they have agreed to work together to support the development of the FinTech ecosystems and encourage greater financial innovation in the two countries. The FinTech Co-operation Agreement between the two countries was signed on the sidelines of the Money 20/20 Asia conference in Singapore.

The agreement will allow both regulators to explore joint innovation projects and share information on emerging market trends. It also enables FinTech companies to tap on the support of the respective regulators to better understand the regulatory regime in each country.

- On April 2, 2018, MAS announced that it is working with key industry stakeholders to develop a guide to promote the responsible and ethical use of artificial intelligence (AI) and data analytics by financial institutions.

The guide will set out key principles and best practices for the use of AI and data analytics, helping financial institutions to strengthen internal governance and reduce risks of data misuse. The guide is targeted for completion by the end of the year. It will cover all segments of the financial sector including FinTech firms.

MAS will be engaging the industry to obtain views and feedback on the proposed guide in Q2 2018. MAS is also working closely with the Infocomm Media Development Authority to co-ordinate a broader understanding of AI governance across sectors.

- On April 6, 2018, MAS issued an advisory to remind financial institutions to remain vigilant, following recent reports of cyber incidents overseas where attackers attempted fraudulent fund transfers using the SWIFT system. MAS' advisory reminds financial institutions to continue to strengthen measures to safeguard themselves in the following areas:
  - (a) Implement a layered security approach to protect IT environment as well as appropriate measures to secure SWIFT payment terminals.
  - (b) Employ strong access controls to restrict the usage of administrator-level system accounts on SWIFT servers.
  - (c) Perform payment reconciliation/monitoring of SWIFT messages to detect any fraudulent payments in a timely manner.
- On April 25, 2018, MAS and the State Bank of Viet Nam (SBV) agreed to establish a new partnership to encourage FinTech innovation and to strengthen cooperation in banking supervision.

The new MOU between MAS and SBV on financial innovation will facilitate joint innovation projects between the two countries, help FinTech companies in one jurisdiction better understand the regulatory regime and opportunities in the other, and encourage the sharing of information on emerging FinTech trends and developments.

MAS and SBV also revised their existing MOU on banking supervision to enhance cooperation in the field of banking supervision and crisis management. The MOU underscores the two regulators' shared commitment to safeguarding the financial sectors in Singapore and Viet Nam.

- On May 17, 2018, the Autoriti Monetari Brunei Darussalam (AMBD) and MAS signed a FinTech Cooperation Agreement (CA) to foster innovation in financial services between Brunei Darussalam and Singapore.

The FinTech CA will facilitate the sharing of information on emerging FinTech trends and developments, and promote joint innovation projects between both countries. It will also establish a framework for both authorities to provide support for FinTech companies to better understand the regulatory regime and opportunities in each jurisdiction.

- On June 2, 2018, the Department of Economic Affairs (DEA), Government of India, and the MAS announced that they had signed a MoU to strengthen cooperation in financial innovation between Singapore and India, through the establishment of a Joint Working Group (JWG).

The JWG will include representatives from the DEA, Ministry of Electronics and Information Technology, Union Identification Authority of India, Reserve Bank of India, Stock Exchange Board of India, Insurance Regulatory Development Authority of India, and the Ministry of External Affairs of India. Representatives from Singapore's agencies will include the Smart Nation and Digital Government Office, Government Technology Agency, Enterprise Singapore and Ministry of Foreign Affairs.

- On August 24, 2018, MAS and SGX announced a collaboration to develop delivery versus payment (DvP) capabilities for settlement of tokenized assets across different blockchain platforms. This will allow financial institutions and corporate investors to carry out simultaneous exchange and final settlement of tokenized digital currencies and securities assets, improving operational efficiency and reducing settlement risks.

Anquan, Deloitte and Nasdaq have been appointed as technology partners for this project. They will leverage on the open-source software developed and made publicly available in Project Ubin phase 2. The project will produce a report that examines the potential of automating DvP settlement processes with smart contracts and identify key design considerations to ensure resilient operations and enhanced protection for investors. The report will be released by November 2018.

- On August 29, 2018, MAS and the Dubai Financial Services Authority (DFSA) signed a FinTech Agreement that allows referrals of innovative businesses between the two authorities. The Agreement reflects the commitment of both authorities to support the continuous development of FinTech and innovation to deliver new and enhanced financial services to manage risks better, reduce costs, and increase efficiency.

The Agreement centres on a referral mechanism which will enable the authorities to refer FinTech companies to each other, as well as facilitate the sharing of information on financial sector innovation in their respective markets. Both authorities have also agreed to work on joint innovation projects on the application of key technologies such as digital and mobile payments, blockchain and distributed ledgers, big data, and Application Programming Interfaces (APIs).

- On September 6, 2018, the MAS consulted on proposed requirements for financial institutions (FIs) in Singapore to implement essential cybersecurity measures to protect their information technology systems. FIs will be required to implement six cybersecurity measures:
  - Address system security flaws in a timely manner;
  - Establish and implement robust security for systems;
  - Deploy security devices to secure system connections;
  - Install anti-virus software to mitigate the risk of malware infection;
  - Restrict the use of system administrator accounts that can modify system configurations; and
  - Strengthen user authentication for system administrator accounts on critical systems.

These measures, which are already part of the existing MAS Technology Risk Management Guidelines, are aimed at enhancing the security of systems and networks of FIs, as well as mitigating the risk of unauthorised use of system accounts with extensive access privileges. The MAS is

proposing to stipulate these measures as a baseline hygiene standard for cybersecurity by elevating them into legally binding requirements. The consultation will close on October 5, 2018.

- On September 13, 2018, the US Commodity Futures Trading Commission (CFTC) and MAS signed an arrangement to foster greater cooperation in FinTech. The arrangement supports both authorities' efforts to facilitate FinTech development and innovation in their respective markets. This arrangement is the CFTC's second FinTech cooperation arrangement with a non-US authority and its first with an authority in Asia.

The arrangement focuses on information sharing on FinTech market trends and developments. This includes sharing insights derived from each authority's relevant FinTech sandbox, proofs of concept, and innovation competitions. The FinTech Arrangement also facilitates referrals of FinTech companies interested in entering the other's market. This will help FinTech companies better understand and navigate the regulatory regime and capitalize on opportunities in each jurisdiction..

- On October 2, 2018, the MAS Cyber Security Advisory Panel (CSAP) provided insights and suggestions on how Singapore's financial sector can harness the benefits of new technologies while remaining cyber resilient. The international panel also provided advice on MAS' own cyber resilience strategies.

CSAP members shared their views on the growing adoption of new technologies, public cloud services, emerging user authentication methods for online financial services, and the use of open application programming interfaces (APIs) by financial institutions (FIs). They also discussed MAS' roadmap on initiatives to expand its cyber intelligence coverage, reinforce protection capabilities, reduce time to recover from incidents, and develop cyber security talent.

- On October 11, 2018, MAS and the Financial Services Authority of the Republic of Indonesia, Otoritas Jasa Keuangan (OJK) today signed a MOU to strengthen cooperation in FinTech and foster innovation in financial services between Indonesia and Singapore.

The MOU will facilitate information sharing on emerging FinTech market trends and developments, and promote joint innovation projects between both countries. As part of the MOU, both authorities will establish a framework to help FinTech companies better understand the regulatory regime and opportunities in each jurisdiction. This will lower the barriers of entry for FinTech companies interested in entering the other's market.

- On October 31, 2018, MAS and the China Securities Regulatory Commission (CSRC) affirmed their commitment to strengthen supervisory cooperation and enhance financial connectivity between the capital markets of both countries, at the 3rd MAS-CSRC Supervisory Roundtable held on 24 October 2018. Key highlights include agreement on cross border derivatives cooperation and formalising staff exchanges.

Building on the discussions at last year's Roundtable, MAS and CSRC have agreed on the substantive areas for cooperation in supervising exchange-traded derivatives with a nexus to each other's capital markets. The agencies will formalise the agreement in a MOU soon. This will enhance cooperation in

the supervision of futures markets in both jurisdictions, and foster sound and stable development of the futures markets in Singapore and China.

Other topics discussed during the Roundtable include ways to enhance cross-border supervision of capital markets, application of data analytics in supervision and the role of capital markets in supporting the Belt and Road Initiative.

- On November 11, 2018, MAS and Singapore Exchange (SGX) announced that they have successfully developed Delivery versus Payment (DvP) capabilities for the settlement of tokenised assets across different blockchain platforms. This will help simplify post-trade processes and further shorten settlement cycles.

The DvP prototypes, developed with technology partners Anquan, Deloitte and Nasdaq, demonstrated that financial institutions and corporate investors are able to carry out the simultaneous exchange and final settlement of tokenised digital currencies and securities assets on different blockchain platforms. The ability to perform these activities simultaneously improves operational efficiency and reduces settlement risks.

The collaboration also demonstrated that DvP settlement finality, interledger interoperability and investor protection can be achieved through specific solutions designed and built on blockchain technology. Following its conclusion, MAS and SGX have jointly published an industry report, which provides a comprehensive view of automating DvP settlement processes with Smart Contracts. The report also identifies key technology and operational considerations to ensure resilient operations, and defines a market framework that governs post-trade settlement processes such as arbitration.

- On November 12, 2018, MAS released a set of principles to promote fairness, ethics, accountability and transparency (FEAT) in the use of artificial intelligence (AI) and data analytics in finance.

Known as the FEAT Principles, the document provides guidance to firms offering financial products and services on the responsible use of AI and data analytics, to strengthen internal governance around data management and use. This will foster greater confidence and trust in the use of AI and data analytics, as firms increasingly adopt technology tools and solutions to support business strategies and in risk management. The summary of the Principles is available in Annex A.

MAS has worked closely with a group of senior industry partners through a FEAT Committee in developing the Principles. The Principles also incorporates views and feedback from financial institutions, industry associations, FinTech firms, technology providers and academia.

- On November 13, 2018, MAS and the Central Bank of Bahrain (CBB) signed a MOU to foster innovation in financial services between the two countries.

The MOU will support the sharing of information on emerging Fintech trends and developments, and facilitate co-operation on innovation projects in Bahrain and Singapore. The MOU also sets out a common framework to help FinTech companies prepare for regulatory requirements in both countries.

On the same day, the Astana Financial Services Authority (AFSA), Astana International Financial Centre Authority (AIFCA) and MAS signed a tripartite Cooperation Agreement to boost FinTech ties between Singapore and Kazakhstan.

The Agreement provides a framework for cooperation between AFSA, AIFCA and MAS in FinTech innovation, allowing the three authorities to explore joint participation in innovative projects and sharing of information on innovation in their respective markets.

- On November 14, 2018, MAS released a consultation paper on the creation of pre-defined sandboxes, known as Sandbox Express, to complement the existing FinTech Regulatory Sandbox that was launched in 2016. The aim is to enable firms which intend to conduct regulated activities to embark on experiments more quickly, without needing to go through the existing bespoke sandbox application and approval process.

The Sandbox Express is suitable for activities where the risks are generally low, or well understood and could be reasonably contained within the specific pre-defined sandbox. As a start, it will include sandboxes specifically pre-defined for insurance broking, recognised market operators and remittance businesses.

- On November 14, 2018, four milestone agreements were concluded between financial regulators and between financial institutions from Singapore and China. These include:
  - Singapore Exchange's (SGX) Cooperative Agreement with China Foreign Exchange Trade System (CFETS) and Bank of China (BOC) to launch the CFETS-BOC Traded Bond Indices on SGX;
  - NETS' MOU with UnionPay International (UPI) to support cross-border connection of their mobile wallets;
  - A Fintech Cooperation Agreement (CA) between PBC and MAS; and
  - A MOU between CSRC and MAS for the Cooperation and Exchange of information on the Regulation of Derivatives Activities.

## 5. MAS Developments

- On August 4, 2017, MAS released its consultation paper on proposed amendments to the Payment and Settlement Systems (Finality and Netting) Act (FNA). It aims to improve protection by extending insolvency protection to transfer orders, netting and settlement in a designated system, insolvency protection to collateral security and clarifying key legal terms to allow for a more comprehensive insolvency protection and payment finality. These also seek to set out clear designated criteria for payment and settlement systems, as well as strengthen the administrative powers of MAS. The deadline for submissions was August 31, 2017.
- On November 20, 2017, MAS released a consultation paper proposing to formalise expectations for certain market participants that fall under the Securities and Futures Act (SFA) to have written policies and procedures in place to ensure that customer orders are executed on the best available

terms (also known as best execution). This follows MAS' earlier proposal for a market operator to have measures in place to facilitate its members' execution of customers' orders in the customers' interests, and to ensure that its handling and execution of bids and offers is conducted on a fair and objective basis. MAS also proposes an enhancement to the existing business conduct requirements, applicable to licensees, banks, merchant banks and finance companies, relating to handling of customers' orders.

- On February 21, 2018, MAS issued for consultation proposed regulations to require the trading of OTC derivatives on organized markets. The MAS proposes to impose obligations for interest rate swaps denominated in US dollar, euro and sterling. The obligations will apply where both counterparties are banks that exceed a threshold of S\$20 billion gross notional outstanding of OTC derivatives contracts booked in Singapore for each of the past four quarters, should a mandated product be traded in Singapore by both counterparties.

MAS states that it expects operators of overseas and domestic organized markets commonly used by participants in Singapore to trade US dollar, euro and sterling interest rate swaps to apply and be granted the appropriate licensing status in Singapore, and that it plans to seek equivalence determinations from the US and European Union for exchanges and other centralized trading facilities in Singapore to address potential concerns on liquidity fragmentation.

- On March 28, 2018, MAS published the Securities and Futures (Reporting of Derivatives Contracts) (Amendment) Regulations 2018, and a response to the feedback received on the consultation paper that proposed the amendments.

The regulations implement the reporting of commodity and equity derivatives contracts in stages, require new data fields, delay the commencement date for the requirement to report an agreed unique trade identifier from April 1, 2018 to April 1, 2020, and make other revisions in the implementation of the OTC derivatives trade reporting regime in Singapore.

- On April 26, 2018, MAS proposed guidelines to strengthen individual accountability of senior managers and raise standards of conduct in financial institutions (FIs). The guidelines are a key part of MAS' broader efforts to foster a culture of ethical behaviour and responsible risk-taking in the financial industry.

The proposed guidelines set out MAS' supervisory expectations of boards and senior management with respect to individual conduct and behaviours. They are not designed to be prescriptive. It is ultimately the responsibility of each FI to hold its senior managers accountable for their actions and ensure proper conduct amongst their employees.

- On May 2, 2018, MAS announced it will introduce regulations to require OTC derivatives to be cleared on CCPs, with effect from October 1, 2018.

The mandatory clearing requirement will apply to Singapore dollar and US dollar fixed-floating interest rate swaps. Banks with OTC derivatives gross notional outstanding exceeding \$20 billion will be required to clear their trades through CCPs that are regulated by the MAS.

The central clearing requirements will be effected through the Securities and Futures (Clearing of Derivatives Contracts) Regulations. The MAS previously consulted on the regulations and has now released its response to the consultation.

- On May 17, 2018, MAS issued revised regulatory requirements which set out the revised reporting standards for banks in Singapore. These changes will take effect on 1 October 2020. This is in line with MAS' objectives to collect data in machine-readable format and to reduce duplicate data submissions by financial institutions (FIs). The key changes to the regulatory requirements include:
  - (i) Collecting more granular data of banks' assets and liabilities by currency, country and industry. Greater granularity allows better identification of potential risks to the banking system;
  - (ii) Rationalising the collection of data on RMB business activities and deposit rates. The standardised requirements will provide greater consistency and reusability of the data; and
  - (iii) Removing the Domestic Banking Unit and Asian Currency Unit<sup>1</sup> and for banks to report their regulatory returns in Singapore dollar and foreign currency instead.

MAS had earlier provided banks with the finalised template for their data submissions on 29 March 2018. This will provide banks with 24 months to make the necessary changes to their systems and processes in order to meet the new requirements. Banks can continue to use the existing reporting forms for data submission prior to 1 October 2020.

- On May 22, 2018, MAS issued a consultation paper reviewing the recognised market operators (RMO) regime. The MAS proposes to expand the current RMO regime from a single tier to three separate tiers that would better match regulatory requirements to the risks posed by different types of market operators, namely:
  - RMO Tier 1, targets market operators with limited access to Singapore-based retail investors;
  - RMO Tier 2, targets market operators that qualify under the current RMO regime; and
  - RMO Tier 3, targets market operators that have a significantly smaller scale of business compared to more established operators under the current regime.

A multi-tier RMO regime with graduated requirements can better accommodate the emergence of new business models, such as blockchain-based or peer-to-peer trading facilities. The MAS also proposes to allow RMO Tier 3 applicants to self-certify their compliance against a checklist of requirements in their application to the MAS, given their smaller business scale and more sophisticated investor base. Comments on the consultation are due by June 22, 2018.

- On May 28, 2018, MAS issued a statement affirming its commitment to the Foreign Exchange Global Code (Code) developed by the Bank for International Settlements (BIS). MAS will adhere to the principles of the Code when acting as a market participant and ensure that its internal practices and processes are aligned with these principles.

MAS also strongly encourages wholesale FX market participants in Singapore to demonstrate adherence to the Code, to promote the integrity and effective functioning of the global FX market.

- On August 1, 2018, the MAS announced that Singapore will undergo the International Monetary Fund's (IMF) Financial Sector Assessment Programme (FSAP). The FSAP will assess the resilience of Singapore's financial sector, the quality of the MAS's regulatory framework and supervision, and the capacity of authorities to manage and resolve financial crises. This will be Singapore's third FSAP assessment and will include:
  - A stress test of the financial system under hypothetical macroeconomic scenarios;
  - The MAS's regulatory and supervisory approaches covering fintech and cybersecurity;
  - Singapore's macro prudential policy framework to mitigate systemic financial risk; and
  - The MAS's regime for managing crises and resolving banks in an orderly manner.

The IMF FSAP delegation will visit Singapore in November 2018 and February 2019 to perform the assessment. The FSAP report will be completed and published in the second half of 2019.

- On September 24, 2018, the MAS published an enforcement monograph to provide greater clarity and transparency into how MAS deters, detects, investigates and takes action against breaches of the rules and regulations it administers.

This monograph builds on the earlier monograph on capital markets enforcement published in January 2016. It has been extended to cover enforcement functions in the banking and insurance sectors following the setting up of a centralized enforcement department in MAS in August 2016. The revised monograph sets out the following:

- The approach that the MAS takes towards enforcement.
  - The role that enforcement plays in the wider objective of financial industry oversight; and
  - The key areas of MAS' enforcement practice and powers across the financial industry.
- On November 27, 2018, MAS and Shanghai Municipal Financial Regulatory Bureau (SFRB) announced key areas for closer financial cooperation between Singapore and Shanghai. These areas include financing Belt and Road Initiative projects, facilitating international investments into China's capital markets, and creating an ecosystem for collaboration between financial institutions and FinTech firms.

The Shanghai-Singapore Financial Forum SSFF concludes a landmark year for financial cooperation between China and Singapore. 2018 saw multiple high-level exchanges and milestone agreements reached, and marks a culmination of strong and consistent efforts by both countries to broaden and deepen financial cooperation over the years.

- On December 4, 2018, MAS released its consultation paper on proposed changes to the exemption framework for business arrangements between financial institutions in Singapore and their foreign related corporations (the FRC Framework). Implemented in 2002, the FRC Framework allows FRCs to provide cross-border financial services to customers in Singapore, without being subject to FRC licensing requirements. Currently, financial institutions that wish to enter into such arrangements need to apply to the MAS for approval on a case-by-case basis. The MAS now proposes to streamline

the FRC Framework by moving from the current ex-ante approval approach to an ex-post notification approach.

## 6. Financial Stability Board (FSB)

- On February 26, 2018, the Financial Stability Board (FSB) published its peer review of Singapore's macroprudential policy framework and the framework for resolution of financial institutions.

The review focused on the steps taken by the authorities to implement reforms in these areas, as well as relevant International Monetary Fund financial sector assessment program recommendations and Group-of-20/FSB reforms. The peer review finds that progress has been made in recent years, reflecting Singapore's strong adherence to international standards and focus on financial stability. Legislative amendments in July 2017 prioritize the MAS's supervision and financial stability objectives vis-à-vis its developmental objective. The resolution regime has a broad scope covering all financial institutions and their holding companies, while recent amendments to the regime incorporated additional elements of the FSB Key Attributes for Effective Resolution Regimes for Financial Institutions.

The review concludes that there is additional work to be done. The peer review report includes recommendations to the Singaporean authorities in order to address these issues.

## 7. SGX Developments

- On March 13, 2018, SGX opened for consultation proposed refinements to the SGX-DC Clearing Fund structure and requirements on members. The proposed amendments included:
  - Combining exchange-traded derivatives and over-the-counter (OTC) commodity derivatives into a single contract class for risk management purposes;
  - Replacing the Security Deposit requirement and the pre-funded Further Assessment with a single Clearing Fund Deposit requirement;
  - Methodology change such that members' contribution requirements are directly determined by potential stress test losses that SGX-DC might suffer in the event of a default of a Clearing Member(s).

Comments on the consultation were due by April 3, 2018. Subject to regulatory clearance, SGX proposed to implement the refinements to the SGX-DC Clearing Fund in the third quarter of 2018.

- On July 5, 2018, SGX released a consultation on the proposed recalibrations of the financial and capital requirements of remote clearing members, remote trading members, bank clearing members and bank trading members. The proposed changes include:
  - The removal of SGX-imposed risk-based capital requirements on bank members and remote members, and reliance on the respective home regulator's financial and capital requirements;
  - The redefinition of base capital for bank and remote members; and
  - The removal of net liquid capital requirements for remote trading members.

Comments were due by July 27, 2018.

- On July 19, 2018, SGX opened a consultation on proposed amendments to the clearing rules of the Singapore Exchange Derivatives Clearing Limited (SGX-DC) and the Central Depository (Pte) Limited (CDP) to enhance their default management capabilities.

On the SGX-DC, SGX proposed to:

- Introduce an auction protocol for liquidating a defaulted SGX-DC clearing member's positions in exchange-traded derivatives contracts and OTC commodities contracts, and a loss distribution mechanism to address losses arising from such an auction;
- Allow the SGX-DC to unilaterally terminate positions of non-defaulting SGX-DC clearing members that exactly offset those of the defaulted clearing member for all classes of contracts that the SGX-DC clears;
- Revise the existing loss distribution mechanism for auctions for OTC derivatives contracts; and
- Modify the SGX-DC clearing fund waterfall for allocating losses arising from auctions.

The SGX also proposed powers for the CDP to write off, as a loss to the CDP, a defaulted CDP clearing member's unsettled buy trades if those securities are not force-sold by the seventh day after the clearing member is declared to be in default.

The SGX expects to implement the amendments in the fourth quarter of 2018. Comments on the consultation are due by August 16.

## **8. Benchmarks reform**

- On July 24, 2018, the ABS Benchmarks Administration and the Singapore Foreign Exchange Market Committee (jointly known as the ABS-SFEMC) announced they have finalized the proposals to enhance the Singapore Interbank Offered Rate (SIBOR). This announcement follows the ABS-SFEMC's public consultation to seek feedback on proposals to enhance the SIBOR, which closed in February 2018.

The finalized proposals have taken into account global guidance on interest rate benchmark reforms. The main proposed enhancement is to increase reliance on market transactions by calculating SIBOR using the following waterfall methodology:

- Transactions in the underlying wholesale funding markets;
- Transactions in related markets; and
- Expert judgement.

These enhancements to SIBOR will be implemented after a period of transitional testing, which is expected to commence in the second half of 2019, with implementation to follow at end-2019. In the interim, the existing processes for SIBOR computation remain unchanged. The ABS-SFEMC also announced that with the implementation of the SIBOR enhancements, the current 12-month SIBOR will be discontinued. This is due to low market usage and a lack of underlying transactions to support its production.

- Part VIAA of the Securities and Futures Act came into force on October 8, 2018. This new Part VIAA sets out a legislative framework for the regulation of financial benchmarks which is intended to promote fair and transparent determination of financial benchmarks and reduce systemic risks. The framework is also intended to safeguard the credibility and reliability of financial benchmarks in Singapore.

## 9. Margin requirements for non-centrally derivatives

- On December 6, 2018, MAS issued its revised guidelines on margin requirements for non-centrally cleared OTC derivatives contracts. These set of guidelines update the guidelines previously issued on December 6, 2016. Under the revised guidelines, securities-based derivatives contracts are expressly excluded from VM and IM requirements until August 31, 2019 only, and then come into scope.

### ISDA Submissions

May 29, 2017: [ISDA submission to The Monetary Authority of Singapore in relation to request for Amendment of Masking Relief under Regulation 11 of the Securities and Futures \(Reporting of Derivatives Contracts\) Regulations 2013 \(“Reporting Regulations”\)](#)

June 5, 2017: [ISDA, FIA and ASIFMA joint submission to The Monetary Authority of Singapore in relation to Consultation Paper I on Draft Regulations Pursuant to the Securities and Futures Act](#)

June 30, 2017: [ISDA, FIA and ASIFMA joint submission to The Monetary Authority of Singapore in relation to Consultation Paper II on Draft Regulations Pursuant to the Securities and Futures Act](#)

August 24, 2017: [Joint ASIFMA-FIA-ISDA submission to the Ministry of Communications and Information \(MCI\) and the Cyber Security Agency of Singapore \(CSA\) on the Consultation Paper on the draft Singapore Cybersecurity Bill](#)

August 25, 2017: [ISDA and ASIFMA joint submission to The Monetary Authority of Singapore in relation to Consultation Paper on Proposed Amendments to Capital Requirements for Singapore-Incorporated Banks in MAS Notice 637](#)

23 March 2018: [ISDA, GFXA, GFMA joint submission to MAS on the Consultation Paper on Draft Regulations for Mandatory Trading of Derivatives Contracts \(“Consultation Paper”\)](#)

23 August: [ISDA submission to Monetary Authority of Singapore of the Consultation Paper on Proposed Regulations to Enhance the Resolution Regime for Financial Institutions in Singapore](#)

7 December 2018: [ISDA submission to Monetary Authority of Singapore on recent amendments to the Monetary Authority of Singapore Act, the Securities and Futures Act, the Financial Advisers Act and Related Subsidiary Legislation](#)

## TAIWAN

### AT A GLANCE

Central Bank:	Central Bank of China (CBC) <a href="http://www.cbc.gov.tw">http://www.cbc.gov.tw</a>
Bank Regulator:	Banking Bureau of the Financial Supervisory Commission (FSC) <a href="http://www.banking.gov.tw">http://www.banking.gov.tw</a>
Securities Regulator:	Securities and Futures Bureau of the FSC <a href="http://www.sfb.gov.tw">http://www.sfb.gov.tw</a>
Other Regulators:	Insurance Bureau of the FSC <a href="http://www.ib.gov.tw">http://www.ib.gov.tw</a>  GreTai Securities is a GSE that monitors trading volumes and advises Taiwan's authorities <a href="http://www.otc.org.tw">http://www.otc.org.tw</a>
Associations:	Trust Association of the Republic of Taiwan (TAROC)  Taiwan Financial Services Roundtable (TFSR)
Legal Opinions:	Netting, Collateral and Principal-to-Principal Clearing Members Reliance opinions by Russin & Vecchi
Master Agreement:	ISDA
CCP/TR Status:	FSC mandated Gretai Securities Market to establish a local trade repository. Taiwan has not proposed any mandatory clearing requirement in respect of OTC derivatives.

## THAILAND

### AT A GLANCE

Central Bank:	Bank of Thailand (BOT) <a href="http://www.bot.or.th/english/Pages/BOTDefault.aspx">http://www.bot.or.th/english/Pages/BOTDefault.aspx</a>
Bank Regulator:	BOT
Securities Regulator:	Securities and Exchange Commission <a href="http://www.sec.or.th/view/view.jsp?lang=en">http://www.sec.or.th/view/view.jsp?lang=en</a>
Associations:	The Thai Bankers' Association Foreign Banks' Association
Legal Opinions:	Netting, collateral and client clearing (clearing members reliance) and e-contract opinions by Baker & McKenzie
Master Agreement:	ISDA
CCP/TR Status:	No announced plans

### Key Regulatory Milestones

#### 1. Memorandum of Understanding (MoU)

- On March 20, 2017, the BoT announced that it has signed a memorandum of understanding (MoU) on the exchange of banking supervision information with the RBI. The MoU provides a formal basis for banking supervisory cooperation between the two authorities. It allows for supervisory cooperation between the BoT and RBI in the areas of information sharing and communication, from the licensing process to ongoing supervision of banks operating under their respective supervisory responsibilities.
- On July 11, 2017, the BOT and the Monetary Authority of Singapore (MAS) announced they have signed a fintech cooperation agreement (CA) and updated an existing MoU on banking supervision.

The CA enables the BOT and MAS to share information on emerging market trends and their impact on regulations, as well as refer fintech companies to their counterparts. The updated MoU serves to strengthen bilateral collaboration in safeguarding the resilience of the two countries' banking systems, and had been in place since 2006. It sets out in greater detail the two central banks' commitment to fostering greater information exchange and cooperation in the areas of licensing, on-site examinations, supervisory colleges and crisis management.

- On July 25, 2017, the BOT and the China Banking Regulatory Commission signed an MOU on Banking Supervision. The MOU serves as a solid foundation for effective supervision of banking institutions operating in both countries in accordance with the principles set out in the Basel Core Principles for Effective Banking Supervision.

The MOU sets out in greater detail the two authorities' commitment to fostering greater information exchange and cooperation in the areas of licensing, on-site examinations, supervisory colleges, and crisis management.

- On August 17, 2017, the BOT and the State Bank of Vietnam signed an MOU on Cooperation between the two central banks. The MoU aims to strengthen bilateral ties and cooperation between the two central banks which would contribute to greater economic relations between the two countries.

The MoU sets out in greater detail the areas of technical cooperation, including human resources development, banking and financial cooperation and other areas of mutual interests of both central banks.

- On June 14, 2017, the BOT and the Financial Services Agency of Japan signed the Exchange of Letters for cooperation (EOLs) on Banking Supervision. The EOLs serves as a solid foundation for effective cooperation in the supervision of banking organizations operating in both countries in accordance with the principles set out in the Basel Core Principles for Effective Banking Supervision.

The EOLs sets out in greater detail the process that the two authorities will follow to foster greater cooperation in the areas of information sharing, on-site visits, supervisory colleges, and crisis management.

## **2. BOT introduces FX regulatory reform**

- On June 5, 2017, the BOT announced it has started a regulatory reform programme for foreign exchange regulations, which will be a starting point for further reforms of other regulations to enhance ease of doing business.

Under this reform programme, the regulations will be revised for greater clarity and transparency with less redundancy. The BOT has changed its paradigm in revising certain regulations to allow the private sector to conduct foreign exchange transactions and hedging based on their own internal risk management and control policies within the framework set by the BOT. In addition, this reform includes streamlining procedures, reducing documents, removing requirements for the BOT's prior approval for certain foreign exchange transactions, allowing new players in the markets, facilitating the use of local currencies for regional connectivity and promoting transactions in electronic form for enhanced efficiency and flexibility.

The BOT has started the relaxations, some of which will be effective this month. Most of the relaxations will be completed in 2017.

## **3. SEC consults on relaxing paid-up capital rules for intermediaries**

- On August 31, 2017, the Thailand Securities and Exchange Commission (SEC) announced that it is seeking public comments on draft rules concerning the determination of paid-up registered capital of securities and derivatives intermediaries to better suit their respective types of risks and facilitate development of different types of securities businesses.

Pursuant to the current rules, the paid-up registered capital of securities companies and derivatives business operators is determined by the types of license packages, each permitting a scope of various

business undertakings. As a result, any intermediary wishing to only operate a brokerage business, for example, would have to meet the high minimum paid-up capital rule, despite its own low risk exposure. In addition, such requirement may be inconsistent with the business types or the business risks of intermediaries, and may not support the development of new businesses that make use of financial innovations.

Therefore, the SEC has proposed amendments to the paid-up capital rules to be issued in three notifications, taking into consideration stakeholders' comments and recommendations gathered from previous hearings on the governing principles in May and June 2017. Responses to the consultation are due by September 19, 2017.

#### **4. Basel III & Capital**

- In September 2017, the BoT announced that it has adopted a supervisory framework for domestic systemically important banks (D-SIBs) by requiring them to maintain higher capital to better absorb losses from their operations.

The BoT uses four main indicators to identify D-SIBs, including the size of the financial institution, the interconnectedness between financial institutions as measured by interbank transactions, its role as provider of financial infrastructure, and the complexity of financial products or business/operational structure. Based on these indicators, five commercial banks are identified as D-SIBs.

D-SIBs are required to maintain additional 1% of common equity Tier 1 from the current minimum requirement. This new requirement will be phased in, at 0.5% in 2019 and 1% in 2020. Additionally, D-SIBs are subject to more rigorous supervisory measures, such as additional reporting requirements. The BoT also advised that all D-SIBs are currently robust, maintaining capital ratios significantly above the level prescribed by BoT.

- On October 30, 2017, the SEC released a consultation on amendments to the ongoing capital requirement rules which are imposed on asset management companies, and operational procedures rules in case of failure to meet the requirement.

The amendments would allow intermediaries undertaking asset management business and investment unit brokerage to maintain ongoing capital at a ratio appropriate for their business and in line with international standards. In addition, the new rules would enhance business continuity while addressing potential damage from operational risks.

The SEC has taken into account feedback from its consultation on the governing principles conducted last August. Changes were made to the level of ongoing capital requirements by taking into account types of business models as well as the existence of lead regulator (if any). Also, certain conditions and periods of protection have been adjusted in this proposal to better manage business risks. The closing date for submissions is November 17, 2017.

## **5. SEC consults on additional disclosures for derivative warrants**

On January 25, 2018, the SEC released a consultation paper on a draft amendment to the rules governing the issuance and offering of derivative warrants (DW) to require additional and continuing disclosure related to DW prices. This includes:

- Additional disclosure on the historical volatility of the underlying shares in the registration statement and prospectus;
- Continuing disclosure of the implied volatility in comparison to the historical volatility on the website of the DW issuer; and
- Disclosure of a warning statement regarding the gearing ratio, a price risk measurement tool, on the cover of the registration statement and prospectus.

The draft amendment would also allow foreign shares and indices to be an additional underlying for DW products to give more investment alternatives to investors. Comments on the consultation are due by February 26, 2018.

## VIETNAM

### AT A GLANCE

Central Bank:	The State Bank of Vietnam (SBV) <a href="http://www.sbv.gov.vn">http://www.sbv.gov.vn</a>
Bank Regulator:	The State Bank of Vietnam
Securities Regulator:	State Securities Commission <a href="http://www.ssc.gov.vn">http://www.ssc.gov.vn</a>
Association:	Vietnamese Bond Market Association (VBMA)
Legal Opinions:	
Master Agreement:	ISDA
CCP/TR Status:	

# APPENDIX

## 2009 - 2016

# AUSTRALIA

## Key Regulatory Milestones

### 1. G20 OTC derivatives commitments

- On April 18, 2012, the Treasury published a Consultation Paper on ‘Implementation of a framework for Australia’s G20 over-the-counter derivatives commitments’. It was proposed that the Minister for Financial Services and Superannuation (Minister) will prescribe a certain class of derivatives as being subject to one or more mandatory obligations for trade reporting, central clearing and trade execution. ASIC would make derivative transaction rules (DTRs), which would require the Minister’s consent. ASIC would be required to undertake a minimum period of consultation with other regulatory agencies (as well as stakeholders) in developing DTRs and to ensure sufficient notice or a transition period is provided prior to the commencement of any mandate. A new trade repository licensing regime would also be introduced.
- On October 12, 2012, the Corporations Legislation Amendment (Derivative Transactions) Bill 2012 (2012 Bill) was introduced into Parliament. The 2012 Bill would amend the Corporations Act 2001 and introduce a legislative framework to carry out the proposals set out in the Treasury’s April 18, 2012 Consultation Paper. The Bill subsequently passed Parliament and received royal assent on December 6, 2012.

### 2. Central clearing

- On February 27, 2014, the Treasury issued a proposals paper on the G4 IRD central clearing mandate, using information from previous reports on the Australian OTC derivatives market. This proposals paper was the first step in the mandating of central clearing for US Dollars, Euro, British Pound and Japanese Yen interest rate derivatives (G4 IRD). The central clearing mandate would apply to large financial institutions with significant cross-border activity in these products (G4 dealers). The proposed implementation timeline was: 2nd quarter 2014 for the Ministerial determination and for ASIC to consult on rules relating to the details of the central clearing obligation; late 2014 for central clearing rules to be completed and early 2015 for central clearing obligations to commence.

For trading platforms, no decision would be taken until subsequent reviews by the regulators. However, the Government would also be reviewing the licensing arrangement for financial markets. The review would consider whether the framework is adequate to deal with derivatives trading platforms that would be suitable for mandatory trade execution. This review is ongoing.

- On April 3, 2014, the RBA, APRA and ASIC (the Regulators) released a Report on the Australian OTC Derivatives Market – April 2014. The Regulators recommended the government consider a central clearing mandate for trades between internationally-active dealers for Australian dollar-denominated interest rate derivatives. The Regulators did not see a case for implementing a central clearing mandate for North American, European and Japanese referenced credit index derivatives at this time, and also did not believe it was appropriate to mandate central clearing for non-dealers. There was no specific recommendation regarding a mandatory platform trading obligation at that time.
- On July 8, 2014, the Treasury issued a proposals paper on the AUD-IRD central clearing mandate. The Paper built on the version published in February which proposed the mandating of central clearing for US Dollars, Euro, British Pound and Japanese Yen interest rate derivatives (G4 IRD). The Paper

proposed to extend the mandatory requirement for central clearing to include interest rate derivatives in Australian dollars as part of the global reforms on OTC derivatives markets in Australia.

The Paper proposed that the clearing requirement would only apply to large financial institutions and provided two options for defining the class of entities that would be captured:

Option A:

1. any domestic financial entity with \$100 billion or more gross notional OTC derivatives outstanding;
2. any foreign financial entity with \$100 billion or more gross notional OTC derivatives outstanding booked or entered into in Australia;
3. any foreign financial institution with \$100 billion or more of gross notional OTC derivatives outstanding with domestic and foreign financial entities subject to the clearing mandate in Australia under the first two rules above; or
4. any entity that opts in to a mandatory clearing obligation in G4-IRD or AUD-IRD.

Option B:

1. any domestic financial entity with \$100 billion or more gross notional OTC derivatives outstanding;
2. any foreign financial entity with \$100 billion or more gross notional OTC derivatives outstanding booked or entered into in Australia;
3. any entity regulated as a swap dealer in the US; or
4. any entity that opts in to a mandatory clearing obligation in G4-IRD or AUD-IRD.

The threshold would be calculated on a legal entity basis, hence, only outstanding OTC derivatives entered into by the legal entity would be counted. Public entities such as central banks etc., would be out of scope of the central clearing rules.

The Paper also proposed to combine the central clearing mandates for G4 and AUD-IRD in one Ministerial determination with the proposed timetable for implementation: draft Ministerial determination to be released for comments in third quarter 2014; determination and regulations to be made in late 2014; and early 2015 for the clearing mandate to come into force.

- On May 28, 2015, announcements were made by the Treasury and ASIC about the release of exposure drafts of legislative documents, an explanatory guide and a consultation paper to give effect to two proposals, including to introduce mandatory central clearing for certain interest rate derivatives in certain currencies from April 2016 (through the release of a draft Ministerial determination, proposed Treasury amendments to the Corporations Regulations and an ASIC consultation paper).

The proposals would require certain interest rate derivatives traded between internationally-active dealers in Australian dollars and four global currencies (US dollars, euro, Japanese yen and British

pounds) to be cleared through a licensed or prescribed clearing and settlement facility. ASIC consultation paper CP 231 Mandatory central clearing of OTC interest rate derivative transactions (CP 231) set out issues such as the entities which would be subject to the clearing requirements, the cross-border application of the draft DTRs (clearing) and the transactions and asset classes subject to the clearing requirements.

- On September 8, 2015, the Treasury announced that the Corporations Amendment (Central Clearing and Single-Sided Reporting) Regulation 2015 and the Corporations (Derivatives) Amendment Determination 2015 (No. 1) had been finalised. The Determination formally specifies that clearing requirements may be imposed on interest rate derivatives denominated in Australian dollars, US dollars, euro, sterling and Japanese yen.

The Regulation covers aspects relevant to central clearing obligations and single-sided reporting for Phase 3 reporting entities when certain conditions are met. For central clearing, the regulation sets out definitions of various types of clearing entities, the list of overseas clearing houses that can be used to meet the central clearing obligation, and the circumstances under which, and persons for whom, clearing requirements can and cannot be imposed.

- On October 28, 2015, the RBA released its conclusions paper on potentially requiring the central clearing of repos in Australia, following an industry consultation. A number of themes emerged from the consultation, including:
  - The commercial viability of a repo CCP, given the small size of the Australian repo market;
  - Currently well-managed credit risk within the repo market, given the directional nature of participants that may limit netting benefits;
  - Potential operational benefits of a repo CCP, particularly through straight-through processing, although it was acknowledged this could also be achieved through increased use of centralised collateral management services;
  - The significant effort undertaken by participants to ensure settlement fails are relatively rare; and
  - The need for any repo CCP to have access to a large reserve of securities and liquidity to ensure smooth default management.

In light of the significant share of repo market transactions that involves the RBA as counterparty, and the relatively small interdealer market, the RBA noted that the financial stability case for central clearing of repos in Australia is not likely to be as strong as in some other jurisdictions. While repo clearing could be a catalyst for other beneficial changes in market infrastructure, some of these benefits could potentially be pursued by enhancing the existing market infrastructure, even without CCP clearing. However, should the industry proceed with a proposal for the introduction of such a CCP, the RBA would stand ready to engage in the debate and consider participation, subject to pre-conditions around continuity, location and design and terms of access.

- On November 4, 2015, the Regulators released a Report on the Australian OTC Derivatives Market – November 2015. Based on an assessment of activity and practices in the Australian OTC derivatives market and overseas developments, the Regulators did not see a case for extending the product scope of the Australian central clearing mandate at that time. The Regulators noted that they see in-principle benefits from increased use of trading platforms and will continue to consider the case for promoting the use of trading platforms, including by introducing a trading mandate. While the Regulators did not make specific recommendations on a mandatory trading obligation, the Report sets out the details of how the Regulators will assess the case for introducing trading mandates in the future.

The Report also noted that Australia intends to implement internationally-agreed margin requirements and other risk mitigation requirements for non-centrally cleared derivatives in its regulatory regime. In the first instance, this will be through APRA's prudential standards, given the prominent role of APRA-regulated institutions in the Australian OTC derivatives market. The Regulators will consider their approach for non-APRA regulated institutions in 2016.

- On December 14, 2015, ASIC released rules implementing Australia's mandatory central clearing regime, ASIC Derivative Transaction Rules (Clearing) 2015. The regime applies to G4 and AUD OTC interest rate derivatives transacted between dealers and provides the basis for substituted compliance or sufficient equivalence determinations by foreign regulators. The clearing obligations commenced in April 2016.
- On March 21, 2016, ISDA and AFMA jointly submitted a request to ASIC for relief from the central clearing requirement for Pre-Mandate Swaptions.
- On April 5, 2016, ASIC made ASIC Corporations (Derivative Transaction Clearing Exemption) Instrument 2016/258, granting relief from the central clearing requirement for Pre-Mandate Swaptions.

### **3. Trade reporting**

- On March 15, 2013, ASIC released Consultation Paper 201 'Derivative trade repositories' (CP 201). CP 201 set out proposed guidance on the process of applying for an Australian derivative trade repository (ADTR) license and the information required; the conditions that ASIC may consider imposing on ADTR licensees; and ASIC's approach for granting exemptions from all or specified provisions of the Corporations Act 2001.
- On March 28, 2013, ASIC released Consultation Paper 205 on 'Derivative transaction reporting' (CP 205) which in summary proposed the following:
  - All Australian entities and foreign subsidiaries (if specified) of an Australian entity would be subject to the reporting requirements.
  - All foreign authorised deposit-taking institutions (ADIs) with a branch located in Australia or a foreign company registered under Division 2 of Pt. 5B.2 of the Corporations Act 2001 would be subject to the reporting requirements, but only in respect of transactions booked to the ADI's Australian branch or entered into by the Australian office.
  - The derivative contracts that would need to be reported are identified by asset classes (credit derivatives, interest rate derivatives, foreign exchange derivatives, equity derivatives, and commodity derivatives excluding electricity derivatives). Reporting would apply to futures and options as well as cleared and uncleared OTC derivatives.
  - Reporting would be phased-in by asset class and reporting entity type. Interest rate derivatives and credit derivatives transactions would be first, followed by foreign exchange derivatives, equity derivatives and commodity derivatives 6 months later. Phase 1 would consist of major financial institutions above the threshold (AUD50 billion notional outstanding in OTC derivatives across all asset classes per legal entity as measured as at September 30, 2013), Phase 2 would consist of major financial institutions below the threshold and Phase 3 would consist of end users. Phase 1 would start on December 31, 2013, Phase 2 would start on June 30, 2014 and Phase 3 would start on December 31, 2014.
  - "Two-sided reporting" would apply.

- On June 5, 2013, the Treasury released the Regulation to Facilitate the Operation of Australia's Derivatives Trade Reporting Regime. The purpose of the Corporations Amendment (Derivatives Transactions) Regulation 2013 was to implement measures that temporarily restricted ASIC's rulemaking power in relation to end users, and operational measures to ensure the derivatives trade reporting regime has appropriate regulations governing the enforcement of trade reporting rules and Regulations for confidential information. An end user is defined as a person who is not an authorised deposit taking institution, an Australian financial services licensee (and certain foreign person exempted from requiring a license), and a clearing and settlement facility licensee. The regulation commenced the day after it was registered. This regulation ceased to have effect on July 28, 2013.
- On July 10, 2013, ASIC published its final rules, the ASIC Derivative Transaction Rules (Reporting) 2013. An Australian entity is required to report all OTC derivatives contracts to which it is a party, regardless of where the contract is entered into. A foreign ADI that has a branch in Australia will need to report all OTC derivatives contracts that are booked to the profit and loss account of that branch; or entered into by that branch.

Australian entities registered as a swap dealer (SD) with the CFTC began reporting all asset classes from October 1, 2013. Australian ADIs, Australian financial services (AFS) licensees, clearing and settlement (CS) facility licensees, exempt foreign licensees and foreign ADIs, which had a total gross notional outstanding position of AUD \$50 billion as at December 31, 2013, and were not required to report under Phase 1, began reporting interest rate and credit derivative transactions from April 1, 2014, with transactions in other asset classes to follow 6 months later. Following the granting of relief by ASIC, the commencement of phase 3 was split into 2 sub-phases, with phase 3A (for entities holding AUD 5 billion or more total gross notional outstanding in reportable OTC positions at at June 30, 2014) commencing on April 13, 2015, with transactions in other asset classes to follow as well as phase 3B reporting entities (in all asset classes) commencing on October 12, 2015. Position reporting in each phase commenced 6 months after the date of the commencement of the relevant reporting obligation in the relevant asset class.

- On September 15, 2014, ASIC granted an ADTR licence to DTCC Data Repository (Singapore) Pte Ltd (DDRS). Phase 1, 2 and 3 reporting entities that are incorporated or formed in Australia were required to report to a licensed trade repository from October 1, 2014. Foreign reporting entities may report to trade repositories prescribed under ASIC Prescribed Trade Repositories Determination [15-0591].
- On February 2, 2015, ASIC published a class order setting out an alternative definition of the 'nexus' concept (referring to a requirement to report trades 'entered into in Australia'), which can be used by phase 2 and 3 reporting entities when reporting. The alternative definition allows reporting entities to utilize a definition more broadly aligned with other Asia-Pacific jurisdictions, and requires these entities to 'tag' their trades as ASIC-reportable from February 25, with an earliest reporting start date of May 25, depending on the phase and asset class. The class order further requires reporting entities to opt in to the relief by asset class, and allows for reporting entities to report under the alternative reporting regime.
- On February 9, 2015, ASIC amended its trade reporting rules following industry consultation and feedback on its consultation paper 221 (CP 221).

The changes include:

- introducing 'snapshot' reporting instead of 'lifecycle' reporting as a permanent option (but also allowing for ASIC to determine otherwise in the future),

- introducing a 'safe harbour' from liability for reporting entities using delegated reporting, if certain conditions are met,
- expanding the abilities of foreign firms to rely on alternative reporting, while also introducing a requirement for firms to 'tag' these trades, and
- making a number of technical changes to the reporting rules, reflecting the proposals in CP 221 and/or feedback received.

ASIC further decided not to proceed with the proposal to require the larger subsidiaries of Australian ADIs and AFS licensees to report OTC trades, after concluding that the regulatory benefit would not outweigh the additional compliance cost.

- On May 28, 2015, announcements were made by the Australian Treasury and ASIC about the release of exposure drafts of legislative documents, an explanatory guide and a consultation paper to give effect to two proposals, including a proposal to enable single-sided reporting by Phase 3B reporting entities under the Australian trade reporting regime from October 2015 (through the release of proposed Treasury amendments to the Corporations Regulations).

The proposals relating to single-sided reporting related to the Australian Government's announcement in December 2014 that it would provide relief from the trade reporting requirements by allowing 'single-sided reporting' for entities with low levels of OTC derivatives transactions, provided they conclude the transactions with counterparties that are already required or have agreed to report the trade. The relief would be implemented by introducing single-sided reporting for Phase 3B entities as defined in the trade reporting derivative transaction rules made by ASIC. Phase 3B entities as defined in those rules have less than \$5 billion gross notional OTC derivatives positions outstanding, calculated on a rolling basis.

- On September 8, 2015, the Australian Treasury announced that the Corporations Amendment (Central Clearing and Single-Sided Reporting) Regulation 2015 and the Corporations (Derivatives) Amendment Determination 2015 (No. 1) had been finalised. The Regulation covers aspects relevant to central clearing obligations and single-sided reporting for Phase 3 reporting entities when certain conditions are met. For single-sided reporting for Phase 3B entities, the regulation sets out the definitions of the various types of reporting entities, the circumstances under which an exemption from double-sided reporting is able to be used, the conditions of single-sided reporting, the dates for determining whether the exemption can continue to be relied upon, and various other provisions in relation to the regime.
- On September 21, 2015, ASIC made ASIC Corporations (Derivative Transaction Reporting Exemption) Instrument 2015/844. The Instrument extends relief that already existed under ASIC Instrument 14/0952.

The changes include:

- Not requiring transactions entered into on certain listed markets to be reported,
- Exempting reporting entities from having to report entity and/or name information,
- Extending relief from reporting identifying information of counterparties, where the counterparty has not provided express consent or if the reporting entity is prohibited from reporting the identifying information by foreign privacy restrictions in certain listed jurisdictions,
- Creating new relief from having to report identifying information of certain government entities,
- Extending the relief from being required to provide a universal trade identifier,
- Extending the relief from being required to report collateral information, and

- Extending the relief from being required to report FX securities conversion transactions.
- On October 9, 2015, ASIC announced that it had made an amendment to the existing ASIC Class Order 14/0633, embodied in ASIC Corporations (Derivative Transaction Reporting) Amendment 2015/0925, which delays the commencement of Phase 3B transaction reporting until 4 December. This would not prevent Phase 3B reporting entities that were ready for reporting from commencing from an earlier date.
- On October 23, 2015, ASIC granted an Australian derivative trade repository licence to Chicago Mercantile Exchange Inc. (CME) setting out the terms of the ADTR licence and the conditions in which it is granted. On December 8, 2015, the Australian Derivative Trade Repository Licence (Chicago Mercantile Exchange Inc.) Variation Notice 2015 No. 1 [15/1131] was published in the Gazette, adding equity derivatives to the classes of derivatives that CME may provide services for under its ADTR licence.
- On January 29, 2016, ASIC made an amendment to ASIC Corporations (Derivative Transaction Reporting Exemption) Instrument 2015/844 to extend the trade identifier reporting relief until 31 January 2017 and to repeal ASIC Corporations (Amendment) Instrument 2016/0030.

#### **4. CFR developments and financial market infrastructure**

- On October 21, 2011, the CFR released a Consultation Paper on 'Review of Financial Market Infrastructure Regulation' that sets out proposals to enhance the supervision of Australia's critical financial market infrastructure (FMI).
- On March 30, 2012, the Deputy Prime Minister and Treasurer released the CFR Working Group's letter of advice on financial market regulation. Key recommendations included: (i) ensuring ASIC and RBA have appropriate powers to ensure FMIs manage their risk effectively; (ii) ASIC and RBA having explicit powers to impose location requirements in key areas; and (iii) Australian regulators having the power to establish oversight arrangements for overseas-based FMIs.
- On July 27, 2012, the CFR issued a consultation paper on 'Ensuring Appropriate Influence for Australian Regulators over Cross-border Clearing and Settlement Facilities'. This is a supplementary paper to the October 21, 2011 consultation paper. This provides further clarity on the measures that could be applied to cross-border CS facilities and how they may be implemented in practice under current legislative arrangements. The framework will apply to overseas facilities operating in Australia and to domestic facilities looking to move some of their operations offshore.
- The Payments System Board of RBA updated its eligibility requirements for Exchange Settlement Accounts (ESA) on July 31, 2012. The Board created a specific category of ESA for CCPs and has developed a policy for use of these accounts that recognises the important role that access to an ESA can play in assisting a CCP to manage its liquidity and settlement risks. The policy applies to any CCP that holds an Australian CS Facility license.
- On August 29, 2012, RBA released a Consultation Paper on 'New Financial Stability Standards'. The consultation seeks views on a proposal to revoke existing financial stability standards (FSSs) for CCPs and securities settlement facilities (SSFs) and to determine new FSSs for both CCPs and SSFs. The proposed FSSs will also implement key elements of the CFR's framework for ensuring Australian regulators have appropriate influence over cross-border CS facilities. FSSs will only apply to licensed CS facilities and only in matters concerning the stability of the Australian financial system.

- On December 18, 2012, ASIC published its amended regulatory guidance for CS facilities, which takes into account CPSS-IOSCO's 'Principles for financial market infrastructures' (FMI Principles) and the CFR's policy. These changes ensure continuing access to Australian-based CS facilities by overseas participants and also provide an appropriate degree of Australian regulatory influence over foreign-based CS facilities that wish to offer services in Australia. It clarifies the circumstances under which a systemically important overseas CS facility with a strong domestic connection may need to hold a domestic license.
- On February 15, 2013, ASIC and RBA issued a joint statement on implementing the FMI Principles in Australia.
- On May 8, 2013, the Regulators published information on how they will assess the case for a clearing mandate under the new regulatory framework for the OTC derivatives markets. By mandating central clearing of products that have been mandated in other jurisdictions, this would increase the likelihood that the Australian regime will be considered equivalent to relevant overseas jurisdictions.
- On July 17, 2013, the same 3 regulators issued a Report on the Australian OTC Derivatives Market – July 2013. The regulators recommended that the Government consider a central clearing mandate for USD, EUR, GBP and JPY denominated interest rate derivatives. The initial focus of such a mandate should be dealers with significant cross-border activity in these products. At this time, the regulators do not see a need for mandating North American and European referenced credit derivatives. Before recommending mandatory central clearing, the regulators will monitor for a further period the Australian banks' progress in implementing the appropriate arrangements for Australian dollar denominated interest rate derivatives. The regulators have not made a specific recommendation regarding mandatory platform trading obligation at this time.
- The CFR released a consultation paper on February 11, 2015, as part of its review of competition in clearing Australian cash equities. This follows a similar review of competition in the clearing and settlement of Australian cash equities in 2012, in which the CFR recommended a two-year moratorium on competition in the clearing of cash equities, but promised a review after that. With the two-year period ending in early 2015, the consultation paper sets out the scope of the CFR's review and the issues that will be considered. Following the consultation process, the CFR will consider stakeholder submissions and will advise the government on the findings of its review in due course.
- On March 27, 2015, the CFR released a consultation paper on the licensing regime for overseas CS facilities. The consultation paper sets out a proposal that aims to provide greater clarity on the circumstances in which a CS facility must be either licensed in Australia or exempted from the Australian CS facility licensing regime. It is not expected that the proposed new approach will result in additional CS facilities being within the scope of Australia's CS facility licensing regime, and the rest of the Australian CS facility licensing regime will remain unchanged.
- On November 4, 2015, the CFR released its fourth report on the Australian OTC derivatives market.

Having assessed current activity and practices in Australia's OTC derivatives market, along with overseas developments, the CFR stated that it does not currently see a case for extending the product scope of Australia's central clearing mandate. The CFR stated it sees in-principle benefits from increased use of trading platforms and will continue to consider the case for promoting their use, including through the introduction of trading mandates. While the CFR did not set out specific recommendations, the report outlined the details of how the CFR will assess the case for introducing trading mandates in the future.

The report also noted that Australia intends to implement internationally agreed margin requirements and other risk mitigation requirements for non-centrally cleared derivatives. In the first instance, this will be through prudential standards from the APRA, given the prominent role of APRA-regulated institutions in the Australian OTC derivatives market. The CFR will consider its approach for non-APRA regulated institutions in 2016.

- On October 12, 2016, the CFR released two policy statements setting out Regulatory Expectations for Conduct in Operating Cash Equity Clearing and Settlement Services in Australia and Minimum Conditions for Safe and Effective Competition in Cash Equity Clearing in Australia.

The CFR also recommended that the relevant regulators be granted rule-making powers to impose requirements on ASX's cash equity clearing and settlement (CS) facilities consistent with the Regulatory Expectations and the Minimum Conditions (Clearing). The relevant regulators would be empowered to make such rules if the expectations were either not being met or were not delivering the intended outcomes; and/ or if specific obligations on CS facilities were needed to support the minimum conditions for safe and effective competition in clearing. Further, the CFR recommended that the ACCC be granted the power to arbitrate disputes about price and/or non-price terms and conditions of access to ASX's facilities. The Government has committed to develop and consult on legislative changes in line with these recommendations.

The Regulatory Expectations cover a range of matters relevant to governance, pricing and access, and apply to ASX's engagement with, and provision of services to, users of its monopoly cash equity clearing and settlement services for both ASX-listed and non-ASX-listed securities. The Regulatory Expectations have been prepared in accordance with a set of core elements outlined in the report, with some amendments and clarifications primarily to ensure their auditability.

ASX is expected to immediately publicly commit to acting in accordance with the Regulatory Expectations. ASX is also expected to commit to submitting an annual external audit of its governance, pricing and access arrangements to the relevant regulators and members of the relevant user governance arrangements, benchmarked against the Regulatory Expectations. The findings of such audits may be one input to any decision by the relevant regulators to employ rule-making powers or in an arbitration determination once the supporting legislative framework is in place. Consistent with the recommendations of the review, the Minimum Conditions (Clearing) cover the following: (i) adequate regulatory arrangements; (ii) appropriate safeguards in the settlement process; (iii) access to settlement infrastructure on non-discriminatory, transparent, fair and reasonable terms; and (iv) appropriate interoperability arrangements between competing cash equity central counterparties. The Minimum Conditions (Clearing) clarify that ASIC and the RBA would not be in a position to recommend the approval of a licence application from a competing clearing provider until the legislative framework underpinning the Minimum Conditions (Clearing) was in place and detailed specific requirements under Minimum Conditions (Clearing) had been developed. The Council of Financial Regulators and the ACCC expect to review the Minimum Conditions periodically, including in the event of material changes to the operating environment or market structure for these services, such as the emergence of a competing settlement facility.

The Minimum Conditions (Clearing) have been developed with reference to the prevailing market structure in settlement – in which there is a sole provider of settlement services. Recent rapid advances in technological developments may increase the prospect of competition emerging in this market. The Council of Financial Regulators and the ACCC will consider the need for specific policy guidance to be issued in respect of settlement facilities.

## 5. ASX

- On October 25, 2012, ASX issued a market discussion paper on ‘Derivatives Account Segregation and Portability’. The paper sought market feedback on potential changes to the account structures such as levels of segregation that would meet the regulatory requirements of the Australian regulators as well as the FMI Principles. For derivatives clearing, the paper considered the appropriate level of client protection benefits arising from the CCPs holding client margin monies, and whether cash margins should be held in trust or on the balance sheet of the CCP.
- On February 21, 2013, ASX released a consultation paper on the Draft Operating Rules for its central counterparty clearing services for OTC interest rate derivatives (OTC Clearing Services). ASX would introduce OTC Clearing Services in phases. Phase 1 would be dealer-to-dealer clearing for AUD IRS and OIS, and would be available from July 1, 2013. The consultation paper also stated the product coverage may be extended to include AUD FRAs in Q3 2013. Phase 2 would introduce client clearing and extend product coverage to include NZD IRS, OIS and FRAs.
- On May 1, 2013, ASX released its response to the above consultation paper including, among others:
  - ASX will maintain a single default fund, however, ASX will formally review its default fund structure in consultation with the Risk Committee annually;
  - The symmetry between the Futures and OTC Commitments will be increased by reducing the Futures Clearing Participants Commitments from AUD\$120 million to AUD\$100 million, in-line with the OTC Clearing Participants Commitments. ASX group would inject a further AUD 20 million, increasing the “first loss” tranche in the default waterfall to AUD 120 million. All Secondary Commitments would be removed for Futures Clearing Participants.
- On August 28, 2013, ASX released a consultation paper on the Draft Operating Rules for the ASX 24 Exchange Traded Derivatives and OTC Interest Rate Derivatives Client Clearing Service (the Consultation Paper). This was the first of two consultation papers in which ASX sought stakeholders’ input on the draft Operating Rules for its Client Clearing Service for ASX 24 Exchange Traded Derivatives and OTC Interest Rate Derivatives. Certain points of the paper are set out below:
  - ASX plans to initially offer 2 different “client account” types: Omnibus Account and Individual Client Account (ICA). A Clearing Participant (CP) may choose whether to offer their clients one account type or both. The ICA structure is modeled on, but is not the same, as ‘LSOC without excess’. ASX planned to offer these two client account structures by March 31, 2014.
  - For an Omnibus Account, a client’s positions and collateral are held in a single client account of the CP and ASX calculates IM on the net position in that account. In the event of a CP’s default, the IM calculated will be protected from losses on the defaulting CP’s house positions and on positions in other client accounts, but it will not be protected from losses of other Clients in the Omnibus Account.
  - For Individual clients account ‘without excess’, a client’s positions are segregated from those of other Clients and IM is calculated on the basis of the Client’s positions exclusively. The aim is to allow ASX to port clients’ positions and associated IM in the event of a CP’s default. If the client’s position is not ported, ASX will close out the positions and return the associated IM to the client directly, less any losses, costs and expenses attributable to closing out the positions. Collateral is not segregated at the ICA level and therefore collateral held by the clearing house in excess of the IM requirement with respect to the client’s position cannot be ported with the positions and associated IM.

- Client positions will be netted within each Omnibus Account or ICA for the purposes of calculating the IM requirement with respect to the account. Collateral will be posted to ASX as margin by CP and not by clients directly. As the CP will post collateral to ASX in respect of a single IM obligation for all client accounts maintained by them, ASX will not be able to determine which non-cash collateral (if any) came from which client. Upon a CP default, ASX will liquidate any non-cash collateral in order to realize the IM requirement calculated by ASX in respect of each client account. The cash value of IM that ASX ports or returns in respect of each client account will not include any portion of the value of excess collateral. Excess collateral may be used by ASX to offset the losses incurred upon close-out or termination of positions in any client account and any shortfalls in the liquidated value of non-cash/ cross-currency collateral as a consequence of insufficient collateral haircuts. Under ASX's account structure, end-of-day payments to and from each CP's Client Clearing Account are netted to a single flow per currency per day. This means each CP has only one client collateral account with ASX, irrespective of how many Omnibus and ICA it has.
- On October 17, 2013, ASX released its second consultation paper on the Draft Operating Rules for the ASX 24 Exchange Traded Derivatives and OTC Interest Rate Derivatives Client Clearing Service. This was the second consultation paper in which ASX sought stakeholders' input on the draft Operating Rules.

Highlights include:

- This Consultation Paper focused exclusively on the default of Clearing Participants. There were no changes proposed in the paper for the default of Clients that was published in the first Consultation Paper.
- The Default Portfolio will comprise all OTC and portfolio-margined ETD transactions of the defaulting OTC Clearing Participant in its own name ("House" transactions) and Client transactions that have not been ported successfully within the porting window, and hedging transactions entered into by ASX following the default. ASX reserves the right to sell/auction the Default Portfolio either as one or more lots comprising either or both House and Client transactions according to the Default Management Process. In the event of multiple contemporaneous or near-contemporaneous defaults, ASX may further combine into a single Default Portfolio House and non-ported Client transactions of multiple defaulting OTC Clearing Participants.
- If terminated open contracts in a default management process relate to both house and client positions of a defaulted OTC participant or the OTC positions of more than one defaulted OTC participant, then ASX Clear (Futures) may combine any such terminated open contracts such that they are treated as part of one or more portfolios at any time after the commencement of the default management process; and allocate any loss in conjunction with that default management process between the relevant defaulted OTC participants and between the house accounts, client accounts and client sub-accounts of the relevant defaulted OTC participant (a Relevant Account). This will be done as of the time of combination of such Terminated Open Contracts and will be conducted by allocating any losses to each Relevant Account proportionately to its relative risk as determined by ASX Clear (Futures) using the value of IM calculated with respect to each Relevant Account; and if the Relevant Account is a client sub-account, the loss will be deducted from the guaranteed IM value of that client sub-account.
- ASX Clear (Futures) will establish default management groups (DMG) in respect of each OTC transaction type for the purposes of advising and assisting ASX Clear (Futures) for all DMG matters.
- On July 14, 2014, ASX issued a consultation paper to seek input on enhancing account structures for client clearing in both ASX 24 exchange traded derivatives (ASX 24 ETD) and OTC interest rate derivatives – the first of 2 planned consultation papers for client clearing accounts. This paper provided

some background to possible enhancements to account structures in order to determine the level of collateral protection favored by stakeholders. Based on feedback from this first consultation paper, a second consultation paper would be released in Q4 2014, presenting ASX's proposed solution for an enhanced account structure and its supporting rules framework. The consultation paper proposed the following account structures:

- Individual Client Account (ICA) with Excess – Value Attribution (applies to cash and non-cash collateral)
  - ICA with Excess - Asset Attribution (applies to non-cash collateral)
  - Full Asset Segregation (applies to cash and non-cash collateral)
- On October 2, 2014, ASX issued a consultation paper on CCP recovery, which considered uncovered loss allocation and replenishment tools for CP default. The paper set out proposals to enhance the crisis management capabilities of ASX's CCPs, including how to address credit losses or liquidity shortfalls and how to replenish the default fund in the event of a CP default.

Some of the new recovery tools in the ASX Clear (Futures) recovery proposal are:

- Emergency assessments
  - Variation margins gains haircutting
  - Partial termination (this is an existing tool; to be amended)
  - Complete termination
  - Mandatory replenishment
- On December 15, 2014, ASX issued a consultation paper “Enhanced Derivatives Account Segregation and Portability”, which sought stakeholders’ input on enhancements to ASX’s client clearing account structures that will offer derivatives clients the choice of increased collateral protection. ASX sought feedback on the proposed amendments to the operating rules of ASX CCPs, ASX Clear and ASX Clear (Futures), which will enable excess customer collateral for derivatives to be held directly with the ASX CCPs and attributed to an ICA. Introduction of the enhancements is to comply with regulatory guidance from the RBA so that ASX CCPs can gain recognition in the EU.
  - On June 3, 2015, the CFTC published a request for public comment on a petition by ASX Clear (Futures) Pty Limited for exemption from registration as a derivatives clearing organisation (DCO).

The CFTC was considering for the first time a petition for exemption from registration pursuant to its authority under section 5b(h) of the Commodity Exchange Act, which permits the CFTC to exempt a clearing organisation from DCO registration for the clearing of swaps to the extent that the CFTC determines that such clearing organisation is subject to comparable, comprehensive supervision by appropriate government authorities in the clearing organisation’s home country.

- On August 18, 2015, the CFTC issued an order of exemption from registration as a DCO to ASX Clear (Futures) Pty Limited (ASX). The order was the first issued by the CFTC based on its authority under Section 5b(h) of the Commodity Exchange Act.

ASX is able to clear proprietary swap positions for its US clearing members, subject to the terms and conditions of the order, which include the reporting of daily information to the CFTC, a requirement to only clear proprietary positions of US clearing persons, open access, the appointment of a US agent, consent to jurisdiction of the US, inspection of books and records, observance of the CPMI-IOSCO

Principles for Financial Market Infrastructures, and record-keeping and reporting requirements, among other things.

- On September 10, 2015, RBA released its annual assessment of ASX's four licenced clearing and settlement facilities, including ASX Clear Pty Limited, ASX Clear (Futures) Pty Limited, ASX Settlement Pty Limited and Austraclear Limited, for the year ended June 30, 2015. The principal focus was the progress made in meeting the recommendations and regulatory priorities identified by the RBA in its 2013/14 assessment. These included recommendations related to CCP model validation – and, in particular, the validation of stress-testing models – and recovery planning across all four facilities.

RBA also stated that all four facilities had made substantial progress in addressing the regulatory priorities identified in its 2014/15 assessment. Many of these priorities have been fully addressed. As a result, the RBA noted that the four facilities have either observed or broadly observed all relevant requirements under Australia's Financial Stability Standards. The facilities have therefore conducted their affairs in a way that causes or promotes overall stability in the Australian financial system, the RBA said.

Nevertheless, the assessment made further recommendations on model validation and stress testing, recovery planning, treasury investment policy and cyber resilience.

- On December 4, 2015, the ASX published a consultation paper on exposure draft rules for the interim replenishment of default funds. The paper sought feedback on ASX CCP recovery rules to facilitate the rapid replenishment of the default funds of ASX Clear and ASX Clear (Futures) if they are depleted as a result of a participant default loss. The proposed changes included:
  - ASX CCPs must replenish to a minimum fund size of A\$100 million (ASX Clear (Futures)) or A\$37.5 million (ASX Clear) as soon as practicable after completion of the default management process, including the next business day when that would be reasonably practicable;
  - ASX CCPs (through funding sourced by the ASX Group) will provide the initial interim contribution to replenish the default fund of up to A\$100 million (ASX Clear (Futures)) or A\$37.5 million (ASX Clear); and
  - ASX CCPs have discretion to call for participants to make interim contributions up to a further A\$100 million (ASX Clear (Futures)) or A\$37.5 million (ASX Clear) to the default fund during the default period.
  - These changes primarily affect the timing of replenishment of mutualised contributions, rather than the amount that is required to be ultimately replenished. As under the current recovery rules, the default fund would be fully replenished up to A\$400 million for ASX Clear (Futures) or A\$150 million for ASX Clear after the default period has ended. ASX would continue to rely on additional margin calls where necessary to ensure it maintains the required level of financial cover during the remainder of the default period.
- On August 15, 2016, the ASX published a consultation paper on OTC Rule and Handbook Amendments. The consultation paper proposed to expand the OTC product coverage of the OTC Clearing Service to include:
  - New OTC Interest Rate Derivatives products – Asset Swaps and BBSW vs AONIA Basis Swaps;
  - extended maturities for existing OTC Interest Rate Derivatives products; and
  - Whether ASX should amend its OTC Rules to confirm that OTC Open Contracts are 'settled to market' rather than 'collateralised to market' by variation margin payments.
  - ASX also proposed to make a number of miscellaneous OTC Rule and Handbook amendments.

## 6. Legislative changes

- On July 1, 2011, the Treasury released a Consultation Paper on the Exposure Draft – Financial Sector Legislation Amendment (Close-out Netting Contracts) Bill 2011 (2011 Bill). The 2011 Bill sought to strike the right balance between ensuring market confidence in the enforceability of close-out netting contracts and protecting depositors and insurance holders by imposing a short stay before close-out netting rights can be enforced. The 2011 Bill addressed the inconsistency related to close-out netting contracts between the Banking Act, the Insurance Act and the Life Insurance Act on the one hand and the Payment Systems and Netting Act 1998 (PSN Act) on the other hand that was introduced when the former Acts were amended in 2008.
- On March 20, 2013, the Corporations and Financial Sector Legislation Amendment Bill 2013 (2013 Bill) was introduced in Parliament. The 2013 Bill amended a number of statutes, in particular, the PSN Act. The amendments to the PSN Act clarified that porting of positions, including associated collateral, in the case of a default or insolvency of a CCP participant is allowed, regardless of provisions in other legislation including the Corporations Act 2001. The proposed amendments to the PSN Act also clarified that a CCP may enforce security that it holds over any type of assets of a defaulting participant.
- On December 20, 2013, the Treasurer announced the final terms of reference for the Financial System Inquiry (FSI). The FSI was charged with examining how the financial system may be positioned to best meet Australia's evolving needs and support Australia's economic growth. By way of background, the FSI was the first major inquiry into Australia's financial system since the Wallis Report in 1997. The FSI's terms of reference were wide in scope and encompassed a wide range of financial activities. The FSI accepted submissions on the issues raised in the terms of reference until March 31, 2014.
- In July 2014, FSI released an Interim Report. The aim of this Interim Report was to elicit comments from interested stakeholders to inform the Final Report to the Treasurer. The report set out the Committee's views on the objectives of the financial system and discusses the financial system from nine perspectives. For each of these observations, it set out a range of options for change, including the option of no change.
- On October 20, 2015, the Australian Government issued its response to the FSI. The FSI delivered its final report to the government on November 28, 2014. A period of consultation had followed the release of the final report. In its response, the Government sets out an agenda to:
  - strengthen the resilience of the financial system;
  - improve the efficiency of the superannuation system;
  - stimulate innovation in the financial system;
  - support consumers of financial products being treated fairly; and
  - strengthen regulator capabilities and accountability.

Among the Government actions proposed in the response:

- With respect to the recommendation to ensure Australia's participation in international derivatives markets, the Government will develop legislative amendments in the second half of 2015 to clarify domestic regulation to support globally coordinated policy efforts and facilitate the ongoing participation of Australian entities in international capital markets.

- The Government also states that it will develop legislative amendments to improve protections for client monies held in relation to derivatives. These are intended to ensure that investors' monies are adequately protected when held by intermediaries. The Government also intends to develop legislative amendments to the definition of a basic deposit product in the Corporations Act 2001.
- The FSI final report was released on December 7, 2014 and FSI has now concluded. FSI made 44 recommendations relating to the Australian financial system, including (but not limited to):
  - Resilience: Strengthen policy settings that lower the probability of failure, including setting Australian bank capital ratios such that they are unquestionably strong by being in the top quartile of internationally active banks; and reduce the costs of failure, including by ensuring ADIs maintain sufficient loss absorbing and recapitalisation capacity to allow effective resolution with limited risk to taxpayer funds – in line with international practice
  - Regulatory System: Improve the accountability framework governing Australia's financial sector regulators by establishing a new Financial Regulator Assessment Board to review their performance annually; Ensure Australia's regulators have the funding, skills and regulatory tools to deliver their mandates effectively; Rebalance the regulatory focus towards competition by including an explicit requirement to consider competition in ASIC's mandate and conduct three-yearly external reviews of the state of competition; Improve the process for implementing new financial regulations; and Introduce an industry funding model for ASIC and provide ASIC with stronger regulatory tools.
  - Capitalisation: Implement a framework for minimum loss absorbing and recapitalisation capacity in line with emerging international practice, sufficient to facilitate the orderly resolution of Australian authorised deposit-taking institutions and minimise taxpayer support; Develop a reporting template for Australian authorised deposit-taking institution capital ratios that is transparent against the minimum Basel capital framework; and Introduce a leverage ratio that acts as a backstop to authorised deposit-taking institutions' risk-weighted capital positions.
- On May 4, 2016, the Financial System Legislation Amendment (Resilience and Collateral Protection) Bill 2016 was passed by the Australian senate. The Bill enables to entities to provide margin and access international clearing houses. This follows recent legislative work on payment systems and netting and protection of client money.
- The Bill addresses the legal impediments which restrict certain Australian entities from providing margin consistent with international principles. This stemmed from the need to provide initial margin by way of security and not absolute transfer which is commonly used in Australia. Certain provisions in the Banking Act, the Corporations Act and the Property Securities Act were amended to remove these impediments. The Payment Systems and Netting Act, include changes, which, among others, extend the current protection of close-out netting to the enforcement of security over obligations under those contracts. Clarity was also provided with respect to close-out netting and the question of stays. Further, the Bill proposed reforms and changes to the approved real time gross settlement systems, approved multilateral betting arrangements and netting markets.

## **7. Resolution regime**

- On September 12, 2012, the Treasury released a consultation paper on 'Strengthening APRA's crisis management powers' to set out a range of options on, among others, strengthening APRA's crisis management powers in relation to ADIs, superannuation entities and general and life insurers and simplifying APRA's regulatory powers across the various statutes it administers in the banking, insurance, and superannuation sectors, given that many firms operate across sectors.

- On February 20, 2015, the Treasury released a consultation paper on the Resolution Regime for FMIs for public comment. Some of the proposals included:
  - Institutional scope: proposed to cover all CS facilities incorporated in Australia and holding a domestic CS facility licence, and all trade repositories incorporated and licensed in Australia and are identified as being systemically important in Australia. Some of the legislative proposals extended to financial markets that are incorporated in Australia and holding a domestic market licence. The institutional scope of the paper did not extend to overseas-based FMIs. Instead, the paper proposed that Australian authorities should have the capacity to take limited action in support of resolution actions by overseas authorities in respect of overseas-based FMIs and financial markets that are licensed to operate in Australia.
  - Resolution powers: (i) statutory management; (ii) moratorium on payments to general creditors; (iii) transfer of operations to a third-party or bridge institution; and (iv) temporary stay on early termination rights.
  - Matters relating to the funding of resolution actions.
  - Direction powers: enhancements to the direction powers of the regulators and resolution authorities, primarily for the purpose of supporting the successful implementation of recovery and resolution actions. They would introduce a streamlined process for the timely issuance of directions, and also strengthen the sanctions for a failure to comply, including criminal sanctions.

## 8. Basel III reforms

- On August 10, 2012, APRA released a discussion and consultation paper on implementing the Basel III counterparty credit risk capital reforms, intending to apply this to ADIs, subsidiaries of foreign banks and clearing members of a CCP. APRA's proposals for counterparty credit risk included, among others, the introduction of the Credit Valuation Adjustment (CVA) risk capital charge.
- In September 2012, APRA released a final set of prudential standards and reporting standards that give effect to Basel III capital reforms in Australia. Some key reforms to apply to ADIs included, among others, the introduction of a new definition of regulatory capital under which common equity is the predominant form of Tier 1 capital.
- On May 6, 2013, APRA released a second consultation package, including draft Prudential Standards APS 210 Liquidity (APS 210), a draft Prudential Practice Guide APG 210 Liquidity (APG 210) and a discussion paper on Implementing Basel III Liquidity Reforms in Australia (Discussion paper). The consultation package outlined APRA's proposed amendments to its 2011 proposals on the implementation of the LCR in Australia and addressed the main issues raised in submissions, dialogue with the industry and other interested parties.

APRA did not make any amendments to its proposed implementation of the NSFR but would ensure that concerns raised in the submissions for the NSFR would be fed to the Basel Committee.

APRA issued its final Basel III liquidity reforms in 2013. The new prudential standards became effective on January 1, 2014. The LCR commenced on January 1, 2015 and NSFR requirements will commence on January 1, 2018.

The changes to the LCR announced in the Basel III liquidity reforms allowed national authorities to have discretion to include certain additional assets in the new Level 2B category of high-quality liquid assets (HQLA). These assets are:

- residential mortgage-backed securities (RMBS) with a long-term credit rating of AA or higher;
- corporate debt securities with long-term credit rating between A+ and BBB-; and
- certain listed non-financial equities.

APRA proposed not to exercise this discretion, hence, the definition of HQLA remains unchanged. However, some debt securities included in the definition of Level 2A and level 2B assets are repo-eligible with the RBA for normal market conditions and are eligible collateral for the Committed Liquidity Facility (CLF).

- On August 8, 2013, APRA released a note for ADIs with further details on its approach to the implementation of the Basel III liquidity framework, in particular the CLF. Due to the relatively short supply of Australian-dollar HQLA, the RBA will allow “scenario analysis” ADIs to establish a secured CLF sufficient to cover any shortfall between the ADI’s holdings of HQLA and the requirement to meet the LCR. The note provided details on APRA’s role in determining the appropriate size of the CLF for each scenario analysis ADI. The main steps are:
  - ADIs will be required to apply for inclusion of a CLF for LCR calculation purposes on an annual basis;
  - ADIs will be required to demonstrate they have taken “all reasonable steps” towards meeting their LCR requirements through their own balance sheet management, before relying on the CLF;
  - ADIs must meet relevant qualitative and quantitative liquidity requirements, including having in place a statement of the Board’s tolerance for liquidity risk, a robust liquidity transfer pricing mechanism, appropriate remuneration arrangements for those executives responsible for the ADI’s funding plan and liquidity management.
- On April 15, 2014, APRA released a letter to inform mutually owned ADIs that they will be able to issue Additional Tier 1 capital (AT1) and Tier 2 capital (T2) instruments that provide for conversion into mutual equity interests in the event that the loss absorption or non-viability provisions in these instruments are triggered. Mutual equity interests that result in such a conversion will qualify to be included in common equity Tier 1 (CET1) capital if they comply with the relevant provisions of APS 111. The final form of APS 111 is now available.
- On May 8, 2015, APRA released a response to submissions and final versions of Prudential Standard APS 110 Capital Adequacy (APS 110) and Prudential Standard APS 330 Public Disclosure (APS 330), which incorporated new disclosure requirements for authorised deposit-taking institutions. These requirements took effect from July 1, 2015, and relate to the leverage ratio, the liquidity coverage ratio and the identification of globally systemically-important banks. These requirements were based on revisions to the Basel Committee on Banking Supervision’s disclosure framework, which aims to improve the comparability of banking institutions’ risk profiles and facilitate market discipline by providing consistent information about key risk metrics to market participants and other interested parties.
- On July 13, 2015, APRA released the results of a study comparing the capital position of Australia’s major banks against a group of international banking peers. The study was conducted by APRA in response to Recommendation 1 of the FSI. The FSI recommended that APRA should “set capital standards such that Australian authorised deposit-taking institution capital ratios are unquestionably strong”.

In its final report, the FSI suggested banks should have capital ratios that position them in the top quartile of internationally-active banks in order for them to be regarded as ‘unquestionably strong’. APRA’s study, which adjusts for differences in measurement methodology across jurisdictions and uses a number of different measures of capital strength, found that the Australian major banks are well-capitalised, but not in the top quartile of international peers.

The results of the study would inform, but would not ultimately determine, APRA’s approach for setting ‘unquestionably strong’ capital adequacy requirements. APRA regards the top quartile positioning as a useful indicator of the strength of the Australian framework, but does not intend to tightly tie Australian requirements to a benchmark based on the capital adequacy ratios of international banks.

A final response to the determination of ‘unquestionably strong’ capital standards would require further consideration by APRA, taking into account the results of this study, changes arising from the Basel Committee on Banking Supervision’s current review of the global capital adequacy framework, and the extent of further strengthening in the capital ratios of peer international banks. Taking all of these factors into account, APRA’s current judgement is that the major banks would need to increase their capital adequacy ratios by at least 200 basis points, relative to their position in June 2014, to be comfortably positioned in the top quartile of their international peers over the medium- to long-term.

- On October 6, 2015, APRA released the results of its secured CLF. APRA implemented the LCR on January 1, 2015 to ensure that ADIs have sufficient HQLA to survive a stress scenario lasting for 30 days. The CLF will be sufficient in size to cover any shortfall between the ADI’s holdings of HQLA and the requirement to hold such assets under the LCR. ADIs will be required to demonstrate that they have taken ‘all reasonable steps’ towards meeting their LCR requirements through balance sheet management, before relying on the CLF. Each LCR ADI that requested a CLF was also required to submit a three-year funding plan to APRA that included, amongst other things, a projection of Australian dollar net cash outflows over the CLF approval period.

All locally-incorporated LCR ADIs were invited to apply for a CLF to take effect on January 1, 2016. Thirteen ADIs applied for CLFs totalling approximately \$272 billion. Following APRA’s assessment of the applications, the aggregate Australian dollar net cash outflow of the 13 ADIs projected for end-2016 was approximately \$402 billion. The RBA determined that the amount of Australian Government Securities and securities issued by state and territory governments that could reasonably be held by locally-incorporated LCR ADIs in 2016 was \$195 billion. On this basis, the CLF was determined to be approximately \$207 billion and the total CLF granted (including buffers over 100%) was approximately \$245 billion.

- On March 31, 2016, APRA released a consultation on its proposed implementation of the Net Stable Funding Ratio (NSFR), proposed to come into effect from 1 January 2018. The discussion paper also proposed options for the future operation of a liquid assets requirement for foreign ADIs, i.e. foreign bank branches, in Australia.

APRA proposed that the NSFR will only be applied to larger, more complex ADIs. APRA stated that it sees limited value in applying the new standard to smaller ADIs with balance sheets that comprise predominantly mortgage lending portfolios funded by retail deposits.

The discussion paper also sets out proposals for the future application of a liquid assets requirement for foreign bank branches that are currently subject to a concessionary 40 per cent LCR requirement. APRA consulted on two options: (i) the continuation of the existing regime or (ii) replacing the existing regime

with a simple metric that would require foreign bank branches to hold specified liquid assets equal to at least nine per cent of external liabilities.

Submissions on the proposals in the discussion paper are due by 31 May 2016. APRA announced that it intends to release a draft revised prudential standard, and an associated prudential practice guide, for consultation later in 2016. This will be followed by revised draft reporting requirements during the second half of 2016.

- On July 14, 2016, APRA announced that it has reviewed the range of assets that qualify for the liquidity coverage ratio (LCR) for some authorised deposit-taking institutions (ADIs), and reconfirmed existing arrangements with an addition to eligible Level 1 assets.

Since January 1, 2015, ADIs subject to the LCR requirement have been required to hold a stock of high quality liquid assets (HQLA) sufficient to survive a severe liquidity stress scenario lasting 30 days. There are two categories of assets that can be included in this stock:

- Level 1 assets - limited to cash, central bank reserves and highest quality sovereign or quasi sovereign marketable instruments that are of undoubted liquidity, even during stressed market conditions. APRA has reconfirmed the existing definition, which is that the only assets that qualify as Level 1 assets are cash, balances held with the Reserve Bank of Australia, and Australian Government and semi government securities.
- Level 2 assets (which can comprise no more than 40 per cent of the total stock) - limited to certain other sovereign or quasi sovereign marketable instruments, as well as certain types of corporate bonds and covered bonds, that also have a proven record as a reliable source of liquidity even during stressed market conditions. APRA has reconfirmed the existing definition, which is that there are no assets that qualify as Level 2 assets.

However, for the purposes of the LCR requirement, Australian government securities now include debt securities of the Export Finance and Insurance Corporation (EFIC). The debt securities of EFIC are high-quality marketable instruments that have a full guarantee by the Commonwealth of Australia.

The treatment of Level 1 and Level 2 assets for the purposes of the LCR requirement does not affect the set of instruments that the Reserve Bank of Australia (RBA) will accept as qualifying collateral for its committed secured liquidity facility. Qualifying collateral will comprise all assets eligible for repurchase transactions with the RBA under normal market conditions.

- On August 5, 2016, APRA reaffirmed its objective, announced in 2015, to raise Australian residential mortgage risk weights applied by banks using internal models to an average of at least 25%.

In July 2015, APRA adjusted the risk-weight calculation used by authorised deposit-taking institutions (ADIs) accredited to use the internal ratings-based (IRB) approach to credit risk. The average risk weight on Australian residential mortgage exposures was to be increased from approximately 16% to an average of at least 25%, measured across all IRB ADIs and effective from July 1, 2016.

Subsequent to the announcement in July 2015, APRA has also required IRB ADIs to make a range of other changes to their models as part of its routine supervisory processes, with a view to improving their comparability, reliability and risk sensitivity. The impact of these changes, when combined with the adjustment proposed in July 2015, would have been an average risk weight that was well in excess of the 25% targeted by APRA in its original announcement.

APRA has therefore advised the relevant ADIs that it will recalibrate the adjustment advised in July 2015 to ensure the original target of an average risk weight for Australian residential mortgages of at least 25% is achieved, while not significantly exceeding this target. In doing so, APRA has taken into account modelling changes that have been instituted, as well as some that are to be completed over the coming quarters. This adjustment to mortgage risk weights remains an interim measure, pending the outcome of the deliberations of the Basel Committee on Banking Supervision to finalise reforms to the capital adequacy framework, and APRA's subsequent consideration of how those reforms should be applied in Australia.

- On September 29, 2016, APRA released a paper setting out its response to issues raised in submissions to a discussion paper on Basel III's net stable funding ratio (NSFR) and the liquid assets requirement for foreign authorised deposit-taking institutions (ADIs). APRA also released draft revised prudential standards that incorporate the NSFR requirements for ADIs and other changes.

The March discussion paper also set out proposals for the future application of a liquid assets requirement for foreign ADIs (i.e. foreign bank branches). Foreign ADIs are currently subject to a minimum LCR requirement of 40 per cent; the discussion paper proposed an alternative approach. Submissions on this matter raised a number of issues that suggested the alternative to the 40 per cent LCR would not be as simple as APRA intended, or necessarily lend itself to a one-size-fits-all approach. APRA is therefore proposing to retain the 40 per cent LCR as the default liquid assets requirement for foreign ADIs, but allow foreign ADIs with simpler business activities to apply to use the alternative approach.

Written submissions on the proposals were due by October 28. APRA expects to release its final position on the introduction on the NSFR in late 2016. APRA will shortly consult on revised reporting requirements for ADIs related to the introduction of the NSFR and other amendments. APRA's current intention is for the NSFR to come into effect from January 1, 2018, in line with the internationally agreed timetable.

- On September 30, 2016, APRA sent a letter to all ADIs releasing aggregate results on the committed liquidity facility (CLF) established between the Reserve Bank of Australia (RBA) and certain locally incorporated ADIs that are subject to the liquidity coverage ratio (LCR). APRA implemented the LCR on January 1, 2015.

The CLF is intended to be sufficient in size to compensate for the lack of sufficient high-quality liquid assets (mainly Australian government and semi-government securities) in Australia for ADIs to meet their LCR requirements. All locally incorporated LCR ADIs were invited to apply for a CLF amount to take effect on January 1, 2017. Fourteen ADIs chose to apply. Following APRA's assessment of the applications, the aggregate Australian dollar net cash outflow of the 14 ADIs projected for end-2017 under the stress scenario was calculated as approximately \$400 billion. The total CLF amount allocated for 2017 (including an allowance for buffers over the minimum 100% requirement) is approximately \$223 billion.

Since the formal implementation of the LCR in 2015, the total CLF has decreased each year. The decreases have been primarily driven by the increased availability of Australian government securities and semi-government securities able to be held as high-quality liquid assets.

- On November 10, 2016, APRA released the final revised prudential securitisation standard, accompanied by a draft revised prudential practice guide on the subject. The final revised standard reflects APRA's implementation of the Basel III securitisation framework, and will take effect from January 1, 2018.

APRA invites written submissions on the draft revised prudential practice guide by December 20, 2016. In the coming months, APRA will separately consult on revised reporting requirements for securitisation that would take effect at the same time as the revised prudential standard.

- On November 16, 2016, APRA published a response to submissions received on its January 6, 2016 discussion paper outlining proposed changes to APRA's Quarterly Authorised Deposit-taking Institutions Performance (QADIP) publication.

APRA proposed to expand the statistics published in the QADIP to include relevant information on the liquidity of ADIs, introduce liquidity statistics for banks and expand the liquidity statistics published for credit unions and building societies. The feedback received and APRA's response focuses on the following main areas:

- Alignment of statistics to public disclosure requirements;
- Confidentiality of additional liquidity statistics; and
- Publication of mutual ADIs segment

On the basis that submissions were broadly supportive of the proposal to publish additional liquidity statistics, APRA will incorporate the expanded liquidity statistics for the September 2016 edition of QADIP, to be released November 29, 2016. These expanded statistics will promote understanding of the ADI industry and provide users of APRA's statistics with additional information to make well-informed decisions. APRA will also release an explanatory note that explains how the liquidity statistics should be interpreted and used.

- On December 20, 2016, the Australian Prudential Regulation Authority (APRA) released the final revised Prudential Standard APS 210 Liquidity (APS 210) and Prudential Practice Guide APG 210 Liquidity (APG 210), which incorporate the net stable funding ratio (NSFR) requirements for some authorised deposit-taking institutions (ADIs).

APRA will retain the 40% LCR as the default liquid assets requirement for foreign ADIs, but allow foreign ADIs with simpler business activities to apply to use the alternative minimum liquidity holdings approach.

The new APS 210 will commence on January 1, 2018, while the new APG 210 replaces the existing APG 210 immediately.

## **9. APRA – Prudential Standards**

- APRA will determine whether an ADI is classified as a LCR ADI or an ADI subject to the Minimum Liquidity Holdings (MLH) regime for liquidity by taking into account the ADI's size and complexity with respect to the liquidity risk. An LCR ADI must undertake scenario analysis of domestic and foreign currency liquidity and must complete the following scenarios:
  - the Liquidity Coverage Ratio (from January 1, 2015);
  - the "name crisis" scenario (until December 2014); and
  - the "going concern" scenario.

An MLH ADI will be required to maintain a minimum holding of 9% of its liabilities in specified liquid assets. An MLH ADI is also required to complete the going concern scenario liquid assets.

- In January 2014, APRA released its final cross-industry Prudential Standard CPS 220 Risk Management (CPS 220) and a consultation draft Prudential Practice Guide CPD 220 Risk Management (CPG 220). On May 8, APRA published a letter outlining responses to several key issues raised during the consultation period – in particular, APRA’s use of the word ‘ensure’ in the prudential standard, the three lines of defence model and the concept of materiality for the risk management declaration. Accordingly, and notwithstanding that CPS 220 was finalised in January, APRA issued a letter on October 7 to all ADIs, general insurers and life companies to propose further amendments to CPS 220 and CPG 220. For CPS 220, APRA sought feedback on the proposed refinements and whether they give rise to any fundamental concerns. CPS 220 and CPG 220 came into effect on January 1, 2015.
- On September 1, 2014, APRA released for consultation an amended APS 210 Liquidity and amended reporting instructions, relating to the LCR. Some of the proposed amendments are:
  - A proposed amendment to the definition of expected derivatives cash inflows and cash outflows that may be shown on a net basis, and clarifications regarding the reporting instructions relating to this matter. This affects all ADIs classified as ‘LCR ADIs’.
  - As the process of assessing applications for a CLF from the RBA has raised a number of challenges in applying the LCR to foreign bank branches in the current form, APRA plans to reassess the nature of, and rationale underlying its application of, liquid asset requirements to foreign bank branches in Australia. APRA intends to publish a consultation on this topic in 2015.
  - In the interim, APRA proposes to apply an LCR with a 15-calendar-day time horizon to branches (rather than the full 30-calendar-day time horizon applied to locally incorporated ADIs). Branches will also be allowed to meet the liquid asset requirements using both assets defined as HQLA, as listed in Attachment A paragraphs 6-11 of APS 210, and assets listed in APS 210 in Attachment C paragraphs 3(c) – (g), subject to paragraph 4 of Attachment C. For clarity, there is no change to the definition of HQLA. It is proposed that minimum liquidity holdings securities comprise an additional asset that will be deemed to form part of the ‘stock of high-quality liquid assets’ in the numerator of the formula in APS 210.
- On September 18, 2014, APRA released for consultation a discussion paper and draft amendments to APS 110 and APS 330, which outline APRA’s proposed implementation of new disclosure requirements for ADIs.

#### Highlights of the proposals:

- Leverage ratio disclosures: APRA proposes that locally incorporated ADIs, with approval from APRA, use an internal ratings-based approach for credit risk under the risk-based adequacy framework. The ADIs are also required to disclose certain quantitative and qualitative information about their leverage ratios, calculated in accordance with the proposed methodology set out in draft APS 110. At this stage, there is no minimum leverage ratio requirement proposed. Any decision on implementation of a minimum leverage requirement will only be taken by APRA once the BCBS agrees a minimum international standard.
- LCR disclosures: APRA proposes that ADIs subject to the leverage coverage ratio should disclose certain data in relation to their ratios.
- Disclosures for the identification of potential global systemically important banks (G-SIBs): APRA proposes that the four major Australian ADIs disclose the 12 indicators used in the G-SIB identification methodology.
- On July 22, 2015, APRA released a revised version of APS 330, which rectified an omission in paragraph 21(b) of the July 2015 version of APS 330. The omission altered the definition of ‘material risk-taker’ for the purposes of the remuneration disclosure requirements in APS 330. This omission

would have imposed quantitative remuneration disclosure requirements on a wider range of persons than APRA intended.

The revised APS 330 amended paragraph 21(b) to align the definition of ‘material risk-taker’ with the definition used in the January 2015 version. No other substantive changes were made, although APRA made a number of minor formatting amendments. Revised APS 330 was not subject to public consultation as the correction was in align with APRA’s previously consulted upon position. The revised version of APS 330 became effective on August 1, 2015.

- On July 20, 2015, APRA announced an increase in the amount of capital required for Australian residential mortgage exposures by ADIs accredited to use the internal ratings-based (IRB) approach to credit risk. This change would mean that the average risk weight on Australian residential mortgage exposures for ADIs accredited to use the IRB approach would increase from approximately 16% to at least 25%.

The increase in IRB mortgage risk weights addressed a recommendation of the FSI that APRA “raise the average IRB mortgage risk weight to narrow the difference between average mortgage risk weights for ADIs using IRB risk-weight models and those using standardised risk weights”. The increase is also consistent with the work being undertaken by the BCBS on changes to the global capital adequacy framework for banks.

The increased IRB risk weights would apply to all Australian residential mortgages, other than lending to small businesses secured by residential mortgage. The increase is being implemented through an adjustment to the correlation factor used in the IRB mortgage risk-weight function for each affected ADI. In order to provide ADIs sufficient time to prepare for the change, the higher risk weights will come into effect from July 1, 2016.

The increase in IRB mortgage risk weights is an interim measure. APRA has stated it is not possible to settle on the final calibration between IRB and standardised mortgage risk weights until changes arising from the Basel Committee’s broader review of this framework are complete. Further changes to IRB mortgage risk weights will be considered by APRA over the medium term in the context of these broader international developments.

- On November 26, 2015, APRA published a discussion paper on its proposals to revise the prudential framework for securitisation for ADIs. APRA also released a draft APS 120.

APRA’s objective in revising the prudential requirements for securitisation is to establish a simplified framework, taking into account global reform initiatives and the lessons learned from the global financial crisis. One of these lessons was that securitisation structures had become excessively complex and opaque and that prudential regulation of securitisation had become similarly complex. APRA first consulted on initiatives to simplify its prudential framework for securitisation in April 2014. APRA’s amended proposals include:

- dispensing with a credit risk retention or ‘skin-in-the-game’ requirement;
- allowing for more flexibility in funding-only securitisation; and
- removing explicit references to warehouse arrangements in the prudential framework.

These amended proposals are expected to assist ADIs in further strengthening their funding profile and provide clarity to ADIs that undertake securitisation for capital benefits. The proposals incorporate the new Basel III securitisation framework, with appropriate adjustments to reflect the Australian context and APRA’s objectives, and will be applicable equally to all ADIs. The discussion paper and draft

prudential standard are subject to consultation. APRA proposes to implement these changes inline with the Basel Committee's effective date of January 1, 2018.

In addition, APRA intends to release a draft prudential practice guide (PPG), reporting standards and reporting forms for consultation in the first half of 2016. APRA expects that these final documents will be released in the second half of 2016.

- On December 17, 2015, APRA announced that the countercyclical capital buffer applying to the Australian exposures of ADIs will be set at 0% from January 1, 2016. The capital framework requires ADIs to hold a buffer of CET1 capital, over and above each ADI's minimum requirement, comprised of three components:
  - a capital conservation buffer, applicable at all times and equal to 2.5% of risk-weighted assets (unless determined otherwise by APRA);
  - an additional capital buffer applicable to any ADI designated by APRA as a D-SIB, currently set to 1.0% of risk-weighted assets; and
  - a countercyclical buffer which may vary over time in response to market conditions. This buffer may range between 0-2.5% of risk-weighted assets.

ADIs will generally be required to maintain a minimum CET1 ratio of 4.5%, plus a 2.5% capital conservation buffer (3.5% for D-SIBs) and a buffer for international exposures in jurisdictions that have set a non-zero countercyclical capital buffer rate. For some ADIs, additional capital requirements are also applied via Pillar 2. All Australian ADIs currently report CET1 ratios above these requirements. The aggregate CET1 ratio for the banking system at the end of September 2015 was 10.1%.

In addition to this announcement on the size of the buffer, APRA also released the countercyclical buffer information paper, the draft prudential practice guide on capital buffers, and the revised prudential standard APS 110 on the same day.

- On December 18, 2015, APRA issued a letter to ADIs on classification of retail and qualifying small and medium enterprises (SMEs) deposit for LCR purposes. In early 2015, APRA conducted a consistency review across 14 large ADIs to determine whether they were taking a consistent approach to the interpretation and application of key terms in APS 210 relating to the LCR. The area that demonstrated the greatest level of inconsistency was the assumptions relating to retail and qualifying SME deposits.

The letter provided APRA's observations of better practice in the approaches taken to determine whether retail deposits are considered stable or less stable. As part of ongoing supervision and the CLF 'all reasonable steps' assessment process in 2016, APRA would consider the extent to which ADI's meet the expectations in this letter. Key elements include:

- Stable deposits: To qualify as 'stable', a deposit needs to be fully insured by the Financial Claims Scheme (FCS) and meet either the 'established relationship' or 'transactional account' criteria.
  - Less stable deposits: The LCR recognises that there are certain types of deposit accounts that demonstrate higher levels of liquidity risk than other deposit accounts.
- On January 6, 2016, APRA released a consultation package on the proposed publication of liquidity statistics for ADIs. APRA proposed to expand the current statistics published in the Quarterly ADI Performance publication to include relevant information on the liquidity of ADIs. APRA proposed to

introduce liquidity statistics for banks, and expand the existing liquidity statistics published for credit unions and building societies.

- On March 29, 2016, APRA consulted on clarifications to the governance and risk management components of the framework for supervision of conglomerate groups. This includes clarifications to nine prudential standards, intended to become effective on July 1, 2017, and two prudential practice guides. These clarifications are not changes in policy position.

APRA has also announced that it has deferred the implementation of conglomerate capital requirements until a number of other domestic and international policy initiatives are further progressed.

While the clarifications to the cross-industry standards of risk management, outsourcing, governance, business continuity management, and fit-and-proper largely relate to their application to conglomerates, these standards also apply to all authorised deposit-taking institutions (ADIs), general insurers and life companies. As such, APRA encourages all entities covered by these standards to review the clarifications.

Responses to the consultation on the nine non-capital prudential standards are due by May 13, while responses to the two prudential practice guidelines are due by May 27.

- On August 5, 2016, APRA reaffirmed its objective, announced in 2015, to raise Australian residential mortgage risk weights applied by banks using internal models to an average of at least 25%.

In July 2015, APRA adjusted the risk-weight calculation used by authorised deposit-taking institutions (ADIs) accredited to use the internal ratings-based (IRB) approach to credit risk. The average risk weight on Australian residential mortgage exposures was to be increased from approximately 16% to an average of at least 25%, measured across all IRB ADIs and effective from July 1, 2016.

Subsequent to the announcement in July 2015, APRA has also required IRB ADIs to make a range of other changes to their models as part of its routine supervisory processes, with a view to improving their comparability, reliability and risk sensitivity. The impact of these changes, when combined with the adjustment proposed in July 2015, would have been an average risk weight that was well in excess of the 25% targeted by APRA in its original announcement.

APRA has therefore advised the relevant ADIs that it will recalibrate the adjustment advised in July 2015 to ensure the original target of an average risk weight for Australian residential mortgages of at least 25% is achieved, while not significantly exceeding this target. In doing so, APRA has taken into account modelling changes that have been instituted, as well as some that are to be completed over the coming quarters. This adjustment to mortgage risk weights remains an interim measure, pending the outcome of the deliberations of the Basel Committee on Banking Supervision to finalise reforms to the capital adequacy framework, and APRA's subsequent consideration of how those reforms should be applied in Australia.

- On August 8, 2016, APRA released final requirements for the governance and risk management components of the framework for supervision of banking and insurance conglomerate groups (Level 3 framework). The new requirements will come into effect from July 1, 2017.

APRA consulted on these requirements in March 2016, and minor clarifications have been made in response to the feedback provided, with details included in a response letter. APRA previously announced its intention to apply the Level 3 framework to eight conglomerate groups. APRA will

formally determine the Level 3 heads and members of each of the eight Level 3 groups between now and July 1, 2017.

APRA announced in March 2016 that it was deferring capital requirements for conglomerates until a number of other domestic and international policy initiatives are further progressed. APRA does not propose to initiate new consultations on the capital component of the conglomerate framework any earlier than mid-2017.

- On August 30, 2016, APRA released a new prudential practice guide on the operation of capital buffers for authorised deposit-taking institutions (ADIs).

Prudential Practice Guide APG 110 Capital Buffers (APG 110) provides clarification and guidance for ADIs on the operation of the capital conservation buffer and the countercyclical capital buffer - collectively referred to as the capital buffers.

APRA released draft APG 110 for consultation in December 2015. In response to feedback received during the consultation period, APRA made amendments to APG 110 to provide some additional clarification on the operation of the capital buffers. Details on these changes can be found in APRA's response to submissions letter, which was also released today.

- On September 15, 2016, APRA released a consultation package on proposed revisions to the counterparty credit risk framework for all authorised deposit-taking institutions (ADIs).

Specifically, APRA proposes to require all ADIs to use the standardised approach to counterparty credit risk (SA-CCR) methodology to measure counterparty credit risk exposures arising from over-the-counter derivatives, exchange-traded derivatives and long settlement transactions. At this time, APRA does not propose introducing the Basel Committee's internal model method for counterparty credit risk into its framework. APRA also proposes that all ADIs will be required to hold capital for exposures to central counterparties in a manner consistent with the Basel Committee's final standard, and proposes to establish a dedicated ADI prudential standard for counterparty credit risk.

The proposed minor amendments apply to all ADIs, and the consultation period will end on November 11. APRA also proposes that an ADI that meets certain criteria may apply for approval to further extend its implementation date for SA-CCR until January 1, 2019.

- On October 18, 2016, APRA released an information paper on current practice in risk culture in banking, insurance and superannuation businesses.

While there has been a stronger focus on risk culture in recent years among APRA-regulated institutions, the paper finds that continued effort and ongoing attention is required by institutions to better understand and manage their risk cultures.

Underpinning much of this work has been APRA's new prudential standards on risk management, which came into effect on January 1, 2015. Among other things, these require each board of an authorised deposit-taking institution (ADI) or insurer to form a view on the risk culture in their institution, identifying any desirable changes to that risk culture, and ensuring the institution takes steps to address those changes. As part of its increased focus in this area, APRA will also commence a review of remuneration policies and practices among its regulated institutions and examine how these interact with risk culture.

## 10. Financial Benchmarks

- On July 8, 2015, ASIC released a report on financial benchmarks, highlighting the importance of key indices to Australia's markets and the broader economy. It also described the regulatory reforms and other responses that have occurred internationally and in Australia in response to concerns about poor conduct in connection with financial benchmarks.

ASIC's report made a number of recommendations for market participants, including measures they should adopt to avoid conduct issues. The report confirmed ASIC is investigating financial institutions to test for conduct and other issues relating to financial benchmarks, such as key interest rate and foreign exchange benchmarks. ASIC's enquiries were informed by the types of benchmark-related conduct and oversight issues that have been observed overseas. Its investigations are ongoing and no conclusions have been drawn yet.

- On October 23, 2015, the CFR announced that it is seeking views on the evolution of the methodology for the bank bill swap rate (BBSW) benchmark.

BBSW is a key financial benchmark in Australia and is administered by AFMA. BBSW rates serve as reference rates for pricing many debt securities and lending transactions. They are also used to determine payment obligations on a range of derivatives. Consistent with international standards, the administration of BBSW was reformed in 2013 with the intention of improving its reliability by moving from a submissions-based to a market data-based benchmark.

To ensure that BBSW remains a trusted, reliable and robust financial benchmark going forward, the CFR recommended a consultation on the methodology for BBSW. The consultation paper presented options and invited views on how the BBSW methodology could evolve going forward.

- On February 9, 2016, the CFR released a discussion paper on Evolution of the BBSW Methodology. This document summarised the feedback received from the submissions to the October 2015 consultation, and set out a proposal for the evolution of the BBSW methodology for discussion with the Australian Financial Markets Association (AFMA) and market participants.
- On March 31, 2016, the CFR released its consultation paper on Financial Benchmarks Regulatory Reform. In this consultation, the CFR considered various regulatory reform proposals which relate to the administration of significant benchmarks, submission to significant benchmarks and offences relating to benchmark misconduct and has asked for views on these. The reforms proposed by the CFR have three aspects:
  - Benchmark administration: making administration of a significant benchmark of a financially regulated activity and imposing obligations on the administrators of a significant benchmark that consistent with the IOSCO Principles of July 2013;
  - Benchmark submission: imposing binding requirements, consistent with the IOSCO Principles, on submitters to a significant benchmark calculated based on submissions and creating a legal power to compel submission to a significant benchmark; and
  - Benchmark misconduct: introducing a new specific offence of benchmark manipulation applicable to financial benchmarks. This includes separately expressly expanding the scope of financial products to bank accepted bills (BABs) and negotiable certificates of deposit (NCDs).

The CFR seeks comments on, among others, the proposed definition and scope of significant financial benchmarks and comments on the proposed mechanism for designating the scope of regulation. This

follows the recent consultation process on the evolution of the BBSW benchmark calculation methodology. Comments are due by April 29, 2016.

- On October 4, 2016, the Australian Treasurer released the CFR's recommendations on the reform of financial benchmarks, following a CFR consultation on the matter in March 2016. The CFR's recommendations are as follows:
  - Administrators of significant benchmarks are required to hold a new 'benchmark administration' licence issued by the Australian Securities and Investments Commission (ASIC) unless granted an exemption;
  - ASIC be empowered to develop enforceable rules for the administrators of significant benchmarks and for entities that make submissions to such benchmarks (including the power to compel submissions to benchmarks in the case that other calculation mechanisms fail); and
  - The manipulation of any financial benchmark (significant or non-significant) or financial product used to determine a financial benchmark used in Australia (such as negotiable certificates of deposit) be made a specific criminal and civil offence. The government has accepted the CFR's recommendations and will work to implement these critical reforms over the next 18 months.

## 11. Memoranda of Understanding (MoUs)

- ESMA and the RBA have concluded a MoU that will allow RBA to have access to data held in European trade repositories according to its mandate. The MoU is effective as of February 18, 2015.
- The ESMA-RBA MoU is the second cooperation arrangement established under Article 76 of the European Market Infrastructure Regulation (EMIR). This provision aims at ensuring that third-country authorities that do not have any trade repository in their jurisdiction may access the information on derivatives contracts held in European trade repositories which is relevant for their mandates. The MoU ensures that guarantees of professional secrecy exist. The first MoU of this kind was concluded in November 2014 between ESMA and ASIC.
- On April 13, 2015, the CFTC and APRA announced that their respective chairmen had signed an MoU on cooperation and the exchange of information in the supervision and oversight of regulated firms that operate on a cross-border basis in the US and in Australia. Through the MoU, the CFTC and APRA express their willingness to cooperate and consult regularly in the interests of fulfilling their respective regulatory mandates, particularly in the area of derivatives activities and conduct, but also in other areas of mutual supervisory interest. The scope of the MoU includes swap dealers and major swap participants in the US, as well as authorised deposit-taking institutions in Australia.

## 12. Fintech

- On June 8, 2016, ASIC released a consultation paper on proposed measures to facilitate innovation in financial services, including a regulatory sandbox licensing exemption. ASIC has identified some barriers faced by new financial technology (fintech) businesses seeking to enter the financial services market. These barriers include speed to market and meeting the organisational competence requirements of a licensee. To address these specific barriers, ASIC is proposing to:
  - Provide examples of how ASIC exercises its discretion under existing policy to assess the organisational competence of a licensee applicant;

- Modify ASIC's policy on organisational competence of a licensee to allow some limited-in-scale, heavily automated businesses to rely, in part, on compliance sign-off from a professional third party to meet their competence requirements; and
  - Implement a limited industry-wide licensing exemption to allow start-ups to test certain financial services for six months (the 'regulatory sandbox' exemption).
- On June 16, 2016, ASIC and the Monetary Authority of Singapore (MAS) announced cross-border cooperation on financial technology (fintech) that will enable companies in Singapore and Australia to quickly establish initial discussions in each other's market, and receive advice on required licences, therefore helping to reduce regulatory uncertainty and time to market.

To qualify for the support offered by the agreement, businesses will need to meet the eligibility criteria of their home regulator. Once referred by the regulator, and ahead of applying for a licence to operate in the new market, a dedicated team or contact person will help them to understand the regulatory framework in the market they wish to join, and how it applies to them.

ASIC and the MAS have also committed to exploring joint innovation projects together, and to share information on emerging market trends and their impact on regulation.

- On November 3, 2016, ASIC announced that Innovative fintech companies in Australia and Ontario, Canada will be able to draw on support from the combined resources of their financial regulators as they seek to operate in the others' market, under a new agreement.

Under the agreement, signed in Toronto, ASIC and the Ontario Securities Commission (OSC) will refer to one another those innovative businesses seeking to enter the others' market. The regulators may provide support to innovative businesses before, during and after authorisation to help reduce regulatory uncertainty and time to market.

The agreement follows the creation of the Innovation Hub at ASIC in April 2015 and the OSC LaunchPad in October 2016. These initiatives were established to help businesses with innovative ideas navigate financial/securities regulation, support them through the authorisation process and ease their engagement with the regulator.

To qualify for the support offered by the agreement, innovative businesses will need to meet the eligibility criteria of their home regulator. Once referred by the regulator, and ahead of applying for authorisation to operate in the new market, the business will have access to dedicated staff that will help them to understand the regulatory framework in the market they wish to join, and how it applies to them.

ASIC and the OSC have also committed to share information on emerging trends in each other's markets and the potential impact on regulation.

- On December 15, 2016, the Australian Securities and Investments Commission (ASIC) released class waivers to allow eligible financial technology (fintech) businesses to test certain specified services without an Australian financial services or credit licence. ASIC has also released a regulatory guide which contains information about Australia's 'regulatory sandbox' framework.

ASIC's fintech licensing exemption allows eligible businesses to test specified services for up to 12 months with up to 100 retail clients, provided they also meet certain consumer protection conditions

and notify ASIC before they commence the business. Businesses that are not eligible for the fintech licensing exemption are able to seek an individual exemption.

### **13. Agreement with US for tax compliance and FATCA implementation**

- On April 28, 2014, the Treasurer, on behalf of the Australian Government, signed an intergovernmental agreement with the United States to improve international tax compliance and implement FATCA. The Government has drafted legislation to give effect to Australia's obligations under this agreement. Effective from July 1, these amendments will require Australian financial institutions to collect information about their customers as necessary.

### **14. China–Australia Free Trade Agreement finalised**

- On November 17, 2014, the Australian Government Department of Foreign Affairs and Trade announced the conclusion of negotiations with China over the China-Australia Free Trade Agreement (ChAFTA), laying a foundation for the next phase of Australia's economic relationship with China. Both governments have signed a declaration of intent to work towards signing the ChAFTA, after which the agreement will be subject to ratification by parliament. There will also be a process to be followed on the Chinese side.

Once ratified, the key changes include:

- Removal and reduction of tariff barriers;
- Relaxation of Australian regulatory barriers to Chinese investment; and
- Facilitation of Australian investment into China.

### **15. ASIC consults on additional Chi-X products**

- On August 20, 2015, ASIC released a consultation paper setting out proposed changes to ASIC market-integrity rules and various instruments to enable Chi-X Australia Pty Ltd (Chi-X) to commence the quotation and trading of warrants and exchange-traded funds (ETFs) on its market.

The proposals aim to apply a consistent regulatory framework for the quotation and trading of warrants and ETFs for market participants and investors that may seek to trade these products on the Australian Securities Exchange (ASX) and/or Chi-X markets. ASIC's objective is to maintain existing levels of market integrity and investor protection for these products, irrespective of the market on which they are traded. The consultation paper also proposes some minor changes to ASIC market-integrity rules for the ASX market in response to recent amendments to ASX operating rules, and individual relief instruments for ASX-quoted ETFs and managed-fund products.

- On October 30, 2015, ASIC published amendments to ASIC market integrity rules to ensure warrants and ETFs admitted to quotation on Chi-X's new investment products market are subject to an appropriate regulatory regime. This follows the recent changes to Chi-X's Australian market licence and amendments to Chi-X's operating rules. Chi-X was aiming to launch its investment products market in late 2015, commencing with the quotation and trading of warrants, followed by the launch of ETFs in 2016. In February 2015, Chi-X released a consultation paper outlining its proposals. ASIC then consulted with the industry on changes to the regulatory framework. Feedback from this consultation is set out in Report 453 Response to submissions on CP 235 Proposed amendments to

ASIC market integrity rules for the Chi-X investment product market (REP 453). ASIC has also made minor amendments to ASIC Market Integrity Rules (ASX Market) 2010 to incorporate recent changes to the definitions of 'ETF' and 'managed fund' in the ASX Operating Rules. These changes were also addressed during the consultation.

## 16. Government review of ASIC's capabilities

- On August 28, 2015, the Treasury released a consultation paper on a potential industry cost-recovery model to fund ASIC, following on from the government's December 7, 2014 release of the Final Report of the FSI, which sets out a blueprint for Australia's financial system over the coming decades. In the case of ASIC, the FSI recommended that the government should move to adopt an industry funding model, similar to that already in place for other Australian regulators, which could provide more funding certainty and enhance the transparency of ASIC's costs and funding.

Submissions on this consultation paper would assist the government's consideration of whether to accept the FSI's recommendation that ASIC's regulatory activities should be funded by the industry. Industry roundtables will also be held during the consultation period.

- On September 10, 2015, the Australian government announced that it has commissioned a review into the capabilities of ASIC. The scope and purpose of the review is to examine how efficiently and effectively ASIC operates to achieve its strategic objectives, including:
  - Identification and analysis of immediate and future priorities and risks, including financial system conduct risks;
  - Resource prioritisation and responsiveness to emerging issues;
  - The skills, capabilities and culture of ASIC and its staff, including in respect of internal review and improvement mechanisms; and
  - Organisational governance and accountability arrangements.

The capability review will be forward-looking, and will assess ASIC's ability to meet future regulatory challenges. It will also look to ensure it is equipped with the capabilities – the leadership, strategy, people and processes – to deliver on its remit. The capability review will consult extensively with business, peak bodies and consumer groups through a series of meetings and roundtables by invitation.

- On April 20, 2016, the Australian government announced a \$127.2 million reform package to strengthen the Australian Securities and Investments Commission (ASIC). The broad reform measures will equip ASIC with stronger powers and funding to enhance surveillance capabilities. The reform measures lead on from ASIC Capability Review, commissioned in July 2015.

The five recommendations to government will be immediately implemented. These focus on governance, recruitment, annual performance discussions with the minister and, most importantly, removing ASIC from the Public Service Act. This last measure will allow ASIC to more effectively recruit and retain staff in positions requiring specialist skills.

The government will invest \$61.1 million to enhance ASIC's data analytics and surveillance capabilities, as well as modernise ASIC's data management systems. An additional \$9.2 million will also be made available to ASIC to ensure it can implement appropriate law and regulatory reform. The government is also providing ASIC with \$57 million to enable increased surveillance and enforcement on an ongoing basis in the areas of financial advice, responsible lending, life insurance and breach reporting.

The government will introduce an industry funding or ‘user-pays’ model for ASIC to commence in the second half of 2017. From 2017-18, ASIC’s costs will be recovered from all industry sectors regulated by ASIC.

- On November 7, 2016, the Treasury announced a consultation on the proposed industry funding model (the model) to recover the regulatory costs of ASIC through annual levies and fees-for-service. It provides an updated proposed model following extensive consultation in 2015. There are two papers; a proposals paper and a supplementary technical paper.

The proposals paper provides a high-level overview of how the industry funding framework could be applied. It details the proposed implementation and legislative framework. It also details the engagement, transparency and accountability mechanisms built into the model to strengthen ASIC’s accountability to consumers and its regulated entities.

The supplementary paper provides details of ASIC’s costs of regulating each sector and the metrics for how the levies could be calculated for each sector.

Roundtables will be held during the consultation period to provide stakeholders with the opportunity to share their views collectively. The submission process will close on Friday, 16 December 2016. Additional public consultation will be held on the legislation and related legislative instruments prior to their introduction into the Parliament.

## **17. ASIC publishes reviews of HFT, dark liquidity**

- On October 26, 2015, ASIC released a report (REP 452) examining the impact of high-frequency trading on Australian equity and futures markets and dark liquidity on Australian equity markets, building on ASIC’s 2012 analyses in these areas.

ASIC’s updated analysis showed that market users have become better informed and equipped to operate in an electronic and high-speed environment, and negative sentiment about high-frequency trading has reduced. The level of high-frequency trading in Australia’s equity markets remained steady (at 27% of total turnover). High-frequency trading grew by 130% in the futures market since December 2013 to 21% of volume traded in the SPI and 14% of bond futures. ASIC did not believe that these levels were currently concerning; however, it would continue to monitor their development. High-frequency traders have become more sophisticated, generating higher gross revenue and trading more aggressively than in 2012. They are also more active in mid-tier securities.

Dark liquidity remained reasonably constant in recent years at around 25–30% of total equity market turnover. However, its composition continued to change. Since ASIC’s 2012 review, there has been a shift back to using dark liquidity for large block trades. Feedback from stakeholders also indicated that there is now less concern with dark liquidity in Australian markets. The concerns that ASIC previously held regarding the transparency and fairness of market participant-operated crossing systems have mostly abated. However, ASIC remained concerned about exchange markets and crossing system operators seeking to preference some users over others. It was also concerned about the methods used by some market participants to manage their conflicts of interest for principal trading and client facilitation.

To increase accessibility, ASIC published a summary version of the report (INFO 209).

## **18. CPMI-IOSCO publishes implementation monitoring report**

- On December 17, 2015, CPMI-IOSCO released its conclusions drawn from a Level 2 assessment of whether the legal, regulatory and oversight frameworks, including rules and regulations, any relevant policy statements, or other forms of implementation applied to systemically important payment systems (PSs), central securities depositories (CSDs), securities settlement systems (SSSs), CCPs and TRs (FMIs) in Australia, are complete and consistent with the FMI Principles PFMI.

The Level 2 assessment reflected the status of the Australian legal, regulatory and oversight framework as of May 15, 2015. Overall, the assessment found that Australia has consistently adopted most of the FMI Principles. The RBA and ASIC took different approaches to the adoption of the PFMI. For PSs, the RBA's adoption of the PFMI was assessed to be consistent and complete. For CCPs and CSDs/SSSs, the RBA and ASIC have consistently adopted three areas of the PFMI consistently. For TRs, while ASIC's rules do not always mirror the language and structure of the PFMI, the relevant requirements were found generally to have been implemented consistently.

## **19. Legislation and regulations on resilience and collateral protection and enhanced protection of client money**

- On December 21, 2015, the Australian Government proposed exposure draft legislation to introduce certain changes to the PSN Act and other Acts, draft regulations to introduce changes to the Superannuation Industry Regulations 1994 and Life Insurance Regulations 1995 and a policy paper on enhanced protection of client money.

The draft legislation was introduced to amend the PSN Act and certain other acts in order to enable Australian entities to enforce rights in respect of margin provided by way of security in connection with certain derivatives in the manner required by international standards, clarify domestic legislation to support globally coordinated policy efforts and provide certainty on the operation of Australian law in relation to the exercise of termination rights (i.e. close-out rights) under derivatives arrangements and enhance financial system stability by protecting the operation of approved financial market infrastructure.

The draft regulation was intended to enable trustees of regulated superannuation entities and life companies to grant security in the manner required to access certain international capital markets and liquidity.

The policy paper provided background information in relation to the enhanced protection of client money in Australia as well as an overview of existing legislation. It detailed proposed reform with respect to “enhancing retail consumer protection for client monies” and considered proposed reform with regards to wholesale clients.

The government sought to introduce legislation in early 2016.

- On February 29, 2016, the Australian Government released the Corporations Amendment (Client Money) Bill 2016 and Corporations Amendment (Client Money) Regulation 2016 to reform the domestic client money regime. Explanatory statements on the bill and regulation, as well as an explanatory memorandum on the bill, were also released.

As background, the Government released a policy paper on enhanced protection of client money, which provides proposals on the enhanced protection of client money in Australia, as well as an overview of existing legislation. The bill and regulation were intended to better align the Australian client money regime with international best practice and community expectations of consumer protection.

Proposals include enabling wholesale clients to contract out of the client money regime, which is aimed at improving the efficiency of the wholesale derivatives markets and ensuring the client money regime does not impose unnecessary limitations on institutional investors. The bill also requires financial services providers to hold all derivative retail client money and property in trust, and only use it to meet obligations incurred by the licensee in connection with dealings in the derivative where the obligation is incurred under market integrity rules or the operating rules of a licensed market or clearing and settlement facility.

- On 8 November, 2016, ASIC announced that it welcomed the Australian Government's decision to proceed with 'client money' reforms in respect of retail OTC derivatives.

The reforms will remove an exception in the client money regime that allows Australian financial services licensees to withdraw client money provided in relation to retail OTC derivatives from client money trust accounts, and use it for a wide range of purposes including as working capital. Under the reforms, licensees would be required to hold retail derivative client money on trust. A fundamental protection of the trust requirement is that client money can be returned to clients, and not paid to creditors, in the event of the licensee's insolvency.

ASIC also welcomed the Government's decision to give ASIC the power to write client money reporting and reconciliation rules. The industry has a 12-month transition period in which to implement the reforms.

## **20. ASIC finds widespread OTC compliance failures**

- On June 20, 2016, the Australian Securities and Investments Commission (ASIC) released a report identifying compliance failures in the retail over-the-counter (OTC) derivatives industry.

Over 70% of licensees reviewed demonstrated issues with three or more of the seven assessed compliance risks. Many of the compliance concerns detected were contraventions of well-established regulatory requirements or non-compliance with fundamental licensing obligations. ASIC also observed a significantly high number of smaller, foreign-owned or foreign-controlled licensees demonstrating either a lack of awareness or understanding of their Australian regulatory obligations, or reluctance to invest resources in meeting compliance obligations for their Australian businesses.

## **21. ASIC consults on risk management guidance for fund managers**

- On July 21, 2016, ASIC released a consultation paper and proposed regulatory guidance on risk management practices for responsible entities in the managed funds sector.

The proposed guidance does not impose new obligations on responsible entities but gives more detailed guidance on how they may comply with their current obligations under the Corporations Act to maintain adequate risk management systems. It outlines ASIC's expectations for responsible entities to have overarching risk management systems in place, processes for identifying and assessing risks and processes for managing risks.

The proposals are intended to provide flexibility for responsible entities to develop and maintain risk management systems that are appropriate for the nature, scale and complexity of their operations. They also reflect international standards and developments in risk management. ASIC is seeking to ensure that the risk management systems of responsible entities include minimum procedures and practices, are adaptable to changing market conditions, and remain effective in identifying and managing risks on an ongoing basis.

## **22. APRA consults on changes to bank reporting requirements**

- On July 28, 2016, APRA released a consultation proposing changes to banks' international exposures reporting requirements. These changes are designed to improve monitoring of credit exposures, supply of bank credit and funding risk to particular countries and counterparty sectors.

The most significant changes to the requirements include a new form for locational data, which combines three existing locational forms and the required new locational data. Two new forms, one each for domestic and foreign banks, will also replace existing consolidated forms and include required new consolidated data. One additional new form will be introduced for domestic banks for balance sheet items. Each bank will be required to report these forms within 28 calendar days after the end of each calendar quarter.

Other requirements include changes to consolidated reporting, counterparty sector breakdowns, local position reporting, reporting of debt security liabilities in the short-term and long-term, balance sheet totals, and currency breakdowns.

While incorporating the new requirements for inclusion in international banking statistics, APRA has redesigned the international exposures forms to reduce the reporting burden on institutions. APRA also proposes to determine that the additional data on the proposed international exposures forms are non-confidential.

## **23. Margin requirements**

- On February 25, 2016, APRA released a discussion paper and draft prudential standard on margining and risk mitigation requirements for non-centrally cleared derivatives. The proposed requirements closely follow the Basel Committee on Banking Supervision and IOSCO framework.
  - Posting and collection of variation margin (VM) on a net basis will be required;
  - Exchange of two-way initial margin (IM) on a gross basis will be required;
  - Requirements apply to most APRA-regulated entities when they trade with financial institutions or systemically important non-financial institutions (the latter subject to a qualifying level of AUD 50 billion);
  - Minimum qualifying levels apply to both parties (AUD 3 billion for VM and AUD 12 billion for IM when fully phased in);
  - Intragroup exemptions may be available based on whether the counterparties are within a Level 2 group for capital adequacy purposes;
  - No rehypothecation of IM;
  - Full or partial substituted compliance may be granted;
  - A framework for automatic deference to home regulators may apply to Australian branches or subsidiaries of foreign-incorporated entities; and

- No margining requirements apply to counterparties in non-netting or non-enforceable collateral jurisdictions.

In addition to comments on the proposed requirements, APRA invited stakeholders to provide information on the compliance impact and cost assessment associated with the proposals.

- On August 22, 2016, APRA announced a deferral in implementation, and will finalise new standards in the near future, with no commencement date set at this stage.
- On October 17, 2016, APRA released the final rules for the margining of non-cleared derivatives. In response to the main issues raised in submissions during the consultation period, APRA has:
  - Excluded physically settled FX forwards and swaps from its variation margin requirements (those transactions are exempted from initial margin requirements as well);
  - Maintained its proposal to apply the requirements to all Level 2 entities bar non-financial entities, and has exempted certain transactions where the relevant entities operate in a legal environment that prohibits full compliance;
  - Clarified that the requirements only apply to transactions that are booked in the accounts of the Australian branch of a foreign ADI, Category C insurer or an eligible foreign life insurance company (EFLIC);
  - Removed from the definition of 'covered counterparty' non-financial institutions, as well as special purpose vehicles and collective investment vehicles established for the sole purpose of acquiring and holding or investing in real estate or infrastructure assets that enter into derivatives transactions for the sole purpose of hedging;
  - Maintained the approval requirement in respect of a quantitative model for the calculation of initial margin, but emphasised it would conduct a simplified approval process for an APRA covered entity using the ISDA SIMM;
  - Decided to expand the automatic deference provisions in respect of margin requirements to foreign risk mitigation requirements that are substantially similar to the International Organization of Securities Commissions risk mitigation standards.

The final rules were released with no set commencement date. APRA is monitoring the progress of implementation in other jurisdictions and will advise on an implementation date and phase-in timetable in due course.

- On December 6, 2016, APRA announced its implementation timetable for new requirements for the margining of non-centrally cleared derivatives. The requirements are contained in Prudential Standard CPS 226 Margining and risk mitigation for non-centrally cleared derivatives (CPS 226), which was released in its final form on October 17, 2016 without a commencement date. APRA has now announced that CPS 226 will commence on March 1, 2017, subject to the following:

#### Variation margin (VM) requirements:

- In relation to the requirements to exchange VM, CPS 226 incorporates a six-month transition period (until September 1, 2017), during which APRA-covered entities may finalise their implementation and transition to full compliance;

- During the transition period, APRA-covered entities should comply with the margin requirements on a best-efforts basis and on-board counterparties in a risk-focused manner;
- All qualifying transactions entered into from the official commencement date of March 1, 2017 are considered new transactions that are in-scope for the variation margin requirements under CPS 226. An APRA-covered entity must be in full compliance with the variation margin requirements in CPS 226 for all in-scope transactions by September 1, 2017, following the conclusion of the transition period.

#### Initial margin (IM) requirements:

- Requirements for the posting and collection of IM will be subject to a phase-in timetable that is broadly equivalent to the international timetable, starting from March 1, 2017 for covered entities with a month-end average notional amount of non-centrally cleared derivatives calculated on a group basis exceeding A\$4.5 trillion.
- The risk mitigation requirements in CPS 226 will take effect from March 1, 2018.

Together with the letter announcing the timetable, APRA has released an updated version of CPS 226 incorporating the implementation arrangements outlined in this letter.

## **24. APRA publishes an update on regulatory cost savings**

- On August 18, 2016, the Australian Prudential Regulation Authority (APRA) published an update on regulatory cost savings since February 2015.

Over the past year, APRA progressed a number of options to reduce compliance costs and improve regulatory outcomes for the industry, including saving more than A\$5 million per annum across APRA-regulated industries. In terms of the upcoming regulatory cost-saving activities, APRA intends to conduct further work to scope and develop regulatory cost-saving options, including in a number of aspects of the prudential framework and the reporting framework.

The paper also outlines the cost saving suggestions which were not progressed.

## **25. ASIC extends relief for foreign financial services providers and consults on regime**

- On September 28, 2016, ASIC announced it has extended seven class orders for two years giving relief to foreign financial service providers (FFSPs) providing financial services to wholesale clients, with an amended information gathering power. These class orders were due to expire between October 1, 2016 and April 1, 2017. ASIC extended this relief for two years so it can comprehensively review and consult on the policy settings underlying the relief for FFSPs.

At the same time, ASIC has released a consultation paper on licensing relief for foreign financial services providers with limited connection to Australia. The paper outlines a proposal to repeal a related class order for foreign entities with a limited connection to Australia providing services to wholesale clients. This class order is due to sunset on April 1, 2017, and comments are due by December 2.

- On November 22, 2016, ASIC announced that it has extended its relief for foreign financial service providers (FFSPs) from the requirement to hold an Australian financial services (AFS) licence when

providing financial services to Australian wholesale clients by certain Luxembourg fund managers.

The relief applies until September 28, 2018, and is consistent with the relief extension that ASIC gave to FFSPs in ASIC Corporations (Repeal and Transitional) Instrument 2016/396. This will allow ASIC to consider the policy settings for all FFSPs comprehensively.

## **26. Treasury consults on Banking Regulation 2016**

- On September 30, 2016, the Australian Treasury released a draft of the Banking Regulation 2016 that updates the Banking Regulations 1966, which is due to sunset on April 1, 2017.

The draft proposes repealing redundant provisions, simplifying language and restructuring provisions that are difficult to navigate. Other minor changes to the regulation have been made, and further details are contained in the explanatory statement.

Submissions on the exposure draft are due by October 28.

## **27. RBA releases Financial Stability Review**

- On October 14, 2016, the Reserve Bank of Australia released the October 2016 Financial Stability Review. The review contains sections on the global financial environment, recent growth of small- and medium-sized Chinese banks, household and business finances, banks' exposures to inner-city apartment markets, the Australian financial system, recent developments in Australian banks' capital position and return on equity, and developments in the financial system architecture.

## **28. ASIC consults on repealing class orders on holding client assets**

- On November 23, 2016, the Australian Securities and Investments Commission (ASIC) released a consultation paper proposing to repeal three class orders due to expire in 2017. These are:
  - Relief from holding client property on trust;
  - Relief from holding scheme property separately; and
  - Relief from obligation to hold client money on trust.

ASIC proposes to repeal these class orders as, in its view, they no longer serve any regulatory purpose, and because it has not identified a class of persons relying on the reliefs. ASIC has also stated that where relief may be required, it would be more appropriate to provide relief on a case-by-case basis. However, ASIC said it welcomes feedback in relation to this proposal, including whether repealing these class orders would itself impose a regulatory burden on businesses.

Submissions to the consultation paper are due by December 21, 2016.

## **29. APRA decides against intraday liquidity reporting**

- On November 24, 2016, APRA sent a letter to all authorised deposit-taking institutions (ADIs) regarding a November 2012 consultation on a proposal for larger ADIs to be positioned to report intraday liquidity data on request. This is part of a broad review of liquidity reporting requirements in preparation for the introduction of the liquidity coverage ratio and the net stable funding ratio.

A number of submissions to that consultation requested reconsideration of the need for any specific intraday reporting to APRA, given that intraday liquidity management in Australia is already overseen by the Reserve Bank of Australia (RBA). Subsequently, APRA stated in its December 2013 response to submissions that the introduction of intraday liquidity reporting to APRA would be deferred, and that APRA would consult further on this issue.

Having considered this issue further, APRA has now determined that it is not necessary to introduce additional intraday liquidity reporting. APRA may review this position if the nature of intraday liquidity risk changes in the future.

### **ISDA Submissions (since 2010)**

- March 16, 2010: [ISDA submission to the Treasury on the Financial Sector Legislation Amendment \(Prudential Refinements and Other Measures\) Bill 2010 \(Commonwealth\)](#)
- May 26, 2010: [ISDA submission to the Attorney General on the Exposure Draft of the Personal Property Securities Regulations 2010](#)
- July 30, 2010: [ISDA \(as part of the JAC\) submission to ASIC on 'Review of Disclosure for Capital Protected Products and Retail Structured or Derivatives Products'](#)
- August 1, 2011: [ISDA submission to the Treasury on Financial Sector Legislation Amendment \(Close-out Netting Contracts\) Bill 2011](#)
- August 26, 2011: [ISDA submission to RBA on the discussion paper 'Central Clearing of OTC Derivatives in Australia'](#)
- November 28, 2011: [ISDA submission to the Treasury on the discussion paper 'Review of Financial Market Infrastructure Regulation'](#)
- January 27, 2012: [ISDA submission to the Treasury with regard to the Consultation Paper on 'Handling and use of client money in relation to over-the-counter derivatives transactions'](#)
- June 15, 2012: [ISDA submission to the Treasury with regard to the Consultation Paper on the 'Implementation of a framework for Australia's G20 over-the-counter derivatives commitments'](#)
- August 20, 2012: [ISDA submission to the Treasury on Corporations Legislation Amendment \(Derivative Transactions\) Bill 2012 - Exposure Draft](#)
- October 18, 2012: [ISDA submission to RBA with regard to the Consultation on New Financial Stability Standards](#)
- October 19, 2012: [ISDA submission to ASIC with regard to Consultation Paper 186 on Clearing and Settlement Facilities: International Principles and Cross-Border Policy \(Update to RG 211\)](#)
- December 14, 2012: [ISDA submission to ASX with regard to Derivatives Account Segregation and Portability](#)
- December 14, 2012: [ISDA submission to the Treasury with regard to Strengthening APRA's Crisis Management Powers](#)
- February 15, 2013: [ISDA submission to the Treasury with regard to its proposal paper on 'Implementation of Australia's G-20 Over-the-counter Derivatives Commitments'](#)
- April 5, 2013: [ISDA submission to ASX with regard to Draft Operating Rules](#)
- April 12, 2013: [ISDA submission to ASIC on Consultation Paper 201 Derivatives Trade Repositories](#)
- April 19, 2013: [ISDA submission to Parliamentary Joint Committee regards to Corporations and Financial Services on Corporations and Financial Sector Legislation Amendment Bill 2013](#)
- May 3, 2013: [ISDA submission to Australian Securities and Investments Commission regards to the Consultation Paper 205 on Derivatives Trade Reporting](#)
- June 20, 2013: [ISDA submission to The Treasury regards to Corporations Amendment \(Derivatives Transactions\) Regulation 2013](#)

- November 19, 2013: [ISDA submission to ASX Limited on ASX 24 Exchange Traded Derivatives and OTC Interest Rate Derivatives Client Clearing Service Second Consultation Paper on Draft Operating Rules](#)
- March 28, 2014: [ISDA submission to the Financial System Inquiry.](#)
- April 17, 2014: [ISDA submission to The Treasury to the proposals paper on the “G4-IRD Central Clearing Mandate”](#)
- June 9, 2014: [ISDA submission to The Treasury on Financial Sector Legislation Amendment \(Netting Contracts\) Bill 2013](#)
- June 23, 2014: [ISDA submission to Australian Securities and Investments Commission on Australian Securities and Investments Commission Corporation Act – Paragraph 907D\(2\)\(a\) - Exemption](#)
- August 1, 2014: [ISDA submission to The Treasury on AUD-IRD Central Clearing Mandate](#)
- August 29, 2014: [ISDA submission to Australian Securities and Investments Commission regards to Consultation Paper 221 on OTC Derivatives Reform: Proposed Amendments to ASIC Derivative Transaction Rules \(Reporting\) 2013](#)
- August 26, 2014: [ISDA submission to Financial System Inquiry regards to the Interim Report of the Financial System Inquiry](#)
- November 17, 2014: [ISDA submission to Australian Securities Exchange regards to the Consultation Paper on Central Counterparty Recovery – Uncovered Loss Allocation and Replenishment Tools for Clearing Participant Default](#)
- March 27, 2015: [ISDA submission to The Treasury regards to the Consultation Paper on the Resolution Regime for Financial Market Infrastructures.](#)
- July 3, 2015: [ISDA submission to the Australian Treasury on Phase 3B single-sided reporting proposals.](#)
- July 10, 2015: [ISDA submission to Australian Securities and Investments Commission on Consultation Paper 231 Mandatory central clearing of OTC interest rate derivative transactions.](#)
- August 20, 2015: [Joint AFMA-ISDA submission to ASIC requesting relief from various provisions of ASIC Derivative Transaction Rules \(Reporting \) 2013.](#)
- September 24, 2015: [Australian Single-Sided Reporting Letter](#)
- November 18, 2015: [ISDA Australian Single-Sided Reporting Multiple Representation Letter](#)
- December 21, 2015: [ISDA submission to ASIC, MAS, HKMA and SFC requesting an extension of the 1 February 2016 Asia-Pacific UTI go-live date](#)
- January 8, 2016: [Joint ISDA-AFMA submission to ASIC with cost savings estimates requesting relief from UTI share-and-pair requirements.](#)
- February 4, 2016: [ISDA submission to ASX Limited on ASX CCP’s consultation on exposure draft rules for the interim replenishment of default funds](#)
- February 5, 2016: [ISDA submission to the Australian Treasury on client money reforms.](#)
- March 3, 2016: [ISDA Clearing Classification Letter \(Australia – ASIC Clearing Classifications\)](#)
- March 21, 2016: [ISDA submission to ASIC requesting relief from central clearing requirements for Pre-Mandate Swaptions](#)
- March 21, 2016: [ISDA submission to the Australian Treasury on client money reforms.](#)
- April 29, 2016: [Joint ISDA-FIA-ASIFMA response to CFR on Australian financial benchmarks regulatory reform.](#)
- May 19, 2016: ISDA submission to APRA on consultation on margining and risk mitigation requirements for non-centrally cleared derivatives. This submission is not yet public.
- May 24, 2016: [Joint ISDA-AFMA submission to APRA on consultation on NSFR and foreign liquid assets requirement for foreign ADIs.](#)
- September 14, 2016: [Joint ISDA-GFMA submission to ASIC requesting an extension of existing relief under Exemption 5 \(Foreign Privacy Restrictions\) of ASIC Corporations \(Derivative Transaction Reporting Exemption\) Instrument 2015/844.](#)

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# CHINA

## Key Regulatory Milestones

### 1. Associations publish a new master agreement and regulator encourages development of onshore OTC equity and commodity derivatives markets

- On November 18, 2012, CSRC published the revised Provisions on the Investment Scope of the Proprietary Trading Business of Securities Companies and Related Issues (the “Proprietary Trading Regulation”).

The amendments to the Proprietary Trading Regulation were intended to expand the scope of investment products of proprietary trading business of securities companies, and clarified the regulatory policies for securities companies’ investment in financial derivatives. Under the revised Proprietary Trading Regulation, the securities companies with proprietary securities business qualification would be allowed to trade financial derivatives listed on exchanges and enter into OTC derivatives transactions regardless of whether the transactions are for hedging purpose or not. The securities companies which were not qualified to conduct proprietary securities business could only enter into financial derivatives transactions for hedging purpose.

- On December 21, 2012, SAC issued the Regulation of Securities Company’s Over-the-Counter Trading Business (only Chinese is available). “OTC trading” is defined under the Regulation as (i) trading carried out between a securities company and its counterparty on a market other than a centralized exchange, or (ii) services provided by a securities company to investors in relation to transactions effected on a market other than a centralized exchange.

The products subject to the Regulation include any underlying or derivative financial products which have been approved, authorised by or filed with the relevant regulatory authority and are issued or sold outside a centralized exchange. A security company conducting OTC trading with counterparties must hold a proprietary securities trading license, and a securities company which provides services to investors in relation to OTC trading must hold a securities brokerage license.

The Regulation also provides that when carrying out a derivatives business, securities companies should execute the SAC Master Agreement in accordance with the applicable requirements; if the derivatives business involves other derivatives markets, securities companies should also comply with the requirements applicable to those markets.

Securities companies are required to file an application with SAC before commencing OTC trading, and afterwards, monthly and annual reports on its OTC trading business. SAC will supervise and regulate the OTC trading business of securities companies. According to SAC, securities companies’ OTC market is designed to be a platform for issuance, transfer and trading of privately offered products and investors will mainly be institutional. To start with, the market will mainly focus on wealth management products issued by securities companies and distribution of financial products.

- On March 15, 2013, as a further step to enable securities companies to carry out their OTC financial derivatives businesses, the Securities Association of China (SAC) published a set of self-regulatory rules (the Regulations), together with a master agreement governing the OTC derivatives businesses of securities companies. The Regulations provide that a securities company which has obtained OTC trading business qualification may trade financial derivatives products subject to a filing with the SAC. The financial derivatives products which a securities company can trade are limited to those which have

been approved authorised or filed with the relevant regulator or self-regulatory organization. Under the Regulations, a securities company may only trade with institutional counterparties. A securities company is required to classify its counterparties into professional investors (PI) and non PIs and conduct suitability checks with trading with non-PIs.

On the same date, SAC also published the China Securities Market Financial Derivatives Master Agreement (2013 Version) (the “SAC Master Agreement”). The SAC Master Agreement adopts the “three pillars” of the ISDA Master Agreement (i.e., “single agreement”, “flawed asset” and “close-out netting”) and is similar to the ISDA Master Agreement (single jurisdiction) both in structure and substance.

- On August 22, 2014, a new Master Agreement for OTC Derivatives Transactions on China’s Securities and Futures Market (the “2014 Master Agreement”) were jointly published by SAC, the China Futures Association and the Asset Management Association of China to replace the SAC Master Agreement published in 2013. On the same date, the three associations also published a set of product definitions for onshore OTC equity derivatives transactions. The 2014 Master Agreement has made several improvements to the 2013 SAC Master Agreement, including among others, adding two more Event of Default (i.e., Default under Specified Transaction and Merger without Assumption) and one more Termination Event (i.e., Credit Event upon Merger). The changes bring the new agreement more aligned with the 2002 ISDA Master Agreement.
- On 16 September, 2014, CSRC issued its Opinions on the Further Promotion of Innovative Development of Futures Business Institutions. The Opinions were issued in order to implement the 'Several Opinions of the State Council on Further Promoting the Healthy Development of the Capital Market'. Among other things, the opinions highlight that CSRC will:
  - further expand the pilot program, under which futures companies are allowed to set up companies that focus on providing commodities pricing and risk management services, and that eligible risk management companies will be allowed to trade offshore derivatives;
  - support applications by futures companies for QDII licenses and those QDII license holders may issue asset management products linked to futures and trade offshore derivatives;
  - encourage foreign institutions to invest in onshore futures companies; and
  - support futures companies to engage in OTC derivatives and to this end, the relevant master agreement and rules will be further improved.

## 2. CBRC Implements Basel III

- On June 7, 2012, CBRC issued the Measures for Commercial Banks’ Capital (Trial Implementation) (the Measures). The Measures apply to commercial banks established in China and set out the requirements for the capital adequacy ratio (CAR). The Measures follow the Basel guidelines and do not provide any exceptional deviation from the Basel guidelines. The CAR would consist of 5% Core Equity Tier 1, 6% Tier 1 and 8% for Total Capital.

A Conservation Buffer of 2.5% of Core Tier 1 capital and a Countercyclical Buffer of 0%-2.5% Core Tier 1 capital would be applied. Additionally, domestic systemically important banks will have to hold an additional 1% of Core Tier 1 capital. A systemically important bank would need to hold a total of 11.5% capital while the non-systemically important banks will need to hold 10.5% capital. Banks should develop and implement a step-by-step compliance plan to meet the new capital requirements and will need to report it to CBRC for approval. CBRC has the right to take regulatory action if banks do not meet their capital requirements.

The Measures also set out the definition of what constitutes Core Tier 1 capital, Tier 1 capital and Tier 2 capital, and have listed which items may be deducted from the CAR, such as goodwill and sales from asset securitization. Additionally, guidance on credit risk, market risk and operational risk are provided in the Measures.

- On November 29, 2012, CBRC released its guidance on innovative capital instruments of commercial banks (the Guidance). The aim of this Guidance is to promote and regulate commercial banks issuing innovative capital instruments, broaden the forms of capital replenishment and enhance the soundness of the banking system. From January 1, 2013, new capital instruments must have a provision that enables either a write off or a conversion to common stock when a “trigger event” occurs:
  - the core equity tier 1 ratio of the commercial bank falls below 5.125% (at which point the additional Tier 1 (AT1) capital instrument will be triggered);
  - CBRC determines that a commercial bank will be non-viable and/or the relevant authority determines a commercial bank will become non-viable without a public sector injection of capital or its equivalent support.

For capital instruments containing a write down provision, upon a trigger event occurring, the AT1 instrument should be written down, in full or in part, as per the contractual agreements, in order for the core equity Tier 1 ratio to return above the trigger point. Upon occurrence of a trigger event for Tier 2 capital instruments, the AT1 and Tier 2 capital instruments shall be immediately written down in full, subject to contractual agreements. If a commercial bank is going to compensate investors for their losses, payment should make in the form of ordinary shares to be paid immediately.

For capital instruments containing a conversion clause, upon a trigger event occurring, the AT1 instrument should be converted to ordinary shares, in full or in part, as per the contractual agreements, in order for the core equity Tier 1 ratio to return above the trigger point. Upon occurrence of a trigger event for Tier 2 capital instruments, the AT1 and Tier 2 capital instruments shall be immediately converted to ordinary shares in full, subject to contractual agreements. To issue capital instruments containing a conversion clause, prior authorization are required to ensure the bank is able to issue the corresponding amount of ordinary shares as per the contractual agreement upon the occurrence of a trigger event.

- On September 27, 2013, the Basel Committee on Banking Supervision published a report on the regulations that implement the Basel capital framework in China. China’s implementation of the Basel capital framework was found to be closely aligned with the Basel III global standards.

### **3. CBRC issues guidelines on capital requirements for bank exposures to CCPs and PBOC mandates central clearing of RMB IRS**

- On July 19, 2013, CBRC issued a set of documents on regulatory capital requirements for commercial banks in China. These documents include banks’ exposures to central counterparties (CCPs); enhancing disclosure requirements for the composition of capital; regulatory policies for implementing IRB for commercial banks and policy clarification of capital rules.

For bank exposures to a CCP, a qualifying CCP (QCCP) is an entity that is licensed to operate as a CCP and is permitted by the regulator to offer such products. If the regulator of the CCP publicly announces the status of a CCP as qualifying, then banks will be allowed to treat exposures to this CCP as a QCCP. If not, a bank will determine if a CCP is qualifying based on the following criteria:

- the CCP is based and is supervised by a regulator who has publicly indicated it applies on an on-going basis, domestic rules and regulations that are consistent with the CPSS-IOSCO Principles for Financial Market Infrastructures (PFMIs);
- if the regulator of the CCP has yet to implement the PFMIs, the bank shall provide to CBRC a list of CCPs it has exposures to and an evaluation of the relevant criteria to determine if the CCP is a QCCP. An important consideration is whether the CCP will be subject to domestic rules and regulations that are consistent with the PFMI principles. This list of QCCPs will be subject to CBRC's approval.

To be considered a QCCP, a CCP must be able to perform the calculations for the various components that are part of the calculation for the default fund exposures. This data should be provided to the clearing members, the regulators and other parties and should be submitted at least on a quarterly basis.

- On January 21, 2014, PBOC and CSRC published the “Notice on Carrying out Evaluation of Financial Market Infrastructures”. In the notice, it was mentioned that the regulators would jointly evaluate a number of China's financial market infrastructures including CCPs and TRs according to the “Principles for financial market infrastructure Disclosure framework and Assessment methodology” issued by IOSCO and CPSS. The assessment is due to be completed by March, 2014.
- On January 28, 2014, PBOC issued a notice to banks regarding central clearing of RMB interest rate swaps. The notice provides that all RMB interest rate swaps referencing 7-day repo, overnight SHIBOR or 3-month SHIBOR which are entered into after July 1, 2014 between financial institutions and have a tenor of no more than 5 years must be submitted to SCH for central clearing, as long as the transactions satisfy SCH's requirements regarding counterparties and contracts.
- On May 30, 2014, Shanghai Clearing House (SCH) issued a notice regarding client clearing of RMB interest rate swaps. The Notice stated that SCH would launch client clearing for RMB IRS from July 1, 2014 and eligible clearing members may apply to SCH to become a “comprehensive clearing member” in order to provide clearing services to clients. The Notice requires the clearing members to sign the Agency Client Clearing Agreement regarding Central Clearing of RMB IRS and segregate their proprietary and client positions. The Notice also stipulates that SCH would calculate the settlement payments and margin payments of a clearing member's proprietary business and client clearing business separately.

Also, on June 3, SCH issued the revised Business Guidance on Central Clearing of RMB IRS with added provisions on two-way margining, collateral in securities form and client clearing. On July 1, 2014, SCH started mandatory direct and client central clearing of RMB interest rate swaps (IRS). According to the SCH website, on the first day, SCH cleared 66 transactions with a notional amount of RMB 7.22 billion, among which 13 transactions were trades cleared on behalf of clients.

On October 11, 2014, SCH made further amendments to its Business Guidance on Central Clearing of RMB IRS to introduce real-time validation of the trades submitted for clearing and real-time contract novation for trades which have been validated. The revised Guidance also allows a clearing member to provide eligible debt securities to satisfy up to 50% of its initial margin requirement.

#### **4. SAFE consolidates and relaxes regulation on RMB/FX transactions and issues new rules regarding cross-border security arrangements**

- On December 19, 2013, SAFE issued the Notice on Adjusting the Administration of RMB/FX Derivative Business (the Notice) which is intended to facilitate domestic entities' hedging of foreign exchange risks. The Notice took effect on January 1, 2014. The Notice appeals the filing requirement

for conducting currency swap and foreign exchange swap business. Banks and their branches that are qualified to conduct RMB/FX forward transactions before the effective date of the Notice may start conducting currency swap and foreign exchange swap business automatically.

The Notice also relaxes certain restrictions on banks' currency swap business: banks are now permitted to enter into a currency swap transaction without exchanging principal at the effective date with their clients who have borrowed debts denominated in a foreign currency. The Notice also allows a bank to decide its own reference exchange rate when conducting cash-settled RMB/FX options with clients or on interbank market as long as the rate is a real and effective rate used in the onshore market. Banks are also permitted to use reasonable and appropriate method and parameters at their discretion to calculate the Delta of their RMB/FX option transactions. Under previous regulations, banks had to use the method and parameters set out in the CFETS guidance when calculating the Delta.

- On May 12, 2014, SAFE issued the Regulations on Foreign Exchange Control over Cross-border Security which came into effect on June 1, 2014. Compared with the consultation draft issued on February 13, 2014 which ISDA commented on, the final regulations include several steps further to deregulate cross-border security.

In order to improve convertibility of RMB under capital account items and simplify administrative approval procedures, the regulations have made a number of significant changes to the current regulatory regime:

- Abolishing the prior approval requirement and most of the qualification requirements regarding cross-border security;
  - Providing that FX control requirement (such as foreign security registration requirement) will not affect the validity of cross-border security contract;
  - The case-by-case registration requirement is only triggered where the enforcement of a cross-border security will give rise to debts owed to non-residents by residents and vice versa;
  - Except for the two types of security provided in the regulations, a domestic entity may provide or accept a security on cross-border basis without any registration or filing with SAFE - this would cover most security arrangements in respect of derivative transactions between foreign entities and Chinese entities;
  - Allowing PRC individuals to provide cross-border security.
- On December 25, 2014, SAFE issued implementing rules on renminbi (RMB) FX sale and purchase transactions conducted by banks. The rules simplify and repeal 14 regulations regarding entry and exit requirements in respect of banks' RMB FX spot and derivatives businesses, RMB FX spot transactions conducted for banks' own accounts, management of RMB FX derivatives businesses and position limits on banks' FX businesses. Regarding derivatives businesses, the rules reiterate that banks have an obligation to verify clients are entering into derivatives transactions for hedging purposes. The rules came into effect on January 1, 2015.

## 5. Shanghai/Shenzhen-Hong Kong Stock Connect

- On November 10, 2014, SFC and CSRC announced they had approved the launch of the Shanghai-Hong Kong Stock Connect pilot scheme following finalization of all the necessary regulatory approvals and relevant regulatory operational arrangements required for its commencement. Under the joint announcement issued by SFC and CSRC, trading through the Shanghai-Hong Kong Stock Connect will commence on November 17. Stock Connect is a pilot programme for establishing mutual stock market access between Hong Kong and mainland China. ISDA published the

Additional Provisions for Stock Connect on October 14, which is intended to be used for cash-settled over-the-counter derivatives transactions referencing certain ‘A’ shares listed on the Shanghai Stock Exchange traded through Stock Connect.

- On August 16, 2016, SFC and CSRC announced the approval, in principle, of the structure of Shenzhen-Hong Kong Stock Connect, which will provide mutual stock market access between Hong Kong and Shenzhen via a northbound trading link and a southbound trading link. There will be no aggregate quota under Shenzhen-Hong Kong Stock Connect.

The joint announcement issued by the SFC and the CSRC also abolishes the aggregate quota under Shanghai-Hong Kong Stock Connect with immediate effect. The Shenzhen- Hong Kong Stock Connect was launched on December 5, 2016.

## **6. CSRC allows foreign participation in commodity futures trading**

- On June 26, 2015, CSRC published the Interim Measures on Trading of Designated Domestic Futures Products by Foreign Persons and Brokerage Firms, which marks an important step in the opening up of the domestic commodity market to foreign investors.

CSRC would designate the specific futures products available for trading by foreign market participants on a step-by-step basis, taking into consideration the pace of opening up the renminbi capital account, market participation, risk control of the domestic futures market and other factors. The CSRC has designated crude oil futures as the first product available for trading by foreign market participants, expected to start in three months.

The measures state that a foreign person (i.e., a foreign entity incorporated or organised in a foreign jurisdiction or a foreign natural person) may trade designated futures products in China either via a domestic futures company or a foreign brokerage firm. A foreign person may also directly trade on a domestic futures exchange, subject to approval by the relevant exchange. A foreign brokerage firm entrusted by a foreign person may, on behalf of its client, trade designated futures products via a domestic futures company or trade directly on a domestic futures exchange, subject to approval by the relevant exchange.

In addition to some prudential requirements, CSRC also requires the foreign regulator in the home jurisdiction of the foreign brokerage firm to enter into a memorandum of understanding with CSRC before the brokerage firm can trade directly on China’s futures exchanges.

The measures also include detailed provisions on issues regarding account opening, operational requirements, clearing and settlement, margin, large trader reporting, mandatory close-out, default and dispute resolution. The measures came into effect on August 1.

## **7. SAFE issues new FX regulations applicable to QFIIs and PBOC and SAFE allow more qualified foreign institutions to trade on China’s inter-bank FX market**

- On February 3, 2016, SAFE issued the new Provisions on Foreign Exchange Administration of the Domestic Securities Investment by Qualified Foreign Institutional Investors (“New Regulation”), which came into force the same day. The New Regulation loosens certain restrictions of the original provisions in terms of the administration of the investment quota, lock-up period and capital inflow and outflow of the Qualified Foreign Institutional Investors (“QFIIs”) to promote further participation by

QFIIs in the domestic securities market. Holders of QFII licences no longer need to seek individual approval for quotas, but will be automatically awarded a quota between USD\$20 million and \$5 billion depending on the assets under their management (“basic quota”). When a QFII applies for an investment quota below its basic quota, the QFII is only required to file the relevant documents with SAFE and there is no need to seek an approval from SAFE. SAFE approval is still required for an investment quote exceeding the basic quota. Managers of open-ended mutual funds will now be able to redeem their investments on a daily, rather than weekly, basis. However, a separate cap, limiting monthly net repatriation to 20 per cent of the size of their QFII assets as of the end of the previous year, remains.

- On 23 December 2015, PBOC and SAFE announced that more qualified foreign institutions would be allowed to trade all types of products on China’s inter-bank FX markets including FX/RMB spot, forwards, swaps, cross currency swaps and options.

## **8. Shanghai Clearing House**

- On May 31, 2016, the US Commodity Futures Trading Commission’s (CFTC) division of clearing and risk issued a time-limited no-action relief letter stating that it will not recommend enforcement action against Shanghai Clearing House (SHCH) for failing to register as a derivatives clearing organization.

The no-action relief applies to swaps accepted for clearing by SHCH and subject by the People’s Bank of China to mandatory clearing, including certain interest rate swaps denominated in renminbi. It is limited to SHCH’s clearing of the proprietary trades of US clearing members and their affiliates and is effective until the earlier of May 31, 2017, or the date on which the CFTC exempts SHCH from registration as a derivatives clearing organisation. SHCH stated that it is committed to petitioning the CFTC for an exemption from this registration requirement no later than six months from the date of the no-action relief.

## **9. China: Relaunch of credit derivatives market**

- On September 23, 2016, the Chinese National Association of Financial Market Institutional Investors (NAFMII) issued revised pilot rules (Chinese only) for credit risk mitigation (CRM) tools in the interbank market and four product-related guidelines covering CRM agreements, credit risk mitigation warrants (CRMW), credit default swaps (CDS) and credit-linked notes (CLNs), as well as new credit derivatives definitions.

China introduced similar instruments to CDS in 2010. Those products are linked to single bonds of issuers and are akin to credit default swaps traded on the international markets. The revised trading rules introduce two new products to the domestic interbank market, CDS and CLNs that are no longer restricted to a single reference obligation. NAFMII also relaxed some of the restrictions under the former rules. For example, under the old rules, there were three tiers of participants – primary dealers, dealers and non-dealers – and there were minimum registered capital requirements in respect of primary dealers and dealers. The new rules simplify the tiered participation to two groups: primary dealers and dealers. They also remove the minimum capital requirements for CRM and CDS products (but retain those for CRMW and CLN issuers) and simplify the review procedures applicable to issuances of CRMW and CLNs.

Similar to the requirement under the 2010 rules, domestic credit derivatives market participants must join NAFMII as members and have to sign a NAFMII master agreement before trading. The CDS guidelines include a restriction on reference obligations of a reference entity that is not a financial institution (FI). For those non-FIs, a CDS can only be written on debt instruments issued by the non-FI that have been registered with NAFMII and issued on the interbank market. The CDS guidelines also provide that a CDS contract should include at least failure to pay and bankruptcy event of default. The new rules retain the position limits under the 2010 rules: each dealer's net short position must be no more than 100% of its net asset. For a primary dealer, its net short position should not be more than 500% of its net asset.

### **ISDA Submissions (since 2010)**

- April 15, 2010: [First ISDA submission to the CSRC and CFFEX regarding index futures trading by the Qualified Foreign Institutional Investors](#)
- May 4, 2010: [Second ISDA submission regarding index futures trading by the Qualified Foreign Institutional Investors](#)
- January 14, 2011: Joint Associations Committee (JAC) submission to CBRC on the draft Regulations governing Sales of Wealth Management Products by Commercial Banks. This submission is not public.
- February 21, 2011: [ISDA submission to CBRC on the revised Provisional Administrative Rules Governing Derivatives Activities of Banking Financial Institutions](#)
- June 5, 2012: [ISDA letter to Shanghai Clearing House on clearing proposal regarding interest rate swaps \(IRS\) denominated in RMB](#)
- December 2013: ISDA letter to PBOC on central clearing and some other issues relating to OTC derivatives transactions. This submission is not public.
- March 10, 2014, [ISDA submission to SAFE on the draft Provisions for Foreign Exchange Control over Cross-border Security](#)
- May 20, 2014, ISDA letter to PBOC on mandatory central clearing. This submission is not public.
- January 30, 2015, ISDA submission to CSRC on the draft Interim Measures on the Trading of Designated Domestic Futures Products by Foreign Persons and Brokerage Firms. This submission is not public.
- September 19, 2015, ISDA letter to PBOC on central clearing, third country CCP recognition, trade reporting, margin for non-centrally cleared OTC derivatives transactions and close-out netting enforceability issues.

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# HONG KONG

## Key Regulatory Milestones

### 1. Hong Kong implements Basel III

- HKMA issued two consultation papers, Implementation of Basel III Capital Standards in Hong Kong and Implementation of Basel III Liquidity Standards in Hong Kong on January 20, 2012. These documents were the first in a series of consultation papers for seeking the banking industry's feedback on its proposals to implement Basel III.
- HKMA released a notice on March 9, 2012, that the Banking (Amendment) Bill 2011 was passed by the Legislative Council on February 29, and enacted as the Banking (Amendment) Ordinance 2012 (BAO 2012).
- On October 19, 2012, HKMA released a notice that three rules were published in the Gazette:
  - The Banking (Amendment) Ordinance 2012 (Commencement) Notice 2012 amended the powers of HKMA, enabling it to make rules prescribing capital and disclosure requirements for AIs incorporated in HK. The notice also prescribed the procedures for remedial action upon contravention of these requirements;
  - The Banking (Capital) (Amendment) Rules 2012 introduced the amendments to the Banking (Capital) Rules to implement the first phase of the Basel III requirements. The new rules revised the capital requirements for locally incorporated AIs scheduled to take effect in January 2013. Under the revised framework, a bank will need to maintain a Common Equity Tier 1 (CET1) capital ratio of 4.5%, a Tier 1 ratio of 6% (both Tier 1 and CET1 to be phased in from January 1, 2013 to January 1, 2015) and 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.
- On December 13, 2012, HKMA issued a notice which indicated that the LegCo has completed the negative vetting of the above 3 Acts which were gazetted on Oct 19, 2012.
- On January 17, 2013, HKMA released a memorandum on the revisions to the LCR. As Basel recently issued its full text with some changes from the original version published in 2010, HKMA would develop, with industry consultation, a framework for local implementation of the revised LCR. Some issues under consideration included:
  - Two-tiered approach: HKMA still maintained the view of adopting a two-tiered approach for Hong Kong banks. Under this approach, only AIs considered at the core of the local banking system would be subject to the LCR. All other AIs will be subject to a modified version of the existing Liquidity Ratio (LR);
  - Phase-in of the LCR: HKMA considered the BCBS phase-in arrangement and assessed the need to adhere to the original timetable;
  - Level 2B Assets: HKMA would examine the attributes of Level 2B assets to determine their level of liquidity in times of market stress. Specific focus will be placed on assessing the price volatility and market liquidity of these assets based on their historical performance in the local markets in

times of stress as well as the potential for incentivizing banks to assume more proprietary risk through increased holdings of particular asset classes;

- Usability of HQLA in times of stress: HKMA would incorporate into their rules the flexibility of banks to use their HQLA, even to the extent of causing their LCR to fall below the minimum requirement during a period of financial stress. HKMA would develop supervisory guidance to set out the circumstances under which such usage may be allowed and the considerations underlying HKMA's supervisory response in such circumstances;
  - Use of alternative liquidity approaches (ALA): As there is limited supply of HQLA denominated in Hong Kong dollars, AIs have been given three ALA options. However, HKMA is most likely to adopt the second ALA option, i.e., the use of foreign currency HQLA to cover local currency liquidity needs for banks subject to the LCR;
  - Implications for the modified LR (MLR) regime: HKMA will be reviewing the implementation timetable of the MLR and how this would be affected if a decision is made to phased-in the LCR. Further deliberation is required particularly in areas in which the LR adopts a more stringent approach than the LCR;
  - Update of LM-2: In addition to meeting the LCR, banks will need to adhere to the enhanced liquidity standards set out in the BCBS Principles for Sound Liquidity Risk Management and Supervision. These Principles have been incorporated into HKMA's Supervisory Policy Manual (LM-2) which were updated later in the year.
- On March 4, 2013, HKMA released its consultation paper on draft Banking (Capital) (Amendment) Rules 2013 (B(C)(A)R) together with two letters to the Hong Kong Association of Banks (HKAB) and the Hong Kong Association of Restricted Licence Banks and Deposit-taking Companies (the DTC Association) respectively. The consultation paper sought feedback on the refinements to the Banking (Capital) Rules (B(C)R). The additional refinements included:
    - Sections 226 X and 226ZD of the B(C)R were amended to recognise the credit risk mitigation given to exposures of authorised institutions (AIs) to central counterparties. One of the refinements proposed was where an AI's exposure is covered by a recognised credit derivative contract cleared by a qualifying CCP (QCCP), the AI may allocate to the credit protection covered portion of the exposure a risk weight of 2% if the AI is a clearing member (CM) of the QCCP; the AI may allocate a 4% if the AI is a client of a CM of a QCCP and certain conditions of section 226ZA(6) are met. The attributed risk-weight of the credit protection provider is 2% if the concerned credit derivative is cleared by a QCCP and the AI concerned is a CM of that QCCP, or a risk weight of 4% if the AI concerned is a client of a CM of the QCCP and only certain conditions are met.
    - Sections 265 and 278 of the B(C)R addressed some internal inconsistencies between certain provisions in the IRB approach for AI's non-securitization exposures and the IRB approach for AI's securitization exposures.

The banking (Capital) (Amendment) Rules 2013 was published on April 12, 2013. The Rules came into operation on June 30, 2013.

- On August 19, 2013, HKMA issued a circular on Basel III implementation, setting out the final version of the standard templates (including associated explanatory text) to be used by locally incorporated authorised institutions for the purpose of making disclosures in relation to their capital base under the Banking (Disclosure) (Amendment) Rules 2013.
- On September 4, 2013, HKMA published a supplementary guidance in the form of Frequently Asked Questions (FAQs) to facilitate a consistent application of the Banking (Capital) Rules and the Banking (Disclosure) Rules (also known as Basel III implementation). These are FAQs on the counterparty

credit risk framework under the Banking (Capital) Rules and are intended to be explanatory in nature. They do not seek to introduce any new requirements into, or replace any requirements specified in, the Banking (Capital) Rules.

Highlights include:

- When applying to HKMA for approval to use the Internal Models Method (IMM) approach, an AI should discuss and agree with HKMA the approach/ methodology for determining and reviewing the stress period.
  - The standard supervisory haircut applicable in consequence of a currency mismatch (8%) should be applied to each element of the collateral that is provided in a currency different from that of the exposure.
  - The supervisory floors set out in Section 226M are minimum requirements. The actual margin period of risk that should be used in the determination of default risk exposures may be longer than the supervisory minima if the liquidity of the positions concerned warrants it.
  - Inter-company transactions between an AI and its subsidiaries subject to consolidation can be excluded from the calculation of the solo-consolidated/ consolidated capital adequacy ratio. These transactions include CVA hedges that are with an internal desk.
  - For the purposes of Section 226P(6) paragraph (e) in Formula 23F, as the market convention is to use a fixed recovery rate for CDS pricing purposes, the AI may use this information to calculate the LGDMKT if both a market instrument of the counterparty concerned and an appropriate proxy spread are not available and there is no other information.
  - Under Section 226T(1)(e), hedges that depend on cross-default are not eligible CVA hedges.
  - It is the primary responsibility of the AI to determine whether a CCP is qualifying. In Hong Kong, HKMA and SFC announced in March 2013 their commitment to comply with the PFMI. Therefore AIs can regard CCPs overseen by SFC as QCCPs for capital adequacy purposes. If a CCP regulator has not made any public statement about its intention to implement the PFMI during 2013, or a CCP regulator has yet to implement the PFMI (regardless of whether a public statement has been made) after 2013, AIs should determine whether a CCP regulated by the CCP regulator is qualifying based on the criteria set out in the definition of “qualifying CCP” in Section 226V(1).
  - Although a CCP’s documentation may not prohibit client trades from being carried over and continued, other evidence such as the criteria in Section 226ZA(6)(c) is necessary to make this claim.
  - The requirement set out in Section 226ZA(6)(a) means that upon insolvency of the clearing member, there is no legal impediment to the transfer of the collateral belonging to the AI to the CCP, to one or more of the other surviving clearing members or to the AI or the AI’s nominee.
- On April 10, 2014, HKMA released a circular on their intent to implement the final standard that was published by BCBS on March 31, 2014, on the standardized approach for measuring counterparty risk exposures. The new standardized approach (SA-CCR) would replace the existing non-modeled counterparty credit risk (CCR) measurement approaches (i.e., the Current Exposure Method (CEM) and the Standardized Method) in the Basel capital adequacy framework. HKMA’s current intent was to implement the SA-CCR in accordance with the BCBS timetable.
  - On April 16, 2014, HKMA released a circular on their intent to implement the final standard published by the BCBS on April 10, 2014, Capital requirements for bank exposures to central counterparties. This would be implemented through the amendment of the banking (Capital) Rules in accordance with the BCBS timetable. The industry would be consulted on the implementation proposals in due course.

HKMA announced that the Banking (Disclosure) (Amendment) Rules 2014 to introduce disclosure requirements associated with the second phase of Basel III requirements for authorised institutions was gazetted on December 24, 2014. The disclosure requirements related primarily to:

- the capital buffers and the liquidity coverage ratio to be implemented via the Banking (Capital) (Amendment) Rules 2014 and the Banking (Liquidity) Rules, respectively, which came into effect on January 1; and
  - the Basel III leverage ratio, which is required to be disclosed by banks with effect from 2015, according to the Basel Committee on Banking Supervision's Basel III implementation timetable.
- On July 20, 2015, HKMA issued a circular regarding a number of FAQs that the BCBS recently published, which provides technical elaboration and interpretative guidance relating to various areas of the Basel III leverage ratio framework.

In the circular, HKMA noted that for the purpose of completing the HKMA's Quarterly Template on Leverage Ratio (which involves institutions calculating their leverage ratio according to the BCBS methodology under Basel III outlined in Annex 1 of the reporting package released on May 19, 2014), institutions are expected to take into account the guidance set out in the FAQs in calculating their leverage ratio.

- On August 6, 2015, HKMA issued a revised version of the Supervisory Policy Manual module CA-D-1 (Guideline on the Application of the Banking (Disclosure) Rules) to provide guidance on disclosure in connection with the implementation of Basel III in Hong Kong. These include disclosure requirements on the composition of capital, capital ratios and capital buffers, as well as the liquidity coverage ratio. In addition, the revised module updates earlier guidance to align with recent changes made to the local prudential reporting regimes relating to mainland activities and international claims.
- On September 25, 2015, HKMA issued the Supervisory Policy Manual (SPM) module CA-B-3 (Countercyclical Capital Buffer - Geographic Allocation of Private Sector Credit Exposures) as a statutory guideline by notice in the Gazette under section 7(3) of the Banking Ordinance.

The SPM module CA-B-3 supplements an earlier SPM module CA-B-1 (Countercyclical Capital Buffer - Approach to its Implementation) and provides further guidance to AIs on how to determine the geographic allocation of private-sector credit exposures for the purposes of calculating their AI-specific countercyclical capital buffer ratio under the Banking (Capital) Rules (BCR).

As set out in section 3O(1) of the BCR, and explained in Section 2 of SPM module CA-B-1, an AI must determine its own specific countercyclical capital buffer rate as the weighted average of the applicable jurisdictional buffer rates in respect of jurisdictions (including Hong Kong) where the AI has private-sector credit exposures. The weight to be attributed to a given jurisdiction's applicable buffer rate is calculated by reference to the ratio of the AI's aggregate risk-weighted amount for its non-bank private-sector credit exposures in a jurisdiction (RWA<sub>j</sub>) to the sum of the AI's RWA<sub>j</sub> across all jurisdictions in which the AI has private-sector credit exposure.

The new SPM module CA-B-3 sets out the HKMA's expectations on how an AI should allocate its non-bank private-sector credit exposures, and the corresponding risk-weighted amount, to different jurisdictions on an ultimate risk basis (as required under section 3O(2) of the BCR), in order to determine RWA<sub>j</sub> for the AI's non-bank private-sector credit exposures in each jurisdiction.

- On October 23, 2015, the Banking (Capital) (Amendment) Rules 2015 were published to introduce refinements to the Principal Rules.

The amendments more closely align certain aspects of the Banking (Capital) Rules with the relevant Basel III standards, addressing several technical details noted in an earlier evaluation by the Basel Committee on Banking Supervision (BCBS) on Hong Kong's capital regime. The Banking (Capital) (Amendment) Rules 2015 came into effect on January 1, 2016.

- On December 4, 2015, the HKMA announced it had finalised the return of quarterly reporting on the countercyclical capital buffer (Form MA(BS)25), the revised return on capital adequacy ratio (Form MA(BS)3), and their accompanying completion instructions.

AIs should make submissions using the countercyclical buffer return and the revised capital adequacy ratio return starting from end-March 2016. The HKMA will inform AIs separately when the electronic files for the returns are available.

- On December 31, 2015, the HKMA announced it has completed its annual assessment of the designation of D-SIBs. The list of authorised institutions designated as D-SIBs remains unchanged compared to the first list published by the HKMA on March 16, 2015, with five entities designated. The HKMA intends to update the list annually.

Under the D-SIB framework, each of the authorised institutions designated as a D-SIB will be required to include a higher loss-absorbency (HLA) requirement into the calculation of its regulatory capital buffers within 12 months from the formal notification of the designation. In line with the schedule set by the Basel Committee on Banking Supervision for assessing D-SIBs and global systemically important banks, the full amount of the HLA requirement will be phased-in between 2016 and 2019, in parallel with the capital conservation buffer and countercyclical capital buffer. Ultimately, the HLA requirement applicable to a D-SIB (expressed as a ratio of an authorised institution's common equity tier-one capital to its risk-weighted assets, as calculated under the Banking (Capital) Rules) will range between 1% and 3.5% (depending on the assessed level of the D-SIB's systemic importance). Under the phase-in provisions (set out in section 3V(2) of the Banking (Capital) Rules), the levels of HLA for 2017 will be increased to the range of 0.50%-1.75% (from a range of 0.25%-0.875% in 2016).

- On January 14, 2016, the HKMA announced that the countercyclical capital buffer for Hong Kong will increase to 1.25% from the current 0.625%, with effect from January 1, 2017. This increase is consistent with the Basel III phase-in arrangements for the countercyclical buffer.

In setting the rate for the buffer, the HKMA considered a series of quantitative indicators and qualitative information, including an 'indicative buffer guide' (which is a metric providing a guide for countercyclical buffer rates based on the gap between the ratio of credit to GDP and its long-term trend, and between the ratio of residential property prices to rentals and its long-term trend). The credit and property price gaps remain at elevated levels, and a simple mapping from the indicative buffer guide (calibrated against a range of 0% to 2.5% in the Basel III regulatory capital framework) would signal a countercyclical buffer of 2.5%, at the upper end of the Basel III range.

The HKMA also reviewed a range of other reference indicators. These included measures of bank, corporate and household leverage, debt-servicing capacity, profitability and funding conditions within the banking sector, and macroeconomic imbalances. The HKMA found the information drawn from these sources consistent with the signal from the indicative buffer guide.

The power to implement the countercyclical buffer in Hong Kong is provided by the Banking (Capital) Rules, which enable the HKMA to announce a buffer rate for Hong Kong if it believes a period of excessive credit growth in Hong Kong is leading to a build-up of risks in Hong Kong's financial system.

## 2. Hong Kong consultation/implementation of mandatory reporting and clearing requirements

- On June 27, 2012, the Securities and Futures (Futures Contracts) Notice 2012 made pursuant to section 392 of the Securities and Futures Ordinance (SFO) became effective. It extended the insolvency override provisions under part iii of the SFO to cover also OTC derivatives transactions that are cleared through a recognised local CCP and are subject also to the rules of a recognised exchange. The availability of insolvency override protection is a key consideration for market participants when deciding whether to implement voluntary clearing. The notice is a temporary measure which has the effect of extending insolvency clawback protection to certain cleared OTC derivative contracts. It was not expected to have any impact on the way that an OTC derivatives business is currently licensed or operated or on how the SFC Code of Conduct (and other guidance issued by SFC) would apply to OTC derivatives. It was also not expected to have any impact on how existing futures contracts or securities are traded or cleared or how the futures market or stock market currently operates.
- On July 11, 2012, HKMA and SFC released consultation conclusions on proposals to regulate the OTC derivatives market. HKMA and SFC also issued a Supplemental Consultation Paper on the proposed scope of newly-regulated activities to be introduced under the proposed OTC derivatives regulatory regime, and the proposed oversight of systemically important players. The proposed regulatory regime regarding OTC derivatives proposed in the consultation conclusions are as follows:

**Joint oversight by HKMA and SFC:** The new regime would be subject to the joint oversight of HKMA and SFC, with HKMA regulating the OTC derivatives activities of locally and overseas incorporated authorised institutions (“AIs”) and inter-dealer brokers who are licensed and regulated by HKMA as approved money brokers (“AMBs”), and SFC regulating that of licensed corporations (“LCs”) and Hong Kong persons.

**Scope of the new regime:** The term “OTC derivatives transaction” would be defined by reference to the term “structured product” (as defined in the SFO) with carve-outs for securities and futures contracts, structured products, securitized products, embedded derivatives and similar products (i.e. products offered by a single issuer to a number of investors) and spot contracts.

**Mandatory reporting obligation:** The mandatory reporting obligation would apply to a reportable transaction: (1) to which a LC, an AMB, a locally incorporated AI (whether acting through a local or an overseas branch) (“Local AI”), a Hong Kong branch of an overseas incorporated AI (“Overseas AI”) or (subject to meeting the reporting threshold) a Hong Kong person is a counterparty; or (2) which a LC, an AMB, a Local AI or a Hong Kong branch of an Overseas AI has originated or executed if the transaction had a “Hong Kong nexus”. HKMA TR was proposed to be the only designated TR although market participants could appoint a reporting agent (e.g. a global TR) through whom reporting to HKMA TR could be made.

**Mandatory clearing obligation:** The mandatory clearing obligation was proposed to apply to a LC, a Hong Kong person, an AMB, a Local AI (whether acting through a local or an overseas branch) or an Overseas AI (where the trade is booked through its Hong Kong branch) if it is a counterparty to a clearing eligible transaction, both counterparties exceed the clearing threshold, and neither party is exempt from the clearing obligation. The regulators proposed to exempt transactions entered into by central banks, monetary authorities and certain public bodies and global institutions (such as IMF and BIS), intra-group transactions and transactions involving “closed markets” from the mandatory clearing obligation. Both local and overseas CCPs may become designated CCPs for the purposes of the mandatory clearing obligation provided that the CCPs are either a recognised clearing house (RCH) or an authorised automated trading services (ATS) provider under the SFO.

**Mandatory trading obligation:** Hong Kong would not impose a mandatory trading requirement at the outset.

**Capital and margin requirements:** The regulators indicated that they intend to impose higher capital and margin requirements for non-cleared OTC derivatives transactions and specific proposals will be put forward for consultation later.

**Regulation of intermediaries:** Two new types of Regulated Activities (RA) will be introduced: (i) a new Type 11 RA which will capture the activities of dealers and advisers, and (ii) a new Type 12 RA which will capture the activities of clearing agents. The scope of the existing Type 9 RA (asset management) would also be expanded to cover the management of portfolios of OTC derivatives.

**Regulations of systemically important players (SIPs):** The regulators also proposed to regulate players who are not otherwise regulated by HKMA or SFC but whose positions or activities may nevertheless raise concerns of potential systemic risk.

- On March 28, 2013, HKMA and SFC jointly announced their commitment to comply with the FMI Principles PFMI issued by CPSS-IOSCO in April 2012.

The FMIs under HKMA's purview are those designated under the Clearing and Settlement Systems Ordinance, and HKMA TR. The FMIs under the purview of the SFC are the clearinghouses recognised under the Securities and Futures Ordinance. Both HKMA and SFC would implement the PFMI within their respective regulatory frameworks through their regulatory guidelines. HKMA revised its oversight guideline on the designated systems, adding new or more elaborate requirements on governance, disclosure and risk management, etc. SFC would issue its guidelines for recognised clearinghouses, after consultation with relevant stakeholders. HKMA and SFC would continue to monitor the compliance of their FMIs against the international standards.

- On June 28, 2013, HKMA announced requirements for interim trade reporting. Licensed banks are required to report FX NDF and vanilla single currency interest rate swaps (Fixed vs Floating swaps, basis swaps and overnight indexed swaps) to a trade repository operated by HKMA (HKTR). Trades (including cleared transactions) conducted by a licensed bank and booked in its Hong Kong office (or Hong Kong branch), of which the counterparty is also a licensed bank (or the original counterparty, in the case of cleared transactions), are required to report to HKTR within 2 business days (T+2 basis). Trades remaining outstanding on August 5 or traded on or after such date are subject to the reporting requirements. A grace period of approximately four months was granted to licensed banks to commence reporting by December 9 and a period of six months was granted to backload the transactions (including transactions entered on or before December 8) by February 4, 2014. All licensed banks are required to join HKTR regardless of whether they have any reportable transaction and whether they adopt direct or indirect reporting.
- On September 6, 2013, HKMA and SFC jointly published their conclusions on a joint supplemental consultation regarding the proposed scope of activities to be regulated under the new OTC derivatives regime, and regulatory oversight of systemically important participants. HKMA and SFC's proposals in relation to these two areas were already included in some detail in the Securities and Futures (Amendment) Bill 2013 (the "Bill") introduced to the Legislative Council on June 28, 2013. The Consultation Conclusions explained the regulators' rationale in framing the new regulated activities and summarized their responses to public comments. The new regulated activities, Type 11 RA and Type 12 RA, were proposed to be introduced under Schedule 5 to the SFO.
- On November 25, 2013, OTC Clearing Hong Kong Limited (OTC Clear) launched its clearing services for inter-dealer interest rate swaps denominated in four currencies: RMB, Hong Kong Dollars, US Dollars and Euros. It also offers clearing services for inter-dealer non-deliverable forwards referencing RMB, Taiwan Dollars, Korean Won and the Indian Rupee. OTC Clear planned to introduce client clearing in 2014 after the new legislation on the Securities and Futures (Amendment) Bill was in place.

and relevant amendments to OTC Clear rules are approved by the Securities and Futures Commission. In addition, it would expand its clearing services to cover other OTC derivatives when appropriate.

- On December 3, 2013, HKMA published its latest updated AIDG for Reporting Service. The changes made were mainly for reflecting the new developments and clarifications.
- At the Legislative Council meeting on March 26, 2014, the Council passed the Securities and Futures (Amendment) Bill 2013 with amendments moved by Secretary for Financial Services and the Treasury at the Committee Stage.

The Bill included the framework for the introduction of mandatory reporting, clearing and trading obligations in line with G20 commitments. Asset management and automated trading services provisions would also be expanded to cover OTC derivative portfolios and transactions. The Bill also provided for the regulation of systemically important participants who are not licensed or registered with either HKMA or SFC, but whose positions or transactions in the OTC derivative market are so significant that they may nevertheless raise concerns of potential systemic risks. The amendments introduced at the Committee Stage included, among others, adding a record keeping obligation and some clarificatory language which provided that even if a transaction contravenes the mandatory reporting, clearing, trading or record keeping obligation, this should not of itself affect the validity and enforceability of the transaction.

In view of the passage of the Bill, it was anticipated that the additional consultation papers to introduce new sub-legislations, codes and/or guidelines will come through in Q2 of 2014.

- On March 31, 2014, HKMA announced that the new phase of the OTC derivatives Trade Repository (HKTR) would be launched in September 2014. In this new phase, 15 products of FX, Rates and Equity would be introduced and institutions could report on a voluntary basis. HKMA also updated the Reference Manual for Reporting Service and the AIDG to accommodate these new products together with some refinements to the existing procedures and technical specifications for reporting. Another batch of products would be added by the end of 2015 to complete the product coverage of the HKTR.
- On July 18, 2014, HKMA and SFC issued a consultation paper on mandatory reporting and recordkeeping obligations under the new OTC derivatives regime. Reporting parties would be required to report certain vanilla interest rate swaps (floating vs. fixed and floating vs. floating) and non-deliverable forward transactions to HKTR. Transactions ‘conducted in’ Hong Kong would also be reportable, subject to certain conditions. Reporting parties include AIs, AMBs, LCs, CCPs that provide clearing services to persons in HK and other persons (subject to a reporting threshold of US\$3billion for IRS and US\$1billion for NDF) that are based in or operate from Hong Kong (Hong Kong persons). In particular, Hong Kong persons would cover all Hong Kong residents and all entities established under Hong Kong law (including all partnerships, trusts, companies and other entities established under Hong Kong law), and all overseas companies registered or required to be registered under the Companies Ordinance (non-Hong Kong companies).

The consultation paper also covered provisions of masking of counterparty information, exemptions and relief and other reporting particulars. The commencement date had not been determined but a 3-6 month grace period was proposed conditionally for reporting new transactions and backloading of transactions.

- On November 28, 2014, HKMA and SFC jointly issued consultation conclusions and a further consultation on the Securities and Futures (OTC Derivative Transactions – Reporting and Record Keeping Obligations) Rules. According to the consultation conclusions:

- The first phase of the mandatory reporting requirement would cover certain types of interest rate swap and NDF. The regulators decided to remove precious metal from scope in response to industry feedback;
- The regulators would prepare FAQs to provide further guidance on the requirements to report transactions ‘conducted in’ Hong Kong;
- The regulators now proposed to defer the implementation of mandatory reporting and related record-keeping requirements for Hong Kong persons to a later time;
- The exempt-person relief applicable to small players was amended;
- The concession period for setting up connections to HKTR was extended to six months, and the grace period to backload historical transactions has been extended to a maximum of nine months; and
- Masking relief was extended to cover both historical transactions and new transactions that are entered into within six months after the rules first take effect when counterparty consent is needed;
- The proposed record-retention period was shortened from seven years to five years, and rules on what types of records need to be kept have been clarified.

The regulators asked for further comment regarding: (1) the reporting of valuation-transaction information; (2) the proposed list of jurisdictions to be designated by SFC for the purposes of masking relief; and (3) the proposed list of markets and clearing houses to be prescribed by the Financial Secretary for the purposes of defining ‘OTC derivative product’.

- On February 18, 2015, HKMA sent ISDA two additional documents to assist Hong Kong reporting entities in enhancing their systems to prepare for OTC derivatives trade reporting. The two documents were a set of draft FAQs and supplementary reporting instructions. The documents give additional detail on how to report and populate certain data fields, and deal with various trading and clearing scenarios. HKMA also allowed for a 3-4 month systems enhancement window for firms from 18 February. The documents were provided via memo to ISDA members, and the HKMA asked for comments on these draft documents by mid-March.
- On March 27, 2015, HKMA sent a letter to all authorised institutions giving them an extra two months to report the unique trade ID (TID) as required under EMIR for new transactions, and complete the provision of TIDs for existing transactions. The deadline would now be end-May, having been previously postponed from end-December 2014 to end-March 2015.
- On May 15, 2015, HKMA and SFC released an update on trade reporting. This included a conclusions paper on a consultation on mandatory reporting and related record-keeping obligations under the new OTC derivatives regime, and updated FAQs (which remained in draft form, pending enactment of the reporting rules). Proposals on certain aspects of the reporting regime were revised after taking market feedback into account.

The revised Securities and Futures (OTC Derivative Transactions – Reporting and Record Keeping Obligations) Rules were gazetted on May 15, and were tabled before the Legislative Council on May 20 for negative vetting, along with a package of related ancillary and subsidiary legislation.

- On July 10, 2015, the mandatory reporting and related record-keeping obligations for regulated entities (i.e., authorised institutions, approved money brokers, licensed corporations and central counterparties operating in Hong Kong) set out in the Securities and Futures (OTC Derivative Transactions – Reporting and Record Keeping Obligations) Rules came into effect.

- On July 17, 2015, SFC released a consultation paper on proposed changes to the Securities and Futures (Financial Resources) Rules (FRR) relating to capital and other prudential requirements for licenced corporations engaged in OTC derivatives activity. The consultation paper also proposed certain changes to non-OTC derivatives-related FRR requirements. The three-month consultation ended on October 16, 2015. The proposals aimed to ensure that licenced corporations maintain their capital and liquidity at levels that are commensurate with the risks they undertake pertaining to derivatives businesses, as well as to encourage them to adopt more advanced risk management standards. The proposed FRR treatment could be calibrated to permit different capital approaches for different levels of OTC derivatives activity. The SFC proposed a small number of changes to the FRR treatment applicable to licenced corporations that do not engage in OTC derivatives activity. These included lowering the haircut percentages for certain types of shares and funds, and introducing measures to better facilitate third-party clearing by general clearing brokers. The consultation paper's proposals covered seven key areas:
  - Minimum capital requirements for licenced corporations engaging in OTC derivatives activity;
  - Capital treatment for market risks of OTC derivatives and other proprietary trading positions;
  - Capital treatment for counterparty credit risks arising from OTC derivatives transactions;
  - Introduction of an internal models approach to calculate the capital requirements for market risk for proprietary investments and counterparty credit risk arising from OTC derivatives transactions;
  - Measures to address operational risks of licenced corporations engaging in certain types of regulated OTC derivatives activities or opting into certain capital approaches;
  - Notification and reporting requirements related to OTC derivatives activity; and
  - Miscellaneous technical changes to other areas of the FRR.
- On September 9, 2015, HKMA issued a letter to all authorised institutions (AIs) regarding the linking and matching of derivatives trades reported under interim reporting requirements since August 2013. The letter highlights that approximately 32,000 trades, or 34% of what was reported to the HKTR, were unlinked. Some of this was due to missing or incorrect information. For linked but unmatched trades because of discrepancies, the letter noted that an AI is required to liaise with its counterparty to resolve the discrepancies within three business days of receiving the discrepancy report from the HKTR. For unlinked trades, AIs should reassess whether they have a reporting obligation for those trades, and report as required. Otherwise, they should use the suppress function by May 9, 2016 for trades where there is no obligation to report.
- On September 30, 2015, HKMA and SFC jointly issued a consultation on introducing the first phase of mandatory clearing and the second phase of mandatory reporting under the OTC derivatives regime. The first phase aimed to mandate the clearing of certain standardised interest rate swaps between major dealers. The proposals identified:
  - The types of transactions that will be subject to mandatory clearing;
  - The persons who will be subject to the clearing obligation and in what circumstances;
  - The exemptions and reliefs that may apply; and
  - The process for designating central counterparties for the purposes of the clearing obligation.

The second phase of mandatory reporting aims to expand the existing reporting regime. The key proposals include:

- Requiring the reporting of transactions in all OTC derivative products;
- Widening the scope of transaction information to be reported, including requiring the reporting of daily valuations; and

- Identifying the specific data fields to be completed under the expanded reporting regime.
- On November 20, 2015, the SFC issued a consultation paper on proposed amendments to the Guidelines for the Regulation of Automated Trading Services (ATS). The proposals reflected recent regulatory developments relating to derivatives in Hong Kong. The implementation of mandatory clearing meant market participants that currently provide ATS for clearing derivatives transactions, and overseas CCPs that wish to provide services as a designated CCP for the purposes of mandatory clearing obligations, would need to become ATS providers. Accordingly, the SFC proposed amendments to the ATS Guidelines to provide more specific guidance on the application requirements and procedures applicable to CCPs offering clearing services for derivatives transactions, and to align the requirements with international standards and practices.
- On January 29, 2016, the Hong Kong regulators released a new version of the Supplementary Reporting Instructions, which extended the commencement date of universal transaction identifier (UTI) share-and-pair obligations from 1 February 2016 to 1 February 2017. The commencement was deferred to allow reporting entities within those jurisdictions to await the release of final recommendations governing the UTI from the CPMI-IOSCO.
- On February 5, 2016, the Securities and Futures (OTC Derivative Transactions – Clearing and Record Keeping Obligations and Designation of Central Counterparties) Rules and the Securities and Futures (OTC Derivative Transactions - Reporting and Record Keeping Obligations) (Amendment) Rules 2016 were gazetted. On the same day, the HKMA and the SFC published the conclusions of their joint consultation paper on introducing mandatory clearing and expanding mandatory reporting issued in September 2015.

Rules on mandatory clearing (phase 1 clearing) will come into effect on September 1, 2016. Highlights include:

- Clearing obligations will commence on July 1, 2017;
- Financial services providers will be designated by the SFC;
- A single clearing threshold (US\$20 billion) applies to all prescribed persons;
- An exit threshold (US\$14 billion) is available whereby a prescribed person may cease to be subject to the clearing obligations;
- Transactions have to be cleared within a T+1 timeframe;
- Exemptions may be available for intragroup transactions, transactions booked in exempt jurisdictions and transactions resulting from multilateral portfolio compression cycle; and
- Substituted compliance is available based on a “stricter rule” approach (i.e. only if the transaction has been cleared under the comparable jurisdiction).

Rules on expanded reporting (phase 2 reporting) will come into effect on July 1, 2017. Highlights include:

- Expanded reporting obligations will commence on July 1, 2017;
- The backloading requirement does not apply to transactions maturing before July 1, 2018; and
- Reporting does not apply to FX forwards entered into for security conversions.
- On June 6, 2016, the Hong Kong Trade Repository published version 1.5.1 of its Administration and Interface Development Guide (AIDG).

- On March 1, 2016, the SFC released the conclusions to its consultation paper on proposed amendments to the guidelines for the regulation of ATS issued in November 2015. The SFC made some drafting revisions to the guidelines to reflect the comments and suggestions received. The revised guidelines will become effective upon implementation of the Hong Kong clearing regime, which is expected to be September 1, 2016. CCPs that are interested in obtaining ATS authorisation or CCP designation in time for implementation of the clearing regime should ensure their applications reach the SFC by April 29, 2016.
- On June 27, 2016, the Hong Kong Trade Repository (HKTR) issued a half-year reminder for the TR members to review and update the identifiers reported for parties that are not TR Members at the HKTR. TR members are required to review:-
  - all the transactions carrying internal customer/counterparty reference code whether any of the third party-assigned identifiers specified in the AIDG have become available and replace the codes by the available third party-assigned identifier of the highest level of priority; and
  - all the transactions carrying third party-assigned identifiers whether those identifiers have become invalid, e.g. the reporting or transacting party no longer possesses an identifier; or an identifier of a higher level of priority has become available for the reporting or transacting party. The TR Member should obtain valid identifiers from the relevant parties and update the records at the HKTR.

In addition, TR Members who are connecting to the HKTR system through Internet with SSL certificates were reminded to renew their certificates before expiration, so as to avoid unexpected interruption. The DN information of renewed SSL certificates was required to input into the affected user accounts.

The HKTR also reminded participants when inputting the UTI-TID value in trades reporting to the HKTR, to not include a pipe character (i.e. “|”) between the prefix and the value of the TID. Doing so may have led to mismatch of trade information with counterparties or failure in trade linking process.

- On July 15, 2016, the HKMA and SFC published further consultation conclusions on introducing mandatory clearing and expanded mandatory reporting, for the second stage of the OTC derivatives regulatory regime. The further conclusions paper sets out the revised proposals on various technical aspects of the next stage of the regime in light of market feedback and comments. Highlights included:
  - removal of the requirement to submit PDF files when reporting transactions;
  - further clarification and guidance on completing specific data fields; and
  - acceptance of internal code references (in place of other counterparty identifying particulars) when reporting transactions involving individuals.

The paper also included a revised version of the specific data fields to be completed under the expanded reporting regime, and a revised list of entities that will be regarded as financial services providers for the purpose of mandatory clearing.

- On August 31, 2016, the SFC announced that it has designated four central counterparties (CCPs) for the purposes of the mandatory clearing obligation of certain derivatives transactions. The designation of one local CCP and three major overseas CCPs will provide a variety of choices for market participants that are subject to mandatory clearing under Hong Kong law, which came into effect on September 1, 2016.

The four designated CCPs are Chicago Mercantile Exchange, Japan Securities Clearing Corporation, LCH.Clearnet and OTC Clearing Hong Kong Limited. Each of these designations has been granted subject to conditions, the full texts of which have been posted on the SFC's website.

- On August 31, 2016, the HKMA sent a letter to all regulated entities informing them that a revised Administration and Interface Development Guide (AIDG 1.5.2) would be published in October 2016.

The guide would update the technical specifications in response to the Further Consultation Conclusions on Introducing Mandatory Clearing and Expanding Mandatory Reporting and a Gazette (Government Notice Number. 3912), published by the HKMA and the SFC on July 15, 2016. Reporting entities were reminded to read the revised AIDG carefully to ensure they are fully aware of the changes (from version 1.5.1 published on June 6, 2016).

- Although Phase 2 reporting will not come into effect immediately, the existing reporting standards and technical specifications found in all the previous versions of the AIDG would be phased out and no longer able to support the mandatory reporting requirements under Phase 2 reporting. The testing environment for the updates made in the revised AIDG would be available in the fourth quarter of 2016.
- On September 1, 2016, a set of frequently asked questions (FAQs) prepared by the SFC and the HKMA was published to provide clarifications with regard to the mandatory clearing regime.
- On October 28, 2016, the Hong Kong Trade Repository (HKTR) published a revised Administration and Interface Development Guide (AIDG 1.5.2).
- On November 11, 2016, a revised set of frequently asked questions (FAQs) prepared by the SFC and the HKMA was published to provide clarifications with regard to the mandatory clearing regime.
- On November 25, 2016, 2 sets of Supplementary Reporting Instructions (SRIs) were published, with the first updating the existing SRIs and the second providing new instructions in preparation for the commencement of Phase 2 reporting on July 1, 2017.

### **3. SFC amends Professional Investor Regime and the Client Agreement Requirements**

- On May 15, 2013, SFC issued a consultation paper on the Proposed Amendments to the Professional Investor Regime and the Client Agreement Requirements. In it, SFC sought views on whether corporate and individual professional investors should continue to be allowed to participate in private placement activities and whether the monetary thresholds set out in the Professional Investors Rules should be increased.

SFC also proposed to require intermediaries to comply with all requirements in the Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission (the “Code”), including the suitability requirement, when dealing with all investors who are individuals, their wholly owned investment vehicles and investment vehicles that are wholly owned by family trusts. For institutional professional investors, SFC proposed to maintain the current position so that intermediaries dealing with them are automatically entitled to all current Code exemptions; and for professional investors that are corporations, SFC proposes that intermediaries can continue to be exempt from the suitability requirement and other current Code exemptions after conducting a principles-based assessment of knowledge and investment experience and obtaining their consent etc.

SFC also proposed that amendments be made to the client agreement requirements in the Code. SFC proposed, in summary, that the Suitability Requirement should be incorporated into client agreements as a contractual term; and client agreements should not contain terms which are inconsistent with the Code and should accurately set out in clear terms the actual services to be provided to the client.

- On September 25, 2014, the SFC released consultation conclusions on proposed amendments to the professional investor regime and launched a further consultation on client agreement requirements. Having reviewed all of the comments received during the consultation launched in May 2013, SFC decided to proceed with the proposal not to allow intermediaries when serving individual professional investors to be exempt from the suitability requirement and other fundamental requirements that have a significant bearing on investor protection under the Code of Conduct for Persons Licensed by or Registered with the SFC Code. Other features of the revised professional investor regime include:
  - individual professional investors and corporate professional investors would continue to be allowed to participate in private placement activities;
  - the minimum monetary threshold for qualifying as individual professional investors and corporate professional investors would be maintained at the current levels; and
  - a principles-based criteria would replace the specific tests now used to assess whether exemptions to the Code requirements apply when intermediaries serve corporate professional investors.

The amendments relating to the professional investors regime would become effective on 25 March 2016. In response to market feedback, SFC modified its proposals on client agreement requirements and sought to further consult the public on the wording of a proposed new clause to be incorporated into all client agreements as a contractual term. The comment period ended on December 24, 2014 in relation to the proposed new clause.

- On December 8, 2015, the SFC released consultation conclusions on its Further Consultation on the Client Agreement Requirements. The SFC decided to proceed with requiring the incorporation of a new clause into client agreements, enabling an investor to claim for damages under the client agreement where the regulated intermediary solicits the sale of or recommends a financial product which is not reasonably suitable.

All intermediaries' client agreements must comply with the new Code of Conduct requirements, including incorporation of the new clause and observance of the new paragraph 6.5 of the Code of Conduct discussed in the Further Consultation, on or before June 9, 2017. The SFC also emphasises that the 18-month transitional period is mainly to cater for circumstances where intermediaries, despite their best efforts, encounter practical difficulties when re-executing agreements with existing clients. However, it is expected that intermediaries should be able to comply well before the end of the transitional period.

#### **4. Resolution regime for financial institutions**

- On January 7, 2014, FSTB, together with HKMA, SFC and the Insurance Authority (IA), issued the first-stage public consultation paper on An Effective Resolution Regime for Financial Institutions in Hong Kong.

Key highlights of the paper included:

- Initial thinking and proposals on how a “resolution regime” might be established, which provides the authorities in Hong Kong with powers to bring about the orderly resolution of financial

institutions (FIs) which could pose systemic risk if they were to become non-viable and, in so doing, complies with the FSB's "Key Attributes of Effective Resolution Regimes for Financial Institutions" (Key Attributes) published in November 2011. The Key Attributes are the new international standards for resolution regimes. The FSB indicated that all of its member jurisdictions (including Hong Kong) should implement resolution regimes which are compliant with the Key Attributes by the end of 2015;

- The Government and regulators' current thinking on legislative changes needed to bring Hong Kong's existing arrangements in line with the Key Attributes were described. A number of gaps were identified in the existing supervisory intervention powers or toolkits of the local regulators when compared to the Key Attributes. To address these gaps and provide the basis for a robust resolution regime, a single cross-sectoral regime was proposed and a case was made for each of the sectoral regulators (HKMA, SFC and IA) to be designated as the resolution authorities for FIs within their purview.
  - Consideration on which FIs should fall within the scope of the regime (taking into account which FIs could pose systemic risk on failure) as well as the conditions under which the regime will be used and the objectives to be advanced in any resolution. The powers which are proposed to be made available to the resolution authorities to stabilize and resolve an FI were those identified in the Key Attributes (namely transfer of the FI or some or all of its business to another FI or to a bridge institution and "bail-in" of liabilities to recapitalize the FI);
  - Discussion on whether a "temporary public ownership" option should be made available;
  - Safeguards that should be available to parties affected by resolution and how the resolution regime might operate in a cross-border context;
  - Discussion on how certain rights of creditors might be temporarily suspended during the initial stages of resolution.
- On June 20, 2014, HKMA issued a new Supervisory Policy Manual (SPM) entitled Module RE-1: Recovery Planning (RE-1), as statutory guidance. RE-1 provides guidance to Authorised Institutions (AIs) on key elements of the effective recovery planning and sets out HKMA's approach and expectations in reviewing an AI's recovery plan.

Some of the key sections of the SPM:

- require all AIs to undertake some degree of recovery planning which will be proportionate to the nature, scale and complexity of their operations;
  - explain the need for the involvement of the Board and senior management in developing, reviewing, approving and maintaining an AI's recovery plan;
  - outline key requirements on the menu of recovery options which should be included in an AI's recovery plan;
  - set out aspects to be considered in identifying triggers for escalation of concerns and activation of the recovery plan;
  - provide guidance on how the impact of a recovery action should be assessed;
  - provide minimum requirements for stress scenarios; and
  - outline the minimum requirements for a communication plan should the recovery plan be activated.
- On January 21, 2015, FSTB, HKMA, SFC and IA launched the second stage of public consultation on establishing an effective resolution regime for financial institutions (FIs), including FMIs in Hong Kong. The consultation ended on April 20, 2015. The second stage of consultation sought views on specific aspects of the regime including: further details on the resolution options and powers proposed in the

first consultation paper; the governance arrangements and especially the approach to designating resolution authorities; as well as safeguards including a ‘no creditor worse off than in liquidation’ compensation mechanism. With regard to derivatives transactions, the consultation paper sought public views on the proposed approach to bail-in of liabilities arising from derivatives as outlined in paragraph 111 of the paper (see question 17). The consultation paper also asked for comment on scope, timing and conditions proposed for temporary stays on early termination rights in financial contracts and on how best to implement a temporary stay of early termination rights in respect of FMIs.

- On October 9, 2015, the FSTB, HKMA, SFC and the IA released a consultation response to the second stage of public consultation on proposals to establish a cross-sector resolution regime for FIs, including FMI, in Hong Kong. The consultation response summarises the respondents’ views on the proposals and sets out the government’s responses along with its refined policy positions on certain aspects of the proposed resolution regime. At the end of the consultation period (January to April 2015), around 30 submissions had been received from a variety of industry associations, FIs, professional bodies and firms.

The consultation response contains further information regarding certain aspects of the proposed regime, including pre-resolution powers; loss absorbing capacity requirements to facilitate bail-in; resolution funding arrangements; the recognition of cross-border resolution actions; and safeguards for those affected by resolution action, including appeal mechanisms. The government and the financial regulators will continue their dialogue with stakeholders throughout the legislative process and thereafter when rules, codes of practice and guidance are developed and issued.

- On November 20, 2015, the Financial Institutions (Resolution) Bill was gazetted. The bill sought to establish a cross-sector resolution regime for financial institutions in Hong Kong, in order to be in line with the key attributes published by the FSB.

The resolution regime covers a wide range of regulated financial institutions. Existing regulators will act as the relevant resolution authorities for their respective sectors. Five resolution options have been included: transfer to a purchaser; transfer to a bridge institution; transfer to an asset management vehicle; bail-in; and transfer to a company wholly owned by the government. The bill also provides further rules and guidance on the bail-in mechanism and safeguards given to certain protected arrangements (such as netting or title transfer arrangements). Two tribunals will be established to review decisions of the resolution authority on resolvability and compensation.

The bill has a statutory recognition framework for recognising foreign resolution actions, to the extent that such actions would not have an adverse effect on financial stability in Hong Kong. The bill also provides for a resolution authority to make rules to require the contractual recognition of bail-in actions and the imposition of temporary stays on early termination rights.

The bill was introduced to the Legislative Council for a first reading on December 2, 2015 and a Bills Committee was formed on December 4, 2015 to scrutinize the bill.

- On June 30, 2016, the Hong Kong Government published in the gazette the Financial Institutions (Resolution) Ordinance (the “Ordinance”) which establishes a resolution regime in Hong Kong. Under the Ordinance, the HKMA, the Insurance Authority (IA) and the SFC are designated as resolution authorities. They are vested with a range of necessary powers to effect orderly resolution of a failed systemically important financial institution, which means maintaining continuity of access to the essential financial services it provides by imposing losses on creditors, whilst minimising the risks posed to public funds.

The Ordinance was passed by the Legislative Council on June 22, 2016. It will commence operation on a date to be appointed by the Secretary for Financial Services and the Treasury pending the Legislative Council's passing of certain of the regulations to be made as subsidiary legislation under the Ordinance.

- On November 22, 2016, the Financial Services and the Treasury Bureau, together with the HKMA, the Securities and Futures Commission and the Insurance Authority, launched a consultation on the regulations on protected arrangements under the Financial Institutions (Resolution) Ordinance (FIRO).

The consultation invites views on the scope and the degree of protection for the different classes of protected arrangements, including necessary carve-outs from the protections in order not to overly restrict a resolution authority from achieving orderly resolution. Views are also sought on remedial actions to be taken if a resolution authority has inadvertently not acted in accordance with the regulations.

Subject to the outcome of the public consultation, the regulators target introducing the regulations as subsidiary legislation under the FIRO into the Legislative Council for negative vetting in the first half of 2017.

The deadline for submission is January 21, 2017.

## **5. OTC Clear ESMA recognition and CFTC registration exemption**

- On January 16, 2015, SFC and ESMA announced they had signed an MoU on December 15, 2014 on cooperation arrangements for Hong Kong-established CCPs applying for ESMA recognition in the EU. The MOU is a precondition for those CCPs being able to offer clearing services to clearing members and trading platforms in the EU. The MOU provides for consultation, cooperation and the exchange of information between the authorities on CCP matters and any other areas of mutual interest (but does not cover EU-based CCP supervision). It follows the EC's decision that the legal and supervisory arrangements of Hong Kong ensure that the relevant CCPs comply with requirements that are equivalent to those under the European Market Infrastructure Regulation.
- On April 29, 2015, ESMA announced that it has recognised ten third-country CCPs established in Australia, Hong Kong, Japan and Singapore, including HKFE Clearing Corporation Limited, Hong Kong Securities Clearing Company Limited, OTC Clearing Hong Kong Limited and SEHK Options Clearing House Limited. The recognition allows these CCPs to provide clearing services to clearing members or trading venues established in the EU. Hong Kong has already been assessed as equivalent by the European Commission with regard to its legal and supervisory arrangements for CCPs. Several other steps led to the recognition of the third-country CCPs, including the conclusion of cooperation agreements with the relevant third-country authorities, as well as the consultation of certain European competent authorities and central banks, as foreseen by EMIR.
- On July 9, 2015, the CFTC published a request for public comment on a petition by OTC Clearing Hong Kong Limited for exemption from registration as a derivatives clearing organization (DCO) pursuant to section 5b(h) of the Commodity Exchange Act, which permits the CFTC to grant such exemption if it determines that the applicant is subject to comparable, comprehensive supervision by appropriate government authorities in its home country.

- On November 26, 2015, the SFC announced that it has signed an MoU that will allow the exchange of information on derivative contracts held in trade repositories. The MoU, which became effective on November 19, 2015, allows ESMA and the SFC to have indirect access to trade repositories established in the European Union and Hong Kong respectively.

The ESMA-SFC MoU is the first cooperation arrangement among authorities to establish an indirect access to TRs through the exchange of information. This follows the recommendation of the FSB to enter into this type of agreement to overcome legal barriers to accessing data on derivatives trades, for example when direct access by foreign authorities to TR data is not possible.

- On December 22, 2015, the CFTC issued an order of exemption to OTC Clearing Hong Kong Limited (OTC Clear) from registration as a DCO.

The CFTC may to exempt a clearing organization from DCO registration for the clearing of swaps if it determines that such clearing organization is subject to comparable, comprehensive supervision by appropriate government authorities in the clearing organization's home country. Subject to the terms and conditions of the order, OTC Clear is permitted to clear proprietary swap positions for its US clearing members or affiliates of such clearing members.

- On December 23, 2015, the SFC announced it has entered into an MoU with the CFTC. The MoU covers the cooperation and exchange of information on the supervision and oversight of regulated entities that operate on a cross-border basis in Hong Kong and the US.

Through the MoU, which covers regulated markets and organised trading platforms, central counterparties, intermediaries, dealers and other market participants, the SFC and the CFTC express their willingness to cooperate with each other in the interest of fulfilling their respective regulatory mandates.

## **6. Margining of non-cleared derivatives**

- On December 3, 2015, the HKMA issued a consultation paper on the margining of non-cleared derivatives, which includes the relevant provisions in the draft Supervisory Policy Manual of the HKMA.

Subject to phase-in arrangements, the HKMA proposes to implement the margin requirements published by BCBS-IOSCO and IOSCO's risk mitigation standards (RMS) starting on September 1, 2016. The proposed margin framework covers guaranteed transactions, partial and substituted compliance for cross-border trades, an outcomes-based approach for comparability assessments, and the operation of two-way margin requirements in non-netting and no-margin jurisdictions. The proposed RMS covers documentation requirements, portfolio reconciliation, portfolio compression and dispute resolution.

- On August 22, 2016, the HKMA released conclusions to its consultation and announced that it would issue final rules in the coming months. Some of the key changes include:
  - FX security conversion transactions (settled within T+7) excluded;
  - Single-stock options and equity index options subject to a three-year phase-in period;
  - Concept of partial compliance removed; and

- Exemptions for trading with non-netting counterparties or non-enforceable collateral counterparties, subject to independent legal advice that netting is not likely to be effective and protection arrangements for collateral are questionable (no threshold).
- On December 6, 2016, the HKMA announced the implementation timetable for margin and risk mitigation standards for non-centrally cleared derivatives. The HKMA also released conclusions to its second consultation and revised rules, indicating that the final rules will be issued later this month. Some key points to note:
  - The phase-in of initial margin (IM) requirements for phase-one institutions, and variation margin (VM) requirements for all covered entities, will commence from March 1, 2017;
  - There will be a six-month transitional period from March 1, 2017 to August 31, 2017, with no retrospective application of margining requirements in respect of transactions entered into during this period;
  - Margin requirements do not apply to physically settled FX forwards and swaps;
  - Margin requirements will apply to equity options from March 1, 2020;
  - Margin standards of certain countries (including Australia, the European Union (EU), Japan, Singapore and the US) are deemed to be comparable from the relevant phase-in dates until the HKMA completes a comparability assessment using an outcome-based approach;
  - Margin requirements do not apply if there is reasonable doubt as to the enforceability of the netting agreement against a counterparty; and
  - IM requirements do not apply if collateral arrangements are questionable or not legally enforceable.
- On December 30, 2016, the HKMA issued final draft of the margin and risk mitigation standards for non-centrally cleared derivatives. It indicated that such final draft and its Chinese version will be gazette in January 2017.

## 7. Hong Kong Stock Connect

- On November 10, 2014, SFC and CSRC announced they had approved the launch of the Shanghai-Hong Kong Stock Connect pilot scheme following finalization of all the necessary regulatory approvals and relevant regulatory operational arrangements required for its commencement. Under the joint announcement issued by SFC and CSRC, trading through the Shanghai-Hong Kong Stock Connect will commence on November 17. Stock Connect is a pilot programme for establishing mutual stock market access between Hong Kong and mainland China. ISDA published the Additional Provisions for Stock Connect on October 14, which is intended to be used for cash-settled over-the-counter derivatives transactions referencing certain 'A' shares listed on the Shanghai Stock Exchange traded through Stock Connect.
- On August 16, 2016, the SFC and the CSRC announced the approval, in principle, of the structure of Shenzhen-Hong Kong Stock Connect, which will provide mutual stock market access between Hong Kong and Shenzhen via a northbound trading link and a southbound trading link. There will be no aggregate quota under Shenzhen-Hong Kong Stock Connect.

The joint announcement issued by the SFC and the CSRC also abolished the aggregate quota under Shanghai-Hong Kong Stock Connect with immediate effect.

The launch of Shenzhen-Hong Kong Stock Connect is subject to the finalisation of all necessary regulatory approvals, market readiness and relevant operational arrangements.

## 8. Mainland-Hong Kong Mutual Recognition of Funds

- On December 18, 2015, the SFC granted authorization for the first batch of four Mainland funds under the Mainland-Hong Kong Mutual Recognition of Funds (MRF) initiative for public offering in Hong Kong. The SFC also welcomed the approval by the China Securities Regulatory Commission (CSRC) of the first batch of three Hong Kong funds for public offering on the Mainland market.

The MRF initiative is intended to open up the Mainland's funds market to offshore funds. It will open up a new frontier for the Mainland and Hong Kong asset management industries and make a wider selection of fund products available to investors in both markets. The SFC and the CSRC have been accepting MRF applications since July 1, 2015.

## 9. Protection of Client Assets

- On February 15, 2016, the HKMA issued a circular to registered institutions to draw their attention to a previous document issued by the SFC on protecting client assets against internal misconduct. The HKMA circular refers to the weak internal controls and lax management supervision of some licensed corporations that make them susceptible to the threat of internal misconduct. Registered institutions should refer to the SFC circular when designing and implementing operating and internal control procedures, and the HKMA will continue to monitor their compliance with the relevant requirements.

## 10. Fintech

- On September 6, 2016, the HKMA launched a Fintech Supervisory Sandbox (FSS) to facilitate the pilot trials of Fintech and other technology initiatives of authorised institutions (AIs) before they are launched on a fuller scale. The HKMA sees the need for a supervisory arrangement with greater flexibility to enable AIs to conduct more timely live tests of these initiatives before their formal launch. This will enable AIs to gather real-life data and user feedback on their new Fintech products or services more easily in a controlled environment, so that they can make refinements to them as appropriate. The FSS is intended for this purpose, and the HKMA will adopt the following principles in operating the FSS:
  - The FSS is available to Fintech as well as other technology initiatives intended to be launched in Hong Kong by AIs;
  - Within the FSS, an AI is allowed to conduct a pilot trial of its initiatives involving actual banking services and a limited number of participating customers (such as staff members or focus groups of selected customers) without the need to achieve full compliance with the HKMA's usual supervisory requirements during the trial period. This is however predicated on the understanding that the management of the AI will ensure that certain provisions around boundaries, customer protection measures, risk management controls and readiness and monitoring; and
  - The FSS should not be used by AIs as a means to bypass applicable supervisory requirements.

As the FSS is a new supervisory arrangement, the HKMA will refine the arrangement over time in the light of implementation experience and industry development.

- On November 7, 2016, the Securities and Futures Commission (SFC) hosted the SFC Regtech and Fintech Contact Day 2016 to enhance understanding of emerging regulatory and financial technologies and how they intersect with securities regulation.

The event featured presentations by financial and regulatory technology providers on topics including cybersecurity, business-to-business Fintech, Know Your Client and suitability requirements. A panel comprising representatives of the SFC, Hong Kong Monetary Authority, Hong Kong Exchanges and Clearing Limited and the Office of the Privacy Commissioner for Personal Data discussed the regulatory implications of new technologies. More than 150 senior delegates from financial institutions, brokers and asset managers attended the full-day event.

- On December 7, 2016, the HKMA and the UK Financial Conduct Authority (FCA) announced that they have entered into an agreement to foster collaboration between the two regulatory authorities in promoting financial innovation.

The HKMA and the FCA will closely collaborate on a number of initiatives such as referrals of fintech firms, joint innovation projects, information exchange and experience sharing. For Hong Kong, the agreement is a key initiative for the Fintech Facilitation Office (FFO) of the HKMA and presents significant opportunities for financial and fintech companies to enhance their services and extend their global footprint.

For the UK, this represents the fifth co-operation agreement that the FCA has signed with international authorities after Australia, Singapore, South Korea and China. The agreement will reduce the barriers for authorised firms looking to grow to scale overseas and assist non-UK innovators interested in entering the market the FCA oversees.

## **11. HKMA publishes reports**

- On April 29, 2016, the Hong Kong Monetary Authority (HKMA) released its annual report for 2015. The report discusses the economic and financial environment, monetary stability, banking stability, participation in regional and international forums and reserves management. The report also discusses the HKMA's progress in implementing various reforms and regulations, including the countercyclical capital buffer, domestic systemically important banks, recovery and resolution schemes and Basel-related reforms.
- On September 27, 2016, the Hong Kong Monetary Authority (HKMA) published the September 2016 issue of its Quarterly Bulletin and Half-Yearly Monetary and Financial Stability Report.

The Quarterly Bulletin features two articles, entitled 'Capacity Building in the Hong Kong Banking Industry', and 'Implementation of the Stored Value Facilities Regulatory Regime'. The report provides detailed analyses of the global and local economy, as well as the monetary and financial conditions in Hong Kong. It also examines the recent performance and risks of the local banking sector.

## **12. SFC inks MOU with FINRA**

- On May 20, 2016, the Hong Kong Securities and Futures Commission (SFC) announced it has entered into a memorandum of understanding (MOU) with the US Financial Industry Regulatory Authority (FINRA) concerning mutual assistance in the supervision and oversight of regulated entities that

operate on a cross-border basis in the two jurisdictions. The MOU covers financial market participants or other entities that are regulated by the SFC or FINRA, and came into effect on May 9.

### **13. HKMA launches cybersecurity initiative**

- On May 18, 2016, the HKMA announced the launch of a Cybersecurity Fortification Initiative (CFI) at the Cyber Security Summit 2016. The CFI aims to raise the level of cybersecurity of banks in Hong Kong through a three-pronged approach:
  - A central element of the CFI is a cyber-resilience assessment framework, which seeks to establish a common risk-based framework for banks to assess their own risk profiles and determine the level of defence and resilience required;
  - There will be a new professional development programme for training and certification, which aims to increase the supply of qualified professionals in cyber security; and
  - A cyber intelligence sharing platform will be developed to allow sharing of cyber-threat intelligence between banks in order to enhance collaboration and improve cyber resilience.
  - To implement the CFI as quickly as possible, the HKMA will issue a formal circular to all banks next week, which will set out that it is a supervisory requirement for them to implement the CFI. Concurrently, the HKMA will conduct a three-month consultation with the banking industry on the proposed cyber-resilience assessment framework. The HKMA will also work with the Hong Kong Institute of Bankers and the Hong Kong Applied Science and Technology Research Institute (ASTRI) to roll out the first training courses for cyber security practitioners by the end of 2016. In addition, the HKMA will work with the Hong Kong Association of Banks and ASTRI to establish the cyber intelligence sharing platform by the end of 2016.

### **14. HKEX receives SFC approval to clear USD/CNH cross currency swaps**

- On July 21, 2016, OTC Clearing Hong Kong Limited (OTC Clear), a subsidiary of Hong Kong Exchanges and Clearing Limited (HKEX), announced that the Securities and Futures Commission has granted approval of its clearing services for cross currency swaps. OTC Clear will initially provide clearing for swaps in the USD/CNH currency pair, which is expected to launch in August.

OTC Clear will be the first international clearing house to provide clearing for USD/CNH cross currency swaps. OTC Clear provides a payment versus payment settlement solution through the real-time gross settlement system operated by the Hong Kong Monetary Authority, which eliminates settlement risk.

### **15. SFC hosts IOSCO Board meeting in Hong Kong**

- On October 20-21, 2016, a meeting of the Board of the International Organization of Securities Commissions (IOSCO) was hosted by the Securities and Futures Commission (SFC) in Hong Kong, focused on key issues facing securities regulators and global financial markets.
- The IOSCO Board discussed ways to advance the organisation's agenda for financial regulatory reform and also reviewed the progress of IOSCO's work on margin requirements, central counterparties, asset management and market conduct.

- Nearly 100 securities regulators from more than 30 member jurisdictions attended the meeting, which was the first chaired by the new IOSCO Board Chairman, Mr Ashley Alder, SFC Chief Executive Officer.

## **16. HKMA Designates Nine CNH Primary Liquidity Providers**

- On October 27, 2016, the Hong Kong Monetary Authority (HKMA) announced that it has designated the following nine banks as Primary Liquidity Providers (PLPs) for offshore renminbi (RMB) market in Hong Kong (i.e. CNH market) with effect from today, following the expiry of the first term of designation to seven PLPs.

The nine PLPs were selected through a competitive process among the former PLPs and the contributing banks for CNH HIBOR fixing, which are all active participants in the CNH market. The selection was based on a wide range of criteria, including the institution's capability in providing CNH funding and making market for CNH instruments, and commitment to using Hong Kong as a global hub for offshore RMB business. The HKMA provides each of the PLPs with a dedicated RMB repo facility of RMB2 billion, so as to facilitate their liquidity management when they carry out market-making activities and provide liquidity in the CNH market.

To enhance the transparency of the RMB market liquidity, starting from 1 November 2016 the HKMA will publish information on the usages of intraday and overnight RMB Liquidity Facility (RLF) as well as the usages of the PLP facility as at 9:00 a.m., 11:00 a.m., 2:00 p.m and 4:00 p.m. Hong Kong time from Monday to Friday, except public holidays. The information will be shown in a new HKMA page on the Reuters (page name: HKMAOOF) within fifteen minutes of the respective points of time.

The designation is for a term of two years, with effect from 27 October 2016. The HKMA will regularly review the experience in operating the scheme and its effectiveness, and consider the need for any refinements, including the number of PLPs and the modalities of the repo facility.

## **17. SFC proposes enhancement to position limits regime**

- On September 20, 2016, the Hong Kong Securities and Futures Commission (SFC) published a consultation paper proposing enhancements to the position limit regime to expand its scope and make it more responsive to financial market developments.

Under the proposals, the cap on the excess position limit that may be authorised by the SFC would increase from 50% to 300% of the statutory position limit. It is also proposed that the statutory position limit for stock options contracts will triple to 150,000. This will facilitate the implementation of the proposals in Hong Kong Exchanges and Clearing Limited's market consultation that concluded in June 2016. In addition, new excess position limits are proposed for index arbitrage activities, asset managers and market-makers of exchange-traded funds.

Submissions to the consultation are due by November 21.

## **18. SFC issues reminder on short position reporting**

- On September 30, 2016, the Hong Kong Securities and Futures Commission (SFC) issued a reminder to all relevant market participants that on March 15, 2017, reporting will be required for reportable short positions in all designated securities eligible for short selling specified by the Hong Kong Stock Exchange.

The SFC further reminded market participants to ensure they have systems and procedures in place to comply with the new requirements. For more details, market participants can refer to the latest frequently asked questions published on the SFC website. The SFC will provide a pilot testing environment in early 2017 to facilitate market participants' preparations for the new requirements. Further details will be available by the end of 2016.

## **19. HKMA releases consultation on NSFR**

- On November 4, 2016, the Hong Kong Monetary Authority (HKMA) released a consultation paper on the net stable funding ratio (NSFR). The proposals are as follows:
  - The NSFR will be applicable to banks that have been designated as category 1 institutions by the HKMA. Category 2 members will be subject to a modified form of the NSFR;
  - The NSFR will be applied on a Hong Kong office basis for all institutions. In addition, institutions having one or more overseas branches must apply the NSFR on an unconsolidated basis. If an institution has one or more associated entities, the HKMA may also require the NSFR to be applied on a consolidated basis;
  - A category 1 institution will be required to maintain an NSFR of not less than 100%. In case of a temporary immaterial shortfall, a category 1 institution will be given a brief opportunity to restore its NSFR position before significant supervisory action is taken;
  - A category 2 institution will be required to maintain a modified NSFR of not less than 75% on average in each calendar month, with no allowance for rectification of shortfalls;
  - Locally incorporated category 2 institutions with total assets amounting to less than HK\$20 billion and category 2 institutions operating as foreign bank branches with total assets amounting to less than HK\$50 billion will be exempted from NSFR requirements; and,
  - NSFR and modified NSFR requirements will become applicable from January 1, 2018.

The deadline for comments is December 23, 2016.

## **20. New HKTR documentation published**

- On November 25, 2016, the Hong Kong Trade Repository (HKTR) published a revised version of the existing supplementary reporting instructions (SRI I), and additional supplementary reporting instructions focusing on the phase-two reporting requirements that will come into effect in July 2017 (SRI II).

The SRI I has been revised to address questions received from the industry, and describe the reporting requirements in a more concise manner. Where new or altered reporting requirements are introduced, grace periods have been provided for their implementation. A tracked-changes version of the SRI I has also been published.

The guidance in the SRI II should enable reporting institutions to complete their preparation for compliance with the phase-two reporting requirements.

## 21. New SFC measures to heighten senior management accountability

- On December 16, 2016, the Hong Kong Securities and Futures Commission (SFC) issued a circular to all licensed corporations to heighten the accountability of senior management and promote awareness of senior management obligations under the current regulatory regime.

The circular aims to provide more guidance on who should be regarded as the senior management of a licensed corporation. It identifies eight core functions which are instrumental to the operations of licensed corporations. Licensed corporations are expected to designate fit and proper individuals to be managers-in-charge of each of these functions. Those who have overall management oversight of the licensed corporations and those in charge of key business line functions are also expected to seek the SFC's approval as responsible officers.

Commencing April 18, 2017, corporate licence applicants and existing licensed corporations will have to submit up-to-date management structure information and organisational charts to the SFC. All existing licensed corporations should submit the required information by July 17, 2017. In addition, their managers-in-charge of the overall management oversight and key business line functions who are not already responsible officers should have applied for approval to become responsible officers by October 16, 2017.

The SFC has also published over 40 frequently asked questions to provide more guidance on the measures and will organise a series of industry workshops in the first quarter of 2017 to help the industry further understand the measures.

### ISDA Submissions (since 2010)

- January 27, 2010: [ISDA submission in response to the Consultation Paper on the Review of Corporate Rescue Legislative Proposals](#)
- December 2, 2010: [JAC submission to the Bills Committee on the Securities and Futures and Companies Legislation \(Structured Products Amendment\) Bill](#)
- July 8, 2011: [ISDA submission to HKMA on the Conceptual Framework of the Trade Repository](#)
- November 30, 2011: [ISDA submission to HKMA and SFC on the consultation paper on the proposed regulatory regime for Hong Kong's over-the-counter derivatives market](#)
- December 6, 2011: [ISDA submission to HKMA on the report on consultation on logistical and technical arrangements for reporting to the Hong Kong trade repository](#)
- January 29, 2013: [ISDA submission to HKMA and SFC with regard to the "originate or execute" definition in the consultation paper on the proposed regulatory regime for the over-the-counter derivatives market in Hong Kong](#)
- April 5, 2013: [ISDA submission to HKMA and SFC regards to the "originated or executed" definition in the consultation paper on the proposed regulatory regime for the over-the-counter derivatives market in Hong Kong](#)
- April 15, 2013: [ISDA submission to HKMA regards to HKMA Consultation on reporting requirement for OTC derivatives transactions](#)

- May 16, 2013: [ISDA submission to HKMA regarding HKMA Consultation on reporting requirement for OTC derivatives transactions](#)
- June 4, 2013: [ISDA submission to HKMA regarding the reporting logic for historical records amendment](#)
- July 5, 2013: [ISDA submissions to HKMA on the Reporting Service Agreement](#).
- July 16, 2013: [ISDA submission to Hong Kong Monetary Authority and Securities and Futures Commission on the “originated or executed” definitions under the trade reporting regime](#)
- July 26, 2013: [ISDA submissions to HKMA on the Reporting Service Agreement – Follow up letter](#)
- August 30, 2013: [ISDA submission to HKMA and SFC on the “originate or execute” definition under the trade reporting regime](#)
- April 4, 2014: [ISDA response to the consultation paper on “An Effective Resolution Regime for Financial Institutions in Hong Kong”](#)
- August 18, 2014: [ISDA submission to Hong Kong Monetary Authority and Securities and Futures Commission on the Consultation paper on the Securities and Futures \(OTC Derivative Transactions – Reporting and Record Keeping\) Rules](#)
- August 30, 2014: [ISDA submission to Hong Kong Monetary Authority and Securities and Futures Commission on the “originate or execute” definitions under the trade reporting regime](#)
- September 4, 2014: [ISDA submission to HKMA on the mandatory reporting of unique transaction identifiers](#)
- December 23, 2014: [ISDA submission to HKMA and SFC on further consultation on the Securities and Futures \(OTC Derivative Transactions – Reporting and Record Keeping Obligations\) Rules](#)
- March 20, 2015: [ISDA submission to HKMA on draft additional trade reporting documentation \(draft FAQs and Supplementary Reporting Instructions\)](#)
- April 13, 2015: [ISDA submission to Financial Services and the Treasury Bureau on an Effective Resolution Regime for Financial Institutions in Hong Kong](#)
- October 16, 2015: [ISDA submission to SFC on consultation on changes to the Securities and Futures \(Financial Resources\) Rules](#).
- November 5, 2015: [ISDA/ASIFMA joint submission to HKMA and SFC on introducing mandatory clearing and expanding mandatory reporting for OTC derivatives transactions](#).
- November 30, 2015: [ISDA submission to HKMA and SFC on question 39 of consultation on introducing mandatory clearing and expanding mandatory reporting for OTC derivatives transactions](#).
- December 30, 2015: [ISDA/FIA/ASIFMA joint submission to SFC on consultation on proposed amendments to the Guidelines for the Regulation of Automated Trading Services \(ATS\)](#).
- January 29, 2016: [ISDA/ASIFMA joint submission to HKMA on consultation on proposed margining and risk mitigation standards for non-centrally cleared OTC derivatives](#)
- September 14, 2016: ISDA submission to HKMA on key comments on proposed margin and risk mitigation standards for non-centrally cleared derivatives. This submission is not yet public.

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## INDIA

## Key Regulatory Milestones

### 1. OTC Derivatives Market Reforms

- On March 6, 2014, the Implementation Group on OTC Derivatives Market Reforms released its report on progress in implementing OTC derivatives reform measures in India. In this report, the Group has made a gap analysis with regard to various OTC derivative products and has suggested tentative timelines for reform implementation.

The report noted that while India was fully committed to achieving the G-20 reform agenda for OTC derivatives, the pace and nature of such reforms depended on domestic market conditions. The recommended roadmap for implementation of reform measures with regard to OTC derivatives in India has been worked out with timelines extending up to March 2015. As some of these milestones might be dependable on variables such as an improvement in liquidity, there was a possibility that timelines might be revisited or revised based on developments in the OTC derivatives market.

### 2. Margin

- On May 2, 2016, the RBI published a discussion paper on margin requirements for non-centrally cleared derivatives. The paper proposes a framework for the exchange of initial and variation margin for all non-cleared derivatives, in line with Basel Committee on Banking Supervision and International Organization of Securities Commissions guidelines. The discussion paper outlines the scope of coverage, types of margin to be exchanged, eligible collateral, treatment of collected margin, treatment of cross-border transactions and implementation schedule.
- On September 1, 2016, the RBI announced that it has decided to postpone the implementation of margining requirements. This delay will help avoid cross-border implementation issues, and will also provide market participants with adequate time to plan and prepare for the new requirements, it said. The RBI intends to release the final guidelines on margin requirements in due course.

### 3. Trade reporting

- Reporting of inter-dealer transactions in INR IRS and FRAs to CCIL has been required since August 30, 2007.
- Since the launch of the onshore CDS market on December 1, 2011, market-makers have been required to report their CDS transactions with both users and other market-makers.
- In line with the G20 commitments, CCIL was designated as the OTC derivatives trade repository for India and reporting was extended to inter-dealer USD-INR FX forwards and swaps and foreign currency (FCY)-INR options on July 9, 2012. This was expanded to other inter-dealer FX forwards and swaps and currency options (i.e., transactions in 13 FCY other than USD against INR, and FCY against FCY transactions) on November 5, 2012. The FCYs (in addition to USD) are EUR, GBP, JPY, AUD, CAD, CHF, HKD, DKK, NOK, NZD, SGD, SEK and ZAR.

- Reporting of client trades in FX forwards and options commenced on April 2, 2013, subject to a reporting threshold of USD1 million (or equivalent in other currencies). The reporting threshold applies to the base currency of the trade at the time of transacting.
- On December 4, 2013, RBI issued a circular on the Reporting Platform for OTC Foreign Exchange and Interest Rate Derivatives. All/selective trades in OTC foreign exchange and interest rate derivatives between the Category-I AD banks/ market makers (banks/PDs) and their clients should be reported on the CCIL platform, subject to a mutually agreed upon confidentiality protocol.

CCIL has completed the development of the platform for reporting of the following OTC derivative transactions: Inter-bank and client transactions in Currency Swaps; Inter-bank and client transactions in FCY FRA/IRS; and Client transactions in INR FRA/IRS. Additionally, CCIL has put in place a confidentiality protocol, in consultation, with the market representative bodies. The platform would be operationalized from Dec 30, 2013 for the above OTC derivative transactions.

#### **4. Clearing & CCIL matters**

- CCIL clears inter-dealer USD-INR FX forwards and plans to launch inter-dealer clearing of INR IRS and FRAs.
- On January 17, 2012, FEDAI issued a notice to its members requiring them to join CCIL's Forex Forward Guaranteed Settlement Segment by June 30, 2012 and to start clearing their eligible FX forward transactions through CCIL by October 1, 2012. The clearing deadline has since been postponed indefinitely.
- CCIL has amended its regulations governing the Forex Forward Guaranteed Settlement Segment with the amendments taking effect on March 31, 2013. The key amendments confer a right upon members to resign and limit the liability of members for losses arising from the default of another member.
- On January 28, 2013, RBI issued a circular on the 'Standardization of Interest rate Swap (IRS) Contracts', which aims to facilitate central clearing and settlement of IRS contracts in the future and to improve tradability. FIMMDA would prescribe the terms regarding minimum notional principal amount, tenors, trading hours, settlement calculations etc., in consultation with market participants. Standardization would be mandatory for INR Mumbai Inter Bank Offer Rate (MIBOR) Overnight Index Swap (OIS) contracts and for all IRS contracts other than client trades. All new INR MIBOR-OIS contracts executed from April 1, 2013 onwards would need to be standardized.
- On January 1, 2014, RBI granted the status of Qualified Central Counterparty (QCCP) to CCIL. CCIL has qualified as a QCCP on the basis that it is authorised and supervised by the RBI under the Payment and Settlement Systems Act, 2007. It is also subject, on an on-going basis, to rules and regulations that are consistent with the Principles of Financial Market Infrastructures (PFMIs) issued by CPSS-IOSCO. In July 2013, CCIL was designated as a critical Financial Market Infrastructure (FMI) for oversight considering its systemic importance in financial markets regulated by the RBI.
- On February 28, 2014, the Risk Management Department of CCIL released its consultation paper on "the Segregation and Portability Related Changes & Clearing Member Structure". CCIL currently deals directly with all its members, with no indirect participation except in the securities segment. All trades of a member and its constituents are not segregated for margin computation. CCIL is seeking to create a structure so that some of its members, based on agreed criteria, may become Clearing Members (CMs). Indirect participants may access the clearing system via these CMs. The CM structure would be

implemented in all segments of CCIL after suitable modification. The aim of the proposals is to meet Principle 14 “Segregation and Portability” of the CPSS-ISOCO PFMI.

CCIL seeks to create a basic structure through which it would receive all trades of the indirect participants through their CMs for settlement. These trades would have identifiers to denote those as trades of individual participants. CMs would have the option to allow indirect participants to report their trades through CMs or even directly to CCIL within certain pre-specified limits. CMs would be responsible for any margin deficit or any settlement shortfall in the account of any of the indirect participants which accesses clearing through them.

Indirect participants would have the option to select fully segregated collateral model or otherwise. If any indirect participant selects fully segregated collateral, it would have full visibility through CCIL system of margins deposited on its behalf by their CMs. This information would be less detailed for indirect participants who select group or omnibus margin accounts. In the CBLO & Forex Segments, indirect participants have to maintain segregated collateral accounts only. However, an indirect participant, when allowed, may clear through multiple CMs.

The consultation paper covered and sought views on margin shortfall, settlement shortfall, default on account of indirect participant and clearing member default.

- On March 27, 2014, RBI issued a circular on the Exposure Norms for Standalone PDs. With effect from April 1, 2014, as an interim measure, a standalone Primary Dealer’s (PD) clearing exposure to a Qualifying Central Counterparty (QCCP) would be kept outside the exposure ceiling of 25% of its net owned funds applicable to a single borrower/counterparty.
- On March 27, 2014, RBI issued a circular on the Exposure Norms for Standalone PDs. Effective April 1, 2014, as an interim measure, a standalone primary dealer’s clearing exposure to a Qualifying Central Counterparty (QCCP) would be kept outside the exposure ceiling of 25% of its net owned funds applicable to a single borrower/counterparty.
- On June 2, 2014, mandatory clearing through CCIL Forex Forward Guaranteed Segment commenced.
- On December 8, 2014, the Risk Management Department of CCIL released its Consultation Paper on the Default Handling: Auction of Trades & Positions of Defaulter etc.

The Consultation Paper proposed the following:

1. Auction for close-out of Defaulter’s positions: CCIL is considering introducing the possibility of auctioning trades of the defaulter.
2. Default classification: CCIL will categorize the event of default into large and small default depending on the impact to other clearing market participants. The classification may be based on the amount involved at a netted position level as compared to the aggregate net outstanding positions being cleared in the institutional segment of the market. Based on a pre-decided scale, a default may be classified based on such ratio and a subsequent course of action be adopted.
3. Committee of Clearing Participations for Default Handling: For large-sized defaults, CCIL is proposing to form a Committee of Clearing Participants. This committee will advise CCIL on handling large-sized defaults and will assist CCIL on close-out positions either through direct sale or auction.
4. Segment-wise approach: The default handling in each segment is different as the default of a market participant for each segment should be handled separately. However, a clearing participant may

default in more than one segment. CCIL is proposing to handle such defaults at a consolidated level instead of through a segment-based approach.

5. Compression of Portfolio of defaulter or of all (including non-defaulters): CCIL is proposing a mandatory compression of trades of all clearing participants before the default process begins.
  6. Sale of positions in the market: In the instance of a small-sized and medium-sized default, CCIL may choose to close-out such positions through a sale in the market either through its anonymous trading systems or through a private sale by inviting quotes from at least three of the large non-defaulting clearing participants. The residual positions may be closed out following the approach as described in paragraph 2.5.5 of the Consultation Paper. In the instance of a large-sized default, the Default Management Committee of clearing participants may be shown the portfolio of the defaulted clearing participant. This Committee, in consultation with CCIL, may be required to decide on the auction size of the defaulter's portfolio. This Committee may also decide to sell the defaulter's portfolio in the market based on pre-determined rules and via the anonymous trading systems of CCIL.
  7. Auction Model: All non-defaulting clearing participants will have an obligation to bid in the auction and buy positions up to a portion of the auctioned position that is equal to the ratio of their contributions to the default fund for the segment to the total contributions of non-defaulting clearing participants to the same default fund. For each tranche, CCIL will declare a minimum price based on its MTM price.
  8. Positions carried forward: If some positions of the defaulter could not be immediately closed-out in the market or through the auction, such positions will be carried forward.
  9. Residual Loss from Default: Any loss not recovered from the handling of a default will be met in terms of the Default Waterfall described in the respective segment.
- On July 17, 2015, CCIL issued a Consultation Paper on Integrated Risk Information System (CCIL IRIS): Additional Functionalities. This Consultation Paper considers additional functionalities to be included in CCIL's web based real time application called CCIL IRIS which provides information of members related to among others, their liquidity exposures, margin and collateral related information, contributions to default fund, imposition of margin and settlement status of trades in different segments.
  - On July 24, 2015, CCIL issued a Consultation Paper on the integration of Forex Forward and Forex Settlement Segment. This Consultation Paper covers considers the process of integration of these two segments. CCIL has considered that the risks to CCIL for both segments are the same and the clearing participants to these segments are more or less the same. The Consultation Paper also considers that the integration will bring significant benefits to the clearing participants.
  - On July 31, 2015, CCIL issued a Consultation Paper on CCP Recovery and Resolution Mechanism (Consultation Paper). In this Consultation Paper, CCIL considered the Principles for Financial Market Infrastructures (PFMI) developed by the Committee on Payment and Settlement Systems and the International Organization of Securities Commissions (CPSS-IOSCO) in April 2012 and carried out an analysis of the PFMI in relation to the development and maintenance of a viable recovery or orderly wind-down plan for CCIL.

#### Critical Services

CCIL is of the view that the critical services which it offers in the clearing space relate to it being a CCP in securities, CBLO, Foreign Exchange (Rupee/US Dollars), Forward Foreign Exchange (Rupee/US Dollars) and Rupee Derivatives segments. It is to be noted that CCIL also offers non-CCP clearing and settlement of daily cashflows in rupee derivatives segment and in the CLS segment. CCIL

has also considered that it is the only CCP offering the clearing services as described above; therefore, these may be considered to constitute critical services for the financial market participants in the Indian market.

### Principal Risks

Aside from defaults by participants, CCIL has identified and described the following major risks to the clearing risks run by CCIL in the Consultation Paper:

- (a) Settlement Bank Risk;
- (b) Investment Risk;
- (c) Operations Risk;
- (d) Legal Risk; and
- (e) Reputation Risk

### Liquidity Risk

CCIL highlights that in order to manage liquidity risk on a day to day basis, maximum liquidity limits are proposed to be set across segments for members. This has presently been imposed in the Forex Settlement Segment in both INR and in USD. CCIL is of the view that this will ensure that the liquidity shortfall will not be faced with the first default, even by the largest participant with its affiliates. CCIL also considers that liquidity risks from settlement bank failures, if any, would have to be shared by the clearing participants which settles through such bank and is required to share the credit loss as stipulated.

### Allocation of Losses

With respect to allocation of losses, CCIL has considered and proposes to follow the PFMI and as well as the report on the *Recovery of Financial Market Infrastructures* issued by the Committee on Payments and Market Infrastructures and IOSCO (CPMI-IOSCO) in October 2014.

### Losses not caused by participant default

CCIL sets out its considerations with respect to losses not caused by participant default. In this regard, CCIL considers its approach as follows: to combine managing these risks in a manner which is optimum and transparent to the participants and having loss sharing principles where appropriate incentives are available for the participants to manage and minimize this risk. CCIL also states that initial losses up to a threshold could be borne out of CCIL's own resources clearly earmarked for this purpose.

- On March 1, 2016, CCIL issued a Consultation Paper on the end of day incremental MTM deposit deadline being brought forward from 11:00 AM after the day of trade to either 7:30 PM the day of trade or 9:00 AM the day after trade.
- On May 5, the RBI released a circular permitting any entity regulated by the RBI, SEBI, the Insurance Regulatory and Development Authority of India (IRDAI), the Pension Fund Regulatory and Development Authority of India (PFRDA), and the National Housing Bank (NHB) to trade in interest rate swaps (IRS) on electronic platforms.

The RBI has designated the Clearing Corporation of India, CCIL as an approved counterparty for transactions executed on electronic trading platforms where CCIL is the central counterparty. Regulated institutional entities may apply for membership of electronic trading platforms in IRS that have CCIL as the central counterparty, subject to the approval of their respective sectoral regulators.]

- On July 4, 2016, CCIL issued a notification amending its by-laws and the regulations governing the securities segment. The amendments include provisions regarding the introduction of a default fund and outlines the default waterfall, as detailed below;

Default fund: CCIL will maintain a default fund for its securities segment, with a view to meeting risks arising from any default by the members of this segment. The size of the fund will be determined as per the guidelines set out in the regulations, and will be reviewed at the end of every month.

- The member's contribution to the fund will be determined with reference to the total size of the fund, and shall be based on the average outstanding gross trade volume of the member and the average initial margin contribution during the previous month, with equal weights assigned to each. The minimum contribution of a member will be INR 1 million.
- The individual contributions towards the fund may be in the form of cash and/or eligible government securities.
- The securities contributed by the members towards the fund will be valued at the end of each day. If the value of the securities net of haircuts falls below a threshold level as notified by CCIL, members will be required to contribute such additional sums to the fund as may be necessary. To start with, the threshold level will be set at 95%.
- The administration of collateral deposited, as well as withdrawals, substitutions and payment of interest will be governed by the relevant clauses in the regulations.
- The utilisation of the default fund and the events triggering the replenishment of a member's contribution will be governed by the relevant clauses in the regulations.

Default waterfall: The loss on account of a participant default shall be met by CCIL by recourse to funds in the following order. First, by appropriation of the margin contribution of the defaulting member. Second, by applying the set-off from the defaulter's own contribution to the default fund. Third, by payment from CCIL's settlement reserve fund, capped at 10% of the balance available. Last, by allocation of the residual loss to the default fund accounts of other members in proportion to their contributions at the time of default.

- On August 12, 2016, CCIL issued a notification amending the regulations to the Collateralized Borrowing and Lending Obligation (CBLO) segment. The amendments include:
  - The revised CBLO shortage handling process;
  - Pre-order check for availability of initial margin and borrowing limits for members;
  - Step-up in haircut rates on securities collateral following the imposition of volatility margin in the securities segment;
  - The introduction of a default fund
- On November 9, 2016, CCIL issued a proposal to resize their 'Skin in the Game' (SIG) and restructure the default waterfall for all clearing segments. CCIL's current SIG is a fixed percentage of the Settlement Reserve Fund (SRF), which is between 5% to 25% depending on the clearing segment. In order to make the SIG more risk-sensitive and calibrate it to the likely losses in a business segment under stress conditions, CCIL proposes to resize their SIG to 25percent of the member contributed default fund of a segment. In addition, CCIL will also ensure that its SIG is at least equal to the highest amount contributed by any member in each segmental default fund.

CCIL also proposes to restructure the default waterfall, so that the SIG is split into two tranches. Tranche 1 will be equal to 15 percent and is to be used before default fund contributions of surviving members are used, while tranche 2 will be equal to 10 percent which will be used after default fund contributions of surviving members are used but before calling for further contributions from them.

- On December 2, 2016, CCIL announced a change in the timing for the collection of incremental mark-to-market margin for the rupee derivatives segment. This change also applies to the FX forwards, FX, collateralised lending and borrowing obligations, and securities segments. It has been decided to advance the stipulated time by which margin becomes payable to 9am Indian standard time (IST) on the next working day (including Saturdays), from the current 11am IST on weekdays and 10:30am IST

on Saturdays. Failure to replenish the margin shortfall by 9am IST on the next business day will attract a penalty.

- On December 16, the European Commission determined that India, Brazil, New Zealand, Japan Commodities, United Arab Emirates and Dubai International Financial Centre have equivalent regulatory regimes for central counterparties (CCPs) to the European Union.

## 5. Onshore CDS and Corporate Bond market development

- RBI's Guidelines on Introduction of CDS for Corporate Bonds (CDS Guidelines) were issued on May 23, 2011, and came into effect on December 1, 2011. Revisions were made via the Guidelines on 'Credit Default Swaps (CDS) for Corporate Bonds – Permitting All India Financial Institutions' (AIFIs) on April 23, 2012 and via Revised Guidelines on January 7, 2013.

Only single-name INR CDS on Indian-resident corporates are allowed. There are a number of other constraints on what CDS can be written. While 'Restructuring' is allowed as a Credit Event, this is a modified version that departs significantly from the international market definition of 'Restructuring'.

The CDS Guidelines creates two categories of participants – market-makers and users. Currently, only commercial banks and primary dealers that fulfil certain eligibility norms are allowed to be market-makers. Commercial banks, primary dealers, non-banking financial companies, mutual funds, insurance companies, housing finance companies, provident funds, listed corporates and foreign institutional investors, and AIFIs, namely, Export Import Bank of India (EXIM), National Bank of Agriculture and Rural Development (NABARD), National Housing Bank (NHB) and Small Industries Development Bank of India (SIDBI) are allowed to be users.

Market-makers can buy or sell CDS without any underlying position in the bonds. Users can only buy CDS as a hedge for a bond that they hold and must unwind the CDS (or with the consent of the CDS seller, novate the CDS to their bond purchaser) within 10 business days of selling the bond with their original protection seller at a mutually agreeable or FIMMDA price. If no agreement is reached, then unwinding will be done at the FIMMDA price.

Participants are required to mark-to-market their CDS positions daily and to margin their CDS positions at least weekly.

- On August 18, 2016, a working group from the RBI published a report on the development of Indian corporate bond market. The working group was formed by the Financial Stability and Development Council Sub-Committee (FSDC-SC), and has representation from the Reserve Bank of India, Ministry of Finance, Securities and Exchange Board of India, Insurance Regulatory and Development Authority, and the Pension Fund Regulatory and Development Authority.

The report examines different initiatives to develop the corporate bond market in India, and analyses the success of these measures. It looks at the structural limitations of the corporate bond market in India, and makes recommendations for relevant regulators to implement, including:

- Developing an electronic dealing platform with a central counterparty to make corporate bond repo operations more transparent;
- Allowing debt market traders to act as market-makers, as a means of improving liquidity;
- Easing norms for foreign portfolio investors;
- Encouraging large corporates to access the market for their working capital needs; and
- Developing a corporate bond index.

It provides recommendation on ways to develop the credit default swap market in order to complement the corporate bond market, but notes the restriction on netting for capital adequacy and exposure norms. If needed, amendments can be made to the RBI Act.

## **6. Financial Sector Legislative Reforms Commission**

- The Financial Sector Legislative Reforms Commission (FSLRC) issued its final report in March 2013. FSLRC was constituted by the Ministry of Finance to review and recast the legal and institutional structures of the financial sector in India in tune with the contemporary requirements of the sector.

In determining the financial legal framework, FSLRC identified 9 areas that needed to be covered by such framework:

- consumer protection,
- micro-prudential regulation,
- resolution of failing financial firms,
- capital controls,
- systemic risk,
- development and redistribution,
- monetary policy,
- public debt management, and
- contracts, trading and market abuse.

On June 6, 2013, the Ministry of Finance also invited comments on the FSLRC Report to be submitted by July 15, 2013.

- On July 23, 2015, the FSLRC released its Revised Draft Indian Financial Code. The modifications mainly relate to the strengthening of the regulatory accountability of financial agencies, removing the provision empowering the Financial Sector Appellate Tribunal (FSAT) to review Regulations, rulemaking and operational aspects of capital controls, monetary policy framework and composition of the Monetary Policy Committee, regulation of, for instance, systematically important payment systems. The Revised Draft Indian Financial Code also considers the enactments made subsequent to the submission of the FSLRC report; namely The Pension Fund Regulatory and Development Authority Act, 2013 (PFRDA Act) and Securities Laws (Amendment) Act, 2014. However, the FSLRC states that the modifications in the revised Draft Indian Financial Code remain consistent with the overall structure and philosophy of the FSLRC Report.

## **7. Implementation of Basel III**

- On February 21, 2012, RBI released the draft guidelines on Liquidity Management and Basel III Framework on Liquidity Standards. RBI would introduce the Liquidity Coverage Ratio (LCR) and the Net Stable Funding Ratio (NSFR) as prescribed by the Basel Committee, with effect from January 1, 2015 and January 1, 2018, respectively. Supervisory reporting of the LCR and NSFR would begin from the end of the second quarter, 2012. The LCR and NSFR would be applicable to Indian banks on a whole bank level, i.e., on a stand-alone basis including overseas operations through branches, and later on a consolidated level. For foreign banks operating in India, the LCR and NSFR would be applicable on a stand-alone basis.

- On May 2, 2012, RBI released the final guidelines on Implementation of Basel III Capital Requirements stating a minimum Common Equity Tier 1 (CET1) ratio at 5.5%, Total Tier 1 capital at 7% and Total capital (Tier 1 + Tier 2) at 9%. A Capital Conservation Buffer (CCB) of 2.5%, comprising of CET1, would be applied. Banks would be required to hold a total of 11.5% of capital. The transitional arrangements would begin on January 1, 2013, in a phased manner and be fully implemented by March 31, 2018.
- On September 1, 2014, RBI issued guidelines on amendments to the implementation of Basel III. These guidelines refer to certain specific eligibility criteria of non-equity regulatory capital instruments by banks under the Basel III framework and become applicable with immediate effect.
  - Non-equity regulatory capital instruments (additional Tier 1 and Tier 2) – loss absorption mechanism
    - Banks may now issue additional Tier 1 capital instruments with the principal loss absorption through either: (1) conversion into common shares; or (2) write-down mechanism (temporary or permanent) that allocates losses to the instruments.
    - The terms and conditions of all non-equity capital instruments (both additional Tier 1 and Tier 2) issues by banks must have a provision that requires such instruments, at the option of RBI, to either be permanently written off or converted into common shares upon the occurrence of a ‘point of non-viability’ trigger event.
    - Banks need to ensure that all non-common equity capital instruments issued by them meet all the eligibility criteria, such as legal, accounting and operational, for such instruments to be recognised as regulatory capital instruments.
  - Additional Tier 1 capital instruments – exercise of call option
    - The call option on additional Tier 1 instruments (perpetual non-cumulative preference shares and perpetual debt instruments (PDIs)) will be permissible at the initiative of the issuer after the instrument has run for at least five years.
  - Tier 2 capital instruments – maturity period
    - Banks are allowed to issue redeemable non-cumulative preference shares and redeemable cumulative preference shares as part of Tier 2 capital with a minimum original maturity of at least five years. All other criteria relating to maturity period of Tier 2 instruments remain unchanged.
  - Non-equity regulatory capital instruments (additional Tier 1 and Tier 2) – issuance to retail investors
    - Banks may issue other forms of Tier 2 capital instruments to retail investors, such as perpetual cumulative preference shares/redeemable non-cumulative preference shares/redeemable cumulative preference shares. Such issuances should be subject to the approval of the Board and conditions as required under paragraph 1.17 of Annex 5 of the master circular.
    - Banks may now issue additional Tier 1 capital instruments to retail investors, subject to Board approval. However, banks should adhere to the investor protection requirements analogous to those contained in paragraph 1.17 of Annex 5 of the master circular.
  - Coupon discretion on additional Tier 1 debt capital instruments
    - Paragraph 1.8(e) of Annex 4 of the master circular has been amended, such as payment of coupons on PDIs, which must be paid out of current year profits. If current year profits are not

sufficient, then the balance amount of the coupon may be paid out of revenue reserves and/or credit balance in the profit and loss account, if any. However, the payment of coupons on PDIs from revenue reserves is subject to the bank meeting the minimum regulatory requirement for core equity Tier 1, Tier 1 and total capital ratios at all times and subject to the requirements of the capital buffer frameworks (capital conservation buffer, countercyclical capital buffer and domestic systemically important banks).

- On January 8, 2015, RBI issued revised guidelines on the leverage ratio framework and attendant disclosure requirements, as per paragraph 20 of the fourth bi-monthly monetary policy statement 2014-15, which was announced on September 30, 2014. This replaces the 'Part E: Leverage Ratio Framework' in the Master Circular DBOD.No.BP.BC.6/ 21.06.201/2014-15, dated July 1, 2014, on Basel III capital requirements. These guidelines would come into effect from April 1, 2015.
- On May 28, 2015, RBI released its draft guidelines on the net stable funding ratio (NSFR) under Basel III. These draft guidelines are based on the final NSFR rules published by the Basel Committee on Banking Supervision in October 2014, and take into account Indian conditions. The deadline for comments is June 26. RBI proposes to impose these requirements on banks in India from January 1, 2018.
- On June 15, 2015, BCBS published a report assessing the implementation of the Basel risk-based capital framework and the Liquidity Coverage Ratio (LCR) for India. This is part of a series of reports on the Basel Committee members' implementation of Basel standards under the Committee's Regulatory Consistency Assessment Programme (RCAP). A key component of the RCAP is to assess the consistency and completeness of a jurisdiction's adopted standards and the significance of any deviations from the regulatory framework. The RCAP does not take into account a jurisdiction's bank supervision practices, nor does it evaluate the adequacy of regulatory capital and high-quality liquid assets for individual banks or a banking system as a whole.

Overall, the assessment outcome for India is highly positive and reflects various amendments to the risk-based capital and LCR rules undertaken by the authorities. Domestic implementation of the risk-based capital framework is found to be "compliant" with the Basel standards as all 14 components are assessed as "compliant". Regarding the LCR, India is overall assessed as "largely compliant", reflecting the fact that most but not all provisions of the Basel standards were satisfied. In addition, the implementation of the LCR regulation's component is assessed as "largely compliant" and the implementation of the LCR disclosure standards' component is assessed as "compliant".

The Basel Committee further noted that several aspects of the domestic rules in India are more rigorous than required under the Basel framework.

- On March 23, 2016, RBI released an Annex to the Liquidity Risk Management & Basel III Framework on Liquidity Standards. The Annex amends certain provisions of the guidelines issued under "Liquidity Risk Management by Banks" (November 7, 2012), "Basel III Framework on Liquidity Standards – Liquidity Coverage Ratio (LCR), Liquidity Risk Monitoring Tools and LCR Disclosure Standards" (June 9, 2014 and November 28, 2014), and "Prudential Guidelines on Capital Adequacy and Liquidity Standards – Amendments" (March 31, 2015). Certain amendments are set out below:
  - Effective February 1, 2016, the time buckets for Statements of Structural Liquidity and Statement of Short-Term Dynamic Liquidity have been aligned with the Liquidity Coverage Ratio monitoring requirements.

- Effective February 1, 2016, corporate debt securities (including commercial paper) can also be considered as level 2B HQLA's, subject to a 50% haircut and the securities meeting certain liquidity and credit conditions.
- Effective March 23, 2016, branches of foreign banks are no longer required to report LCR by Significant Currency as these branches do not hold any foreign currency HQLA's.
- HQLA-eligible assets received as a component of a pool of collateral for a secured transaction can be included in the stock of HQLA (with associated haircuts) to the extent that they can be monetized separately.

The amount of outflow for funds raised under a Secured Funding Transaction (SFT) is calculated based on the amount of funds raised through the transaction, and not the value of the underlying collateral.

The Annex also discusses the run-off factor for retail term deposits, the outflow factor for contingent funding liabilities, the outflow factor for deposits against which a loan has been allowed, and the outflow factor for funding from other legal entity customers.

- On June 22, 2016, the RBI issued draft guidelines on the standardised approach for measuring counterparty credit risk exposures (SA-CCR), which will replace the current exposure method. This approach will apply to over-the-counter derivatives, cleared derivatives, exchange-traded derivatives, and long settlement transactions. Exposures will be calculated separately for each netting set. Where bilateral netting is not permitted, each netting set will be considered a netting set of its own.
- On July 21, 2016, the RBI issued a circular reviewing the Basel III framework on liquidity standards. The assets currently allowed as the level 1 high quality liquid assets (HQLA) for the purpose of calculating the liquidity coverage ratio (LCR) of banks include:
  - Government securities in excess of the minimum statutory liquidity ratio (SLR) requirement and within the mandatory SLR requirement;
  - Government securities to the extent allowed by the RBI under the marginal standing facility (MSF), presently 2% of the bank's net demand and time liabilities (NDTL); and
  - Government securities to the extent allowed by the RBI under the facility to avail liquidity for liquidity coverage ratio (FALLCR), presently 8% of the bank's NDTL.

In addition to the assets above, banks will now be allowed to use government securities held by them up to another 1% of their NDTL under FALLCR within the mandatory SLR requirement as level 1 HQLA for the purpose of computing their LCR.

Therefore, the total carve-out from SLR available to banks will be 11% of their NDTL. For this purpose, banks should continue to value such government securities within the mandatory SLR requirement at an amount no greater than their current market value, irrespective of the category in which the security is held.

- On November 10, 2016 the RBI issued final guidelines on the standardised approach for measuring counterparty credit risk exposures (SA-CCR) in line with the draft guidelines issued on June 22, which will replace the current exposure method (CEM). This approach will apply to over-the-counter derivatives, cleared derivatives, exchange-traded derivatives, and long settlement transactions. Exposures will be calculated separately for each netting set. Where bilateral netting is not permitted,

or if the RBI is not satisfied about netting enforceability, each trade will be considered a netting set of its own. The final guidelines will be effective April 1, 2018.

## **8. Regulation and Supervision of Financial Market Infrastructures**

- On July 26, 2013, RBI released a policy document on Regulation and Supervision of Financial Market Infrastructures. The policy document describes in detail the criteria for designating an FMI, the applicability of the Principles for Financial Market Infrastructures (PFMIs) to the FMIs, oversight of FMIs and other related aspects. The financial market infrastructures regulated by RBI include Real Time Gross Settlement (RTGS), Securities Settlement Systems (SSSs), CCIL and Negotiated Dealing System (NDS). RBI also stated in the policy document that as a member of the Financial Stability Board (FSB) and the Committee on Payment and Settlement Systems (CPSS), it is committed to the adoption of the PFMI issued by CPSS and the International Organisation of Securities Commission (IOSCO) in April 2012.

## **9. RBI issues guidelines on capital requirements for bank exposures to CCPs**

- On January 10, 2013, RBI issued draft Guidelines on Capital Requirements for Bank Exposures to Central Counterparties which differs from the Basel Committee on Banking Supervision (BCBS)'s interim framework in the following respects:
  - The RBI capital framework treats a CCP as a financial institution while the BCBS framework does not;
  - Only the Current Exposure Method (CEM) can be used by a bank clearing member to calculate its trade exposures to the CCP;
  - Bank clearing members of CCIL may calculate their total replacement cost to CCIL on a net basis. For all other CCPs, banks must calculate their total replacement cost on a gross basis; and
  - A clearing member exposure to clients is treated as a bilateral trade. However, under the BCBS framework, in addition to the clearing member exposure being treated as a bilateral trade, a margin period of risk is calculated by multiplying the exposure at default by a scalar of no less than 0.71 if a bank adopts either the CEM or the Standardized Method.
- On July 2, 2013, RBI issued finalized guidelines on Capital Requirements for Banks' Exposures to Central Counterparties. Exposures from the settlement of cash transactions (e.g. equities, spot FX, commodity etc.) will not be subject to these requirements.

Capital requirements will be dependent on whether the CCP is a qualifying CCP (QCCP) or a non-Qualifying CCP. If a bank acts as a clearing member (CM) of a QCCP, the risk weight of 2% applies. The exposure amount will be calculated by using the Current Exposure Method (CEM). Banks will need to demonstrate via a legal opinion the legal certainty of netting exposures to a QCCP. If a bank is a client of a CM of a QCCP, it may apply the same risk weight as a CM's exposure to a QCCP. The client must obtain a legal opinion that, in the event of a legal challenge, the relevant courts and administrative authorities will find that the client will bear no losses on account of the insolvency of an intermediary under the relevant laws. If a client is not protected from losses in the event of a CM and another client of a CM jointly defaulting, but all other conditions are met, a risk weight of 4% will apply.

Collateral posted by a CM that is held by a custodian and is bankruptcy remote from the QCCP will have a 0% risk weight. Collateral posted by a client that is held by a custodian and is bankruptcy remote from the QCCP, CM and other clients, will also apply a 0% risk weight, otherwise it will apply a 2% or a 4% risk weight depending on the degree of protection the client has from a default.

- On January 7, 2014, RBI issued a circular on the interim arrangements for Banks' Exposure to Central Counterparties (CCPs). As an interim measure, a bank's clearing exposure to a Qualifying CCP (QCCP) will be excluded from the exposure ceiling of 15% of its capital funds for a single counterparty. The clearing exposure will include trade exposure and default fund exposure. Other exposures to QCCPs such as loans, credit lines, investments in the capital of the CCP, liquidity facilities etc. will remain within the existing exposure ceiling of 15% of capital funds to a single counterparty. All exposures of a bank to a non-QCCP will fall within the 15% exposure ceiling to a single counterparty.

Banks will be required to report their clearing exposures to each QCCP to RBI. RBI may initiate suitable measures, requiring banks to initiate risk mitigation plans if their exposures to QCCPs are considered high. Currently, there are four QCCPs in India: CCIL, National Securities Clearing Corporation Ltd. (NSCCL), Indian Clearing Corporation Ltd. (ICCL) and MCX-SX Clearing Corporation Ltd. (MCX-SXCCL).

- On June 22, the RBI issued draft guidelines for the capital treatment of bank exposures to central counterparties (CCPs). Under this framework, counterparty credit risk treatment will apply to exposures to CCPs arising from OTC derivatives, exchange-traded derivatives, securities financing transactions and long settlement transactions. Cash transactions are not subject to this treatment. Capital requirements will vary depending on the status of a clearing house as a qualifying or non-qualifying CCP.
- On November 10, 2016, the RBI issued final guidelines for the capital treatment of bank exposures to central counterparties (CCPs), in line with the draft guidelines that were issued on June 22. Under this framework, counterparty credit risk treatment will apply to exposures to CCPs arising from OTC derivatives, exchange-traded derivatives, securities financing transactions and long settlement transactions. Cash transactions are not subject to this treatment. Capital requirements will vary depending on the status of a clearing house as a qualifying CCP (QCCP) or non-qualifying CCP. The final guidelines will be effective April 1, 2018.

## **10. RBI releases circular on prudential norms for off-balance sheet exposures of banks**

- On June 18, 2013, RBI released its circular on Prudential Norms for Off-balance Sheet Exposures of Banks – Deferment of Option Premium. By way of background, banks are permitted to defer, at their discretion, the premium on plain vanilla options sold by them to users subject to certain prescribed conditions, with effect from January 25, 2012. This facility has now been extended to cost reduction forex option structures in which the liability of the users never exceeds the net premium payable to the bank under any scenario. Certain conditions have been prescribed such as deferral of the payment of premium for option structure with maturity of more than 1-year, provided that the premium payment period does not extend beyond the maturity date of the contract. Banks will also need to carry out the necessary due diligence with regard to the ability of users to adhere to the premium payment schedule.

## **11. RBI releases capital and provisioning requirements for bank exposures**

- On July 2, 2013, RBI released its draft guidelines on Capital and Provisioning Requirements for Exposures to Unhedged Foreign Currency Exposure. RBI proposed to introduce incremental provisioning and capital requirements for bank exposures to corporates that have unhedged foreign currency exposures. RBI proposes the following calculation methodology:
  - determine the amount of unhedged Foreign Currency Exposure (UFCE);
  - estimate the extent of likely loss;
  - estimate the riskiness of unhedged position.

This loss may be calculated as a percentage of EBID per the latest quarterly results certified by statutory auditors. The higher the percentage, the higher the incremental capital and provisioning requirements would apply.

## **12. RBI issues circular on Risk Management and Interbank Dealings relating to PN/ODI**

- On August 1, 2013, RBI issued a circular on Risk Management and Interbank Dealings. RBI referred to its earlier circular issued on June 26 which provided that if a foreign institutional investor (FII) wishes to hedge the rupee exposure of one of sub-account holders, it should be done on the basis of a mandate from the sub-account holder for this particular purpose. In the August 1 circular, RBI clarified that if an FII wishes to enter into a hedge contract for the exposure relating to that part of the securities held by it against which it has issued any Participatory Notes (PN) / Overseas Derivative Instruments (ODI), it must have a mandate from the PN /ODI holder for this specific purpose of hedging. AD Category banks are expected to verify such mandates. In cases where this is rendered difficult, they may obtain a declaration from the FII regarding the nature/structure of the PN/ODI establishing the need for a hedge operation and that such operations are being undertaken against specific mandates obtained from their clients.

## **13. RBI allows exporters and importers to cancel and rebook forward contracts**

- On September 4, 2013, RBI issued a circular on Risk Management and Inter Bank Dealings. With a view to providing operational flexibility to importers and exporters to hedge their foreign exchange risk, RBI has reviewed market conditions and decided to allow exporters to cancel and rebook forward contracts to the extent of 50 percent of the contracts booked in a financial year for hedging their contracted export exposures. Additionally importers are now allowed to cancel and rebook forward contracts to the extent of 25 percent of the contracts booked in a financial year for hedging their contracted import exposures.

## **14. Companies Bill 2013**

- On August 8, 2013, the Upper House of the Indian Parliament passed the Companies Bill, 2013 which had previously been passed by the Lower House of the Indian Parliament on December 18, 2012. The Bill received the President's assent on August 29, 2013. The Bill is intended to replace the Companies Act 1956. The provisions of the Bill would be enforced in phases. A notification in the Official Gazette announced the coming into force of 98 sections of the Bill. The Ministry of Corporate Affairs would facilitate the setting up of the National Company Law Tribunals (NCLTs). In parallel, the draft rules of the Bill would be finalized through a process of consultation with stakeholders. The Bill brings about significant changes to existing corporate law and procedures. The changes are varied in nature and

range from issues relating to the formation of companies, corporate social responsibility, governance, transparency as well as mergers and acquisitions.

## **15. RBI framework for foreign banks' wholly owned subsidiaries**

- On November 6, 2013, RBI released the framework for setting up of Wholly Owned Subsidiaries (WOS) by foreign banks in India. The policy is guided by the two cardinal principles of reciprocity and single mode of presence. As a locally incorporated bank, the WOSs will be given near-national treatment which will enable them to open branches anywhere in the country at par with Indian banks (except in certain sensitive areas where the RBI's prior approval would be required). They would also be able to participate fully in the development of the Indian financial sector. The policy creates an incentive for existing foreign bank branches which operate within the framework of India's commitment to the WTO to convert into WOS, due to the attractiveness of near-national treatment.

Key features of the framework include:

- Banks with complex structures, banks which do not provide adequate disclosure in their home jurisdiction, banks which are not widely held, banks from jurisdictions having legislation giving a preferential claim to depositors of home country in a winding up proceedings, etc., would be mandated entry into India only in the WOS mode;
- Foreign banks in whose case the above conditions do not apply can opt for a branch or WOS form of presence;
- A foreign bank opting for branch form of presence shall convert into a WOS as and when the above conditions become applicable to it or it becomes systemically important on account of its balance sheet size in India;
- Foreign banks which commenced banking business in India before August 2010 shall have the option to continue their banking business through the branch mode;
- To prevent domination by foreign banks, restrictions would be placed on further entry of new WOSs of foreign banks/capital infusion, when the capital and reserves of the WOSs and foreign bank branches in India exceed 20 per cent of the capital and reserves of the banking system;
- The initial minimum paid-up voting equity capital for a WOS shall be Rs5 billion for new entrants. Existing branches of foreign banks desiring to convert into WOS shall have a minimum net worth of Rs5 billion.

The issue of permitting WOS to enter into M&A transactions with any private sector bank in India subject to the overall investment limit of 74 per cent would be considered after a review is made with regard to the extent of penetration of foreign investment in Indian banks and functioning of foreign banks (branch mode and WOS).

## **16. Financial Benchmarks**

- On January 3, 2014, RBI released its Draft Report of the Committee on Financial Benchmarks. The Report considered different measures recommended by various international bodies/committees and reforms which were already underway in key benchmarks, and provided an in-depth analysis of the existing methodology and governance framework of the major Indian Rupee interest rate and foreign exchange benchmarks.

The Report found the existing system generally satisfactory, but several measures are recommended to strengthen benchmark quality, methodology and the governance framework of the Benchmark Administrators, Calculation Agents and Submitters. In line with the international move towards greater regulatory oversight, the Report also reviewed the existing regulatory powers of RBI over the financial benchmarks. It recommended, as a long term measure, amendments to the Act to empower RBI to determine benchmark policy in Money, G-sec, Credit and Foreign Exchange markets and to issue binding directions to all the agencies involved. Pending these amendments, the Report recommended appropriate regulatory and supervisory framework to be put in place by RBI for the above financial benchmarks under its existing statutory powers.

- On February 7, 2014, the Final Report of the Committee on Financial Benchmarks was released. The Committee had finalized its report after taking into account the feedback received from market participants and other stakeholders.
- RBI complied and published on a daily basis reference rates for spot USD/INR and spot EUR/INR. On August 7, 2014, RBI announced the following changes in the existing methodology:
  - The rate for spot US dollar against Indian rupee will be polled from the select list of contributing banks at a randomly chosen five minute window between 11.30 a.m. and 12.30 p.m. every week day (excluding Saturdays, Sundays and Bank Holidays in Mumbai).
  - The other three rates, viz. EUR/INR, GBP/INR and JPY/INR would be computed by crossing the USD/INR reference rate with the ruling EUR/USD, GBP/USD and USD/JPY rates.
  - The daily press release on RBI reference rate for US dollar will be issued every week-day (excluding Saturdays, Sundays and bank holidays in Mumbai) at around 1.30 p.m.

These changes shall be effective from September 1, 2014.

Under the existing methodology, the rates are arrived at by averaging the mean of the bid/offer rates polled from a few select banks at a randomly chosen five minute window between 11.45 am and 12.15 pm every week day (excluding Saturdays, Sundays and bank holidays in Mumbai). The contributing banks are randomly selected from a large panel of banks, identified on the basis of their standing, market-share in the domestic foreign exchange market and representative character.

- By way of background, on June 28 2013, RBI constituted a committee on Financial Benchmarks to consider various issues relating to financial benchmarks in India. Apart from other existing benchmarks, the committee also reviewed the process of computation and dissemination of Rupee reference rate published by RBI and made some recommendations in this regard.
- On April 21, 2016, the RBI announced a change to the methodology for the computation and dissemination of the reference rate for spot USD/INR. Under the existing methodology, the reference rate is calculated from USD/INR rates polled from certain banks. Based on the recommendations of the Committee on Financial Benchmarks, the reference rate will now be derived from actual market transactions in order to better represent the prevailing spot USD/INR rate. The revised changes are:
  - The reference rate for spot USD/INR will be derived from the volume-weighted average of actual market transactions that have taken place during a randomly selected 15-minute window between 11:30am local time and 12:30pm local time during trading days.
  - The other reference rates (EUR/INR, GBP/INR and JPY/INR) will continue to be derived by crossing the USD/INR reference rate with the relevant EUR/USD, GBP/USD and USD/JPY rates.
  - The default window of 15 minutes will be increased over a period of time.

- The daily press release of the RBI reference rate will be issued at around 1:30pm local time on trading days.

## **17. RBI releases guidelines on intra-group transactions and exposures**

- On February 11, 2014, RBI released its “Guidelines on Management of Intra-Group Transactions and Exposures” (Guidelines). RBI decided to prescribe these Guidelines based on, among others, comments received on its draft guidelines issued on August 14, 2012. These Guidelines contain certain quantitative limits on financial intra-group transactions and exposures (ITEs) and prudential limits for non-financial ITEs to ensure that banks engage in ITEs in a safe and sound manner in order to contain concentration and contagion risks arising out of ITEs. The Guidelines set out that banks should adhere to the following intra-group exposure limits:

### **Single Group Entity Exposure**

- 5% of paid-up capital and reserves in the case of non-financial companies and unregulated financial services companies; or
- 10% of paid-up capital and reserves in the case of regulated financial services companies.

### **Aggregate Group Exposure**

- 10% of paid-up capital and reserves in the case of all non-financial companies and unregulated financial services companies taken together; or
- 20% of paid-up capital and reserves in the case of the group i.e. all group entities (financial and non-financial) taken together.

Banks should also put in place a board approved comprehensive policy on monitoring and managing of ITEs. The policy should lay down effective systems and processes to identify, assess and report risk concentrations and material ITEs. The policy should also be reviewed at least annually.

The Guidelines also provide that banks should not enter into cross-default clauses whereby a default by a group entity on an obligation (whether financial or otherwise) is deemed to trigger a default of the bank on its obligations. This requirement would be applicable from the effective date of the Guidelines. Such agreements which have already been executed by banks would be exempted from this requirement. However, the existing agreements should not be renewed by banks.

The Guidelines became effective from October 1, 2014. Banks should accordingly submit data on intra-group exposures to RBI from the quarter ending December 31, 2014. In the event a bank's current intra-group exposure is more than the limits stipulated in the Guidelines, it should bring down the exposure within the limits at the earliest but not later than March 31, 2016. The exposure beyond permissible limits subsequent to March 31, 2016, if any, would be deducted from Common Equity Tier 1 capital of the bank.

## **18. CCIL amends its bye-laws and regulations of voluntary winding-up**

- On April 23, 2014, CCIL made certain amendments to its Bye-Laws and Regulations. A new Chapter XV was inserted in the Bye-Laws providing for, among others, that in the event of CCIL filing for voluntary winding-up or if any insolvency proceeding is admitted against CCIL before any court or tribunal, all outstanding trades with CCIL under all segments shall be terminated by way of close-out at a predetermined price as may be notified. A new Bye-Law 16 was also inserted to provide that in the event of any default or insolvency of CCIL, a non-defaulting member shall have the right of set-off of

the net payables or net receivables across all segments of CCIL that have become due and payable resulting in a net pay-in or net pay-out position.

The Forex Forward Regulations of CCIL were also amended to provide that on receipt of a notice seeking termination and close out, CCIL shall at its discretion, not later than two business days thereafter, by notifying all members of this segment to effect close-out of outstanding trades of such member or to close-out all outstanding trades in the segment.

- On August 14, 2015, certain amendments to Chapter XV Bankruptcy of Clearing Corporations of CCIL's Bye-Laws and Regulations were made to reflect that in the event of CCIL filing for voluntary winding-up or if any insolvency proceeding is admitted against CCIL before any court or tribunal, all outstanding trades with CCIL under all segments shall be terminated forthwith by way of close-out at the mark to market prices of CCIL as at the end of the previous business day. On such close-out, the member-wise mark-to-market loss or gain (as the case may be) in respect of the trades shall be determined and notified to each member.

## **19. IRDA issues new guidelines on IR derivatives**

- On June 11, 2014, the Insurance Regulatory and Development Authority (IRDA) in India issued its Guidelines on Interest Rate Derivatives, replacing earlier IRDA guidelines on the same subject. These guidelines set out that insurers are allowed to deal as users with forward rate agreements (FRAs), interest rate swaps (IRS) and exchange traded interest rate futures.

Participants can also undertake different types of plain vanilla FRAs and IRS transactions; however it should be noted that IRS having explicit /implicit option features are prohibited. Participants must also meet requirements relating to, among others, the permitted purpose of dealing in interest rate derivatives and regulatory exposure and prudential limits. Of interest is the requirement that insurers are advised to ensure documentation requirements are met and completed in all aspects as per relevant guidelines of the and using ISDA documentation.

The guidelines further state that in order to settle the mark to market profits/losses and maintenance of collateral, counterparties should enter into suitable two-way Credit Support Annex in order to mitigate counterparty risk. The guidelines also note that derivative contracts shall be subject to Indian law and the jurisdiction of the Indian courts and be consistent with relevant guidelines and regulations.

## **20. India and US sign FATCA agreement**

- On June 27, 2014, RBI issued a circular on the inter-governmental agreement (IGA) with the United States for the implementation of FATCA. India and the US have reached an agreement in substance and India is now treated as having an IGA with effect from April 11.

The IGA would only be signed however after the approval of Cabinet. Indian financial institutions would have until December 31, 2014 to register with the US authorities and obtain a Global intermediary Identification Number (GIIN). Indian financial institutions having overseas branches in Model 1 jurisdictions, including those jurisdictions where an agreement under Model 1 has been reached in substance would have up to December 31 to register with US authorities and obtain a GIIN. Overseas branches of Indian financial institutions in a jurisdiction having an IGA under Model 2 or in a jurisdiction that does not have an IGA in place but permits financial institutions to register and agree to an FFI agreement may register with US authorities and obtain a GIIN before July 1 to avoid potential withholding under FATCA.

## 21. RBI designates domestic systemically important banks

- On July 22, 2014, RBI released its Framework for dealing with Domestic Systemically Important Banks (D-SIBs). The Framework considers the methodology to be adopted by RBI in identifying D-SIBs as well as promulgating additional regulatory or supervisory policies which D-SIBs will be subject to.

RBI has based its assessment methodology primarily on the Basel Committee on Banking Supervision (BCBS) methodology for identifying Global Systemically Important Banks (G-SIBs). Indicators which would be used for assessment include size, interconnectedness, substitutability and complexity. Based on the sample of banks chosen for computation of their systemic importance, a relative composite systemic importance score of the banks will be computed. RBI will then determine a cut-off score beyond which banks will be considered as D-SIBs.

RBI noted that based on data as at March 31, 2013, it was expected that about four to six banks may be designated as D-SIBs under various buckets. D-SIBs would be subject to differentiated supervisory requirements and higher intensity of supervision, taking into account the risks they pose to the system. The computation of systemic importance scores would be carried out at yearly intervals. The names of the banks classified as D-SIBs would be disclosed in August of every year starting from 2015.

- On August 31, 2015, RBI announced the designation of State Bank of India and ICICI Bank Ltd as D-SIBs.

RBI issued the framework for dealing with D-SIBs on July 22, 2014, which requires the RBI to disclose the names of banks designated as D-SIBs every August, starting from August 2015. The framework also requires D-SIBs to be placed in four buckets depending upon their systemic importance scores. Based on the bucket in which a D-SIB is placed, an additional common equity tier 1 (CET1) requirement has to be applied to it. ICICI Bank Ltd has been placed in the first bucket (additional CET1 of 0.2%), while State Bank of India has been placed in the third bucket (additional CET1 of 0.6%).

The additional CET1 requirements for D-SIBs would be applicable from April 1, 2016 in a phased manner, and would become fully effective from April 1, 2019. The additional CET1 requirement would be in addition to the capital conservation buffer.

## 22. RBI and ECB sign MOU on cooperation

- On January 14, 2014, RBI and ECB signed a MoU on cooperation in the field of central banking. The MoU provides a framework for regular exchange of information, policy dialogue and technical cooperation between the two institutions. Technical cooperation may take the form of joint seminars and workshops in areas of mutual interest in the field of central banking.

## 23. Guidelines for Implementation of Countercyclical Capital Buffer

- On February 5, 2015, RBI issued its guidelines for implementation of Countercyclical Capital Buffer (CCCB). The CCCB may be maintained in the form of Common Equity Tier 1 (CET1) capital or other fully loss absorbing capital only and may vary from 0-2.5% of total risk weighted assets (RWA) of the banks. The CCCB decision would normally be pre-announced with a lead of four quarters. However, depending on the CCCB indicators, the banks may be advised to build up requisite buffer in a shorter span of time.

The credit-to-GDP gap will be the main indicator in the CCCB framework in India and will be used in conjunction with GNPA growth. The CCCB framework will have two thresholds, a lower and an upper threshold, with respect to the credit-to-GDP gap. The lower threshold of the credit-to-GDP gap where the CCCB is activated shall be set at 3%. The upper threshold where CCCB reaches its maximum shall be kept at 15% of the credit-to-GDP gap. In between the 3- 15% of the credit-to-GDP gap, the CCCB shall increase gradually from 0-2.5% of RWA of the bank but the rate of increase would be different based on the level/position of credit-to-GDP gap.

## 24. RBI issues draft guidelines on covered options

- On June 25, 2015, RBI issued its draft guidelines on the writing of covered options by resident exporters and importers against their contracted exposures. Persons resident in India are currently permitted to buy plain vanilla European call or put options to hedge foreign currency exposures. The RBI now intends to permit resident exporters and importers of goods and services to sell standalone plain vanilla European call or put options against their contracted export or import exposures to any AD Cat-I bank in India, subject to certain operational guidelines and prescribed terms and conditions as set out in the draft guidelines.

## 25. SEBI Developments

- On September 1, 2015, the SEBI announced that its Committee on Clearing Corporations had tabled a report. The committee was established in November 2012 with the following broad terms of reference:
  - The viability of introducing a single clearing corporation (CC) or interoperability between different CCs;
  - Investment by a recognised CC and the manner of utilisation of CC profits;
  - To examine and review the existing regulation of transfer of profits every year by recognised stock exchanges to the fund of a recognised CC;
  - To define 'the liquid assets' of CCs for the purpose of calculating the net worth of a CC; and
  - Any other matter that the committee considers relevant or incidental to this. The issue of transfer of depositories' profits to their investor protection fund (IPF) was referred to the committee.

SEBI also announced it would seek public comments on the recommendations of the committee. These include:

- On the interoperability/viability of a single CC, the committee recommended that maintaining separate CCs for each exchange would be prudent at this stage. However, SEBI may keep the interoperability option open and consider the proposal for implementation when conditions are met, which include clear intent of the participants coming together and having a suitable framework in place to the satisfaction of the SEBI.
- On investments by CCs, the committee recommended that CCs be permitted to invest in fixed deposits and central government securities. However, CCs may not invest in instruments like non-convertible debentures (NCDs), commercial paper (CP) and money-market mutual funds, as these instruments carry credit/liquidity risks.
- As the requirement of a core settlement guarantee fund (SGF) has already been met, it was recommended that the requirement to transfer 25% of every recognised stock exchange's profits to the fund of the recognised clearing corporation may no longer be required. However, the risk

management review committee of SEBI may review the stress-test model used to determine the minimum required corpus of the core SGF before making such a departure.

- The 'liquid assets' of CCs for the purpose of calculating net worth shall comprise fixed deposits/central government securities. Other instruments like NCDs, CP and money-market mutual funds carry credit/liquidity risks and so cannot be considered in the calculation.
- With regards to the transfer of profits by depositories, it was recommended they may transfer 5%, or such percentage as may be prescribed by the SEBI, of their profits from depository operations every year to the IPF since the date of amendment of SEBI (Depositories and Participants) (Amendment) Regulations 2012 requiring transfer of profits.
- On September 8, 2015, SEBI issued the Securities and Exchange Board of India (Stock Brokers and Sub-Brokers) (Amendment) Regulations, 2015. The regulations impose requirements on clearing members, including self-clearing members, such as:
  - Prohibiting a stock broker carrying on the activity of buying, selling or dealing in securities (other than commodity derivatives) from the activity of buying, selling or dealing in commodity derivatives unless permitted by SEBI, and vice-versa;
  - Imposing fees on members dealing in securities, other than commodity derivatives;
  - Imposing non-refundable fees for applications made under the regulations;
  - Imposing new net-worth and deposit requirements for members dealing in securities other than commodity derivatives and members dealing in commodity derivatives.
- On September 28, 2015, SEBI commenced regulating the Indian commodity derivatives market; taking over from the Forward Markets Commission (FMC). SEBI created a number of new departments to fulfil this additional responsibility and has named 12 commodity exchanges as recognised stock exchanges. SEBI also released a circular to regional commodity exchanges on risk management. The circular sets out a number of requirements that must be met by April 1, 2016 at the latest, including in the areas of:
  - Member deposits;
  - Ordinary margins;
  - Other margins;
  - Additional ad-hoc margins;
  - Margin computation at client level;
  - Margin collection and enforcement;
  - Collateral types to cover margin/deposit requirements; and
  - Mark-to-market settlement.
- On October 6, 2015, SEBI released a circular announcing a medium term framework for Foreign Portfolio Investor (FPI) limits in Government securities in consultation with the Government of India.
 

Key notable changes include:

  - limits for FPI investment in debt securities shall henceforth be announced/fixed in rupee terms;

- limits for FPIs in Central Government securities (Government debt, Long-term Government debt and State Development Loans (SDLs)) will be increased in 2 stages, on 12 October 2015 and 1 January 2016;
  - a security-wise limit of 20% of the amount outstanding under each Central Government security. Existing investments in the Central Government securities where aggregate FPI investment is over 20% may continue. However, fresh purchases by FPIs in these securities shall not be permitted until the corresponding security-wise investments fall below 20%;
  - all future investments by Long Term FPIs shall be required to be made in Central Government securities and SDLs which have a minimum residual maturity of 3 years;
  - investment of coupons received by FPIs on their existing investments in Central Government securities as well as SDLs shall continue to be outside the applicable limits; and
  - depositories shall put in place the necessary systems for the daily reporting by the custodians of the FPIs and shall also disseminate on their websites the negative investment list, the aggregate security-wise holdings by FPIs and the coupon investment data along with the daily debt utilization data.
- On January 11, 2016, SEBI published a circular to commodity derivatives exchanges, setting out the circumstances under which a commodity derivatives exchange would be liable to exit. This builds on an existing circular of May 19, 2015. In the new circular, SEBI stipulates that if there is no trading operation on the platform of any commodity derivatives exchange for more than 12 months, then the exchange shall be liable to exit. In addition, all national commodity derivatives exchanges must continuously meet the turnover criteria of Rs1000 crores per annum. Regional commodity exchanges must ensure they have at least 5% of the nation-wide market share of the commodity principally traded on their platform. In case the national and regional commodity exchanges fail to meet these criteria for two consecutive years, then they shall be liable to exit.

In the event a recognised commodity derivatives exchange, for any reason, suspends its trading operations, it may only resume trading after ensuring that adequate and effective trading systems, clearing and settlement systems, monitoring and surveillance mechanisms, and risk management systems are put in place. They must also comply with all other regulatory requirements stipulated by SEBI. In addition, these recognised commodity derivatives exchanges can only resume trading operations after obtaining prior approval from SEBI.

The circular also sets out requirements for commodity derivatives exchanges that want to voluntarily surrender their recognition.

- On January 15, 2016, the SEBI announced it has decided to make a number of regulatory changes with regards to the trading of agricultural commodities to curb speculation and volatility in agricultural commodity prices. These include:
  - Reducing position limits for near-month contracts for both the member and client level from 50% to 25% of the overall position limits for all contracts expiring in the month of March 2016 and onwards; and
  - Reducing the daily price limits from 6% to 4%.

SEBI has reviewed the performance and operation of forward contracts being traded on commodity derivatives exchanges, and decided to stop participants entering into new forwards contracts until further notice. However, existing contracts will be allowed to be settled as per the terms of the contracts.

- On January 15, 2016, SEBI announced it has decided to enhance the gross open position limits for bank stock brokers as authorised by the RBI with respect to USD-INR.

Gross open positions across all contracts shall not exceed 15% of the total open interest or \$100 million, whichever is higher. For bank stock brokers, as authorised by the RBI, the gross open position across all contracts shall not exceed 15% of the total open interest or \$1 billion, whichever is higher.

The RBI will keep SEBI and the stock exchanges informed about the bank stock brokers that are authorised to have enhanced position limits.

- On March 9, 2016, the SEBI announced it will permit recognised stock exchanges to introduce cross-currency futures and options contracts on EUR-USD, GBP-INR and USD-JPY, and currency options on EUR-INR, GBP-INR and JPY-INR currency pairs. The existing limits applicable to USD-INR contracts and non-USD-INR will remain unchanged.

Before launching these products, the stock exchange/clearing corporation must submit a proposal to SEBI for approval, containing information on contract specifications, the risk management framework, surveillance systems and compliance. Stock exchanges are also required to implement dynamic price bands, so as to prevent acceptance of orders placed beyond the price limits set by the stock exchanges.

It has also been decided, in consultation with the Reserve Bank of India, to allow trading in cross-currency derivatives contracts between 9:00am and 7:30pm. Accordingly, stock exchanges are permitted to set their trading hours for cross-currency derivatives contracts subject to the fulfillment of certain conditions.

- On April 25, 2016, the SEBI released a circular announcing the alignment of provisions relating to proprietary trading carried out by stock brokers of commodity derivatives exchanges with those for the securities market. Provisions of previous circulars applicable to commodity derivatives brokers, requiring disclosure of whether they trade on a proprietary basis, are now applicable to all commodity derivatives exchanges. Similarly, all commodity derivatives exchanges are now required to ensure compliance with SEBI provisions on pro-account trading terminals.
- On May 4, 2016, the SEBI published a circular setting out new requirements for clearing corporations in the areas of investment policy, transfer of profits and liquid assets calculations, as recommended by a committee formed to examine these issues. Accordingly, clearing corporations will now be required to:
  - Consider principles stipulated by SEBI, and align their investment policies for utilisation of profits and investments to these principles;
  - Calculate their net worth according to a set of eligible investment instruments specified by SEBI; and
  - Transfer 25% of profits to the core settlement guarantee fund, refund any contributions made by clearing members and top up any shortfall in the fund at any time.
- On May 19, 2016, the SEBI issued a release detailing the minutes of its board meeting. The focus of the meeting was on eligibility and investment norms for offshore derivative instruments (ODIs). The board approved the following measures on the issuance of ODIs:

- In order to ensure uniformity, Indian know-your-customer (KYC) and anti-money laundering norms will now be applicable to all ODI issuers, in line with those for domestic investors. ODI issuers will be required to identify and verify the beneficial owners in the subscriber entities that hold in excess of the threshold defined under Rule 9 of the Prevention of Money-laundering (Maintenance of Records) Rules, 2005. This is currently 25% for a company and 15% for partnership firms/trusts/unincorporated bodies. In such cases, the ODI issuers will be required to identify and verify the persons who control the operations of these entities.
- The KYC review will have to be conducted on the basis of risk criteria, as determined by the ODI issuers. This will be at the time of on-boarding and once every three years for low-risk clients, and at the time of on-boarding and every year for other clients.
- ODI subscribers will have to seek prior permission of the original ODI issuer for the transfer of ODIs.
- In addition to the mandatory monthly reporting of ODI holders' details, ODI issuers will also have to include all intermediate transfers during the month.
- ODI issuers will be required to file suspicious transaction reports with the Indian Financial Intelligence Unit in relation to the ODIs issued by it.
- ODI issuers will be required to carry out reconfirmation of ODI positions on a semiannual basis.
- ODI issuers will be required to put in place the necessary systems and carry out a periodical review and evaluation of its controls, systems and procedures with respect to ODIs.

Amendments to the relevant regulations and circulars will be made to bring these measures into effect.

- On June 10, 2016, SEBI issued a circular detailing the revised eligibility and investment norms for offshore derivative instruments (ODIs). This circular brings into effect the measures that were approved at SEBI board meeting on May 19 and will come into effect on July 1. The reporting of the ODI in the revised format will be applicable for the month of July, to be submitted on or before August 10.
- On June 29, 2016, SEBI issued a circular clarifying the following points with respect to foreign portfolio investors (FPIs) issuing offshore derivative instruments (ODIs):
  - ODI subscribers under foreign institutional investor (FII) regulations can continue to subscribe to ODIs under the FPI regime, subject to complying with regulation 22 of SEBI FPI Regulations, 2014, and meeting with other eligibility criteria. Those ODI subscribers that do not meet these criteria can continue to hold their positions until expiry or December 31, 2020, whichever is earlier. These subscribers cannot take fresh positions or renew the old positions.
  - Fresh ODIs can be issued to entities that comply with Regulation 22 of SEBI FPI Regulations, 2014, along with other conditions and circulars that may be notified by SEBI.
- On June 30, 2016, SEBI released a set of frequently asked questions (FAQs) on SEBI(Foreign Portfolio Investors) Regulations 2014. The FAQs give guidance on the following areas of those regulations:
  - Transition from the foreign institutional investors (FII) regime to the foreign portfolio investors (FPI) regime;
  - Transition from the qualified foreign investors (QFI) regime to the FPI regime;
  - Eligibility of FPIs;

- Roles and responsibilities of designated depository participants (DDPs);
  - Generation of an FPI registration certificate and fees;
  - Clubbing of investment limits;
  - FPI investments in debt securities;
  - Offshore derivative instruments (ODIs); and
  - Replies to additional queries received from DDPs.
- On July 15, 2016, SEBI issued a circular advising clearing corporations not to accept fixed deposit receipts (FDRs) from trading/clearing members as collateral if these are issued by the trading/clearing member themselves, or banks who are associates of the trading/clearing member. Trading/clearing members who have deposited such collateral are required to replace these with other eligible collateral within a period of six months from the date of the circular.

Clearing corporations are also required to take the necessary steps to put in place systems for the implementation of the circular, including necessary amendments to the relevant bye-laws, rules and regulations. They are also required to bring the provisions of this circular to the notice of their members, implement the provisions of this circular, and communicate to SEBI the status of implementation.

These guidelines are in line with the Principles for Financial Market Infrastructures published by the International Organization of Securities Commissions.

- On August 19, 2016, SEBI issued a circular reviewing the position limits for hedgers in the commodity derivatives market. SEBI has instructed commodity derivatives exchanges to stipulate a hedge policy for granting hedge limits to their members and clients. The exchanges should adhere to the following broad guidelines while granting hedge limit exemptions to their members and clients:
  - The hedge limit to be granted by the exchanges shall be in addition to the normal position limit. The hedge limit is non-transferrable and shall be utilised only by the hedger to whom the limit has been granted;
  - This hedge limit granted for a commodity derivative shall not be available for the near month contracts;
  - Hedge limits for a commodity shall be determined on a case-to-case basis, depending on the applicant's hedging requirement in the underlying physical market based upon certain guidelines and other factors as the exchanges may deem appropriate;
  - The exchanges shall undertake proper due diligence by verifying documentary evidence of the underlying exposure and ensuring that the hedge limit granted is genuine;
  - At any point of time during the hedge period, hedging positions taken in derivatives contracts by the hedger across multiple exchanges/contracts should not exceed its actual or anticipated exposure in the physical market, even if there is a usable hedge limit available as per allocation made by the exchanges to the hedger;
  - A hedger having availed of hedge limits shall preserve relevant records for a period of minimum three years for inspection by SEBI or the exchange;
  - The exchanges shall disclose on their website the hedge position allocated to various hedgers, indicating the period for which approval is valid, in an anonymous manner and in a fixed format.

These guidelines come into effect from September 29, in supersession of all earlier directives issued by the Forward Markets Commission.

On September 1, 2016, SEBI issued a circular outlining additional risk management measures to be implemented by national commodity derivatives exchanges. The risk management measures relate to initial margin, procedures for regaining a matched book, minimum capital levels for clearing members, and default waterfall requirements, as well as several other risk management issues.

- On September 28, 2016, SEBI announced that commodity derivatives exchanges will introduce trading in options. Commodity derivatives exchanges will need to take approval from SEBI prior to the trading of options, for which detailed guidelines will be introduced in due course.

Commodity derivatives exchanges are required to make the necessary amendments to the relevant by-laws, rules and regulations for the implementation of trading in options.

- On December 16, 2016, SEBI announced that the following commodity derivatives exchanges will be designated as systemically important financial market infrastructures (FMIs), and will be required to comply with the Principles for Financial Market Infrastructures published by the Committee on Payments and Market Infrastructures and the International Organization of Securities Commissions:
  - National Commodity & Derivatives Exchange Ltd
  - Multi Commodity Exchange of India Ltd

Commodity derivatives exchanges that are currently providing in-house clearing services and that had an annual turnover above a certain level in the previous financial year shall be deemed to be systemically important FMIs. This criteria may be reviewed by SEBI from time to time.

## 26. RBI Developments & Circulars

- On October 8, 2015, RBI announced the liberalisation of the Foreign Exchange Management (Foreign Exchange Derivative Contracts) Regulations, 2000 for Authorised Dealers Category-I (AD Cat-I) banks, regarding Booking of Forward Contracts – Liberalisation, in terms of which resident individuals, firms and companies, to manage / hedge their foreign exchange exposures arising out of actual or anticipated remittances, both inward and outward, are allowed to book forward contracts, without production of underlying documents, up to a limit of USD 250,000 based on self-declaration. The RBI has decided to allow all resident individuals, firms and companies, who have actual or anticipated foreign exchange exposures, to book foreign exchange forward and FCY-INR options contracts up to USD 1,000,000 without any requirement of documentation on the basis of a simple declaration. While the contracts booked under this facility would normally be on a deliverable basis, cancellation and rebooking of contracts are permitted. Based on the track record of the entity, the concerned AD Cat-I bank may, however, call for underlying documents, if considered necessary, at the time of rebooking of cancelled contracts.
- On February 8, 2016, the RBI released a report from the working group on the introduction of interest rate options. In 2015, the RBI's technical advisory committee on financial markets had constituted a working group to consider and provide recommendations on the framework for the introduction of interest rate options in India. The working group was to make specific recommendations on the product design (including appropriate tenor and benchmarks), suggest a feasible market microstructure, and

recommend appropriate guidelines for valuation and capital requirements. In its report, the working group made the following key recommendations:

- As a start, to consider permitting simple call and put options, caps, floors, collars and swaptions. Complex structures may be considered subsequently.
- Both over-the-counter (OTC) and exchange-traded options may be introduced. However, for the OTC segment, only European options may be permitted. For exchanges, both US and European structures may be permitted.
- The Fixed Income Money Market and Derivatives Association of India and the Financial Benchmark India Private Limited may provide a list of eligible domestic money or debt market rates.
- Subject to the approval of the relevant regulators, banks, primary dealers and other regulated entities that have sound financials and prudent risk management may be allowed as market makers. All domestic entities that have an underlying interest rate risk may be permitted as users.

No documentation relating to underlying exposures is required for exposures up to Rs 5 crores. Large corporates may be allowed to take hedging positions for their anticipated interest rate exposures.

- On February 25, 2016, the RBI issued the master direction on Know Your Customer (KYC), anti-money laundering and combating of financing of terrorism. The master direction consolidates all relevant instructions issued by different departments of the RBI on the subject, and will be applicable to all its regulated entities.

RBI master directions consolidate instructions on rules and regulations framed by the central bank under various acts, including banking issues and foreign exchange transactions. The process of issuing master directions involves issuing one master direction for each subject matter, covering all instructions on that subject. Any change in the rules, regulation or policy is communicated during the year by way of circulars or press releases. The master directions will be updated whenever there is a change in the rules/regulations or there is a change in the policy. Explanations of rules and regulations will be issued after the release of master directions in easy to understand language wherever necessary. The existing set of master circulars issued on various subjects will stand withdrawn with the issue of the master direction on the subject.

- On April 5, 2016, the RBI Governor announced the First Bi-monthly Policy Statement for 2016-2017. This statement reviews the progress on various monetary, development, and regulatory policy measures announced by the RBI in recent policy statements. The statement also sets out new measures to be implemented for:
  - Margin requirements for non-centrally cleared OTC derivatives. A consultation paper will be issued by end-April 2016, with the target of a final framework by end-July 2016.
  - Revising the regulatory framework for measuring counterparty credit risk (SA-CCR), the capital treatment of bank exposures to CCPs, and Pillar 3 disclosure requirements. Draft guidelines will be issued by May 31, 2016. There will also be a revision to the securitization framework, for which draft guidelines will be issued by June 2016.
  - The introduction of money market futures. Specifics will be decided in conjunction with the SEBI by end-September 2016.
  - A policy framework for the introduction of trading platforms for OTC derivatives. The draft framework will be released by end-September 2016. There will also be a review of the existing guidelines on OTC derivatives by end-May 2016.

- The easing of restrictions on plain vanilla currency options. Draft guidelines will be issued by end-September 2016.
- Changes in the methodology for the RBI Indian Rupee reference rates effective May 2, 2016, and
- Allowing Non-Resident Indians (NRI's) to participate in the Exchange Traded Currency Derivatives (ETCD) market. Guidelines will be issued in consultation with SEBI by end-June 2016.
- On April 7, 2016, the RBI issued a release calling for public comments on the draft operational guidelines for the hedging of currency risk arising out of trade transactions by residents under the contracted exposure route.

The draft proposal introduces a more liberalised framework for exporters and importers by reducing the documentary requirements for hedging under the contracted exposure route. Under the proposed framework, clients will be able to book foreign exchange derivatives contracts for hedging trade transactions based on underlying exposure on the basis of self-declaration, subject to the operational guidelines, terms and conditions outlined in the draft proposal.

- On April 28, 2016, the RBI released a circular permitting the waiver of physical confirmations of OTC trades on the Financial Market Trade Reporting and Confirmation Platform (F-TRAC). The RBI had issued an earlier circular in 2014 that allowed the waiver of physical confirmations of trades subject to participants entering into a bilateral agreement.
- On June 23, 2016, the RBI issued a circular permitting resident exporters and importers of goods and services to write standalone, plain vanilla European options against their contracted exposure to any authorised dealer bank in India. These guidelines will be reviewed after one year, if needed.
- On September 14, 2016, the RBI announced the formation of a working group to review the guidelines for the hedging of commodity price risk by residents in overseas markets. The working group is constituted of members from the RBI, the Securities and Exchange Board of India (SEBI), commercial banks and corporates. The working group may also invite representatives from any sector relevant to its terms of reference, and interested parties may also email their suggestions and comments. The working group will submit its report by February 28, 2017.
- On September 21, 2016, the RBI announced that Legal Entity Identifier India Limited (LEIL) will be the designated issuer of legal entity identifiers under the amended Payment and Settlement Systems Act of 2007.
- On November 7, 2016, the RBI issued clarifications on hedging practices in the External Commercial Borrowing (ECB), market with a view to provide clarity and bring uniformity in hedging practices in the market so as to effectively address currency risk at a systemic level. The RBI issued the following clarifications:

#### 1. Coverage

Wherever hedging has been mandated by the RBI, the ECB borrower will be required to cover principal as well as coupon through financial hedges. The financial hedge for all exposures on account of ECB should start from the time of each such exposure (i.e. the day liability is created in the books of the borrower).

## 2. Tenor and rollover

A minimum tenor of one year of financial hedge would be required, with periodic rollover ensuring that the exposure on account of ECB is not unhedged at any point during the currency of the ECB.

## 3. Natural Hedge

A natural hedge, in lieu of financial hedge, will be considered only to the extent of offsetting projected cash flows or revenues in a matching currency, net of all other projected outflows. For this purpose, an ECB may be considered naturally hedged if the offsetting exposure has the maturity or cash flow within the same accounting year. Any other arrangements or structures where revenues are indexed to foreign currency will not be considered as natural hedge.

The designated AD Category-I bank will have the responsibility of verifying that the 100 percent hedging requirement is complied with. All other aspects of the ECB policy shall remain unchanged.

- On November 4, 2016, RBI released draft operational guidelines to provide greater flexibility for hedging the currency risk arising from current account transactions of Indian subsidiaries of multinational companies by the parent or any non-resident group entity. The draft guidelines apply to all OTC or exchange-traded currency derivatives that the Indian subsidiary is eligible to undertake.

Terms and conditions of the draft guidelines include:

- Non-resident entity should be incorporated in a country that is member of the Financial Action Task Force (FATF) or member of a FATF-style regional body;
- The non-resident entity may approach an authorised bank that handles the foreign exchange transactions of its subsidiary for hedging the currency risk of and on the latter's behalf, either directly or through its banker overseas;
- The Indian subsidiary shall be responsible for compliance with the rules, regulations and directions issued under the Foreign Exchange Management Act (FEMA) and any other laws or regulations applicable to these transactions in India;
- The transactions under this facility will be covered under a multiple party agreement involving the Indian subsidiary, the non-resident entity and the authorised bank;
- The concerned authorised bank shall be responsible for monitoring all hedge transactions booked by the non-resident entity, and also responsible for ensuring that the Indian subsidiary has the necessary underlying exposure for the hedge transactions;
- Authorised banks should report hedge contracts booked under this facility by the non-resident related entity to CCIL's trade repository with a special identification tag.

Comments on the draft guidelines are due by November 11, 2016.

- On December 1, 2016, RBI published the final large exposures framework (LEF) in line with the draft guidelines published on August 25, as summarized below:
  - Banks will have to comply with the LEF at the consolidated (group) level, as well as at the solo (branch) level;
  - A bank's exposure to all its counterparties and groups of connected counterparties will be considered for exposure limits, with certain defined exceptions;

- The sum of all exposure values of a bank to a counterparty or a group of connected counterparties is defined as a large exposure (LE) if it is equal to or above 10% of the bank's eligible capital base;
- The sum of all the exposure values of a bank to a single counterparty must not be higher than 20% of the bank's available eligible capital base at all times; and
- The sum of all the exposure values of a bank to a group of connected counterparties must not be higher than 25% of the bank's available eligible capital base at all times.

The LEF will be effective from April 1, 2019.

## **27. Bankruptcy and Bank Resolution and Recovery**

- On April 28, 2016, the joint committee on insolvency and bankruptcy code submitted its report to parliament. The committee was constituted in December 2015 to examine the code and propose recommendations. The report included proposed modifications to various clauses of the code, including time frames for insolvency resolution and liquidation, requirement of creditor consent, and the inclusion of public financial institutions in the definition of financial institutions.
- On September 29, 2016, an Indian Ministry of Finance committee submitted a draft of the Financial Resolution and Deposit Insurance Bill 2016. Some key provisions of the draft bill are:
  - Establishment and structure of a resolution corporation;
  - Funds and accounts of the resolution corporation;
  - Designation of systemically important financial institutions (SIFIs);
  - Classification of institutions based on their risk to viability;
  - Resolution and restoration plans;
  - Stay on termination rights;
  - Tools of resolution;
  - Receivership and liquidation; and
  - Cross-border insolvency

## **28. Fintech**

- On July 14, 2016, the RBI announced the formation of a 13-member inter-regulatory working group to study regulatory issues related to financial technology and digital banking in India. The working group was formed based on the recommendation of the sub-committee of the Financial Stability and Development Council (FSDC), in view of the growing significance of fintech innovations and their interactions with the financial sector as well as financial sector entities. The working group will be chaired by RBI executive director Shri Sudarshan Sen and will focus on:
  - Gaining a general understanding of the major fintech innovations and developments, counterparties and entities, technology platforms involved, and how markets and the financial sector are adopting new delivery channels, products and technologies.

- Assessing the opportunities and risks arising for the financial system from digitisation and use of financial technology, and how these can be utilised for optimising financial product innovation and delivery to the benefit of end users and other stakeholders.
- Assessing the implications and challenges for the various financial sector functions, such as intermediation, clearing, and payments, being adopted by non-financial entities.
- Examining cross-country practices and studying global models of successful regulatory responses to disruption.
- Drafting appropriate regulatory responses with a view to re-aligning and re-orienting regulatory guidelines and statutory provisions for enhancing fintech and digital banking associated opportunities, while simultaneously managing the evolving challenges and risk dimensions.

## 29. RBI permits trading in money market futures

- On October 28, 2016, the RBI issued a circular permitting cash-settled interest rate futures based on money-market benchmarks. This is in addition to futures based on the 91-day Treasury Bill, which are already permitted. Exchanges are free to select the underlying money-market benchmark and structure the other details of the contracts. However, RBI approval of the contract specifications is required before any new or modified futures contract is introduced for trading on the exchanges.

## ISDA Submissions (since 2010)

- March 9, 2010: [ISDA submission to the MOF Working Group on Foreign Investment in India](#)
- June 11, 2010: [ISDA submission to the MOF Working Group on Foreign Investment in India](#)
- June 22, 2010: [ISDA submission to the MOF Working Group on Foreign Investment in India](#)
- October 4, 2010: [ISDA submission to RBI on the draft Report of the Internal Group on Introduction of Credit Default Swaps for Corporate Bonds](#)
- October 8, 2010: [ISDA submission to the MOF on Report of the Working Group on Foreign Investment in India](#)
- March 8, 2011: [ISDA submission to RBI on the draft Guidelines on Credit Default Swaps for Corporate Bonds](#)
- April 26, 2012: [ISDA submission to MOF in response to the Finance Bill 2012](#)
- May 4, 2012: [ISDA submission to MOF with regard to service tax in response to the Finance Bill 2012](#)
- October 12, 2012: [ISDA submission to RBI, MOF and the FSLRC on 'Consistency of netting application to spur financial market growth'](#)
- October 16, 2012: [ISDA submission to RBI on the draft Guidelines on Management of Intra-Group Transactions and Exposures](#)
- January 31, 2013: [ISDA submission to RBI on the draft Guidelines on Capital Requirements for Bank Exposures to Central Counterparties](#)
- March 20, 2013: [ISDA submission to RBI, the Ministry of Finance \(MOF\) and CCIL on CCIL's Forex Forward Guaranteed Segment](#)
- July 15, 2013: [ISDA submission to The Ministry of Finance on Report of the Financial Sector Legislative Reforms Commission](#)
- February 28, 2014: [ISDA submission to CCIL on USD/INR Segment - Procedure to be adopted for allocation of funds shortage if shortage exceeds available resource](#)
- March 14, 2014: [ISDA submission to CCIL on Intra-day Mark-to-Market Margin Collection in CCIL's CCP Cleared Segments](#)
- March 21, 2014: [ISDA submission to CCIL on Segregation and Portability Related Changes & Clearing member Structure](#)

- June 6, 2014: [ISDA submission to regards to the Report of the Working Group on Resolution Regimes for Financial Institutions](#)
- January 19, 2015: [ISDA submission to The Clearing Corporation of India Ltd. regards to the Consultation Paper on Default Handling: Auction of Trades & Positions of Defaulter.](#)
- September 25, 2015: [ISDA submission to The Clearing Corporation of India Limited with regards to the Consultation Paper on CCP Recovery and Resolution Mechanism.](#)
- March 31, 2016: [ISDA submission to The Clearing Corporation of India Limited with regards to the Consultation Paper on the collection of end of day incremental MTM margin.](#)
- April 29, 2016: [ISDA letter to RBI on Industry Associations Recommend Global Adoption of Entity-Based Reporting.](#)
- June 8, 2016: [ISDA submission to RBI's discussion paper on margin requirements for non-centrally cleared derivatives.](#)
- July 22, 2016: [ISDA submission to RBI on Draft Guidelines for computing exposure for counterparty credit risk arising from derivative transactions.](#)
- October 14, 2016: ISDA preliminary submission to Ministry of Finance on Consultation on the draft Financial Resolution and Deposit Insurance Bill, 2016 and the Report of the Committee to Draft Code on Resolution of Financial Firms. This submission is not yet public.
- November 4, 2016: ISDA submission to Ministry of Finance on Consultation on the draft Financial Resolution and Deposit Insurance Bill, 2016 and the Report of the Committee to Draft Code on Resolution of Financial Firms. This submission is not yet public.

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# INDONESIA

## Key Regulatory Milestones

### 1. OJK

- The law setting up the OJK was passed in October 2011. Pak Muliaman D Hadad (formerly a BI Deputy Governor) was appointed as the first OJK Chairman. Like the UK FSA, the OJK is an independent body set up to regulate and supervise the financial services industry. OJK has started to take over the regulation and supervision of capital markets and non-banking financial institutions from Bapepam-LK at the beginning of 2013. OJK is to start taking over the banking supervisory function from BI at the end of 2013. The OJK law also creates a Coordinating Forum for Financial System Stability, comprising the Minister of Finance, the BI Governor, the Chairman of the Board of Commissioners of the OJK and the Chairman of the Indonesia Deposit Insurance Corporation. In this forum, the OJK is required to monitor and evaluate the stability of the financial system and communicate its findings to other institutions.
- On December 13, 2016, the Otoritas Jasa Keuangan (OJK) announced that the Basel Committee on Banking Supervision (BCBS) completed its review of Indonesia's implementation of the risk-based capital framework. The country's liquidity coverage ratio (LCR) regulations are assessed as compliant, the highest of the four possible grades. The country's capital framework is assessed as largely compliant, one notch below the highest grade.

The Indonesian authorities amended their regulations during 2016 to address differences identified between the Indonesian rules and the Basel framework. This reflects the commitment of the Indonesian authorities to adopt global prudential standards, both now and as forthcoming standards come into effect.

### 2. Currency Law

- Law No. 7 of 2011 (Currency Law) came into effect on June 28, 2011. The Currency Law (in particular Articles 21 and 23) creates uncertainty around the use of a currency other than IDR as the settlement currency or the denomination currency for domestic and cross-border transactions. The Directorate General of Treasury at the Ministry of Finance published "Sosialisasi Undang-Undang Nomor 7 Tahun 2011 Tentang Mata Uang" (Socialization Booklet) and together with BI, conducted a briefing session in December 2011. The Socialization Booklet clarifies that the Currency Law is limited to transactions that involve physical payment in bank notes and coins. As OTC derivative transactions rarely involve settlement by physical delivery of bank notes and coins, this would mean that the Currency Law would not apply to OTC derivatives. However, as the Socialization Booklet does not have the force of law, concern remains that neither the enforcement agencies nor the courts are bound by it. Pending legal confirmation of the scope of the Currency Law, it may be prudent to take steps to try to bring a cross-border OTC derivative transaction within the "international trade transactions" exemption in Article 21(2) of the Currency Law or to include explicit 'contracting out' language to bring a domestic OTC derivative transaction within Article 23(2) (though it should be noted that the scope of Articles 21(2) and 23(2) are themselves unclear).

### 3. National Language Law

- On July 9, 2009, Law No.24 of 2009 on the National Flag, Language, Seal and Anthem (National Language Law) came into effect. The National Language Law requires that all agreements involving an Indonesian party must be in the national language, Bahasa Indonesian. ISDA has published Indonesian translations of the 2002 ISDA Master Agreement as well as confirmation templates and glossaries for certain plain vanilla FX, currency option, interest rate and cross currency swap transactions.
- In June 2013, the West Jakarta District Court in PT Bangun Karya Pratama Lestari v Nine AM Ltd case ruled that a loan agreement governed by Indonesian law and written only in English to be void for being in violation of Law No. 24 of 2009.
- In August 2015, the Indonesian Supreme Court announced that it had rejected an appeal filed by Nine AM Ltd in connection with the annulment of the loan agreement described above. The announcement indicates that previous judgments handed down by the West Jakarta District Court and subsequently by the Jakarta High Court, have been upheld by the Indonesian Supreme Court.

#### **4. Regulations impacting OTC derivatives**

- BI Regulation No. 11/26/PBI/2009 on ‘Structured Products’ (SP Regulation) came into effect on July 1, 2009. OTC derivatives fall within this Regulation. Banks must obtain an in-principle approval from BI before they can offer any structured products. In addition, for non-principal protected structured products, banks must obtain transaction-type approval from BI. Banks with an FX license can offer structured products with FX and/or interest rates as underlying. Non-FX banks can only offer structured products with interest rates as underlying. Foreign currencies against IDR structured products are prohibited. The SP Regulation imposes restrictions on the types of structured products that can be offered to different customer categories. There are other business conduct and disclosure requirements such as a mandatory cooling-off period for non-principal protected structured products and a requirement that term sheets and agreements be in the Indonesian language.
- BI Regulation No. 12/9/PBI/2010 on ‘Prudential Principles in Conducting Offshore Financial Products Agency Activities by Commercial Banks’ came into effect on June 29, 2010. Commercial banks in Indonesia (including Indonesian branches and subsidiaries of foreign banks) with an FX license can carry out agency activities for offshore financial products (OFP) only if certain conditions are met. Although an OFP is defined as an “investment instrument issued by foreign issuers”, BI has clarified that OTC derivatives could be impacted. OFPs can only be offered to non-retail customers. The issuer of the OFP must be licensed and supervised by a competent authority in the issuer’s home country. For a non-security OFP, the issuer must have a branch in Indonesia. The bank must carry out an analysis of the OFP and provide offering materials to the customer in the Indonesian language.

On September 18, 2014, Bank Indonesia organized socialization activities to announce amendments to Bank Indonesia regulations concerning foreign currency transactions in order to deepen financial markets. Bank Indonesia would promulgate several provisions that summarize and elaborate upon a number of existing regulations regarding foreign exchange transactions amended to provide increased flexibility and a more precise explanation to market participants when conducting foreign exchange transactions. The amendment covers, amongst others, relaxing and clarifying underlying assets, clarifying netting to settle a transaction, as well as restrictions on extending credit or financing in a foreign currency and/or the rupiah for derivative transactions. The amended regulation officially supersedes the following six Bank Indonesia Regulations:

- PBI 10/28/PBI/2008 concerning the Purchase of Foreign Exchange against the Rupiah.

- PBI 10/37/PBI/2008 and PBI 11/14/PBI/2009 concerning Foreign Exchange Transactions against the Rupiah.
- PBI No.7/14/PBI/2005; PBI No.14/10/PBI/2012; and PBI No.16/9/PBI/2014 concerning Restrictions on Rupiah Transactions and the Extension of Foreign Currency Credit by a Bank.

Bank Indonesia would also issue an amended regulation concerning hedging transactions between a bank and Bank Indonesia, representing efforts to augment hedging liquidity on the domestic foreign exchange market through the expansion of underlying assets, increase flexibility and assurance for market participants by allowing the extension of hedging contracts, as well as provide flexibility over swap transaction tenor extensions.

- In May 2015, Bank Indonesia announced that it together with State Institutions and fund-related agencies will continue to coordinate and cooperate to support the application of hedging transactions in order to provide optimal contribution in maintaining the stability of the Indonesian rupiah exchange.

## **5. Bank Indonesia amended regulation on FX transactions**

- On September 18, 2014, Bank Indonesia announced certain amendments to existing Bank Indonesia regulations relating to foreign currency transactions against the Indonesia rupiah. These amendments were made in relation to foreign exchange transactions against the rupiah that are settled between banks and their domestic customers, banks and a foreign party, as well as banks and Bank Indonesia. These amendments are intended to deepen the financial markets, bolster economic activity and minimise speculative transactions against the rupiah. The amendments cover certain key elements including clarifying netting for the purposes of settling a foreign exchange transaction against the rupiah.

## **6. Bank Indonesia clarified foreign currency hedging regulations**

- Bank Indonesia issued a revised Regulation (No.16/21/PBI/2014)(in Bahasa only) and Circular Letter (16/24/DKEM/2014)(in Bahasa only) in January to clarify requirements and address concerns raised in the original rules. The new regulation and circular letter would supersede the previous regulation in their entirety.

From January 1, 2017, the hedging requirements set out in the revised regulation and circular letter must be fulfilled with an Indonesian bank, including Indonesian branches of foreign banks. Bank Indonesia has the ability to specify minimum hedging requirements and thresholds, and has confirmed that the long introduction period is meant to assist Indonesian banks prepare for the anticipated increase in demand for hedging transactions.

The definition of ‘foreign currency asset’ and ‘foreign currency liabilities’ are specified in detail in the circular letter. For example, ‘foreign currency asset’ now includes cash, giro, bank deposits, receivables, inventories, marketable securities and payables under forward, swap and option contracts, counted on the basis of the quarterly balance sheet. There is also a new minimum threshold that means net foreign currency liabilities do not need to be hedged if they are less than \$100,000.

The new rules also provide an exemption from certain hedging requirements for non-bank companies that have (a) export revenues exceeding 50% of their total revenues in the preceding calendar year and (b) have permission from the Ministry of Finance to report financial statements in US dollars.

## **7. Bank Indonesia introduces regulation on obligation to use Rupiah in Indonesia**

- On March 31, 2015, Bank Indonesia issued Regulation No. 17/3/PBI/2015 on the Obligation to use Rupiah in the Territory of Indonesia. This regulation contains certain provisions which require, among others, that the Indonesian rupiah be used to settle certain financial obligations and other payment transactions taking place in the Territory of Indonesia (unless exemptions apply). These requirements would apply to both cash and non-cash transactions. This new regulation appears aimed at supporting the stability of the Indonesian rupiah and is also intended to assist in effectively implementing the provisions in Law No. 7 of 2011 on Currency. Law No. 7 of 2011 had imposed the general requirement to use the Indonesian Rupiah for certain transactions in Indonesia.
- On June 5, 2015, Bank Indonesia issued SE No17/11/DKSP regarding the Obligation to Use Rupiah in the Territory of the Unitary State of the Republic of Indonesia. The regulation contains technical guidance in implementing Bank Indonesia Regulation (PBI) Number 17/3/PBI/2015 concerning the Obligation to Use Rupiah in the Territory of the Unitary State of the Republic of Indonesia (NKRI) which was issued on March 31, 2015. SE No17/11/DKSP governs the Obligation to specify the prices of goods and/or services in rupiah, the Implementation of obligation to use rupiah for strategic infrastructure projects agreed in writing, the implementation of obligation to use Rupiah for non-cash transactions for business actors with certain characteristics, reports related to the use of Rupiah in the territory of Indonesia and sanctions for violators of the obligation to use Rupiah.
- On July 1, 2015, the mandatory use of the Indonesian rupiah came into force in the Territory of Indonesia.

## **8. Bank Indonesia holds CCB at 0%**

- On May 23, 2016, Bank Indonesia issued a press release announcing the decision to hold the countercyclical capital buffer (CCB) unchanged at 0%. The goal of the CCB is to prevent a build-up of systemic risk due to excessive credit growth, while simultaneously absorbing potential bank losses through the application of a buffer. Bank Indonesia performs an assessment of the CCB at least once every six months. The credit-to-GDP gap, as the main CCB indicator, has not shown any signs of excessive credit growth that could prompt systemic risk, the central bank said.

## **9. Bank Indonesia issues regulations on FX transactions**

- On 14 December 2016, Bank Indonesia released two circulars No. 18/34/DPKK (Circular No.34) and No. 18/35/DPKK (Circular No.35). Both Circulars are released in Bahasa Indonesia only. Circular No. 34 deals with foreign exchange transactions entered into between a bank and a domestic party whereas Circular No. 35 deals with foreign exchange transactions entered into between a bank and a foreign party. FAQs on these circulars were released on 22 December 2016.

Paragraph I.6 of Circular 35 provides that the contract used by a market participant to document a derivative transaction must be a derivative contract. An example of such a contract is attached in Schedule A of Circular No. 35. The attached Schedule A contract is the form of derivatives master agreement developed by Bank Indonesia. Circular No. 35 does not make the use of this Schedule A form mandatory and there does not appear to be any clauses which stipulate the mandatory use of Indonesian law in derivative transactions.

Paragraph 2 of Circular 34 provides that a bank is obligated to provide education regarding derivative transactions to its customers. This may be done by way of a seminar, workshop, focus group discussion, and other similar events.

**ISDA Submissions (since 2010)**

- January 17, 2012: [ISDA submission to the Ministry of Finance and Bank Indonesia on Law No. 7 of 2011 \(Currency Law\)](#)
- January 28, 2014: [ISDA submission with regards to the West Jakarta District Court decision in PT Bangun Karya Pratama Lestari v Nine AM Ltd on Law No 24 of 2009 concerning the National Flag and Emblem](#)

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## SOUTH KOREA

### Key Regulatory Milestones

#### 1. Mandatory clearing requirements

- KRX issued in December 2011 the first draft central clearing proposal for public consultation and the second draft in March 2012.
- On March 5, 2013, the Revision Bill of the Financial Investment Services and Capital Markets Act (FSCMA) passed the plenary session of the National Assembly, following approval by the Legislation and Judicial Committee of the National Assembly the previous day. The final steps for this amendment to come into force require only that the government promulgate the Amendment and a grace period be given prior to implementation.

The legislation creates a new business sector, central counterparty clearinghouses (CCPs), to deal with clearing for OTC transactions in financial investment products. While clearinghouse operators would be approved depending upon the types of financial products they deal with, KRX is believed to be the only institution currently considered as a CCP for OTC clearing in Korea. The FSC press release also states that "OTC derivatives whose default could deliver significant impact to the market would be mandatorily cleared through a CCP."

- On May 15, 2013, the FSC issued its draft regulation regarding central clearing of OTC derivatives. The regulation mainly deals with CCP licensing process and CCP's reporting obligation.
- On July 3, 2013, after consulting with market participants, the FSC decided to postpone the enforcement date of mandatory clearing obligations under the amended FSCMA from October 2013 to June 30, 2014.
- On September 11, 2013, KRX received authorization on OTC derivatives clearing business from the FSC. KRX would be the central counterparty for both exchange traded and OTC market products. The mandatory clearing of KRW-denominated interest rate swaps would come into effect on June 30, 2014.
- Effective from March 3, 2014, KRX started to provide a voluntary clearing service of Korea Won (KRW)-denominated interest rate swap (IRS) contracts to meet the G20 mandate on OTC derivatives clearing. KRX has indicated that the service is temporarily offered to 35 members on a voluntary basis until June 30, 2014. Thereafter, all KRW-IRS contracts would be cleared through KRX on a mandatory basis.
- On June 3, 2014, KRX published the amended rules of OTC Derivatives Clearing and Settlement Business Regulation. With these rules, KRX intends to:
  - revise clearing member admission criteria to reflect the capital regulations under Basel III and the Net Capital Ratio (NCR) revised by the FSC;
  - improve clearing efficiency and align with international standards in view of the demands generated from its voluntary clearing service.

Key amendments include:

- Change of the capital ratio criteria for clearing member admission under Article 11 to correspond to the capital ratio criteria pursuant to both Article 3-26(1) of the Financial Investment Business Regulation and Article 34(1) of the Regulation on Supervision of Banking Business;
- Change of hours for requesting and accepting the assumption of obligation under Article 49 and 98;
  - To extend by 30 minutes the hours for requesting and accepting the assumption of obligation from current hours of 9:00 - 15:50 to become 9:00 - 16:20
  - To extend by 20 minutes the hours for requesting the cancellation of assumption of obligation from current hours of 9:00- 16:00 to become 9:00 to 16:20
  - To reduce by 20 minutes the period for requesting the change of contracts of cleared transactions from current hours of 16:00 to 17:00 to become 16:20 to 17:00
- Additional reasons for close-out are added including KRX's default, its suspension of payment, its request for commencement of rehabilitation procedures and its filing of bankruptcy under Article 111 on the Commencement of Close-out Netting Procedures;
- Deletion of Article 123 in relation to the designation of an employee that is responsible for the clearing operation, and an employee that performs the tasks related to the clearing operation;
- Other, less material, amendments were made to Articles 2, 29, 31, 35, 58 and 122.

The revised rules came into effect on June 30, 2014.

- On June 13, 2014, KRX announced the revised provisions of Enforcement Rules of OTC Derivatives Clearing and Settlement Business Regulation.

Key amendments include:

- The period for clearing membership reapplication under Article 4(2) is deleted;
- A new provision is added to Article 7 stating that when there is a change of major stakeholders, the review of clearing membership application would be suspended;
- The criteria for settlement banks and custodian banks under Article 15 and 43 respectively are revised;
- Period of Registration of Assumption of Obligation under Article 27 is shortened from 5 business days currently to 2 business days;
- A new provision is added to Article 32 stating that KRX can claim necessary expenses and remuneration from clearing members in relation to task delegation;
- Requirements for the committee member of Default Management Group under Article 78 are relaxed;
- The bid price is defined under Article 84 and the Article 84(3) which relates to bid abort price is deleted;
- Article 86(1) which relates to the allocation and early termination of a cleared transaction of a default clearing member is deleted;
- A new provision stating that eligible margin securities, foreign currency or foreign currency securities deposited by a clearing member in KRX are subject to close-out netting is added to Article 88;
- Article 88-2 is newly added to define the method of the close-out netting notification;
- Article 93(3) in relation to the Cap Period is deleted;

- Articles 97, 98 and 99, which relate to the designation of an employee that is responsible for the clearing operation and an employee that performs the tasks related to the clearing operation, are deleted;
- The interest rate for the calculation of late payment penalty is stipulated under Article 101;
- Other, less material, amendments were made to Articles 35, 50-54, 56, 60-62, 77 and 85.

The revised rules came into effect on June 30, 2014.

- On June 26, 2014, the CFTC Division of Clearing and Risk (DCR) issued a time-limited no-action letter stating that it would not recommend that the Commission take enforcement action against KRX for failing to register as a derivatives clearing organization (DCO) pursuant to Section 5b(a) of the Commodity Exchange Act (CEA).

The no-action relief is limited to KRX's clearing of the proprietary Korean Won-denominated interest rate swaps trades of US clearing members, and is effective until the earlier of December 31, 2014, or the date upon which the CFTC either registers KRX as a DCO under Section 5b(a) of the CEA or exempts KRX from registration under Section 5b(h) of the CEA. This no-action letter is consistent with earlier no-action letters granting relief with respect to the clearing of proprietary trades of US clearing members.

- Effective from June 30, 2014, KRX started to provide a mandatory clearing service for Korea Won-denominated IRS contracts to meet the G20 mandate on OTC derivatives clearing. KRX's clearing service was previously offered to 35 members on a voluntary basis from March 3. During this period, the accumulated number of cleared transactions was 427 and accumulated notional amount was \$11.5 billion (KRW 11.8 trillion as of June 26, 2014). As of June 27, 24 securities firms and 28 banks (12 domestic banks and 16 foreign banks) have submitted their applications for this mandatory clearing service and only two securities firms among these clearing members are general clearing members able to offer client clearing service. Going forward, all KRW-IRS contracts would be cleared through the KRX-CCP on a mandatory basis.
- On September 30, 2014, FSS announced revised regulations on supervision of banking business to implement the Basel Committee on Banking Supervision's rule on capital requirements for bank exposures to CCPs (BCBS 282).

Key amendments include:

- Introduction of the internal models method (IMM) to calculate counterparty credit risk and credit valuation adjustment, alongside the current method of calculation (Basel II's current exposure method and standardised method).
- Revision of capital requirements for CCP exposures:
  - Qualifying CCP (QCCP): the FSS plans to grant QCCP status to KRX, and stipulates that banks must calculate and distribute data required to calculate capital requirements against CCP default fund contributions.
- Calculation method of risk weight: OTC derivatives transactions cleared through QCCPs would receive a preferential capital treatment. In particular, trade exposures would receive a risk weight of 2%. Foreign bank branches in Korea should calculate counterparty risk based on Basel II standards in the same manner as domestic banks.

Implementation date for domestic banks is September 30, 2014. For foreign banks with their financial year ending on December 31, the implementation would start on October 1, 2014. Otherwise, it would start on November 1, 2014.

- On October 6, 2014, KRX established a default management committee (DMC) in order to enhance the stability and efficiency of CCP clearing services. The DMC consists of a chairman from KRX and six committee members from clearing members of the CCP. These six members include Korea Development Bank, Standard Chartered Bank Korea, Deutsche Bank, BNP Paribas, Daewoo Securities and Samsung Securities, which were appointed based on positions and volumes of OTC derivatives transactions. The DMC would mainly provide advice on hedging and the auction of remaining positions following the default of a clearing member.
- On November 11, 2014, KRX announced standards for the calculation and distribution of data required to compute bank capital requirements for CCP default-fund contributions. These were issued as subsidiary rules of the Enforcement Rules of OTC Derivatives Clearing and Settlement Business Regulation. KRX aims to incorporate this key requirement for a CCP to be considered a qualifying CCP following the amendment of Detailed Regulations on Supervision of Banking Business, which FSS announced on September 30, 2014.

Key points include:

- Based on the last business day of every month, the CCP should calculate capital-requirements factors, such as the hypothetical capital requirement of the CCP, the aggregate capital requirement for all clearing members and the c-factor. These factors should be provided to clearing members through OTC derivatives clearing terminals within seven business days from the base date;
- The CCP should examine the adequacy of capital-requirements factors, recalculate them depending on the results of its analysis, and inform clearing members of them every month;
- The CCP should report details of the calculation/recalculation to the FSS. The regulators of a foreign clearing member may also request this information

The standards became effective from November 12, 2014.

- On November 13, 2014, KRX announced an amendment of the enforcement rules of the OTC Derivatives Clearing and Settlement Business Regulation.

Key issues include:

- KRX would prevent deposit of the cash and foreign-currency contribution to the OTC derivatives joint compensation fund and members' margin in a particular financial institution;
- KRX would let independent and qualified external institutions examine the adequacy of its calculation methods and the management systems of members' margin if necessary. As such, it intends to be accordance with international standards, such as the Principles for Financial Market Infrastructures and relevant rules in EU and US;
- KRX would conduct crisis response training and the Risk Management Committee would be notified of the results.

The amendment were effective from November 17, 2014.

- On February 11, 2015, KRX announced its revised OTC Derivatives Clearing and Settlement Business Regulation.

Key contents include:

- In terms of capital ratio among the admission criteria of a clearing member, the net capital ratio would be applied to investment traders and investment brokers, and the net operating capital ratio would be applied to the remaining financial investment business entities under Article 11(1):
  - o The net capital ratio = (net operating capital – gross risks)/sum of equity capital required to maintain each business unit’s license
  - o The net operating capital ratio = net operating capital/gross risks
- In the event that clearing members transfer the net cash settlement amount from their bank accounts to the settlement bank account of KRX, clearing members shall be prohibited from cancelling under Article 62-2.
- In case of receiving the notification on member assessment from KRX, the clearing member shall deliver the concerned amount in cash by 12:00PM of the next business day under Article 114.
- To compensate quick losses incurred as a result of a clearing member’s non-fulfillment of settlement, KRX shall enforce its pledge provided as collateral from the defaulting member without a legal procedure (the method of execution as provided for in the Civil Execution Act) under Article 123.

The revised Article 11(1) would be implemented on January 1, 2016 and other revisions became effective on February 26, 2015.

- On June 30, 2015, KRX published a brief report analysing the performance of the KRX-CCP over one year. Since the launch of mandatory clearing, the total cleared notional amount and volume have reached KRW 404 trillion (\$354 billion) and 14,674, respectively, as of June 26.

As of June 2015, 55 financial institutions (32 banks and 23 securities companies) had participated in the CCP as clearing members. Forty-four per cent of interest rate swaps trading took place between banks and securities firms, 40% was between banks, and 16% was between securities firms.

KRX also revealed that the scope of OTC derivatives clearing would be expanded to include longer maturities (from 10 years to 20 years). In addition, clearing services for non-deliverable forwards would be promoted to strengthen the transparency of the OTC derivatives market.

- On August 18, 2015, the CFTC published a request for public comment on a petition by KRX for an exemption from registration as a DCO pursuant to section 5b(h) of the Commodity Exchange Act, which permits the CFTC to grant such exemption if it determines that the applicant is subject to comparable, comprehensive supervision by appropriate government authorities in its home country.
- On September 25, 2015, the CFTC announced that the CFTC chairman Timothy Massad signed a memorandum of understanding (MoU) with chairman Yim Jong-Yong of FSC and governor Zhin Woong-Seob of FSS regarding cooperation and the exchange of information in the supervision and oversight of clearing organisations that operate on a cross-border basis in the US and Korea.
- In October 2015, KRX amended its OTC Derivatives Clearing and Settlement Business Regulation and Enforcement Rules in order to expand the range of clearing eligible transactions for the KRW IRS as a part of follow-up measures to the ‘Development Plan of Derivative Products Market’, which was announced by the FSC on June 17, 2014.

The amendment was enforced on November 23, 2015 after the notice period. Therefore, starting on November 23, financial investment companies (domestic financial investment companies or foreign

financial investment companies that have made trades with domestic financial investment companies) must clear KRW IRS trades subject to extended range of clearing eligible transactions through KRX in accordance with the FSCMA.

- On October 26, 2015, the CFTC issued an order of exemption from registration as a DCO to KRX. The CFTC issued this order based on its authority under Section 5b(h) of the Commodity Exchange Act.

This provision permits the CFTC to exempt a clearing organization from DCO registration for the clearing of swaps as long as the CFTC determines that such clearing organization is subject to comparable, comprehensive supervision by appropriate government authorities in the clearing organization's home country. The order permits KRX to clear proprietary interest rate swap positions of US persons that are clearing members of KRX or affiliates of such clearing members.

- On November 13, 2015, the European Commission determined that the Republic of Korea has the equivalent regulatory regimes for central counterparties as the European Union.
- On February 8, 2016, KRX was granted an exemption by the CFTC that will allow some of its members to accept funds from and trade derivatives with US customers without registering as futures commission merchants. The order also permits these designated KRX members to engage in marketing conduct in the US for a period not to exceed 30 days.

KRX has indicated it will soon start administrative procedures for qualified member firms. KRX has also stated it plans for its index options product to become legally accessible to US investors through relief by the Securities Exchange Commission.

- On March 22, 2016, European Securities and Markets Authority (ESMA) established a MoU under EMIR with the South Korean FSC and FSS respectively. The MoU establishes cooperation arrangements, including the exchange of information, regarding CCPs which are established and authorised or recognised in South Korea, and which have applied for EU recognition under EMIR.

The MoU is effective as of 15 March 2016.

- On April 22, 2016, KRX was granted a third-country (non-EU) CCP recognition by the ESMA. This comes after the EC adopted the implementing act determining the legal and supervisory framework of Korea is equivalent to the EU in October 2015, and the March 2016 memorandum of understanding signed between European and Korean authorities.

KRX stated that 10 over-the-counter clearing members and three exchange-traded derivatives clearing members currently fall under the scope of the European regulations. Members will be able to benefit from the lower risk weight applied to the exposure value to qualifying CCPs under European capital rules.

## **2. Basel III & Capital**

- On May 30, 2013, the FSC issued a press release to announce Korea's plan to implement Basel III rules as of December 1.
- On July 31, 2013, the FSC issued a press release announcing the Basel III Implementation for Bank Holding Companies to begin in December. The revision of the banking supervision rules and regulations had been completed in July 2013. Common Equity Tier 1 ("CET1") must be at least 4.5%

of the risk-weighted assets and Tier 1 capital must be at least 6% of risk-weighted assets. Tier 1 and Tier 2 capital must be at least 8%. The new rules would incorporate the new CET1 capital and Tier 1 capital requirement from 2015. The new rule also introduces a capital conservation buffer of 2.5% of risk-weighted assets to be phased-in from Jan 11, 2016.

- On November 25, 2013, the FSC issued a press release announcing the capital regulations under Basel III, which would be phased in for domestic banks from December 1, 2013. The Tier 1 Capital Ratio would increase from 4.5% to 6% from December 2013 to December 2015. CET1 would increase from 3.5% to 4.5% from December 2013 to December 2015. 90% of non-qualifying instruments as contingent capital already issued would be recognised as regulatory capital under Basel III from December 1, 2013. This percentage would be gradually reduced by 10% per year. Capital Conservation Buffer would start from 0.625% in January 2016 and gradually increased to 2.5% in December 2019. The total Capital Ratio and the Capital Conservation Buffer would be 10%.

The FSC planned to introduce the Liquidity Coverage Ratio (LCR) in 2015 and the Countercyclical Capital Buffer in 2016. Domestic systemically important banks (D-SIFIs) would be required to hold capital surcharges from 2016.

- On August 26, 2014, the FSC announced its plan to introduce the liquidity coverage ratio under Basel III to banks operating in the country. Key points include:
  - Domestic banks are required to meet the minimum ratio of 100%, starting from January 2015.
  - For domestic branches of foreign banks, the minimum ratio starts at 20% in 2015, and would gradually increase by 10 percentage points a year to reach 60% in 2019.
  - For specialised banks or policy banks, the minimum ratio begins at 60% in 2015, and would rise by 10 percentage points a year to reach 100% in 2019.

Institutions have until October 6, 2014, to prepare for implementation of the revisions to the regulation on the supervision of banking business. Revisions to the regulation would take effect following approval by Korea's Regulatory Reform Committee and the FSC.

- On December 24, 2014, the FSC approved revisions to the Regulation on Supervision of Banking Business, which includes the introduction of the LCR. The minimum ratio for commercial banks would begin at 80%, which is higher than the Basel III requirement of 60%, given the current liquidity ratio of domestic banks. The ratio would be raised by 5 percentage points per year over the next four years to meet 100% in 2019. The LCR rules became effective on January 1, 2015.
- On June 5, 2015, the FSS announced that regulatory measures are set to be taken for full implementation of Basel Pillars II and III in 2016. Under the proposals for Pillar II, the current dual system of CAMEL-R and RADARS used for supervisory assessment and rating is to be integrated into CAMEL-R, and the risk items under each of the CAMEL-R components are to be aggregated and rated on a scale of one to five for use as a Pillar II rating. Supervisory action, including a capital surcharge for unsatisfactory Pillar II ratings, is expected. The application of the Pillar II rating is set to cover 18 banks and eight bank holding companies (BHC).

For Pillar III implementation, the FSS noted that the key elements of Pillar III standards have already been incorporated into the Common Banking Disclosure Standards (CBDS) that are set by the Korea Federation of Banks.

The FSS would revise the CBDS in order to ensure the inclusion of disclosures that currently fall short of the Basel requirements, particularly disclosures with respect to credit risk, securitisation and credit risk mitigation.

- On June 4, 2015, FSS announced its plan to implement domestic systematically important banks (D-SIBs) regulation for the domestic banking community, starting January 2016. FSS would require D-SIBs to increase loss absorbency by a quarter of 1% every year over the four-year period, from 2016 to 2019.

To identify D-SIBs, the FSS would assess five banks, eight BHCs and 21 foreign bank branches for their degree of systemic importance, except the Export-Import Bank of Korea, which does not take deposits, and small foreign branches with less than KRW5 trillion in assets.

The assessment would be based on available year-end data. According to the implementation schedule, the first group of D-SIBs would be identified and announced later this year.

The methodology would involve: i) scoring a bank or BHC for its degree of systemic importance based on weighted averages for each of five assessment categories, including size, interconnectedness, substitutability, complexity and country-specific factors; and ii) identifying those that score above a cut-off point as a D-SIB. This methodology would be reviewed every three years to capture developments in the banking sector.

- On December 16, 2015, the FSC approved amendments to the regulation on supervision of banking business and the supervisory regulation on financial holding companies. The amendments are intended to implement the Basel Committee recommendations such as D-SIBs and a countercyclical capital buffer and ease capital requirements for Internet-only banks in their early years. Key amendments include:
  - The FSC should select D-SIBs considering their systemic importance to the financial system. Those identified as D-SIBs are to be required to set aside an additional capital of 1% if deemed necessary, by 0.25% per year in the next four years from 2016 to 2019;
  - Considering domestic economic conditions, the FSC should decide on a quarterly basis whether to impose a countercyclical capital buffer and, if so, it will be imposed based on levels of such capital requirements (ranged from 0% to 2.5%);
  - The FSC may require banks falling behind the evaluation of risk management by the FSS to hold an additional capital under the Basel II; and
  - Internet-only banks are to be subject to the Basel I rules by 2019, while the Basel III rules are to be phase in for them from 2020 to full implementation in January 1, 2023. The LCR applied to Internet-only banks are to be raised by 10 percent points ever year from 70% for 2016 to 100% for 2019.

Additional capital requirements for D-SIBs and for a countercyclical capital buffer will be effective from January 1, 2016 and capital rules for Internet-only banks will be effective immediately.

- On March 30, 2016, the FSC set the counter-cyclical capital buffer to 0% for banks and bank holding companies, effective March 31. Korea joins 19 other countries that have set the buffer at 0%. The FSC states that it will review whether to impose a counter-cyclical buffer on a quarterly basis.
- On July 19, 2016, the FSC announced draft amendments to the Financial Holding Companies Act to provide legal grounds for bank holding companies to issue contingent convertible capital securities (CoCos) in line with the Basel III framework. Currently bank holding companies can only issue

CoCos based on Article 165-11 of the FSCMA. This created a number of issues because the FSCMA is only applicable to listed companies and the FSCMA does not provide for issuance of perpetual bonds, which the Basel III framework requires.

The draft amendments were open for public comments until August 29 and planned to be submitted to the National Assembly in October 2016.

### **3. Margin requirements for non-centrally cleared derivatives**

- On December 14, 2016, the FSS published the draft guidelines on margin requirements for non-centrally cleared derivatives. It includes requirements for initial and variation margin to be exchanged between banks, financial investment companies, insurance companies, asset managers and collective investment businesses (including off-shore collective investment businesses transacting on-shore) for all non-centrally cleared over-the-counter (OTC) derivatives transactions, excluding physically settled FX forwards/swaps and the principal exchange portion of currency swaps.

Initial margin shall be phased-in starting from September 2017 for institutions with aggregate month-end average notional amount (AANA) over three quadrillion KRW and variation margin shall be phased-in from March 2017 for institutions with AANA over 10 trillion KRW. Variation margin requirements shall apply to all entities from September 2017. There shall be a three month transitional relief for each variation margin phase-in.

Comments on the consultation were due by January 2, 2017.

### **4. Implementation of trade reporting**

- On August 17, 2015, the FSC announced that KRX had been designated as a trade repository. For this designation, a task-force was set up comprising FSC, FSS and experts from the industry in the second half of 2014, in order to study global standards and current trends of TRs, operational cases of overseas TRs and TR requirements. Based on this study, FSC subsequently formed a committee for the designation of TRs, and established specific standards for TR designation in July.

FSC expects the TR to centrally collect and efficiently manage large amounts of data and information regarding over-the-counter derivatives trades, improving derivatives market monitoring and transparency. Specific action plans, including details on the transaction information that would be centrally collected and the development of an IT system, would be set out by KRX.

- On April 7, 2016, KRX signed a MoU with the Depository Trust and Clearing Corporation (DTCC) to facilitate cooperation in developing its trade repository (TR) services. KRX stated that it expects to develop an implementation plan fitting the global standards through this cooperation with DTCC.

KRX stated that the purposes of this MoU are to:

- Devise a reporting scheme suitable to local and foreign market participants;
- Enhance global cooperation through standardization of required data;
- Support advisory and education in the implementation of TRs.

KRX indicated that the FSC is currently reviewing the draft amendments to the Financial Investment Services and Capital Markets Act to implement trade reporting in Korea. KRX announced that it expects to commence TR services in the second half of next year, after testing.

## 5. FSC regulations

- On January 15, 2014, the FSC together with the FSS, KRX and KOFIA announced a plan to improve the security of derivatives transactions. The introduction of a “shutdown switch” and price banding limits is intended to prevent the recurrence of large scale losses from erroneous orders, and to mitigate settlement risk and violent price fluctuations of derivatives. The FSC would implement the measures before the end of the first half of 2014 by amending the related rules and improving systems.

Key highlights of the plan included:

- The FSC would encourage securities firms to strengthen the standard of their internal control systems related to excessive orders, and supervision thereof by FSS and KRX would be enhanced;
  - Currently, KRX runs the price limits and circuit breakers (CBs) as safety mechanisms, which are inadequate for controlling excessive price fluctuations. In the future, KRX would allow all securities firms to trade derivatives within a certain price range of the latest trade price during market hours, depending on the type of derivatives. Similar systems are now in force in the US (CME), Germany (Eurex) and Japan (OSE);
  - At present, under an agreement by counterparties, a derivatives price could only be corrected. Going forward, if necessary, erroneous transactions can be canceled by KRX’s authority in order to maintain stability in settlement;
  - All securities firms dealing derivatives would be required to upgrade their trading platforms so as to minimize algorithmic errors and enhance their risk management and internal control systems against possible mistakes.
- On April 8, 2014, the FSC announced its plan to amend the net capital ratio (NCR) rules for securities companies as part of its effort to revitalize the country’s capital markets. Key changes include a modification to the NCR formula:
    - Current  $NCR(\%) = (\text{net operating capital} / \text{gross risks}) * 100$
    - Revised  $NCR(\%) = [(\text{net operating capital} - \text{gross risks}) / \text{sum of equity capital required to maintain each business unit's license}] * 100$

Until the end of 2015 securities firms can use either the current or revised NCR formula. From 2016 onwards, all securities should apply the revised NCR formula.

The FSC would also introduce consolidated computations of NCR for all securities firms with subsidiaries under the K-IFRS in 2016. Prior to the full implementation, the consolidated NCR rule would be applied to large securities companies in 2015 as a pilot scheme. In addition, securities companies’ corporate loans would be reflected into credit risks, instead of being subtracted from net operating capital. This adjustment would be implemented as soon as relevant regulations were revised in the third quarter of 2014.

- On April 29, 2014, the FSC announced its plan to establish rules for the implementation of FATCA. This followed the signing of the intergovernmental agreement on March 17 between the Ministry of Strategy and Finance and the United States, which aimed at improving the international tax compliance and implementing FATCA.

The FSC would set out further details of the agreement such as the confirmation procedure and the relevant form of clients' account information in order to help financial institutions and their clients in reporting.

- On June 17, 2014, the FSC announced its roadmap for further development of Korea's derivatives market.

For the Exchange-Traded Derivatives Markets:

- Greater autonomy in market operation with the condition that stable operation of the markets and investor protection would not be undermined;
- Introduction of new derivatives markets in high demand such as V-KOSPI 200 futures, sector index futures and night time trading of US dollar futures, which would provide professional investors with risk hedging instruments;
- Introduction of qualified retail investors with two entry barriers to prevent retail investors from reckless investments and huge losses;
- Expanding the participation of professional investors by allowing banks to directly trade treasury bond and currency derivatives on KRX;
- Enhancing settlement stability by giving KRX greater authority to monitor and supervise default risks of security firms, and by considering the revision of the default waterfall in accordance with the PFMI;
- Enhancing transaction stability by introducing price banding limits on futures and options trading to mitigate excessive price fluctuation, and allowing KRX to take remedies for huge losses incurred by erroneous transactions;
- Strengthening the regulations and tightening the monitoring of high-frequency trading to prevent market manipulation and unfair trading.

For the OTC Derivatives Market:

- The scope of derivatives contracts subject to the CCP clearing would be gradually expanded from IRS to NDF to CDS and other derivatives.
- Trade Repository (TR) would be introduced in accordance to the G20 after considering domestic conditions and international standards.

For the Derivatives-Linked Securities (DLS) Market:

- Exchange-trade note (ETN) would be introduced to be listed and traded on KRX.
  - Issuance structure of equity-linked securities (ELS) would be diversified.
  - Public disclosure and sales method of ELS and DLS would be improved to make it easier for investors to compare and choose products.
  - Issuance terms of equity linked warrant (ELW) would be standardized.
- On June 18, 2014, the FSC approved the Implementation Rules for Korea-U.S. Tax Information Exchange of Agreement, which would be effective from July 1, 2014.

Key rules include:

- Financial institutions which include depository institutions, custodial institutions, investment entities and insurers and, financial accounts which include depository account, custodial account, fund account, insurance contract and annuity contract, are subject to FATCA reporting obligation;

- Implementation: A financial institution is required to identify U.S.-related financial accounts through reviewing the electronic records of financial accounts; If a financial account is identified as U.S.-related, the financial institution is required to report the NTS information about the financial account including account holder's name, account number, account balance, and interest payments.
- On July 10, 2014, the FSC announced its plan for financial regulatory reform to create new opportunities and growth drivers for Korea's financial industry and economy.

Key points with regards to new business opportunities for the financial industry included:

- If a financial company is granted a business license for financial investment business, the company would be allowed to add a new business within the licensed category with registration only;
- For banks, the FSC would allow sales of OTC derivatives of currency, interest rate, commodity and credit as part of efforts to integrate different sectors of the financial industry to boost efficiency;
- Domestic financial companies would be permitted to operate overseas businesses which are not allowed under the Korean law in a foreign country as long as such businesses are permitted under the country's law;
- Non-banking financial institutions such as insurers and brokerage firms would be allowed to own overseas banks.
- On July 15, 2014, the FSC announced its plan to ease regulations on license system for financial investment business, which includes integrating business units for license, currently overly subdivided, and simplifying license process. A draft bill to revise relevant laws and supervision regulations would be submitted to the National Assembly by the end of this year. Measures that can be taken without law revision would be implemented in September.
- On September 4, 2014, the FSC announced its plan to revise the regulations on financial investment business, and the issuance and public disclosure, etc. of securities, in order to support its roadmap for the development of Korea's derivatives market (announced on June 17) and financial regulatory reform (announced on July 10).

On derivatives, the FSC stated that financial investment business entities would have to establish internal control standards that limit maximum losses by derivatives proprietary trading to 50 percent of net working capital to avoid risk by excessive derivatives proprietary trading.

Institutions had until October 14 to prepare for implementation of the revisions, which would take effect following approval by Korea's Regulatory Reform Committee and the FSC.

- On September 25, 2014, the FSC set out its plan to improve prudential regulations for the asset management industry. The plan includes the abolishment of the NCR rules and management evaluation, and reform of the prompt corrective action scheme.

The plan includes:

- A plan to replace the NCR rules with a minimum capital requirement. Asset management companies would be required to hold equity capital that exceeds the minimum capital requirement, which is the sum of the regulatory capital requirement, the capital requirement for client asset management and the capital requirement for proprietary investments.
- The current management evaluation system would be abolished for the asset management industry. Instead, operational risk evaluation would be introduced to evaluate asset management companies' internal controls and risk management.

A public hearing session would be held in October to discuss the details. A preliminary announcement on the revision to the related acts would be made in November. The plan would come into force in April 2015.

- On November 26, 2014, the FSC announced its plan to revitalise South Korea's stock market. On derivatives, the FSC would allow the listing of new derivatives products such as mini futures and RMB futures in one to two years. The listing of V-index options or ETF futures would be also considered, depending on the commodity market situation.
- On March 20, 2015, FSC released business guidelines for financial market infrastructures (FMIs), which adopt the principles for financial market infrastructures (PFMIs), published by the Committee on Payment and Settlement Systems and International Organization of Securities Commissions in 2012. The guidelines have immediate effect.

The guidelines reorganize provisions related to financial market infrastructures, which were scattered through the FSCMA. The 24 key principles of the PFMIs are reorganized into 14 principles in accordance with domestic circumstances, and provide detailed standards for implementation.

FMIs need to self-evaluate on a regular basis whether their internal rules and business operations are in compliance with international standards and disclose the results of self-evaluation. The FSS would adopt the guidelines as supervisory principles in its supervision on FMIs. The guidelines would serve as guiding principles for new FMI entrants when devising internal rules.

- On April 23, 2015, the FSC announced its policy direction for capital market reform, which contains several measures to enhance the country's derivatives market. The measures include:
  - Mini KOSPI 200 futures and options: Trading units for KOSPI 200 derivatives products would be downsized and the trading units of Mini products would be cut to one-fifth of the level of KOSPI 200 futures and options. For example, if KOSPI 200 futures are KRW130 million per unit, then Mini KOSPI 200 futures would be KRW26 million per unit. If KOSPI 200 options are KRW30 million, then Mini options would be KRW6 million.
  - KOSDAQ individual equity futures: New futures products would be developed with individual stocks listed on KOSDAQ as the underlying.
  - Dividend index futures: New futures products would be developed and introduced with a dividend index as the underlying in response to a growing demand for dividend investments.
  - RMB currency futures: Chinese renminbi (RMB) futures would be introduced.

A tentative listing schedule for the above products is: July for Mini KOSPI 200 products and KOSDAQ futures; August for dividend index futures; and September for RMB futures.

- On June 9, 2015, the FSC announced a 20-day notice period (June 10 – July 1) for the revision of the regulation on financial institutions' outsourcing of data processing and IT facilities, with the aim of complying with global standards. Korea established the regulation in June 2013 to allow for the outsourcing of data processing.

Key contents include:

- Streamline regulatory system: the requirement for approval in regards to IT facilities outsourcing would be abolished. Under the revised regulation, financial firms would be required to report the outsourcing of their data processing business to the FSS.

- 'Ex post' reporting of data outsourcing: financial institutions would be allowed to outsource their data processing business with the principle of 'ex post customers' financial transaction information. This information would be required to be reported to the FSS prior to the outsourcing of data processing.
  - Abolish restrictions on offshore outsourcing: the provision that restricts offshore outsourcing to a financial firm's head office, branch and affiliates would be eliminated to allow outsourcing to a third party, including a professional IT company.
  - Abolish the obligatory use of standard contract form: the obligatory use of a standard contract form would be abolished to allow financial institutions to reflect sector-specific conditions as long as the contract form includes basic requirements such as obligations to receive the regulator's supervision and inspection or responsibility for a customer's loss.
- On July 2, 2015, the FSC outlined its plan to strengthen the competitiveness of Korea's exchange market and boost capital markets. Key elements include:
    - The structure of KRX would be converted into a holding company, and KOSPI, KOSDAQ and derivatives markets would be spun off;
    - The spun-off KOSDAQ would compete with KOSPI by attracting listings of innovative companies and introducing new products and services;
    - KRX holding company (tentatively named 'KRX Holding Company') would pursue an IPO;
    - Relevant regulations would be eased to facilitate the establishment of an alternative trading system.

The revision to the FSCMA to convert KRX into a holding company would be discussed at the National Assembly's regular session in the second half of 2015.

- On October 30, 2015, the FSC announced the basic direction for improving recovery and resolution regimes. Key issues include:
  - A recovery plan will be drafted by each systemically important financial institution. This will be assessed by the FSS and reported to the FSC. A resolution plan will be drafted by the Korea Deposit Insurance Corporation and assessed by the FSC. The aim is to minimise the negative impact on the financial system from the failure of a troubled financial institution.
  - The FSC plans to provide a legal basis for ordering insolvent financial institution to convert debt to equity and/or write off debt when deemed necessary.
  - The FSC will have the power to impose temporary stays on the termination of derivatives, repos and other contracts.

Relevant laws was planned to be amended in 2016.

- On January 20, 2016, the FSC posted proposed amendments to the Enforcement Decree on Financial Investment Business and Capital Markets Act, Regulations on Financial Investment Business, Regulations on Issuance, Public Disclosure, etc of Securities.

These amendments cover a variety of policy areas, including boosting the financial investment and exchange-traded fund (ETF) markets and improving corporate disclosure. These policy directions follow those indicated in the first and second round of reports to the president and the findings by the Financial Reform Committee. Major changes include:

- Strengthening the function of comprehensive investment business entities;
- Expanding the definition of 'professional investors' and encouraging the private capital market;

- Easing the restriction on information exchange between business lines;
- Encouraging the ETF market;
- Amending credit extension regulations;
- Strengthening internal controls on ELS, ELB, DLS, etc;
- Allowing uncollateralized lending of securities for the purposes of posting collateral;
- Amending corporate disclosure requirements.

The notice for amendment was open for comments for 40 days, until February 29, 2016. The final amendments are planned for end-March or beginning of April 2016.

- On February 1, 2016, the FSC announced its plan to introduce an 'omnibus account' in an effort to make it easier for foreign investors to trade locally-listed stocks in the Korean stock market. The new system is intended to reduce transaction costs for global asset management companies and make foreign investors' trading of locally-listed stocks through global securities firms more convenient.

The omnibus account will be a single account established by a global asset management company or securities company for the purpose of consolidating trading orders and settlements from multiple clients. The account is held under the name of the global asset management company or securities company. A qualified global asset management company and securities company will have to register with the FSS in order to process trading orders and settlements on behalf of the end clients, and securities companies or custodian banks are required to report to the FSS (T+2) the details of end clients' investments that they received from the account holder.

It is expected that the Regulations on Financial Investment Business will be amended and the electronic system of Foreign Investment Management System will be reformed by April 2016 for the introduction of the omnibus account system. The omnibus account will be fully introduced in 2017 following a test operation starting in May 2016.

- On March 15, 2016, the FSC published the draft enforcement decree and subsequent FSC regulation to the Corporate Restructuring Promotion Act (CRPA). After passing the National Assembly on March 3, the CRPA was promulgated on March 18. The draft rules clarify the corporations exempt from the CRPA (financial institutions prescribed in Article 61(2) of the enforcement decree of the Corporate Tax Act, small corporations with less than 3 billion KRW credit offered, etc), the definition of 'credit offering', and the process of designating the principal creditor bank. The draft rules were open for comments until March 25. The FSC has indicated it plans to enact the rules in April.
- On June 16, 2016, the FSC announced that it will introduce a heightened foreign currency liquidity coverage ratio (LCR) rule in 2017, which will require commercial banks to hold 60% of their foreign exchange debt in high-quality liquid assets to withstand a 30-day period of market stress. Banks will be required to calculate their foreign currency LCR each business day and maintain the ratio at a monthly average above the minimum requirement.

The foreign currency LCR for commercial banks will be increased to 70% in 2018 and 80% in 2019. A foreign currency LCR of 40% in 2017, 60% in 2018 and 80% in 2019 will be applied to certain specialised banks. Korea Development Bank, in recognition of its special role as a state lender, will be subject to 40% foreign currency LCR in 2017, 50% in 2018, and 60% in 2019.

- On November 11, 2016, the FSC outlined its plans to improve its short-selling rules to strengthen investor protection. Under the plan:

- Short sellers shorting during a period of a paid-in capital increase will be barred from buying the newly-issued stocks;
- Sanctions against violation of short-selling rules will be strengthened; and
- The deadlines for reporting and disclosing short positions in large amounts or by shares will be shortened from the current T+3 days to T+2 days.

Relevant regulations will be implemented in the fourth quarter of 2016, and an amendment to the Financial Investment Services and Capital Markets Act will be submitted to the National Assembly in the first quarter of 2017.

KRX will designate 'overheated short-selling stocks' at the close for stocks showing extraordinary increases in short selling and sharp falls in prices during trading hours to prohibit short selling for those stocks on the following day. The new rule will be implemented in early 2017, after the revision of relevant regulations by KRX.

- On November 22, 2016, the FSC announced a set of measures to improve the Korean derivatives market:

Exchange-traded derivatives:

- Simplify derivatives listing procedures and diversify the types of listed derivatives (Q4 2016); and,
- Introduce flexible requirements for retail investors, and 'omnibus account' for exchange-traded derivatives for foreign investors (Q2 2017)

OTC derivatives:

- Introduce additional clearing eligible products, such as US dollar interest rate swaps (Q4 2016), non-deliverable forwards (2017), interest rate swaps in other currencies and credit default swaps (2018);
- Implement guidelines on margin requirements for non-centrally cleared derivatives (Q1 2017); and,
- Consider introduction of electronic trading platforms (Q3 2017).

Derivatives-linked securities:

- Require stress tests for equity-linked security (ELS) and derivatives-linked security markets (Q3 2017), and segregation of ELS-related assets from proprietary assets (Q1 2017);
- Introduce tougher 'know-your-product' rules (Q4 2016) and a 'cooling-off period' for investors (Q1 2017); and,
- Promote alternative derivatives-linked products such as exchange-traded notes (Q1 2017) and derivatives investment funds (Q4 2016).

- On November 30, 2016, the FSC announced that it has approved amendments to the Regulations on Supervision of Banking Business adopting a foreign currency LCR. This follows a policy announcement made on June 16, and requires commercial banks to hold 60% of their foreign exchange debt in high-quality liquid assets (HQLA) to withstand a 30-day net cash outflow in systemic risks starting from 2017. This level will be increased gradually to 70% in 2018 and 80% in 2019. This regulation is not applicable to commercial banks with foreign exchange debt of less than \$500 million and 5% of their total debt, and branches of foreign banks operating in Korea.

However, to streamline foreign currency regulations, it removes monitoring of certain foreign currency ratios in all entities, such as the liquidity ratio for less than a seven-day maturity mismatch between

assets and liabilities in foreign currency, and the ratio of 'riskless assets' denominated in foreign currency.

The amended rules are effective from January 1, 2017.

- On December 16, 2016, the FSC released draft amendments to the Regulations on Financial Investment Business to allow securities lending and borrowing for collateral purposes, and the re-use of such collateral. The draft amendments include the following requirements:
  - Securities lending must be for the purposes for posting collateral for transactions under a Master Agreement;
  - Eligible securities: Korean Treasury Bonds and Monetary Stabilization Bonds;
  - Re-use is permitted only for the purpose of repurchase agreements or for posting collateral or margin;
  - Counterparty must consent to the re-use of collateral upon entry into the relevant collateral agreement;
  - Re-use of collateral must be notified to the collateral provider;
  - Collateral must be returned to the provider except for an occurrence of event of default under the Master Agreement; and
  - If the Master Agreement is for OTC derivatives transactions, securities lending for the purposes of posting initial margin is prohibited.

Comment period on the draft runs until January 25, 2017.

## 6. FSS regulations

- On June 17, 2013, the FSS issued the Best Practices for Managing Settlement Risk in Foreign Exchange Transactions.

Key recommendations included:

- A comprehensive internal risk management framework that ensures all FX settlement-related risks are properly identified, measured, monitored and controlled;
- A bank should maximize the use of PVP to eliminate principal risk when settling FX transactions, where practicable;
- In non-PVP settlements, a bank should set exposure limits for FX trading and settlement on a counterparty basis. A bank should use legally enforceable netting agreements and legally enforceable collateral arrangements;
- A bank should conduct stress tests on a regular basis and develop contingency plans to address possible liquidity shortfalls due to a counterparty's failure to settle. A bank should maximize the use of STP to control operational risks and ensure that netting and collateral agreements are legally enforceable for each aspect of its activities in all relevant jurisdictions;
- A bank should consider including principal risk and replacement cost risk among all FX settlement-related risk. A bank should ensure it has sufficient capital held against these potential exposures, as appropriate.

The best practices were implemented on October 1, 2013.

- On August 18, 2014, FSS set forth a comprehensive plan to prepare for the Regulatory Consistency Assessment Programme (RCAP) of the Basel Committee on Banking Supervision (BCBS). In this plan, the FSS stated that they would complete a self-assessment and preparation of relevant documents in English until the first half of 2015. The FSS had been running a task force team which consists of staff from relevant departments in the FSS in order to get ready for RCAP.
- On September 1, 2014, the FSS announced its measures to ensure effective compliance at financial companies. The FSS stated that compliance should be considered a profit centre with a high level of confidence, not a cost centre, and compliance would be included in the performance measurement of the financial company.

Key contents of the measures include:

- The chief compliance officer would be given the appropriate standing, authority and independence within the organisation;
  - the bank's senior management and internal auditor would take more responsibility for the effective compliance function;
  - compliance would be connected to performance measurement of the financial company;
  - the government would step up infrastructure for preventing financial incidents;
  - efforts to reduce the cost of compliance would be stepped up.
  - Measures requiring amendments to the current laws and regulations to incorporate changes would be implemented this year, while changes that can be made through amendments to best practices for the compliance function would come first.
- On December 15, 2014, the FSS announced its revised risk management standards on FX derivatives transactions. The FSS inspected the compliance of domestic banks and foreign bank branches with the risk management standards on FX derivatives transactions that were established in January 2010 to restrict over-hedging and encourage sound FX risk management practices. The findings of the inspection pointed to the need to further fine-tune and reinforce the standards, including the calculation methods used to determine the maximum transaction amount permitted for an FX derivatives transaction.

The revised standards would take effect on January 1, 2015 following an inter-agency review and assessment of the proposed enhancements to the standards by Regulatory Reform Committee.

- On December 29, 2014, the FSS announced a complete revision of the manual for licensing requirements and procedures for financial investment services business, which was first published in March 2009. The revised manual provides detailed licensing criteria for regulatory approval, and FSS believes it would contribute to the transparency of the licensing procedure. Specifically, the new manual provides explanations on requirements to be satisfied by an applicant for a business licence, such as a sound business plan, the availability of business assets including human resources and physical facilities, and arrangements for the prevention of conflicts of interest. It also provides various application forms that must be filed as part of the licensing process
- On June 24, 2015, the FSS announced it has developed best practices for the management of country risk to strengthen the management of external risks by domestic banks and financial holding companies, and to bring domestic supervisory rules in line with global standards.

The best practices reflect Principle 21 (Country and Transfer Risks) of the Core Principles for Effective Banking Supervision established by the BCBS, and present detailed guidelines to enable financial companies to file comprehensive reports on their risk exposure and profile.

The best practices apply to 18 domestic banks and eight bank holding companies, except for local branches of foreign banks. The key recommendations involve detailed guidelines for analysing country risk, assigning credit ratings and setting exposure limits.

Financial company risk management units, such as the board of directors and risk management committee, should permit and review exposure limits on a regular basis. Financial companies should assign credit ratings to each country on the basis of risk analysis, and use the ratings to set exposure limits. They should also monitor their compliance with country-specific exposure limits, conduct stress tests and have relevant internal control and audit procedures in place.

The best practices are set to be implemented on October 1, 2015, to allow financial companies time to establish internal standards and relevant IT systems. The FSS is scheduled to monitor how the best practices are being reflected in companies' risk management during the fourth quarter of the year.

- On September 16, 2015, the FSS published new guidelines on bank internal control and compliance functions. The FSC and the FSS will implement the new guidelines on September 17, 2015 to ensure the effectiveness of internal controls in the banking sector. This is a follow-up to the “measures to ensure effective compliance at financial companies” that the FSS introduced in August 2014 to restore public confidence in the financial sector in the wake of a series of financial incidents.

## **7. MOSF, National Assembly, and other government offices**

- On November 11, 2013, the MOSF issued a press release announcing the easing of regulations by the Korean government in regard to foreign exchange transactions. The revised regulations would expand the scope of FX transaction-related businesses by non-bank financial institutions and promote the use of the won in foreign exchange related settlements.

The revised regulations would take effect in 2014 and include:

- Foreign exchange transactions between securities brokerages would be allowed;
  - Investment banks would be allowed to lend securities denominated in a foreign currency by notifying the Bank of Korea following the transaction, instead of reporting it beforehand;
  - Trust companies would be allowed to deal with derivatives and credit derivatives. However, credit derivatives which have high capital movement risks should be reported to the Bank of Korea before transactions;
  - Borrowing the won from the Korea-China swap currency line would be made easier with the fund to be made available by opening won accounts in Chinese branches of Korean banks instead of having won accounts in Korea;
  - Accessing won deposits in foreign banks would be made easier with transactions through domestic banks' accounts to be allowed.
- On February 17, 2014, the Tax Reform Subcommittee, under the umbrella of the Strategy and Finance Committee, announced that the ruling and the opposition parties agreed to levy a capital gains tax on derivatives. Though there would be further discussions, the plan to include a 10 percent capital gains tax rate on derivatives with an exemption for the first Won 2.5 million of annual capital gains is most

likely. This plan would be ratified in a provisional session of the National Assembly in April after simulations for its alignment with the policy direction, effects on tax revenue and impacts on Korean economy and stock market.

- In response, KRX's CEO and Chairman Choi Kyoung Soo recommended delaying the derivatives tax until after the market recovers. Given the stagnant Korean derivatives market, it would be best not to impose tax on derivatives. However, if it is unavoidable for tax fairness, such taxation should be delayed until 2016 or 2017 when the stock market may bounce back.
  - FSC would be preparing their opinions on this plan after analyzing the background of this consensus and gleaning market participant views. FSC would also announce a plan to revitalize the Korean derivatives market in March and it is unknown how FSC would be dealing with this capital gains tax in their plan.
- On April 8, 2014, the Enforcement Decree of the Covered Bond Act was approved by the Korea cabinet and would come into force starting from April 15, 2014.

Key contents include:

- Eligible Issuers: financial institutions are required to meet both institutional and eligibility requirements to issue covered bonds and institutions are designated by Enforcement Decree;
  - Cover Pool: the minimum ratio of collateralization is 105%. Underlying assets in a cover pool need to be evaluated by market prices if there are credible market prices as a reference price. In the absence of market prices, the assets can be evaluated by book value or acquisition prices;
  - Issuance Cap: covered bond issuance is limited to 4% of the issuer's total assets.
- On August 12, 2014, the MOSF announced 'Measures to Stimulate Investment: Fostering Promising Service Industries,' at the 6th Trade Investment Promotion Meeting chaired by President Park.

To promote the listing of enterprises with strong growth potential, the government plans to double the daily price movement limit on stocks listed from between  $\pm 15$  percent to  $\pm 30$  percent. In responding to excessive price fluctuations, such transactions would be stopped for a certain period of time in order to maintain price stability.

- On December 2, 2014, an amendment to the Income Tax Law, which would impose a capital gains tax on profits from certain derivatives transactions, was passed in the plenary session of the National Assembly of the Republic of Korea.

Key points include:

- Basic tax rate: 20% (+/- 10% is flexible);
- An exemption for the first Won 2.5 million of annual capital gains;
- Gains from the transfer of derivatives products are not to be aggregated with other capital gains but computed separately;
- The scope of derivatives products subject to capital gains tax would be stipulated under Presidential Decree.

The amendment was effective from January 1, 2016.

## 8. KRX developments

- On June 3, 2014, KRX announced the revised rules of Derivatives Market Business Regulation. KRX intends to:
  - improve the stability of derivatives transactions by preventing huge losses to investors and excessive price fluctuations through the implementation of real-time quotation price limit as well as improving the methodology for error trade adjustments;
  - improve the stability of settlement by stipulating that once KRX issues payment instructions, trades can no longer be amended.

Key amendments include:

- Implementation of real-time quotation price limit under Article 70-2(new), 74, and 82-8
  - o the real-time upper limit price is equal to the most recent execution price plus a specified range of change in price, or the real-time lower limit price is equal to the most recent execution price minus a specified range of change in price
  - o Where deemed executions prices deviate from the band of the real-time limit prices while connecting to trading system, the real-time upper limit price(bid) and the real-time lower limit price(ask) shall be converted into the limit quotation.
- Improvement of the method for adjusting trading errors
  - o Introduction of Ex-officio Adjustment of Erroneous Transactions under Article 81-2
  - o Introduction of cancellation of transaction by KRX under Article 81-3(new)
  - o Adjustment of settlement amount by Ex-officio Adjustment of Erroneous Transactions under Article 103 and 149
- Stipulating the completion time of settlement in the Derivatives Market under Article 104-2
- Other, less material, amendments were made to Articles 2(1)4, 2(1)5, 60 and 104-3

The revised rules were effective from June 13, 2014.

- On September 1, 2014, KRX introduced real-time price-band and modified error-trade policies for settlement stability of the derivatives market. The real-time price band was introduced to prevent market fluctuations resulting from sudden price changes during trading sessions caused by error trades of investors or members. In addition, KRX would introduce improved policies on error trades to minimize the negative impact of large-scale error trades.

Key contents of the plan:

- Real-time price band: when a quotation that deviates from the upper or lower limit of the real-time price band is received, the quotation would be rejected.
  - Improved policies on error trades: when a loss exceeding a certain amount occurs due to consecutive erroneous orders despite the real-time price band, KRX would amend the matched price of the relevant transactions into a notation price that represents the upper or lower limit of resolution range of error trades. A party responsible for the error trade would have 30 minutes after the trade execution of the first error trade to request error-trade treatment.
- On September 22, 2014, the Ministry of Environment (MOE) and KRX announced they would start a mock emission trading system from September 29, 2014, ahead of the opening of an official emission trading market in January 2015. The mock market would be operated in two phases until December 24, based on an emission trading system to be developed by KRX.

- On November 13, 2014, KRX announced an amendment of the Enforcement Rules of Derivatives Market Business Regulation.

Key issues include:

- KRX would let independent and qualified external institutions examine the adequacy of its calculation methods and the management systems of members' margin if necessary. As such, it intends to be in accordance with international standards, such as the Principles for Financial Market Infrastructures (Principle 6: Margin) and relevant rules in the EU and US;
- KRX would prevent deposit of the cash and foreign-currency contribution to members' margin in a particular bank or securities finance company;
- KRX would conduct crisis response training to ensure immediate and appropriate actions, such as suspension of trading and suspension of delivery, are performed if a settlement failure occurs. The risk management committee would be notified of the results.

- On November 14, 2014, KRX announced an amendment of the Enforcement Rules of Membership Regulation.

Key issues include:

- KRX would conduct stress testing of its management system for calculating and monitoring the amount of the CCP's contributed capital and the joint compensation fund for the listed derivatives market required to make up for losses caused by settlement failure. The risk management committee would be notified of the results.
- KRX would prevent deposit of cash to the joint compensation fund in a particular bank or securities finance company.

The amendment came into effect from November 14.

- On December 10, 2014, MOE announced that Korea's emission trading market would officially launch on January 12, 2015. The opening date was decided through consultation with relevant agencies, including the Greenhouse Gas Inventory & Research Center of Korea (GIR) and KRX. MOE designated KRX as the official emission permits exchange in January 2014, and KRX subsequently announced the Emission Trading Market Business Regulation on December 2, 2014.

Key highlights include:

- Member requirement: 525 business entities eligible for allocation and three government-owned financial institutions (Korea Development Bank, Industrial Bank of Korea, Korea Exim Bank);
- Trading items: emissions allocation permit and emissions offset permit;
- Trading hours: 10:00am – 12:00pm;
- Price limit: base price +/- 10%;
- Trading unit: one emission permit (= 1tCO<sub>2</sub>-eq);
- CCP: KRX.

Before the official opening day, user registration of business entities eligible for allocation and OTC transactions of emission permits commenced on January 2, 2015.

- On January 6, 2015, KRX announced the launch of a carbon emission rights (CERs) market, which commenced on January 12, 2015. Key details include:

- Eligibility of market participants: companies that are allocated with emission allowances and public financial institutions, such as Korea Development Bank, Industrial Bank of Korea and Export-Import Bank of Korea.
  - Trading products: Korean carbon allowance unit (KAU) and offset CERs in each phase.
  - Trading period: from the first day of the planned period to the end of June of the year following the year of implementation.
  - Trading hours: 10:00am to 12:00pm (two hours).
  - The Greenhouse Gas Inventory & Research Center of Korea would conduct the delivery of KAUs upon KRX's settlement instruction.
- On January 6, 2015, KRX announced major institutional changes in its securities and derivatives markets in 2015.

On derivatives, key highlights include:

- The opening of new derivatives markets to strengthen capital market dynamics: this would include dividend index futures, Chinese yuan futures and short-term interest futures.
  - The provision of risk management levers for the capital market: KRX would open the KOSDAQ single-stock futures and KOSDAQ index futures markets, as well as introduce exchange-traded fund futures.
  - Improvement in price stability: KRX would take a phased approach to expand the price limit of stocks and index-based derivatives.
  - A change in the tick size of KOSPI 200 options and VI futures: the tick size of KOSPI 200 options would be set at 0.01 points and the tick size of volatility index futures would be reduced to 0.01 points.
  - Exemption of the Securities Transaction Tax for derivatives market makers: the target taxpayer would be financial investment companies that have concluded market-making contracts with KRX, and target trading would be stock sales trading that is conducted for the purpose of avoiding risks that may occur in the process of market-making for derivatives products with underlying assets of stocks. The target period is the first half 2015 to December 31, 2017.
  - Reprioritisation of financial resources for resolving settlement failure: KRX would appropriate its partial reserve first before tapping into the joint clearing fund.
- On January 30, 2015, KRX announced that the Committee for Management of Public Institutions under the Ministry of Strategy and Finance had decided to terminate its designation as a public institution. The reason cited for the change was to ensure KRX is best placed to develop the capital market. KRX was designated as a public institution in January 2009.
  - On February 11, 2015, KRX announced its revised Derivatives Business Market Regulation. KRX intended to provide a legal basis for disposing the underlying asset balance or securities held under the payment suspension according to the method set forth by KRX. Without a legal procedure, this is necessary to compensate quickly losses incurred as a result of a clearing member's non-fulfillment of settlement. The revised regulation became effective on February 26, 2015.
  - On March 12, 2015, KRX amended its Enforcement Rules of the Derivatives Market Business Regulation. Key contents include:
    - Delta for market-makers of single-stock futures and options amended to implement the securities transaction tax exemption (Article 90-3 and Annex 27, with effective date on March 13):

- Single-stock futures: (buying) 1; (selling) -1
  - Single-stock options: set based on arrival of the last trading day, type of call and put options, etc (specified in Annex 27)
  - Change of institution for calculating the final settlement price of mini-gold futures (Article 30 and 32-2, with effective date on March 20)
  - (Current) The London Gold Market Fixing Ltd
  - (Revised) InterContinental Exchange Benchmark Administration Ltd (IBA)
- On March 13, 2015, KRX announced its implementation of the securities transaction tax exemption for market-makers of single-stock futures and options based on the amended Restriction of Special Taxation Act.

Going forward, the securities transaction tax (0.3%) would not apply to the portion of underlying stocks that are sold for the purpose of hedging against the risk of price fluctuations that may occur in the course of market-making for single-stock futures and options by the market-makers concerned. The tax exemption was implemented for KOSPI single-stock futures and options market-makers from March 13, and would be expanded to include KOSDAQ's single-stock futures, which would be listed by the end of 2015.

- On April 23, 2015, KRX published an updated version of its disclosure framework on the PFMI, which is a self-assessment report on the PFMI. This report, in line with the CPMI-IOSCO disclosure template, contains major changes since the last update of the disclosure framework in July 2013, including OTC clearing services.

In this report, KRX also announced it would establish a technological platform for disclosure in 2015, and would start disclosing quantitative information (including the C-factors for both exchange-traded and OTC products) in 2016, in accordance with the public quantitative disclosure standards for CCPs published by CPMI-IOSCO.

- On April 29, 2015, KRX announced its revised business regulations for securities and derivatives markets to improve market stabilisation facilities and expand daily price limits in these markets.

For the derivatives markets, key elements include:

- Improved price stabilisation safeguards: In line with circuit breakers that have been strengthened with interval-based triggering in the stock markets, the trading of derivatives products would also be suspended by intervals accordingly.
- Expansion of daily price limits: An interval-based price limit would be introduced for equity-related derivatives products in line with the expansion of daily price limits in the stock markets.
- Introduction of intraday additional customer margin: As a result of the expanded range of price limits for underlying assets, intraday additional customer margin would be introduced to ensure proactive risk management. In cases where underlying assets change beyond a certain level, additional customer margin must be demanded by a clearing member to customers when their total deposit amount falls short of the intraday customer maintenance margin. When a call for intraday additional customer margin has been made, clearing members should reject orders placed by the customer until they check the deposit of the requested margin, but allow the customer to send offsetting orders for reducing requested margin deposit amounts (or relevant risk).

KRX plans to revise relevant enforcement rules including details and timeline for the implementation of the revised regulations.

- On May 26, 2015, KRX announced revised Enforcement Rules of the Derivatives Market Business Regulation to introduce intraday additional member margin and intraday additional customer margin.

Key elements are:

- Intraday additional member margin is equal to the intraday member margin, which is calculated at noon during trading hours or when it is deemed necessary for market management (both are called 'time t'), minus the total amount of deposit, which is calculated at time t or time t plus one hour. This intraday additional member margin would be imposed if: i) the price rate of change ([the underlying asset price at time t – the base price of the underlying asset on previous day] / the base price of the underlying asset on previous day) of the KOSPI 200 is greater than or equal to 0.5 times the member margin rate of KOSPI 200 futures; and ii) intraday member margin is greater than or equal to 1.2 times the total amount of deposit at time t.
- KRX would determine one hour from time t whether to impose the intraday additional member margin and would notify members immediately. Members need to deposit their intraday additional member margin within two hours of being notified by KRX. However, this intraday additional member margin would be cancelled if the intraday member margin calculated 30 minutes after being imposed is less than or equal to the total amount of deposit calculated one hour after being imposed.
- Members shall impose intraday additional customer margin on their clients when the underlying-asset change is greater than or equal to 80% of the intraday customer maintenance margin rate of KOSPI 200 futures.

The revised rules are effective from June 15, 2015.

- On June 24, 2015, KRX announced an amended Derivatives Market Business Regulation in order to launch mini KOSPI 200 futures and options and renminbi (RMB) currency futures, following the FSC's announcement on policy direction for capital markets reform on April 23.

Key highlights include:

- Mini KOSPI 200 futures and options: underlying asset (KOSPI 200), multiplier (100,000), contract months (the four non-quarterly months plus two quarterly months), position limit (10,000 contracts for institutions and 5,000 contracts for individuals);
- RMB currency futures: underlying asset (RMB), contract size (100,000 yuan) and multiplier (100,000);
- Article 154(1)2 of the Derivatives Market Business Regulation regarding position limits of 10-year KTB futures would be abolished.

The amendment is effective on July 20, 2015.

- On June 29, 2015, KRX announced it had selected 10 KOSDAQ-listed stocks as underlying assets for single-stock futures, which would be listed on August 3. In addition, KRX selected new underlying assets through the regular change of existing single-stock futures and options based on stocks listed on the KOSPI market. The number of underlying stocks for single-stock futures was expanded to 10 KOSDAQ stocks and 80 KOSPI stocks.

KRX noted that the listing of KOSDAQ single-stock futures would enable investors to risk manage KOSDAQ blue-chip stocks. It would also promote the participation of institutional and foreign investors in the KOSDAQ market, the exchange said.

- On July 3, 2015, KRX announced its amended enforcement rules of the Derivatives Market Business Regulation, with additional details on mini KOSPI 200 futures and options. Key contents include:
  - Mini KOSPI 200 futures and options: tick size (0.02P), final settlement price (the closing value of KOSPI 200), strike price interval (mini KOSPI 200 option only, 25 strike prices with 2.5P interval);
  - Article 111 was amended to restrict designation of settlement banks to banks that satisfy the condition of a minimum liquidity coverage ratio of 110%.

The amendment is to be implemented on July 20, 2015, when mini KOSPI 200 futures and options are launched.

- KRX announced its plan to launch mini KOSPI 200 futures and options starting from July 20, 2015. Key details of the product specifications include:

#### Mini KOSPI 200 futures

- Underlying assets: KOSPI 200;
- Multiplier: 100,000;
- Tick size: 0.02 point;
- Type of order: limit order but real-time price banding is not applicable;
- Delivery months: designed to have consecutive six delivery months with maturity of six months, so a delivery month arrives every month;
- Settlement price: the closing contract price. In the case where a KOSPI 200 futures contract and a mini KOSPI 200 futures contract have been listed simultaneously, the settlement price of KOSPI 200 futures is applied;
- Base price: the settlement price on previous day. In the case where a KOSPI 200 futures contract and a mini KOSPI 200 futures contract have been listed simultaneously, the quotation price unit shall be adjusted after the settlement price of KOSPI 200 futures is applied;
- Last trading day: the second Thursday of each delivery month;
- Last settlement day: next trading day of the last trading day.

#### Mini KOSPI 200 options

- Underlying assets: KOSPI 200;
- Multiplier: 100,000;
- Tick size: 0.02 points for order price less than 10 points and 0.10 points for order price of 10 points or more;
- Type of order: limit order but real-time price banding is not applicable
- Expiration months: consecutive four non-quarterly months and two quarterly months;
- Strike price interval: 25 strike prices with 2.5p interval;
- Base price for member margin: borrowing base price for member margin of KOSPI 200 options;
- Base price: base price of KOSPI 200 options is applied. If it is not consistent with the quotation price unit (tick size), the nearest price to the tick size would be applied;
- Last trading day: the second Thursday of each expiration month;
- Last settlement day: next trading day of the last trading day.

- On July 6, 2015, the FSC announced that the revision bill on the amendment of the FSCMA, including changes to KRX's default waterfall, was passed at the plenary session of the National Assembly of Korea. Going forward, KRX would use its own allocated settlement reserve prior to the default fund contributions of non-defaulting clearing members – commonly referred as skin-in-the-game. The FSC also noted it would modify other regulations such as the Enforcement Decree and the Enforcement Rule of the FSCMA in July in order to implement this amendment smoothly. In addition, the KRX Membership Regulation specifying the details of the revised default waterfall is expected to be amended accordingly.
- On August 7, 2015, KRX amended its guidelines on the connection to member systems to ease concerns about maximum capacity and the application for additional communication lines that may be allocated to members for the derivatives market. Key elements include:
  - The number of communication lines that may be allocated to members in case of requests for additional main, back-up and disaster recovery lines would be expanded to five, respectively. The implementation date would be announced later.
  - In a case where a member system has changed due to office relocation, as well as a merger or split, the member may request KRX to allocate additional communication lines. The implementation date is August 17.
- On September 2, 2015, KRX amended its Membership Regulation in response to a FSC decision to allow banks to obtain a licence to engage in the trading of exchange-traded derivatives based on currency or interest rate. Key elements include:
  - Definition of currency/interest rate derivatives member: a member that is entitled to take part in trading of exchange-traded derivatives based on currency or interest rate in the derivatives market.
  - The amount that a clearing member that is a currency/interest rate derivatives member contributes to the joint compensation fund: basic contribution (KRW 0.5 billion) plus intermittent contribution. The intermittent contribution is calculated by multiplying the ratio of a clearing member's average daily margin relative to that of all clearing members obliged to contribute to the fund for a retroactive one-year period from the end of the previous quarter, by the difference obtained by subtracting the total basic contribution from the total amount of the joint compensation fund.
  - The rules for postponement or cancellation of the measures imposed due to unsatisfactory financial conditions shall be stipulated in the enforcement rules.
- On September 10, 2015, KRX amended the Enforcement Rules of the Disclosure Regulations of the KOSPI and KOSDAQ markets as a follow-up measure after the Regulatory Reform for the Corporate Disclosure System (FSC, June 1, 2015), which became effective on September 7, 2015.

#### Summary of the amendment;

- Enhancement of autonomy of corporate disclosure;
  - Reinforcement of disclosure responsibility of listed corporations;
  - Reinforcement of incentives for the outstanding disclosure companies, etc.
- On June 14, 2016, KRX announced plans to offer voluntary clearing of US dollar interest rate swaps from November 2016. KRX estimates that such trades make up as much as 12% of the total onshore interest rate swaps trades.

KRX also indicated its plans to offer non-deliverable Korean won interest rate swaps and Korean won/US dollar non-deliverable forwards in 2017, and to possibly expand its clearing services to credit default swaps in the medium-to-long term.

## 9. KOFIA developments

- On March 18, 2014, KOFIA amended the “Financial Investment Company Model Rules for Preventing Financial Accidents” to prevent any future recurrence of disastrous financial incidents like the default of HanMag Securities.

This rule, among others, was implemented to limit daily order amounts of self-account transaction by financial investment companies to the ratio which they set up within 50% of their net working capital which is calculated based on #3-11 in the rulebook for Financial Investment Business of FSC. Members of KOFIA must comply with this rule which would take immediate effect.

## 10. Korea Securities Depository developments

- On October 9, 2014, FSC announced that the Regulatory Oversight Committee endorsed the Korea Securities Depository (KSD) as a pre-local operating unit under the sponsorship of the FSC. Accordingly, domestic companies and financial institutions that previously received legal entity identifiers (LEIs) from authorised issuers in the US or Germany for their over-the-counter derivatives transactions in overseas markets would be able to obtain LEIs from the KSD from January 2015, once its system for issuing LEIs is ready.

## 11. International Assessments

- On May 20, 2014, IMF issued its report, Financial System Stability Assessment of the Republic of Korea, based on the work of the Financial Sector Assessment Program (FSAP) mission conducted in 2013. The FSAPs are designed to assess the stability of the financial system as a whole and to help countries identify and remedy weakness in their structure in order to enhance their resilience to macroeconomic shocks and cross-border contagion.

In this report, IMF used six core assessment parameters: soundness of the financial sector and potential risks; macroprudential framework; financial sector supervision; sectoral regulation and supervision; systemic liquidity; and crisis management and resolution framework.

On the same day, IMF also published the Report of the Observance of Standards and Codes on the Republic of Korea as a background document to this Financial System Stability Assessment report. The analysis was based on core principles such as Basel core principles for effective banking supervision (BCP) and CPSS-IOSCO principles for financial market infrastructures (PFMI).

- On September 21, 2016, the Basel Committee on Banking Supervision (BCBS) published a report assessing the implementation of the risk-based capital framework and the LCR for South Korea.

Overall, the domestic implementation of the risk-based capital framework is found to be "largely compliant" with the Basel standards, reflecting the fact that most but not all of the provisions in the Basel standards are satisfied. Specifically, 12 of the 14 components of the framework are assessed as compliant, while two components (the definition of capital and the transitional arrangements) are assessed as largely compliant and "materially non-compliant", respectively. In regards to LCR, South Korea is assessed as "compliant".

## 12. Fintech

- On July 22, 2016, a new fintech bridge was established between the UK and the Republic of Korea by the signing of a regulatory co-operation agreement between the UK Financial Conduct Authority (FCA) and the FSC. This will enable the regulators to share information about financial services innovations in their respective markets, including emerging trends and regulatory issues. By strengthening links between the regulators and governments, it is hoped the agreement will reduce the barriers to entry in a new jurisdiction and further encourage innovation in both countries' financial services sectors.
- On August 30, 2016, the FSC announced the launch of a fintech open platform aimed at helping fintech firms in developing innovative financial services. The fintech open platform is a combination of an open application programming interface (API) system, where fintech firms can download program commands used in the development of fintech services, and a physical test-bed where they can run test operations of the programs they develop. The open API system provides program commands needed in programming fintech services with banking functions, including money transfer and balance check, in the form of standardised API.

The Korea Financial Telecommunications & Clearings Institute and Koscom will provide virtual data and simulation environments for fintech firms to run test operations of their fintech services, and offer technology consulting services. The Financial Security Institute will ensure stability of fintech services and financial consumer safety before the launch of the services.

- On October 24, 2016, the Monetary Authority of Singapore (MAS) and the FSC signed a cooperation agreement to foster greater cooperation in fintech. Under the agreement, the MAS and the KFSC will explore potential joint innovation projects on technologies such as big data and mobile payments. The agencies will also discuss issues of common interest, and share information on fintech trends and how it may impact existing regulations.

### ISDA Submissions (since 2010)

- June 3, 2011: [ISDA submission to the Ministry of Strategy and Finance \(MOSF\) on the Foreign Exchange Prudential-Stability Levy](#)
- September 19, 2011: [ISDA submission to FSC on Proposed Amendment to Financial Investment Services and Capital Markets Act \(FSCMA\) Relating to Central Counterparty](#)
- June 24, 2013: [ISDA submission to FSC on the draft FSC regulation on central clearing counterparties](#)
- March 17, 2014: [ISDA submission to KRX on OTC clearing house risk management procedures.](#)
- September 30, 2014: [ISDA submission to FSC/FSS on QCCP status of KRX](#)
- November 17, 2014: [ISDA submission to Financial Services Commission \("FSC"\) with regards to amendments of Article 399 of the Financial Investment Services and Capital Markets Act \("FISCMA"\).](#)
- November 18, 2015: [ISDA submission to The National Assembly of the Republic of Korea with regards to the Proposed Bill of the Corporate Restructuring Promotion Act as a Permanent Statute](#)

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# MALAYSIA

## Key Regulatory Milestones

### 1. Developments relating to close-out netting enforceability

- The Financial Services Act (FSA) and the Islamic Financial Services Act (IFSA) rationalize the legislative regime for institutions, payment systems and markets under the purview of BNM. The FSA repeals the Banking and Financial Institutions Act 1989, the Exchange Control Act 1953, the Insurance Act 1996 and the Payment Systems Act 2003 and the IFSA repeals the Islamic Banking Act 1983 and the Takaful Act 1984. The FSA and the IFSA introduces the concept of a “qualified financial agreement” (QFA) (please refer to the Annex for the definition) and provides a safe harbor for QFAs when BNM exercises its powers under these statutes to issue directions to institutions or when exercising its intervention powers over distressed institutions (but subject in this case to a temporary stay before the safe harbor operates) or when taking measures relating to international and domestic transactions. The FSA and the IFSA came into force on June 30, 2013.
- The Central Bank of Malaysia (Amendment) Act 2013 (CBA 2013) which has come into force on February 8, 2013 introduces a comparable safe harbor for QFAs into the Central Bank of Malaysia Act when powers under Sections 31, 32 (read with the Third Schedule) and 77 are exercised by BNM.
- On October 25, 2013, the Malaysian Prime Minister and Minister of Finance Datuk Seri Najib Tun Razak tabled the 2014 Malaysia Budget Speech at the Dewan Rakyat and made the following statements:  

“Currently, the domestic bond market is the largest in South-East Asia with a value exceeding RM1trillion, while daily transactions in the foreign exchange and money markets are more than RM30 billion. To ensure efficient operations of financial markets, a clear regulatory framework is required. “In this regard, amendments would be made to existing laws and Bank Negara Malaysia would lead the initiative in formulating the Netting Act to protect enforcement rights of close-out netting under the financial contract. This is to reduce credit risk and promote the derivatives market, thereby reducing systemic risks in the domestic financial market as well as reduce the cost of doing business.”
- On September 9, 2014, BNM released its consultation paper on the Netting of Financial Agreements Bill. The initiative follows the 2014 budget speech given by the Prime Minister in October 2013.

The Bill introduces a definition of ‘netting provision’ under certain ‘qualified financial agreements’ in order to address close-out netting mechanisms that are typically embedded in financial contracts. The scope of the Bill would extend to certain ‘qualified financial transactions’ which include OTC derivatives, Islamic financial instruments such as Islamic derivatives, repurchase transactions and a securities borrowing and lending of unlisted debt securities under the real time electronic transfer of funds and securities systems. The consultation paper also provides an overview of the key concerns relating to close-out netting in Malaysia. BNM envisages that the legislation would provide legal assurance for the enforceability of close-out netting mechanisms under certain types of financial agreements by removing legal impediments or uncertainties to netting in existing legislation.

- On January 8, 2015, BNM issued its response to feedback received from the consultation paper on the Netting of Financial Agreements Bill on September 9, 2014, which proposed to enact a legislation to provide legal certainty for the enforcement of close-out netting arrangements.

- The Netting of Financial Agreements Act came into force on March 30, 2015. BNM, Perbadanan Insurans Deposit Malaysia and Pengurusan Danaharta Malaysia Berhad also announced that a stay period of two business days under the Act became effective on March 30, 2015. Subsequently, ISDA published an updated netting opinion for Malaysia on 30 July, 2015.

## 2. Trade reporting

- The Capital Markets and Services (Amendment) Act 2011 (CMSA 2011) in Subdivision 4 of Division 3 of Part III introduces the legislative framework for the licensing and regulation of OTC derivatives trade repositories by the SC. It also empowers the SC to impose mandatory trade reporting for OTC derivatives (except transactions to which BNM or the Government of Malaysia is a party). This Subdivision came into operation in October 2013 (and may be deferred for up to another year).
- On March 26, 2012, PIDM together with BNM, issued a joint concept paper on 'Recordkeeping and Reporting Requirement for Over-the-Counter Derivatives'. These requirements were to apply to banks and insurance companies regulated by BNM and all member institutions of PIDM, and were intended as an interim measure pending the establishment of the trade repository in Malaysia and mandatory trade reporting under the CMSA 2011.
- On April 3, 2013, PIDM and BNM announced that they had decided not to proceed with the proposals set out in the March 26, 2012 joint concept paper. Instead, they would work with the SC on the implementation of the trade repository. The detailed requirements for the trade repository were expected to be substantially similar to the transaction-level data requirements set out in the joint concept paper. Although an appropriate transitional arrangement would be considered, PIDM and BNM note that it was important that reporting institutions plan their system enhancements at a sufficiently early stage to ensure readiness in meeting the future requirements under the trade repository. PIDM and BNM also noted that the readiness of reporting institutions to report the required data would allow PIDM and BNM to reduce the temporary suspension period before the safe harbor for qualified financial agreements comes into operation under the PIDM Act 2011, FSA and IFSA (each as defined below).
- On November 20, 2013, SC, BNM and PIDM issued a joint public consultation paper on requirements for the reporting of OTC derivatives trading activity to a trade repository in Malaysia.

The regulatory agencies would look to leverage on the trade repository as a single point of access to OTC derivatives information for the purpose of performing their respective mandates. Accordingly, the interim reporting of aggregated level data on OTC derivatives implemented by BNM would be phased out when the trade repository has been established.

The Consultation Paper highlights include:

- Reportable Transactions: All OTC derivative contracts (which may include a swap, forward or option with an underlying reference to foreign exchange, interest rates, credit, commodity or equity, conventional or Islamic derivatives, and of any remaining maturity) must be reported, subject to certain exemptions. Foreign exchange spot transactions are not deemed to be an OTC derivative contract and therefore would not be required to be reported to the trade repository.
- Exempted Transactions: A structured product is not a reportable transaction. However, the reporting entity must report these OTC derivative transactions to the trade repository if it enters into an OTC derivative or hedging transaction as a principal party to manufacture the underlying economics of a structured product or if it enters into a hedging transaction as a principal party to manage risks arising from the portfolio of structured products sold to their customers. BNM or SC

may also require a reporting entity to report information on structured products that they offer separately on a need to basis. Transactions where BNM or the Government of Malaysia is a party are exempted from reporting requirements under Section 107J(2) of the Capital Markets and Services Act 2007 (CMSA). In addition, PIDM's "member institution" means a financial institution or any person that is deemed to be or prescribed as a member institution under the Malaysia Deposit Insurance Corporation Act 2011. The reporting obligation shall not apply to BNM or the Government of Malaysia.

- Principal Party: Each reporting entity who is a principal party to an OTC derivative transaction has an obligation to report the required information directly to the trade repository.
- Branches: Each reporting entity must ensure that their reporting covers all transactions to which the reporting entity is a principal party, including transactions which are originated from, negotiated, arranged or booked by its domestic or foreign branches.
- Treatment of subsidiaries of Capital Markets Services Licence (CMSL) holders and BNM licensed entities: The reporting obligation would apply to a subsidiary company of a CMSL holder or an entity licensed by BNM under the FSA 2013 and IFSA 2013 only if the subsidiary is a "reporting entity" as set out above. The reporting obligation does not extend to a subsidiary which is incorporated in a foreign jurisdiction.
- Phase-in-reporting: Reporting would be implemented in three phases. Phase 1 would involve the investment banks licensed by the SC and BNM. Phase 2 would include the CMSL holders other than those captured in Phase 1. Phase 3 would involve any registered person or any other persons who deals in OTC derivative transactions and have exceeded certain reporting thresholds, not captured in Phase 1 or Phase 2. The specific type of entity, the reporting threshold and an appropriate commencement date for reporting to the trade repository would be determined at a later date by the regulatory agencies.

Reporting entities with mandatory reporting obligations include:

- Investment banks licensed by SC under the CMSA and by BNM under the Financial Services Act (FSA) 2013;
- Holders of a CMSL under the CMSA. These include derivatives brokers, stockholding companies and fund management companies;
- Institutions licensed by the Bank under the FSA and the IFSA 2013. These include conventional and Islamic commercial banks, international Islamic banks, insurance and reinsurance companies, as well as takaful and re-takaful operators; and
- Any other person dealing in OTC derivatives as prescribed by the SC. The SC would further define the scope of these entities and consult the industry before prescribing any person for this purpose.

### **3. Regulation of OTC derivatives activity**

- The CMSA 2011 (except the provision amending Section 92 of the CMSA) which came into force on October 3, 2011 makes OTC derivatives a regulated activity. However, participants that deal bilaterally on a principal-to-principal basis (as would generally be the case for OTC derivatives under an ISDA Master Agreement) would fall within the exemption in Schedule 3 and licensed banks would also fall within the exemption in Schedule 4. Persons that fall within the Schedule 3 or Schedule 4 exemptions are not required to obtain a CMSL from the SC. A person falling within Schedule 3 is not subject to the business conduct requirements in the CMSA whilst a registered person under Schedule 4 is subject to the business conduct requirements set out in Section 76(5) to (8) of the CMSA. Other provisions of the CMSA such as Part V (Market Misconduct and Other Prohibited Conduct) and the obligation to report

trades to a trade repository under Section 107J applies to both a person falling within Schedule 3 and a person falling within Schedule 4.

#### **4. Offer of unlisted capital market products**

- The CMSA 2012 which came into force on December 28, 2012, introduces a new approval framework intended to facilitate the offering of a broader array of capital market products. The definition of “capital market products” has been amended and includes, among others, derivatives and any product or arrangement which is based on securities or derivatives or any combination thereof. The framework distinguishes between listed and unlisted capital market products, taking into account their characteristics and risk profiles and seeks to apply the appropriate level of regulation for these products. In particular, authorization of the SC is required for an unlisted capital market product or in the case of a foreign unlisted capital market product, recognition by the SC.
- The SC also issued Guidelines on Sales Practices of Unlisted Capital Market Products (Guidelines) which applies to all capital market products (other than shares, debentures and sukuk) that are not listed on a stock exchange or derivatives exchange in Malaysia, regardless of whether they are manufactured within or outside Malaysia. Investors are divided into two main classes of investors, namely retail investors and non-retail investors comprising of high net-worth individuals, high net-worth entities and accredited investors.

The Guidelines require, among others, that a Product Highlights Sheet be prepared providing certain prescribed information and a Suitability Assessment be conducted to ensure that any product recommendation provided by a product distributor is made on a reasonable basis. Additionally, the Guidelines include principles on treating investors fairly which require that product issuers and product distributors have in place certain policies and processes that give due regard to the interests of the investors. The requirements relating to Product Highlights Sheet and Suitability Assessment would apply to all retail investors and high net-worth individuals. These requirements would also apply to high net-worth entities, unless they opt out. They would not however apply to accredited investors. The principles on treating investors fairly would apply to all categories of investors.

- The SC also released the Guidelines on Private Debt Securities, the Business Trusts Guidelines, the Guidelines on Sukuk, the Guidelines on Real Estate Investment Trusts, the Guidelines on Unlisted Capital Market Products: Structured Products and Unit Trust Schemes, the Prospectus Guidelines and the Guidelines on Disclosure Documents.

#### **5. BNM’s revised guidelines on product transparency and disclosure**

- BNM’s Revised Guidelines on Product Transparency and Disclosure which took effect on June 30, 2011, requires banks to provide documents to customers in plain language and in the Malay language if so requested by the customer. While the ISDA Master Agreement and related ISDA documentation would be subject to the Revised Guidelines, BNM has acknowledged that it recognises that it may be inefficient for ISDA documents to be subject to the plain language and Malay language requirements. BNM has also confirmed that the aim of the Revised Guidelines is to establish a consistent and comprehensive disclosure regime for financial service providers in Malaysia when dealing with retail customers.

#### **6. PIDM Act 2011**

- The revised Perbadanan Insurans Deposit Malaysia or Malaysia Deposit Insurance Act 2011 (PIDM Act 2011) came into operation on December 31, 2010. The PIDM Act 2011 represents a significant improvement by protecting close-out netting rights under qualified financial agreements once a temporary stay period has elapsed without PIDM deciding to transfer the outstanding derivatives positions of the distressed bank. However, there remain certain concerns which militate against close-out netting enforceability. These concerns center around the definition of a “qualified financial agreement” (which is significantly different from the definition under the FSA, IFSA and the CBA 2013) which requires the “derivative” to be the “subject of recurrent dealings in the over-the-counter derivatives markets” and the duration of the temporary stay period. Pursuant to the Malaysia Deposit Insurance Corporation (Temporary Suspension Period) Regulations 2012, the temporary stay period has been set at 10 days. One other concern was the nature of a “qualified third party” to whom outstanding derivative positions of the distressed bank could be transferred by PIDM and the terms of such transfer. However, in its below response, PIDM has narrowed the scope of who can be a qualified third party, in particular, removing as a qualified third party foreign financial institutions without a license in Malaysia in relation to a transfer of the positions of a PIDM member institution and anyone in relation to a transfer of the positions of an Affected Person (as defined in the PIDM Act 2011).
- On March 26, 2012, PIDM issued its Response to the Consultation Paper on Criteria for Qualified Third Party. PIDM would define a “qualified third party” as being any of the following entities:
  - an institution, other than a bridge institution, licensed under the Banking And Financial Institutions Act 1989, the Islamic Banking Act 1983, the Insurance Act 1996 and the Takaful Act 1984 or an institution prescribed under the Development Financial Institutions Act 2002 which is in compliance with the capital and prudential requirements of BNM;
  - an institution licensed under the Labuan Financial Services and Securities Act 2010 and Labuan Islamic Financial Services and Securities Act 2010, which is in compliance with capital and prudential requirements of the Labuan Financial Services Authority;
  - a public entity established under its own statutory act; or an entity whose obligations under the qualified financial agreements would be guaranteed by the Government of Malaysia, BNM or PIDM.

## **7. SSM releases consultation document on the Proposed Companies Bill**

- On July 2, 2013, the Companies Commission of Malaysia (SSM) released its consultation document on the proposed Companies Bill. This Bill sets out the new legal framework to replace the existing Companies Act 1965. The provisions in this Bill were drafted primarily on the basis of policies which had been approved by the Cabinet on June 18, 2010 and derived from a four-year comprehensive corporate law review conducted by the SSM’s Corporate Law Reform Committee (CLRC) as well as the recommendations by the Accounting Issues Consultative Committee (AICC).

## **8. BNM consults on liquidity coverage ratio**

- On September 30, 2014, BNM released a concept paper on the liquidity coverage ratio (LCR). The concept paper outlined BNM’s approach to implementing the LCR, specifically covering areas such as the scope and level of application of the LCR, the implementation timeline and the relevant transition arrangements, the eligible stock of high-quality liquid assets, and the treatment for cashflow items for the purposes of LCR calculation.

## 9. SC announced amendments to securities laws come into force

- On September 22, 2015, SC announced the coming into force of the Capital Markets and Services (Amendment) Act 2015 (CMSA) and Securities Commission (Amendment) Act 2015 (SCMA) on September 15. The amendments to the securities laws were made to facilitate new fundraising structures, enhance investor protection, clarify responsibilities of issuers and advisers, and expand the scope of the SC's supervisory powers.

The CMSA Amendment introduced a new recognised market framework to facilitate the establishment of alternative trading platforms, including equity crowd-funding (ECF) platforms. Under this framework, private companies that are hosted on a registered ECF platform are provided a safe harbour from provisions in the Companies Act 1965, which prohibit private companies from offering shares to members of the public. The introduction of ECF is in line with the SC's objective to promote capital-market inclusion and widen avenues for capital-raising.

To promote a more conducive environment for the issuance and subscription of corporate bonds, the CMSA Amendment has clarified the roles and responsibilities of persons in charge of preparing disclosure documents. Minority shareholder protection in relation to takeovers and mergers transactions is also strengthened, with the SC now empowered to appoint an independent adviser where the offeree fails to do so. The CMSA Amendment also seeks to preserve netting provisions of market contracts and strengthen crisis management of market institutions, such as exchanges and clearing houses.

The SCMA Amendments were amended to align securities laws with International Organization of Securities Commissions principles. To elevate the standards of auditors and quality of financial statements, the Audit Oversight Board's regulatory reach is extended to capital market institutions, scheduled funds and reporting accountants. The SC's examination powers have also been expanded to include persons performing outsourced functions for regulated entities, including branches and subsidiaries.

## 10. Capital Adequacy Framework

- On July 15, 2015, Bank Negara Malaysia released its concept paper which sets out its proposals on the computation of the weighted average Countercyclical Capital Buffer requirements for private credit exposures held in jurisdictions where the national authority has announced the Countercyclical Capital Buffer rate for that jurisdiction, in line with the requirements set out under Basel III. On the same day, it also released its concept paper on the same topic for Islamic banks.
- On October 13, 2015, Bank Negara Malaysia finalized the revisions to the Capital Adequacy Framework (Capital Components and Basel II – Risk-Weighted Assets) and the Capital Adequacy Framework for Islamic Banks (Capital Components and Risk-Weighted Assets).

The revised policy documents:

- Extend the capital adequacy requirements to financial holding companies which are engaged predominately in banking business; and
- Detail the formula to incorporate the countercyclical capital buffer requirements into the calculation of the capital adequacy ratios.

## 11. Bank Negara reduces reserve ratio

- On January 21, 2016, Bank Negara Malaysia announced a decrease in the statutory reserve requirement (SRR) ratio from 4.00% to 3.50%, effective from February 1.

The decision was taken as part of an initiative by Bank Negara Malaysia to ensure sufficient liquidity in the domestic financial system. Since early 2015, Bank Negara Malaysia has relied on its monetary operations, including the reverse repo facility, to provide liquidity to the banking system as net external outflows reduced the amount of liquidity in the system. As of January 21, this amounted to RM40 billion.

## **12. IOSCO establishes APAC hub in Kuala Lumpur**

- On February 22, 2016, the Securities Commission Malaysia announced that the International Organization of Securities Commissions (IOSCO) has approved the establishment of its first ever regional office, to be set up in Kuala Lumpur.

The Asia-Pacific regional hub will play a key role for IOSCO initiatives within the Asia-Pacific region, which covers both developed and emerging markets. The hub will also facilitate cross-border regulatory cooperation and contribute to the development of the region's capital markets through its initiatives. It is expected to be in operation by the end of 2016.

## **13. Renminbi investment licence open for application**

- On March 8, 2016, the Securities Commission Malaysia (SCM) and BNM jointly issued a guidance note to facilitate applications to the China Securities Regulatory Commission (CSRC) for a renminbi qualified foreign institutional investor (RQFII) licence. The guidance note outlines the criteria and eligible entities that may apply for the licence, as well as additional requirements by the SCM and/or BNM prior to any application submission to the CSRC.

On November 23, 2015, the People's Bank of China (PBOC) recognised Malaysia as an RQFII jurisdiction, with an aggregate quota of RMB50 billion. With this, Malaysia-based institutions are now able to invest directly into the Chinese capital market using renminbi funds. The RQFII programme creates opportunity for qualified Malaysian institutions to offer a wider range of renminbi investment products and will serve as an avenue for greater utilisation of offshore renminbi funds.

## **14. Deposit insurance Insurance (Amendment) Act comes into force**

- The Malaysia Deposit Insurance Corporation (Amendment) Act 2016 received royal assent on March 2, and came into force on March 8, 2016. The amendment act introduces a new subsection 2(IA) to the Malaysia Deposit Insurance Corporation Act, which seeks to re-define qualified financial agreements (QFAs) under the act and align this to the equivalent definition as used in the Financial Services Act 2013 (FSA) and the Central Bank of Malaysia Act 2009 (CBMA). Subsection 2(IA)(g) also introduces the definition of a qualified financial transaction (QFT), which is largely similar to the equivalent definition used in the FSA and CBMA. It should also be noted that the requirement of 'recurrent dealings' under the act no longer applies under the new definitions of QFAs and QFTs as now set out in subsection of 2(IA).

## **15. BNM establishes Financial Markets Committee**

- On May 13, 2016, Bank Negara Malaysia (BNM) announced the establishment of a Financial Markets Committee. The committee has been established with the objective of broadening industry engagement, with a focus on reviewing and formulating strategies for the wholesale financial markets to meet the demands of a more developed and internationally integrated economy.

The committee will comprise representatives from Bank Negara Malaysia, financial institutions, corporations, financial service providers and other institutions or stakeholders that have a prominent role or level of participation in the financial markets.

The committee also aims to provide a senior-level forum for market participants to discuss potential issues and risks relating to the development of the Malaysian financial market.

## 16. Fintech

- On April 13, 2016, Securities Commission Malaysia (SC) announced the regulatory framework for peer-to-peer financing (P2P), setting out requirements for the registration of a P2P platform as provided in the amended Guidelines on Recognised Markets. The introduction of the new Chapter 13 in the Guidelines provides for the duty and responsibility of a P2P operator, type of issuer and investor who can participate in P2P.
- On June 2, 2016, Bank Negara Malaysia announced the establishment of a financial technology enabler group, which will be responsible for formulating and enhancing regulatory policies to facilitate the adoption of technology innovations in the Malaysian financial services industry.
- On July 29, 2016, Bank Negara Malaysia released a consultation paper on proposed guidelines for a “regulatory sandbox” in order to facilitate the development and adoption of fintech solutions in the financial sector. The proposed regulatory sandbox framework will grant certain regulatory flexibilities to financial institutions and fintech companies to experiment with fintech solutions in a production environment and will be accompanied by appropriate safeguards and regulatory requirements. The discussion paper sets out the eligibility criteria, minimum standards and requirements, as well as a proposed operational approach.

The public consultation period ended on August 30.

- On September 23, 2016, Bank Negara Malaysia hosted a conference with financial institutions themed future finance in Sasana Kijang, Kuala Lumpur. The Conference adopted an innovative and more participative approach in discussing the future direction of finance in Malaysia. The Conference was attended by Chief Executive Officers and Chairmen of financial institutions, financial technology companies, as well as several important ancillary entities within the financial sector.

This Conference was convened at the midpoint of the ten-year Financial Sector Blueprint to reflect progress and reaffirm commitments for continued development of the financial sector, as well as recalibrate new strategies to accelerate momentum towards the envisioned outcomes amidst the constantly evolving domestic and global environment.

Financial technology (fintech) was also featured as a main theme, showcasing a host of fintech solutions as well as facilitating exchange of perspectives on key developments in the fintech space and its resulting implications to the industry.

- On October 18, 2016, Bank Negara Malaysia (BNM) issued the Financial Technology Regulatory Sandbox Framework, following the consultation on the proposed framework that was released on July 29. Based on the consultation, BNM has expanded the eligibility criteria to clarify the focus of innovations that the sandbox aims to support. Innovations should have clear potential to:
  - Improve the accessibility, efficiency, security and quality of financial services;
  - Enhance the efficiency and effectiveness of Malaysian financial institutions' management of risks; or
  - Address gaps in or open up new opportunities for financing or investments in the Malaysian economy.

The framework will be effective immediately and is now open for application. BNM will inform applicants of their eligibility to participate in the sandbox within 15 working days of receiving a complete application. This will be followed by preparatory engagements between BNM and the applicant prior to testing.

- On October 30, 2016, Securities Commission Malaysia (SC) announced that in its on-going efforts to lead the conversation in digitalisation of the capital market space, SC is organising "SCxSC Digital Finance Conference 2016" (SCxSC), with the theme "Capitalising Entrepreneurship". The two-day conference would be held on 3 and 4 November at the SC building in Bukit Kiara, Kuala Lumpur. This year's conference would also broaden the focus of discussions on digital investment services (which include robo-advisory services) and distributed ledger technology. These new digital finance capabilities will change the complexion of capital markets and bring new potential growth to the industry.

## 17. Financial Benchmarks

- On June 15, 2016, Bank Negara Malaysia (BNM) and the Financial Markets Association of Malaysia (FMA) announced the following changes as part of their effort to adopt global best practices for the domestic financial market:
  - Adoption of a new methodology in USD/MYR spot fixing based on market transaction data. Under the new methodology, the reference rate will be known as the Kuala Lumpur USD/MYR Reference Rate, and will be computed based on the weighted average volume of the interbank USD/MYR spot rate transacted by domestic financial institutions between 8:00am to 3:00pm. It will be published daily at 3:30pm.
  - An expanded official closing hour for the onshore ringgit market from 5:00pm to 6:00pm to give businesses additional time to complete their foreign exchange transactions. Onshore market participants can continue to transact after the official closing hour.
  - Both these changes are effective from July 18. The new Kuala Lumpur USD/MYR Reference Rate will be published in parallel with the current reference rate starting from June 20 to allow for the market to transition.

## 18. BNM revokes derivatives amendments

- On August 1, 2016, Bank Negara Malaysia announced that the following policy documents have been revoked:
  - Guidelines on Regulatory Treatment for Credit Derivatives Transactions (issued in 2005)

- Guidelines on Offering of Investment Linked to Derivatives Products (issued in 2006)

The capital treatment for credit derivatives transactions in the trading book is now included in the Capital Adequacy Framework. Other requirements relevant to the risk management of credit derivatives and offering of investment linked derivatives have already been provided for in existing policy documents.

## 19. Cybersecurity

- On March 21, 2016, the Securities Commission Malaysia (SC) published a consultation paper seeking public feedback on the proposed regulatory framework relating to the management of cyber security risk by capital market participants.

The SC views sound management of cyber security risk as a key priority to further strengthen the resilience of the Malaysian capital markets. This includes setting the direction for effective management of risks by the company's board of directors and establishing internal cyber security policies and procedures.

Interested parties and the public were invited to submit their comments and feedback before the closing date of 29 April 2016.

- On October 31, 2016, SC issued new guidelines to enhance cyber resilience of the capital market by requiring capital market entities to establish and implement effective governance measures to counter cyber risk and protect investors.

The Guidelines on Management of Cyber Risk (Guidelines), among other requirements, clearly stipulate the roles and responsibilities of the board and senior management in building cyber resilience of a capital market entity. The guidelines have also mandated the entity to identify a responsible person to be accountable for the effective management of cyber risk. These measures aim to ensure that cyber risk is managed in an optimised manner, in light of the changing landscape in the market.

These Guidelines require regulated entities to have in place a risk management framework to minimise cyber threats, implement adequate measures to identify potential vulnerabilities in their operating environment and ensure timely response and recovery in the event of a cyber-breach. In this regard, regulated entities are required to implement adequate physical and systems security arrangements.

The involvement of the board and senior management is important to ensure that the capital market entity puts adequate focus on cyber risk issues, determines risk tolerance and priorities, and allocates sufficient resources to cyber risk. As such, these Guidelines require the entity to outline the roles and responsibilities of the board, responsible person and key personnel in critical functions with a role in managing cyber risk.

In order to enable SC to engage effectively with capital market entities and to share information on cyber breaches and potential cyber threats, regulated entities are required to report cyber incidents to the SC. This engagement will enhance industry's awareness on, and preparedness in dealing with, cyber risk. It will also provide a platform for SC to collaborate with market entities and stakeholders to enhance cyber resilience on an ongoing basis.

These Guidelines will be implemented in phases. Entities will be selected for the different phases based on, among others, size, nature of activities and market share. The Guidelines took effect on 31 October 2016.

## **20. BNM and OJK to cooperate on banking**

- On August 1, 2016, Bank Negara Malaysia signed a bilateral agreement with Otoritas Jasa Keuangan, the Indonesian financial services authority, under the Association of Southeast Asian Nations (ASEAN) Banking Integration Framework.

The agreement will provide greater access and operational flexibility for Malaysian and Indonesian qualified ASEAN banks operating in the respective jurisdictions. The commitments in the agreement form part of the ASEAN Framework Agreement on Services. Under the agreement, it is envisaged that both Malaysian and Indonesian banks will have a greater role in facilitating cross-border trade and investment between both countries.

To promote adequate safeguards in a more integrated environment, Bank Negara Malaysia and Otoritas Jasa Keuangan also signed a memorandum of understanding (MoU) in April 2016 to further enhance supervisory cooperation. The MoU covers areas of supervisory cooperation and coordination, including exchange of information, facilitation of consolidated and cross-border on-site supervision, financial crime, and crisis management. The agreement and the MoU signify the commitment of both Bank Negara Malaysia and Otoritas Jasa Keuangan towards promoting greater regulatory cooperation as the region moves forward in pursuit of deeper regional financial integration.

## **21. BNM consults on regulatory framework for trustees and custodians**

- On October 12, Securities Commission Malaysia (SC) published a consultation paper seeking public feedback on a proposed regulatory framework for trustees and custodians in the Malaysian capital market.

Currently, there are 90 custodians and trustees safekeeping approximately RM1.7 trillion worth of assets on behalf of investors. The SC recognised the significant role played by trustees and custodians in maintaining investors' trust in the capital market by safeguarding investors' assets and interest.

In view of the important functions undertaken by these entities, the SC proposed to revise the regulatory framework that included streamlining entry standards and on-going conduct obligations that would create a level playing field among trustees and custodians. To enhance efficiency, the SC also proposed a one-time registration to enable trustees to provide services for all capital market products instead of the current product-based registration.

This framework is consistent with SC's efforts in realigning its regulatory approach from product-focused to intermediary/activity-focused. This framework would focus on conduct regulation to ensure that trustees and custodians prioritise investors in all of their decision-making process. In addition, it would place greater emphasis on board and management responsibilities by holding them accountable for the conduct of the registered entity and their representatives. The SC would also enhance the supervision of trustees and custodians to ensure that these registered entities continue to remain fit and proper when carrying out their obligations and responsibilities in protecting investors' rights and assets.

Interested parties and the public were invited to submit their comments and feedback before the closing date of 12 November 2016.

## 22. BNM releases concept paper on stress testing

- On October 14, 2016, BNM released a paper on stress testing for banking institutions. The concept paper outlines the following:
  - BNM's supervisory expectations and requirements with regards to the governance, coverage of risks, design, and implementation of a banking institutions stress testing programme;
  - The basis for BNM's supervisory assessment on the safety and soundness of banking institutions, monitoring of risks in the financial system, and pre-emptive policy actions; and
  - Reporting requirements on stress-testing results to BNM.

Comments are due by December 14. The policy is effective on June 1, 2017, with the exception of the reverse stress-testing requirements, which are effective on June 1, 2018.

## 23. Initiative to develop the onshore financial market

- On December 2, 2016, the Financial Markets Committee (FMC), in collaboration with Bank Negara Malaysia (BNM), announced measures intended to enhance the liquidity of the FX market and liberalise and deregulate the onshore ringgit hedging market. These took effect from December 5, and are as follows:
  - Market participants have greater flexibility to manage FX risk. Residents, including resident fund managers, may freely and actively hedge their US dollar and CNH exposures up to a limit of RM6 million per client, per bank. A one-time declaration of non-speculative activity would suffice;
  - Residents and non-resident fund managers can manage their FX exposure up to 25% of their invested assets; and
  - Offshore non-resident financial institutions may participate in the Appointed Overseas Office (AOO) framework, which provides for FX hedging (for own account or on behalf of a client) for current and financial accounts based on commitment, opening of ringgit accounts and extension of ringgit trade financing.

Resident entities with domestic ringgit borrowing are free to invest in foreign currency assets both onshore and abroad up to the prudential limit of RM50 million. Exporters can retain up to 25% of export proceeds in foreign currency.

On December 6, 2016, the FMC announced more details of the expanded AOO framework, which allows non-resident traders and investors greater ability to settle trade or investment in ringgit through an approved channel. The framework is now expanded to include additional transactions, such as foreign exchange hedging (own account or on behalf of a client) for current and financial accounts based on commitment, opening of ringgit accounts (book keeping), and extension of ringgit trade financing.

- On December 9, 2016, the Financial Markets Committee (FMC), in collaboration with Bank Negara Malaysia (BNM), released an updated FAQ on the initiative to develop the onshore financial market that was previously released on December 2. The FAQ has updated questions on:
  - Hedging flexibilities for institutional investors;
  - Hedging without documentary evidence;
  - Appointed overseas offices;

- Export proceeds and foreign currency accounts;
- Special deposit facility for resident exporters;
- Payment in foreign currency between residents; and
- Investment in foreign currency assets.

## 24. PIDM signs MoUs with US, Korean deposit insurers

- On December 8, 2016, Perbadanan Insurans Deposit Malaysia (PIDM) announced that it signed two separate memoranda of understanding (MoUs) with the Federal Deposit Insurance Corporation (FDIC) of the United States and the Korea Deposit Insurance Corporation (KDIC) to extend mutual cooperation and collaboration with its international counterparts.

The MoUs will facilitate the sharing and exchange of information and the mutual collaboration between the KDIC and its US and Korean counterparts respectively. Besides seeking to enhance the working relationship, the MoUs will also provide opportunities for sharing of knowledge, expertise and experiences through study visits, secondments, trainings and seminars. The MoU with the KDIC is a renewal of that previously signed by the two parties in 2013.

To date, PIDM has established bilateral cooperation with several other deposit insurers, which include the Philippines Deposit Insurance Corporation (PDIC) and the Central Deposit Insurance Corporation (CDIC) Taiwan. PIDM also has a tripartite arrangement with the Deposit Protection Agency (DPA), Thailand and the Indonesia Deposit Insurance Corporation (IDIC).

## ISDA Submissions (since 2010)

- April 30, 2010: [ISDA submission to SC on Public Consultation Paper on ‘Review of Sophisticated Investors and Sales Practices for Capital Market Products’](#)
- July 30, 2010: [ISDA submission to PIDM on Consultation Paper on ‘Proposed Amendments to the Malaysia Deposit Insurance Corporation Act 2005 Affecting Certain Financial Transactions’](#)
- December 17, 2010: [ISDA submission to BNM on Revised Guidelines on Product Transparency and Disclosure](#)
- September 15, 2011: [ISDA submission to PIDM regarding Consultation Paper on Criteria for Qualified Third Party](#)
- September 23, 2011: [ISDA submission to SC on Capital Markets and Services \(Amendment\) Bill 2011](#)
- November 3, 2011: [ISDA submission to SC on CMSA 2011](#)
- April 30, 2012: [ISDA submission to PIDM in response to the Concept Paper on Recordkeeping and Reporting Requirements for Over-the-Counter Derivatives](#)
- January 20, 2014: [ISDA submission to Securities Commission Malaysia, Bank Negara Malaysia and Perbadanan Insurans Deposit Malaysia on Joint Public Consultation Paper on Trade Repository Reporting Requirement for Over-the-Counter Derivatives](#)

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# NEW ZEALAND

## Key Regulatory Milestones

### 2. Financial Markets Conduct Bill

- The Financial Markets Conduct Bill passed the Third Reading on August 27, 2013 and received the Royal Assent on September 13, 2013. It represents the most comprehensive reform of New Zealand's securities and financial markets law in decades. OTC derivatives would, for the first time, become a regulated financial product. However, dealings between wholesale market participants would largely be exempted. The new Act would be brought into force progressively from April 2014. Much of the detail would be established through regulations with consultation on drafts to begin in October 2013.

### 3. Basel III

- On November 8, 2011, RBNZ released a consultation paper on 'Implementation of Basel III Capital Adequacy Requirements in New Zealand' and followed up on March 23, 2012, with a Consultation Paper on 'Further Elements of Basel III Capital Adequacy Requirements in New Zealand'. The RBNZ proposed the adoption of the Capital Conservation Buffer to be comprised of 2.5% of Common Equity Tier 1, above the minimum capital requirement and to be fully implemented by January 1, 2014. The paper also introduced a framework for implementing the Countercyclical Buffer which would be initially applied to registered banks but may extend it to include other lenders, such as non-bank deposit takers, in the future. The RBNZ intends to introduce the Basel III requirement that regulatory capital instruments be capable of absorbing losses.

### 4. Derivatives regime overhaul with FMCA implementation

- New Zealand's derivatives regime would be overhauled from 2015 by the full implementation of the Financial Markets Conduct Act 2013 (FMCA), with major implications for participants that transact OTC derivatives in New Zealand. The last stage before the new regime came into effect would be the publication of the FMC regulations. A near-final draft was published on September 26, 2014.

The FMCA would replace the Securities Markets Act 1988 (SMA), along with several other pieces of legislation, including New Zealand's outdated 'futures contract' and 'futures dealers' regime. Derivatives would be one of a number of classes of financial products under the FMCA. In a move away from the current approach, the regulation of disclosure for derivatives offered to retail investors would be substantially aligned with securities regulation. The FMCA definition of derivatives would cover most generally recognised market categories of cash-settled derivatives. The legislation gives New Zealand's financial markets regulator, the Financial Markets Authority, the authority to rule on the status of particular agreements.

The FMCA sets out a disclosure regime that would apply when derivatives are offered to retail investors (termed a 'regulated offer' under the legislation). The most important component of the new disclosure regime is a product disclosure statement (PDS), and specific requirements for the PDS have recently been published through regulation (it should be noted that this is not the same as the PDS currently used by New Zealand-registered banks). In addition to the disclosure regime, the new legislation

imposes general ‘fair-dealing’ obligations that would apply to all dealings in derivatives in New Zealand, whether with retail or wholesale counterparties.

The FMCA also creates a regime for licensing derivatives ‘issuers’ that make regulated offers to enter into derivatives, with the FMA acting as licensing authority and the supervisor of licensed derivatives issuers. While dealings with wholesale counterparties and most dealings in exchange-traded derivatives would be excluded from being deemed regulated offers, any market participant that is in the business of offering derivatives to retail investors would need to consider whether it requires a licence. Transitional provisions in the FMCA provide an interim licence for persons who are authorised or approved as futures dealers under the SMA and who would require a licence under the new regime. The licensing regime under the FMCA would cover prudential and systems and controls matters, as well as conduct of business (with a carve-out for registered banks and other entities subject to Reserve Bank oversight). In addition to these requirements for licensed derivatives issuers, the FMCA regime also sets out new rules for dealing with client funds that would apply to all derivatives issuers, whether or not they hold a licence from the FMA.

The transition process would be complex, and a recently announced delay to its implementation (other categories of financial product would come under the new regime from December 1, 2014) meant this would be a major concern for participants in New Zealand’s OTC markets for some time to come. Derivatives issuers would need to assess whether they need a licence under the new legislation and apply for one as soon as possible if they would not have a transitional licence. Those derivatives issuers that would have a transitional licence would have more time to obtain a licence (until December 2016), but would need to prepare new offering documentation during 2015.

## **5. RBNZ consults on outsourcing**

- On August 26, 2015, the RBNZ released a consultation paper with proposals for an updated outsourcing policy for banks. The current outsourcing requirements date back to 2006, and apply to all locally incorporated banks with New Zealand liabilities exceeding \$10 billion. The current policy is mainly focused on underpinning the provision of liquidity to the financial system in the event of stress or the failure of a bank or a service provider to a bank. The main proposals (subject to the outcome of consultation) are:
  - An explicit requirement for a separation plan for subsidiaries of foreign-owned banking groups;
  - A list of functions that are not relevant for the outsourcing policy;
  - A list of functions that cannot be outsourced;
  - A clearer process for obtaining non-objection from the RBNZ for outsourcing proposals;
  - A compendium of outsourced functions; and
  - A possible alignment of the threshold used for deciding which banks the outsourcing policy should apply to, with the threshold used for the RBNZ’s open bank resolution (OBR) policy.

RBNZ further notes that outsourcing can produce efficiency benefits for banks, and provides access to state-of-the-art technology and practices that are not necessarily available internally or within New Zealand. The proposed new policy does not prevent banks from realising those benefits. The policy also does not prohibit the use of outsourcing arrangements. Comments on the consultation paper are due by November 4, 2015.

## **6. RBNZ publishes new rules for banks, NBDTs**

- On December 18, 2015, the RBNZ published the conclusions of its stocktake of the prudential regulations that apply to banks and non-bank deposit takers (NBDTs). The stocktake aims to enhance the efficiency, clarity and consistency of the rules for banks and NBDTs.

Changes were proposed to the current requirement that banks must prepare “off-quarter” disclosure statements, with the RBNZ looking into the possibility of a new ‘dashboard’ mechanism for providing these off-quarter disclosures after a more detailed discussion with banks and other interested parties.

The consultation found broad support for most of the RBNZ’s specific proposals such as improving the drafting and layout of the documents that set out prudential requirements for banks and a number of technical changes that were proposed in specific prudential requirements. The RBNZ also received useful feedback on several matters relating to the prudential requirements for NBDTs.

## **7. RBNZ to retain NZClear**

- On March 11, 2016, the RBNZ announced it has decided to retain the NZClear business. After a strategic review in 2014, the RBNZ sought interest from potential operators of securities settlement services. It has now concluded the search without attracting suitable bids that met service requirements and commercial terms.

NZClear is a real-time settlement system and depository, owned by the RBNZ, which provides financial markets with clearing and settlement services for high-value debt securities and equities. The RBNZ is now planning to invest in a new platform to provide these services. The new platform will be separate from the exchange settlement account system, which the RBNZ is also replacing.

## **8. RBNZ consults on crisis management regime for FMIs**

- On March 24, 2016, RBNZ commenced a public consultation on a crisis management regime for systemically important financial market infrastructures (SIFMIs). The proposed regime forms the final part of proposals the RBNZ published in December 2015 for a new oversight regime for SIFMIs. The proposed crisis management regime has two parts. First, SIFMIs would be required to maintain business continuity plans and recovery and wind-down plans. Second, the RBNZ and the Financial Markets Authority (FMA) (joint regulators) could call on proposed new statutory powers when these plans are inadequate to manage a crisis. Submissions are due by May 20, 2016.

## **9. RBNZ reviews Insurance (Prudential Supervision) Act**

- On April 12, 2016, RBNZ announced that it is planning a review of the Insurance (Prudential Supervision) Act (IPSA). IPSA provided the first comprehensive framework for the prudential regulation and supervision of insurers in New Zealand.

The review seeks to ensure that IPSA provides for a supervisory regime that is cost effective, risk-based and that promotes the soundness and efficiency of the insurance sector. RBNZ plans to publish an issues paper in late 2016 and seek feedback from the public and stakeholders.

## **10. RBNZ seeks submissions on proposed outsourcing rules**

- On May 23, 2016, RBNZ announced that it is seeking submissions on proposed amendments to rules about outsourcing of services by registered banks.

If implemented, the rules would give the RBNZ better assurance about the provision of basic ongoing banking services in the event of service disruption, while allowing banks to capture the efficiency benefits of robust outsourcing arrangements. The current rules state a range of outcomes that banks must be able to deliver on an on-going basis, and apply to locally incorporated banks with New Zealand liabilities of more than \$10 billion. After an initial round of consultation last year, the RBNZ is now proposing revised rules based on feedback it has received.

The revised proposals allow banks greater flexibility in achieving the desired policy outcome. Changes to the proposed policies include:

- maintaining the existing \$10 billion threshold for the outsourcing rules;
- a more detailed definition of basic banking services;
- an outcomes based policy where the outsourcing of critical functions is not prohibited, provided there is robust back-up capability;
- a more comprehensive list of functions that will not be captured by the outsourcing rules; and
- a five year transition path to compliance.

Submissions closed on 12 August 2016. The RBNZ started reviewing the outsourcing rules in 2015, due to inconsistent application of the existing outsourcing policy by banks over a number of years.

## **11. FMA reports on NZX's regulatory framework**

- On June 23, 2016, the Financial Markets Authority released its latest annual review of NZX and reports that it is meeting its statutory obligations as a market operator and frontline regulator of those markets.

The review is just one of the ways that the FMA engages with NZX. A Memorandum of Understanding signed in 2015 reflects the two regulators' shared responsibilities for the regulation of New Zealand's capital markets. This has enabled many levels of regular engagement, discussion and co-ordination between NZX and the FMA. Over the year the FMA saw clearer regulatory messages being given to issuers and more instances of potential non-compliance being referred to the FMA for investigation.

Complementing the regular interactions and coordination with NZX throughout the year, the FMA also performed an end-of-year review of the market operator. The FMA paid particular attention to how NZX regulates the compliance of participant firms, and how it responded to new developments in its business and the markets, focussing on:

- The launch of the NXT market and the purchase of SuperLife;
- Whether governance, operational infrastructure, compliance policies and procedures took into account the changes to NZX's business; and
- Reviewing the effectiveness of the participant compliance function to ensure the maintenance of fair, orderly and transparent markets.

## **12. RBNZ consults on dual registration for non-systemic banks**

- On June 17, 2016, RBNZ published a consultation paper on its approach to the registration of foreign-owned banks that have a small, non-systemic, locally incorporated presence in New Zealand.

The consultation proposes a way to assess whether these banks may be permitted to ‘dual-register’, simultaneously operating a local branch alongside a subsidiary, and notes that permitting banks to operate branches alongside their existing subsidiaries could potentially open up more diversified funding channels in New Zealand and encourage greater competition for the incumbent banks. The consultation paper does not address the RBNZ's process for assessing standalone branch applications.

### **13. FMA releases conduct guide for feedback**

- On July 28, 2016, the New Zealand Financial Markets Association (FMA) released a guide to how it will examine whether financial services providers are demonstrating good conduct under the Financial Markets Conduct Act (FMC Act).

The guide describes how conduct will be the ‘lens’ through which the FMA will examine what providers do, how they do it, and how that translates to what their customers experience. A mandate to focus on conduct shifts the FMA’s emphasis from compliance with regulations to assessing whether providers can show that they consistently and purposely deliver good outcomes to their customers.

The FMA is seeking feedback from licensed providers under the FMC Act and welcomes submissions from others in the financial services industry. Given the importance of the subject matter, the FMA has decided a longer consultation period is appropriate so submissions will be accepted until October 31.

- On December 13, 2016, the New Zealand Financial Markets Association (FMA) announced that following an earlier consultation in 2016 on a guide on good conduct, the final version of the guidance and a report on the submissions received will be published in 2017. The guidance will signal to New Zealand financial services providers what to expect from interaction and engagement with the conduct regulator.

The FMA recognised that the Financial Markets Conduct Act does not contain broad conduct obligations for providers, beyond prohibiting mis-selling and misrepresentation under its fair dealing provisions. A number of responses to the consultation had focused on the legal status of the FMA’s expectations as to conduct set out in the draft guide.

The FMA also stated that as it moves into operational mode, staff will refer to the guide as they assess how sectors and firms have designed their systems, processes and culture to generate consistently good conduct. Likewise, when confronted with issues, complaints or alleged breaches of the law, the relevant firm’s approach to conduct will be a factor and the guide will be a reference point for the FMA teams.

### **14. LVR start date deferred until 1 October 2016**

- On August 12, 2016, the RBNZ announced that it is deferring the start of the proposed changes to investor loan-to-value restrictions (LVRs) nationwide from 1 September to 1 October 2016, based on feedback from the banking industry from its recent consultation on the proposals. Under the proposed new restrictions:

- No more than 5% of bank lending to residential property investors across New Zealand would be permitted with an LVR of greater than 60% (i.e. a deposit of less than 40%).
- No more than 10% of lending to owner-occupiers across New Zealand would be permitted with an LVR of greater than 80% (i.e. a deposit of less than 20%).
- Loans that are exempt from the existing LVR restrictions, including loans to construct new dwellings, would continue to be exempt.

## 15. RBNZ consults on new dashboard for local banks

- On September 23, 2016, the Reserve Bank of New Zealand (RBNZ) released a consultation document on a proposed new ‘dashboard’ approach to quarterly disclosures for locally incorporated banks.

The dashboard proposal involves publishing quarterly information from locally incorporated banks on the RBNZ website in a standardised and easily comparable manner, replacing the requirement for locally incorporated banks to prepare off-quarter disclosure statements. However, banks will continue to produce full-year and half-year disclosure statements.

The consultation document includes an alternative to the dashboard in the form of an amended off-quarter disclosure statement. The paper discusses issues arising from the dashboard proposal and the potential alternative, and from the RBNZ’s separate proposal to remove the requirement for registered bank branches to prepare off-quarter disclosure statements.

Submissions on the consultation close on December 1, 2016.

## ISDA Submissions (since 2010)

- August 20, 2010: [ISDA submission to MED on the discussion paper on ‘Review of Securities Law’](#)
- September 6, 2011: [ISDA submission to the Ministry of Economic Development \(MED\) on the Financial Markets Conduct Bill](#)

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# PHILIPPINES

## Key Regulatory Milestones

### 1. Basel III & Capital

- On December 26, 2012, the Monetary Board approved the implementing guidelines for the January 1, 2014 adoption of the revised capital standards under the Basel III Accord. BSP maintained the minimum Capital Adequacy Ratio at 10%. The revised Common Equity Tier 1 (CET1) would be 6% and the Tier 1 ratio would be at a minimum of 7.5%. The new guidelines also introduce a capital conservation buffer of 2.5%, which would be comprised of CET1 capital. Banks that have issued capital instruments from 2011 would be allowed to count these instruments as Basel III-eligible until end-2015.
- On June 9, 2015, the BSP announced its implementing guidelines on the Basel III leverage ratio framework. The leverage ratio shall not be less than 5%, computed on both a solo (head office plus branches) and consolidated (parent bank plus subsidiary financial allied undertakings but excluding insurance companies) basis.

The guidelines implementing the leverage ratio are provided in Appendix 111 of the Manual of Regulations for Banks (MORB) and in Appendix Q-65 of the Manual of Regulations for Non-Bank Financial Institutions (MORNBFI), respectively. The guidelines would apply to universal banks and commercial banks and their subsidiary banks/quasi-banks (QBs).

Specific guidelines on the mode and manner of submission of the leverage ratio reporting and disclosure templates would be covered by a separate memorandum issuance. During the monitoring period, BSP would continue to assess the calibration and treatment of the components of the leverage ratio. Final guidelines would be issued in view of the changes to the framework, as well as migration from monitoring of the leverage ratio to a Pillar I requirement from January 1, 2017.

Public disclosure of information on the leverage ratio would not be required during the monitoring period (i.e., December 31, 2014 to December 31, 2016).

Banks (or QBs) would not be penalised for any breach of the 5% minimum leverage ratio during the monitoring period. However, late and/or erroneous reports would be subject to penalties provided under Subsection XL92.2 of the MORB and Subsection 4192Q.2 of the MORNBFI.

- On July 16, 2015, BSP published guidelines on the electronic submission of the Basel III leverage ratio (BLR) report. Further to the guidelines on the Basel III leverage ratio framework published on June 9, 2015, the submission guidelines would be observed for the BLR report starting with the reporting period ending December 31, 2014 and every quarter thereafter until December 31, 2016. The submission guidelines include: 1) a link to where the prescribed data entry template (DET) and the corresponding control prooflist (CP) of the BLR report can be downloaded; 2) prescribed reporting periods and corresponding submission deadlines; 3) formatting for electronic submission; and 4) the mailing address in case banks are unable to submit electronically.
- On March 1, 2016, BSP approved its liquidity coverage ratio (LCR) framework aimed at strengthening the liquidity position of universal and commercial banks (U/KBs). This is part of the Basel III reform package issued by the Basel Committee.

Under the new rule, U/KBs, including foreign bank branches, must hold sufficient high-quality liquid assets that can be easily converted into cash to service liquidity requirements over a 30-day stress period. This provides banks with a minimum liquidity buffer to be able to take corrective action to address a liquidity stress event. The net stable funding ratio is being finalised and the exposure draft may be issued within the year.

The approval of the monetary board provides for an observation period from July 1, 2016 to end-2017, during which banks will start reporting their LCR to the BSP. Beginning January 1, 2018, the LCR threshold that banks will be required to meet will be 90%, which will then be increased to 100% beginning January 1, 2019.

- On March 10, 2016, the BSP issued a circular on the implementation of the LCR and related disclosure standards consistent with the Basel III capital framework. Provisions have been inserted into the MORB to impose requirements for compliance with the LCR, LCR disclosure requirements, sanctions, transitional arrangements and related matters. Compliance with the LCR will be required from January 1, 2018 at a level of 90%, with movement to 100% one year later.
- On June 27, 2016, the BSP approved new guidelines on the electronic submission of the Basel III Liquidity Coverage Ratio for the observation period of the LCR report from measurement date 30 June 2016 to 30 September 2017. The guidelines are mainly procedural and technical in nature.
- On December 29, 2016, the Monetary Board deferred by one year the full adoption of the Basel III leverage ratio in view of recent revisions by the Basel Committee on Banking Supervision (BCBS). Universal and commercial banks and their subsidiaries had been scheduled to wind-up the monitoring period and begin adhering to the 5% minimum leverage ratio by January 1, 2017.

In relation to this, the Monetary Board also extended the monitoring period for the leverage ratio until December 31, 2017.

## **2. BSP regulations**

- On August 11, 2015, the Monetary Board of BSP approved new guidelines for segregating customer funds received by banks under a securities brokering arrangement from the deposit-taking activities of these banks. The segregation is undertaken by introducing a new account in the books of the banks, called 'broker customer accounts'. Under prior practice, banks would book as deposits the money they receive from clients that wish to purchase securities. The bank is acting as a securities broker for the client under this transaction.

The broker customer account makes clear that funds recorded under this item are not to be classified as deposits. They are transactional in nature because there is an instruction to use them to purchase securities. In this context, the broker customer account would not be subject to bank reserve requirements and would not be covered by the Philippine Deposit Insurance Corporation.

Broker banks are required to submit a monthly report of their weekly balances of securities and cash they receive from their customers, starting from October 2015.

As a step towards the segregation of banking activities from other business activities, the current

Financial Reporting Package of the BSP was also amended to introduce reporting of the amount of securities broking transactions of its supervised financial institutions.

- On November 2, 2015, the Monetary Board of the BSP published Circular No.890 approving amendments to the MORB and MORNBFIL. Key elements include:

Section 10 Circular No. 827 deleted Section X116, Subsections X116.1 to X116.7, and Appendix 63a of the MORB. The following subsections/appendices of the MORB contain references pertaining to the deleted section/subsections/appendix. References to the deleted section/subsections/appendix are changed to "under applicable and existing capital adequacy framework". With respect to derivatives:

- App.46b: Instructions for Accomplishing the Report on Computation of the Adjusted Risk-Based Capital Adequacy Ratio Covering Combined Credit Risk and Market Risk (For Universal Banks and Commercial Banks With Expanded Derivatives Authority);
  - App.46c: Instructions for Accomplishing the Report on Computation of the Adjusted Risk-Based Capital Adequacy Ratio Covering Combined Credit Risk and Market Risk (For Universal Banks and Commercial Banks with Expanded Derivatives Authority but Without Options Transactions);
  - App.46d: Instructions for Accomplishing the Report on Computation of the Adjusted Risk-Based Capital Adequacy Ratio Covering Combined Credit Risk and Market Risk (For Universal Banks and Commercial Banks Without Expanded Derivatives Authority).
- On May 16, 2016, the BSP announced the formal shift in its monetary operations to an interest rate corridor (IRC) system starting 3 June 2016. The IRC is a system for guiding short-term market rates towards the BSP policy interest rate which is the overnight reverse repurchase (RRP) rate.

The IRC system consists of the following instruments: standing liquidity facilities, namely, the overnight lending facility (OLF) and the overnight deposit facility (ODF); the overnight RRP facility; and a term deposit auction facility (TDF). The interest rates for the standing liquidity facilities form the upper and lower bound of the corridor while the overnight RRP rate is set at the middle of the corridor. The repurchase (RP) and Special Deposit Account (SDA) windows will be replaced by standing overnight lending and overnight deposit facilities, respectively. Meanwhile, the reverse repurchase (RRP) facility will be modified to a purely overnight RRP. In addition, the term deposit facility (TDF) will serve as the main tool for absorbing liquidity.

The shift to the IRC system does not represent a change in the BSP's stance of monetary policy. In particular, the new Term Deposit Auction Facility is expected to have a rate between that of the RRP and overnight deposit facility such that the weighted rate for monetary operations will remain broadly the same. Moreover, the interest rate at the floor of the corridor, where the bulk of the BSP's liquidity absorption with the market currently takes place, is being kept steady at the launch of the IRC system. At the same time, short-term liquidity conditions are expected to remain broadly unchanged as funds will continue to be absorbed through monetary operations under the new IRC system. In conducting monetary operations, the BSP will calibrate carefully the volume of the TDF offerings to achieve a smooth transition to the new system.

### 3. SEC regulations

- On August 6, 2015, the Philippines Securities and Exchange Commission (SEC) announced that it had approved the 2015 Implementing Rules and Regulations of the Securities Regulation Code (2015 SRC Rules). The 2015 SRC Rules enhance existing requirements, including the ability of companies to raise

funds in the domestic market. It also addresses regulatory gaps, strengthens market and regulatory structures, and adopts global best practices to ensure participants are able to meet the challenges posed by increasing market sophistication and regional integration.

The initial draft of the proposed amendments was opened for public comment in 2011. Following that, SEC conducted a series of consultations with market participants and various stakeholders. The final draft of the rules was adopted after reviewing and considering responses. Some key features of the rules are:

- An expansion of shelf registration;
  - A new definition for commercial paper;
  - A new category of exempt security;
  - A registration exemption for public offerings that have a limited character;
  - Loosening of underwriting requirements;
  - Relaxed requirements for qualified buyers; and
  - A facelift of the mandatory tender offer rules.
- On October 8, 2015, the SEC issued a series of corrections to the 2015 SRC Rules.
  - On November 11, 2016, the SEC announced that it has approved the rules to govern the listing, trading and settlement of dollar-denominated securities (DDS) at the Philippine Stock Exchange (PSE).

The introduction of DDS aims to provide issuers with dollar-denominated requirements an opportunity to raise capital without incurring foreign exchange risks. The eligible issuers of DDS are those existing listed companies in good standing with the PSE. The issuer is required to engage at least two eligible brokers that are qualified to trade DDS.

The eligible brokers definition is as follows:

- Must have attended the DDS training session or seminar conducted by the PSE;
- Must be operationally ready to trade DDS and shall issue a sworn certification to the PSE attesting to its operational readiness;
- Maintain a US deposit account or foreign currency deposit unit and a separate US dollar settlement account for clearing of trades;
- Open a separate US dollar cash collateral deposit account for DDS; and,
- Submit an undertaking to obtain the consent of its clients to the disclosure of their names to the SEC if said information is requested by the SEC in the course of an investigation, examination, official inquiry or as part of the surveillance procedures or compliance with other pertinent laws.

The procedures for securities deliveries are the same as with peso-denominated securities. However, settlement shall be denominated in US dollars. Therefore, brokers intending to participate in the trading of DDS are required to have a US dollar deposit account with any universal or commercial bank, and a separate US dollar cash settlement account with the designated settlement bank.

#### **4. Repo reporting**

- On August 31, 2016, the BSP announced new requirements for reporting on repurchase agreements by banks and quasi-banks. New provisions have been added to the MORB requiring quasi-banks, universal

and commercial banks and their thrift bank subsidiaries to submit a report on repurchase agreements on a solo basis in accordance with the Reporting Guidelines and Instructions on Reportorial Template on Repurchase Agreements.

Reporting will commence with a pilot run for the month of November 2016, followed by monthly ongoing reporting when this takes effect on June 30, 2017.

## 5. FX Rules

- On December 2, 2015, the BSP approved further liberalization of rules governing foreign exchange (FX) transactions in the Philippines. The policy amendments are as follows:
  - Prior BSP approval is no longer required for the borrowings from offshore sources/FCDUs of banks of the following resident entities:
    - Purely private sector loans (i.e., without guarantee from the public sector or banks) that are intended to finance energy-/power-related projects. The policy is in support of the country's growing economy and increasing need for infrastructure.
    - Private non-bank financial institutions engaged in microfinance activities where loan proceeds will be used for microfinance lending. This will help promote financing of microfinance activities in line with the BSP's flagship program for financial inclusion and poverty alleviation.
  - Conversion to FX of pesos arising from disapproved subscriptions of non-resident investors to stock rights offering of companies listed at the Philippine Stock Exchange is now allowed. The measure will facilitate outward remittance of excess funds arising from such cases and in the process encourage more foreign investors in investing in the Philippines.

Other procedural/clarificatory amendments to the Manual of Regulations on Foreign Exchange Transactions were also approved for better guidance of users. The implementing circular will be issued shortly.

- On September 13, 2016, the BSP released a circular revising provisions to the regulation of FX transactions. The revised provisions consist of six parts:
  - Rules on FX transactions, including general provisions and resident to resident transactions;
  - Current account transactions, including non-trade foreign FX exchange receipts and disbursements, cross-border transfer of local and foreign currencies, gold transactions, and foreign merchandise trade transactions;
  - Capital account transactions, including loans and guarantees and foreign investments;
  - Offshore banking units, representative offices and foreign currency deposit units;
  - FX forward and swaps and open FX position of banks; and
  - General provisions setting out reporting requirements.

The circular takes effect on September 15, 2016.

## 6. Recovery plans

- On March 10, 2016, the BSP approved new guidelines on the recovery plan which is required to be submitted by D-SIBs. A circular sets out the guidelines that D-SIBs should follow in drawing up and maintaining a recovery plan that prepares them for future destabilising events and/or crises, and will form an integral part of the internal capital adequacy assessment process document to be submitted on March 31 of each year.

## 7. BSP and BOJ cross-border liquidity arrangement

- On August 26, 2016, BSP announced that the guidelines governing the cross-border liquidity arrangement (CBLA) between the BSP and the Bank of Japan (BOJ) have taken effect. The BOJ and the BSP agreed to establish the CBLA in February 2015 to enhance financial stability in the Philippines.

The establishment of the facility allows banks operating in the Philippines, including Japanese banks, to access Philippine peso liquidity against their Japanese yen holdings during emergency situations.

## 8. BSP includes renminbi in international reserves

- On October 24, 2016, the BSP announced that its monetary board approved the inclusion of the Chinese renminbi (RMB) in the official international reserves of the BSP effective October 13, 2016. The BSP may hold RMB as part of its gross international reserves to ensure that RMB is available to the banking system when needed. At present, the country's reserves are held in various currencies, mainly the US dollar, International Monetary Fund (IMF) special drawing rights, and gold.

In deciding to make the RMB Philippine reserve-eligible, the monetary board took into consideration the inclusion of the RMB in the basket of reserve currencies that determine the value of the IMF special drawing rights and the rising economic and financial importance of China. The monetary board also took into consideration the country's increasing economic links with China.

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# SINGAPORE

## Key Regulatory Milestones

### 1. G20 OTC derivatives commitments

- On February 13, 2012, MAS released two consultation papers setting out MAS' proposals to implement G20 commitments. The key proposal was to extend the ambit of the SFA to OTC derivative contracts by implementing a legislative framework for the regulation of OTC derivatives trade repositories (TRs) and clearing facilities (CCPs), OTC derivatives intermediaries and derivative market operators and empowering MAS to mandate reporting, clearing and execution of OTC derivatives on exchanges or electronic trading platforms.

This was followed on:

- May 23, 2012 by its 1st Response to feedback received and its Consultation Paper I on proposed amendments to the SFA dealing with the regulation of TRs and CCPs; and
  - August 3, 2012 by its 2nd Response to feedback received and its Consultation Paper II on proposed amendments to the SFA dealing with mandatory reporting and clearing of OTC derivatives.
- On November 15, 2012, the Securities and Futures (Amendment) Bill 2012 was enacted. This introduces the following new Parts to the SFA:
  - Part IIA – regulation of TRs,
  - Part III – regulation of CCPs,
  - Part VIA – mandatory reporting of OTC derivatives, and
  - Part VIB – mandatory clearing of OTC derivatives.
- On January 10, 2013, MAS issued a Consultation Paper on the draft Securities and Futures (Trade Repositories) Regulations and the Securities and Futures (Clearing Facilities) Regulations which would operationalize the new Part IIA and Part III of the SFA respectively.

In summary:

#### TRs and CCPs

- A single-tier regulatory regime applies to TRs with Singapore-incorporated TRs being regulated as licensed trade repositories (LTR) and foreign-incorporated TRs being regulated as licensed foreign trade repositories (LFTR).
- A two-tier risk-based regulatory regime applies to CCPs with a “lighter touch” regime applicable to RCHs (as defined below). Entities (which must be Singapore-incorporated) operating clearing facilities that are systemically-important would be regulated as approved clearing houses (ACH) and entities (which can be Singapore or foreign-incorporated) operating clearing facilities that are not systemically-important would be regulated as recognised clearing houses (RCH).
- One can establish or operate a TR without being licensed but reporting to a non-licensed TR would not fulfil any Singapore mandatory reporting requirement. However, it is an offence to hold oneself out as an LTR or LFTR if one is not licensed as such.
- In contrast, it is an offence to establish or operate a CCP or hold oneself out as operating a CCP unless one is an ACH or RCH.

### Reporting

All financial institutions regulated by MAS (FIs) and non-FIs resident or having a presence in Singapore above a reporting threshold are required to report all transactions (except FX spots) but only if booked or traded (based on trader location) in the Singapore office. However, Singapore-incorporated banks must report on a group-wide basis though there is no need for consolidated reporting.

- Single-sided reporting would apply. Where an FI faces a non-FI that is below the reporting threshold, the FI must still report the trade.
- However, where one party to the transaction is a central bank or government or a supranational organization, the other party (if otherwise subject to the reporting obligation) need not report the transaction.
- Outstanding contracts with a remaining maturity of more than one year on the relevant implementation date would need to be reported. However, this would be phased-in at a later stage.
- Transactions would need to be reported by the next business day.
- Reporting by an agent is permitted but the party subject to the mandate remains responsible.
- Reporting would be phased-in by asset class and reporting entity type.

### Clearing

- All FIs and non-FIs resident or having a presence in Singapore above a clearing threshold would be required to clear certain products if one leg of the contract is booked in Singapore and either (i) both parties are resident or have a presence in Singapore and are subject to the clearing mandate; or (ii) one party is resident or has a presence in Singapore and is subject to the clearing mandate and the other party would have been so subject had it been resident or had a presence in Singapore.
- The products to be cleared would be identified through a bottom-up and top-down approach. FX spots and deliverable FX forwards and swaps would be exempted.
- FIs with minimal derivatives exposures in aggregate and by asset class, central banks and governments, and supranational organizations would be exempted. Intra-group transactions (subject to appropriate safeguards) and possibly pension schemes would also be exempted.

This was followed by:

- On July 25, 2013, MAS published the Securities and Futures (Trade Repositories) Regulations 2013 which came into operation on August 1. An applicant for a TR license needs to demonstrate to MAS that it is able to meet the obligations of, and comply with the requirements imposed on, a licensed TR; and the applicant is able to maintain a minimum base capital of at least \$10 million. The TR would have the obligation to notify MAS of certain matters, such as any civil or criminal legal proceeding instituted against the licensed TR, whether in Singapore or elsewhere; and any disruption of or delay in, or any suspension or termination of any systems relating to, the reporting of transactions, including those from any system failure.

An LTR shall seek approval prior to commencing any linkage, arrangement or co-operative arrangements. The LTR would need to submit periodic reports to MAS. The LTR shall maintain confidentiality except in certain circumstances, such as where the disclosure of user information is necessary for the making of a complaint or report under any written law for an offence. An LTR would need to maintain at all times a business continuity plan and a recovery and resolution plan as well as procedures and systems to maintain the integrity and security of the transmission and storage of all information reported to the LTR. An LTR would also need prior approval from MAS to impose any reporting fee on its participants for any services provided by the LTR; or modify, restructure or otherwise change any existing reporting fee imposed on its participants.

- On July 25, 2013, MAS also published the Securities and Futures (Clearing Facilities) Regulations 2013, which came into operation on August 1 as well. An approved clearinghouse needs to comply with the requirements imposed for an approved clearinghouse and would need to maintain a minimum base capital of at least \$10 million. A recognised clearinghouse would need to comply with the requirements imposed for a recognised clearinghouse and would need to maintain a minimum base capital of at least \$5 million.

MAS may approve a Singapore corporation as an approved clearinghouse if MAS is satisfied that a disruption in the operations of a clearing facility could (a) trigger, cause or transmit further systemic disruptions to the financial system; or (b) affect public confidence in the financial system. A Singapore corporation would be a recognised clearinghouse if the above two conditions do not apply.

An approved clearinghouse would have the obligation to notify MAS of certain matters, such as any civil or criminal legal proceeding instituted against the approved clearinghouse, whether in Singapore or elsewhere; any disruption of or delay in any clearing or settlement procedures of the approved clearing house, including system failures. An approved clearinghouse would need to seek approval from MAS prior to making any change to its risk management frameworks, including the types of collateral accepted, the methodologies for collateral valuation and determination of margins, and the size of the financial resources available to support a member's default. An approved clearinghouse would need to maintain at all times a business continuity plan and a recovery and resolution plan as well as procedures and systems to maintain the integrity and security of the transmission and storage of its user information.

- On June 26, 2013, MAS released its consultation paper on Draft Regulations Pursuant to the Securities and Futures Act for Reporting of Derivatives Contracts (SF(RDC)R).

MAS proposed to require derivatives contracts which are traded in Singapore and/or booked in Singapore by specified persons to be reported to an LTR or LFTR. The term “traded in Singapore” means the execution of the specified derivatives contract by any trading desk (of a specified person) located in Singapore.

MAS proposed to subject non-financial specified person (NFSP) to the reporting obligation only when his aggregate gross notional amount of specified derivatives contracts traded in Singapore or aggregate gross notional amount of specified derivatives contracts booked in Singapore exceeds the reporting threshold of S\$8 billion. Once an NFSP exceeds the reporting threshold, he must notify MAS no later than one calendar month from the end of the quarter the threshold is exceeded. An NFSP ceases to be subject to the reporting obligation when both his aggregate gross notional amount of specified derivatives contracts traded in Singapore or aggregate gross notional amount of specified derivatives contracts booked in Singapore falls below the reporting threshold for four consecutive quarters. However, an NFSP would still be required to continue reporting any amendment, modification, variation or change to the information of all specified derivatives contracts that it had previously reported to the LTR or LFTR, even after it has stopped being subject to the reporting obligation. The Singapore Government and statutory boards; central banks; foreign central banks or agency of central government not incorporated for commercial purposes and; certain multilateral agencies, such as the Asian Development Bank, the Bank for International Settlements, the African Development Bank to name a few, would be exempt from the reporting obligation.

All asset classes would be reportable, however, it would be subject to a phased implementation process. Reporting began on October 31, 2013 for interest rate derivatives contracts and credit derivatives

contracts. This would be followed by foreign exchange, equity and commodity derivatives contracts on April 1, 2014. FX spots would not be reported.

Reporting would also be subject to a phased implementation process by the type of reporting party which includes banks/merchant banks; other FIs and NFSPs. Banks/merchant banks would have a transition period of one month from the Date of Listing. Other FIs would have three months from the Date of Listing and NFSPs would have six months from the Date of Listing. Each of these dates were set out in the fourth schedule of the SF(RDC)R. Contracts with a remaining maturity of not less than one year as of the Date of Listing would need to be back-loaded. Firms would have six months from the reporting commencement date to do so. Contracts entered into on/ after the Date of Listing and before the reporting commencement date would need to be reported and given six months to do so from the reporting commencement date.

MAS has the power under Section 128 of the SFA to allow specified persons who are complying with a comparable reporting regime in foreign jurisdictions to be deemed as having complied with Section 125 of the SFA. MAS would await further international consensus before exercising such power.

- On October 30, 2013, MAS published the Securities and Futures (Reporting of Derivatives Contracts) Regulations 2013, which came into operation on October 31, 2013. Reporting would begin on April 1, 2014 for licensed banks and merchant banks for credit and interest rate derivatives. All other financial entities began reporting for credit and interest rate derivatives on July 1, 2014, followed by significant derivatives holders on October 1, 2014.

A significant derivatives holder is prescribed as a Singapore resident person with an aggregate gross notional exceeding SGD 8 billion over 4 consecutive quarters. A specified derivative contract would need to be reported if it is any interest rate or credit derivative contract which is traded in Singapore or booked in Singapore to a licensed trade repository or licensed foreign trade repository.

- On March 26, 2014, MAS published the Securities and Futures (Reporting of Derivatives Contracts) (Amendment) Regulations 2014, which came into operation on March 31, 2014.

Some of the changes included:

- a specified person or a specified person who enters into a specified derivatives contract as agent of a part to the specified derivatives contract, need not report counterparty information before November 1, 2014 if he is prohibited from reporting of counterparty information under the laws of any jurisdiction, or requirements imposed on him by any authority of any jurisdiction or is required to attain client consent and has made all reasonable efforts but was unable to attain such consent;
  - for uncleared contracts that are not electronically confirmed and entered into on or after April 1, 2015, counterparties would need to agree on the UTI to be reported;
  - for counterparties that are not specified persons, if the counterparty does not have a LEI or a pre-LEI, the SWIFT BIC code, AVOX ID, any identifier issued by a licensed trade repository or licensed foreign trade repository, or client code may be used;
  - reporting of interest rate contracts and credit derivatives “traded in Singapore” would start on April 1, 2015 instead of April 1, 2014.
- On July 1, 2014, MAS published the Securities and Futures (Reporting of Derivatives Contracts) (Exemption) Regulations 2014. These regulations came into effect on July 1 and exempted certain entities below a \$8 billion threshold from Section 125 of the SFA. The exemptions are as follows:

- A holder of a capital services license to carry on the business of fund management or real estate investment trust management is exempted from section 125 of the Act if the total value of the holder's managed assets as at the last day of its most recent completed financial year does not exceed \$8 billion; or where the holder has not held the capital markets services license for a full financial year, the total value of the holder's managed assets does not exceed \$8 billion;
  - An approved trustee under section 289 of the Act of a collective investment scheme managed by (a) a holder of a capital markets services license who is exempt from section 125 of the Act under paragraph (1); (b) a Registered Fund Management Company; or (c) a person (but not a specified person) who carries on the business of fund management, is exempted from section 125 of the Act in respect of a specified derivatives contract which it enters into in its capacity of a trustee.
- On July 10, 2014, MAS released a consultation paper on the draft regulations for reporting of foreign exchange derivatives contracts. The draft regulations proposed the following on FX derivatives requirements:
    - The reporting of FX derivatives would be phased-in. The first phase would be FX derivatives booked in Singapore by banks on April 1, 2015. The draft amendment regulations were expected to come into effect by September 30, 2014, providing banks with a 6 month transition period. The second phase would be FX derivatives traded in Singapore by banks by October 1, 2015;
    - Banks are to report information in Part I, IA and IV of the First Schedule by April 1, 2015. This would be followed by the information in Part IB of the First Schedule by October 1, 2015;
    - For the other specified derivatives contracts that were previously prescribed for reporting, MAS proposed for banks to report the additional information in Part IA of the First Schedule by April 1, 2015 and information in Part IB of the First Schedule by October 1, 2015. Part IA of the First Schedules are data fields relating to information for all classes of specified derivatives contracts while Part IB of the First Schedule are data fields relating to collateral;
    - FX derivatives are forwards, swaps and options that are related to currencies or currency indices, or whose cash flows are determined by reference to currencies or currency indices. This would include non-deliverable forwards (NDFs), non-deliverable options (NDO) and non-deliverable exotic options. Information regarding the execution, termination, amendments, modifications, variations to a FX derivative must be reported within 2 business days after the execution, termination, amendment, modification, variation or change.
    - MAS did not intend to require the reporting of transactions that are considered by the market to be spot transactions. MAS proposed not to require the reporting of transactions settled by the actual delivery of the underlying currency within 2 business days of execution. MAS would assess the readiness of non-bank entities to report FX derivatives at a later stage and provide a transition period as appropriate.

On 'traded in' Singapore, MAS proposed to tie the execution of the transaction to a trader as opposed to a trading desk. MAS further proposed to consider any transaction that is executed by a trader who is generally employed in Singapore, regardless of the trader's physical location at the time of transaction, as having been traded in Singapore. Additionally, MAS proposed to consider a trader to be employed in Singapore if he conducts, or is authorised to conduct on behalf of specified persons, activities relating to the execution of derivatives contracts in Singapore for more than half the preceding quarter.

On masking relief for counterparty information, specified persons would not need to report counterparty information before November 1, 2015, subject to the condition as stated in the Draft Regulations. However, this masking relief would not be extended to EU countries. MAS proposed to remove all EU countries from the Fifth Schedule.

- On September 17, 2014, the Australian Securities and Investments Commission (ASIC) and MAS entered into a memorandum of understanding (MoU) to allow trade repositories licenced in one jurisdiction to provide relevant data to the authority in the other jurisdiction. Through this MoU, ASIC and MAS would cooperate with each other to fulfil their respective responsibilities and mandates by facilitating each authority's access to relevant trade repository data, while ensuring the confidentiality of the information is appropriately protected.
- On October 31, 2014, MAS released the Securities and Futures (Reporting of Derivatives Contracts) (Amendment) (No.2) Regulations and their response to the feedback received on the consultation paper for the Securities and Futures (Reporting of Derivatives Contracts) Regulations (Amendment) 2014 (SF(RDC)R). Key changes included:
  - the regulations exclude certain categories of FX contracts from the reporting requirements;
  - the refined definition of "traded in Singapore" to include contracts executed by traders located in Singapore who have been executing or have been authorised to execute contracts for at least the last 30 days prior to the date of the contract;
  - the reporting commencement date for credit, interest rate and FX derivatives contracts traded in Singapore would commence on November 1, 2015;
  - the reporting commencement date for FX derivative contracts booked in Singapore would commence on May 1, 2015;
  - the requirement to report the additional data fields would commence from November 1, 2015; and
  - Masking relief was extended to November 1, 2015.
- MAS and ESMA also signed an MoU to establish cooperation arrangements regarding CCPs in Singapore that have applied for recognition under EMIR. The MoU fulfils a pre-condition for ESMA to recognise CCPs in Singapore providing clearing services to European Union (EU) participants and trading venues. This would allow ESMA-recognised CCPs in Singapore to be used by EU market participants to satisfy their mandatory clearing obligations under EU law and would allow EU banks to enjoy lower capital charges for their clearing exposures to such recognised CCPs.
- On July 1, 2015, MAS issued a Consultation Paper on Draft Regulations for Mandatory Clearing of Derivatives Contracts. The draft Securities and Futures (Clearing of Derivatives Contracts) Regulations provided the implementation details of the initial set of product and persons subject to clearing obligations under the Securities and Futures Act, Chapter 289 of Singapore.

Key highlights of the policy proposals include:

- MAS intends to commence mandatory clearing by asset class, beginning with interest rate derivatives contracts. This includes Singapore dollar fixed-to-floating swaps based on the Singapore swap offer rate and US dollar fixed-to-floating swaps referenced to LIBOR. MAS is also considering interest rate swaps denominated in euro, sterling and yen.
- MAS seeks views on subjecting transactions that are booked in the Singapore-based operations of both transacting counterparties (ie, a Singapore-incorporated company or a Singapore branch of a foreign entity) to clearing obligations.
- MAS proposes to exempt all banks from clearing obligations, as long as they do not exceed a maximum threshold of S\$20 billion in derivatives gross notional outstanding booked in Singapore for each of the past four calendar quarters.

- The paper proposes to exempt intra-group transactions from the scope of clearing obligations. MAS also proposes to exempt public bodies from clearing requirements, including all central banks and governments, as well as international multilateral organisations such as the Bank for International Settlements, the International Monetary Fund and the World Bank.
  - MAS intends to issue regulations by the end of 2015, and would provide at least six months' notice before the clearing obligations take effect.
- On October 30, 2015, MAS released the Securities and Futures (Reporting of Derivatives Contracts) (Amendment) Regulations 2015, which amend the following reporting components of the Singaporean regime:
    - The scope for determining whether an entity is a significant derivatives holder. In particular, for the purpose of calculating whether an entity breaches the gross notional threshold (SGD 8 billion) and therefore becomes a significant derivatives holder, the new amendment serves to remove from the calculation: i) FX derivatives contracts traded in or booked in Singapore, where the last day of the quarter in question is on or after August 1, 2015, but before November 1, 2015; and ii) interest-rate- and credit-nexus derivatives contracts, and FX derivatives contracts traded in or booked in Singapore, in any other case.
    - Reporting of derivatives contracts traded in Singapore for specified persons in paragraphs (b) and (d) to (g) under section 124 of the Securities and Futures Act, as well as significant derivatives holders (essentially all non-banks); and
    - Extending the ability to mask counterparty information from November 1, 2015 to July 1, 2017. The time period in which to unmask historical transactions after expiry of the relief has also been extended, from a two-month window (November 1, 2015 – December 31, 2015) to a six-month window (July 1, 2017 – January 1, 2018).
  - On January 18, 2016, MAS released a consultation paper proposing amendments to the Securities & Futures (Reporting of Derivatives Contracts) Regulations to implement reporting of commodity and equity derivatives contracts, as well as other revisions to complete implementation of the derivatives trade reporting regime in Singapore. Under the proposed amendments, MAS intends to implement the reporting of equity and commodity derivatives by banks and merchant banks on November 1, 2016. This is in addition to interest rate, credit and foreign exchange derivative trades already being reported. MAS is also proposing revisions to fine-tune the reporting obligations for certain non-bank financial institutions, while maintaining effective data coverage of derivative activities in Singapore.
  - On January 28, 2016, MAS published the Securities & Futures (Reporting of Derivatives Contracts) (Amendment) Regulations 2016, which defers the implementation of an UTI share-and-pair obligations until February 1, 2017.
  - On May 26, 2016, the Chicago Mercantile Exchange (CME) announced that it has been formally granted the status of a recognised clearing house by the Monetary Authority of Singapore (MAS) with effect from May 18, 2016.

With this status, CME Clearing is now able to sign up direct clearing members from Singapore for clearing of both exchange-traded futures and options, as well as over-the-counter derivatives. In addition, with the implementation of MAS' proposal to mandate clearing for interest rate swaps, including Singapore-dollar and US-dollar-denominated swaps, recognised clearing house status will permit local market participants to fulfill their clearing obligations in these instruments with CME

Clearing.

## **2. MAS proposes margin requirements for non-centrally cleared derivatives**

- On October 1, 2015, MAS issued its Policy Consultation on Margin Requirements for Non-Centrally Cleared Derivatives (Consultation). These policy proposals will be effected by way of new rules, which MAS will consult on after considering feedback received from this Consultation.
- On August 22, 2016, the Monetary Authority of Singapore (MAS) made announcements deferring the implementation of margin requirements for non-cleared derivatives beyond the proposed September 1, 2016 commencement date.

It further indicated that it would issue final rules in the coming months and would announce a revised phase-in schedule in due course.

- On December 6, 2016, the Monetary Authority of Singapore (MAS) released the final guidelines on the margining on non-centrally cleared derivatives. Some key points to note:
  - There will be a six-month transition period from March 1, 2017 to August 31, 2017, with no retrospective application of margining requirements in respect of transactions entered into during this period;
  - During the transition period, the MAS expects covered entities to make progress to meet the guidelines as soon as practicable;
  - The margin requirements apply to any bank licensed under the Banking Act and any merchant bank approved as a financial institution under the MAS Act;
  - Margin requirements apply to all non-cleared derivatives contracts booked in Singapore, except physically settled FX forwards or swaps and commodity derivatives contracts entered into for commercial purposes;
  - Margin requirements do not apply to any covered entity with an aggregate month-end average notional amount of non-cleared derivatives contracts booked in Singapore for March, April and May of the year not exceeding S\$5 billion;
  - The phase-in of IM requirements for phase-one institutions, and VM requirements for all covered entities, will commence from March 1, 2017;
  - The MAS may deem that a covered entity is in compliance with the guidelines if the margin requirements in the foreign jurisdiction are assessed to be comparable to the requirements in the guidelines, and the MAS-covered entity can demonstrate that it has complied with the margin requirements of that foreign jurisdiction;
  - The MAS is of the view that margin requirements implemented by jurisdictions such as Australia, Canada, the EU, Hong Kong, Japan, Singapore, Switzerland and the US are comparable; and
  - Margin requirements will not apply if a legal review has concluded that the relevant netting agreement or initial margin arrangement is not legally enforceable.

## **3. MAS publishes liquidity and policy analyses for platform trading of OTC derivatives**

- On December 16, 2016, MAS issued a paper on liquidity and policy analyses for the on-platform trading of OTC derivatives.

This paper is not a consultation, but rather a thought piece on when it might be appropriate to mandate the trading of standardized OTC derivatives on trading platforms, including a two-stage trading infrastructure and a product test. The paper also introduces a methodology to assess the liquidity of a product using a clustering technique and analyses the cost-benefit of public dissemination of anonymised transaction-level post-trade data from a trade repository as an alternative to improve market transparency.

#### 4. Basel III commitments

- Banks incorporated in Singapore would be required to meet the Basel III minimum capital adequacy ratio (CAR) standards by January 1, 2013, ahead of Basel's January 1, 2015 timeline. While Basel III requires banks to meet a Common Equity Tier 1 CAR of 4.5% and Tier 1 CAR of 6% by January 1, 2015, MAS would require Singapore-incorporated banks to meet these requirements by January 1, 2013. Further, MAS would require them to meet a higher Common Equity Tier 1 CAR of 6.5% and Tier 1 CAR of 8% by January 1, 2015. MAS' existing requirement for Total CAR of 10% (which is higher than Basel III's 8%) would remain unchanged. Additionally, there would be a capital conservation buffer of 2.5% to be comprised of Common Equity Tier 1. This buffer would be phased in from January 1, 2016 to January 1, 2019. The new eligibility criteria for regulatory capital would also be phased in from January 1, 2014 to January 1, 2018. These requirements would apply to both the bank-group and bank-solo levels.
- On August 16, 2013, MAS issued a consultation paper on Local Implementation of Basel III Liquidity Rules – Liquidity Coverage Ratio. MAS is proposing to replace the existing Minimum Liquid Assets (MLA) with the LCR framework. Locally incorporated banks, foreign bank branches and finance companies in Singapore would be required to comply with the LCR requirement. Additionally, MAS is proposing that merchant banks be subject to the LCR requirement as well.

MAS is proposing to impose an individual LCR requirement on an entity level for financial institutions in Singapore, however, MAS is prepared to consider proposing a collective LCR requirement on an aggregated country level where the related entities in Singapore can justify and demonstrate that their liquidity needs are managed on a country level basis; governed by clear and common liquidity management frameworks, policies and processes. MAS is also prepared to vary the LCR requirement for foreign bank branches under certain conditions and would be assessed on a case-by-case basis.

MAS proposes to impose a SGD LCR requirement of 100%, to be implemented by Jan 1, 2015. MAS proposes to impose a USD LCR requirement and this would be set at 80%. Bank-specific requirements would be imposed on a case-by-case basis if prudential concerns warrant them. The USD LCR would start at 40% on Jan 1, 2015 and rise in equal annual steps to reach 80% on Jan 1, 2019.

- On August 6, 2014, MAS released its response to feedback received from the consultation paper on Local Implementation of Basel III Liquidity Rules – Liquidity Coverage Ratio (LCR), issued on August 16, 2013. The revised framework for banks would be implemented in a new MAS notice, which have been appended in Annexes A and B of this paper.

In the draft MAS notice, MAS proposes to adopt a two-tiered liquidity requirement framework. Banks and related entities assessed by MAS to be systemically important to Singapore would be required to adopt the LCR framework. Smaller, niche institutions whose operations in Singapore are simpler than the larger banks would be given a choice to comply with either the LCR or a modified MLA framework.

MAS would not impose a separate US dollar liquidity requirement but would monitor how institutions manage prudently their liquidity risks by currency on a supervisory basis.

- On August 6, 2014, MAS issued its proposed amendments to Parts II, IV, XI and XII of MAS Notice 637 on Risk Based Capital Adequacy Requirements for Banks Incorporated in Singapore (the Notice) to implement the leverage ratio disclosure requirements for Singapore-incorporated banks that are consistent with the requirements issued by the Basel Committee on Banking Supervision (BCBS). The proposed amendments would take effect from Jan 1, 2015. The draft amendments to the Notice are appended in Annex 1.
- On July 31, 2015, MAS issued its consultation paper on the proposed notice (Proposed MAS Notice) on LCR and MLA requirements for merchant banks. MAS issued two consultation papers on Local Implementation of Basel III Liquidity Rules in August 2013 and August 2014.

Responses to the consultation feedback described revisions to the liquidity regulatory framework in Singapore, which includes the introduction of the LCR rules in Singapore and a revision of the MLA rules. Another key revision to the framework was the expansion of the scope of liquidity requirements, in particular, which means that merchant banks would therefore be subject to the same liquidity requirements as banks from January 1, 2016. The revised framework for banks was implemented through MAS Notice 649, which was published in November 2014. The Proposed MAS Notice (as set out in Annex A of the consultation paper) prescribes equivalent requirements for merchant banks in Singapore. The corresponding reporting forms are set out in Annex B of the consultation paper.

- On October 9, 2015, MAS issued its consultation paper on proposed amendments to MAS Notice 637 to implement revisions to the Basel III Capital Framework. The Notice sets out the risk based capital adequacy requirements for banks incorporated in Singapore.

The proposed amendments are intended to implement requirements for Singapore-incorporated banks that are consistent with the final standards issued by the Basel Committee on Banking Supervision (BCBS). In particular, proposed amendments to Part VII of the Notice will enhance the risk capture of banks' equity exposures and counterparty credit exposures (including exposures to central counterparties). Revised Pillar 3 disclosure requirements will enable market participants to better compare banks' disclosures of risk-weighted assets and improve consistency of disclosures. Technical revisions were also made to Part VI of the Notice to clarify the regulatory capital treatment for investments in unconsolidated entities.

Other than the proposed amendments to Part XI of the Notice, the proposed amendments are intended to take effect on January 1, 2017. Singapore-incorporated banks are to publish their first standalone Pillar 3 report, which complies with the revised disclosure requirements from the publication date of their first set of financial statements relating to a balance sheet on or after December 31, 2016.

- On December 11, 2015, MAS issued its response document to industry's feedback on its consultation paper on LCR disclosure requirements, which was issued on October 9. The document includes MAS's responses to industry comments on specific areas identified for feedback in the consultation paper, in particular the scope of application, the retention period, the reporting currency and treatment of country-level groups.

The LCR disclosure requirements comprise a common LCR disclosure template to promote consistency and comparability in banks' disclosure of their liquidity risk position. In addition, banks are required to provide qualitative discussion around the LCR to help users understand the results and data provided

in the LCR disclosure template. Banks are also encouraged to disclose additional qualitative and quantitative information related to its internal liquidity risk measurement and management framework.

MAS noted that they have considered all feedback received and are responding to feedback deemed to be of wider interest. Areas not covered in this document will be addressed directly with the respondents involved. The finalized Notice is appended in Annex C in the document and will take effect on January 1, 2016.

- On October 17, 2016, the MAS issued amendments to Notice 637 on risk-based capital adequacy requirements for banks incorporated in Singapore, and a response to feedback received on the October 9, 2015 consultation paper. The MAS has revised Notice 637 to implement requirements for Singapore-incorporated banks that are consistent with the following final standards:
  - Capital requirements for banks' equity investments in funds;
  - The standardised approach for measuring counterparty credit risk exposures (SA-CCR);
  - Capital requirements for bank exposures to central counterparties (CCPs); and
  - Revised pillar 3 disclosure requirements.

The amendments will take effect from January 1, 2017. For the amendments related to the SA-CCR and capital requirements for bank exposures to CCPs, transitional arrangements are provided to allow more time for implementation. Pillar 3 disclosure required under the revised framework will be for the reporting periods ending on or immediately after January 1, 2017 (for the majority of disclosure templates) and January 1, 2018 (for the remaining templates).

## 5. MAS requirements for assessing systemically important banks

- On October 4, 2013, MAS issued the Proposed Amendments to MAS Notice 637 on Disclosure and Submission Requirements for Assessing Global Systemically Important Banks and Point of Non-Viability Requirements. The proposed disclosure and submission requirements in the Consultation Paper aim to allow BCBS to assess the systemic importance of Singapore-incorporated banks. The methodology is based on the BCBS' framework "Global systemically important banks: updated assessment methodology and the higher loss absorbency requirement".

The Consultation Paper would require Singapore-incorporated banks to make publicly available the 12 indicators used in the BCBS assessment methodology for identifying "G-SIBs"; and submit to MAS the full set of data required by the BCBS' data collection exercise. The Consultation Paper also proposes requirements to ensure loss absorbency at the point of non-viability, for example: whether the assets of a Bank, in MAS's opinion, are sufficient to provide adequate protection to the bank's depositors and creditors. The proposed amendments would be effective from Jan 1, 2014.

- On June 25, 2014, MAS issued a consultation paper on the proposed Framework for Systemically Important Banks in Singapore. In this paper, MAS seeks to develop a D-SIB framework that achieves the objectives of updating MAS' diagnostic toolkit for assessing systemic importance and identifying D-SIBs as well as establishing a range of policy measures that may be applied to D-SIBs.

The proposed D-SIB framework builds on MAS' existing impact assessment framework to assess a bank's systemic importance to Singapore's financial system and broader domestic economy. It would also establish other relevant policy measures that may apply to D-SIBs to address the specific negative externalities that they pose. In terms of scope, MAS proposes to assess locally-incorporated banks, including subsidiaries of foreign banks, and foreign bank branches under the D-SIB framework. The D-SIB framework would also assess locally-incorporated banks at the consolidated group level. In

addition, the D-SIB assessment of foreign banks would take into account the activities of all related banking entities in Singapore.

MAS also proposes:

- to adopt an indicator-based approach to assess banks' systemic importance based on size, interconnectedness, substitutability and complexity;
  - to set out appropriate policy measures with respect to each type of D-SIB;
  - to require D-SIBs to undertake recovery and resolution planning;
  - to publish the initial list of D-SIBs, which would include D-SIB branches (if any), by the first quarter of 2015, in order to provide banks with sufficient time to comply with relevant D-SIB policy measures;
  - to review the D-SIB framework, including the methodology and indicators, every three years.
- On April 30, 2015, MAS published its framework for identifying and supervising domestic systemically important banks (D-SIBs) in Singapore, and the inaugural list of seven D-SIBs.

MAS would apply additional supervisory measures on banks designated as D-SIBs. Banks that have a significant retail presence in Singapore would be required to locally incorporate their retail operations. Locally-incorporated D-SIBs would need to meet higher capital requirements – a minimum common equity Tier 1 capital adequacy ratio CAR of 6.5%, Tier 1 CAR of 8% and total CAR of 10%, compared with the Basel III minimum requirements of 4.5%, 6% and 8%, respectively. Other measures, such as recovery and resolution planning, liquidity coverage ratio requirements and enhanced disclosures, would also apply, depending on the bank's operating model and structure. MAS would allow a transition period for affected banks to comply with the requirements that are currently not in effect, such as the local incorporation requirement.

- On October 9, 2015, MAS issued its consultation paper on LCR disclosure requirements. The Paper contains a set of proposed disclosure requirements which are intended to complement the LCR requirement as set out in MAS Notice 649.

The LCR requirement was introduced for D-SIBs in Singapore. These proposed disclosure requirements closely mirror the requirements promulgated by the BCBS for internationally active banks. A common LCR disclosure template has been provided in order to promote consistency and comparability of liquidity disclosures by banks, and accompanying qualitative disclosures to help users understand the information published by banks. Guidance is also provided on additional qualitative and quantitative disclosures that banks are encouraged to disclose in order to provide market participants with a broader understanding of the reporting banks' liquidity risk profile and management. These requirements are intended to take effect on January 1, 2016. Banks are required to comply with these disclosure requirements from the date of the first reporting period after January 1. MAS also identified specific areas for comment, in particular the scope of application, the retention period, the reporting currency and treatment of country-level groups. MAS proposed that the LCR disclosure requirements not apply to D-SIBs that are foreign branches.

## **6. MAS releases consultation on NSFR and NSFR disclosure requirements**

- On November 16, 2016, the Monetary Authority of Singapore (MAS) released a consultation paper on the NSFR and NSFR disclosure requirements. The proposals are as follows:

- The NSFR will be applicable to banks that have been designated as domestic systemically important banks (D-SIBs) by the MAS;
- For a D-SIB that is locally incorporated with a group headquartered in Singapore, the NSFR will be implemented at the consolidated group level on a 100% all-currency basis
- For a D-SIB with a group not headquartered in Singapore, the NSFR will be implemented at the entity level on a minimum 50% all-currency basis;
- Derivatives transactions with central banks arising from short-term monetary policy and liquidity operations will be excluded from NSFR computations;
- Banks should report their monthly NSFR numbers together with the full quarter-end NSFR data per the prescribed format to the MAS by the 30th day of the following month after quarter-end; and,
- NSFR requirements will be applicable from January 1, 2018, and the NSFR disclosure requirements will become effective from the date of the first reporting period after January 1, 2018.

The deadline for comments is December 15, 2016.

## **7. Review on bankruptcy, insolvency regimes**

- On October 4, 2013, the Insolvency Law Review Committee (ILRC) submitted its report reviewing the existing bankruptcy and corporate insolvency regimes in Singapore to the Ministry of Law, which has invited comments through December 2.

The aims of the review were to:

- unify the bankruptcy and corporate insolvency regimes into a single piece of legislation;
- modernize the law of bankruptcy and corporate insolvency as well as adopt practices best suited to Singapore;
- make the attendant processes user-friendly and accessible for individuals and corporations alike;
- where appropriate, take into account the relevant recommendations made by the Companies Regulation Framework Steering Committee in 2002.

The main recommendation in the report is for the enactment of a new Insolvency Act. This new act would consolidate and update the core areas of Singapore's personal and corporate insolvency regime, as well as set out common principles and procedures. This is intended to provide greater consistency certainty on various concepts that are common to the various insolvency regimes; and better support the transition and coordination between these regimes.

The report also considers the various corporate insolvency regimes in Singapore including private receivership, liquidation, judicial management and schemes of arrangement.

- On 21 October 2016, the Ministry of Law (MoL) released its public consultation on proposed amendments to the Companies Act to reform Singapore's debt restructuring and corporate rescue framework. These changes are intended to come into effect in 2017. This public consultation follows the recommendations of the ILRC as well as the Committee to Strengthen Singapore as an International Centre for Debt Restructuring (Restructuring Committee).

These reforms are part of the efforts of the MoL and Ministry of Finance (MoF) to introduce changes to the Companies Act and fully implement the recommendations of the ILRC and the Restructuring Committee. Taking into consideration the volume of proposed legislative amendments and the complexity of the proposed changes and recommendations, the MoL intends to take a phased approach to the implementation of these proposals.

It should be noted that these set of proposed changes are intended to form the first phase of legislative amendments and include, among others:

-A new set of provisions to support creditor schemes of arrangement, including:

- (i) Enhanced moratoriums against creditor action, including: (a) allowing the Court to grant a moratorium when the company has made an application to call a meeting of its creditors or intends to make such an application, (b) an expansion in the scope of the moratorium available to be similar to what is available under judicial management, (c) allowing for an automatic 30 day moratorium, subject to safeguards for creditor interests, (d) moratoriums with in personam worldwide effect and, (e) allowing extension of moratorium to related entities to the debtor.
- (ii) Rescue finance provisions, enabling the Court to grant new financing and allowing the Court to be able to grant three levels of priority
- (iii) Cram-down provisions, allowing a scheme to be approved even if a class of creditors oppose the scheme.
- (iv) Enhanced creditor protection.
- (v) Pre-packaged provisions.
- (vi) Procedural enhancements.

-Amendments to judicial management, including:

- (i) Enabling companies to apply for judicial management order more easily.
- (ii) Introducing provisions for super-priority for rescue financing in judicial management.

-Reforms to facilitate cross-border insolvency:

- (i) Judicial management to be made available to foreign companies.
- (ii) Specific criteria to guide the Court on its discretion to take jurisdiction over foreign debtors.
- (iii) Adoption of the UNCITRAL Model Law on Cross-Border Insolvency.
- (iv) The abolition of the general ring-fencing rule in the winding up of foreign companies. Ring-fencing will be retained with respect to specific financial institutions, including banks and insurance companies.

## 8. MAS issues consultation on resolution

- On June 23, 2015, MAS released its Consultation Paper on Proposed Enhancements to Resolution Regime for Financial Institutions in Singapore. In this paper, MAS proposes to enhance its resolution regime by strengthening its powers to resolve distressed institutions while maintaining continuity of their critical economic functions. The policy proposals cover:
  - Recovery and resolution planning;
  - Temporary stays and suspensions;
  - Statutory bail-in powers;
  - Cross-border recognition of resolution actions;
  - Creditor safeguards; and
  - Resolution funding

The proposed policy changes would be introduced primarily through amendments to the MAS Act, supported by the necessary regulations. MAS would also consult on the legislative amendments, after considering the feedback received on the policy proposals in this consultation.

- On April 29, 2016, the Monetary Authority of Singapore (MAS) released a consultation paper on proposed legislative amendments to enhance the resolution regime for financial institutions in Singapore. This follows an MAS consultation released on June 23, 2015, which set out the policy proposals on enhancements to the resolution regime.

The proposed legislative amendments include strengthening the MAS's powers to resolve distressed financial institutions, while maintaining continuity of their critical economic functions. In addition, the MAS will issue a notice and guidelines on the recovery and resolution planning for banks. The MAS has proposed legislative amendments in these areas: temporary stay on termination rights; a statutory bail-in regime; cross-border recognition of resolution actions; resolution funding arrangements; and creditor compensation framework.

The MAS has also proposed amendments to the Monetary Authority of Singapore (Control and Resolution of Financial Institutions) Regulations 2013, which are intended to provide broad protection to ensure that netting and set-off arrangements will not be affected by the exercise of resolution powers – in particular, where there is a transfer of part of the business of a pertinent financial institution.

## 9. MAS issues notice on FMI standards

- On August 31, 2015, MAS issued its Notice on Financial Market Infrastructure Standards (Notice). The notice applies to licensed trade repositories and approved clearing houses. MAS had previously released its Monograph on Supervision of Financial Market Infrastructures (Monograph). MAS also administers the Securities and Futures Act (Cap. 289) (SFA) in respect of the supervision and oversight of trade repositories and clearing houses in accordance with the Committee on Payment and Settlement Systems and International Organization of Securities Commissions Principles for Financial Market Infrastructures (PFMIs), as set out in the monograph. Some of the principles of the PFMIs are set out in the SFA and subsidiary legislation issued under the SFA. The notice sets out the remaining principles in the PFMIs that an FMI has to comply with.

The notice sets out the standards that are applicable to FMIs. These standards apply to:

- Legal risk management;

- Governance arrangements;
- Credit risk management;
- Framework for the comprehensive management of risks;
- Collateral;
- Margin;
- Liquidity risk;
- Settlement finality;
- Money settlements;
- Physical deliveries;
- Exchange-of-value settlement systems;
- Participant-default rules and procedures;
- Segregation and portability;
- General business risk;
- Custody and investment risk;
- Operational risks;
- Access and participation requirements;
- Tiered participation arrangements;
- FMI links;
- Efficiency and effectiveness;
- Communication procedures and standards;
- Disclosure of rules, key procedures and market data; and
- Disclosure of market data by trade repositories.

The notice takes effect on August 31, 2015.

## **10. MAS issues monograph on ‘Supervision of Financial Market Infrastructures in Singapore’**

- On January 14, 2013, MAS issued a monograph on ‘Supervision of Financial Market Infrastructures in Singapore’. This monograph updates and replaces the monograph on ‘MAS’ Roles and Responsibilities in Relation to Securities and Clearing and Settlement Systems in Singapore’ issued in 2004; and complements earlier MAS monographs which set out MAS’ overall approach to financial supervision.

## **11. SGX developments**

- On July 25, 2012, SGX announced the enhancement of its rules to strengthen its default management framework to protect against systemically destabilizing events, which may include the possibility of multiple member defaults. This enhancement followed a public consultation issued in September 2011.

- On October 3, 2012, SGX released a consultation paper on the proposed amendments to the SGX-DC clearing rules for client clearing of OTC financial derivative contracts (OTCF contracts) and enhanced customer collateral protection.
- On November 6, 2013, SGX issued a consultation paper on the Proposed Refinements to the SGX-DC Clearing Fund and OTCF Default Management Procedures. SGX aims to implement the proposed amendments in February 2014. Singapore Exchange Derivatives Clearing Limited (SGX-DC) is proposing refinements to its Clearing Fund structure and improvements in the auction process for managing a default of a member that clears OTC financial derivatives. The proposed rule amendments specify the appointment and sequence of use of resources in the event of a default.
- On October 25, 2013, SGX issued a consultation paper on the proposed SGX-DC Remote Membership and Derivatives Clearing Organization Rules. The Singapore Exchange Derivatives Clearing Limited (SGX-DC) has applied for registration with the CFTC as a derivatives clearing organization (DCO). Consequently, SGX-DC would be required to comply with the applicable US laws and regulations as well as the CFTC Commodity Exchange Act (CEA) requirements for a DCO.

Under Section 4d(f)(1) of the CEA, an intermediary accepting collateral from a US person for a swaps contract cleared through a DCO must be a futures commission merchant (FCM) registered with the CFTC. SGX-DC proposes to allow remote clearing members (RCMs). FCMs based in the US or otherwise may apply to become members of SGX-DC as a RCM in order to clear swap contracts for their US customers through SGX-DC. A RCM must be regulated and licensed by a recognised regulator and governed by the laws of a jurisdiction acceptable to SGX-DC. SGX-DC would consider the comparability of laws of the foreign jurisdiction and the regulatory standards with Singapore laws and regulations; the licensing and supervision of OTC activities by an independent statutory regulator; and the existence of information sharing arrangement between MAS and the statutory foreign regulator or between SGX-DC and any foreign self-regulatory organization responsible for the supervision of the RCM.

A RCM clearing Non-Relevant market contracts and/or customers OTCF contracts is required to have, or have a parent entity who has a long term credit rating indicating strong overall creditworthiness supporting fulfillment of its financial obligations. RCMs would have reporting, access to records, appointment of management personnel, segregation of positions and collateral and default management requirements that are similar to those of the General Clearing Members (GCMs). There would be additional membership criteria, for example: RCMs must have the ability to conduct its clearing activities during SGX-DC's business hours and maintain adequate contactable staff and RCMs should not have a business presence in Singapore related to the provision of financial services or serve Singapore-domiciled customers.

- On December 27, 2013, the CFTC issued an Order granting Singapore Exchange Derivatives Clearing Limited (SGX-DC) registration as a derivatives clearing organization (DCO) pursuant to Section 5b of the Commodity Act. SGX-DC, which is a subsidiary of Singapore Exchange Limited and is organized under the laws of Singapore, is also regulated by MAS. Subject to the terms and conditions of the Order, SGX-DC is authorised to provide clearing services for swaps that SGX-DC currently clears and such other swaps that the CFTC determines SGX-DC is eligible to clear. This Order was effective on December 31, 2013.

## 12. LCH recognised by MAS

- On February 1, 2016, LCH.Clearnet announced that it has been granted the status of Recognised Clearing House by MAS, pursuant to the provisions of the Securities and Futures Act, Chapter 289, of Singapore (SFA) and the Securities and Futures (Clearing Facilities) Regulations 2013. Recognition applies to LCH.Clearnet's EnClear (Freight Division), ForexClear and SwapClear services.

LCH.Clearnet currently clears Singapore Dollar-denominated interest rate swaps as well as commodity futures, including freight, iron ore, and steel, executed on Cleartrade Exchange (CLTX), the MAS-regulated trading venue. LCH.Clearnet also has a number of Singapore-based clients clearing interest rate derivatives and commodities via clearing brokers.

### 13. Benchmarks reform

- On June 14, 2013, the Associations of Banks in Singapore (ABS), in consultation with the Singapore Foreign Exchange Market Committee (SFEMC), announced the following changes to the ABS financial benchmarks:
  - Ceasing publication on July 12, 2013 - USD/VND spot rate, SGD IRS rate, THB SOR rate and IDR SOR rate;
  - Ceasing publication on August 5, 2013 - USD/MYR spot rate. This would be replaced with benchmarks in other jurisdictions;
  - Ceasing publication on September 30, 2013 - SGD SOR rate (1wk, 2mths, 9mths and 12mths) and SGD SIBOR rate (2mths and 9mths);
  - Ceasing publication on December 31, 2013 - USD SIBOR rate. This would be replaced with benchmarks in other jurisdictions.

The USD/VND spot rate benchmark, SGD IRS, IDR SOR and THB SOR rate benchmarks and the SGD SOR and SGD SIBOR rate benchmarks for the discontinued maturities are being discontinued due to the lack of liquidity in the underlying rates.

In order to facilitate a smooth transition to the new benchmarks, SFEMC has made a number of recommendations including:

- Rate swap and other contracts referencing the SGD SOR rate benchmarks for the continuing maturities of overnight, 1 month, 3 months or 6 months that may be entered into on or after October 1, 2013 should apply the corresponding new benchmarks;
- Parties should mutually agree to amend rate swap and other contracts referencing the existing SGD SOR rate benchmarks for the continuing maturities of overnight, 1 month, 3 months or 6 months that remain outstanding on October 1, 2013 to reference the new SGD SOR rate benchmark for the corresponding maturity;
- Parties should mutually agree to amend rate swap and other contracts referencing the existing SGD SOR rate benchmark for the discontinued maturities of 1 week and 2 months that remain outstanding on October 1, 2013 to reference a linearly interpolated rate using rates determined by reference to the new SGD SOR rate benchmarks for the maturities of overnight and 1 month, and 1 month and 3 months respectively;
- Parties should mutually agree to amend rate swap and other contracts referencing the existing SGD SIBOR rate benchmarks for the discontinued maturities of 2 months or 9 months that remain outstanding on October 1, 2013 to reference a linearly interpolated rate using rates determined by reference to the SGD SIBOR rate benchmarks for the continuing maturities of 1 month and 3 months, and 6 months and 12 months respectively;

- Parties should mutually agree to amend rate swap and other contracts referencing the existing USD SIBOR rate benchmark that remain outstanding on January 1, 2014 to reference the USD LIBOR rate benchmark;
  - NDF and other relevant contracts referencing the USD/SGD, USD/THB or USD/IDR spot rate benchmarks that may be entered into on or after August 6, 2013 should apply the corresponding new benchmarks;
  - NDF and other relevant contracts referencing the USD/MYR spot rate benchmark that may be entered into on or after August 6, 2013 should apply the onshore USD/MYR spot rate benchmark published on Reuters Screen MYRFIX2 Page;
  - Parties should mutually agree to amend NDF and other relevant contracts referencing the existing USD/SGD, USD/THB, USD/IDR or USD/MYR spot rate benchmarks that remain outstanding on August 6, 2013 to reference (as applicable) the new spot rate benchmarks for USD/SGD, USD/THB or USD/IDR or to reference the onshore USD/MYR spot rate benchmark published on Reuters Screen MYRFIX2 Page.
- On June 14, 2013, MAS released a consultation paper on the Proposed Regulatory Framework for Financial Benchmarks, which aims to deter and penalize attempts to manipulate any financial benchmark, and to safeguard the credibility and reliability of key financial benchmarks in Singapore. MAS proposed to introduce a regulatory framework for the setting of financial benchmarks. The framework would be affected via amendments to the SFA.

The key elements of the proposed framework include:

- Introduce criminal and civil sanctions for manipulation of any financial benchmark;
- Provide legal powers to designate key financial benchmarks and subject their Administrators and Submitters to regulation;
- Issue best practice guidance for other benchmarks consistent with IOSCO Principles;
- Provide legal powers to compel entities to be Submitters to designated benchmarks.

MAS proposes that the Singapore Interbank Offered Rate (SIBOR) and the Swap Offer rate (SOR), administered by the Association of Banks in Singapore (ABS), be designated as financial benchmarks. As ABS also administers foreign exchange spot benchmarks (FX Benchmarks), which are largely used in the Non-Deliverable Foreign Exchange Forwards (NDFs) market, MAS is also proposing to include FX Benchmarks as designated benchmarks.

- On July 5, 2013 ISDA, together with EMTA, published the 2013 Multilateral Amendment Agreement for Certain Asian Currency Non-Deliverable FX and Currency Option Transactions with Non-Deliverable Swap Transactions Supplement and Other Transactions Supplement Thereto (FX-MAA) to assist parties wishing to make the amendments referred to above. The closing date for signing up to the FX-MAA was August 2, 2013.
- On August 29, 2013 ISDA published the 2013 Multilateral Amendment Agreement for Certain Rate Swap and Other Transactions (Rates-MAA) to assist parties wishing to make the amendments referred to above. The Rates-MAA would apply to OTC derivatives and other financial transactions such as repos. In addition, the Rates-MAA would apply to the ISDA English or New York law governed Credit Support Documents. As between any two parties to the Rates-MAA, the relevant transactions or Credit Support Documents between them would be amended only if and to the extent that such transactions or Credit Support Documents have a fixing of an affected rate that is to take place (i) on or after October 1, 2013 and (ii) after the date of discontinuation of the affected rate (i.e. September 30, 2013 for the

SGD-SOR and SGD SIBOR rate benchmarks and December 31, 2013 for the USD SIBOR rate benchmark. The closing date for signing up to the Rates-MAA was September 26, 2013.

- On August 29, 2013, ISDA also published Supplement Nos. 35 and 36 to the 2006 ISDA Definitions. Supplement No. 35 provides for the deletion of “IDR-SOR-Reuters”, “SGD-SOR-Reuters”, “SGD-SOR Reference Banks”, “SGD-SONAR-OIS-COMPOUND” and “THB-SOR-Reuters” and the addition of “SGD-SOR-VWAP”, “SGD-SOR-VWAP-Reference Banks” and “SGD-SONAR-OIS-VWAP-COMPOUND” under Section 7.1(j), (t) and (aa) and for consequential amendments to Section 6.2 (g). Supplement No. 36 provides for the deletion of “USD-SIBOR-SIBO” under Section 7.1 (ab).
- On February 18, 2014, ABS Benchmarks Administration Co Pte. Ltd. (ABS Co), in consultation with SFEMC, that it would discontinue the USD/IDR spot rate benchmark (denoted as “IDR VWAP” or “IDR03” in the 1998 FX and Currency Option Definitions). The last day of publication of IDR VWAP (IDR03) would be 27 March 2014. ABS Co, together with the SFEMC, has decided that it is no longer necessary to continue IDR VWAP (IDR03) given the development of an onshore USD/IDR spot rate benchmark. The onshore USD/IDR spot rate benchmark is reported by Bank Indonesia and published on its website and would be denoted as “IDR JISDOR” or “IDR04” in the 1998 FX and Currency Option Definitions. The SFEMC has recommended that market participants apply IDR JISDOR (IDR04) to NDF and other relevant contracts that have trade dates on or after 28 March 2014. The SFEMC has also recommended that parties mutually agree to amend legacy outstanding contracts that reference IDR VWAP (IDR03) to instead reference IDR JISDOR (IDR04).

To facilitate such amendments, on 4 March 2014, ISDA published the 2014 Multilateral Amendment Agreement for IDR Non-Deliverable FX and Currency Option Transactions, Non-Deliverable Swap Transactions and Certain Other Transactions (IDR-MAA). The closing date for signing up to the IDR-MAA was March 26, 2014.

- On July 29, 2014, MAS released a consultation paper on legislation to introduce a regulatory framework for financial benchmarks which would bring the regulation of benchmark setting activities into the regulatory ambit of MAS. This follows MAS consultation in June 2013 which had set out certain policy proposals for introducing a regulatory framework for financial benchmarks. MAS has also issued a response paper to the 2013 consultation.

The proposed legislation provides, among others, that the manipulation of any financial benchmark in Singapore would be made liable to criminal and civil sanctions under the Securities and Futures Act. This would apply to acts of manipulation occurring within Singapore and in respect of financial benchmarks administered in Singapore. Additionally, administrators and submitters of financial benchmarks designated by MAS would be subject to regulation, including licensing requirements. MAS would designate key financial benchmarks, taking into account their systemic importance and susceptibility to manipulation. Presently, MAS intends to designate the SIBOR and SOR as key benchmarks.

- On November 7, 2016, the Securities and Futures (Amendment) Bill was read in Parliament. This Bill incorporates the proposed amendments in relation to the regulation of financial benchmarks. MAS also issued a Response to Feedback received on the consultation on proposed amendments to the Securities and Futures Act on Regulation of Financial Benchmarks.

#### **14. Amendments to MAS Act**

- On March 15, 2013, the Monetary Authority of Singapore (Amendment) Bill 2013 (MAS(A) Bill) and the Financial Institutions (Miscellaneous Amendments) Bill 2013 were passed (but have not yet come into force). They expand the powers of MAS to exercise control over and to resolve distressed financial institutions. The new resolution regime would cover more financial institutions (other than banks and insurance companies) including CCPs.

One concern that had arisen from the original MAS(A) Bill was its potentially adverse impact on the enforceability of close-out netting. On January 12, 2013, ISDA made a submission to MAS highlighting its concerns. In its response to feedback received, MAS stated that:

*“MAS agree that the legal framework governing contractual netting should be clear and transparent during resolution of regulated entities, and not hamper implementation of resolution measures. In light of the comments, the MAS(A) Bill would be amended to expressly reflect that the exercise of resolution powers is not intended to defeat bilateral netting arrangements. MAS would also provide in the MAS(A) Bill, a general power to prescribe safeguards to the exercise of the resolution powers. This would enable the Minister to expressly provide in subsidiary legislation that bilateral netting arrangements, as well as other similar arrangements warranting carve-out, would not be affected by the exercise of resolution powers under the MAS Act.”*

The MAS(A) Bill that has been passed has been revised accordingly. In particular, Section 30AAZN has been significantly amended to empower the Minister through subsidiary legislation to create the appropriate safe harbors for bilateral netting arrangements.

## 15. MAS consults on amendments to the Securities and Futures Act

- On February 11, 2015, MAS released a Consultation Paper on Proposed Amendments to the SFA. In this Consultation Paper, MAS proposes certain amendments to the SFA in order to complete the expansion of its scope to regulate OTC derivatives (including the transfer of regulatory oversight commodity derivatives from the Commodity Trading Act (CTA) (Cap. 48A)).

The proposed amendments are set out in the following parts of the Consultation Paper:

- Part A – Amendments arising from the OTC Reforms;
- Part B – Transfer of Regulation of Commodity Derivatives from CTA to SFA; and
- Part C – Other Amendments to the SFA

The Consultation Paper also includes four annexes, which set out the draft amendments to the SFA as well as to the Second Schedule to Securities and Futures (Licensing and Conduct of Business) Regulations (SF/(LCB)R).

Certain key amendments proposed in the Consultation Paper include, among others:

- Amendments to the product definitions in Part I of the SFA;
- Amendments to Part II of the SFA to extend the markets regime to OTC derivatives;
- New provision in Part VIA of the SFA to ensure that banking confidentiality does not restrict the efficacy of the trade reporting regime;
- New Part VIC of the SFA to introduce powers to set out the requirements under the trading obligation;
- Amendments Part IV and the Second Schedule to the SFA, and the Second Schedule to the SF/(LCB)R to extend the capital markets services licensing regime to OTC derivatives; and

- Consequential amendments to the remaining parts of the SFA, the FAA and the CTA arising from the proposals.

MAS also proposes a revised principles-based definition of a “derivative contract”, which aims to describe the key elements of derivatives. This also provides flexibility for MAS to regulate OTC derivatives, which may evolve in complexity and structure.

- On November 7, 2016, the Monetary Authority of Singapore (MAS) released an explanatory brief on the Securities and Futures (Amendment) Bill 2016.

The MAS is introducing legislative amendments to the Securities and Futures Act (Cap. 289) (“SFA”) to implement policy proposals aimed at ensuring that the capital markets regulatory framework in Singapore keeps pace with market developments and is aligned to international standards and best practices. The Bill completes MAS’ two-phase review to implement OTC derivatives regulatory reforms, in line with recommendations made by the Financial Stability Board (“FSB”) and the Group of Twenty (“G20”) to strengthen regulation of OTC derivatives markets following the 2008 global financial crisis. MAS is also introducing amendments aimed at enhancing regulatory safeguards for retail investors, enhancing the credibility and transparency of the capital markets, and strengthening MAS’ ability to take enforcement action against market misconduct.

MAS conducted public consultations on significant policy changes and the proposed SFA amendments between 2012 and 2015. MAS has further engaged key industry stakeholders where appropriate before finalising the Bill. The Bill includes the following key provisions:

- Regulation of OTC derivatives;
- Enhance regulatory safeguards for retail investors, including:
  - o Widen regulatory perimeter to products that are in substance capital markets products;
  - o Refine non-retail investor classes;
- Enhance credibility and transparency of capital markets, including:
  - o Securities short-selling requirements;
  - o New regulatory framework for financial benchmarks;
- Strengthen enforcement regime against market misconduct, including:
  - o Clarify scope of prohibition against false or misleading disclosures (section 199)
  - o Introduce statutory definition of “persons who commonly invest” for prohibitions against insider trading;
  - o Confer priority on MAS’ civil penalty claims;
  - o Standardisation of civil penalty ceiling;
- Other technical amendments.

## **16. MAS releases policy consultation paper on intermediaries dealing in derivative contracts**

- On June 3, 2015, MAS released its Policy Consultation paper on Regulatory Framework for Intermediaries Dealing in OTC Derivative Contracts, Execution-related Advice and Marketing of Collective Investment Schemes. Part A of the consultation considers the proposed regulatory framework for intermediaries dealing in OTC derivatives. This includes considerations relating to admission criteria, business conduct requirements, capital and financial requirements and transitional

arrangements. Part B considers proposed amendments to the SFA and FAA, in relation to execution-related advice and marketing of collective investment schemes, among other things.

As background and as described earlier, on February 11, 2015, MAS issued a consultation paper that proposed amendments to the SFA in order to complete the expansion of the scope of the SFA to regulate derivatives contracts. This included the expansion of the capital markets services licensing requirement to OTC intermediaries.

## **17. EMA develops electricity forward trading**

- On May 23, 2013, the Energy Market Authority (EMA) issued a request for interest document for the Forward Sale Contract Scheme (FSC) to facilitate the development of an electricity futures market in Singapore. The aim of the development of the futures market is to support the trading of “forward” electricity products and complement the existing wholesale and retail electricity markets.

In its public consultation paper released in October 2012, the EMA requested feedback on the FSC scheme, which provides incentives for generators through long term contracts of up to three years (FSCs), in return for them participating as market makers in the electricity futures market. The FSCs are fixed volume indexed price contracts with generators on the sell-side and Market Support Services Licensee (MSSL), i.e. SP Services, on the buy-side. The total volume for the FSC is 8,400GWh over the three year tenure and would be allocated evenly across all time periods in the quarter during the contract duration. The FSC price may be pegged to the prevailing Liquefied Natural Gas Vesting Price (LVP) or Balance Vesting Price (BVP) and generators would not be allowed to switch between the price references during the tenure of the FSC scheme. The expected launch of the Singapore electricity futures market is in the first half of 2014.

## **18. MAS enhances safeguards for the sale of financial products at retailers and public places**

- On September 17, 2013, MAS released the Consultation Paper on Draft Regulations pursuant to the SFA and Financial Advisers Act (FAA) to effect certain policy proposals arising from the review of the regulatory regime governing the sale and marketing of listed and unlisted investment products as set out in MAS’ consultation papers dated 12 March 2009 and 28 January 2010. In order to strengthen safeguards for retail investors, the Securities and Futures (Amendment) Act 2012 empowers MAS to prescribe Regulations in relation to requirements relating to:
  - A Products Highlights Sheet to be issued in a prescribed format for certain offers of securities under Part XIII of the SFA;
  - Issuers of unlisted debentures to provide timely and ongoing disclosures to investors; and
  - Advertisements of certain offers of securities to give it a fair and balanced view of the product and comply with certain restrictions.
- On March 14, 2014, MAS issued its Consultation Paper on Draft Regulations to Enhance the Regulatory Framework for Unlisted Margined Derivatives Offered to Retail Investors (the 2014 Paper). In the 2014 Paper, MAS consulted on the Draft Regulations pursuant to the SFA which would affect the policy proposals set out in the 2012 Consultation Paper as well as the MAS Response to the 2012 Consultation Paper.

Highlights of some proposed amendments are:

- Presently, banks which are licensed under the Banking Act are not caught under the SFA for the regulated activity of LFX trading. MAS proposes certain amendments to the Second Schedule to the SFA to remove the regulatory carve-out in order to effect the proposals set out in the 2012 Policy Paper in relation to banks carrying on LFX trading with retail customers.
- MAS also proposes certain amendments to the Securities and Futures (Licensing and Conduct of Business) Regulations to require Capital Markets Services License holders (“CMSL holders”) and entities exempted under section 99(1)(a), (b) and (c) of the SFA (collectively the “derivative holders”) who offer CFDs and/or LFX to:
  - (a) maintain separate trust accounts for retail customers’ transactions in listed and unlisted products;
  - (b) maintain retail customer moneys in trust accounts with a bank in Singapore;
  - (c) not use retail customer moneys/assets in trust/custody accounts for meeting other obligations incurred by the derivative dealer in connection with the retail customer’s unlisted margined derivative transactions;
  - (d) perform daily computation of all retail and non-retail customer money/assets which are deposited in a trust/custody account; and
  - (e) act as a principal to the trade when dealing in unlisted margined derivatives with retail customers.
- MAS proposes certain amendments to the Securities and Futures (Financing and Margin Requirements for Holders of Capital Markets Services Licences) Regulations to:
  - (a) Impose minimum margin requirement of 5 % on CMSL holders dealing in CFDs on FX and other LFX contracts with retail customers; and
  - (b) Require a base capital requirement of S\$5 million for CMSL holders dealing in unlisted derivatives with retail customers.
- MAS also proposes to introduce a new set of regulations being the Securities and Futures (Margin Requirements for Exempt Financial Institutions) Regulations which would prescribe margin requirements for exempt financial institutions as set out under Section 99(1)(a), (b) and (c) of the SFA.
- On July 21, 2014, MAS released its consultation paper on proposals to enhance regulatory safeguards for investors in the capital markets after reviewing its regulatory framework in light of recent market developments. The proposals consult on three key areas:
  - extending to investors in non-conventional investment products the current regulatory safeguards available to investors in the capital markets;
  - requiring investment products to be rated for complexity and risks, and for these ratings to be disclosed to investors; and
  - refining the investor classes under the SFA and the FAA.

By way of background, MAS has taken into account, among others, that the pace of development of the capital markets necessitates continual review of the regulatory framework to ensure that it remains relevant and effective in achieving its regulatory objectives. Additionally, the myriad pieces of product information being pushed out to investors as a result of more complex features underscore the need for better means of illustrating the risk-return trade-offs associated with each product.

Part I of the paper proposes to modify the scope of capital markets products under the SFA and FAA. MAS proposes to subject the offer and distribution of products and schemes that exhibit similar features as regulated capital markets products to the same treatment under the SFA and FAA.

Part II of the paper tackles regulated investment products which are offered to retail investors by introducing a framework by which all investment products can be rated for their complexity and the risk that investors may lose some or all, or more than their principal investment amount. It also requires product issuers to rate their products and discloses these ratings in regulated offering documents and through other stipulated channels.

In Part III, MAS notes that while the existing tiered level of regulator protection is appropriate for safeguarding the interest of retail investors, it has nonetheless set out proposals to refine and streamline classes of non-retail investors.

- On July 23, 2015, MAS published a consultation paper on Market Conduct Guidelines outlining measures to safeguard consumers' interests when buying financial products and services at retailers and public places. These measures include ensuring that there are adequate controls for a proper sales and advisory process. MAS also proposes to require financial institutions to notify MAS of their marketing and distribution activities at retailers and public places. The proposals seek to address the risk of consumers making purchases of financial products that may be unsuitable for them when they are prospected at retailers or public places. The proposed Guidelines complement existing rules and practices, and ensure consistency and alignment of standards across the financial industry.
- On September 22, 2015, MAS announced that it will proceed with enhancements to its regulatory framework for safeguarding investors' interests, taking into account feedback received on its consultation paper which was published on July 21, 2014 (described above).

Key changes include:

- Retail investors in non-conventional investment products will be accorded the same regulatory safeguards as investors in capital markets products.
- Investors who meet prescribed wealth or income thresholds to qualify as accredited investors (AIs) will have the option to benefit from the full range of regulatory safeguards that are applicable for retail investors.

Amendments to the SFA to implement these changes will be tabled in Parliament in 2016. MAS will also extend its capital markets regulatory framework to non-conventional investment products that share features similar to capital markets products. These are currently not subject to MAS' regulations. In future, such non-conventional investment products will be regulated either as debentures or investment funds, depending on their features. Examples given include precious metals buy-back arrangements and collectively managed investment schemes.

Under the current regulatory regime, investors who meet prescribed wealth or income thresholds are classified as AIs by default. They are accorded a lower level of regulatory protection as they are considered to be better able to protect their own interests. This may not be true for all investors who meet the prescribed wealth or income thresholds.

MAS intends to refine the regulatory regime to empower AI-eligible investors to choose the level of regulatory safeguards best suited to their individual circumstances:

- FIs will have to treat new customers who are AI-eligible as retail investors by default, unless the customers choose to "opt-in" to AI status.
- FIs can continue to treat existing customers who are AI-eligible as AIs, unless the customers choose to "opt-out" of AI status to benefit from the full range of capital markets regulatory safeguards available to retail investors.

AI-eligible customers who choose to “opt-in” to, or retain their, AI-status may be those that are willing to forgo the benefits of stronger regulatory safeguards available to retail investors, in return for the ability to more easily access a wider range of complex and risky products.

Also, MAS notes that it is still reviewing feedback on the remaining proposal to introduce a complexity-risk ratings framework for investment products and will issue a separate public response later.

## **19. MAS releases Consultation Paper on Amendments to Corporate Governance Regulations**

- On September 20, 2013, MAS released the Consultation Paper on Amendments to Corporate Governance Regulations. By way of background, the Securities and Futures (Corporate Governance of Approved Exchanges, Designated Clearing Houses and Approved Holding Companies) Regulations 2005 (the “2005 Regulations”) were introduced in 2005 and are applicable to approved exchanges, approved clearing houses and approved holding companies regulated under the SFA. In this consultation paper, MAS proposes amendments to the 2005 Regulations, taking into account developments in the corporate governance requirements as well as recent amendments to the SFA.

The proposals in this consultation paper cover the following areas:

- Director independence;
- Board and board committees;
- Appointment of key management officers

MAS also proposes to extend the 2005 Regulations to licensed trade repositories (“LTRS”) in view of their status as systematically important financial market infrastructure. The proposed Securities and Futures (Corporate Governance of Approved Exchanges, Approved Clearing Houses, Licensed Trade Repositories and Approved Holding Companies) Regulations 2013 is intended to replace the 2005 Regulations. Compliance by approved exchanges, approved clearing houses, approved holding companies and licensed trade repositories with the regulations would be reviewed by MAS as part of its ongoing supervisory programme. The deadline for submission is October 21, 2013.

## **20. MAS review of the Banking Act**

- On November 28, 2013, MAS released a Consultation Paper on the Review of the Banking Act. MAS proposes several changes to the Banking Act (BA) to strengthen its supervisory oversight over banks and codify its expectations regarding the risk management practices that banks should implement.

Key proposed amendments include:

Duty to inform MAS of material developments:

- MAS proposes that banks be required to notify MAS as soon as they become aware of any material adverse developments affecting the bank (including the head office and branches) or any entity in its group.
- Material adverse developments include, at a minimum, the breach (or possible breach) of any laws or regulations, business rules or codes of conduct in Singapore or elsewhere.
- Locally incorporated banks are currently required to obtain MAS’ prior approval for the appointment of directors, chief executive officers, deputy chief executive officers, chief financial officers and chief risk officers. MAS proposes banks to notify them when they become aware of

any material information which may negatively affect the fitness and propriety of any officer whose appointment was approved by MAS.

- Sections 15A and 15B of the BA require the Minister's approval before any person becomes a substantial shareholder of a bank incorporated in Singapore. MAS proposes to require banks incorporated in Singapore to notify them when they become aware of persons who have become shareholders or controllers without obtaining approval. MAS also proposes that banks be required to notify MAS as soon as they become aware of any material information that may negatively affect the suitability of their substantial shareholders and controllers.

MAS' control over key officers and auditors:

- Currently, under section 54(2) of the BA, MAS may direct the removal of a director of a locally incorporated bank or an executive officer of any bank in Singapore if the director or officer has (a) wouldfully contravened or wouldfully caused the bank to contravene any provisions of the BA; (b) without reasonable excuse, failed to secure the bank's compliance with the BA or the MAS Act; or (c) failed to discharge any duties of his office where MAS thinks such removal is necessary in the public interest or for the protection of the depositors of the bank.
- MAS proposes replacing the current grounds for removal in section 54(2) with a single criterion of the director or the executive officer ceasing to be fit and proper.
- MAS further proposes to include "interest of the Singapore financial system" as an additional premise for the removal of a bank director or executive officer. This would allow MAS to consider the reputation of and stakeholder confidence in the financial system when determining whether to exercise its power of removal.

Duty to implement adequate risk management systems and controls:

- MAS proposes to codify its expectation that all banks institute and maintain adequate risk management systems and controls in the BA. Banks would be required to establish a comprehensive risk management framework and internal controls. MAS would determine whether the risk management systems and controls are adequate.
- On January 15, 2015, MAS published its response to feedback on its November 2013 consultation paper on the review of the Banking Act. MAS had previously sought feedback on proposed amendments aimed at:
  - Formalising banks' duties to inform MAS of material adverse developments and information related to the bank, its shareholders and controllers, and key appointment holders;
  - Strengthening MAS's control over banks' key appointment holders and auditors; and
  - Formalising banks' duties to implement risk management systems and controls.

MAS has now launched another consultation on further proposed amendments to the Banking Act. The proposed amendments include:

- Requiring banks to seek MAS's approval to open a new place of business or change the location of their existing place of business at which they conduct other financial or related activities (for example, money-changing and remittance activities); and
- Empowering MAS to declare any day or part thereof to be a bank holiday or holidays, and to prescribe either a positive or negative list of activities that banks may or may not conduct during the bank holiday.

MAS has also invited comments on the draft Banking Act (Amendment) Bill, which is appended at Annex B of the January 2015 consultation paper.

## **21. MAS consults on transaction requirements for banks**

- In December 2013, MAS released a consultation paper on Related Party Transaction Requirements for Banks. The consultation paper sets out the proposed changes to MAS' requirements on banks' transactions with their related parties (RPTs) as set out in MAS Notice 643 "Transactions with Related Parties" and in the BA.

Key highlights include:

- Exemption of RPTs below SGD \$100,000. Exemption of all other staff transactions, besides staff loans, from the requirements that RPTs be conducted on no more favorable terms, provided that these transactions are granted as part of the officer or employee's overall remuneration package, in accordance with the staff remuneration policy that has been approved by the board;
- Views on whether a bank's majority-owned subsidiaries should be excluded from the bank's list of related parties and the scope of MAS Notice 643. The paper consults on the level of majority shareholding in subsidiaries for the subsidiaries to qualify for the exclusion;
- For a bank incorporated outside Singapore, the consultation paper seeks views on whether the definition of "senior management" should be confined to the senior management of the bank in Singapore;
- For the list of banks' related parties, the consultation paper seeks comments on whether this list should be expanded to include firms, LLPs and companies of which banks are directors, partners, executive officers, agents, guarantors or sureties;

## **22. CFTC, MAS sign MoU on supervision of cross-border entities**

- On December 27, 2013, the CFTC and MAS signed a Memorandum of Understanding (MoU) regarding the cooperation and the exchange of information in the supervision and oversight of regulated entities that operate on a cross-border basis in the United States and Singapore. The MoU was signed by former CFTC Chairman Gary Gensler and MAS Deputy Managing Director, Financial Supervision, Ong Chong Tee.

The CFTC and MAS expressed their willingness through this MoU to cooperate in the interest of fulfilling their respective regulatory mandates regarding derivatives markets, particularly in the areas of protecting investors and customers, fostering integrity of and maintaining confidence in financial markets and reducing systemic risk. The scope of the MoU includes markets and organized trading platforms, central counterparties, trade repositories, and intermediaries, dealers and other market participants.

## **23. MAS opens applications for RQFII**

- On January 24, 2014, MAS announced that eligible financial institutions may submit applications for the Renminbi (RMB) Qualified Foreign Institutional Investor (RQFII) license. The RQFII license would allow these institutions to offer RMB investment products and invest offshore RMB into China's securities markets. The applications are made to the China Securities Regulatory Commission (CSRC)

via approved custodian banks. All Singapore-incorporated financial institutions that are approved by MAS to conduct fund management activities may apply for the license. Singapore was allocated an aggregate quota of RMB 50 billion under China's RQFII programme.

## **24. MAS consults on MAS Act and Trust Companies Act amendment**

- On June 5, 2014, MAS released a consultation paper on the proposed amendments to the MAS Act and Trust Companies Act. The aim of the consultation paper is to strengthen the regulatory framework for combating money laundering (ML) and terrorism financing (TF) through enhancing the effectiveness of Singapore's AML/CTF regime, in particular international cooperation. These enhancements would align Singapore's regime with the revised Financial Action Task Force (FATF) Recommendations as well as other international standards such as the Basel Committee on Banking Supervision. MAS is also currently developing subsidiary legislation to amend the definition of 'financial institutions' in the MAS Act to include designated financial holding companies, which would subject these companies to the appropriate AML/CFT regulation.

## **25. Authorities consult on FATCA regulations**

- On September 22, 2014, the Ministry of Finance, MAS and the Inland Revenue Authority of Singapore released a public consultation on proposed regulations to help financial institutions in Singapore to comply with the US Foreign Account Tax Compliance Act (FATCA). In order to ease the compliance in relation to FATCA, Singapore has now substantially concluded a Model 1 Intergovernmental Agreement (IGA) with the US.

The FATCA IGA would be signed in the fourth quarter of 2014. The public consultation invites feedback on the draft Income Tax (International Tax Compliance Agreements) (United States of America) Regulations 2014 and the draft FATCA e-Tax Guide. The draft regulations set out the due diligence and reporting obligations of Singapore-based financial institutions in relation to the FATCA IGA, whereas the draft e-Tax Guide provides further explanation of those obligations. The public consultation would be from September 22 to October 17. On March 17, 2015, MOF, IRAS and MAS published their responses to public feedback on the draft income tax regulations and e-tax guide relating to the implementation of the Singapore-US Foreign Account Tax Compliance Act (FATCA) Intergovernmental Agreement (IGA).

A total of 567 suggestions were received from the public consultation, held between September 22 and October 17, 2014. They covered areas such as the information reporting obligations of trusts, the applicability of US regulations and the exemption of supplementary retirement scheme accounts (SRS) and SRS investment accounts. More than 200 suggestions that helped advance the policy objectives for implementing the Singapore-US FATCA IGA were accepted and incorporated into the regulations and e-tax guide. The remaining suggestions were felt to be inconsistent with Singapore's policy on the implementation of the IGA or with the provisions of the IGA.

## **26. Singapore and China strengthen financial cooperation**

- MAS announced on October 27, 2014 that Singapore and China have reached an agreement on financial cooperation in offshore RMB market, capital markets and insurance.

In particular, two initiatives were agreed:

- Direct currency trading between Chinese Yuan and SGD would commence on October 28, 2014. This would lower foreign exchange transaction costs and encourage the greater use of the two currencies in cross border trade and investment; and
- China-incorporated financial institutions can issue RMB-denominated debt instruments in Singapore directly. This would help to diversify long-term funding for Chinese financial institutions by allowing them to tap into the international institutional investor base in Singapore.

MAS indicated further that the two countries would explore measures to strengthen cooperation in the areas of derivatives and catastrophe risk insurance.

- On October 13, 2015, MAS announced that Singapore and China have agreed on new initiatives to further promote the international use of the RMB through Singapore. The agreement was reached at the 12th Joint Council for Bilateral Cooperation (JCBC). The new initiatives will broaden the cross-border RMB channels between Singapore and China.

Under the agreement, banks in Singapore will be able to lend RMB to corporates across Suzhou and Tianjin, and corporates in Suzhou and Tianjin will be able to issue RMB bonds in Singapore. Corporates in Suzhou and Tianjin will be allowed to repatriate 100% of the proceeds raised from bonds issued in Singapore, and corporates in SIP will be allowed to borrow from Singapore-based companies. Qualifying privately-owned banks in Singapore-Sino Tianjin Eco-City (SSTEC) will be allowed to borrow from Singapore-based banks.

Singapore also supports the inclusion of the RMB in the International Monetary Fund's (IMF) Special Drawing Rights' basket of currencies, noting that the use of the RMB for payments, trade settlement, and investments has grown rapidly in recent years. Singapore and China also look forward to enhancing financial connectivity to support projects under the "One Belt One Road" initiative in order to facilitate access by Chinese companies to ASEAN markets through Singapore.

- On November 9, 2015, MAS announced that initiatives to strengthen cross-border RMB flows and a commitment to collaborate on capital market connectivity between China and Singapore were key financial co-operation outcomes arising from a recent state visit to Singapore by the president of the People's Republic of China.

Three key initiatives further expand channels for cross-border RMB flows and help support greater use of the RMB outside China. First, China and Singapore agreed to extend the same cross-border RMB initiatives that currently exist with respect to Suzhou and Tianjin to Chongqing municipality. The enhanced cross-border channels will boost RMB activities in Singapore. They will also provide a larger variety of financing solutions for Chinese corporates and help strengthen financial connectivity between Singapore and China's western region. Second, Singapore's quota under the RMB qualified foreign institutional investor scheme will be doubled from RMB 50 billion to RMB 100 billion. Third, MAS and the People's Bank of China agreed to renew and enhance the bilateral currency swap arrangement established between the two central banks.

The financial co-operation agenda between Singapore and China now includes an agreement to enhance capital market co-operation through two initiatives. This includes an agreement to institute a regular high-level dialogue between MAS and the China Securities Regulatory Commission (CSRC). In addition, MAS and CSRC agreed to explore product collaboration to broaden capital market offerings.

## **27. MAS and RBA sign MOU**

- On April 14, 2015, MAS and RBA entered into a memorandum of understanding (MoU) on cooperation arrangements to facilitate access by the RBA to information on derivatives contracts held in trade repositories in Singapore. The MoU is meant to enable RBA to fulfil its responsibilities and mandates, while ensuring the privacy of the information is appropriately protected. The MoU also provides for derivatives trade data to be disclosed to an Australian governmental entity, subject to strict conditions.

## **28. MAS paper on removing DBU-ACU divide**

- On August 31, 2015, MAS released its Consultation Paper on Removing the DBU-ACU Divide – Implementation Issues. All banks in Singapore currently have to maintain two accounting units – the domestic banking unit (DBU) and the Asian currency unit (ACU). Transactions in Singapore dollars can be booked only in the DBU, whereas transactions in foreign currencies are typically booked in the ACU. In June, MAS announced that it will remove the DBU-ACU divide. Therefore, banks will no longer need to maintain two separate accounting units.

This consultation paper considers the proposed amendments to regulatory requirements that will be required following the removal of the DBU-ACU divide. As many of the prudential limits in Singapore are calibrated based on the DBU-ACU divide, the removal will require changes to certain regulatory provisions, including:

- Priority of specified liabilities in insolvency (Section 62(1) of the Banking Act);
- Asset maintenance requirements (MAS Notice 640);
- Anti-commingling limits (regulations 23F and 23G of the Banking Regulations);
- Equity investment limits (Section 31 of the Banking Act) and immovable property limit (Section 33 of the Banking Act); and
- Concentration limits (MAS Notice 639)

MAS is also working separately with industry participants on proposed amendments to the regulatory returns based on the DBU and ACU, as set out in MAS Notice 610 –Submission of Statistics and Returns.

## **29. MAS proposes amendments to financial market legislation**

- On September 18, 2015, MAS issued a consultation paper on proposed amendments to the SFA, FAA and Trust Companies Act (TCA). MAS had conducted a review of these acts and their subsidiary legislation to identify areas where MAS' supervisory powers should be further enhanced, as well as strengthen business conduct requirements applicable to entities regulated under these acts. This is in line with MAS' ongoing review of the Banking Act, and it is intended that these proposed enhancements will harmonise similar requirements across the various acts where appropriate.

The proposed amendments would also ensure that MAS is apprised of specified adverse developments in financial institutions, provide for suitable powers of regulatory oversight, and align requirements for these financial institutions with those applicable to banks where appropriate. The proposed amendments will apply to financial institutions including SFA-regulated entities comprising capital markets services licence holders and market infrastructures consisting of approved exchanges and recognised market operators, approved clearing houses and recognised clearing houses, licenced trade repositories and licenced foreign trade repositories and approved holding companies.

In the consultation, MAS also proposes to provide an option for investors to more conveniently pledge securities held in their central depository direct accounts to their brokers. This would facilitate investors using these securities to meet collateral requirements. To promote financial prudence, securities brokers will be required to collect a minimum of 5% of collateral from their customers for the trading of listed securities.

### **30. MAS issues explanatory brief on banking amendments**

- On January 25, 2016, MAS released an explanatory brief on the Banking (Amendment) Bill 2016, which has been moved for a first reading in parliament. These legislative amendments aim to enhance prudential safeguards and corporate governance and risk management controls in the banking industry, as well as strengthen and align MAS' regulatory and supervisory framework with international best practice. Amendments are also being made to formalise MAS' existing requirements and clarify policy intent. MAS conducted public consultations on the significant policy changes (November 2013) and developed a draft bill (January 2015), and has incorporated the feedback into the bill where appropriate. The bill touches on three key areas:
  - Prudential safeguards: including empowering MAS to require foreign banks to locally incorporate all or part of their banking business. MAS is also able to set prudential requirements that cap banks' leverage and ensure they maintain sufficient liquidity, in line with international standards;
  - Corporate governance: including empowering MAS to remove key appointment holders of banks if they are found to be not fit and proper, and providing protections to external auditors from liability associated with disclosures. MAS is also able to direct banks to remove their external auditors and to prohibit, restrict or direct a bank to terminate any transaction it enters into with its related parties; and
  - Risk management controls: including formalising MAS' expectation for banks to institute risk management systems and controls that are commensurate with their business profiles and operations, with penalties for failing to do so. It also introduces a requirement for banks to obtain MAS' approval to establish new places of business where non-banking activities (such as money changing and remittance) are conducted.

There are also a number of other amendments, including a duty to inform MAS of any adverse material developments, and other amendments of a technical nature.

### **31. Parliament passes the Choice of Court Agreements Bill**

- On April 14, 2016, parliament passed the Choice of Court Agreements Bill. This bill seeks to give effect to the Hague Convention on Choice of Court Agreements, which established an international legal regime for upholding exclusive choice of court agreements in international civil or commercial cases, and governs the recognition and enforcement of judgments among parties to the Hague Convention.

In implementing the Hague Convention, the bill paves the way for Singapore to ratify the Hague Convention, thereby enhancing the enforceability of Singapore court judgments. Under the bill, if a Singapore court is the chosen court, it will have the jurisdiction to decide the dispute at hand. The Singapore court cannot generally decline jurisdiction on the grounds that the dispute should be decided by a court of another state. Conversely, if Singapore is not the chosen court, then the Singapore court must generally stay or dismiss the matter.

### 32. MAS facilitates retail investment in corporate bonds

- On May 19, 2016, the Monetary Authority of Singapore (MAS) introduced two new regulations to facilitate corporate bond offerings to retail investors.

Under the bond seasoning framework, wholesale bonds issued by issuers that meet eligibility criteria stipulated by the Singapore Exchange (SGX) can be offered to retail investors after the bonds have been listed on SGX for six months. These ‘seasoned’ bonds can be re-denominated into smaller lot sizes and offered to retail investors on the secondary market.

Eligible issuers can also offer additional bonds to retail investors on the same terms as the seasoned bonds without a prospectus. SGX has amended its rules to effect the framework, and issued a practice note to provide guidance to issuers on the relevant procedures and processes.

In addition, under the exempt bond issuer framework, issuers that satisfy specified thresholds that are higher than the eligibility criteria under the bond seasoning framework can offer bonds directly to retail investors at the start of an offer without a prospectus.

The changes are part of an effort to widen the investment options available to retail investors. The new regulations give effect to the policy and legislative proposals on the bond seasoning framework and exempt bond issuer framework, which were open for consultation in September 2014 and December 2014, respectively. As an additional incentive for eligible issuers under the bond seasoning framework and exempt bond issuer framework, the Minister for Finance will grant a tax deduction of up to two times to qualifying retail bond issuers for issuance costs attributable to these retail bonds. The tax concession will be available for five years and took effect on May 19.

### 33. Fintech

- On April 12, 2016, The Monetary Authority of Singapore (MAS) announced the inaugural Singapore FinTech Festival, to be held in Singapore from 14 to 18 November 2016. The Singapore FinTech Festival will comprise three components:

**Global FinTech Hackcelerator** – In May 2016, the global FinTech community will be invited to ideate and co-create solutions to specific problems or challenges solicited from the financial industry. Up to 20 teams will then be selected from across the world to develop market-ready solutions to these problems over the following months. The selected teams will present their completed solutions at the Demo Day during the Festival.

**MAS FinTech Awards** – The Awards will recognise innovative FinTech solutions that have been implemented by FinTech start-ups, financial institutions, and technology companies.

**Conferences and Events** – The Festival will include the MAS FinTech Conference, ABS-MAS Tech Risk Conference, ABS-MAS Regulation Technology (RegTech) Forum. The Festival will also feature other community and networking activities like the Innovation Lab Crawl, the SGX Bull Charge Charity Run, etc.

- On June 6, 2016, the Monetary Authority of Singapore (MAS) released a consultation paper on proposed guidelines for a “regulatory sandbox” that will enable financial institutions, as well as non-financial players, to experiment with financial technology (fintech) solutions in an environment where actual products or services are provided to the customers. For the duration of the regulatory sandbox, MAS will relax specific regulatory requirements, which an applicant would otherwise be subject to. MAS recognises that the purpose of the regulatory sandbox is to provide appropriate safeguards to contain the consequences of failure for customers rather than to prevent failure altogether.

Interested firms are encouraged to approach MAS to discuss how their innovative fintech solutions can be launched in the regulatory sandbox, even while the proposed guidelines are being consulted and finalised.

- On August 2, 2016, the Monetary Authority of Singapore (MAS) announced that it has set up an international technology advisory panel. The panel will advise MAS on international developments in fintech and how Singapore can harness new technologies to enhance the provision of financial services.

The panel comprises of chief innovation and science officers in major financial institutions, fintech business leaders, venture capitalists, and thought leaders in technology and innovation. It met for the first time on August 2. The meeting was attended by the deputy prime minister and chairman of MAS, as well as senior MAS officials.

The panel discussed emerging trends in fintech; explored the wider applications of decentralised systems, such as blockchains, and new business models in areas such as retail and corporate banking; wholesale markets and insurance; and highlighted the importance of a regulatory regime that facilitates innovation and adoption of new technologies while maintaining trust and confidence. Panel discussions explored the impact of technologies like blockchains, wearables, and telematics on the financial services, as well as new business models for banking and fixed income and foreign exchange markets.

- On August 24, 2016, the Monetary Authority of Singapore (MAS) announced the opening of its FinTech Innovation Lab. The purpose-built facility, known as Looking Glass @ MAS, is located within the MAS Building. Looking Glass @ MAS will serve the following purposes:
  - allow MAS to experiment FinTech solutions with financial institutions, start-ups, and technology vendors;
  - facilitate consultations for start-ups by industry experts on areas of interest such as legal, regulation, and business-related matters; and
  - provide a venue for relevant training sessions and networking activities for the FinTech community.
- On September 12, 2016, the Monetary Authority of Singapore (MAS) and the Swiss Financial Market Supervisory Authority (FINMA) signed a cooperation agreement to foster greater cooperation on FinTech. This initiative was launched at the second Financial Dialogue between the MAS and the State Secretariat for International Finance (SIF) held today. The annual Dialogue aims to deepen bilateral cooperation and exchange views on domestic and international financial market developments and policies.

The cooperation agreement between MAS and FINMA provides a framework for innovative FinTech companies in Singapore and Switzerland to expedite initial discussions on introducing new FinTech solutions in each other's market and understand regulatory requirements, thus helping to reduce regulatory uncertainty and the time-to-market for these new FinTech solutions. The agreement will help to create opportunities for FinTech businesses from Singapore and Switzerland to expand into each other's markets. FINMA and MAS have also committed to share information about emerging FinTech trends and regulatory issues pertaining to innovation.

- On October 24, 2016, the Monetary Authority of Singapore (MAS) and the Korean Financial Services Commission (KFSC) signed a cooperation agreement to foster greater cooperation in FinTech. The signing took place at the sidelines of the FinTech Demo Day organised by the Korean FinTech Centre. The agreement provides a framework for cooperation in FinTech between Singapore and South Korea. Under the agreement, MAS and KFSC will explore potential joint innovation projects on technologies such as big data and mobile payments. MAS and KFSC will also discuss issues of common interest, and share information on FinTech trends and how it may impact existing regulations.
- On November 16, 2016, the MAS published its regulatory sandbox guidelines to encourage experimentation of solutions that utilise technology innovatively to deliver financial products or services. The guidelines incorporate feedback from the public consultation, as well as learning points from actual sandbox applications. The guidelines will improve the clarity, flexibility and transparency of the regulatory sandbox through improved clarity, greater flexibility and increased transparency.

#### **34. Consultation on enhancements to customer protection rights**

- On July 19, 2016, the Monetary Authority of Singapore (MAS) released its consultation paper on Enhancements to Regulatory Requirements on Protection of Customers' Moneys and Assets. These proposed enhancements take into account international standards promulgated by the International Organization of Securities Commission and the Financial Stability Board.

Holders of a capital markets services license conducting regulated activities under the Securities and Futures Act Chapter 50 of Singapore are required to take the necessary measures to safeguard customer's moneys and assets as prescribed under the Securities and Futures Licensing and Conduct of Business (LCB) regulations. The proposals follow a review by MAS. This consultation considers various aspects and measures including the definition of customer's money, due diligence on third party custodian, acknowledgement form financial institutions, information requirement and record keeping, disclosure to customers, daily computation of trust accounts and custody accounts and re-hypothecation and other use of customer's assets.

The LCB regulations governing the treatment and handling of moneys and assets received from customers are presently applicable to banks, merchant banks and finance companies (collectively referred to as exempt financial institutions), which conduct regulated activities under the Securities and Futures Act. In this consultation, MAS proposes to remove the LCB money rules for these exempt financial institutions. MAS intends to continue to apply the LCB asset rules to exempt

financial institutions.

It should be noted that the proposals in this consultation do not apply to the non-centrally cleared derivatives.

The proposals set out in this consultation will be subsequently effected via new rules, which MAS intends to consult on after receiving and considering the feedback from this consultation.

### **35. MAS issues guidance on outsourcing risk management, cloud services**

- On July 27, 2016, the Monetary Authority of Singapore (MAS) issued new guidelines on outsourcing risk management to financial institutions following extensive industry and public consultation. These provide expanded guidance to the industry on prudent risk management practices for outsourcing, including cloud services, which have been adopted by a growing number of financial institutions. Key changes to the guidelines include the introduction of a new section on cloud computing that sets out MAS' stance on cloud computing, removal of the expectation for financial institutions to pre-notify MAS of material outsourcing arrangements, and revision to the definition of 'material outsourcing arrangement' to include, under certain circumstances, an arrangement that involves customer information.

This set of guidelines replaces the existing MAS outsourcing guidelines as well as the circular on information technology outsourcing.

### **36. MAS consults on amendments to exemption from requirement to hold CMSL**

- On August 5, 2016, the Monetary Authority of Singapore (MAS) released a consultation paper on Consultation Paper on Proposed Amendments to Securities and Futures (Exemption from Requirement to Hold Capital Markets Services Licence) Regulations.

To expand their futures clearing business, central clearing counterparties ("CCPs") operating in Singapore may admit clearing members which are based overseas and do not have physical operations in Singapore ("Remote Clearing Members"), in addition to onshore clearing members. To the extent that Remote Clearing Members conduct their business activities outside Singapore and only serve overseas-based customers, the business conduct concerns which they pose are limited. Accordingly, MAS intends to exempt Remote Clearing Members which clear futures contracts on Singapore-based CCPs from the requirement to hold a Capital Markets Services ("CMS") licence in respect of trading in futures contracts under the Securities and Futures Act ("SFA"), subject to certain conditions.

This paper seeks views on the proposed exemption, including whether the conditions of exemption are adequate to address the risks that may arise from the participation of these Remote Clearing Members in Singapore's clearing system.

### 37. MAS hosts EU-APAC forum on financial regulation

- On October 14, 2016, the Monetary Authority of Singapore (MAS) hosted regulators from the European Union (EU) and the Asia-Pacific region at the inaugural EU-Asia-Pacific Forum on Financial Regulation.

The forum seeks to enhance information exchange between regulators from the EU and the Asia-Pacific region on a number of key aspects related to cross-border cooperation. These include the current regulatory framework governing financial services, future regulatory developments, issues and challenges that may arise in cross-border coordination for regulatory purposes, and forward-looking and emerging policy priorities for the global regulatory agenda.

Delegates covered the three topics on the forum agenda of this year: the cross-border implications of financial services regulatory frameworks; asset management and funds passporting; and opportunities in fintech. Participants agreed to reconvene in a year in Asia.

### ISDA Submissions (since 2010)

- March 12, 2010: [ISDA submission to MAS on the Consultation Paper on 'Review of the Regulatory Regime Governing the Sale and Marketing of Unlisted Investment Products'](#)
- March 26, 2012: [ISDA submission to MAS on the Consultation Paper on 'Proposed Regulation of OTC Derivatives'](#)
- March 26, 2012: [ISDA submission to MAS on the Consultation Paper on 'Transfer of Regulatory Oversight of Commodity Derivatives from IE to MAS'](#)
- June 22, 2012: [ISDA submission to MAS on the Consultation Paper I on 'Proposed Amendments to the Securities and Futures Act on Regulation of OTC Derivatives'](#)
- August 31, 2012: [ISDA submission to MAS on the Consultation Paper II on 'Proposed Amendments to the Securities and Futures Act on Regulation of OTC Derivatives'](#)
- November 7, 2012: [ISDA submission to SSGX with regard to the Consultation Paper on 'Client Clearing in OTCF Contracts and Enhanced Customer Collateral Protection for OTC Contracts and OTCF Contracts'](#)
- January 12, 2013: [ISDA submission to MAS on the Consultation Paper on 'Proposed Amendments to the MAS Act regarding the resolution of Financial Institutions'](#)
- February 8, 2013: [ISDA submission to MAS on the Consultation Paper on 'Draft Regulations pursuant to the Securities and Futures Act for Trade Repositories and Clearing Facilities'](#)
- July 24, 2013: [ISDA submission to Monetary Authority of Singapore regards to the Consultation Paper on Draft Regulations Pursuant to the Securities and Futures Act for Reporting of Derivatives Contracts.](#)
- August 7, 2013: ISDA submission to Monetary Authority of Singapore on [Feedback](#) on the [data fields](#) in Schedule 2 of the Consultation Paper on Draft Regulations Pursuant to the Securities and Futures Act for Reporting of Derivatives Contracts.
- November 5, 2013: [ISDA letter to MAS on Over-the-Counter Derivatives Trade Reporting in Singapore](#)
- November 15, 2013: [ISDA submission to Singapore Exchange Limited on Proposed Amendments to SGX-DC Remote Clearing Membership and Derivatives Clearing Organization Rules.](#)
- March 7, 2014: [ISDA submission to The Monetary Authority of Singapore on MAS Relief Letter.](#)

- August 8, 2014: [ISDA submission](#) to Monetary Authority of Singapore on the [data fields](#) in the First Schedule of the Consultation Paper on the Draft Securities and Futures (Reporting of Derivatives Contracts) (Amendment) Regulations 2014.
- August 15, 2014: [ISDA submission to Monetary Authority of Singapore regards to the Consultation Paper on Draft for Reporting of Foreign Exchange Derivatives Contracts.](#)
- March 31, 2015: [ISDA submission to Monetary Authority of Singapore with regards to MAS's Consultation Paper on Proposed Amendments to the Securities and Futures Act.](#)
- July 10, 2015: [ISDA joint submission with FIA Asia and ASIFMA to Monetary Authority of Singapore with regards to Policy Consultation on Regulatory Framework for Intermediaries Dealing in OTC Derivative Contracts, Execution-Related Advice, and Marketing of Collective Investment Scheme.](#)
- July 29, 2015: [ISDA submission to Monetary Authority of Singapore with regards to Consultation Paper on Proposed Enhancements to Resolution Regime for Financial Institutions in Singapore.](#)
- July 31, 2015: [ISDA submission to Monetary Authority of Singapore with regards to Consultation Paper on Draft Regulations for Mandatory Clearing of Derivatives Contracts.](#)
- October 13, 2015: [ISDA submission to Monetary Authority of Singapore requesting extension of current masking relief under Rule 11 of the Securities and Futures \(Reporting of Derivatives Contracts\) Regulations.](#)
- November 6, 2015: [ISDA joint submission with ASIFMA to Monetary Authority on Policy Consultation on Margin Requirements for Non-Centrally Cleared OTC Derivatives.](#)
- February 24, 2016: [ISDA submission to Monetary Authority of Singapore on Consultation Paper P002: Proposed Amendments to the Securities and Futures \(Reporting of Derivatives Contracts\) Regulations.](#)
- June 6, 2016: ISDA submission to Monetary Authority of Singapore on draft data fields under the proposed amendments to the Securities & Futures (Reporting of Derivatives Contracts) Regulations. This submission is not yet public.
- June 10, 2016: ISDA submission to Monetary Authority of Singapore on Consultation Paper on proposed legislative amendments to enhance the resolution regime for financial institutions in Singapore. This submission is not yet public.
- June 13, 2016: ISDA submission to Monetary Authority of Singapore on Guidelines on Margin Requirements for Non-Centrally Cleared OTC Derivatives Contracts. This submission is not yet public.

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# TAIWAN

## Key Regulatory Milestones

### 1. Taiwan implements mandatory trade reporting

- Taiwan's FSC has mandated Gretai Securities Market to establish a local trade repository. Financial institutions are required to report their trades to a local trade repository under a phased approach. Effective on April 1, 2012 (Phase 1), NDF, FX swap, vanilla IRS, TWD equity, and structured deposit are required to be reported. Effective on January 02, 2013 (Phase 2), FX options and forwards must be reported. Reporting of all other derivatives started from July 1, 2013 onwards (Phase 3). The local trade repository settings are bespoke in terms of reporting format (e.g. MTM, PVBP and Delta are required to be reported monthly, on a transaction-by-transaction basis) and connectivity (it does not support connection from global TR or any confirmation matching platform). Effective on January 2, 2013, reporting firms are required to separately confirm the uploaded details of the single-sided deals (trades to which uploaded by one party only) by T+1 and Gretai started to perform sample checking for those confirmed single-sided deals from March 18, 2013.

### 2. Derivatives

- On June 17, 2014, FSC approved that revised "Self-regulatory Rules governing Banks' Financial Derivatives Business" issued by the Bankers Association, a SRO in Taiwan. Under the revised rules, onshore banks selling OTC derivatives to non-institutional investor including all corporates and individuals must provide Chinese translation of the agreements. FSC has given banks a 3-month grace period (and in the case ISDA documentation, 6-month) to comply with the new language requirement.

### 3. FSC introduces new measure to strengthen regulation regime for derivative business of banks

- On February 1, 2016, Taiwan's FSC announced new measures to strengthen the regulatory regime for derivatives business of banks. The new measures include increasing the threshold for professional investors; imposing restrictions on banks dealing high-risk products with natural persons; imposing restrictions on high-risk and complex FX derivatives (eg, maturity, leverage); enhancing disclosure requirements; imposing initial margin requirements for certain types of transactions; prescribing the transaction size of derivatives products offered to non-professional investors who are not professional investors nor high-net-worth institutional investors; and amending the calculation requirements for credit valuation adjustment (CVA). In particular, it proposes the following margining requirements for derivatives products offered to investors who are not professional investors nor high-net-worth institutional investors:
  - Initial margin (IM): For high-risk and complex OTC derivatives products, IM will not be less than 2% of the notional amount. For certain FX products with a maturity of more than one year, IM will not be less than 5% of the notional amount. For other products, IM will be determined by the bank's risk management system.
  - Variation margin will be determined by the bank's risk management system.
 The new measures came into effect on March 1, 2016.

### 4. FSC publishes new rules on liquidity coverage ratio

- On November 4, 2014, FSC issued new rules to implement the liquidity coverage ratio (LCR) and liquidity risk monitoring. From January 1, 2015, domestic Taiwanese banks would be required to submit monthly reports on their LCR to FSC and the central bank. Additionally, a phase-in period would be implemented whereby Taiwanese domestic banks would be required to maintain a minimum LCR of at least 60% from January 1, 2015. The LCR percentage would be raised by 10 percentage points per annum until it reaches a 100% by January 1, 2019.

## **5. Amendment to the Futures Trading Act**

On 8 May, 2018, the draft Futures Trading Law amendments were submitted to the Executive Yuan for review. The original draft bill proposed to subject all centrally cleared trades (both mandatorily cleared and voluntarily cleared) to the Futures Trading Act. The draft bill submitted to the Executive Yuan removed the voluntarily centrally cleared trades from the application scope of the law. In addition, a provision was added to clarify that the central bank should be consulted when the transactions subject to mandatory central clearing have an FX element. The draft bill was approved by the Executive Yuan and submitted to Legislative Yuan for review on August 9, 2018.

## **ISDA Submissions (since January 2010)**

- August 23, 2011: [ISDA submission jointly with ECCT/AmCham Joint Banking Committee to Taiwan Financial Supervisory Commission on trade repository development in Taiwan](#)
- July 28, 2016: ISDA submission to the Securities and Futures Bureau of the Financial Supervisory Commission on securities investment trust funds providing collateral for their OTC derivatives transactions.
- April 3, 2018, ISDA submission to SFB on the Amendment to the Futures Trading Act (Chinese version and English translation).

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## THAILAND

### Key Regulatory Milestones

#### 1. Basel III commitments

- On December 14, 2012, BOT issued a notification on capital adequacy framework under Basel III. Thai banks would be required to maintain a minimum Common Equity Tier 1 (CET1) ratio of 4.5%, Tier 1 capital ratio of 6% and Total capital ratio of 8.5%, the latter of which remains unchanged from the Basel II ratio. Under the new Basel III capital framework, foreign bank branches would now be required to maintain a Total capital ratio of 8.5%, which is in line with the Thai banks. The new requirement became effective on January 1, 2013. BOT would assess the developments and impact studies on the Leverage ratio and Liquidity risk framework before adoption in Thailand.

#### 2. Legislation on new type of security interest

- On August 7, 2015, the National Legislative Assembly formally greenlighted the Business Security Act. This new Act will address the obstacles and concerns in the existing Civil and Commercial Code (CCC) that presently prevent the taking of security in Thailand. For instance under the CCC, only mortgages and pledges can be used as security to ensure performance under contracts. This new Act introduces a new type of security interest under Thai law to be referred to as “business security”. As security interest, the creditor in whose favor the business security is created is recognised as the secured creditor under bankruptcy law. The Act describes the persons eligible to use assets as security under the Act, the types of collateral, the creation of the business security and certain features relating to the business security as well as the enforcement of such business security. The Act was published in the Royal Gazette on 5 November, 2015. The Act will be effective on July 1, 2016.

#### 3. SEC

- On November 5, 2015, the SEC announced it was seeking public comment on a proposed relaxation of rules governing the investment policy of mutual funds offered for sale to accredited investors (institutional and high-net-worth investors), to enhance the competitiveness of asset management companies and diversify choices for investors with higher risk tolerances.

The draft revision will allow asset management companies to offer more diversified, complex types of mutual funds, similar to those sold in foreign markets, and introduce investors to more investment

opportunities through various types of complex products. The relaxation would allow mutual funds offered to accredited investors to invest in any types of financial instruments without company limit ratio, which has already been the case with hedge funds. Meanwhile, the investor qualifications would also be revised to ensure that only accredited investors with matching risk profiles would be eligible to invest in higher-risk mutual funds. The public hearing ends on 16 November.

- On November 12, 2015, the SEC announced it was seeking public comment on a draft amendment to the rules on calculation and reporting of net liquid capital to better reflect asset values and the changing market environment. The proposed key changes include:
  - Adjustment of the position risk calculation;
  - Inclusion of diverse financial instruments, such as equity, debt, investment units and trusts in the risk calculation; and
  - Updating the net liquid capital calculation methods to be more flexible and suitable to current market trends.

The latest draft amendment includes feedback and recommendations from stakeholders who participated in the hearing in August 2015. The public hearing ends on December 7, 2015.

- On January 26, 2016, the SEC revised several regulations concerning the investment policies of mutual funds and provident funds (PVDs), to enhance flexibility and compliance with international guidelines and market developments. Amendments include:
  - Determination of the types and characteristics of investible assets based on principles instead of specific details;
  - Permission for mutual funds to invest in a wide variety of assets according to a suitable risk profile. For example, funds offered to retail investors are now allowed to invest in non-listed infrastructure funds that may not have accepted retail investors, subject to pre-specified ratios. Previously, mutual funds were allowed to invest in Stock Exchange of Thailand-listed infrastructure funds or those offered to retail investors only;
  - Relaxation of PVD rules by increasing the permissible investment proportion for PVDs in property funds and infrastructure funds, combined with alternative assets, such as commodities, from 15% to not more than 30% of the net asset value. In addition, the establishment of PVDs as a sector fund, the investment policy of which concentrates on securities of certain industry sectors, is allowed, provided there is an investment limit for each member;
  - Promotion of investment diversification to be in line with international standards and market development. This includes determination of investment ratios for certain products (product limit) suitable for the market environment and relevant investment policies, and cancellation of the product limit for general mutual funds; and
  - Derivative investment in accordance with international standards. This includes calculation of the ratio limit; categorisation of fund types to better reflect investment risks based on net exposure instead of investment value; and revision to the investment ratio in various types of assets to be more suitable and in line with different types of funds.
- On February 8, 2016, the SEC announced it was seeking public comments on draft revisions to the rules governing the operation of capital market infrastructures. The proposed revisions would apply to futures exchanges, derivatives clearing houses, securities clearing houses and securities depositories with regard to improving business contingency management, IT security, operational outsourcing and complaint handling. In addition, all such firms, barring futures exchanges, would be required to comply

with new rules on organisational structuring, capital resources and risk management. The consultation process closed on March 8.

- On April 12, the Securities and Exchange Commission of Thailand (SEC) announced it is seeking public comments on a draft amendment to the rules governing intermediaries' business continuity management and service outsourcing to enhance their risk management capacity and lower potential disruption to the overall market in compliance with international standards.

Essentially, the amendment would require that the senior management of securities companies and derivatives business operators take full ownership of the written business continuity management policy and enforce strict implementation of the business continuity management plan. In case of outsourcing business functions to service providers, the outsourcing contract would have to incorporate a business continuity management plan therein as well.

#### **4. Bank of Thailand**

- On December 17, 2015, the BoT announced that the People's Bank of China (PBC) granted Thailand a quota of RMB 50 billion to invest in RMB-denominated securities in China under the Renminbi Qualified Foreign Institutional Investor (RQFII) scheme. This will provide opportunities for institutional investors in Thailand to efficiently manage their investment returns and diversify risks, as well as promote the use of Renminbi to facilitate the growing trade and investment between Thailand and China.

Over the years, the two central banks have deepened their financial cooperation in support of the use of local currencies for trade and investment, starting with the signing of the RMB-THB Bilateral Swap Arrangement (BSA) in 2011 and its subsequent extension in December 2014, followed by the establishment of the RMB Clearing Bank in Thailand in early 2015.

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# Vietnam

## Key Regulatory Milestones

### 1. Derivatives Market Regulations

- In May 2015, The Vietnamese government issued a new decree 42/2015/ND-CP (Decree 42), which is understood to provide general provisions on the establishment of a derivatives market in Vietnam. Decree 42 provides information on the types of instruments that may be traded in Vietnam, as well as the participants that are expected to take part in this market. The scope of Decree 42 does not cover interest rate swaps or foreign currency swaps – these continue to be regulated by the State Bank of Vietnam. Decree 42 is the first set of regulations that are expected to be released this year aimed at developing the Vietnamese market.

### 2. SBV announces new administrative procedures

- On August 5, 2015, the governor of SBV issued Decision No. 1548/QĐ-NHNN to publicise new administrative procedures.

The new administrative procedures cover the establishment and operations of credit institutions, including:

- the procedure applicable to commercial banks and foreign bank branches requesting the renewal of a licence;
- the procedure applicable to commercial banks and foreign bank branches requesting additional operations;
- the procedure applicable to commercial banks and foreign bank branches requesting the renewal of a licence and additional operations.

The new administrative procedures are formulated as stipulated in Circular No. 08/2015/TT-NHNN dated June 30, 2015, revising several articles of Circular No. 40/2011/TT-NHNN dated December 15, 2011 on granting licences and the operational structure of commercial banks, foreign bank branches and representative offices of foreign credit institutions and other foreign institutions with banking operations in Vietnam.

At the same time, SBV announced new administrative procedures for revising, providing additional operations and scope of operations of foreign branches, joint-venture banks and wholly foreign owned banks.

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