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Re: Consultation paper on the proposed regulatory regime for the over-the-counter derivatives market in Hong Kong

To whom it may concern:

Managed Funds Association¹ appreciates the opportunity to provide comments to the Hong Kong Monetary Authority (the “HKMA”) and the Securities Futures Commission (“SFC”) on their joint “Consultation paper on the proposed regulatory regime for the over-the-counter derivatives market in Hong Kong” dated October 2011 (the “Consultation”). MFA thanks the HKMA and SFC for offering interested parties an important opportunity to provide input into the proposed over-the counter (“OTC”) derivatives regulatory regime prior to drafting legislative proposals. We recognize that many of these areas are complex and new to regulatory oversight, and we pledge to be active and constructive participants throughout the process and support the HKMA and SFC in their efforts to meet their G20 commitment to enhance oversight of the OTC derivatives markets.

As active, longstanding participants in the OTC derivatives market, MFA members have a strong interest in promoting its integrity and proper functioning. We strongly support the goals of OTC derivatives regulation to enhance transparency and reduce systemic risk. We also believe that a well-functioning OTC derivatives market is essential to the restoration of capital

¹ The Managed Funds Association (“MFA”) represents the global alternative investment industry and its investors by advocating for sound industry practices and public policies that foster efficient, transparent and fair capital markets. MFA, based in Washington, DC, is an advocacy, education, and communications organization established to enable hedge fund and managed futures firms in the alternative investment industry to participate in public policy discourse, share best practices and learn from peers, and communicate the industry’s contributions to the global economy. MFA members help pension plans, university endowments, charitable organizations, qualified individuals and other institutional investors to diversify their investments, manage risk and generate attractive returns. MFA has cultivated a global membership and actively engages with regulators and policy makers in Asia, Europe, North and South America, and all other regions where MFA members are market participants.

flows, given its critical role in the investment and risk management activities of many market participants. In keeping with this spirit, we thought it appropriate to offer our comments on the proposals in the Consultation in order to help bolster the effectiveness of the proposed regulatory regime and minimize any adverse impacts or unintended consequences in its implementation.

I. Proposed Mandatory Clearing Obligation

MFA supports the HKMA's and SFC's efforts to reduce systemic risk by transitioning appropriate OTC derivatives transactions to a mandatory clearing regime. We believe that mandatory clearing is essential to reducing systemic, operational and counterparty risk. While we expect a bilateral market to remain for limited customized business and risk management needs, we believe that mandatory clearing is a key first step that will offer increased regulatory and market efficiencies, greater market transparency and competition.

We also applaud and strongly support the HKMA's and SFC's desire to facilitate client clearing.² Although a number of key impediments to client clearing exist in the OTC derivatives market,³ clients, including our members, have undertaken significant steps to prepare for greater, open access to clearing. For example, a number of client firms have negotiated clearing arrangements, tested margin methodologies, tested straight-through processing and worked through a wide range of operational and reporting prerequisites to clearing in volume. Clearing members have also been working for several years now on structuring offerings to clients, including smaller clients with limited operational capacity, to support widespread clearing. In light of the continued existence of impediments to client clearing, MFA would be pleased to provide the HKMA and SFC with further recommendations on the appropriate primary or subsidiary legislative provisions that would ensure the proposed regulatory regime for OTC derivatives addresses such impediments.

As a result, we feel strongly that regardless of what products the HKMA and SFC initially make subject to the mandatory clearing obligation, once clearing is available for any product, there should be mandatory access to clearing for all eligible market participants that desire to clear on a voluntary basis that product. Indeed, we believe that encouraging market participants to clear derivatives transactions voluntarily will help to facilitate the development of a clearing infrastructure that takes into account the views of many types of market participants.

However, with respect to the proposed mandatory clearing obligation, we are concerned about the inclusion of a "specified clearing threshold" as a determinant of whether the rules require a market participant to clear a transaction. We understand that the HKMA and SFC are proposing to use the specified clearing threshold to limit the scope of the mandate "so as to minimise the impact on the market as far as possible without compromising the objectives of the obligation."⁴ However, we believe that the application of this threshold is contrary to the goal of

² Consultation at 34.

³ See the "Framework for the Open Items List from Buy-Side Participants of Actions Required for Buy-Side Access to Clearing", which provides a list of key impediments to buy-side clearing, and was sent to a number of U.S. regulators in March 2010 as part of an industry effort sponsored by the U.S. Federal Reserve Bank of New York, available at <http://www.managedfunds.org/wp-content/uploads/2011/06/3.24.11-Key-Impediments-to-Buy-Side-Clearing-FINAL-March-2010.pdfvb>.

⁴ Consultation at 28.

incentivizing greater clearing and will prove administratively burdensome. In particular, MFA's members have dynamic business models where the average notional value of the positions in their transaction portfolios may turnover, increase or decrease substantially from one six-month period to the next. Accordingly, unlike other market participants, our members have the potential to routinely fall above and below any specified clearing threshold.

As a result, we recommend that the HKMA and SFC eliminate the specified clearing threshold and impose the mandatory clearing obligation based solely on the type of market participants that are parties to the transaction. While we appreciate that the HKMA and SFC desire not to impose the mandatory clearing obligation on certain smaller or less actively trading authorized institutions, licensed corporations or Hong Kong persons,⁵ we believe that there are preferable options for addressing this issue (e.g., other G20 countries have proposed clearing regimes that could provide useful guidance).⁶ More importantly, we believe that eliminating this threshold and imposing a mandatory clearing obligation that looks to type of market participant would create clear delineations that would give market participants certainty and consistency as to whether they must clear their transactions, and would avoid the burden on the HKMA and SFC of establishing, calibrating, administering and monitoring compliance with such a threshold.

II. Proposed Mandatory Reporting Obligation

In the Consultation, the HKMA and SFC propose to require certain market participants to report specified "reportable transactions" to the trade repository that the HKMA is in the process of establishing ("HKMA-TR").⁷ MFA fully supports the need for the HKMA and SFC to receive timely transaction reporting in order to have transparency and provide effective oversight of the financial markets.

1. HKMA-TR Confidentiality Protections

Although the Consultation discusses the transactions that market participants will report to the HKMA-TR, it does not establish parameters with respect to access to the data maintained by the HKMA-TR or commercial use of that data. As mentioned above, MFA recognizes the need for regulators to have access to information about market participants' activities in order to have a comprehensive view of the markets and effectively oversee the financial system. In addition, we understand that it is necessary to establish a trade repository to collect data for such

⁵ *Id.* at 19-20, which sets forth the proposed definition of "Hong Kong person", which may include commercial entities and high net worth individuals.

⁶ See Sections 723 and 763 of the U.S. Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the "Dodd-Frank Act"), which require market participants to clear any swap that a clearing agency will accept for clearing, but excludes a swap transaction if one of the counterparties to the swap: "(i) is not a financial entity [as defined in Sections 723 and 763 of the Dodd-Frank Act]; (ii) is using swaps to hedge or mitigate commercial risk; and (iii) notifies the [relevant U.S. regulatory agency] . . . how it generally meets its financial obligations associated with entering into noncleared swaps." See also Articles 3 and 7 of the European Commission's "Proposal for a Regulation of the European Parliament and of the Council on OTC derivative transactions, central counterparties and trade repositories", which sets forth the proposed clearing obligations for financial counterparties and non-financial counterparties.

⁷ See Consultation at 16-25.

oversight purposes. At the same time, we want to emphasize the importance of maintaining utmost confidentiality of the transaction data reported.

MFA's members invest heavily in their customized and proprietary investment strategies, which form the foundation of their businesses. Although not contemplated by the Consultation, disclosure of position level information, whether intentional or accidental, could reveal such strategies to the market, thus, undermining our members' intellectual property and inviting copycat behaviour. Therefore, we recommend that the HKMA and SFC augment the proposed mandatory reporting regime by requiring the HKMA-TR to establish, maintain and enforce written policies and procedures reasonably designed to protect the privacy and confidentiality of reported transaction information. Specifically, we respectfully request that the HKMA and SFC obligate the HKMA-TR to implement policies and procedures: (1) specifying that it will use any confidential information it receives solely for the purposes of fulfilling its regulatory obligations; and (2) that limit access to confidential information exclusively to directors, officers, employees, agents and representatives of the HKMA-TR who need to know such information to fulfil its regulatory obligations.

In addition, with respect to commercial use by the HKMA-TR of the data it collects, MFA strongly urges the HKMA and SFC to expressly prohibit the HKMA-TR to use data maintained by it for the commercial or business purposes of it or any of its affiliated entities.⁸ We believe the addition of the foregoing confidentiality protections, policies and procedures will ensure that market participants' proprietary information is adequately protected and will utilize the HKMA-TR with confidence.

2. Foreign Regulator Access to Transaction Data

Although the Consultation discusses the HKMA and SFC using information collected by the HKMA-TR "to facilitate their joint oversight of the OTC derivatives market and the performance of their respective statutory functions",⁹ the Consultation does not specify to what extent data maintained by the HKMA-TR will be shared with regulators outside of Hong Kong and whether those regulators might be permitted to obtain position level data. While MFA supports foreign regulators having appropriate access to transaction data maintained by the HKMA-TR for purposes of monitoring and regulating systemic risk, we are concerned about foreign regulators having unlimited access to that data. As a result, we request that the HKMA and SFC: (1) establish policies and procedures that limit access only to a foreign regulator that is acting clearly within the scope of the regulator's authority; and (2) actively participate in facilitating appropriate access and confirming a foreign regulator's relevant authority in connection with any data request.¹⁰ We believe that these measures would appropriately protect

⁸ See e.g., the U.S. Commodity Futures Trading Commission's ("CFTC") Final Rule on "Swap Data Repositories: Registration Standards, Duties and Core Principles", 76 Fed. Reg. 54538 (Sept. 1, 2011), available at <http://www.cftc.gov/ucm/groups/public/@lrfederalregister/documents/file/2011-20817a.pdf>, which includes sample language for such a prohibition.

⁹ Consultation at 12-13.

¹⁰ See *Id.* for sample requirements for foreign regulator access to data maintained by trade repositories.

the proprietary nature of market data without constraining the legitimate needs of other regulators to receive data necessary to oversee the financial system.¹¹

3. Specified Reporting Threshold

Pursuant to the Consultation, if a Hong Kong person is the reporting party for purposes of a transaction, the Hong Kong person is required to report the transaction only if they have exceeded the “specified reporting threshold”.¹² As with the “specified clearing threshold”,¹³ MFA believes that the HKMA and SFC should eliminate the specified reporting threshold because we do not believe that eliminating this threshold will impose an undue burden on smaller or less active market participants. Rather, we believe it is likely that most transactions that involve Hong Kong persons will also involve an authorized institution (“AI”) or licensed corporation (“LC”), which are typically dealers or other large and more active market participants). Thus, since only one party to a transaction is required to report it, the reporting burden would fall on such Hong Kong persons’ AI or LC counterparties. Consequently, given the importance of transaction reporting for purposes of market transparency and regulatory oversight, we encourage the HKMA and SFC to require reporting of all transactions that they determine are reportable transactions and otherwise involve relevant Hong Kong market participants.

III. Capital Charges and Margin Requirements

In the Consultation, there is reference to the HKMA’s and SFC’s consideration of whether to subject uncleared derivatives transactions to margin requirements as well as whether to “impose higher capital requirements for OTC derivatives transactions that are not cleared through a CCP”¹⁴. Given that capital requirements are incompatible with the business models of certain clients, as discussed below, MFA strongly opposes subjecting clients to any capital requirements. In addition, initially the HKMA and SFC will limit the mandatory clearing obligation only to certain types of interest rate swaps (“IRS”) and non-deliverable forwards (“NDF”)¹⁵ and clients may not be able to clear certain other transactions in a commercially reasonable manner. Thus, for these uncleared transactions, we respectfully request that the HKMA and SFC exercise caution by ensuring that if they impose capital requirements on these transactions that they are not so high as to become punitive. With regard to any potential margin requirements for uncleared transactions, MFA believes that is important that the HKMA and SFC ensure that any such requirements: (1) permit legally enforceable netting; (2) allow the use of a variety of margining approaches that are transparent and consistent; and (3) include liquidation horizons that are consistent with the related cleared products.

¹¹ See the CFTC and the U.S. Securities and Exchange Commission Joint Final Rule on “Reporting by Investment Advisers to Private Funds and Certain Commodity Pool Operators and Commodity Trading Advisors on Form PF”, Release No. IA-3308; File No. S7-05-11, available at <http://www.sec.gov/rules/final/2011/ia-3308.pdf>, which discusses the controls and systems that those agencies are developing to protect the confidential data that they will collect.

¹² Consultation at 16.

¹³ See Section II above.

¹⁴ Consultation at 35.

¹⁵ *Id.* at 3.

1. Capital Charges

With respect to the notion of imposing capital requirements generally, we note that capital requirements are inconsistent with the business structures and risk profiles of certain non-bank entities that are not already subject to regulatory capital requirements, and imposing capital requirements on such entities could have significant, unintended consequences, including by effectively precluding them from participating in the market. In particular, unlike banks, MFA's members do not hold capital, but instead manage assets on behalf of their investors, who have the right to redeem them subject to the terms of their contractual agreements. Accordingly, instead of holding capital, our members post margin to secure their obligations to their counterparties and our members are generally comfortable with margin requirements consistent with current market levels. Moreover, our members posting of margin serves a risk mitigation purpose functionally equivalent to the role that capital serves for banks (*i.e.*, protecting our counterparties and the financial system against our default).

As a result, requiring our members to hold capital would be inconsistent with their business structures and would materially increase the cost for them to enter into OTC derivatives contracts. Thus, in determining whether to establish capital requirements for OTC derivatives transactions that are not cleared through a central counterparty ("CCP"), we believe it is important for the HKMA and SFC to consider the different business structures and risk profiles of the various participants and tailor requirements appropriately.

However, as mentioned herein, MFA is supportive of greater clearing of OTC derivatives transactions. Therefore, if the HKMA and SFC do decide to impose capital requirements, we believe that the HKMA and SFC should reflect the lower risk associated with central clearing by ensuring that the capital charge for a cleared transaction is lower than any capital charge for an equivalent uncleared transaction. As a result, we would support the HKMA and SFC if they sought to incentivize clearing by imposing such higher capital charges on parties when they do not clear a transaction that they could voluntarily clear in a commercially reasonable manner.

On the other hand, if the transaction is not subject to the mandatory clearing obligation and the parties are not capable of clearing the transaction in a commercially reasonable manner (*i.e.*, subject to commercially reasonable terms and with sufficient liquidity), we would urge the HKMA and SFC not to impose capital requirements on such uncleared transactions that are so high as to be unfairly punitive. We anticipate that a bilateral market will remain and be necessary for certain types of transactions that will not be clearable at all or in a commercially reasonable manner. For these uncleared transactions, we think the policy implications behind imposing high capital charges to incentivize clearing are absent. Consequently, we would ask the HKMA and SFC to be mindful of this distinction if they determine to set capital requirements for uncleared transactions.

2. Margin Requirements

In the event that the HKMA and SFC decide to proceed with margin requirements for uncleared derivatives transactions, MFA believes it is critical that such requirements ensure that a well-functioning market for uncleared transactions remains and that any such requirements are not so punitive that the market for uncleared transactions becomes destabilized. Even after greater clearing has become commonplace, market participants will need a market for uncleared

transactions to meet their trading needs, including entering into customized transactions. Therefore, to ensure a transparent and efficient market for uncleared transactions, we respectfully request that any adopted margin requirements: (1) permit legally enforceable netting; (2) allow the use of a variety of margining approaches that are transparent and consistent; and (3) include liquidation horizons that are consistent with the related cleared products.

(i) Netting Arrangements

Effective netting arrangements lower systemic risk by reducing both the aggregate requirement to deliver margin and trading costs for market participants. Many market participants currently have netting agreements in place that allow them to net initial and variation margin amounts across many different exposures and assets. It is important for the HKMA and SFC to ensure that any margining regime permits market participants to net across a wide variety of offsetting exposures with their counterparties because, in addition to reducing aggregate counterparty credit risk and lowering trading costs, it would: (i) allow entities to make efficient use of their capital; (ii) provide market participants as well as the HKMA and SFC with better transparency as to the overall amount of counterparty risk between two parties, which is informative of risk in the derivatives market; and (iii) reduce complexity and settlement risk.¹⁶ In contrast, without adequate allowances for netting, any proposed margin requirements would drain liquidity from the OTC derivatives markets as participants seek other execution strategies to prevent the over-collateralization of otherwise offsetting positions. Therefore, MFA respectfully urges the HKMA and SFC to allow for such broad netting arrangements if they decide to adopt margin requirements for uncleared transactions.

(ii) Margin Approaches

MFA believes it is important that if the HKMA and SFC impose margin requirements, those requirements promote margin practices that are fair and understood by all market participants. Accordingly, we suggest that initial margin requirements should be determined in a transparent way that allows both parties to a derivatives transaction to determine independently the applicable margin. The ability of clients to replicate initial margin models enables them to anticipate how margin might change over the life of the transaction and how much they should hold in reserve. Such replicability is fundamental to conducting capital planning and underlies a client's ability or inability to devote its resources strategically to other investments or obligations.

However, it is equally important that the HKMA and SFC preserve some flexibility as to the margin approaches that they permit market participants to use. Specifically, we recommend that any proposed margin requirements not mandate the use of any particular method for determining initial margin amounts. Rather, MFA believes that, in setting any margin requirements, the HKMA and SFC should set minimum standards for all margin determinations that promote fairness and transparency, but should otherwise permit the parties to the transaction to negotiate the selection of an approach or calculation tool that best suits them.

¹⁶ Conversely, placing an artificial prohibition on offsetting margin requirements for cleared and uncleared derivatives transactions will impede a voluntary transition to the use of clearing.

(iii) Liquidation Time Horizons

MFA understands that, in setting initial margin for uncleared transactions, arguably the margin requirements must be equal to or greater than margin requirements for comparable cleared transactions, since uncleared transactions may involve greater risks. Thus, we realize why the HKMA and SFC might want to use a liquidation time horizon for uncleared transactions that is much greater than for its cleared counterparts. However, we believe that an uncleared transaction is unlikely to be substantially less liquid than a comparable cleared transaction prior to the implementation of the proposed mandatory clearing obligation, and may not be less liquid after the mandatory clearing obligation's implementation. Therefore, in our opinion, it is appropriate to use liquidation horizons for the margin requirements for uncleared transactions that are consistent with the related cleared products.

IV. Segregation and Portability

MFA agrees with the HKMA and SFC that a "key aspect of indirect clearing (or client clearing) is to ensure portability and segregation of client positions and collateral".¹⁷ We also appreciate the HKMA's and SFC's willingness to review the existing insolvency override provisions and other protections under Part III of the Securities and Futures Ordinance (Cap. 571) to determine whether changes are necessary to support client clearing as well as any segregation and portability arrangements established by designated CCPs.¹⁸

MFA supports and has consistently advocated for measures aimed at increasing protections for client collateral as well as the portability of cleared client contracts.¹⁹ We believe that the segregation of client initial margin, including in a segregated account or other form permitted under applicable regulation, from the proprietary assets of a CCP or clearing member is a critical component to the effective functioning of the mandatory clearing obligation. In particular, such segregation protections are important to ensure the protection of client assets in the event of the CCP's or clearing member's insolvency.

In addition, we support fostering efficient portability of client collateral and positions because such transferability greatly reduces client and systemic risk associated with the trading

¹⁷ Consultation at 34.

¹⁸ *Id.* at 35.

¹⁹ See MFA's comment letter to the CFTC on its Notice of Proposed Rulemaking on "Protection of Cleared Swap Customer Contracts and Collateral; conforming Amendments to the Commodity Broker Bankruptcy Provisions", 76 Fed. Reg. 33818 (Jun. 9, 2011) dated August 8, 2011, available at <http://comments.cftc.gov/PublicComments/ViewComment.aspx?id=48013&SearchText=>; MFA's comment letter to the CFTC on its Advanced Notice of Proposed Rulemaking on "Protection of Cleared Swap Customers Before and After Commodity Broker Bankruptcies", 75 Fed. Reg. 75162 (Dec. 2, 2010) dated January 18, 2011, available at <http://comments.cftc.gov/PublicComments/ViewComment.aspx?id=27165&SearchText=>; MFA's letter to the U.S. Securities and Exchange Commission, U.S. Treasury and U.S. Commodity Futures Trading Commission dated December 23, 2008; MFA's written statement before the U.S. House of Representatives Committee on Financial Services' hearing entitled, "Reform of the Over-the-Counter Derivatives Market: Limiting Risk and Ensuring Fairness" on October 7, 2009; MFA's letter to the U.K. House of Lords dated February 1, 2010, available at <http://www.managedfunds.org/wp-content/uploads/2010/02/House-of-Lords-Derivatives-Letter-FINAL.pdf>; MFA's letter to the U.S. Treasury dated February 12, 2010, available at <https://www.managedfunds.org/wp-content/uploads/2010/02/Bankruptcy-Letter-to-Deputy-Secretary-Wolin-final.pdf>.

of derivatives through a CCP. Permitting portability allows clients to move cleared transactions without incurring incremental costs or encountering the various operational, accounting, tax and legal issues that would arise if the client had to terminate and recreate those positions with another clearing member. In addition, the ability to quickly transfer client positions not only limits such client's exposure to market fluctuations by minimizing the period between the default of a clearing member and the reestablishment of the client's position, but also minimizes any disruption or dislocation in the derivatives markets.

Based on our review of Part III of the SFO, it appears that each recognized clearinghouse establishes its own rules to address what occurs in the event of a clearing member's actual or potential default or insolvency.²⁰ To the extent permissible under Hong Kong law and practicable from a cost and risk management perspective, we encourage the HKMA and SFC to require each CCP to segregate client initial margin in accounts that are separate and apart from the assets of the clearing member, CCP or their affiliates, and also completely remote from the insolvency of such clearing member.

V. Designation and Regulation of CCPs

1. Designation of CCPs

In the Consultation, the HKMA and SFC express concern about permitting overseas CCPs to clear transactions in domestic products that are of systemic importance as part of their hesitation to allow CCPs organized outside of Hong Kong to become designated CCPs for purposes of any mandatory clearing obligation in Hong Kong.²¹

MFA has a strong interest in ensuring that any regulatory reform in Hong Kong addresses counterparty and systemic risk, while permitting access to, and competition among, CCPs. Therefore, we are concerned that if the HKMA and SFC do not permit foreign CCPs to become designated CCPs, there is potential that the derivatives market will become fragmented along jurisdictional lines. Such segmentation could cause significant harm to the markets by, among other things, impeding competition, impairing portability and eventual interoperability, limiting participant access to clearing and their ability to operate in certain jurisdictions, and ultimately creating artificial barriers across a global marketplace and instrument type.

While MFA respects the HKMA's and SFC's concerns, we believe that the HKMA and SFC could resolve these concerns through coordination with regulators in the relevant CCPs' jurisdictions on the designation procedures, with the view toward encouraging cross-border efficiency and consistency. For that reason, we encourage the HKMA and SFC to allow designation of CCPs organized outside of Hong Kong for purposes of the mandatory clearing obligation, and we respectfully request that the HKMA and SFC ensure that such CCP designations do not become unreasonably difficult to obtain.

²⁰ Part III(40)(2)(a) of the SFO.

²¹ Consultation at 33-34.

2. Regulation of CCPs

In the Consultation, the HKMA and SFC reference leveraging “on the existing provisions and frameworks that govern the regulation of CCPs”.²² As experienced and active market participants, MFA’s members recognize that the success of the mandatory clearing obligation will depend on the structure, governance and financial soundness of CCPs. Accordingly, we emphasize the need for CCPs, wherever applicable, to have transparent and replicable risk models and straight-through, real-time processing that enable fair and open access in a manner that incentivizes competition and reduces barriers to entry.

Real-time processing and acceptance of transactions is a critical component to the implementation of the mandatory clearing obligation because it gives market participants certainty of clearing immediately following execution, thereby allowing them to hedge more efficiently and maintain balanced risk management. Real-time acceptance also promotes open, competitive markets and access to best execution by giving parties to a cleared trade immediate certainty that they will face the CCP, thus eliminating the need to negotiate individual credit agreements with each of their counterparties.

From the perspective of protecting clients and promoting clearing, we believe it is also important to have non-dealer, client representation on the governance and risk committees of CCPs because given the critical decisions such committees will make (e.g., decisions about which classes of derivatives transactions the CCP is permitted to clear), they will benefit from the perspective of such significant and longstanding market participants. We also believe that to completely effectuate fair representation and balanced governance, it is critical that the HKMA and SFC prohibit CCPs from having any one group constitute a controlling majority of CCP boards or risk committees. In our view, measures that require non-dealer client representation and balanced governance will foster transparency and confidence in CCPs.

VI. International Harmonization

MFA greatly appreciates the HKMA’s and SFC’s recognition of the global nature of the OTC derivatives markets and the efforts of other countries to implement their G20 commitments as well as Hong Kong’s “endeavours to ensure that its financial markets’ regulation is on a par with international standards”.²³ To assist with the HKMA’s and SFC’s development of a robust and internationally consistent regulatory regime for OTC derivatives, in this letter, we have identified some areas where we think it is important for the HKMA and SFC to harmonize the proposals in the Consultation with the proposed regulatory regimes in other jurisdictions.

As a general matter, MFA supports an internationally coordinated approach to regulation that ensures consistent regulation, reflects the global nature of the OTC derivatives markets and promotes competition and innovation. In that vein, we respectfully request that the HKMA, SFC and Hong Kong policymakers coordinate with their counterparts in other jurisdictions to ensure that any regulatory reform is consistent, where applicable, and addresses counterparty and systemic risk, while promoting competition and limiting duplicative regulation.

²² *Id.* at 33.

²³ *Id.* at 6-8 and 43-44.

While we recognize that the Hong Kong regulatory regime for OTC derivatives may need to diverge from similar laws promulgated in other jurisdictions, we strongly encourage the HKMA, SFC and Hong Kong policymakers to maintain an open dialogue with their global counterparts and actively work toward developing harmonized regulations. Substantive regulatory differences may unintentionally and adversely impact the OTC derivatives markets by creating confusion or multiple standards that result not from necessity, but rather custom or insufficient attention. Our concerns about this potential disharmony extend to, among other areas, recognition of CCPs organized in countries outside of Hong Kong, transaction reporting requirements and protections related to collateral segregation and portability.

We recognize that it is not solely the responsibility of the HKMA, SFC or Hong Kong policymakers to ensure that international coordination and harmonization of OTC derivatives regulation proceeds in a thoughtful and expedient manner; therefore, we have made similar comments to regulators and policymakers in others jurisdictions as well.²⁴ We want to emphasize that ensuring that regulations are consistent wherever possible, will serve both the global development of the market as well as the ability of all regulators to oversee it effectively.

MFA thanks the HKMA and the SFC for the opportunity to provide comments regarding the proposals in the Consultation. We strongly support the efforts of the HKMA and SFC to develop a regulatory framework for OTC derivatives transactions that will provide for appropriate levels of investor protection and for a pragmatic approach to encourage clearing. We would welcome the opportunity to discuss our views in greater detail. Please do not hesitate to contact with any questions the HKMA, SFC or their respective staffs might have regarding this letter.

Respectfully submitted,

²⁴ See MFA's written statement before the U.S. Senate Committee on Agriculture, Nutrition and Forestry's hearing entitled "One Year Later - The Wall Street Reform and Consumer Protection Act - Implementation of Title VII" on June 15, 2011, available at <https://www.managedfunds.org/wp-content/uploads/2011/11/Senate-AG-Committee-Written-Testimony-FINAL-6-15-11.pdf>; and MFA white paper to European regulators and policymakers entitled "MFA's Response to Proposed Regulation of OTC Derivatives, Central Counterparties and Trade Repositories" dated November 11, 2010, available at <https://www.managedfunds.org/wp-content/uploads/2011/11/Final-MFA-White-Paper-EC-Derivatives-Proposed-Regulation.pdf>.