

CLIENT UPDATE 2016 AUGUST



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MAS Consults on Enhancements to Regulatory Requirements on Protection of Customer's Moneys and Assets

Introduction

In recent times, financial crises like the Lehman Brothers and MF Global insolvencies have brought the issue of protection of client assets to the forefront. As a result of these events, investors are now trying to better understand the potential implications of placing their assets with intermediaries. Regulators, such as the Monetary Authority of Singapore (“MAS”), are also looking for ways to address potential risks to client assets and how to transfer or return client assets in case of default, resolution or insolvency scenarios.

Currently, in Singapore, holders of a Capital Markets Services licence (“**CMS licensees**”) conducting regulated activities under the Securities and Futures Act (“**SFA**”) 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) Regulations (“**LCB Regulations**”).

MAS has undertaken a review of the regulatory requirements governing the protection of customers' moneys and assets and is proposing to enhance those relating to the safeguarding, identification and use of customer's moneys and assets, and disclosures to customers and has come up with several proposals, which are contained in the [Consultation Paper on Enhancements to Regulatory Requirements on Protection of Customer's Moneys and Assets](#) (“**Consultation Paper**”) that was published on 18 July 2016. The consultation period ends on [19 August 2016](#).

In formulating the proposals contained in the Consultation Paper, MAS has also considered the international standards promulgated by the IOSCO¹ and the Financial Stability Board².

MAS intends to effect the proposed changes primarily through amendments to the LCB Regulations and will consult separately on the legislative amendments after considering feedback to this consultation.

The proposals in this Consultation Paper do not apply to the non-centrally OTC derivatives included under the Consultation Paper on Margin Requirements for Non-Centrally Cleared OTC Derivatives, issued in October 2015, which you can read about in our [October 2015 client update](#).

Summary of Proposals

The key changes proposed by MAS are:

1. Expanding the definition of customer's moneys to include contractual rights arising from transactions entered into by a CMS licensee on behalf of or with a customer;
2. Requiring CMS licensees to conduct suitability due diligence when appointing deposit-taking financial institutions (“**FIs**”) with whom they maintain customers' trust accounts and carrying

¹ IOSCO's Report on Recommendations Regarding the Protection of Client Assets (January 2014).

² FSB's Key Attributes of Effective Resolution Regimes for Financial Institutions (October 2011) and Annex on Client Asset Protection in Resolution (October 2014).

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out periodic reviews to assess whether the deposit-taking FIs and custodians with whom they maintain customers' trust accounts and custody accounts remain suitable, taking into a prescribed list of factors;

3. Extending the applicability of Regulations 18 and 28 of the LCB Regulations to situations where customer moneys and assets are placed with overseas FIs;
4. Requiring CMS licensees to maintain information systems and controls that can promptly produce, both in normal times and in the event of resolution or insolvency, salient information pertaining to their customers' moneys and assets;
5. Extending the daily computation requirement under Regulation 37 of the LCB Regulations to all CMS licensees holding customer moneys and assets;
6. Requiring CMS licensees to provide risk disclosures to, and obtain consent from, their customers prior to lending, mortgaging, pledging, charging or re-hypothecating customer assets; and allowing CMS licensees to provide the relevant risk disclosure in, and obtain the requisite consent through, the agreement governing the customer's account;
7. Requiring CMS licensees to respond reasonably promptly to customers requesting their statements of accounts;
8. Disapplying Regulations 16(1)(b) and 26(2) of the LCB Regulations to retail customers; and
9. Disapplying the customer money rules under the LCB Regulations in respect of exempt FIs that conduct regulated activities under the SFA ("EFIs"), but extending the proposed enhancements in respect of the customer asset rules under the LCB Regulations to EFIs.

Annex A of this Update sets out in more detail the current position under the LCB Regulations, and MAS' proposals in the Consultation Paper.

Contact Us

If you have any questions on the consultation proposals, or wish to submit feedback to MAS, please contact one of our team members below, who will be able to assist you.



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ANNEX A - TABLE OF PROPOSED CHANGES

	Current Position	MAS Proposals
Definition of “customer’s money” in the LCB Regulations	The definition of “customer’s money” in the LCB Regulations currently does not include contractual rights arising from transactions entered into by an intermediary with or for a customer.	To expand the definition of “customer’s moneys” in the LCB Regulations to include contractual rights arising from transactions entered into by CMS licensees with or for a customer. This is to ensure that all customer’s moneys received and held by CMS licensees are accorded protection under the LCB Regulations. No change is proposed to the definition of “customer’s assets” as in general, mark to market accruals and other contractual rights owed by the CMS licensee to the customer are met with cash and not assets.
Suitability Due Diligence on Third Party Deposit-Taking Institutions and Third Party Custodians	Unlike the suitability due diligence requirements in Regulation 29 of the LCB Regulations which require CMS licensees to conduct such due diligence on a third party custodian prior to opening a custody account to keep their customer’s assets, CMS licensees are not currently required to conduct similar due diligence on a deposit-taking institution with whom a trust account is to be opened to safe-keep their customer’s moneys. There is also no requirement for CMS licensees to periodically review and assess the suitability of the deposit-taking institution or custodian (each a “Third Party Intermediary”) on an ongoing basis.	In order to safeguard customer’s rights in customer assets and to minimize the risk of loss and misuse, MAS proposes to require CMS licensees to (i) conduct suitability due diligence on deposit-taking institutions prior to opening of trust accounts; and (ii) periodically review and assess the suitability of all Third Party Intermediaries with whom trust accounts and custody accounts are maintained. In conducting such suitability due diligence and periodic suitability reviews and assessments, CMS licensees should consider: (i) the legal requirements or market practices relating to the holding of customer’s moneys and assets that could adversely affect customer’s rights during business-as-usual and default/resolution scenarios involving the CMS licensee or the Third Party Intermediary; (ii) the financial condition, expertise and market reputation of the Third Party

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		<p>Intermediary;</p> <p>(iii) protection (or lack thereof) attendant upon the regulatory status of the Third Party Intermediary; and</p> <p>(iv) the need for diversification and mitigation of risks, where appropriate, by placing customer's moneys and assets with more than one Third Party Intermediary.</p>
<p>Acknowledgement from Financial Institutions - Regulations 18 and 28 of the LCB Regulations</p>	<p>CMS licensees are required to obtain an acknowledgment from the domestic financial institutions with whom they keep customer's moneys and assets, confirming (i) the designation of the relevant accounts as customer's trust accounts, (ii) the moneys and assets therein are held on trust for the customers and segregated from the CMS licensees' own moneys and assets, and (iii) the unavailability of the customer's moneys and assets for set-off against the CMS licensee's debts owed to the domestic financial institution.</p> <p>These regulations currently do not apply to situations where customer's moneys and assets are placed with overseas financial institutions.</p>	<p>MAS proposes to extend the applicability of these regulations to situations where customer's moneys and assets are placed with overseas financial institutions.</p>
<p>Information Systems and Controls for the Prompt Production of Information and Records concerning Customer's Money and Assets</p>		<p>In addition to the existing record-keeping requirements under the SFA and LCB Regulations, MAS proposes to require CMS licensees to maintain information systems and controls that can promptly produce, both in normal times and in the event of resolution or insolvency, and in a format understandable by external parties, salient information pertaining to the following:</p> <p>(i) the location of customer's moneys and assets</p>

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		<ul style="list-style-type: none"> (ii) how the assets are held by the CMS licensee, its affiliate, or the Third Party Intermediary (iii) the identity of all relevant depositories (iv) the type of segregation (“omnibus” or “individual”) at all levels of a holding chain (v) the effects of the segregation on customer’s ownership rights (vi) the applicable customer’s moneys and assets protection rules, in particular where customer’s moneys and assets are held in a foreign jurisdiction and will be subject to the customer’s moneys and assets protection, and resolution or insolvency regime, of that foreign jurisdiction; and (vii) outstanding loans of customer’s securities arranged by the CMS licensee, including details of counterparties, contract terms and collateral received on behalf of the customers.
New Requirements	Disclosure	<p>To provide transparency to customers on the manner in which the CMS licensees hold customer’s moneys and assets and the attendant risks, MAS intends to require CMS licensees to disclose to customers the following information in advance:</p> <ul style="list-style-type: none"> (i) the manner in which the CMS licensees hold the customer’s moneys and assets, including the type of segregation and the existence of any holding chain, and the risks

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		<p>associated with the arrangements adopted by the CMS licensees;</p> <p>(ii) where the customer's moneys and assets are held in a foreign jurisdiction, the material differences between the customer's moneys and asset protection regimes in Singapore and that jurisdiction, and the potential consequences of such differences.</p> <p>The disclosures required are to be presented in a clear and simple language that investors can easily understand. This is so that the client can make an informed decision concerning its investment.</p>
Daily Computation of Trust Accounts and Custody Accounts – Regulation 37 of LCB Regulations	A CMS licensee that trades in futures contracts or carries out leveraged foreign exchange trading is required to perform daily computation of the amount of its moneys and assets deposited in its customer's trust accounts or custody accounts. The daily computation requirement ensures proper accountability and reconciliation of moneys and assets held in trust by the CMS licensee on behalf of its customers.	MAS is proposing to extend the daily computation requirement under Regulation 37 to all CMS licensees holding customer's moneys and assets, so as to ensure proper accountability for a customer's moneys and assets.
Re-hypothecation and Other Use of Customer Assets – Regulation 33 of LCB Regulations	<p>CMS licensees are required to provide risk disclosure to, and obtain consent from, their customers before they lend out the customer's securities. However, Regulation 33 does not prescribe the content of the risk disclosure, nor does it apply to situations where CMS licensees mortgage, charge, pledge or hypothecate their customer's assets.</p> <p>CMS licensees are not be required to provide such risk</p>	It may be recalled that the MAS had previously proposed for consultation certain legislative changes to prohibit the use of a retail customer's monies and assets for the purposes of the CMS licensee's margining purposes with hedging counterparties, or for meeting other obligations incurred by the CMS licensee in connection with the retail customer's unlisted margined derivative transactions. ³

³ See [MAS Consultation Paper of May 2012 on Review of Regulatory Framework for Unlisted Margined Derivatives Offered to Retail Investors](#) and [MAS Consultation Paper of March 2014 on Draft Regulations to Enhance the Regulatory Framework for Unlisted Margined Derivatives Offered to Retail Investors](#).

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	disclosures in lending (or arranging to lend) the securities of a customer who is an accredited investor.	<p>In the present case, MAS proposes to require CMS licensees to provide risk disclosure to, and obtain consent from, the customers prior to using, mortgaging, charging, pledging or re-hypothecating the customer's assets.</p> <p>The risk disclosure should highlight, among other things, how the grant of such rights by the customers to the CMS licensees to use their assets would affect the customer's rights over those assets as well the protection available to the customers under the LCB Regulations.</p> <p>MAS proposes to allow such risk disclosures and such consents to be provided and obtained through the agreement governing the customer's account.</p> <p>It is not expressly stated that the MAS proposes to expand the requirements of Regulation 33 beyond securities to apply to all asset classes, although MAS' use of the expression "customer's assets" rather than "customer's securities" would appear to suggest this is the case.</p> <p>There is also no indication whether or not the existing exemption from risk disclosure requirements when dealing with the securities of accredited investors would be retained.</p>
Statement of Account – Regulation 40 of LCB Regulations	<p>CMS licensees are required to furnish its customers with monthly and quarterly statements of accounts, including information such as the status of every asset held by the CMS licensee and the movement of money and every asset of the customers.</p> <p>This regulation does not apply where is no change to any of the particulars stated in the last statement of account; or the customer is an accredited investor or a related corporation</p>	<p>To require CMS licensees to respond reasonably promptly to customers who make a request for their statements of accounts.</p> <p>MAS proposes to permit CMS licensees to impose a reasonable fee for providing such statements on their customers' request.</p> <p>It is not clear whether CMS licensees would be required to provide statements of accounts requested by customers who are accredited investors and who, at the time of such request, has</p>

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	of the CMS licensee, and (i) the CMS licensee has made available to the customer real-time electronic records or (ii) the customer has requested in writing not to receive the statement of account.	access to real-time electronic records.
Disapplication of Regulations 16(1)(b) and 26(2) of LCB Regulations	CMS licensees are presently permitted to deposit customer's moneys and assets in a trust account or any other account directed by the customer. These regulations are intended to provide the flexibility to a customer to ask the CMS licensee to deposit his moneys or assets into an account of his choice.	MAS has noted that CMS licensees and other financial institutions typically only permit deposit of customer's moneys or assets into an account previously designated for this purpose and typically do not allow customers' assets or moneys to be paid into a different account. In addition, some financial institutions have relied on these regulations to obtain the customer's direction, for instance by seeking the customer's consent via a clause in the account agreement for the financial institution to deposit the customer's moneys and assets in any account as determined by the financial institution, which is not the intention of the regulations. MAS is now seeking feedback on whether Regulations 16(1)(b) and 26(2) should be dis-applied in the case of retail customers, as such customers may not fully appreciate the implications of consenting to such a clause.
LCB Money Rules and LCB Asset Rules	The LCB Regulations governing the treatment and handling of moneys (" LCB Money Rules ") and assets (" LCB Asset Rules ") received from customers are also applicable to banks, merchant banks and finance companies (collectively referred to as " Exempt Financial Institutions " or " EFIs ") which conduct regulated activities under the SFA.	<i>Customer's Moneys</i> MAS is proposing to dis-apply the LCB Money Rules for EFIs in respect of customer's monies. MAS has noted that EFIs carrying out SFA-regulated activities would not generally make a determination upfront as to the purpose of the moneys received from their customers and would generally place all moneys received from a customer in a deposit account maintained by the customer, and even if the customers subsequently effect capital markets transactions, the EFIs may only withdraw such monies from the deposit account on

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		<p>settlement date for payment to the customers' counterparties.</p> <p>MAS also recognizes that it may not be practical for EFIs to ask customers the specific purpose of their moneys at the point of receipt, and customers may also not have applied their minds to the intended purpose of the moneys when they place it with the EFIs.</p> <p>MAS noted that the proposal will also bring Singapore in line with the position in other major jurisdictions (e.g. United States, United Kingdom, Australia and Hong Kong) which do not apply their domestic customer's moneys rules to banks that carry out capital markets activities.</p> <p><i>Customer's Assets</i></p> <p>MAS will continue to apply the LCB Asset Rules to EFIs, as customer's asset are clearly identifiable and EFIs are already able to identify assets belonging to customers and comply with LCB Asset Rules.</p> <p>EFIs will thus continue to be subject to the LCB Asset Rules (including the proposed enhancements set out in this consultation when these are effected).</p>

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