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CONSULTATION PAPER "Proposed Enhancements to Resolution Regime for Financial Institutions in Singapore" (P011-2015)

Dear Madams and Sirs,

We are thankful for the opportunity to take part in the consultation concerning the proposed enhancements to resolution regime for financial institutions in Singapore.

Deutsche Börse Group (in the following DBG) is conducting various businesses in the financial markets via a broad range of companies, some of which are regulated. Asia is an important part of our strategic business development and Singapore as a financial hub plays a prominent role in that strategy. DBG is currently doing business in Singapore i.a. via subsidiaries as well as branches of its subsidiaries and intends to enlarge these business activities in upcoming years. As such we have also taken into account the feedback of our Singapore based entities namely Clearstream Banking S.A., Singapore branch and Eurex Clearing Asia Pte. Ltd.

DBG entities are not engaged in classic banking operations, e.g. deposits taking and loan granting are rather ancillary services to foster our core

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capital market infrastructure[1] services (CSDs[2], CCPs[3], market places / exchanges and trade repositories – collectively CMIs).

In the following we only respond to questions affecting us directly or at least indirectly or which are of general interest for our group.

A. General remarks

The Financial Stability Board (FSB) has issued "Key Attributes of Effective Resolution Regimes for Financial Institutions", updated in 2014 and. CPMI-IOSCO issued "principles on recovery of financial market infrastructures" in October 2014.

In order to have a global level playing field we support the implementation of these rulings worldwide and therefore appreciate the efforts of MAS to introduce a resolution framework closely aligned with the FSB framework / CPMI IOSCO principles. Nevertheless as the international implementation for Recovery and Resolution regimes (including levies) for CMIs is at an early stage we believe that the current proposals with regard to CMIs should be regarded as brain storming that need to be further discussed, analysed and calibrated.

As the MAS proposal not only follows the FSB framework to a high degree but also takes into account the EU equivalent (BRRD), we are very supportive to the MAS approach.

The various different types of CMIs are not only fundamentally different to classic banks but also from each other, having specific business models and balance sheet structures. Even when CMIs also hold a banking license, a variety of the rules applicable to banks do not fit on CMIs. The intended framework therefore needs to take into account different business models in an appropriate manner. We clearly notice the approach of MAS to consider specifics of CMIs and welcome this. Nevertheless we encourage the MAS to take further elements into account. In the Securities and Futures Act (SFA)

[1] We are using in this response the terminology chosen by MAS which we deem equivalent to the terminology of financial market infrastructures (FMI) as used e.g. by CPMI IOSCO.
[2] Central Securities Depositories
[3] Central Counterparties

Central Counterparties (CCPs) and Central Securities Depositories (CSDs) are both defined as "Clearing Houses".

However, the details of the different business models and risk profiles of these two types of CMIs are important to be understood: While a CCP becomes a party to the transaction / position and performs strong risk management practises including a comprehensive default waterfall, a CSD is at no time party of a settlement transaction. Having said this, both types of - CMIs have to fulfil tight risk management practices according to the CPSS-IOSCO "Principles for Financial Market Infrastructures" (PFMI)[4] and their balance sheets contain in principle only short term positions. Any resolution regime should recognise these specifics but also the crucial differences between these two types of CMIs. As outlined above CCPs and CSDs have different risk profiles. Although the SFA takes care for these differences in the legal consequences of a classification as a Clearing House (both Recognised Clearing House and Approved Clearing House), there are nevertheless circumstances in which the different approaches would be more appropriate. This relates i.a. to the need to become a Recognised Clearing House for a CSD with Singapore based participants. We therefore kindly ask the MAS to reconsider the current SFA approach and at least undertake further steps to exclude CSDs from Clearing House requirements which are tailored for CCPs.

In addition other CMIs such as market places / exchanges and trade repositories as well as DPS operators and DPS settlement institutions have a very low risk profile, especially with regard to financial risk which MAS may wish to take into consideration when finalising its rules and executing its foreseen powers.

[4] http://www.bis.org/cpmi/info_pfmi.htm

B. Answers for questions

Question 1:

MAS seeks views on the proposal for legislative amendments that will subject notified financial institutions that are systemically important or maintain critical functions, to the requirements in paragraphs 2.2 (a) to (e).

Reply:

We agree that financial institutions that have been notified by MAS to formulate RRPs adopt measures to address deficiencies in RRPs and to remove impediments to the implementation of the RRPs. For financial institutions with international operations, they may need to align the RRP requirements for their key offices. Hence, a reasonable period of time (to be determined based on market consultations) should be allowed for the implementation phase for the enhanced RRPs.

Question 2:

MAS seeks views on the proposal to impose the responsibility for ensuring compliance with RRP requirements on the financial institution's board and executive officers, with contravention by the financial institution and/or any of its board members and executive officers constituting an offence with penalties.

Reply:

We consider an appropriate level of penalties for committed offences as reasonable. The proposal made by MAS is going in the right direction.

Question 3:

MAS seeks views on the proposal to introduce statutory powers to stay early termination rights of counterparties to financial contracts, in particular –

(a) the scope of financial contracts to be subject to the stay;

(b) the proposed duration of the stay and the circumstances in which it may be necessary to extend the duration of the stay in order to achieve an effective resolution or to support the stability of the financial system;

(c) the proposed safeguards to be introduced in connection with the stay as set out in paragraph 3.9 and whether any additional safeguards should be provided for; and

(d) whether the exercise of statutory powers to stay early termination rights for financial contracts of a distressed financial institution traded, cleared, settled or reported on a CMI or DPS, as the case may be, will compromise the safe and orderly operations of the relevant CMI or DPS and if so, how this may be mitigated.

Reply:

DBG takes the view that stay-of-termination rights can be a useful tool for a resolution authority to implement their resolution plan without undue disruption. The stay of termination rights granted to the Resolution Authority need to follow an appropriate ruleset and need to take into account the soundness of the general framework for financial markets. As such the topics raised by MAS in the sub-questions (a) to (d) are the right ones to be tackled:

(a) Agreed.

(b) Due to the urgency of the situation and in order to effect the stay-of-termination rights quickly, perhaps it is worth considering if the notification in the Official Gazette needs to be a prerequisite. Alternatively a MAS notification could be sent out to the involved parties first and posted on the MAS homepage simultaneously which will then be accompanied by publication in the Official Gazette in due course. Furthermore we also

consider a timeframe of two days for that stay order as potentially not being long enough. The period should be long enough to evaluate the best way forward, but also not too long to avoid unintended negative impact on financial markets or the confidence therein. As such we consider a period of around five days with the option of setting shorter periods or even extend as the case may be, as a possible timeframe to be considered by the MAS.

(c) In general agreed, please consider our comments on lit. d.

(d) We ask to treat Securities Settlement System[5] as well as CCPs and CSDs in a specific manner in consideration of their important role in the capital markets. We submit that the proposed approach does not take into account the blocking of settlement transactions in an Securities Settlement System which is deemed to be confirmed and due to settle but has not settled yet. We strongly support the MAS to keep this going forward. Furthermore, a stay-of-termination right should only be applied against a CCP for the positions of a defaulting clearing member if the obligations of the clearing member are fulfilled by Resolution Authorities. CCPs should be able to maintain continuity for the benefit of the resolution authority as long as margin, clearing fund, and settlements are still conducted. If this is not ensured, the CCP cannot expose its non-defaulting members beyond their expected commitments. As such the consultation should consider a specific exemption for CCPs from stay-of-termination rights in the case of non-fulfilment of the obligations by a clearing member under resolution.

Question 5:

MAS seeks feedback on the proposal to introduce powers to ensure continuity of essential services and functions by suspending the termination rights of non-financial contracts, or requiring these contracts to be performed on the same terms and conditions that were in place prior to the resolution. Views are invited, in particular, on –

(a) the scope of non-financial contracts to be subject to such powers; and

[5] As defined in the PFMIs.

(b) the potential implications on existing and future non-financial contracts.

Reply:

No comment.

Question 6:

MAS seeks views on the proposal to introduce statutory bail-in powers under the MAS Act and for the bail-in powers to be first applied to Singapore-incorporated banks and bank holding companies.

Reply:

We agree that it seems sensible to apply a bail-in regime to Singapore-incorporated banks and bank holding companies at first, while monitoring international developments before considering any extension to the bail-in regime.

From our perspective, any future regime should take into consideration, the unique and specific roles and business models of CMIs, irrespective of whether they have a banking license and therefore could be included in the bail-in regime. In this context we strongly support the current MAS proposal to limit bail-in regimes to the banking sector. Even stronger, this could be limited to the banking sector in a context of ordinary deposits taking and loan granting business which uses the capital markets for mid- to long-term debt financing instruments in order to foster the above described business. Consequently, we submit that any other financial institution including CMIs, should be excluded from the scope of any bail-in regime.

As an example, the business models of CCPs and CSDs are short term and, in principle, do not require (bail-in-able) mid- to long-term funding with debt instruments to finance their operations.

In addition, the default waterfall of a CCP already mutualises losses from a default of a clearing member across the members of the CCP, and is carefully structured to incentivise prudent behaviour in the default management process.

Question 7:

MAS seeks views on the proposal to apply the statutory bail-in regime to unsecured subordinated debt and unsecured subordinated loans, issued or contracted after the effective date of the relevant legislative amendments implementing the bail-in regime.

Reply:

We agree to the approach to include only subordinated loans and subordinated debt as bail-in able. The MAS may, in line with international initiatives, extend the scope of bail-in able instruments. In this context we want to share some thoughts with the MAS:

For the well-functioning of capital markets it is crucial that any obligation towards CMIs like CCPs and CSDs is properly fulfilled in order to avoid spill-overs into the safeguards of the CMIs. As such in line with the provisions of Article 44 (2) lit. f BRRD liabilities with a remaining maturity of less than seven days, owed to CMIs should be excluded from bail-in instruments also in the future.

Question 8:

MAS seeks views on the proposal to complement the proposed statutory bail-in regime with contractual bail-in provisions for liabilities within the scope of MAS' statutory bail-in powers which are governed by the law of a foreign jurisdiction. MAS also seeks views on requiring banks to comply with the conditions set out in paragraph 6.11.

Reply:

We agree to the outlined approach.

Question 9:

MAS seeks views on the proposal for banks to prominently disclose the consequences of a bail-in to debtholders for liabilities within the scope of MAS' statutory bail-in powers.

Reply:

No comment.

Question 10:

MAS seeks views on the proposal for statutory powers to be introduced for MAS to either convert into equity or write down those instruments that are contingently convertible or which can be contractually bailed in, but whose terms and conditions for conversion or bail-in had not been triggered prior to entry into resolution.

Reply:

No comment.

Question 11:

MAS seeks views on –

(a) the possibility of achieving a cooperative solution with foreign resolution authorities by giving effect to foreign resolution actions through a recognition process, subject to the considerations set out in paragraphs 7.8(a) to (c); and

(b) the scenarios where a foreign resolution action may not be in the interest of a local branch or subsidiary of a foreign financial institution, which MAS would need to take into consideration when deciding if it should recognise or support the foreign resolution action.

Reply:

Agreed.

Question 12:

MAS seeks views on the proposal to establish a creditor compensation framework applicable to creditors of banks, merchant banks, finance companies, insurers, CMIs, DPS operators and settlement institutions, and financial holding companies regulated by MAS.

Reply:

Agreed.

Question 13:

MAS seeks views on the features of the proposed creditor compensation framework –

(a) the proposal to engage a qualified independent valuation agent to determine any creditor compensation payable and the criteria (if any) for the appointment of such a valuation agent;

(b) the valuation principles that such a valuation agent should adopt;

(c) the appeal process on the compensation amount determined by the valuation agent; and

(d) other features that MAS should consider including in its creditor compensation framework.

Reply:

a) Agreed.
b) to d) No comment.

Question 14:

MAS seeks views on the proposal for resolution funding arrangements to be used for –
(i) costs incurred in the implementation of resolution measures; and
(ii) any creditor compensation claims that may arise.

Reply:

Agreed.

Question 15:

MAS seeks views on the proposal not to establish full ex ante funding to implement resolution measures, but to establish an ex post recovery mechanism and tap on prevailing ex ante funds.

Reply:

We agree with the argumentation of MAS that in advance no estimation about possible losses can be 100% accurate.
Nevertheless the inability to assess future financial requirements of a protection scheme should not have the misleading effect that contributions are only collected when they are instantly needed (ex post funding). It could lead to moral hazard concerns.
With regard to banks, all assumed beneficiaries should be obliged to contribute to those resolution financing arrangements including those who may be bailed out. Therefore MAS could set a target level that should be achieved and calibrated over time. In our view MAS should also consider ex-ante funding in order to distribute individual contributions over time and avoid one time expense hits, which could endanger certain market participants at a time of volatility and create unintended spill-overs. As such ex-ante funding would also give the opportunity to price-in the cost of such arrangements into the fee schedules.
In case of ex-post resolution financing, those who accepted most risk while managing those risks poorly are least affected, while those who perform business in a prudent manner may end up paying more.

We propose following waterfall of funding sources to be tapped, in the event of a default to be financed:

1. If losses occur the (existing) contributions to the resolution financing arrangements (ex-ante) are used;
2. In case the already existing financial resources in the resolution financing arrangements are not sufficient further contributions might be called (ex-post) up until a certain predefined limit to be set in an appropriate manner;
3. If means provided to the resolution funding arrangement are not sufficient to cover all needs a bridge financing arrangement, e.g. loan financing, should be taken into account;
4. Any bridge financing arrangement needs to be paid back by contributions of the contributors to the resolution funding arrangement.

This generic approach should be taken for all banks and no segregation for banks of different kind which are not CMIs should be employed.
For CMIs the process with regard to Resolution regime is at an early stage. We are giving our first thoughts and considerations in our response to Q.21 and Q.22 below and ask MAS to consider further discussions on that topic as well as alignment with global initiatives in this regards.

Question 16:

MAS seeks suggestions on the appropriate level of losses to be imposed on equity holders and unsecured creditors of the financial institution to be resolved, before resolution funding arrangements are tapped upon.

Reply:

From our perspective a mixture of bail-in and a levy based fund would be the most appropriate solution. Instead of creditors we propose to approach participants in the CMI. As the global initiative is at an early stage we cannot be more precise rather than describing our generic preferences.
We are critical to currently discussed TLAC concept[6] and MREL proposal[7] to be applied on CMIs. Demanding such high levels of pre-funded resources in the proposed magnitude will on the one hand bring these (pre-funded) funds into the risk position of the defaulting entities and therefore at risk. On the other hand in case the requirement is fulfilled with equity instruments this will reduce the possibilities and willingness of equity holders to pay in fresh funds if and when they are needed. As such the minimum level of bail-in able debt and equity may be slightly increased to the current required equity levels for banking entities including any buffer requirements and to some extend for the fulfilment of such requirements MAS should consider contractually agreed contingent funding agreements (possibly scaled-up to a higher amount).

[6] http://www.financialstabilityboard.org/wp-content/uploads/TLAC-Condoc-6-Nov-2014-FINAL.pdf
[7] http://www.eba.europa.eu/documents/10180/1132900/EBA-RTS-2015-05+RTS+on+MREL+Criteria.pdf

Example:
A financial institution is currently exposed to regular capital requirement of X.
Additionally those financial institutions shall maintain bail-in able liabilities or equity in an amount of Y. We propose that Y is capped to a degree that makes Y significantly lower than X. Beside equity and bail-in able liabilities contingent obligation to pay in funds should be considered as well. As those contingent obligations entail a higher risk than pre-funded resources we propose to weight those obligations, with a factor lower than 100% and possibly a maximum portion of the additional funds (Y).
We are explicitly critical with regard to introducing TLAC and MREL and a bail-in style contribution of unsecured "creditors" for CMIs. There is currently only the beginning of an international discussion for appropriate concepts in this regard. The business model of CMIs is limited in its' kind and has to follow strict risk limitation rules. As such a certain increase of capital requirements in combination with an ex-post participation of participants in case a resolution deems appropriate may be the right approach.
In any case, it is important that MAS considers implementing a framework for CMIs in that area that is in alignment with international developments in order to maintain a global level playing field. In our reply to Q.21 and Q.22 we elaborate further on that topic.

Question 17:

MAS seeks views on the proposal to expand the use of the DI Fund to include the funding of the resolution of DI Scheme Members, but excluding any creditor compensation claims that may arise, subject to the equivalent cost criterion.

Question 18:

MAS seeks views on the proposal to apply ex post levies on all other banking entities.

Reply:

We kindly ask the MAS not to have specific sector arrangements and instead introduce possibly different levels of contributions. This is in particular true for banking entities as described in chapter 9.13 to 9.16 of the consultation paper. Due to the interconnectedness of financial markets there is a strong interlinkage that should be taken into account when setting up the arrangements. Insurers may be excluded and a dedicated scheme may be appropriate due to their different business model and risk profile.

The DI scheme has a dedicated purpose to cover deposits. As deposits are not considered to be bail-in able we kindly ask the MAS to reconsider usage of DI scheme funds for resolution purposes. As the DI funds need to pay out to depositors this is the contribution the DI funds will do in the default case anyway. But MAS should carefully consider whether any contribution beyond in favour of the defaulting institution is advisable.

With regard to the general set-up of any levy on the banking entities we refer to our proposal to Q.15 and once more kindly ask the MAS to consider ex-ante collection of levies different from the DI scheme. We cannot judge the appropriate levels necessary for the Singapore market and therefore refrain from any indication in this regard.

Question 21:

MAS seeks views on the scope of ex post recovery, i.e. the scope of entities from which costs should be recovered.[8]

Question 22:

MAS seeks views on the manner by which costs should be recovered, for example, whether this may be through levies on participants or transaction levies, and the apportionment of such levies.

[8] We are not responding with regard to DPS operators. The arguments below may be valid in a similar manner though.

Reply:

The discussion for Recovery and Resolution arrangements for CMIs on international level is at an early stage which is in particular true for dedicated resolution funding arrangements but also for an appropriate bail-in like approach to allow for recovery or resolution of a CCP as a consequence of non-default-losses (NDL) or of a CSD. So far there is only limited experience with defaults of CMIs. Risk management standards according to PFMI including business limitations are by far stricter than for ordinary banks. For CCPs in addition a default waterfall exists to cover losses from defaulting clearing member (default management process – DMP) to the extent possible.

Different from our views with regards to the resolution funding arrangement for banks, the financing of resolution of CMIs should neither include market wide contributors nor include an external fund with ex-ante collected funds based on a banking levy like scheme. Moreover we are in particular, concerned with the proposal to have only the CMI providers themselves to contribute to the resolution funding arrangements or for only the CMI providers of the same kind to do so. As there are usually only a few such providers, this would make the well-functioning ones paying for the one failing and consequently honour poor risk management, spill over the default to the remaining infrastructures and reduce proper due diligence of the CMI by the participants. As such, this is not tailored to stabilise the system and make the market taking care for well-functioning as in case of a default, others have to pay the bill. Contrary to banks, CMI are by far less relying on each other and the impact of one defaulting CMI provider on others is supposed to be rather limited while this in our view is not the case between banking entities which are interconnected via the interbank (money / liquidity) market to a substantial degree.

As the discussion on this topic is not yet matured on a global scale, the most important aspect is to take the appropriate time for international discussion and a harmonised approach. Although there are differences between the various kinds of CMI and dedicated companies operating as CMIs as well as between the various domestic and international markets they operate in, we

see clear benefits in first agreeing to the cornerstones of the approach and then calibrating to national specifics. In case some countries / regions would go ahead while globally the discussion is far from setting the rules and may finally move towards different approaches, there is a high risk of creating damage to the national CMI and shifting business to other markets.

As such, only a reasonable balanced global approach that secures a level playing field to the extent possible seems to be the appropriate path going forward. As such, we encourage the MAS to continue its discussion on that point with the industry and experts and to contribute in a leading role to the international discussion. However, taking the low risk profile of CMIs into account which have proven robustness during the financial crisis of the last years, we submit that there is arguably less urgency to implement a solution in the short term.

Having said this, we do want to contribute to the ongoing discussion with some thoughts on key elements of a future framework for both CSDs and CCPs which we see as the most important CMIs to take care for in this regard.

Any loss / cost in order to recover or resolve a CMI should be borne by the shareholders and the participants of the failing CMI only and the portion related to the participants should be set having in mind their vital interest to keep the CMI up and running, i.e. to a substantial level. There should be no loss sharing beyond the above mentioned scope as this would lead to moral hazard. The shareholders of a CMI need to have a crucial interest in keeping the business going and securing their investments. Participants should have an interest in getting their business efficient, safely and without disruptions processed and management and keeping the likelihood of having to participate in any recovery or resolution situation very low. As such, they will perform due diligences on the CMI they are using. Furthermore, as they will also determine to some extent the systemically importance (i.e. a CMI is supposed to be systemically important mainly as a consequence of its size has become so due to the usage by its participants), it should be the participants having a vital interest to keep the CMI up and running.

For the CCPs it needs to be taken into account that the default waterfall for DMP losses is already creating a bail-in like system and is sharing losses

between the non-defaulting participants and the CCP itself and its shareholders respectively. A CCP already needs to have available a pre-defined amount of capital based on a variety of risks to cover which include operational risk, financial / investment risk, business risk, etc. Any additional (pre-funded) charge to shareholders should be carefully considered and well balanced compared to possible (contingent) contributions of the participants.

The contribution of participants (clearing members) of CCPs in our mind should be on an ex-post basis. They should be set in a manner that is not changing the well balanced DMP process. As such, any usage of collateral should not set any unintended incentive to shift collateral between different kinds of collateral (i.e. cash, securities or third party guarantees). Possible contributions should take into account the size of the usage of the CMI. As such, ex-post contributions could be based on fees paid, collateral requirements or collateral posted.

As CSDs are not part of the transactions, in principle a default of a CSD-participant is not creating similar effect like it is the case for a CCP. Consequently, no default waterfall exists.

In order to foster the need to cover a recovery or even a resolution situation of a CSD nevertheless, similar structures as for the NDL-process for CCPs could be implemented. However, a CSD also does not have a pool of collateral or collateral requirements (margin requirements) like a CCP.

Financial risk of a CSD is mainly driven by the holding / investing of participants' cash deposits and short term (intraday) collateralised loans to participants. As such, in case of a recovery or resolution event, participants could be required to fund in an amount being equal of a certain portion of their (average) deposits and / or credit lines granted. Again, this would not be a transformation of a dedicated debt (bail-in) but a contribution based on operational figures. Also a different basis (e.g. fees paid) could be used for any ex-post contribution. Deposited cash and placed securities collateral for cash loans could be used as collateral also for the obligations to fund. Also for a CSD the mechanism chosen should not have an unintended impact on the funding behaviour of participants for the DvP transactions. In case a bail-in would be imposed on deposits placed with a CSD, participants would increase the usage of intraday loan which are only funded after settlement

took place. This demonstrates that plain bail-in is not the right approach as deposits are not placed in order to earn interest but to secure settlement.

The thoughts described above in our view clearly demonstrate that any detail on how to balance resolution funding and participants and shareholders contribution, needs to be tailored taking into account a thorough analysis and impact assessment. We are more than willing to contribute to that discussion and help the MAS and the international bodies working on this to develop a proper approach which is not creating imbalanced consequences, market disruptions, moral hazard, etc.

We are at MAS disposal to continue the discussions.

Yours faithfully,

Marcus Thompson Jürgen Hillen