



HONG KONG MONETARY AUTHORITY
香港金融管理局

Our Ref: B9/135C

23 August 2013

The Chief Executive
All Licensed Banks

Dear Sir/Madam,

Interim Reporting Requirements for OTC derivative transactions

Following the issue of the letter of 28 June 2013 on the interim reporting requirements for OTC derivative transactions, we have received various enquiries from banks about the requirements. To facilitate banks' implementation of the requirements, I am enclosing a list of frequently asked questions (FAQs) and our responses for reference.

Should your bank have any questions regarding the FAQs, please contact Lionel Wai on 2878-1279 or Andy Cheung 2878-1022.

Yours faithfully,

Rita Yeung
Head (Banking Policy Division)

Encl.

cc. Financial Services and the Treasury Bureau
(Attention: Mr Jackie Liu)

Interim reporting requirements for OTC derivative transactions
Frequently asked questions (Aug 2013)

In the Q&A below, the term “the Letter” refers to the circular letter issued by the HKMA on 28 June 2013 regarding “Interim reporting requirements for OTC derivative transactions” and the term “HKTR” refers to the trade repository facilities provided by the HKMA (this has the same meaning as HKMA-TR used in the previous circulars issued regarding the interim reporting requirements).

Membership related questions

Q1 Does a bank need to join HKTR membership if it does not carry out any reportable transaction under the interim reporting requirements?

A1: Yes, the bank has to become an HKTR member even if it does not carry out any reportable transaction (see paragraphs 12 and 13 of the Annex to the Letter). In order to enrol as a HKTR member, the bank is required to submit a number of forms, copies of certain documents and a duly signed Reporting Service Agreement. The original deadline for enrolment has been deferred to 5 September 2013 (see our letter dated 2 August 2013). Banks that have not yet become HKTR members are advised to contact our technical support hotline on 8100-3115 as soon as possible for details of the application procedures.

Q2 If a bank does not carry out any reportable transaction under the interim reporting requirements, can the bank defer undertaking the system linkage testing with the HKTR until it plans to enter into reportable transactions?

A2: This is acceptable. However, banks planning to start entering into reportable transactions should allow sufficient time for conducting the user-defined and simulation tests. In particular, reporting banks must complete the simulation test to the satisfaction of the HKTR before they will be accepted for reporting (see paragraph 14 of the Annex to the Letter). Depending on the testing schedule and the number of applications, it could take months to get a bank’s system ready for reporting while an average lead time is around one and a half months.

Q3 As a HKTR member, does a bank need to report a nil return to the HKTR even if it does not carry out any reportable transaction specified in the interim reporting requirements?

A3: This is not necessary. Reporting is required only when a reportable event occurs (see paragraph 16 in the Annex to the Letter).

Clarification on reporting requirements

Q4 Is an IRS or NDF transaction entered into by a bank in Hong Kong not reportable if the other counterparty to the transaction is a bank located outside Hong Kong?

A4: This is not correct. The bank will have an obligation to report the transaction as long as the other counterparty to the transaction is also a licensed bank. The geographical location of the office of that counterparty bank is not a deciding factor. (See the example in paragraph 6 of the Annex to the Letter for reference.)

Q5 Is it necessary to report a transaction deemed to undergo central clearing?

A5: Yes, transactions associated with “centrally clearing” the original transaction (i.e. termination of the original transaction and entering into a new transaction with the central counterparty (CCP)) are all reportable business events.

Q6 How should a “de-cleared and re-cleared” transaction¹ be reported?

A6: For a “de-cleared and re-cleared” transaction, a simplified approach for reporting is allowed. Instead of reporting all the business events involved in the de-clearing and re-clearing process, the bank concerned could simply report the changes in economic terms to the original transaction as one single amendment to the original centrally cleared transaction. See illustration in the example below.

Example

A reportable trade Alpha is established between Licensed Bank A, Hong Kong Branch and Licensed Bank B, Hong Kong Branch. After central clearing, two transactions, namely Beta (Bank A versus CCP) and Gamma (Bank B versus CCP) are created. If subsequently Bank A and Bank B agree to change certain economic terms of the original transaction, the transactions Beta and Gamma have to be de-cleared, and a new transaction has to be created between Bank A and Bank B and such transaction should be novated to CCP for re-clearing. For the purpose of reporting, Bank A and Bank B should each report an amendment business event to trade Beta and Gamma respectively within the usual T+2 timeline (T being the day “re-clearing” is completed).

Q7 Can a bank report the break clause or similar early termination features of a transaction to the HKTR? For example, a 10-year IRS started from 11 January 2012 and will mature on 11 January 2022, with a break clause on 13 January 2017 and on 13 January of every year afterwards.

A7: The HKTR currently does not support the reporting of any break clause or early termination features, although there is a plan to accommodate such reporting tentatively in 2014. In the meantime, a bank should report an OTC transaction that contains a break clause or early termination features according to the contractual maturity of the transaction only (but not the early termination date).

Q8 A bank reported a transaction to the HKTR on the trade date but the transaction was cancelled the next day. Since the interim reporting requirements provide that reporting is not required if the transaction is

¹ “De-clear and Re-clear” operation usually arises when an amendment is made to a transaction that has been centrally cleared. Under such a scenario, the counterparties have to (i) “de-clear” the transaction; (ii) create a new transaction with amended terms; and (iii) novate the new transaction to CCP for central clearing (“re-clear”).

cancelled or terminated within two days of the trade date, can the bank not report the event of cancellation of the transaction to the HKTR?

A8: Once a transaction has been reported to the HKTR, any subsequent business events happening on the transaction must also be reported. The cancellation of a transaction within T+2 will not have to be reported only if the transaction has not been reported to the HKTR in the first place (see paragraph 21 of the Annex to the Letter).

Q9 Can the HKMA provide some examples to illustrate how a transaction cleared via a clearing agent should be reported?

A9: The reporting of such a transaction is illustrated by the example below:

Example

Bank A and Bank B entered into a reportable transaction and submitted the transaction to central clearing. Bank A carried out the central clearing through an agent, Entity C, while Bank B did it directly. Entity C may or may not be a licensed bank. In summary:

Bank A is a counterparty to the transaction;
Bank B is the other counterparty to the transaction; and
Entity C is a clearing agent or broker of Bank A.

Transactions involved in relation to central clearing are as follows:

- (1) Bank A and Bank B entered into a new trade;
- (2) Cancellation of the trade in (1) above for the sake of central clearing;
- (3) Bank A entered into another transaction with its clearing agent Entity C;
- (4) Entity C entered into a transaction with the CCP for clearing the original transaction for bank A; and
- (5) Bank B entered into another transaction with the CCP.

Reporting requirement for Bank A

- Bank A should report transactions (1) and (2) above according to the instructions set out in the Annex to the Letter. When submitting the report for the new trade, Bank A should complete the information in relation to “Clearing Broker” to indicate Entity C as its clearing broker (i.e. “Clearing Broker ID Type”, “Clearing Broker ID” and “Clearing Broker Name” must be filled in for these trades, in addition to the Mandatory Reporting Fields set out in the list in Appendix 2 to the Letter).

- On reporting the central clearing transactions, Bank A should make only one report to the HKTR on the basis of seeing through the clearing agent as if the CCP is its counterparty. In this report, Bank A should also complete the information in relation to “Clearing Broker” to indicate Entity C as its clearing broker (i.e. “Clearing Broker ID Type”, “Clearing Broker ID” and “Clearing Broker Name” must be filled in for these trades, in addition to the Mandatory Reporting Fields set out in the list in Appendix 2 to the Letter).

Reporting requirement for Bank B

- Bank B was not involved in indirect clearing. It should simply follow the instructions in the Annex to the Letter to report the transactions.

Reporting requirement for Entity C

- Entity C, the clearing agent, does not need to report to the HKTR the transactions that it cleared for its client clearing customers.

Q10 A bank is not eligible to become a direct clearing member of CCP but it has a subsidiary which is such member and this subsidiary is not a licensed bank. For the purposes of central clearing, the bank novates OTC derivative transactions conducted with counterparties to this subsidiary, which then acts as the principal to centrally clear the transactions concerned with the CCP. That subsidiary does not offer indirect clearing service in its ordinary course of business. How should these transactions be reported to the HKTR?

A10: For the purpose of the interim reporting arrangement, the bank should report these transactions following the same method set out in the answer to Q9, i.e. by the principle of seeing through the subsidiary and reporting the subsidiary as the bank's clearing agent. The HKMA will review the reporting treatment in this respect when the statutory reporting requirements are implemented in future.

Q11 A bank has agreed with its counterparty to partially reduce the notional value of an OTC derivative transaction already reported to the HKTR. Can the bank report this business event by submitting a report of full termination of the original transaction and a report of a new transaction that reflects the revised notional value of the transaction, while keeping the transaction date as the one in the original contract instead of the date of the current partial termination event (this is for the sake of internal administrative convenience)?

A11: The reporting of a business event should reflect the economic substance of the event. Reporting a new trade with the "old" trade date is obviously not consistent with this principle and therefore not acceptable. The bank should report the business event of partial termination as either amendment or partial termination using the respective forms/templates provided by the HKTR.

Q12 Will a gale warning day or a black rainstorm warning day be counted as a business day under the T+2 reporting requirement?

A12: A gale warning day or a black rainstorm warning day, as defined in section 71(2) of the Interpretation and General Clauses Ordinance (Cap 1), will not be counted as a business day under the T+2 reporting requirement. However, please note that the HKTR system stands ready for trade submission even on a gale warning day or on a black rainstorm day, although its hotline and email enquiry service will be suspended. For the avoidance of doubt, a gale warning or black rainstorm warning happening on the trading date only but not the two days immediately following the trading date should not affect the normal timing for reporting under the T+2 basis. For example,

assume a bank entered into an OTC derivative transaction in the morning of Monday 10 June, and a gale warning was issued in the afternoon of that day but 11 June and 12 June were not gale warning days, black rainstorm warning days or public holidays. The bank should report the transaction on the T+2 basis as usual. However, if 11 June were also a gale warning day, the deadline for reporting the transaction would be extended for one business day.

Others

Q13 What procedures should a bank follow if it intends to appoint an agent to report trades on its behalf to the HKTR? Will the use of the reporting service provided by an agent constitute outsourcing under the Supervisory Policy Manual module on Outsourcing (SA-2)?

A13: Yes, using the service of an agent for the reporting of trades to the HKTR will constitute outsourcing. To ensure compliance with the HKMA's outsourcing requirements, a bank should commission external auditor(s) or other independent parties with sufficient expertise to conduct an independent review against the requirements. Upon issuance of a satisfactory report by the independent reviewer, the bank can engage in agency reporting and notify the case officer of this arrangement. The independent reviewer's report should be made available to the HKMA when requested. In addition, there are some administrative procedures required by the HKTR. The bank should follow steps 6 to 8 on the registration checklist prepared by the HKTR, which forms a part of the HKTR membership application documents.

Q14 Is the list of HKTR members available on the web?

A14: The HKTR member list is accessible at the following web page:-
<http://www.hkma.gov.hk/eng/key-functions/international-financial-centre/infrastructure/otc-derivatives-trade-repository.shtml>

Q15 Are the implementation timelines of 9 December 2013 and 4 February 2014 mentioned in the Letter still the same after the circular issued on 2 August 2013?

A15: Yes, these implementation timelines have not been changed.