

CONSULTATION PAPER

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Review of Regulatory Framework for Unlisted Margined Derivatives Offered to Retail Investors

MAS

Monetary Authority of Singapore

PREFACE

In recent times, derivatives that are traded off-exchange on a margin basis [“unlisted margined derivatives”], such as contracts for differences and leveraged foreign exchange, have increased in popularity among retail investors.

2 Trading in unlisted margined derivatives involve real risks which can be difficult to assess. These include not only the market risk of leveraged trading but also other risks such as counterparty risk and recovery risk of customer moneys. Retail investors may not fully appreciate the risks associated with such unlisted transactions.

3 To address the specific risks arising from retail investors trading in unlisted margined derivatives and to better protect investors’ interests, MAS is proposing to enhance the regulatory requirements applicable to holders of a capital markets services [“CMS”] licence and other financial institutions [“FIs”] such as banks (where specified) which offer unlisted margined derivatives to retail investors. This will ensure that our regulatory regime remains relevant, effective and aligned with international reforms to strengthen the regulatory framework for unlisted products following the global financial crisis, and that confidence in the Singapore market will be maintained.

4 This consultation paper should be read in conjunction with the consultation papers issued by MAS on 13 February 2012 on the “Proposed Regulation of OTC Derivatives” and the “Transfer of Regulatory Oversight of Commodity Derivatives” from the Commodity Trading Act [“CTA”] to the Securities and Futures Act [“SFA”]. To the extent that MAS proposes to expand the scope of the SFA to regulate over-the-counter derivatives on the asset classes of commodities, credit, equities, foreign exchange and interest rates, the proposals outlined in this consultation paper are intended to apply accordingly.

5 MAS invites interested parties to forward their views and comments on the proposals and issues outlined in this consultation paper. Written comments should be submitted to:

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6 MAS requests that all comments and feedback be submitted by 2 July 2012. Please note that all submissions received may be made public unless confidentiality is specifically requested for the whole or part of the submissions.

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1 INTRODUCTION

1.1 Unlisted margined derivatives have gained popularity among retail investors¹ in Singapore, with contracts for differences [“CFD”] and leveraged foreign exchange [“LFX”] being the two most commonly traded.

1.2 Under the SFA, FIs that deal in (i) CFDs referenced to underlying shares or debentures are deemed as dealing in securities; (ii) CFDs referenced to underlying currency exchange rates, or foreign exchange traded on a margin basis, are deemed as leveraged foreign exchange trading². Accordingly, holders of the CMS licence [“CMS licensees”] or FIs exempted from holding the CMS licence [“Exempt FIs” or “EFIs”] such as banks offering CFDs/LFX [collectively referred to as “derivative dealers”] are subject to the applicable business conduct requirements under the SFA and its Regulations.

1.3 CFDs/LFX are essentially leveraged bets on the direction of price movements of the underlying referenced asset. Highly leveraged and traded bilaterally with the derivative dealer, CFDs/LFX entail two key specific risks for retail investors:

- (a) Risk of substantial losses. Due to high leverage, investors stand to lose more than their initial margin deposits. Even if they have the means to fund the losses, investors may fail to recognise that liquid funds are needed in reserve to promptly meet unanticipated margin calls in volatile markets. Otherwise, the derivative dealer may close out their positions, resulting in immediate realised losses and failure to participate in any subsequent price recovery in the markets.
- (b) Counterparty risk. As derivative dealers trade as principal to their customers, investors are exposed to the financial standing and quality of risk management of the dealers.

¹ Retail investors are investors other than accredited investors or institutional investors as defined in Section 2 of the Securities and Futures Act.

² Dealing in securities and leveraged foreign exchange trading as defined in Second Schedule of the SFA.

Should the derivative dealer run into any financial or liquidity issues, there is the risk that the dealer will not be able to meet its obligations or payments to investors. In addition, investors are exposed to the dealer's other counterparties, including other customers and counterparties of the dealer. In the event the derivative dealer defaults, investors may not easily recover their moneys or margins that they have deposited with the dealer for their trades. Investors have no recourse to the underlying CFD/LFX assets as they do not actually own them; and unlike exchange-traded derivatives, they cannot simply transfer the unlisted derivative contracts to other parties.

1.4 The workings and risks of CFDs/LFX as highlighted can be difficult for a retail investor to fully assess whether they are suitable instruments that meet his investment needs, objectives and risk profile³.

1.5 In view of the significant growth of retail participation in the CFD and LFX markets, MAS is concerned to ensure that the regulatory requirements applicable to derivative dealers are appropriate and sufficiently robust to address the specific risks posed by these products to retail investors. To this end, MAS has reviewed the current financial and business conduct requirements in respect of the dealing of unlisted margined derivatives, and are proposing measures as set out in this consultation paper to enhance the regulatory regime to better protect retail investors' interests. In the process, MAS has also studied and considered regimes in other major financial jurisdictions to ensure that the proposals are updated and in line with international practice.

1.6 The proposals aim to:

- (a) Enhance credit risk management by derivative dealers and mitigate the risk of over-leveraging by retail investors.
- (b) Ensure derivative dealers dealing with retail investors are adequately capitalised to operate as a going concern in compliance with the regulatory requirements, and in the event

³ In Hong Kong and the US, CFDs are not permitted.

of insolvency, to help facilitate a proper and orderly wind-up of the business.

- (c) Enhance the protection and recovery of retail investors' moneys and assets in the event of insolvency of the derivative dealer.
- (d) Enhance risk disclosure to better bring out the risks and implications associated with trading unlisted margined derivatives, so as to help retail investors make informed decisions on the suitability of such products.

1.7 The proposals are intended to apply specifically to retail investors, as they may not fully appreciate the risks associated with trading in unlisted margined derivatives. Although the proposals are targeted at unlisted margined derivatives, MAS intends where relevant to extend them to exchange traded derivatives. The rationale for the scope of the proposals will be discussed in greater details in the following sections.

1.8 These proposals should also be read in conjunction with the consultation papers issued by MAS on 13 February 2012 on the "Proposed Regulation of OTC Derivatives" under the SFA ["MAS Consultation Paper on OTC Derivatives"], and the "Transfer of Regulatory Oversight of Commodity Derivatives" from the CTA to the SFA. As set out in the said consultation papers, MAS proposes to expand the scope of the SFA to regulate OTC derivatives on the asset classes of commodities, credit, equities, foreign exchange and interest rates. To that effect, MAS will consider amendments to relevant parts of the SFA to rationalise the definition of unlisted margined derivative contracts (such as CFDs) to include such asset classes. To the extent that unlisted margined derivatives on these asset classes will be regulated by MAS, the proposals set out in this consultation paper are intended to apply accordingly.

2 MARGIN REQUIREMENTS

Current Regime and Issues

2.1 Currently, CMS licensees that deal in CFDs are subject to minimum margin requirements as stipulated in Table 18 of the Fourth Schedule to the Securities and Futures (Financial and Margin Requirements) Regulations ["SF(FMR)R"]. The minimum margin requirements range from 2% of the notional value of the transaction for CFDs on foreign exchange ["FX"], to 5% – 20% for CFDs on equity, and 20% for CFDs on any other underlying assets. In cases where the derivative dealer provides stop-loss features, the margin requirements can be lowered.

2.2 The margin requirements serve to ensure that the CMS licensee mitigates the counterparty risk to its customers when it enters into a CFD with the customers. They also serve as a safeguard to curtail excessive leveraging by customers.

2.3 Since the global financial crisis, and amidst the uncertain global economic outlook, capital markets globally have experienced volatile price fluctuations and funds flows. In this volatile financial climate, MAS is concerned that the current margin requirements allow retail investors to take on an excessive amount of leverage, thereby exposing them to substantial risk of loss. At the same time, the margin requirements may not be sufficiently robust to protect the FIs against unexpected price movements and counterparty losses of their customers. In particular, MAS considers the minimum margin requirement of 2% (or 50 times leverage) for CFDs on FX to be inadequate based on market conditions in the wake of the financial crisis.

2.4 In Hong Kong, the minimum initial margin level for LFX trading is set at 5%, while in Japan, the minimum margin requirement for LFX trading was recently raised from 2% to 4% in August 2011. The US recently imposed margin requirements in October 2010 for retail LFX dealers of 2% in the case of major currencies and 5% for all other currencies.

2.5 Besides the above consideration, the current margin regime under the SF(FMR)R presents two issues:

- (a) The margin requirements apply only to CMS licensees but not to the EFIs. As the issues and risks with respect to margin trading of unlisted derivatives by retail investors are relevant to EFIs as well, there is no basis not to subject EFIs to equivalent requirements.
- (b) Although CFDs on FX are subject to a minimum margin requirement of 2%, there is no such requirement for trading in other LFX contracts⁴. Trading in other LFX contracts presents pay-off characteristics akin to those of trading in CFDs on FX, which are based on underlying currency pairs and traded in off-exchange on a margin basis. This can lead to undesirable regulatory arbitrage.

Proposals

2.6 To enhance credit risk management by derivative dealers, and ensure retail investors have sufficient financial buffer to cope with unexpected losses, MAS proposes to:

- (a) Increase, for CMS licensees, the minimum margin requirement for CFDs on FX entered into with retail investors from 2% to 5% of notional transaction value;
- (b) Retain the current margin requirements for CFDs on other underlying referenced assets under the SF(FMR)R, as the margin levels for these CFDs are assessed to be adequate;
- (c) Extend the minimum margin requirements for all CFDs that are applicable to CMS licensees to EFIs, in respect of EFIs' dealing in such products.

⁴ Such as deliverable FX forward contracts traded on a margin basis.

2.7 To further address the regulatory arbitrage posed by the current differential treatment of CFDs on FX and other LFX contracts, and potentially between CFDs and other unlisted margined derivatives in other referenced assets, MAS proposes to:

- (a) Introduce for CMS Licensees and EFIs a minimum margin requirement of 5% for all other LFX contracts entered into with retail investors;
- (b) Apply the minimum margin requirements as set out in the SF(FMR)R for CFDs on a specified underlying reference asset, to the margin trading of all other unlisted derivatives on the same referenced asset by retail investors.

2.8 The proposal to extend the minimum margin requirements to EFIs is applicable to EFIs' dealings in the retail unlisted derivative markets. For margin requirements in respect of the EFIs' dealings in the non-retail and wholesale OTC derivative markets, as indicated in the MAS Consultation Paper on OTC Derivatives of 13 February 2012, MAS will be taking into account upcoming international standards on margin requirements for non-centrally cleared derivatives⁵ and will consult on the proposed regulatory changes to implement these standards in due course.

2.9 The margins deposited by customers in respect of trading in CFDs and other unlisted margined derivatives with CMS licensees and EFIs must be in the form of acceptable collateral. Should the current market value of the acceptable collateral deposited in the customer's margin account fall below the minimum margin requirements, CMS licensees and EFIs shall immediately call for additional margins from the customer, which shall be met within two business days. Acceptable collateral is as defined under regulation 24(6) of the SF(FMR)R, and haircuts for the different types of collateral are as found in Table 17 of the Fourth Schedule to the SF(FMR)R. For ease of reference, the list of

⁵ Representatives of the BCBS, CGFS, CPSS, and IOSCO have formed a working group to look into setting standards for non-centrally cleared derivatives; a consultative report is expected to be published by June 2012.

acceptable collateral under regulation 24(6) and Table 17 are reproduced at Annexes 1 and 2 respectively.

2.10 The proposals are not intended to cover exchange-traded derivatives, which are traded through a regulated exchange and subject to operating rules of the exchange and clearing house. The exchange and clearing house have established procedures to raise margin requirements during volatile market conditions, and the financial capacity and safeguards (e.g. clearing funds) to guarantee the settlement obligations to investors, and facilitate the transfer of investors' trading positions and margins in the event a member default.

Question 1: MAS seeks views on:

- (a) the proposed minimum margin requirement of 5% of notional transaction value for CFDs on FX and other LFX contracts entered into with retail investors;**
- (b) the proposal to extend the minimum margin requirements that are applicable to CMS licensees dealing in CFDs on a referenced asset, to their dealing in other unlisted margined derivatives of the same asset with retail investors;**
- (c) the proposal to impose the minimum margin requirements for CFDs and other unlisted margined derivatives that are applicable to CMS licensees on EFIs, in respect of the EFIs' dealing with retail investors.**

Question 2: MAS seeks views and suggestions on any other unlisted margined derivatives that could or should be subject to minimum margin requirements.

3 BASE CAPITAL AND GROUP SHAREHOLDERS' FUNDS REQUIREMENTS

3.1 As derivative dealers act as principal to their customers' trades, investors are exposed to the financial standing and quality of risk management of the dealers. Should the derivative dealer run into any financial or liquidity difficulties, there is the risk that the dealer will not be able to meet its obligations or payments to investors, or worse, resort to the unauthorised use of customer moneys to meet its other obligations.

3.2 It is essential that CMS licensees engaging in unlisted derivatives maintain adequate financial resources to put in place the necessary risk management systems, controls and procedures to conduct their regulated activities in compliance with the laws and regulations. In addition, CMS licensees should have adequate financial buffer to provide for any business expenses and risks as a going concern, and if the business fails, to ensure a proper and orderly wind-up⁶.

Base Capital

3.3 Currently, the base capital requirement for a CMS licensee dealing in CFDs or LFX may differ depending on whether the licensee is a clearing member of an exchange. CFD/LFX dealers that are clearing and non-clearing members are subject to a base capital requirement of \$5 million and \$1 million respectively.

3.4 Considering that the CMS licensee's counterparty exposure to retail investors are applicable regardless of whether the licensee is a clearing member or not, and considering the need to have sufficient financial buffer to ensure a proper and orderly wind-up if the licensee

⁶ This is particularly important if the licensee has a huge number of retail customer accounts, where the liquidation process involving the sheer number of accounts can be tedious and costly.

fails⁷, MAS proposes to set the base capital requirement for any CMS licensee dealing in unlisted derivatives with retail investors at S\$5 million.

Group Shareholders' Funds

3.5 Given the nature of the unlisted market, having a strong group financial track record is an important criterion in assessing the qualification of a CMS licence applicant applying to deal in unlisted derivatives with retail investors. In the Guidelines on Criteria for the Grant of a CMS Licence, MAS specifies an admission criterion that securities CFD dealers should have minimum group shareholders' funds of \$200mil. However, the Guidelines do not specify such a requirement for LFX dealers.

3.6 Given that CFDs, LFX and other unlisted derivatives are similar in nature and risks, MAS proposes to address the inconsistency by specifying in the Guidelines a minimum group shareholders' funds of S\$200million for all CMS licence applicants applying to deal in unlisted derivatives (including CFDs and LFX) with retail investors.

Question 3: MAS seeks views on:

- (a) the proposed base capital requirement of \$5 million for CMS licensees dealing in unlisted derivatives with retail investors;**
- (b) the proposed group shareholders' funds requirement of \$200 million for CMS licence applicants applying to deal in unlisted derivatives with retail investors.**

⁷ The liquidation process involving unlisted derivatives can be more complex and costly than that for exchange-traded derivatives, since there may not be ready parties to simply transfer the unlisted derivatives.

4 TRUST ACCOUNT REQUIREMENTS

4.1 When the derivative dealer enters into an unlisted derivative contract such as a CFD/LFX with its customer, the dealer trades as a principal against its customer. As part of the trading, the customer deposits his moneys/assets as collateral margins with the dealer, to cover any trading losses incurred by the customer. To hedge its trading exposure, the derivative dealer typically enters into back-to-back contracts with other hedge counterparties.

4.2 Under the Securities and Futures (Licensing & Conduct of Business) Regulations [“SF(LCB)R”], a CMS licensee is required to deposit all moneys and assets received on account of its customers in a segregated trust account maintained with a bank, merchant bank or finance company in Singapore⁸. In this regard, customers’ moneys and assets deposited with the CMS licensee as margins for the trading of unlisted margined derivatives such as CFDs/LFX are required to be maintained in trust accounts segregated from the CMS licensee’s own moneys and assets.

4.3 With respect to the licensee’s hedging transactions, regulations 16 and 26 of the SF(LCB)R prohibit the CMS licensee from using its customer’s moneys and assets as margins to secure its hedging transactions. Regulations 21 and 35 of the SF(LCB)R further prohibits the CMS licensee from withdrawing any money and asset from a customer’s trust account except for the purposes as set out in these regulations respectively. As such, the derivative dealer is required to hold the customer’s collaterals on trust and not use them for the dealer’s own hedging activities.

Collateral Arrangements effected through Customer Agreement

4.4 Notwithstanding, regulations 21(d) and 35(c) of the SF(LCB)R permit the CMS licensee to make a payment from the customer’s trust account to any other person or account (besides the customer) in accordance with the written direction of the customer. This may allow

⁸ For customers’ assets, the CMS licensee may also deposit the assets in a trust account maintained with specified custodians pursuant to regulation 27 of the SF(LCB)R.

the derivative dealer to obtain the customer's written authorisation under such terms and conditions in the trading agreement, to effect collateral arrangements with customers or withdraw customer moneys/assets from the trust account, to onward place as margins with the dealer's hedging counterparty, instead of using its own house funds.

4.5 Such collateral arrangements expose customer moneys and assets to risks. Retail investors may be unable to fully appreciate the implications and risks involved when consenting to such arrangements. Customer moneys that are taken out of segregated trust accounts to service the dealer's hedging activities may not be protected or readily recoverable should the derivative dealer or its hedge counterparty become insolvent. This is unlike exchange-traded derivatives⁹ ["ETD"], where the clearing and settlement of the derivative trades are performed and guaranteed under the regulated, well-capitalised and highly-organised environment of a clearing house. In the event of a default of the clearing member with which investors trade their ETD contracts, the clearing house default procedures and clearing fund may be utilized, to facilitate the orderly settlement or transfer of the defaulting member's customer positions and collaterals.

4.6 To enhance the trust account safeguards for retail investors trading in unlisted margined derivatives, MAS is proposing to disallow the derivative dealer from using retail customer moneys and assets for the dealer's margining purposes with hedging counterparties, or for meeting other obligations incurred by the dealer in connection with the customer's unlisted margined derivative transactions. In the UK, the Financial Services Authority recently amended its rules to disallow arrangements of title transfers of a retail customer's moneys if the transfer was to secure the customer's obligations under a CFD or LFX. This effectively stopped retail derivative dealers in the UK from using customer moneys for their own hedging purposes.

⁹ Under regulations 19 and 30 of the SF(LCB)R, customer margins are expressly permitted to be placed with a clearing house or its clearing member to facilitate or settle the customer's ETD transaction.

White Label and Agency Arrangements

4.7 Increasingly, MAS has seen white-label partnerships and arrangements adopted by FIs looking to enter or expand their retail online-trading business. White labelling refers to the practice of leasing the right to place the FI's (the lessee) name on another firm's (the lessor) trading platform and market it as its own, and then passing the trades through to the lessor (typically another licensed FI). In the typical while label arrangement, the lessee's customers do not have a contractual relationship with, and in fact may be unaware of, the lessor that owns and operates the platform. The lessee is the issuing counterparty of the unlisted derivative contract to the customer. In other models, the lessee may trade as an agent on behalf of the customers and places the customers' margins with the lessor that is the eventual counterparty/issuer of the derivative contract.

4.8 White-label arrangements based on an agency model for unlisted derivative transactions may create confusion for retail investors over the actual counterparty, accountability or recourse available to retail investors. To further safeguard retail investor interests, MAS proposes to allow the lessee in any white-label arrangements to trade only as principal to retail customers in unlisted margined derivatives, i.e. any recourse which the retail customers would have would be against the lessee regardless of whether the trades were conducted by the lessee or the lessor. The corresponding transactions which the lessee may have with the lessor are separate transactions between the lessee and the lessor and do not involve the customer.

Trust Accounts maintained outside Singapore

4.9 Under regulations 17(2) and 27(3) of the SF(LCB)R, a CMS licensee may, subject to the customer's prior written consent, deposit customer moneys and assets which are denominated in a foreign currency, in a trust account maintained with a custodian outside Singapore that is authorised to act as a custodian in the country where the account is maintained.

4.10 For exchange-traded derivatives, customer moneys and assets are held with a clearing member or clearing house for the purpose of facilitating or settlement of a transaction for the customer. To this effect, it is operationally expedient for the CMS licensee to maintain customer trust accounts in overseas jurisdictions where the transactions are traded and settled, so as to move funds promptly between the overseas trust account and the clearing account of the clearing member or clearing house.

4.11 For unlisted derivative transactions, the derivative dealer trades as principal to its customers. With MAS' intention to restrict customer margins of retail investors from being used by the dealer for its hedging activities, the need to deposit customer moneys in trust accounts with overseas custodians should not arise. Maintaining trust accounts in Singapore will facilitate the quick recovery of customer moneys and assets if the dealer were to be wound up¹⁰. MAS therefore proposes to require derivative dealers to maintain trust accounts only in Singapore in respect of their dealing with retail investors.

Daily Computation of Trust Accounts

4.12 Currently, a CMS licensee that trades in futures contract or carries out LFX trading is required to perform daily computation and recording of the amount of its customers' moneys and assets deposited in the trust accounts as specified in regulation 37 of the SF(LCB)R. This ensures proper accountability and reconciliation of customers' margins and collaterals held in trust by the CMS licensee on behalf of its customers. The requirement however does not apply to dealing in securities, which include CFDs on equity, as well as other regulated activities under the SFA.

4.13 MAS understands that in practice, CMS licensees authorised to deal in CFDs or other securities are already performing trust account computations on a daily basis. As the trust account regime is a core pillar of MAS' regulations to ensure investors' moneys and assets are

¹⁰ For instance, when MF Global in Singapore went into administration, the customer moneys that were maintained with banks in Singapore were quickly traced and recovered.

protected, MAS proposes to extend the computation requirement to all other regulated activities where applicable.

Proposals

4.14 To enhance the protection of retail investors' moneys and assets in respect of their trading in unlisted margined derivatives, and the recovery of their moneys and assets in the event of insolvency of their derivative dealer, MAS proposes to:

- (a) Prohibit the dealer from using retail customer moneys and assets in trust accounts for the dealer's margining purposes with hedging counterparties, or for meeting other obligations incurred by the dealer in connection with the customer's unlisted margined derivative transactions;
- (b) Prohibit the dealer from maintaining retail customer moneys and assets in trust accounts with custodians outside Singapore;
- (c) Allow the dealer to trade only as principal (as opposed to an agent) to retail customers;
- (d) Extend the requirement for daily computation and record keeping of customer moneys in trust accounts to all regulated activities.

Question 4: MAS seeks views on:

- (a) the proposal to prohibit the derivative dealer from using retail customer moneys and assets in trust accounts for the dealer's margining purposes with hedging counterparties or for meeting other obligations incurred by the dealer in connection with the customer's unlisted margined derivative transactions;**

- (b) the proposal to require the derivative dealer in respect of its dealing in unlisted margined derivatives with retail investors to maintain retail customer moneys and assets in trust accounts with authorized custodians in Singapore;**
- (c) the proposal to require the derivative dealer dealing in unlisted margined derivatives with retail investors to trade only as principal (not as agent) to the retail investor;**
- (d) the proposal to extend the requirements for daily computation and recording of customer moneys and assets as set out in regulation 37 of the SF(LCB)R to all regulated activities.**

Options on Maintenance of Trust Accounts

4.15 To implement the proposals in paragraphs 4.14(a) and 4.14(b), MAS is considering a few options on the maintenance of trust accounts as follows:

- (a) Option 1: The derivative dealer maintains an omnibus trust account for all customers in all investment products (e.g. funds for all customers' trades in futures contracts listed on exchange and unlisted margined derivatives are kept in one single/consolidated account), but has an effective system to monitor and account for customers' positions and entitlement to their moneys and assets at all times.

This is the typical structure adopted by FIs and is operationally easy and less costly to administer. However, it may not facilitate a speedy reconciliation and distribution of customer funds in a default resolution, especially if investors trade in overseas markets through the FI. This is because in the normal course of business, the FI deposits a ready pool of customer funds with the overseas exchange members to open new customer trades or meet margin calls promptly. In such an arrangement, it is not feasible to attribute the pooled funds

located overseas at an individual customer level. It is also not possible to ensure that a customer's funds meant for trading in unlisted margined derivatives are maintained in Singapore at all times.

- (b) Option 2: Similar to Option 1, the derivative dealer maintains an omnibus segregated trust account for customer funds, which includes margins for both unlisted and listed products. However, the trust moneys for unlisted derivatives are segregated (accounting-wise) from trust moneys for listed products at the customer level, i.e. a particular customer who trades both unlisted and listed products would have to put up the margins for each separately, as though they were for two separate trust accounts. At all times, the trust moneys for unlisted margined trades would be accounted for and maintained in Singapore.

This option may be operationally inconvenient for the customer as he has to allocate his funds or collaterals for different products. The collaterals may also not always be in cash and fungible.

- (c) Option 3: The derivative dealer maintains separate trust accounts for unlisted and listed products. Compared to option 2, it provides enhanced operational segregation and reduces the risk of under-segregation by affording separate reconciliation checks for the trust accounts. It may however be more costly to maintain separate trust accounts.
- (d) Option 4: The derivative dealer maintains separate trust accounts for unlisted and listed products, for each individual customer. While this ensures operational and legal segregation, it is operationally costly as funds have to be accounted at the individual customer and account level to facilitate any trade transaction or settlement.

This would be similar to the way banks operate multiple deposit accounts maintained by individual customers with the bank.

4.16 MAS has not decided on any of the options, but would consider options 2 or 3 as a balanced approach between achieving the regulatory intent and minimising regulatory burden on the industry.

4.17 The above proposals are applicable to retail customer moneys and assets received in relation to the unlisted margined derivative transactions (in so far as they are regulated activities) conducted by both CMS licensees and EFIs.

Question 5: MAS seeks views on the options on the maintenance of trust accounts, as well as any other options, to implement the proposals in paragraphs 4.14(a) and 4.14(b).

5 RISK DISCLOSURE REQUIREMENTS

5.1 Regulation 47E(1) of the SF(LCB)R requires a CMS licensee dealing in LFX (including CFDs on FX), before the opening of a trading account, to provide a risk disclosure document to its customer as prescribed in Form 13 of the SF(LCB)R, and to receive a signed acknowledgement from the customer that he has understood the nature and contents of the risk disclosure document. For CMS licensees dealing in CFDs on other underlying referenced assets, they are not subject to any prescribed risk disclosure format or template, although in practice, licensees would generally adapt from Form 13 as the risks of trading in LFX would be applicable to CFDs as well.

5.2 Trading unlisted margined derivatives such as CFDs and LFX involves considerably more risks than ordinary share trading, which can be difficult to assess. Besides the specific risks of leveraged trading and counterparty default (including recovery risk of customer moneys and assets) which could result in unexpected losses, there are often contractual obligations on the customer contained in the terms and conditions of the trading agreement, the implications of which may not be highlighted to and understood by the retail investor. Based on a review of the trading agreements of several CFD/LFX providers, MAS considers that there are specific risks and contractual arrangements in the trading of unlisted margined derivatives that can be better disclosed to retail investors.

Proposal

5.3 To ensure the specific features and risks of unlisted margined derivatives are better disclosed in a clear, concise and consistent manner, MAS proposes to require the derivative dealer to provide retail investors with a prescribed set of baseline information in an Additional Risk Fact Sheet ["Fact Sheet"], separate from its risk disclosure statements.

5.4 The Fact Sheet should contain disclosure of specified information and risks in plain language in a "Question & Answer" format. Where specified, the disclosure should be presented in numerical

examples to make it easier for readers to understand. To ensure that the Fact Sheet is succinct, the length of the document should be capped at three A4-size pages. Information in the Fact Sheet should be presented in a font size of at least 10-point Times New Roman. The Fact Sheet should be signed and acknowledged by the retail investor.

5.5 To provide greater guidance to the industry on the contents of the answers, MAS will consider issuing worked examples or templates to promote effective disclosure.

5.6 The proposed questions to be covered in the Fact Sheet are set out as follows:

Leverage Risk

- (a) How does leverage affect my losses*?
- (b) When will a margin call be issued*, and what can the company do if I fail to meet margin call?

Counterparty Risk

- (c) Where are my margins and deposits kept and maintained? Are they kept in trust accounts?
- (d) What will happen to my margins and deposits if the company becomes insolvent? Will I be able to get back my margins and deposits?
- (e) Under what circumstances can the company close my position?
- (f) What happens when trading in the underlying asset is suspended or halted? How can I exit my position and will I suffer losses?

Other Relevant Disclosure

- (g) Does the derivative contract have an expiry period? What is the impact on my account on expiry?
- (h) What are the commissions, fees and other charges that I have or may have to pay*?
- (i) How is the derivative contract quoted*? Can the trade be executed at a price that is different from my order price?

* To be illustrated with numerical examples.

- (j) If I place a stop-loss order, am I assured of the price that I set the stop-loss at?

5.7 Some of the questions above, specifically (a) to (e), are applicable to trading in futures contracts as well. In this regard, MAS proposes to introduce a similar Fact Sheet with the relevant questions for trading in futures contracts.

Question 6: MAS seeks views on:

- (a) the proposed risk disclosure requirements for derivative dealers dealing in unlisted margined derivatives with retail investors;**
- (b) the proposed form and content of the Additional Risk Fact Sheet;**
- (c) the proposal to apply the Additional Risk Fact Sheet to trading in futures contracts where applicable.**

Question 7: MAS invites suggestions on:

- (a) how the Additional Risk Fact Sheet can be made more readable and useful for investors;**
- (b) additional information and specific features that should be disclosed in the Additional Risk Fact Sheet for particular products.**

* To be illustrated with numerical examples.

Annex 1

Current List of Acceptable Collateral under Regulation 24(6) of the Securities and Futures (Financial and Margin Requirements for Holders of Capital Markets Services Licences) Regulations

- (a) Cash;
- (b) A share or convertible bond listed on the Singapore Exchange Securities Trading Limited;
- (c) A share or convertible bond listed on a recognised group A exchange and that is —
 - (i) in the case of a share, included in a market index of that recognised group A exchange; or
 - (ii) issued by a corporation with shareholders' funds of not less than \$200 million or its equivalent in any foreign currency;
- (d) A debt security —
 - (i) issued by a government or public authority of any country or territory, or a recognised multilateral agency specified in Table 3 of the Fourth Schedule, with a long-term rating of —
 - (A) not less than BB-minus by Fitch Ratings;
 - (B) not less than Ba3 by Moody's Investor Services; or
 - (C) not less than BB-minus by Standard & Poor's;
 - (ii) issued by any other entity with a long-term rating of —
 - (A) not less than BBB-minus by Fitch Ratings;
 - (B) not less than Baa3 by Moody's Investor Services; or
 - (C) not less than BBB-minus by Standard & Poor's;
 - (iii) being a short-term debt instrument with a rating of —
 - (A) not less than F3 by Fitch Ratings;
 - (B) not less than P3 by Moody's Investor Services; or
 - (C) not less than A3 by Standard & Poor's; or
 - (iv) listed on the Singapore Exchange Securities Trading Limited or a recognised group A exchange if, and only if, the issuer's shares are listed on that exchange and qualify as a share referred to in paragraph (b) or (c);
- (e) A collective investment scheme —
 - (i) authorised by the Authority under section 286 of the Act (other than exchange traded funds and property funds); or
 - (ii) recognised by the Authority under section 287 of the Act (other than exchange traded funds and property funds) —
 - (A) for which prices are published daily; and

- (B) which invests at least 90% of the deposited property of the collective investment scheme in instruments being any or all of the instruments specified in paragraphs (a) to (k) (including this paragraph);
- (f) An exchange traded fund quoted on the Singapore Exchange Securities Trading Limited or a recognised group A exchange, which tracks an index of, or basket of, stocks quoted on —
 - (i) the Singapore Exchange Securities Trading Limited; or
 - (ii) a recognised group A exchange;
- (g) A property fund listed on the Singapore Exchange Securities Trading Limited or a recognised group A exchange;
- (h) Any contract traded on —
 - (i) the Singapore Exchange Securities Trading Limited; or
 - (ii) a recognised group A exchange, where the shares of the issuer of the contract, and the shares of the issuer of the underlying security, qualify as a share referred to in paragraph (b) or (c);
- (i) In the case of an initial public offer, securities to be listed for quotation or quoted on the Singapore Exchange Securities Trading Limited which have been fully paid for by a customer of the holder of a licence;
- (j) Securities quoted on the Central Limit Order Book (CLOB) International; or
- (k) Such other securities or financial instruments as the Authority may specify in a guideline issued by the Authority.

Annex 2

Table 17 of the Fourth Schedule to the Securities and Futures (Financial and Margin Requirements for Holders of Capital Markets Services Licences) Regulations – Applicable Haircuts for Acceptable Collateral

LIST OF ACCEPTABLE COLLATERAL		HAIRCUT (%)	
Cash		0	
Issue Rating for Debt Securities (Long-Term / Short-Term)	Residual Maturity	Sovereign	Other Issuers
Fitch : AAA to AA- / F1	≤ = 1 year	0.5	1
Moody's : Aaa to Aa3 / P1	≤ 1 year,	2	4
	= 5 years		
S & P : AAA to AA-/A-1	> 5 years	4	8
Fitch : A+ to BBB-/ F2 to F3	= 1 year	1	2
Moody's : A1 to Baa3/P2 to P3	> 1 year,	3	6
	< 5 years		
S & P : A+ to BBB-/A-2 to A-3	> 5 years	6	12
Fitch : BB+ to BB-			
Moody's : Ba1 to Ba3	All	15	25
S & P : BB+ to BB-			
Debt securities that are listed on SGX-ST or a recognised group A exchange, where the issuer's shares —	All	Not permitted	15
(a) are listed on the same exchange; and			
(b) included in the Straits Times Index, MSCI Singapore Index or a market index of a recognised group A exchange			
Debt securities that are listed on SGX-ST or a recognised group A exchange, where the issuer's shares are listed on the same exchange	All	Not permitted	25

LIST OF ACCEPTABLE COLLATERAL	HAIRCUT (%)
Shares and convertible bonds that are listed on SGX-ST or a recognised group A exchange and included in the Straits Times Index, MSCI Singapore Index or a market index of a recognised group A exchange	15
Shares and convertible bonds that are listed on SGX-ST or a recognised group A exchange and issued by a corporation with shareholders' funds of not less than S\$200 million or its equivalent in any foreign currency	25
Collective investment schemes (other than exchange traded funds and property funds)	25% or highest haircut applicable to the deposited property of the collective investment scheme, whichever is lower
Property funds listed on SGX-ST or a recognised group A exchange	25
Any other contract traded on SGX-ST or a recognised group A exchange	40
Initial public offerings to be listed for quotation or quoted on the SGX-ST, which has been fully paid for by a customer	25
Securities quoted on Central Limit Order Book (CLOB) International	25
Any other collateral	100
CURRENCY MISMATCH	HAIRCUT (%)
Where the counterparty exposure and the acceptable collateral are denominated in different currencies	8



Monetary Authority of Singapore