

Ong Chong Tee: Financial integration – a collective effort towards efficient and resilient markets

Speech by Mr Ong Chong Tee, Deputy Managing Director (Financial Supervision) of the Monetary Authority of Singapore, at the Launch Event for EU-Asia -Pacific Forum on Financial Regulation, Singapore, 14 October 2016.

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Mr Olivier Guersent, Director General for Financial Stability, Financial Services and Capital Markets Union (European Commission)
Dr Michael Pulch, EU Ambassador to Singapore,
Mr Ashley Alder, Chair of the IOSCO Board and Chief Executive of Hong Kong SFC,
Mr Ryozo Himino, APRC Chairman and Vice-Minister of International Affairs, Japan FSA,
Mr Paul Andrews, IOSCO Secretary General,
Distinguished guests, ladies and gentlemen,

On behalf of all my colleagues at the MAS, let me extend a warm welcome to everyone at this launch event of the EU - Asia- Pacific Forum on Financial Regulation.

It is a privilege and honour for the MAS to host this inaugural forum on financial regulation between the EU authorities and members of the IOSCO Asia-Pacific Regional Committee (APRC). This launch event will no doubt set the stage for the in-depth closed-door discussions to follow over the course of today.

The impetus for this forum is a recognition that the financial markets of Europe and Asia are increasingly inter-connected. One measure, for example, is the total portfolio assets held by investors from the largest five EU economies¹, in the Asia and Pacific region². This has grown from around US\$240 billion in December 2001 to over US\$820 billion in December 2015 (according to IMF statistics). And this growth has been positive each year except for a decline during the last global financial crisis. In the same period, total portfolio investment assets held by investors from the Asia and Pacific region in these same European markets have grown from US\$420 billion to over US\$930 billion.³

Therefore, developments in each of our jurisdiction and region can have a significant spill-over impact on the other. Financial regulators form one important stakeholder group and platforms for dialogue and sharing such as in this forum will be helpful in promoting greater mutual understanding and cooperation.

Importance of regulatory cooperation

I am sure that everyone in this room will agree on the importance of regulatory exchanges and co-operation.

Asia-Pacific jurisdictions including Singapore play host to many European financial institutions which are active and significant participants in our respective financial markets. Such cross-border and cross-region participation have benefitted both regions.

For example, the recognition of LCH.Clearnet and the Singapore Exchange Derivatives Clearing by MAS and EU authorities, respectively, provide local market participants and European Financial Institutions a choice of where to clear their transactions. More importantly, the recognition will allow market participants to comply with their respective jurisdiction's central clearing requirements when they are effected, thus avoiding duplicating or conflicting requirements. Beyond clearing, MAS also recognises Europe-based exchanges such as ICE Futures, London Metal Exchange, and Eurex Deutschland, which allows financial institutions,

traders, and finance and treasury centres based in Singapore to have access to a wide range of risk management instruments.

With this experience, MAS has fine-tuned our approach to the recognition and regulation of overseas players, including European exchanges and clearing houses, in our markets. In setting our standards and the methodology to determine equivalence, we have aligned ourselves with international standards such as Principles of Financial Market Infrastructures (PFMI). We have also clarified the factors that we will take into consideration in determining whether an overseas player has “substantial and reasonably foreseeable effect in Singapore” and hence requires recognition by the MAS⁴.

However, beyond just standards and rules, regulatory cooperation can promote appreciation for each other’s regulatory framework, and to lay the foundation for an outcomes-based approach in equivalence assessments.

I am pleased to note that this has been the spirit guiding the interaction among regulators, including with our European colleagues. For instance, in 2014, the EC recognised the central counterparty (CCP) regulatory regimes of several Asia-Pacific jurisdictions – Australia, Hong Kong, Japan, Singapore and Korea - as equivalent on the basis of an “outcomes based approach”. This was also seen in September 2016 with the positive opinion issued by ESMA on the grant of the AIFMD passport to Singapore and other Asia-Pacific jurisdictions.

I am confident that this constructive engagement in which regulators across our regional blocs have worked together will continue in other equivalence assessments, such as in the areas of financial benchmarks and organised markets or trading platforms. As we have learnt from past experience, greater clarity in equivalence assessments, including in relation to timing, can help provide greater certainty and thereby support the continued participation of European market participants in overseas markets and vice versa.

International standards and peer assessments as basis for equivalence assessment

Allow me to highlight one area where international standards and peer assessments have allowed a good basis for equivalence assessment – for financial market infrastructure (FMI).

Market functioning, and therefore financial stability, is dependent on the continuity and orderly operation of services provided by these infrastructures. The multilateral nature of FMIs also mean that their services are often cross-border and accessed by a wide range of market participants.

Since the development of the PFMI by IOSCO and the BIS Committee for Payments and Market Infrastructures (CPMI), these standards have been used by many regulators including Singapore as a key basis for comparability assessments. CPMI-IOSCO has also been conducting Level 2 assessments of jurisdictions’ implementation of the PFMI. Assessments of the EU, Japan, US and Australia are complete, and assessments of Singapore and Hong Kong are under way. Such peer assessments against international standards will help to promote greater understanding and alignment amongst various jurisdictions’ frameworks.

Peer assessments have also helped to identify and close gaps at the entity level. For instance, the recent Level 3 assessment by CPMI-IOSCO on the implementation of the PFMI⁵ by ten CCPs (including SGX-DC) helped to identify gaps and shortcomings which CPMI-IOSCO expects to be addressed by the CCPs and their respective regulators by the end of the year. As outstanding issues are addressed and the progress tracked, regulators should also have greater confidence in undertaking their equivalence assessments of CCPs that their domestic market participants can access. This can then provide greater certainty to global market participants.

Improving market access for CCPs

Singapore, as with other jurisdictions, will be commencing our clearing mandate next year thereby enhancing the role of CCPs as a risk mitigating tool. However, a clearing mandate cannot be effectively implemented if access to CCP remains an issue for counterparties, particularly smaller players. We share similar concerns to those that have been expressed by ESMA.

In this regard, it is noteworthy that ESMA has looked into possible ways to improve CCP access and has, for example, proposed indirect clearing arrangements which strikes a balance between having an appropriate level of indirect client protection and counterparty risk. I hope today's forum will allow MAS and other regulators to learn from ESMA's insights.

To enable a wider range of market participants – including those based outside Singapore - to have direct access to CCPs in Singapore, MAS will allow our CCPs to introduce self-clearing and remote clearing memberships. This benefits not only the participants but the CCP and the system as a whole; with a larger and more diversified pool of participants, the impact on the CCP due to a default of any single particular participant would be reduced.

Self-clearing can also widen CCP access on cost-effective terms and allow proprietary derivatives trading firms, such as buy-side players, to join CCPs as members and thereby reduce their counterparty and fellow customer risks. CCPs will have the flexibility to design suitable self-clearing models, taking into account the risks and needs of self-clearing members. We have seen recent innovations by Eurex and CME to allow certain market participants which are not allowed to take part in the CCP risk mutualisation as a result of their mandates, to self-clear on the CCP.

Remote clearing will allow offshore participants, which do not currently have a presence in Singapore, to join our CCPs, thus bringing about new, additional liquidity to local markets. The increased breadth and depth of the markets in turn benefits onshore members which will continue to be key players in our domestic markets. At the same time, such memberships allow offshore firms to gain familiarity with the local market and to deepen their participation.

There are some understandable concerns if remote or self-clearing can undermine financial stability in domestic markets. In Singapore, our regulatory standards and expectations will not change. We will only allow CCPs to admit self-clearing or remote clearing members if they have put in place adequate admission, ongoing monitoring and risk management frameworks. Beyond equivalence assessments, we will consider the formation of supervisory colleges for our CCPs should they be deemed as internationally active.

Putting recovery and resolution plans in place

Allow me to share a final set of remarks on recovery and resolution plans. Even as we continue to strengthen the resilience and accessibility of CCPs, we must continue our efforts to ensure that recovery and resolution plans for CCPs are in place. There have been greater focus and thought given to arrangements to deal with default risks but it should also be recognised that other risks such as custody and investment risks can also pose a threat to a CCP's viability.

Hence, in line with the CPMI-IOSCO report on Recovery of Financial Market Infrastructures, MAS expects and will place priority to ensure our CCPs have clear arrangements to enable custody and investment losses to be allocated in a way which allows CCPs to be solvent and can continue to provide its critical services. At the same time, there must be appropriate governance arrangements and incentive structures to promote prudent risk management on the part of the CCP. Such arrangements can include providing transparency to member firms, having "Skin-In-The-Game" (SITG) contributions from the CCP, and putting in place oversight structures to oversee such safeguards.

It has been said that regulators are pessimists in our DNA and always inclined to worry about things going wrong – and certainly, we cannot ignore the possibility of the failure of key FMIs no matter how remote, and this may occur in FMIs overseas. I started my speech this morning, noting the increasing connectedness between markets. This is true in the ‘life’ of a CCP - and can be true in its ‘death’ too. The failure of an internationally active CCP, that provides critical services in multiple jurisdictions, will have significant cross-border impact. When a CCP fails, its members are inevitably affected. Such members are likely to also have relationships with other financial institutions, or may trade and clear on other trading venues and CCPs. Through these network of interdependencies, the default of a CCP can trigger destabilising effects not only in the home market it serves directly, but outside of it.

It is therefore important for authorities of jurisdictions that may be affected by a CCP’s failure to participate in that CCP’s resolution planning. Similar to the establishment of Supervisory Colleges to support ongoing supervisory co-operation, setting up Crisis Management Groups (CMG) for CCPs will allow the cross-border impact to be considered in resolution planning. In a failure situation, when resolution actions are time-sensitive, it may be necessary to limit the size of a CMG to enable efficient and effective discussions. But in normal times, resolution planning can benefit from a broader participation of relevant authorities. Such inclusive, ongoing cooperation and information sharing builds trust and understanding. It will also enhance the effectiveness of resolution implementation by pre-empting host regulators from taking actions that may be incompatible with the home regulator’s resolution actions, due to a lack of clarity or awareness over the home regulator’s intended actions.

Conclusion

In conclusion, the issues confronting regulators today are wide ranging. This event is an excellent showcase of how regulators can come together to share our experiences and to keep each other apprised of developments in our respective regions. For instance, Europe’s Capital Markets Union project is an exciting development which we look forward to learning more about from our European colleagues. With various market integration initiatives also underway in Asia, there is room for us to exchange views and to learn from each other.

Thank you for your attention.

¹ France, Germany, Italy, Spain, UK.

² Australia, China, India, Indonesia, Japan, Malaysia, New Zealand, Philippines, Singapore, South Korea, and Thailand.

³ Data source: IMF.

⁴ MAS’ Guidelines on the Regulation of Clearing Facilities, revised , set out the circumstances under which overseas clearing houses are required to be regulated in Singapore, and how we approach the regulation of such entities.

⁵ In relation to financial risk management and recovery practices.