HONG KONG MONETARY AUTHORITY
香港金融管理局

Banking Policy Department *銀行政策部*

Our Ref: B9/135C
B1/15C

11 June 2015

The Chief Executive
All Licensed Banks

Dear Sir/Madam,

Interim reporting requirements for OTC derivative transactions – migration to new reporting regime

In 2013, the HKMA introduced interim reporting requirements for licensed banks with respect to some of their OTC derivative transactions. As explained at the time of their introduction, these interim reporting requirements are a simplified version of the reporting requirements which will ultimately be adopted under the new regulatory framework for the OTC derivatives market.

I am now writing to inform you that following the enactment of the Securities and Futures (Amendment) Ordinance 2014 which establishes the new regulatory framework, a set of Securities and Futures (OTC Derivative Transactions – Reporting and Record Keeping Obligations) Rules (the "Reporting Rules")[1] have now been introduced into the Legislative Council for negative vetting. We will notify all authorized institutions, once the negative vetting process has been completed, of the effective date of the Reporting Rules.

The interim reporting requirements will cease to apply upon the commencement of the Reporting Rules. Accordingly, your institution should comply with the Reporting Rules for reporting OTC derivative transactions from the effective date of their commencement.

To ensure a smooth transition from the interim to the new reporting regime, licensed banks should follow the supplementary guidance annexed to this letter. The supplementary guidance endeavours to provide the clarifications necessary for a smooth transition. The relevant staff in your institution are therefore requested to study the supplementary guidance carefully and make system and procedural changes as appropriate to facilitate compliance with its terms.

[1] The draft Rules were published on the government gazette on 15 May 2015 and accessible at http://www.gld.gov.hk/egazette/pdf/20151920/es22015192096.pdf

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In particular, although a concession period and a grace period are provided for in the Reporting Rules, we consider that licensed banks should already have their reporting systems ready (given that they have been reporting transactions under the interim reporting requirements) and so should continue to report those transactions (new transactions or subsequent events relating to existing transactions) that would have been reported under the interim reporting requirements on a T+2 basis after the commencement of the Reporting Rules. This will avoid any unnecessary interruption to the availability of data for regulatory purposes.

We also draw to your attention the draft FAQs for the Reporting Rules jointly issued by the SFC and the HKMA on 15 May 2015. This set of FAQs serves as a reference to aid understanding of the new reporting requirements and is accessible on the following website: http://www.hkma.gov.hk/media/eng/doc/key-information/press-release/2015/20150515e3a2.pdf.

Should your bank have any questions about this letter, please contact Mr Andy Cheung on 2878-1022 or Mr Lionel Wai on 2878-1279.

Yours faithfully,

Karen Kemp
Executive Director (Banking Policy)

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

Annex

Supplementary guidance regarding transition from interim reporting requirements to the reporting framework under the Securities and Futures (OTC Derivative Transactions – Reporting and Record Keeping Obligations) Rules (the Reporting Rules)

Introduction

1. The interim reporting requirements set out in the HKMA's circular letter of 28 June 2013 will cease to operate upon the commencement of the Reporting Rules. Thereafter licensed banks should comply with the Reporting Rules for reporting OTC derivative transactions.

2. This Annex is divided into two parts. The first part sets out the supplementary guidance to be observed by licensed banks under the new reporting regime. The second part highlights some points-to-note under the new reporting regime.

Part 1

A) Reporting time

3. To avoid interruption to the availability of data for regulatory purposes, licensed banks will be expected to continue to report new transactions or subsequent events relating to reported transactions, which would have been reported under the interim reporting requirements, on a T+2 basis after the commencement of the Reporting Rules, unless a relevant exemption or relief applies. This is the case notwithstanding the concession period and grace period provided in the Reporting Rules.

4. Paragraph 3 only applies to transactions which would have fallen under the interim reporting requirements. In brief, it refers to the transactions in interest rate swaps or non-deliverable forwards that a licensed bank has entered into with another licensed bank (including connected transactions undertaken for central clearing).

5. With regard to transactions not captured under the interim reporting requirements, licensed banks will be entitled to take the benefit of the concession period and

the grace period set out in the Reporting Rules. Such transactions include the following:

(i) a transaction with product features not captured under interim reporting – While the product types specified for reporting under the interim reporting requirements and the Reporting Rules are the same (i.e. interest rate swaps (IRS) and non-deliverable forwards (NDF)), only plain vanilla transactions of this type are subject to the interim reporting requirements. Therefore IRS/NDF transactions that bear special product features are eligible for the concession period and the grace period;

(ii) a transaction to which the counterparty is not a licensed bank;

(iii) a transaction that a licensed bank enters into in the course of providing client clearing services;

(iv) a "conducted in Hong Kong" transaction (including a transaction within the meaning of rule 4(1) or specified under rule 12(1)(b) of the Reporting Rules); and

(v) for a locally incorporated licensed bank, a transaction booked in an overseas office/branch of the bank.

B) Precious metal transactions

6. Precious metal transactions will be classified under the product class of commodity derivatives in the new reporting regime. As reporting of commodity derivative transactions will not be required (at least initially) under the Reporting Rules, licensed banks are advised to stop reporting precious metal transactions (and relevant subsequent events) from the commencement date of the Rules. If time is required to undertake system modifications to terminate the reporting, banks may continue to report precious metal transactions and relevant subsequent events up to the end of the concession period. Nonetheless, licensed banks should, by the end of the grace period, submit reports to withdraw all of the precious metal transactions that they have reported under the interim reporting requirements or during the concession period from the trade repository operated by the HKMA (HKTR) unless the transactions have matured or been terminated before the end of the grace period. This is to avoid confusion with classification when the mandatory reporting requirement is extended to commodity derivatives in the future.

C) Transactions that involve a client clearing service provider

7. The "see-through" approach[1] for reporting transactions with client clearing service providers under the interim reporting requirements will cease to apply upon the commencement of the Reporting Rules. By then, licensed banks should endeavour to report transactions with client clearing service providers in the same way as those with other counterparties. If it takes time to undertake system enhancement to cater for this new reporting method, banks may continue to report new transactions with client clearing service providers using the "see-through" approach up to the end of the concession period. Nonetheless, licensed banks should, by the end of the grace period, submit reports to withdraw all of the transactions with client clearing service providers that have been reported on a "see-through" basis under the interim reporting requirements or during the concession period and report these transactions again according to the prevailing reporting requirements (i.e. report the client clearing service provider instead of the central counterparty concerned as the counterparty of the transactions). This withdrawal and resubmission does not, however, apply to the transactions that have already matured or been terminated before the end of the grace period.

Part 2

8. Highlighted below are some key points relevant to licensed banks which may require significant preparation in advance or which could be easily overlooked:

   (i) Certain information which is not collected under the interim reporting requirements will be collected under the Reporting Rules (e.g. reference branch of trade party, trading desk identifier and unique transaction identifier). The provision of such information will be optional for a transitional period to allow time for system enhancement to produce and report the required information. The relevant instructions are set out in the Supplementary Reporting Instructions (which will form an annex to the Administration and Interface Development Guide of the HKTR) to be issued by the HKMA in due course. The draft FAQs for the Reporting Rules issued jointly by the HKMA and SFC on 15 May 2015 also elaborate on the requirements.

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[1] The "see-through" approach is illustrated in Q9 of the FAQs for the interim reporting requirements issued by the HKMA on 23 August 2013.

(ii) If a licensed bank has reported transactions to the HKTR under the interim reporting requirements and any of those transactions remain outstanding on the commencement date of the Reporting Rules, the bank will not be eligible for the exempt person relief as specified under Rule 3 of the Reporting Rules.

(iii) Under the interim reporting requirements, it is not necessary to report a transaction otherwise required to be reported if it is cancelled or fully terminated within the T+2 reporting timeline. This treatment is removed in the Reporting Rules. Licensed banks should be prepared to comply with the new requirement to report every transaction in respect of which they have a reporting obligation without regard to whether the transaction will be / has been cancelled or terminated within two business days after the trade day.

(iv) Transactions carried out by a licensed bank in the course of providing client clearing services, which are not reportable under the interim reporting requirements, will become reportable under the Reporting Rules. For transactions of this nature, both new transactions occurring after the commencement of the Reporting Rules and historical transactions are required to be reported to the HKTR if they meet the reporting criteria under the Reporting Rules. Since these transactions do not fall under the interim reporting requirements, a licensed bank can avail itself of the concession period and grace period under the Reporting Rules when reporting these transactions.

Hong Kong Monetary Authority