

14 December 2018

Mr. Chris Kirkpatrick  
Secretary  
Commodity Futures Trading Commission  
Three Lafayette Center  
1155 21st St., N.W.  
Washington, DC 20581  
United States of America

VIA EMAIL

Dear Mr. Kirkpatrick

**SELF-CERTIFICATION OF UPDATE TO SGX-DC'S COLLATERAL MANAGEMENT POLICY**

**1. Introduction**

- 1.1 Singapore Exchange Derivatives Clearing Limited ("**SGX-DC**"), a derivatives clearing organisation ("**DCO**") registered with the Commodity Futures Trading Commission (the "**Commission**") hereby submits a self-certification of rule amendment pursuant to Commission Regulation 40.6(a) with respect to an update to its collateral management policy (the "**Update**").
- 1.2 The update to SGX-DC's collateral management policy does not require any attendant amendments to the SGX-DC Clearing Rules. However, for the purposes of the Commission Regulations Part 40, the update to SGX-DC's collateral management policy is a rule amendment subject to self-certification.

**2. Update to Collateral Management Policy**

*Background*

- 2.1 SGX-DC holds collateral it receives from its clearing members on trust. SGX-DC Clearing Rule 7.03A.1 provides that collateral held on behalf of both SGX-DC clearing members and customers of those clearing members are held on trust.
- 2.2 Under the SGX-DC Clearing Rules, any loss in value of collateral that is not attributable to any breach of fiduciary responsibility would be borne by the beneficiaries. Such a loss will reduce the value of that collateral held with SGX-DC for all purposes under the SGX-DC Clearing Rules, including but not limited to, the calculation of required margins for all relevant Contracts. This may result in a call for additional collateral under the SGX-DC Clearing Rules.

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### *Purpose of the Update*

- 2.3 While custody and investment risks on the collateral are remote<sup>1</sup>, the Committee on Payments and Market Infrastructures and the International Organisation of Securities Commissions in the *Resilience and recovery of central counterparties (CCPs): Further guidance on the PFMI* have recommended that a CCP should identify and set aside an amount of its own resources to be applied towards losses arising from custody and investment risk (“**non-default losses**”). This is intended to enhance participants’ confidence that the CCP’s interests are aligned with theirs.
- 2.4 Following an internal review, SGX-DC has set aside S\$10 million (“**First Loss Contribution**”) to absorb non-default losses, prior to affected non-default clearing members sharing in the residual losses according to general principles under trust law. Accordingly, SGX-DC issued the Update to inform its members of the same.
- 2.5 For clarity, SGX-DC also set out in the Update how the residual loss would be borne by each affected clearing member in accordance with the general distribution principles. Save for the application of SGX-DC’s First Loss Contribution, there is no change to how losses are to be allocated among SGX-DC clearing members; that is, loss allocation will be in accordance with established trust laws. SGX-DC’s First Loss Contribution only reduces the quantum that would be borne by SGX-DC clearing members in the event of such loss. Distribution of proceeds from any subsequent recovery of loss is similarly unchanged.
- 2.6 There are no changes to the SGX-DC Clearing Rules, including Practice Notes.

### **3. Implementation Date**

- 3.1 The Update was communicated to SGX-DC clearing members via a circular on 16 November 2018, attached as Appendix 1. Notwithstanding, SGX-DC will revise the circular accordingly if the CFTC has any concerns during its 10 business day review period.

### **4. Certification of Compliance with Core Principles**

- 4.1 The Update is promulgated in respect of SGX-DC’s compliance with Core Principle F on the treatment of funds, in particular, to protect and ensure the safety of member and participant funds and assets.
- 4.2 SGX-DC hereby certifies to the Commission that the Update complies with the Commodity Exchange Act, and the regulations promulgated thereunder.

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<sup>1</sup> SGX-DC adheres to prudent collateral management policy that is transparent to its participants. Collateral for both customer contracts and house contracts are placed only in bank deposits and instruments that are approved by the Monetary Authority of Singapore. Counterparties and custodians with whom collateral is placed are selected based on stringent risk assessment and selection criteria.

**5. Public Notice of Pending Certification**

- 5.1 SGX-DC has made publicly available a notice of the Update's pending certification with the Commission, together with a copy of this submission on its website at the following address: [http://www.sgx.com/wps/portal/sgxweb/home/regulation/consult\\_pub/dco\\_submissions](http://www.sgx.com/wps/portal/sgxweb/home/regulation/consult_pub/dco_submissions).

**6. Opposing Views**

- 6.1 There were no opposing views expressed to SGX-DC by its board or committee members, SGX-DC clearing members or market participants.

**7. Contact Details**

- 7.1 Please do not hesitate to contact the undersigned at [jolene.ng@sgx.com](mailto:jolene.ng@sgx.com), or +6567136843 should you require any clarification.

Yours sincerely



Jolene Ng  
Senior Associate  
Regulatory Development and Policy (Regulation)



# APPENDIX 1



## Circular

16 November 2018

Circular No. DC/AM – 61 of 2018

To: All Clearing Members

## UPDATE TO SGX-DC'S COLLATERAL MANAGEMENT POLICY

Collateral placed with SGX-DC is held on trust for the benefit of Clearing Members, and the customers of Clearing Members, as the case may be. SGX-DC is updating its existing Collateral management policy to provide clarity on, among other things, the loss allocation arrangement for custody and investment risks arising from this policy.

### Collateral management policy

SGX-DC adheres to a prudent Collateral management policy. Rule 7.03A.7 provides that SGX-DC is entitled to manage such Collateral as it deems fit, provided that, among other things, Collateral in respect of Customer Contracts is invested in accordance with the requirements of the Securities and Futures Act (Chapter 289 of Singapore) (the "SFA").

SGX-DC places Collateral for Customer Contracts in bank deposits and other instruments approved by the Monetary Authority of Singapore pursuant to the SFA (each an "Instrument"). The placement of Collateral for House Contracts is similarly aligned. Currently, Collateral in the form of cash may be invested in reverse repurchase arrangements to further mitigate the risk of loss from a bank counterparty default. SGX-DC applies stringent risk assessment and selection criteria for our counterparties and custodians, as described in [Annex A](#).

Under Rule 7.03A.8, SGX-DC collects administrative fees for the management of Collateral, and pays Clearing Members interest on Collateral, at such rate and in such manner prescribed by SGX-DC. SGX issued Circulars No. DC/AM – 63 of 2016 on 27 July 2016 and No. DC/AM - 41 of 2017 on 14 June 2017 setting out the policy in this regard. This policy remains unchanged.

### Loss allocation arrangement

In line with recommendations by global standard setters for financial market infrastructures, SGX-DC is setting aside an amount of its own resources to be applied towards losses arising from custody and investment risks on the Collateral.<sup>1</sup> Nonetheless, SGX-DC highlights that custody and investment risks on the Collateral are remote.

For the purpose of this loss allocation arrangement, losses arising from such custody and investment risks refer to any loss or diminution in the value of Collateral that might arise as a result of the insolvency or default of any of the following (such loss referred to as "Loss in Value"):

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<sup>1</sup> In the final report on *Resilience of central counterparties (CCPs): Further guidance on the PFMI* (2017) and the revised report on *Recovery of financial market infrastructures* (2017), CPMI-IOSCO recommends that a CCP apply its own resources towards such losses prior to those of all participants to absorb losses resulting from the custody and investment of participant assets.

# **APPENDIX 1**

- (a) the issuer of an Instrument;
- (b) the counterparty to SGX-DC in respect of the Instrument;
- (c) the deposit-taking institution at which an Instrument is placed; and
- (d) the custodian bank at which an Instrument is placed.

The aggregate amount of Loss in Value will be first borne by SGX-DC for up to S\$10 million (“**SGX-DC’s First Loss Contribution**”). This application of SGX-DC’s First Loss Contribution will not in any way vary SGX-DC’s existing rights under Singapore law, the Rules and the Security Deed.

Any residual and/or subsequent Loss in Value in excess of SGX-DC’s First Loss Contribution will be borne by each Clearing Member in accordance with the following:

- (i) for cash Collateral in a particular currency, on a pro-rata basis, calculated as the proportion of cash Collateral it has deposited with SGX-DC relative to the aggregate amount of cash Collateral held by SGX-DC in that currency at the time of determination of the Loss in Value; and
- (ii) for non-cash Collateral, the Clearing Member that deposited the relevant Collateral will bear the loss,

(collectively, the “**Allocated Loss**”).

The Allocated Loss will reduce the value of such Collateral held with SGX-DC for all purposes under the Rules, including but not limited to, the calculation of required margins for all relevant Contracts. This may result in a call for additional Collateral under the Rules.

If SGX-DC subsequently makes a recovery in respect of the Loss in Value, SGX-DC will distribute the proceeds of such recovery (i) for cash Collateral in a particular currency, pro-rata to the amount of the Allocated Loss borne by each Clearing Member, (ii) for non-cash Collateral, to the Clearing Member that deposited the relevant non-Cash Collateral.

For the avoidance of doubt, the arrangements above have no bearing on any apportionment of losses between each Clearing Member and its clients.

## **Contact**

If you have any queries regarding this circular, please contact [dcc@sgx.com](mailto:dcc@sgx.com) or the clearing house hotline at +65 6236 5319.

LEE CHIH-WEI  
SENIOR VICE PRESIDENT  
RISK MANAGEMENT

# **APPENDIX 1**

## **ANNEX A**

Cash and non-cash Collateral deposited with SGX-DC in respect of House Contracts and Customer Contracts are held with regulated banks in Singapore and custodians. This is in accordance with SGX's Risk Limit Policy. SGX-DC's management of custody and investment risks are aligned with the Principles for Financial Market Infrastructures<sup>2</sup> ("PFMI").

### **Counterparties that hold cash assets**

Bank counterparties with which SGX-DC places participants' cash assets are required to meet a minimum Moody's baseline credit assessment of "baa2" and/or a long-term debt rating of at least "A". The counterparties must also be supervised by a recognised home financial regulator, and either have a local presence in Singapore or hold a valid banking licence from the Monetary Authority of Singapore ("MAS"). In addition, bank counterparties must meet Basel III capital requirements.

SGX's Board sets a limit on SGX-DC's exposure to each bank counterparty, based on the counterparty's Moody's credit ratings. In addition, concentration limits are established to ensure that SGX-DC does not have excessive exposure to any one single counterparty. All deposits are either in current or fixed deposit accounts in the same currency.

### **Counterparties in reverse repurchase arrangements**

SGX-DC may also put participants' cash Collateral in reverse repurchase arrangements with qualified counterparties, in exchange for government securities of high liquidity and credit quality that are held with qualified custodians. Where the counterparty is a non-bank financial institution, its bank entity will be subject to the same criteria as bank counterparties set out above.

### **Counterparties that hold non-cash assets**

SGX-DC uses local and foreign custodian banks, international central securities depositories and national central securities depositories that are supervised and regulated by their respective national regulatory authorities.

There is no limit on the value of non-cash assets that can be held with custodians that have a minimum Moody's baseline credit assessment and/or long term debt rating of "baa3", or an equivalent rating from Standard & Poor's or Fitch Ratings. There are similarly no such limits on national central securities depositories. For unrated custodians, there is a limit on the value of assets that SGX-DC can place with them. Currently, SGX-DC does not use any unrated custodian.

### **Managing risk posed by bank and custodian counterparties**

Prior to opening an account with a bank or a custodian, SGX-DC will assess that such counterparty meets the admission criteria set out in SGX's Risk Limit Policy and also the service levels required by SGX. This provides assurance that these entities have robust accounting practices, safekeeping procedures and internal controls that fully protect the assets of SGX-DC and its participants. Thereafter, these banks and custodians are required to periodically provide statements on SGX-DC's accounts and asset holdings with them for reconciliation purposes. SGX-DC's external auditor also conducts an annual confirmation with the banks and custodians on SGX-DC's accounts and asset holdings.

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<sup>2</sup> Please refer to the PFMI disclosure document on SGX website for updates on SGX-DC's management of custody and investment risks. The web link is:  
[http://www.sgx.com/wps/portal/sgxweb/home/clearing/derivatives/pfmi\\_disclosure](http://www.sgx.com/wps/portal/sgxweb/home/clearing/derivatives/pfmi_disclosure).

