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Dear Sirs

AIMA response to the Consultation Paper on the Securities and Futures (OTC Derivative Transactions - Reporting and Record Keeping Rules)

The Alternative Investment Management Association (AIMA) welcomes the opportunity to provide comments on the Hong Kong Monetary Authority (HKMA) and Securities and Futures Commission (SFC) (together, the Authorities) Consultation Paper on the Securities and Futures (OTC Derivative Transactions - Reporting and Record Keeping Rules) in Hong Kong (the Consultation).

About the Alternative Investment Management Association

The Alternative Investment Management Association (AIMA) is a global hedge fund association with over 1, 400 corporate members (with over 7,000 individual contacts) worldwide, based in over 50 countries. Members include hedge fund managers, fund of hedge funds managers, prime brokers, legal and accounting firms, investors, fund administrators and independent fund directors. AIMA's manager members manage a combined US$1.5 trillion in global assets (as of March 2014).

General comments relating to matters raised in the consultation paper

AIMA members are active participants in the global derivatives markets, using derivatives for investment and hedging purposes; and our members (both those established domestically and outside of Hong Kong) are also active in the Hong Kong market.

AIMA supports the Authorities' proposals to implement the G20 commitments, however we have reservations as to whether aspects of the reporting regime, as detailed in the Consultation, will be effective in their implementation. In particular, the method of including LCs in this reporting regime raises some significant concerns. Fund managers would face a reporting obligation in Hong Kong that they do not face in the United States or European Union (either because their counterparties carry the sole responsibility to report, as in the United States; or because their counterparties are readily willing to take on such responsibility). As a result, many fund managers do not currently perform any OTC reporting and face the prospect of needing to implement reporting solely for the benefit of Hong Kong, even though their OTC derivatives activity is, via their counterparties, already reported in other jurisdictions. Consequently, smaller entities would be disproportionately affected by reporting in Hong Kong versus elsewhere. Furthermore, the proposed regime is less flexible than regional regimes in Australia and Singapore in several different aspects. As discussed in more detail below, while LCs can rely on various counterparties and service providers to report in other jurisdictions, they may not benefit

from similar assistance in Hong Kong or on cost-effective terms (if at all). Our view is that these higher costs, coupled with the imposition of reporting on smaller entities, may adversely affect the implementation of OTC reporting in Hong Kong.

For these reasons, we would recommend structural changes to this proposal. In particular, we would recommend that:

(1) LCs should benefit from phased-in compliance with reporting obligations;

(2) An exemption for smaller LCs should be created; and

(3) The regime should be made more flexible and could be better harmonized with global efforts to implement OTC reporting. In particular, we urge the Authorities to consider implementing a form of "substituted compliance" and permit reporting to TRs outside of Hong Kong as a means of complying with local reporting obligations.

As discussed further herein, we believe that the resources required for LCs to implement reporting have been underestimated, and that, without such changes, reporting will not be feasible for many market participants.

LCs Are Unlikely to Receive Assistance

In other jurisdictions, LCs' counterparties alone perform reporting. This is true both in "one-sided reporting" jurisdictions, such as the United States (where the reporting obligation generally falls upon large institutions), and "two-sided reporting" jurisdictions, such as the European Union (where fund managers typically delegate their reporting obligations to their counterparties).

LCs' counterparties are often directly subject to reporting requirements in the EU. As a result, such counterparties incur little additional cost when providing EMIR reporting services on behalf of LCs. But many of these counterparties will not be subject to reporting under the Consultation as their trades are not "conducted in Hong Kong." Consequently, while the Consultation makes clear that delegation of reporting obligations is permissible, it is unrealistic to expect that EU-based counterparties will offer reporting services in Hong Kong for a comparable price. Initial discussions indicate that counterparties are yet to determine whether they will be able to provide Hong Kong reporting services on behalf of LCs at all.

Equally, LCs may not be able to rely on existing HKTR members to perform reporting. The existing HKTR members are not those typically used as counterparties by the hedge fund industry. It is unclear whether such HKTR members could provide reporting services to parties with whom they are not counterparties. Even if they were to agree, trade data confidentiality requirements, privacy and record keeping requirements may render the price for such services substantially higher than any other developed market. Furthermore, as non-counterparties, the HKTR members would not have direct access to trade-level data and therefore may not be able to guarantee its accuracy. As it stands, we believe there are only two reporting agents that can act on the industry's behalf—and they will face considerable capacity constraints. Even in those jurisdictions where there were significant financial incentives to offer reporting, the market for reporting services has developed slowly and with notable 'growing pains'. For example, EMIR reporting services, offered by market leading data reporting companies, were delayed and experienced significant technical difficulties. Consequently, it may not be realistic to expect reporting services to be available to LCs on Day 1 of Hong Kong's reporting regime.

While delegation is essential, LCs must possess a high degree of comfort with their delegates, particularly where the delegate may not be a counterparty. It is unclear as to how such delegates will guarantee the accuracy of reportable information (especially when LCs do not have access to all required information themselves ie: order IDs etc). We would request that any required supervision over third-party reporting

agents be commercially reasonable. In some cases, LCs may not wish to share reporting information with possible delegates, as it might result in the disclosure of confidential trading information.

If existing TR members are unsuitable or cannot act as reporting agents, LCs may instead need to report directly. However, the process of applying to be a TR member could be cumbersome: even for larger financial institutions, the process has involved establishing new data sourcing processes and has taken significant time to complete. We are concerned that the application process was originally designed for financial institutions and bespoke data providers, and it is unclear as to whether the membership documents are negotiable. As a result of these factors, and because of the differences typically seen between many AIs and LCs, the process is likely to take longer for LCs. Furthermore, it is unclear as to what technical criteria HKMA will use to approve TR membership for LCs (the existing criteria may be cost-prohibitive for LCs). In particular, under Clause 5.1.3 of the HKTR reporting service agreement, each user must have "experienced, trained, qualified and skilled [employees] for the purpose of accessing and using the Reporting System". At an LC this may involve increased headcount or additional training: such costs may be prohibitive for smaller LCs. Furthermore, Clause 2.3 gives HKMA absolute discretion to "vary, suspend or terminate the Reporting Service by giving prior written notice to the Member". Because "prior written notice" is not defined, LCs face the prospect of losing TR membership without being given appropriate time to determine alternative solutions.

Specific Relief Requested

Phased-In Reporting

Because of the unique features of Hong Kong's reporting regime, market participants will be required to develop various new IT processes. Fund managers may also need to hire additional headcount to respond to the regime (entities subject to Dodd-Frank and EMIR reporting had to do so). The industry's experience with other OTC reporting regimes suggests that putting reporting systems in place is costly, even for large institutions that can allocate costs across different business lines and draw on institutional knowledge from existing reporting regimes. In order to implement reporting cost-effectively, AIMA supports the introduction of phased-in reporting obligations, first on AIs and AMBs, and later to LCs.

We acknowledge that the Authorities have a mandate to implement OTC derivatives reporting in a timely manner. We support this goal. We further acknowledge that certain AIs have already begun interim reporting and that, in implementing reporting only for certain IRSs and NFDs, the regime is, in a sense, already conducted in phases. However, we do not believe these aspects of the reporting regime ameliorate the acute challenges that the hedge fund industry faces.

Phased-in reporting can allow the AIs and AMBs, who typically have greater resources, to work out any technical issues first, ahead of reporting being extended to small market participants. But for a phase-in to be effective, market participants must have final rules and technical specifications. The interim reporting regime does not meet this criterion. We are concerned that the experience HKTR members have gained from reporting thus far falls short of the detailed trouble-shooting that entities in other jurisdictions have undertaken after the final rules are implemented. Nor does the interim reporting regime assist LCs with the creation of the IT processes necessary to implement their own reporting—such processes cannot be created until final rules and technical specifications are released. In other jurisdictions (even those that provide for substituted compliance), market participants have generally had a year *or more* after the adoption of final rules, before the reporting requirements commence. Furthermore, as discussed above, the interim reporting regime has not yet spurred the creation of a usable reporting service for the hedge fund industry. Existing HKTR members may not be able or be suited to provide reporting, and prime brokers remain uncertain as to whether they can provide such services on a cost-effective basis.

Accordingly, we propose that a staggered reporting schedule be created (as was done in Singapore) that will apply reporting first to AIs and AMBs, and then, at a minimum, six months later to LCs. In addition, we request that the rules not be implemented sooner than a year following their publication in final

form. A number of OTC reporting regimes come more fully into effect next year, and it would be prudent to stagger the implementation of Hong Kong's regime to ensure its smooth roll-out.

Relief for Small LCs

Given that we expect the costs associated with reporting in Hong Kong to be higher than in any other developed jurisdictions, we support the creation of an exemption for small LCs. We note that regional peers, such as Singapore, have implemented the same.[1] Such exemption would cover Type 9 managers with managed assets not exceeding HKD50 billion. Smaller managers are unlikely to be systematically important. Even to the extent that they are, these small LCs are likely to use international or local AIs already required to report, eliminating the risk of OTC transactions going unreported. As noted in the October 2011 consultation, "the HKMA and SFC should be able to obtain information on transactions by overseas persons".[2] We believe it is therefore unreasonable to impose the higher cost of Hong Kong's unique reporting system on small LCs, when their reporting may actually often be redundant.

Increased Harmonization and Flexibility

The Consultation proposes a regime that differs significantly from other reporting regimes: it lacks a provision for substituted compliance (provided for in the United States, European Union, Singapore, and Australia) and does not feature a true phased-in reporting (as in the United States, European Union, Singapore, and Australia). Even with the more flexible features of other regimes, the implementation of OTC reporting has been difficult. We are concerned that the proposed reporting regime will compound these difficulties if it does not, at a minimum, feature the same flexibility.

We support the introduction of a "substituted compliance" framework, similar to that provided for in other regional jurisdictions. Under such a framework, a party would not be required to report if: (a) the other party (or the principal) is in a "substituted compliance jurisdiction" and (b) it has complied with the requirements relating to the reporting of the HK-reportable derivatives under the laws of that substituted compliance jurisdiction.[3] Such a framework would respect the principles of comity and encourage other jurisdictions to recognize Hong Kong as a substituted compliance jurisdiction. We acknowledge the Authorities' desire to have the requisite information reported to the HKTR; however we believe the most direct, simple and cost-effective manner for the Authorities to access such information is to enhance information sharing between regulators. Such sharing would involve a relatively small number of parties and pose fewer technical issues; we feel that this would be preferable to imposing reporting on a substantial number of LCs and gathering information that may already be available to the Authorities via other reliable and cost-effective means.

Similarly, we believe that allowing market participants to report to other TRs (numerous jurisdictions have suitable TR reporting services) may also alleviate any TR bottleneck. At a minimum, market participants should be permitted to report to third-party TRs for an interim period, whilst the Authorities continue to assess the readiness of reporting services to the HKTR.

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1 Singapore Securities and Futures Act (Chapter 289), Securities and Futures (Reporting of Derivatives Contracts) (Exemption) Regulations 2014.

2 Consultation paragraph 85.

3 Singapore Securities and Futures Act (Chapter 289), Securities and Futures (Reporting of Derivatives Contracts), Section 128.] Australia RG 251.29: reporting is not required if "another entity reports information that is substantially equivalent (see RG 251.53) to the derivatives transaction information in accordance with a foreign reporting obligation."

Finally, we support the harmonization of data fields for OTC reporting. Where jurisdictions have not followed the principle of harmonization, it has increased costs and resulted in the industry needing to duplicate efforts from various jurisdictions rather than building on them.

Additional Issues - Reporting Obligations Generally

We welcome the acknowledgement in Consultation paragraph 133 that delegation of reporting is permissible. We respectfully request that this concept be embedded in the final rules to give third-party service providers greater certainty about the legal status of providing reporting services. Any such clarification should indicate that delegation is permissible to *any* person and not only to TRs.

We also propose that "single-sided" reporting be permitted, as in other regional jurisdictions. The reporting obligation should be extinguished for both counterparties whenever a person, in fact, reports to the HKTR (or any TR under substituted compliance), regardless of whether such person is a party to a transaction or a reporting entity. If single-sided reporting is not permitted, LCs will face difficulties in obtaining necessary information: for example, execution and clearing details, such as order IDs and clearing IDs, in many cases will not be in a fund manager's possession. As with EMIR, the Hong Kong reporting regime should acknowledge that not all fields may be completed, and LCs should only have to report transaction information related to the economics of the trade.

Consultation paragraph 135 states that the HKMA may publish reporting guidelines on its website, which will provide information on the form and manner for reporting via the HKTR. We would ask that such information, particularly technical details, be circulated for consultation as soon as possible. As noted above, the processes needed to implement reporting depend greatly on these details, and significant parts of the planning process cannot be undertaken until their release.

Annex

Section B: OTC Derivative Transactions that will be subject to Mandatory Reporting

3. Do you have any comments or concerns as to how IRS and NDF are proposed to be defined in Part 1 of Schedule 1 to the Draft Rules, or how the reportable transactions, or the class to which they belong, have been described in Part 3 of Schedule 1?

Reportable IRSs and NDFs will initially include only contracts referencing currencies, floating rate indices and precious metals specified by the HKMA and supported by the HKTR. We request that such HKMA specification occur as soon as possible so that market participants have sufficient advance notice to determine whether (1) they use reportable IRSs and NDFs, (2) third-party reporting services are available, and (3) they are able to build IT processes to capture the necessary information.

We note that the term "specified currency" may cause confusion because it also includes precious metals.[4] We recommend instead the use of a term such as "reference asset" (defined to include currencies and precious metals).

Section C: Reporting Obligations of AIs, AMBs and LCs

4. Do you have any comments or concerns about how the terms "conducted in Hong Kong" and "affiliate" are proposed to be construed, or how this limb of the reporting obligation is cast? In particular, do you have concerns as to how this proposal might impact entities that keep a global book?

While AIMA welcomes the simplification of the Hong Kong nexus concept, we wish to reiterate our belief that substituted compliance should be available. Entities that keep a global book are already subject to OTC reporting obligations elsewhere (occasionally under multiple regimes). Because of this, we support the introduction of a "substituted compliance" framework, similar to those frameworks provided for in other regional jurisdictions. Under this framework, no reporting would be required if the other party (or the principal) (a) is in a "substituted compliance jurisdiction" and (b) has complied with the requirements relating to the reporting of the HK-reportable derivatives under the laws of that substituted compliance jurisdiction.

We would also welcome clarification of Draft Rule 4(b)(ii). The rule provides that a trade is conducted in Hong Kong if it is "entered into" by a trader who performs a "substantial part of his or her duties in Hong Kong". We suggest that this requirement be clarified to include only a trader who has worked in Hong Kong for more than 46 days of the preceding quarter and who is officially seconded or employed by the Hong Kong entity. We further suggest that the rule explicitly excludes "execution only" services from the definition of "entered into". Finally, we note that the term "trader" may cause confusion in the industry, as it frequently refers to individuals who perform execution-only functions. We suggest that the term "portfolio manager" be used instead.

[4] Schedule 1, Part 1, Section 1 "specified currency ( ) means a currency or precious metal that is specified by the Monetary Authority by notice in the Gazette."

5. Do you have any comments or concerns about how we have cast the proposal that AIs and LCs that are registered/licensed for Type 9 RA must report transactions that they have entered into in their capacity as fund managers?

Exemption for Small Managers

Because of the costs associated with reporting in Hong Kong, we support the creation of an exemption for small LCs. We note that regional peers have done the same.[5] Accordingly, we would propose that the Authorities create an exemption for Type 9-licensed managers with managed assets not exceeding HKD50 billion.

Phased-In Implementation

As noted in our introduction, the proposed reporting regime would result in reporting by much smaller entities than in other jurisdictions. In our view therefore, the case for phased-in implementation is even stronger in Hong Kong than elsewhere. We propose that a staggered reporting schedule be created (as was done in Singapore and Australia) that will apply reporting first to AIs and AMBs, followed by LCs six months later. In addition, we request that the rules not be implemented sooner than a year following their publication in final form. A number of OTC reporting regimes come more fully into effect next year, and it would be prudent to stagger the implementation of Hong Kong's regime to ensure its smooth roll-out.

Reporting Hierarchy

We support the Authorities' goal of reducing duplication of reporting and facilitating the aggregation of data across jurisdictions. Accordingly, we believe that the final rules should include a "reporting hierarchy" that places primary reporting responsibility on those entities with greater financial and institutional means to implement OTC reporting. We note the Authorities' concerns in their 2011 Consultation that such a hierarchy may be complex. Therefore, we would propose a simple hierarchy as follows:

1. If an AI/AMB is a counterparty (or is acting on behalf of a counterparty) to a reportable transaction and the other counterparty is not an AI/AMB, then the AI/AMB should have sole primary responsibility for reporting.

2. If an LC is a counterparty (or is acting on behalf of a counterparty) to a reportable transaction, and the other counterparty is not an AI, AMB or an LC, then the LC should have sole primary responsibility for reporting.

3. If a Hong Kong person is a counterparty to a reportable transaction, and the other counterparty is an AI, AMB or an LC, then the AI, AMB or LC should have sole primary responsibility for reporting.

4. In all other situations, both parties shall have shared responsibility for reporting.

We note that the Consultation already includes an element of this hierarchy (i.e., the exemption from reporting for Hong Kong persons when the other party is an AI, AMB or LC). We also note the Authorities' desire to have two-sided reporting as a "check and balance". With respect to cleared trades, the Authorities will already receive duplicated reporting from the reporting at the counterparty and clearing entity levels. We note that the HKTR has been designed to match trades between counterparties. However, many trades will not have matches because the counterparty is outside of Hong Kong. Given that unmatched transactions will be routine, the structure of the HKTR should not in itself be a reason

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5 Please note the Singapore's OTC regime has recently implemented such an exemption. Singapore Securities and Futures Act (Chapter 289), Securities and Futures (Reporting of Derivatives Contracts) (Exemption) Regulations 2014.

for two-sided reporting. We note that other jurisdictions have been accepting of single-sided reporting (either by regulation, as in the United States, or de facto, with the right to delegate under EMIR).

We would suggest that a reporting hierarchy should be combined with a substituted compliance regime: for example, if a non-Hong Kong bank has, in fact, reported a transaction in another jurisdiction, such reporting should extinguish the obligations of an LC for that transaction.

"Enters Into"

We would appreciate clarification of the term "enters into a transaction on behalf of the other person." The Consultation provides that "enters into a transaction" refers to transactions where an "LC had full discretionary and authority to agree the terms of the transaction" and notes that "[a] particular focus here was to capture transactions entered into by fund managers who negotiate transactions on behalf of the funds they manage".

We request that the final rules clarify that "entering into a transaction" refers to a situation where an AI/LC negotiates with a counterparty on behalf of a fund that the AI/LC manages.

6. Do you envisage any specific difficulties if this proposal were to be extended to also require an AI or LC that is registered/licensed for Type 9 RA to report transactions that it has advised a counterparty on, i.e., even though it has not entered into the transaction on behalf of that counterparty? If so, please provide details of the specific difficulties envisaged.

We do not support the extension of reporting to AIs or LCs that merely advise counterparties with respect to transactions. Various practical difficulties may arise. For example, AIs and LCs in purely advisory roles may not know the final terms of the transactions, nor even whether the transaction has occurred. They may also lack the means to communicate such information: AIs and LCs in advisory roles may not share trading or technology systems with the manager negotiating such transactions. As a result, it may be costly or impractical to share data. Additional client confidentiality concerns would arise as clients may not have the expectation that a non-discretionary adviser would have access to such data or would be able to share data with regulators.

We would also query the efficacy of such data in the monitoring of systemic risk in Hong Kong. Such trades are not necessarily entered into or booked in Hong Kong (and if they are, then it is likely that other parties will already have reporting responsibilities). We fully support the "conducted in Hong Kong" approach to jurisdiction and note that it would be necessary to revise this concept to cover non-discretionary managers. But any revised definition that includes non-discretionary managers would likely suffer from those same concerns that led to the revisions of the Hong Kong nexus concept initially.

Section D: Reporting Obligations of CCPs

7. Do you have any comments or concerns about how the reporting obligation in respect of CCPs has been cast?

We support the introduction of reporting obligations on CCPs. We believe that centralized reporting provides for a more efficient and robust view of the cleared OTC market than multiple reportings by individual LCs.

Section E: Reporting Obligation of Hong Kong Persons

8. Do you have any comments or concerns about the proposed approach to be taken in respect of the different types of Hong Kong persons?

AIMA welcomes the revised approach to the definition of Hong Kong persons.

9. Do you have any comments or concerns about how the reporting obligation will apply to funds? Do you envisage that funds may face practical difficulties in complying with this obligation? If so, please provide details of the specific difficulties envisaged.

We propose that the exemption in Draft Rule 20 be extended to situations where a fund is not managed by an AI or LC, but where such manager undertakes to report on behalf of the fund. We believe it unnecessary to create duplicative reporting with respect to the same side of any one trade.

10. Do you have any comments or concerns about the proposed methodology for calculating if the reporting threshold or exit threshold has been reached?

AIMA supports this proposal, in particular, the acknowledgement that threshold calculations for sub-funds underneath an umbrella fund structure should be calculated separately.

11. Do you have comments or concerns about the proposed levels of the reporting threshold and exit threshold?

We support the use of reporting thresholds for Hong Kong persons. We would recommend that threshold calculations be performed on the basis of net notional exposure, as it provides a better measurement of risk than gross exposure.

Although we expect that most Hong Kong persons will be able to take advantage of either the reporting hierarchy or these thresholds, we do not believe that Hong Kong persons should be required to report at all, if a counterparty to the transaction is already reporting elsewhere. Accordingly, we support a framework for substituted compliance that would carve-out reporting responsibilities for Hong Kong persons if the counterparty has complied with its reporting obligations in any other substituted compliance jurisdiction.

Section F: Application to Cross Border Transactions

13. Do you have any comments or concerns about the proposed application of the mandatory reporting obligation to cross-border transactions? If so, please provide specific details.

We support the proposal with respect to cross-border trades. In particular, we welcome, with respect to cross-border transactions, the concept that if one counterparty is caught, then there is an obligation to report. However, as noted above, we support the introduction of a "substituted compliance" framework similar to that provided for in Singapore, in order to avoid duplicative reporting and burdensome costs. Under such a framework, a party would not be required to report if: (a) the other party (or the principal) is in a "substituted compliance jurisdiction" and (b) has complied with the reporting requirements with respect to the Hong Kong-reportable derivatives under the laws of that substituted compliance jurisdiction.

Section G: Exemptions and Other Relief from the Reporting Obligation

14. Do you have any comments or concerns about the proposed exemptions and reliefs, and the criteria for triggering them?

Need for Small Manager Relief

As noted above, we propose that the Authorities create an exemption for Type 9-licensed managers with managed assets not exceeding HKD50 billion.

The "Less Active" Exemption and Fund Managers

We are concerned that the "less active" exemption is not available to AIs, AMBs and LCs (in their capacity as principals) that also manage funds. We acknowledge that the Authorities' rationale for this exclusion is "that AIs, AMBs and LCs that participate in such activities [*i.e.* fund management] will likely be more active in the OTC derivatives market". But while this may generally be the case, it does not clarify why an AI/LC that, in fact, is less active in the OTC derivatives market should be precluded from using the exemption. Any AI/LC that meets the other criteria for the "less active" exemption uses, by definition, only a *de minimus amount* of OTC derivatives transactions.

We also acknowledge the Authorities' statement "that AIs, AMBs and LCs that participate in such activities [*i.e.*, fund management] [...] will have to set up the necessary connection with the HKTR for reporting of such transactions anyway." This may not be true in all situations, particularly if delegated reporting or substituted compliance are available; some AIs and LCs will not have HKTR connections. If their derivatives activity otherwise qualifies as "less active", then they should be able to rely on the "less active" exemption. The Authorities have acknowledged that "less active" AIs and LCs "may be discouraged from entering into OTC derivatives transactions at all" or "may be unable to enter into such transaction because they have not set up connections with the HKTR in time." We would draw attention to the fact that this rationale applies equally to AI/LCs that are fund managers.

We also wish to highlight the costs of ongoing compliance with these reporting obligations. We believe that the Authorities are rightly concerned with the timeliness of setting up HKTR connections. But the ongoing costs of reporting should not be underestimated.

The Authorities note that the "less active" exemption has been proposed "to avoid the unintended consequences of an end user not being able to hedge its commercial risks as a result of the mandatory reporting obligation[....]" This rationale applies equally to AI/LCs that are fund managers. Because the Consultation does not have an end-user exemption (as proposed and implemented in other jurisdictions), the "less active" exemption remains the only means for AI/LCs that engage, as principals, in *de minimus* derivatives activity to avoid the costs of both establishing the HKTR connection and ongoing reporting.

The "Less Active" Exemption and Hong Kong Person Counterparties

The Authorities' intention is "to avoid overlap between this ["less active" exemption] and the [Rule 20] exemption proposed for Hong Kong persons." We believe that there may be another way to avoid this overlap: namely, rather than limiting relief whenever a Hong Kong person counterparty is present, we propose to limit this relief only where such Hong Kong person has, in fact, availed itself of the exemption contained in Rule 20.

16. With respect to the relief for AIs, AMBS and LCs that are less active in the OTC derivatives market, do you consider the proposed criteria of 5 transactions per product class, and aggregate gross notional value of US$30 million to be appropriate? If not, please provide specific details of why they may be inappropriate and what alternative criteria should be adopted.

We believe that the 5 transaction limit should be removed. The primary driver of systemic risk is not the number of derivatives transactions, but rather the net exposure of such transactions. The limit can be easily exceeded by even small funds and managers. Because fund shares are often denominated in U.S. dollars and regional investments are denominated in various local currencies, funds and managers may use various currency NDFs to hedge each regional currency. While such use is *de minimus*, it may involve more than 5 transactions. With respect to the US$30 million threshold, we propose that it should be calculated on a net notional basis, as that is a better measure of risk.

We also believe that the "less active" exemption should not be lost on a permanent basis if the exemption thresholds are passed. As noted above, while establishment of connections with the HKTR represents a significant one-time cost, our experience in other jurisdictions suggests that ongoing reporting costs will be significant—particularly for the smaller AIs and LCs that are most likely to use the "less active" exemption. We propose that AIs/AMBs/LCs should be able to regain the exemption if (a) their average net notional derivatives exposure falls below 70% of the threshold (or US$21 million, if the current US$30 million is adopted) as of month-end for the past six months and (b) the AI/AMB/LC expects their average net notional derivatives exposure to remain below the US$30 million threshold for the next twelve months. Without such a proposal, AI/AMB/LCs would lose the exemption permanently, limiting their ability to respond to abnormal market conditions with the occasional use of derivatives.

Section H: Backloading Requirement for Outstanding Transactions

17. Do you have any comments or concerns about how the proposed backloading requirement will apply to transactions outstanding on the starting day? If so, please provide specific details.

We welcome this proposal as drafted. We further note that the backloading exemptions and relief in the Consultation acknowledge many of the same issues (*e.g.*, access to data) that concern us in the Consultation's treatment of the reporting obligations of LCs.

18. Do you have any comments or concerns about the proposal to have different starting days in respect of different types of reportable transactions? If so, please provide specific details.

We support the proposal to have different starting days in respect of different types of reportable transactions. Because each transaction type (and the specific data fields associated with it) will require their own compliance period, it is not practical to have common starting days with respect to a broad variety of reportable transactions.

Section I: Time for Reporting and Grace Periods

20. Do you have any comments or concerns about how the concession period and grace period are proposed to operate?

We believe that the three-month grace period for establishment of a connection to the HKTR is not sufficient. As noted in our introduction, there are currently a limited number of HKTR counterparties, and many of them are not suitable for LC reporting. In some cases, an LC may need to register. However, the application process is currently geared towards institutions, and LCs may experience delays because the membership process is not adequately designed for them. Similarly, as noted above, because Hong Kong's reporting regime would place unique demands on market participants, the market participants

must develop various new IT processes. Fund managers will need to hire additional headcount to respond (indeed, as the much larger banks subject to Dodd-Frank and EMIR reporting have had to do).

Furthermore, three months may not be enough for each new product. We suggest that the grace period should be determined based on a product's complexity, with three months as an absolute minimum. More lead time should be allowed if a product is complicated.

We also note that other regional reporting regimes are expected to be more fully implemented in 2015. Because of these regional issues, LCs are likely to face capacity constraints and struggle to comply initially with HKTR reporting if it is implemented at the same time.

Section J. Form and Manner of Reporting Obligations

22. Do you have any comments or concerns about the proposed types of transaction information required to be reported for the purposes of the reporting obligation, or as to how these have been expressed in Schedule 2?

We respectfully request that more detail be provided with regards to not only the types of transaction information required, but the actual data fields. The precise data fields are necessary in order for market participants to gauge their ability to comply. We also request that the data fields be harmonized with data fields used by other jurisdictions. We fully support attempts to harmonize reporting. Harmonized reporting will increase the probability of Hong Kong enjoying substituted compliance status from other jurisdictions and also increase the likelihood that LCs' counterparties will provide delegated reporting services: overseas banks may not offer HK reporting unless it is substantially similar to the reporting to which they are already subject. As noted above, reporting may be impractical for funds, especially smaller funds, unless such delegation is available on cost-effective terms. Finally, increased harmonization should help limit any unnecessary costs associated with Hong Kong's reporting regime.

23. Do you have any comments or concerns about the proposal to require the reporting of valuation transaction information in the future?

We propose that the Authorities defer consultation on valuation until other jurisdictions have sufficient experience with valuation reporting to identify problem areas.

24. Do you have any comments or concerns about our proposals on how subsequent events are to be reported, and when they will cease to be reportable?

We propose that the definition of "subsequent events" be clarified. The definition is "an event that occurs after a transaction in an OTC derivative product is entered into, and *which affects the product*, the terms or conditions on which the transaction was entered into or the persons involved in entering into the transaction" [*emphasis added*]. The phrase "which affects the product" is somewhat vague and could be interpreted to include market events not in control of the counterparties. Similar rules in other jurisdictions generally define subsequent events to include assignments, novations, exchanges, transfers, amendments, conveyances or extinguishing of rights (other than through normal termination provisions). We propose that the definition be amended to reflect similar concepts. This appears to be in line with the Authorities' intent: Consultation paragraph 128 refers to subsequent events as "changes in the economic terms or counterparty of the contract".

25. Do you have any comments or concerns about the proposals on masking counterparty information under certain circumstances as a temporary measure?

We respectfully request that the list of covered jurisdictions be released as soon as possible to allow parties to obtain the necessary waivers.

Because situations may arise where reporting becomes impossible, due to current events and the covered jurisdiction list not being able to be updated at the same time; we would also propose that a client be allowed to rely on an opinion from legal counsel that reporting is impermissible in a jurisdiction during the interim period prior to the SFC's update of the list.

26. Do you have any comments or concerns about the proposals for subsequently reporting information when the pre-requisites for masking cease to exist?

We broadly support the proposal for subsequently reporting information when masking ceases to apply. We believe that the timelines for implementing reporting are shorter than those required to ensure that such reporting can be fulfilled. The task of identifying individual transactions that are no longer subject to masking will, in many cases, involve the coordination of multiple streams of information and business function. At a minimum, we would request that reporting entities be given four months to begin reporting when the pre-requisites for masking cease to exist (*i.e.*, regardless of whether it is the revocation of the designation or the receipt of consent).

Section M: Proposed Mandatory Record Keeping Obligation

28. Do you have any comments or concerns about the proposed record keeping requirements in relation to mandatory reporting?

To the extent possible, we would suggest that record keeping requirements be harmonized with existing record keeping provisions of the SFO. Section 9 of the SFO record keeping rules states that records shall be kept in writing in Chinese or English or in such manner as to enable them to be readily accessible or readily convertible into written form in the Chinese or English language. In comparison, the Consultation proposes that records should be kept in electronic form "save that: (i) records created and maintained in paper form may be kept in paper form; and (ii) audio recordings may be stored in a sound recording media."

29. Do you have any comments or concerns about the types of records proposed to be kept, and the manner in which they are to be kept?

The Consultation places recordkeeping obligations on LCs that are not in line with international standards. The records requirements are, at this stage, relatively broad: we acknowledge that the SFC's intention is to create a principles-based approach. We ask that whatever record keeping and monitoring of delegates is required by this section be commercially reasonable.

Paragraph 1: "records evidencing the existence and nature of the transaction, including all agreements relating to the transaction" should be simplified to "all agreements relating to the transaction" as it is both more specific and practical.

Paragraph 5: we suggest the paragraph be revised to read "records sufficient to support the basis of the transaction information submitted to the Monetary Authority under Division 3 of Part [ ] of these Rules".

Alternative Investment Management Association

We are grateful for the opportunity to provide our thoughts on this Consultation and would be pleased to discuss these comments in further detail.

Yours faithfully,

The Alternative Investment Management Association Ltd, Hong Kong Branch