Singapore's Mandatory Clearing of OTC Derivatives

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Introduction

As expected Singapore has joined the US, Europe and Japan in announcing the introduction of mandatory clearing for the most liquid OTC derivatives. The MAS has published a short consultation paper and is looking for feedback on its proposals. Their main proposal is for vanilla IRS in USD, SGD, EUR, GBP, JPY fixed-floating constant notional swaps out to 30-50 years should be cleared when both contracting parties are either Singaporean banks or the Singaporean branches of foreign banks and both parties book the trade in Singapore. Banks with little OTC derivative activities where their total gross derivative notional is below S$20 billion will be exempt as are non banks. The MAS expect the clearing obligation to come into effect from mid 2016.

What will be cleared?

The MAS seems most definite about USD and SGD contracts out to 30 years (the draft regulation only includes these two currencies) and is seeking feedback over other common contracts such as OIS, FRAs and basis swaps and the other currencies. They are only proposing the standard reference indices, SOR, LIBOR, EURIBOR and to exempt contracts with any optionality or variable notional. This aligns very closely with the contract specifications of other major regulators.

Where will they be cleared?

SGX-DC is an authorised clearing house (ACH) and the MAS expect that the other main international CCPs such as CME and LCH will either recognised or approved and be available for banks to use.

Cross-border conflicts

The MAS is clearly trying to avoid exacerbating the cross-border conflicts which have effectively split the OTC derivative markets into a US domestic market and a non-US international one. The proposal will not make a trade dealt with a non-Singaporean entity subject to clearing which is very convenient as the MAS recognises that now or in the near future such trades may be subject to a clearing mandate in the US or EU. One common booking structure is for a local entity to arrange a trade but for it to be contracted and booked offshore in an overseas affiliate. The MAS appear to be content to supervise such trades which will be reportable to the MAS but does not intend to make such trades subject to clearing. This seems to balance the need for the local regulator to supervise local activity but also recognises that any systematic risks to such affiliates are better assessed and regulated by the affiliate's home regulator.

Exemptions

The MAS are exempting all the usual great and good supranational and government and central bank institutions from the requirement.

The S$20 billion notional threshold will be measured at the end of the last four calendar quarters. The MAS include the word "initially" when they describe the exemption for non banks which clearly suggests they may extend the requirement in the future. At the same time they note that the bulk of the market is actually traded by banks and also that client clearing is not widely available. Indeed as we see major banks withdraw from this business combined with their remaining competitors raising their fees the long-term future of client clearing in its current form is raising questions.

Implementation

The MAS want feedback by the end of this month, and plan to finalise the implementing rules by the end of this year. Compliance with rules will be six months after this date for new contracts. They make no mention if this will apply to existing contracts which are subsequently amended.

Next Steps

The MAS will consider extending the requirement to vanilla FX contracts and also possibly lowering the exemptions threshold and extending the requirement beyond banks. They will also consider if they should broaden the cross-border requirement.

Market Impact

I suspect the market impact will be very light on the assumption that the existing big CCPs gain ACH or RCH status. By now the bulk of the professional inter-bank market in the vanilla IRS is always cleared as the capital and operational costs are lower. Also as the implementation date for mandatory initial margin approaches for the major banks the funding benefits of staying uncleared are now fast disappearing. The main market impact is likely to be on the non bank sector who can stay outside the clearing regime. Hong Kong's regulators plan to publish a similar consultation on mandatory clearing later this year. It seems highly likely that they too will restrict clearing to an active segment of banks and major brokers much as they did for the reporting and record keeping requirement for OTC derivatives. Without a mandatory requirement to clear the take up of client clearing by buy-side and minor derivative players is likely to remain low in Asia. At this time in Asia, only Japan has a programme to extend mandatory clearing beyond the major interbank players.