October 30, 2015

Comments on the Consultation Paper: *Policy Consultation on Margin Requirements for Non-Centrally Cleared OTC Derivatives* issued by the Monetary Authority of Singapore

Japanese Bankers Association

1. Preamble

(1) First of all, we would like to express our deep gratitude to the Monetary Authority of Singapore ("MAS") for giving consideration in various ways to areas of concern expressed by market participants and also for intending to consider comments from market participants with respect to almost all major issues in formulating its policy proposals.

(2) The policy proposals will have effects on many Japanese financial institutions as they engage in cross-border transactions with Singapore financial institutions. Therefore, it would be appreciated if MAS would sufficiently reflect in its policy proposals views of not only local financial institutions but also financial institutions in U.S., Europe, Japan and other jurisdictions.

(3) Given that the proposed margin requirements cover cross-border transactions, they need to be consistent with other jurisdictions' rules. However, while there are already some inconsistencies among rules proposed by authorities in U.S., Europe and Japan, additional inconsistent areas are identified when comparing rules across jurisdictions, irrespective of judgment as to which rules are more effective. Such areas include the phase-in of initial margin ("IM"), T+2 settlement period and permission of a (one-time) re-hypothecation of IM. Under the current trend, transactions with financial institutions in countries where margin requirements are not introduced are also subject to margin requirements. Given this, those financial institutions only subject to the Singapore margin rules, for example, are assumed to have difficulties in establishing, and putting into practice, relevant processes and procedures because requirements for transactions with financial institutions in U.S., Europe and Japan and for transactions with financial institutions in other jurisdictions will differ. While other G20 member countries are expected to publish their proposed rules going forward, MAS is requested to make harmonisation efforts in order to prevent a single financial institution from being subjected to double standards, or even triple standards.

(4) When reading our comments provided herein, please refer to our comments of July 10, 2015 submitted to the European Supervisory Authorities ("the ESAs") (entitled "Comments on Second Consultation Paper: *Draft Regulatory Technical Standards on risk-mitigation techniques for OTC-derivative contracts not cleared by a CCP under Article 11(15) of*

Regulation (EU) No 648/2012 issued by the European Supervisory Authorities")[1]. We presume that the consultation paper issued by the ESAs reflects harmonisation efforts made among main supervisors, such as U.S., Europe and Japan, and would like to ask MAS to recognise our comments to such a consultation paper as our most recent views and gain full understanding of it.

2. Our comments on questions in the consultation paper

Question 1	MAS seeks comments on the proposed product scope whether any other products should be exempted from margin requirements and the basis for such exemptions.

(Our comments)

We appreciate and support from the perspective of international consistency MAS's decision to exempt physically-settled foreign-exchange forwards and swaps from the margin requirements, which we believe is a realistic and reasonable approach taken also by the U.S. and Japanese authorities (although the ESAs subjects such transactions to the proposed margin rules), and its further decision to encourage entities to refer to the FX guidance (BCBS Supervisory Guidance for Managing Risks Associated with the Settlement of FX Transactions, February 2013: https://www.bis.org/publ/bcbs241.pdf).

Question 2	MAS seeks comments on the proposed entity scope, and whether there are any other types of entities that should be subject to margin requirements, and the basis for such inclusions.

(Our comments)

There is no particular comment on this issue.

Question 3	MAS seeks comments on the thresholds and exemptions in paragraphs 3.4 and 3.5, and the way these thresholds and exemptions should be determined.

(Our comments)

It would be reasonable to ensure consistency between thresholds to be applied to margin requirement for non-centrally cleared derivatives and thresholds applied to central clearing mandates. Also, MAS is requested to list on its website those entities subject to the margin requirements in ensuring the validity of the information so that counterparties can refer.

[1] http://www.zenginkyo.or.jp/fileadmin/res/abstract/opinion/opinion270740.pdf

Question 4	MAS seeks views on whether investment funds domiciled in Singapore should be subject to margin requirements, and the factors that should be taken into consideration in formulating the margin requirements for such investment funds.

(Our comments)

Although it is depending on thresholds to be applied, individual funds should not be subject to the proposed margin requirements, at least when they are initially introduced, for the following reasons:

(i) Investment funds engage in transactions not for purposes of earning profit but mostly for hedging purposes, and their transactions are limited.

(ii) In some cases, depending on funds, it is not permitted to use fund assets as collateral.

(iii) In many cases, numerous funds are established on a deal-by-deal basis. If CSA execution is introduced to all of those numerous funds, the number of transactions for which regulatory compliance tasks are required will increase sharply, causing practical difficulties in making such regulatory compliance efforts. Therefore, the proposed margin requirements should be phased in, starting from those banks which have a higher risk relative to funds and thus should be applied the requirements prior to others.

Question 5	MAS seeks comments on the proposed margin obligations (including operational requirements) on MAS Covered Entities, specifically on the options of (i) a post-and-collect requirement; and (ii) a collect-only requirement, and the pros and cons for the suggested option.

(Our comments)

Given that other major jurisdictions like U.S., Europe and Japan are working towards implementing their margin requirements, the option (ii) a collect-only requirement is considered to be appropriate in order to ensure effectiveness of the exchange of margin in cross-border transactions. It would be ideal to address conflicting requirements between jurisdictions (e.g. differences in legal enforceability of collateral) and afterwards adopt the option (i) a post-and-collect requirement. However, to take the option (ii) thereby limiting to the collection requirement first should be regarded highly as by this the margin requirements can be introduced within a shorter time period. This particularly reflects (c) described in the Pros & Cons Analysis shown below. To avoid any misunderstanding, we would like to mention that our comment here is based on our expectation that after the application of at least the collect-only requirement is expanded to multiple countries at the level of WGMR, an option of (i) the post-and-collect requirement would be adopted.

[Pros & Cons Analysis]

(i) Pros and cons of the post-and-collect requirement:

(a)Pros	Meets the policy objective to reduce systemic risk by preventing the build-up of potentially unstable exposures in the financial system.
(b)Cons	In the absence of clear rules on dispute resolution, entities would have different views on to what extent negotiation needs to be held with counterparties. Given this, requiring posting, in addition to collection, of margin is expected to further increase operational burdens and/or confusion of market participants.

(ii) Pros and cons of the collect-only requirement:

(c)Pros	Covered entities and market participants will be able to avoid any confusion arising from regulatory compliance as much as possible, and thus the proposed margin requirements would be introduced in a smooth manner and within a shorter time period.
(d)Cons	This option may only benefit those financial institutions under the oversight of MAS.

Question 6	MAS seeks comments on the proposed thresholds set out in Section 4.

(Our comments)

We believe the method of establishing thresholds for the IM and minimum transfer amount is reasonable, as it is in line with the BCBS/IOSCO Final Report. Further, the threshold amount itself is also be deemed as reasonable, since the amount represents which set out in the BCBS/IOSCO Final Report and is converted from the euro into Singapore dollars at the exchange rate as of the publication of this consultation paper.

With regard to a *de minimis* minimum transfer amount of not higher than S$800,000 (paragraph 4.9), it is unclear whether this threshold is applied to (i) IM and VM separately or to (ii) the aggregate of IM and VM. MAS is requested to clarify that this *de minimis* minimum transfer amount is applied to (ii) the aggregate of IM and VM, similarly to the approach proposed in the second consultation paper of the ESAs.

Question 7	MAS seeks comments on the proposed IM calculations and requirements, particularly, but not limited to, the recalculation frequency and requirements of IM, data history for IM calculation and the recalibration and back-testing requirements of the IM model.

(Our comments)

(i) MAS is requested to allow classification into four asset classes to be based on risk amounts, instead of asset classification based on transactions. Generally, several types of risks are inherent in derivatives transactions and major risks vary depending on transaction conditions and market environment. Therefore, it is difficult to define asset classes based on static rules (and it is even more difficult to define common rules within the industry). The classification of asset classes based on risk amounts is considered as appropriate also from the perspective of maintaining consistency with derivative risk management practices where risks are hedged across multiple types of transactions.

(ii) This consultation paper proposes at least semi-annual recalibration of quantitative models, which is considered to be strict and actually is stricter than other jurisdictions' proposed rules. It is requested that this proposed frequency will be eased to annual recalibration, as with the approach proposed in the second consultation paper of the ESAs.

(iii) Given that the WGMR Framework does not require stress testing, it should be deleted from the requirements.

(iv) When exchanging collateral with a financial institution domiciled in those countries where legal enforceability is not assessed, that counterparty will be required to post IM always on a gross basis, incurring increased collateral cost and additional exposures. This may rather increase systemic risk. Therefore, it would be very difficult for the counterparty to accept this condition. Although imposing such a requirement on those countries where legal enforceability is not assessed is considered to be a reasonable approach to a certain extent in a sense that it will promote legislation of netting arrangements, that may hinder financial institutions in such countries from conducting derivative transactions. It would be realistic to set a certain period of grace and in the meantime to encourage those countries where legal enforceability is not assessed to legislate on netting arrangements.

(v) MAS's website (https://masnetsvc.mas.gov.sg/FID.html) lists Commercial Banks/Foreign Full Banks which include three Japanese banks (i.e. The Bank of Tokyo-Mitsubishi UFJ, Ltd., Mizuho Bank, Ltd. and Sumitomo Mitsui Banking Corporation) that are deemed as a "MAS Covered Entity" defined in paragraph 3.3. We would like to confirm that the banks do not need to apply for approval of MAS to use a quantitative model, which is referred to in paragraph 5.5, when they have been approved to use that model in the country where their head office is located.

(vi) Proposed rules of other jurisdictions exclude the notional amount of currency swaps from IM posting and collection requirements. MAS is requested to specify this point in the policy proposals as well.

Question 8	MAS seeks comments on the proposed VM calculations and requirements.

(Our comments)

When exchanging collateral with a financial institution domiciled in those countries where legal enforceability is not assessed, the counterparty will be required to post VM always on a gross basis and as a result is likely to incur increased collateral cost and additional exposures. This is not in line with the policy object to reduce risks. Therefore, an approach recommended in the above comment (iv) on Question 7 should be taken also for VM (i.e. to set a certain period of grace).

Question 9	MAS seeks comments on the proposed range of eligible collateral and corresponding schedule-based haircuts.

(Our comments)

The proposed range of eligible collateral is generally in line with the BCBS/IOSCO Final Report. With regard to haircuts for debt securities, different haircuts are applied to debt securities with external credit ratings (from Fitch Ratings, Moody's Investors Services, and Standard and Poor's Rating Services) of (i) AAA to AA- and (ii) A+ to BBB-; taking a conservative approach by setting a higher haircut for (ii) relative to (i). We support this treatment. Also, it is considered as reasonable to apply the highest haircut of 15% to debt securities with credit ratings of BB+ to BB- issued by central banks and governments, thereby preventing abuse of speculative assets.

Question 10	MAS seeks comments on the proposed application of the 8% schedule-based standardised FX mismatch haircut when cash is used to meet the VM requirements in the case of an FX mismatch (i.e. where the collateral is denominated in a different currency from the settlement currency of the underlying derivative transaction). Specifically, MAS seeks comments on whether cash collateral denominated in certain liquid currencies (please specify currencies) should be subject to a lower FX mismatch haircut (please specify). If so, what criteria should be used in assessing the liquidity of these currencies? MAS also seeks comments on whether there are cases where a higher than 8% FX mismatch haircut may be warranted.

(Our comments)

We do not support the proposal to apply an 8% haircut to all FX mismatch cases even when cash is used as collateral, and request that the conditions to apply 8% haircut will be eased. It is a fact that cash collateral has a higher effect to reduce exposures compared to other collateral such as bonds and equities. Given this, it would be reasonable for both financial institutions and authorities to treat cash collateral differently from other collateral assets.

There is also a view[2] that the FX mismatch is captured in the IM calculation and thus the application of an 8% haircut is unnecessary. MAS is requested to reconsider this issue by taking into account such a view.

Further, exempting cash collateral denominated in certain liquid currencies from the 8% haircut requirement, as indicated in Question 10, is not a realistic approach as, given recent market volatility, it would be difficult to establish precise and nearly perfect criteria for determining such liquid currencies.

In view of the above, we would like to propose an alternative approach assuming that cash collateral and other collateral assets will be treated in the same fashion, and provide below excerpts from our comment letter of July 10, 2015 submitted to the ESAs ("Comments on Second Consultation Paper: *Draft Regulatory Technical Standards on risk-mitigation techniques for OTC-derivative contracts not cleared by a CCP under Article 11(15) of Regulation (EU) No 648/2012* issued by the European Supervisory Authorities") for your reference.

<Easing the conditions for applying the additional haircut of 8%>

- To avoid the 8% haircut that results in an increase in collateral cost, the transfer currency needs to be the same as the currency in which VM is denominated, or the termination currency needs to be the same as the currency in which IM is denominated.
- However, since counterparties' interests would completely conflict in cross-border transactions for the former case, it is difficult to enter into a contract by the designated deadline. For the latter case, if counterparties set a single currency without considering their intent in executing a cross border transaction, this might give rise to confusion at the time of bankruptcy.
- Given that the most of financial institutions are required to exchange IM in addition to VM, the need for setting the additional haircut of 8% is considered to be low in the first place.
- It is considered necessary to ensure consistency with the treatment of not applying haircut for cash collateral in VM.

[2] http://www2.isda.org/functional-areas/wgmr-implementation/
[August 17, 2014] ISDA letter to the ESAs on Proposed Margin Requirements: Analysis of Currency Mismatch Haircut

Given the above, it is requested to consider the following alternative:

While a single termination currency or transfer currency should be set for a contract within the same jurisdiction, it should be permitted to set multiple currencies in a cross-border contract (that is, each counterparty may set a different single currency).

Question 11	MAS seeks comments on the proposed safe-keeping of IM collateral.

(Our comments)

We do not have any particular objection against the necessity of safe-keeping and also consider that the requirement set out in paragraph 7.1 is consistent with the BCBS/IOSCO Final Report and proposed rules of other jurisdictions. Nonetheless, please note that when IM is posted through establishment of security interests, it might be difficult, due to applicable national laws and regulations, to use IM for recovering receivables immediately in the event of the posting party's default. See ISDA's comment letter submitted to the ESA[3].

Question 12	MAS seeks comments on examples of the types of legally-enforceable safe-keeping arrangements that may be put in place under paragraph 7.2 (b).

(Our comments)

To our knowledge, there is currently no arrangement that is deemed as what is referred to in paragraph 7.2 (b). If, going forward, any legally enforceable schemes and arrangements are established, MAS is requested to also allow those schemes and arrangements which do not use custodies or trusts.

Question 13	MAS seeks comments on the proposal that all collateral arrangements need to be reviewed periodically with updated legal opinions to ensure that the arrangements continue to be legally enforceable.

(Our comments)

First of all, instead of uniformly requiring external legal opinions as part of periodic reviews, MAS should require entities to have a sufficient legal ground to confirm that the requirements set out in paragraph 7.1 are met. Further, given necessary cost and workload, it is not a realistic approach to require the each entity to obtain a legal opinion for all collateral arrangements they engage in as part of their legal reviews (irrespective of whether to obtain external legal opinions). From this view, the entities should be allowed to rely on reviews conducted or opinions obtained by industry associations and other relevant organizations.

[3] http://www2.isda.org/functional-areas/wgmr-implementation/
[July 10, 2015] ISDA letter to the ESAs on the Second Consultation Paper regarding draft regulatory technical standards on risk-mitigation techniques for OTC-derivative contracts not cleared by a CCP

Here are the examples that will enable periodic reviews of legal enforceability without causing undue burdens.

(i) In a way similar to ISDA issuing its opinion on legal enforceability of netting under the ISDA master agreement, an industry association periodically obtains legal opinions on representative schemes and arrangements on behalf of the industry while market participants refer to such opinions.

(ii) Service providers, such as custody and trustee, obtain legal opinions on representative schemes and arrangements while market participants refer to such opinions.

(iii) An appropriate department within the entity confirms legal enforceability of its representative schemes and arrangements.

Question 14	MAS seeks comments on the proposal to permit a one-time re-hypothecation of non-cash IM collateral and the liquidity implications of such a proposal.

(Our comments)

We appreciate MAS's decision to propose flexible operational procedures for re-hypothecation.

The conditions set out in Annex D, on the other hand, are difficult to satisfy and impractical (because they are applicable only in very limited situations). Therefore, it is likely that the conditions will not contribute to improving liquidity. In order to improve liquidity, MAS would be required to ease the conditions in Annex D, as well as to allow unlimited chain re-hypothecations.

Maintaining consistency with relevant ongoing discussions on cash IM such as in the second consultation paper of the ESAs, it is requested that MAS will retain accommodativeness for treatment of re-hypothecation, re-pledge and re-use including non-cash IM.

Question 15	MAS seeks comments on the proposed treatment of intra-group transactions.

(Our comments)

Intra-group transactions occur inevitably when entities consider their preferable market risk management and/or booking structure. The proposed flexible treatment of intra-group transactions exemption from the scope of margin requirements is considered as an appropriate approach which understands and reflects such nature of those transactions. With regard to footnote 22, this rule should also be deemed to be satisfied where both the parties are controlled by the same parent company in excess of 50% regardless of direct control relationship between those subsidiaries, not limiting to management control or ownership in excess of 50% between the parties,

Question 16	MAS seeks views on the proposed treatment of cross-border transactions, and whether there are other arrangements that may better address concerns of level playing field and regulatory arbitrage. Please elaborate on the rational for the suggested option.

(Our comments)

Proposed comparability assessment is an appropriate approach, which is outcome-based and not requiring a line-by-line comparison (paragraph 9.6). We are of the view that transactions with the counterparty in those countries where legal enforceability of netting arrangements is not assessed should be exempted from the margin requirements. If this is not acceptable, imposing a certain threshold for margin requirement exemption, which are referred to in paragraph 9.4, would be worth discussing (under the condition that such a threshold is set at an appropriate level).

Question 17	MAS seeks views on the proposed approach for the application of deemed compliance, particularly for cross-border transactions.

(Our comments)

We believe that proposed treatment of deemed compliance stipulated in paragraph 9.5 is appropriate. Having said that, the proposed treatment will still not solve the issue of applying duplicative requirements in the case where a company incorporated in Singapore may be required to comply with margin requirements of other jurisdictions even when transacting with the counterparty in Singapore (for example, in the case of a transaction between locally-incorporated subsidiaries guaranteed by a U.S. parent company). In this case, negotiation between relevant national authorities would be needed while it would be legitimate for MAS to require compliance with Singapore's margin requirements.

Question 18	MAS seeks comments on the proposed phase-in schedule for margin requirements to apply to MAS Covered Entities

(Our comments)

We appreciate MAS's decision to provide a 6-month transition period for implementation of the requirements. While the phase-in implementation schedule for the IM requirements is not always consistent with the internationally-agreed, proposed phase-in implementation schedule, it is assumed that MAS has considered and decided to adopt that schedule to mitigate impact on the market by taking into account circumstances specific to Singapore. Nonetheless, please note that merchant banks in Singapore may also be required to post/collect IM from September 1, 2016 because market participants outside Singapore would be subject to margin requirements of home jurisdiction.

Others:	Comments on paragraphs 4.4, 4.5 and 4.6

A) We would like to comment on the settlement period of IM and VM.

Covered entities are required to calculate VM at least on a daily basis and exchange VM within two business days following the execution of a derivative contract (T), and to calculate IM on a sufficiently regular basis and exchange IM within two business days following the recalculation of IM. Our view on this issue is expressed in our comments to the second consultation paper of the ESAs as follows and we would like MAS to take this into consideration.

<Setting a practical settlement period>

- If the time difference is large, such as between Sydney and London, the settlement in T+1 or T+2 may be physically impossible or very difficult.
- On the other hand, if both counterparties are domiciled in the EU, collateral can be settled within a relatively short period of time. However, many regional financial institutions in Europe are executing a considerable amount of cross-border transactions.

Given the above and taking into account the combination of negotiated transactions, more physically feasible settlement period should be considered as follows:

(i) If a transaction is executed between counterparties within the same jurisdiction or within a predetermined region, both variation margin (VM) and initial margin (IM) shall be settled on a T+2 basis, at a maximum.

(ii) In cases other than the above (e.g., one counterparty is in the EU and the other is in Asia), on a T+3 basis, at a maximum.

(iii) If the settlement is executed within the above maximum period, the adjustment to margin period of risk (MPOR) is not necessary.

B) We would like to clarify the definition of recalculation date.

For example, in the case where an entity in Singapore needs to reflect transactions executed up to the end of business in New York in order to calculate IM on a group basis, “the day” will include the next day from the perspective of Singapore time. In this case, we understand that the recalculation date is the day before the day when it actually carries out the IM calculation, instead of the day it actually calculates IM. We would like to ask MAS to confirm our understanding.