CME Group

VIA E-MAIL AND ONLINE SUBMISSION

28 November 2011

Hong Kong Monetary Authority
mdd@hkma.gov.hk

Securities and Futures Commission
http://www.sfc.hk/sfc/html/EN/speeches/consult.html

Re: Consultation Paper on the Proposed Regulatory Regime for the Over-the-Counter Derivatives Market in Hong Kong

Ladies and Gentlemen:

CME Group Inc. (CME Group), on behalf of its subsidiaries Chicago Mercantile Exchange Inc. (CME) and CME Clearing Europe Ltd. (CMECE), would like to express appreciation to the Hong Kong Monetary Authority (HKMA) and the Securities and Futures Commission (SFC) for the opportunity to comment upon their consultation paper on the proposed regulatory regime for the over-the-counter (OTC) derivatives market issued in October 2011 (the Consultation Paper). CME's clearing house division (CME Clearing) offers clearing and settlement services for exchange-traded futures contracts, and for OTC derivatives through CME ClearPort. CME is registered with the U.S. Commodity Futures Trading Commission (CFTC) as a derivatives clearing organization (DCO). CMECE is authorized by the U.K. Financial Services Authority as a recognized clearing house. At present, CMECE offers clearing services for certain OTC commodity derivatives.

CME Group is also the parent company of the Chicago Board of Trade (CBOT), the New York Mercantile Exchange (NYMEX) and the Commodity Exchange (COMEX), which are registered with the CFTC as designated contract markets and/or DCOs. CME, CBOT and NYMEX are authorized automated trading services (ATS) providers in Hong Kong.

The Consultation Paper contains the HKMA's and SFC's current thinking on key aspects of developing a regulatory regime for the OTC derivatives market in Hong Kong. Issues addressed in the Consultation Paper reflect the G20 Leaders commitments to regulatory reforms that would require:

1. mandatory reporting of OTC derivatives transactions to trade repositories;
2. mandatory clearing of standardized OTC derivatives transactions through central counterparties (CCPs);
3. mandatory trading of standardized OTC derivatives transactions on exchanges or electronic trading platforms, where appropriate; and
4. imposition of higher capital requirements for OTC derivatives transactions that are not centrally cleared.

This letter focuses on those portions of the Consultation Paper relating to the designation and regulation of CCPs.

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1. *Requirement to be an RCH or authorized ATS provider*

The Consultation Paper sets forth a proposal to introduce a mandatory clearing obligation in Hong Kong whereby specified OTC derivatives transactions would be required to be cleared through a designated CCP,[1] subject to certain exemptions.[2] CME Group strongly supports the proposal to allow both recognized clearing houses and authorized ATS providers to be designated CCPs for purposes of the mandatory clearing obligation. As noted in the Consultation Paper, utilization of the existing ATS regime under Part III of the Securities and Futures Ordinance (amended as necessary to cover OTC derivatives transactions) is particularly suited to overseas CCPs, such as CME and CMECE, that meet international standards for regulation of OTC derivatives clearing houses and are primarily regulated in their home jurisdiction.

Allowing ATS providers located abroad to be designated CCPs for purposes of the mandatory clearing obligation is consistent with observations in CPSS-IOSCO's May 2010 consultative report entitled *Guidance on the application of the 2004 CPSS-IOSCO Recommendations for Central Counterparties to OTC derivates CCPs*, which states:

> As the international regulatory community promotes greater use of CCPs for OTC derivatives markets, a growing number of market participants are likely to seek access to OTC derivatives CCPs abroad especially if there are no feasible domestic alternatives. OTC derivatives clearing may involve a number of OTC derivatives CCPs and third-party service providers located in different jurisdictions or even different regions of the world.[3]

As further observed in CPSS-IOSCO's May 2010 consultative report, "[g]reater use of CCPs for OTC derivatives will increase their systemic importance."[4] Successful management of systemic risk will require a regulatory regime that incorporates appropriate measures whereby more than one designated CCP may be utilized for purposes of the mandatory clearing obligation. CME Group believes that this can be best accomplished by allowing both recognized clearing houses and authorized ATS providers to be designated CCPs, as proposed.

2. *Location requirement*

The HKMA and the SFC have requested comment on whether only domestic CCPs should be designated to clear transactions in domestic products that are of systemic importance. The Consultation Paper notes that the Australian Council of Financial Regulators has expressed concerns about a mandatory clearing requirement that results in a systemically important domestic market, such as Australian dollar-denominated interest rate derivatives, being cleared through offshore CCPs. Those concerns are predicated on assumptions that use of offshore CCPs for such markets would introduce risks to the

[1] The HKMA and SFC propose that the mandatory clearing obligation initially would apply to certain types of interest rate swaps and non-deliverable forwards, and would be extended in phases to cover other interest rate and foreign exchange derivatives, and other asset classes such as equity derivatives.
[2] As proposed, an exemption would be given where: (a) both counterparties to the transaction are overseas persons (*i.e.,* persons who are not Authorized Institutions, Licensed Corporations or Hong Kong persons); and (b) the transaction is (i) subject to mandatory clearing under the laws of an acceptable overseas jurisdiction and has been centrally cleared in accordance with those laws, or (ii) exempted from mandatory clearing under those laws.
[3] CPSS-IOSCO May 2010 consultative report, at 9.
[4] *Id.* at 1.

domestic financial system that do not exist,[5] and that domestic regulators "would have less scope to oversee offshore CCPs relative to domestic ones, and to respond as needed in conditions of stress."[6]

CME Group does not believe that limiting clearing of systemically important markets to domestic CCPs would necessarily decrease systemic risk. The more prudent approach, and the one suggested in the Consultation Paper, is to ensure that any designated CCP – whether domestic or foreign – meets international standards for regulation of OTC derivatives CCPs, such as those put forth by CPSS-IOSCO. Moreover, under the current proposal, in order to be a designated CCP for purposes of the mandatory clearing obligation, an overseas CCP would have to be an authorized ATS provider in Hong Kong. As such, an overseas CCP clearing transactions in domestic products that are of systemic importance would be subject to regulation and oversight by the HKMA and/or the SFC, in addition to the regulation and oversight it receives from one or more regulators in its home jurisdiction. Any concerns regarding lack of sufficient regulatory authority over ATS providers that clear systemically important domestic products would be best addressed through appropriate amendments to the existing ATS regime.

CME Group thanks the HKMA and the SFC for the opportunity to comment on this matter. If you have any comments or questions with respect to this submission, please feel free to contact

Sincerely,

[5] We note that CME has been clearing Australian Dollar futures (which go to physical delivery four times per year) for nearly 25 years, without incident.
[6] *Central Clearing of OTC Derivatives in Australia: A discussion paper issued by the Council of Financial Regulators* (June 2011), at 3.