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18 August 2014

By Post & Email:

Hong Kong Monetary Authority  
55th Floor, Two International Finance Centre  
8 Finance Street  
Central, Hong Kong

Dear

**Consultation on Securities and Futures (OTC Derivative Transactions – Reporting and Record Keeping) Rules**

Thank you very much for your letter in respect of the Securities and Futures (OTC Derivative Transactions – Reporting and Record Keeping) Rules (“**Draft Rules**”) and the opportunity for us to put forward HKAB’s feedback in respect of these.

We have prepared the attached submission which addresses the questions raised in the joint HKMA and SFC Consultation Paper on the Draft Rules dated July 2014 as well as some additional issues for clarification.

We have sought to provide specific examples of issues that we have identified as causing issues in implementing the Draft Rules however we would be very pleased to discuss our submission in further detail and, where we have requested clarifications, to discuss these issues directly with the HKMA as appropriate.

In the meantime, please let us know if you have any questions.

Yours sincerely

Encl.

*Chairman* Bank of China (Hong Kong) Ltd  
*Vice Chairmen* The Hongkong and Shanghai Banking Corporation Ltd  
Standard Chartered Bank (Hong Kong) Ltd  
*Secretary*

主席 中國銀行（香港）有限公司  
副主席 香港上海匯豐銀行有限公司  
渣打銀行（香港）有限公司  
秘書

**Hong Kong Monetary Authority and Securities and Futures Commission  
Financial Stability Surveillance Division**

**Securities and Futures (OTC Derivative Transactions – Reporting and Record  
Keeping) Rules**

**Submission of The Hong Kong Association of Banks**

**18 August 2014**

**Introduction**

This paper sets out the views of The Hong Kong Association of Banks (“**HKAB**”) in relation to the proposed introduction of the Securities and Futures (OTC Derivative Transactions – Reporting and Record Keeping) Rules (“**Draft Rules**”), to accompany changes made to the Securities and Futures Ordinance (“**SFO**”) pursuant to the Securities and Futures (Amendment) Ordinance 2014 (“**Amendment Ordinance**”) in relation to the provisions establishing a regulatory framework for the over-the-counter (“**OTC**”) derivative market in Hong Kong.

Assisted by King & Wood Mallesons, HKAB has examined the proposals set out in the Rules and explained in the accompanying Consultation Paper dated July 2014 issued by the Hong Kong Monetary Authority (“**HKMA**”) and the Securities and Futures Commission (“**SFC**”). These views are set out in the “**HKAB’s response**” section of this written submission, with our key suggestions summarised in the “**Executive summary**”.

We would be pleased to engage in further discussions with the HKMA and SFC in relation to the proposed changes and to provide further industry input where necessary.

*Unless otherwise defined, terms used in our response have the meaning given to them in the Draft Rules.*

**Executive summary**

HKAB acknowledges the important role that the Draft Rules will play in implementing the OTC derivatives regime, given that the Amendment Ordinance established a high level framework for that regime and left much detail to be set out in subsidiary legislation.

As the Draft Rules implement the detailed reporting and record keeping obligations, clarity is key. As such, we have suggested a number of drafting clarifications where we felt there was ambiguity. For example, we have made suggestions regarding:

- (a) the definitions embedded in the triggers for reporting obligations including the relevant connection to Hong Kong and the coverage of trader activities;
- (b) clarity on the scope of product classes for which calculation of positions must be based as well as defining the scope of the affected product types;
- (c) the scope of, and interaction between, exemptions;

- (d) clarity around interbranch transactions and HKMA’s intended approach to substitute compliance arrangements; and
- (e) confirming the scope of reporting in respect of subsequent events.

HKAB is also concerned that practical matters (such as technology limitations) may impact members’ ability to comply with the proposed record keeping requirements, particularly in relation to phone records. We also have concerns about the proposed 7-year document retention period, which we suggest is out of step with other key markets in the Asia-Pacific region.

Finally, timing is a key concern as global OTC derivative reforms are considered and implemented. We therefore reiterate the need for appropriate time to review the Draft Rules once settled and provide sufficient time to build and implement technology and processes to support the regulatory regime.

We welcome the opportunity to discuss these comments further.

**HKAB’s response**

**A Persons (other than AIs/AMBs/LCs) that will be subject to mandatory reporting**

**1 Do you have any comments or concerns about the proposed definition of “Hong Kong person”, “RCH” and “ATS-CCP”?**

We have a small number of comments in respect of the definitions of RCH and ATS-CCP and how international entities are regulated under these definitions. Please refer to our comments in response to Question 7.

**B OTC derivative transactions that will be subject to mandatory reporting**

**2 Do you have any comments or concerns about the proposed types of IRS and NDF that will be subject to the mandatory reporting obligation in the initial phase of implementation?**

2.1 The IRS and NDF products subject to mandatory reporting under the Draft Rules should align with the interim reporting requirements imposed by the HKMA (“**HKMA Interim Requirements**”) and with which HKAB members are currently complying. This will facilitate a smooth implementation process and aid certainty amongst industry stakeholders.

2.2 In this regard we note the following:

- (a) **Overnight index swaps** - this product is not listed in Part 3, Schedule 1 to the Draft Rules however is within the product coverage of the HKMA Interim Requirements. Could the HKMA and SFC confirm that overnight index swaps are intended to be covered under the Draft Rules on the basis of the inclusion of a fixed v floating interest payment calculation?
- (b) **Precious metal trades** - we note that the definition of “specified currency” captures specified precious metals. We query the inclusion

of precious metals as this will effectively incorporate transactions relating to commodities into the first phase of reporting under the Draft Rules. HKAB believes that further analysis is required in consultation with relevant dealers to understand the scope of precious metals transactions that may fall within the new definition and the associated costs and build times. We therefore ask that references to precious metals transactions be removed from the initial scope.

**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 of the Draft Rules, or how the reportable transactions, or the class to which they belong, have been described in Part 3 of Schedule 1?**

3.1 We are concerned about the decision not to rely on industry standard ISDA definitions and classifications, with few specifics being included in Part 3 of Schedule 1 for each of the specified product types. We suggest the ISDA framework provides a standard that is well known to the industry and uniformity assists compliance. We would therefore welcome the inclusion of concepts and definitions set out in this framework to inform the drafting in the Draft Rules.

*Drafting comments*

3.2 In particular, the proposed drafting raises the following concerns:

- (a) there is no reference to the purchase of the currency being on a future date (at least one business day post trade date) to ensure that forwards are being captured;
- (b) it is not clear that the NDF has only one value or settlement date; at present it captures any trade involving the purchase of a reference currency, meaning that non-deliverable swaps are also captured, for example; and
- (c) there needs to be a reference currency amount in the settlement currency.

3.3 We ask that this drafting be reconsidered as a matter of priority. We will be pleased to discuss terminology with you further if required.

*Future amendments*

3.4 As a general comment, we ask that any future updates to the definitions of “specified OTC derivative transactions” or “specified currency” or to other details in the Draft Rules that can be updated by notice in the Hong Kong Government Gazette, be preceded by sufficient notice to, and time for consultation with, market participants. Appropriate implementation periods are also necessary.

**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?**

***“Conducted in Hong Kong”***

4.1 HKAB is concerned that there are a number of elements to the definition of “conducted in Hong Kong” that are left undefined and uncertain. In particular:

- (a) ***meaning of “trader”*** - we appreciate that the Consultation Paper indicates that the word “trader” is to be given its ordinary meaning, which is suggested to be “the persons who make the trading decision”.<sup>1</sup> However as a number of people may be involved in the decision to trade, we suggest that further clarification would be useful, especially to help distinguish a person acting as a salesperson in relation to a trade whose activities are not intended to be captured.

For example, trades are often made on the basis of a decision made by a junior employee on the basis of instructions and mandates provided by a more senior trader. The junior and senior trader may be located in different jurisdictions. This may involve a number of different persons in multiple jurisdictions. We welcome clarification on the impact of trading hierarchies and the relevant decision maker under the definitions. In our view, the definition should be confined to the substantive decision-makers in relation to the trade. See further, our comments in paragraph (d).

In order for this definition to be implemented with confidence, HKAB would welcome the provision of explicit examples as how the HKMA and SFC interprets the role between sales and trading to ensure that market participants are aware of the regulators’ expectations in this regard and how these provisions will be interpreted;

- (b) ***meaning of engaged by*** - we query the use of the term “engaged by”. While we acknowledge that this is intended to mean that not only employment relationships are captured, we query the scope and certainty of this term. Further clarification would be helpful;
- (c) ***performing functions “substantially in Hong Kong”*** - we understand that the intention of the Draft Rules is to capture trading activity, wherever that trading activity may occur, if it is done by a trader who is employed or engaged to perform a substantial part of their duties in Hong Kong. HKAB would welcome more certainty around the meaning of the phrase “substantial part”. We note that ISDA has previously proposed a 30-day/one month calendar concept in respect of this test.

In addition, it is unclear whether the “duties” that must be substantially performed in Hong Kong are just those duties that constitute (or directly relate to) trading or if it is intended to capture all of the duties that the person is employed or engaged to perform in

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<sup>1</sup> Paragraph 66(b) Consultation Paper.

Hong Kong. We would welcome more certainty than the definitions currently provide;

- (d) **identification of decision-maker** - we note that the ability to identify the essential “decision” point for any transaction will differ depending on the modality of the trading activity and the rules should be interpreted to allow for enough flexibility to allow for this. For example:
- (i) where a global book is being used to book the risk of a trade, there will be multiple traders in multiple jurisdictions who are risk-managing the book over a 24-hour period. In such a case, flexibility should be provided to look at alternative factors to risk management such as price origination/formation; and
  - (ii) in contrast, in an e-trading context it may not be possible for a bank to identify an individual that has contributed the price or the essential pricing elements that form the traded rate due to system constraints, for example. In this case, it may be appropriate to look at the risk manager of the trade or the owner of the risk that is created when the counterparty clicks to trade (if this is a global book it may be the case that a trade should be reported where just one of multiple risk managers is based in Hong Kong).

We suggest that members themselves would be in the best position to identify where the relevant decision was made and who should be treated as the decision-maker. We suggest the Draft Rules be amended to specifically provide for this discretion; and

- (e) **electronic trading platform** - further to our comments in paragraph (d) in respect of identifying the decision-maker, we welcome guidance on the circumstances under which online transactions will be captured for reporting purposes. HKAB would like confirmation as to whether trades executed via an electronic trading platform are reportable, where the contracting party (also the e-trading service provider) to such a trade is an authorised financial institution incorporated outside of Hong Kong, and the trade is booked to an offshore branch of that institution.

For example, prices for the trades may be set automatically outside of Hong Kong, however a trader in the Hong Kong branch may help to adjust the final price at which the authorised financial institution offers to trade. While these prices are then made available through the electronic platform, it is ultimately the platform user’s decision whether to execute a trade on the terms, including the price, offered. Would trades executed under these circumstances be reportable under the Draft Rules?

- 4.2 Certain members would also like to discuss the impact of these definitions on global books and possible solutions.

***Substitute compliance***

4.3 As demonstrated in our comments above, identifying the relevant jurisdiction trigger and connection to Hong Kong may be difficult. We refer the HKMA and SFC to our comments in response to Question 13 in respect of substitute compliance (that is, compliance with the OTC derivatives regimes in certain other identified international jurisdictions should be sufficient to discharge compliance obligations in Hong Kong) and consider that this should be taken in account in considering ways to resolve the difficulties identified.

**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?**

In the event that a fund is a Hong Kong person and its trustee has entered into a relevant transaction on its behalf as an entity licensed for Type 9 regulated activities, our understanding is that it will be the trustee's obligation to report under Draft Rule 9. The fund would then be exempt on the basis of Draft Rule 22. Could the HKMA and SFC please confirm that our understanding is correct?

**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**

HKAB considers that such an obligation may be unduly burdensome and difficult to coordinate for AIs or LCs that do not enter into the transaction. Not only may it be difficult to determine whether the trade has been actioned, the trade may be subject to advice from other fund managers and the LC or AI may have given non-binding advice without sufficient oversight of the transaction details that would then need to be reported.

**D Reporting obligations of CCPs**

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

***Coverage of CCPs***

7.1 HKAB asks for clarification of the role of international CCPs in reporting transactions to the HKTR. For example, if a Hong Kong person enters into a transaction cleared through an international CCP, does the HKMA and SFC expect that the CCP will report this transaction to the HKTR?

7.2 In connection with this, is there any intention for the definition of RCHs to be expanded in the near future?

### *Duplicate reporting*

- 7.3 We note that reporting by CCPs to the HKTR is likely to result in duplicated reporting. We are interested to hear how these reports will be reconciled and what action will be taken in the event of discrepancies between information provided to the HKTR.

## **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?**

- 8.1 HKAB is generally supportive of the proposal to exclude transactions entered into outside of Hong Kong by non-Hong Kong companies.
- 8.2 We understand that transactions “entered into” in Hong Kong under Draft Rule 15(1)(f) is meant to be a different concept to transactions “conducted” in Hong Kong within the meaning of Draft Rule 4. However, as the terminology is very similar and has significant impacts on the reporting obligation, we would welcome the terminology used in Draft Rule 15(1)(f) being clarified.

### **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.**

Please refer to our comments in respect to Question 6 above.

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

#### *Correctly calculating thresholds – product types*

- 10.1 HKAB understands that it is the intention that the reporting obligations will be triggered depending on the thresholds attributed to a product class, whether or not all transactions within that product class also fall within a product type that is specified for the purpose of the Draft Rules (that is, the product type may not necessarily be subject to reporting requirements under the Draft Rules, but transactions of that type would count towards the specified reporting threshold).<sup>2</sup>
- 10.2 While the product type listed in Schedule 1 to the Draft Rules should be identifiable with ease (as these products are defined with specifics), it may be more difficult to determine what products fall within the overarching product class. To ensure that a consistent approach across the market to identify products within a class, we recommend that the HKMA and SFC provide a comprehensive list of products within a product class that are expected to be included in the calculation of the reporting threshold.

<sup>2</sup> Paragraph 87(b) Consultation Paper.



10.3 In addition HKAB welcomes the HKMA and SFC confirming that reporting is permissible whether or not the thresholds have been met. It may be more efficient and convenient for market participants to determine that they will report the relevant transactions without ongoing monitoring of the threshold. This would alleviate an administrative burden while ensuring that HKTR receives the information that it requires for regulatory oversight.

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

At this stage we have no comments in respect of the proposed level of the reporting and exit thresholds.

**12 Do you have any comments or concerns about the proposed reductions to the reporting threshold and exit threshold at a later stage?**

Our only comment at this stage relates to timing. Specifically, while the proposed reduction is intended to come into effect no earlier than 2017,<sup>3</sup> HKAB emphasises that any reform must have due regard to providing affected participants with sufficient time to review and update their processes and systems once the details of the relevant reduction are settled. HKAB also welcomes consultation on proposed reductions.

**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.**

*Substitute compliance*

13.1 A significant number of HKAB's members are subject to regulatory reform in respect of OTC derivatives worldwide and will be required to comply with extensive reporting obligations in a number of jurisdictions.

13.2 A number of jurisdictions have announced that they will adopt substituted compliance arrangements. Under these arrangements, compliance with local OTC derivative requirements can be substituted for compliance with the OTC derivative regimes in another jurisdiction. For example, the United States Futures Commodity Futures Trading Commission ("CFTC") has approved comparability determinations in a number of jurisdictions including Australia, Canada, the European Union and Hong Kong.<sup>4</sup> However it is unclear what the HKMA and SFC's expectations are in respect of Hong Kong banks complying with international regimes as a substituted compliance measure for Hong Kong obligations.

13.3 Substitute compliance is a key measure for members to ensure that regulatory impacts are appropriately managed and to ensure that undue resources are not expended on multiple levels of comparable regulation.

<sup>3</sup> Paragraph 95, Consultation Paper.

<sup>4</sup> See CFTC website at <http://www.cftc.gov/LawRegulation/DoddFrankAct/CDSCP/index.htm>

HKAB would welcome further guidance on the HKMA and SFC's expectations in respect of substitute compliance.

*Interbranch transactions*

13.4 Consistent with the HKMA Interim Requirements,<sup>5</sup> we expect that where an OTC derivative transaction is entered into on an inter-branch basis (that is, between branches of the same legal entity), these transactions will not be reportable under the Draft Rules. We would appreciate confirmation that this is in fact the position under the Draft Rules. Ideally, we would ask that this be formalised in relevant guidance, if not the Draft Rules themselves.

**G Exemptions and other relief from the reporting obligations**

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

*Exempt persons*

14.1 HKAB welcomes the inclusion of an exemption for AIs whose dealing in OTC derivative products is limited. However, we draw the following drafting comments to the HKMA and SFC's attention:

- (a) *threshold transactions*- paragraph 102 of the Consultation Paper suggests that a person will not be an "exempt person" under Draft Rule 3 if the AI has more than five transactions of an outstanding class, irrespective of the value of those transactions. The Consultation Paper also suggests that the exemption will be lost if there are outstanding class transactions with a value of over US\$30million. However, Draft Rule 3(2)(e) provides that there must be more than five outstanding class transactions **and** those transactions must have a total gross notional value exceeding \$30million. We suggest that the drafting in Draft Rule 3(2)(e) is appropriate - that both the number and value of the transactions should have to be exceeded for the exemption to be lost. However, we would welcome confirmation that this is the intention of the drafting, given that the Consultation Paper suggests otherwise; and
- (b) *Hong Kong persons as counterparty* – HKAB welcomes the inclusion of Draft Rule 3(2) so that entities within the thresholds described above are exempt persons. However, the loss of this exemption for local AIs entering into transactions where the counterparty is a Hong Kong person (as provided for under Draft Rule 3(2)(a)), is unduly burdensome. The Draft Rule means that the local AI will become subject to the reporting requirement even though the AI has not met the relevant thresholds under Draft Rule 3(2)(e).

<sup>5</sup>

See paragraph 7 of the Annex and Appendix 1 of the 28 June 2013 circular of HKMA in respect of interbranch trades

If the Hong Kong counterparty has met the thresholds under Rule 15(1) we suggest that this person is likely to be sufficiently sophisticated to make an enquiry and determine that the AI counterparty is exempt from reporting under Draft Rule 3 and that they must report the transaction. Such enquiry is acknowledged in paragraph 105 of the Consultation Paper.

We therefore suggest that the carve out for transactions entered into with Hong Kong persons under Draft Rule 3(2)(a) therefore be reconsidered.

#### ***Reporting for Hong Kong persons***

- 14.2 HKAB asks for clarification as to whether an AI, AMB or LC needs to report a transaction in circumstances where a Hong Kong person is relying on Draft Rule 20.
- 14.3 More specifically, HKAB's expectation is that Hong Kong persons will report in accordance with their obligations under Draft Rules 9 to 12 without regard to whether or not the counterparty is also required to report and therefore there would be no separate identification or due diligence requirement by AIs, AMBs or LCs. However, if members are required to assess the relevant thresholds of the counterparty and make an assessment of how these trades would otherwise be reported by that counterparty this would lead to a significant operational and compliance burden.
- 14.4 Clarification of the interaction between Draft Rule 20 and the reporting obligations under Draft Rules 9 to 12 would therefore be welcome.

#### ***Affiliate reporting and Draft Rule 21***

- 14.5 HKAB welcomes the inclusion of the good faith reporting exemption in Draft Rule 21, which applies where transactions are conducted in Hong Kong on behalf of an affiliate and the affiliate has confirmed in good faith that the transaction has been reported.
- 14.6 It is HKAB's understanding of Rule 21 that the exemption will enable AIs incorporated outside of Hong Kong, that would otherwise be required to report under Draft Rule 11(1)(c) when they enter into transactions on behalf of an affiliate by a trader employed to perform a substantial part of their duties in Hong Kong, to obtain a good faith assurance from their affiliate that this reporting obligation has been fulfilled.
- 14.7 As the reporting obligation will otherwise be owed by the AI under Draft Rule 18, HKAB would welcome a specific clarification in the Draft Rules that, to the extent that any agency agreement is entered into between affiliates for the reporting of such transactions to the HKTR, this arrangement would not fall under the HKMA's rules on outsourcing under its Supervisory Policy Manual SA-2 "Outsourcing" module, such that detailed approval and conduct requirements would apply.

#### ***Counterparty relief equivalent to Singapore requirements***

- 14.8 We draw the HKMA and SFC's attention to the exempted persons under the OTC derivatives reporting regime in Singapore introduced under the

Securities and Futures Act. Specifically, transactions with persons listed in the Fourth Schedule (exempt persons) to that Act (“**Fourth Schedule**”) are exempted from the Singapore transaction reporting obligations. In practice, this means that both the exempt person and their counterparties are exempt from reporting.

- 14.9 We submit that an equivalent exemption should be provided under the Draft Rules. The persons listed in the Fourth Schedule include the government, statutory boards, central banks, government agencies and certain specified multilateral agencies or organisations including multijurisdictional banks.
- 14.10 Providing such an exemption in Hong Kong would ensure that HKAB members are able to report OTC derivative transactions consistently throughout the region and avoid the significant cost and compliance burden that complicated jurisdiction-by-jurisdiction obligations bring. It would also acknowledge that receiving consent to report transactions from such bodies is expected to be challenging, if not impossible in some cases.
- 14.11 We note that the Consultation Paper, at paragraph 111(b), states that the decision not to include such an exemption is in line with other major jurisdictions. As this is not the position taken in Singapore, we urge the HKMA and SFC to reconsider this issue.

***Impact on funds reporting***

- 14.12 HKAB would welcome an explanation of the practical operation of Draft Rule 20 on fund arrangements when “giving-up”, or transferring, transactions to a third party prime broker. In such circumstances, the AI may not execute the trade themselves – rather, this may be done by a broker that would also be a relevant prescribed person under Draft Rule 20.

- 15 Do you have any comments or concerns about the proposal to exclude from the exempt person relief for IRS and NDF those licensed banks which have already reported to the HKMA via the HKTR under the interim reporting requirement and have outstanding reportable transactions on the commencement of the Draft Rules?**

At this stage, we have no comments in respect of this exclusion.

- 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 \$30million to be appropriate? If not, please provide specific details of why they may be inappropriate and what alternative criteria should be adopted.**

Please refer to our comments in response to Question 14 regarding threshold requirements.

## 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.**

### *Start date*

- 17.1 We understand that for regulated prescribed persons, the start date will be the later of the product type specification day and the day on which the person became a regulated prescribed person.<sup>6</sup>
- 17.2 As the HKMA and SFC would be aware, relevant HKAB members have been reporting to the HKMA under the HKMA Interim Requirements. We understand that the start date for these members, in respect of the specified product types, will be the date referred to in Draft Rule 1(1): that is, the start date of the Rules. We would appreciate if the HKMA and SFC could please clarify that our understanding is correct.

### *Backloading and offshore transactions*

- 17.3 As set out in the Consultation Paper, the start date will be relevant to historical transactions.<sup>7</sup> We understand that the backloading is not intended to apply to transactions of AIs incorporated outside of Hong Kong where that transaction is “conducted in Hong Kong” – that is, it is undertaken on behalf of an affiliate with the relevant Hong Kong connection.<sup>8</sup>
- 17.4 We also understand that, to the extent that the AI is a counterparty to an agreement but has not recorded the transaction in the books of its local branch, that transaction will not be subject to backloading as it is not a transaction captured under Draft Rule 11(1)(a). We would welcome confirmation of this position.

- 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.**

At this stage, we have no specific comments in respect of these proposed time frames. We note that there has been some support expressed within HKAB members for different start days as set out in the Draft Rules and explained in the Consultation Paper.

- 19 Do you have any comments or concerns about how the starting day might impact AIs, AMBs and LCs that previously qualified for the exempt person relief? If so, please provide specific details.**

At this stage, we have no comments in respect of previously qualified exempt persons.

<sup>6</sup> Paragraph 114(c), Consultation Paper.

<sup>7</sup> Paragraph 114(a), Consultation Paper.

<sup>8</sup> Paragraph 115(b), Consultation Paper.

## I Time for reporting and grace periods

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

- 20.1 The timing obligations under the Draft Rules are a key issue for HKAB, particularly as they involve significant technological and process changes to be developed, tested and implemented. The start date of the Draft Rules is therefore a key issue for HKAB.
- 20.2 While we acknowledge the appropriateness of a concessional and grace period, the start date of the Draft Rules themselves is still not defined.
- 20.3 In order to build and test the new systems and processes necessary to ensure the successful implementation of the reporting requirements, we suggest that a period of at least six months be provided between the Draft Rules being finalised and their start date. An indication of the HKMA and SFC's expectations in this regard would be extremely helpful to ensure that planning and resource allocation is undertaken accordingly.

### 21 Do you have any comments or concerns about how the grace periods will vary in respect of entities that become an AI, AMB or LC at a later date, or that cease to be an exempt person at a later date?

At this stage, we have no comments in respect of these varied dates.

## J Form and manner of reporting obligation

### 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?

#### *Reporting information in respect of subsequent events and other information to be defined*

- 22.1 We note that "transaction information" is defined under the Draft Rules as the information and particulars specified in Schedule 2.<sup>9</sup>
- 22.2 Item 7 of Schedule 2 includes details relating to subsequent events. The Consultation Paper explains that this means "events relating to the transaction that have occurred after the transaction was entered into (e.g. increase or decrease in the notional amount, partial or full termination, etc)". The definition in the Draft Rules of a subsequent event is an event that "affects the product, the terms and conditions on which the transaction was entered into or the persons involved in entering into the transaction".
- 22.3 These concepts are very broad and do not provide a sufficient level of certainty. In addition, the Consultation Paper notes that the HKMA may also require additional information under the HKTR User Manual. Together, this leaves our members in a position of relative uncertainty as

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<sup>9</sup> Draft Rule 2.

to the information that they will actually be required to gather, monitor and report under the Draft Rules.

22.4 We are particularly interested in obtaining clarification in respect of the scope of reportable subsequent events, including whether knock-ins, fixings or resets will be captured. Such events reflect the terms of the OTC derivative and it is therefore unclear whether these are changes that are captured.

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

23.1 As flagged in our response to Question 20, the implementation of reforms with significant technological and systems impacts must have a sufficient lead time. As the reporting of valuation transaction information will have significant operational impacts including requiring technology changes as well as having a cost impact on our members' businesses, we urge an appropriate lead time to comply with this new reporting obligation.

23.2 We suggest that at least six months' notice prior to the start of the obligation to report valuation transaction information is provided.

**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?**

24.1 We refer to our comments in response to Question 22 in respect of the broad and uncertain definition of "subsequent event".

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

*Designated jurisdictions*

25.1 We note that the Draft Rules provide for the HKMA to be able to designate a jurisdiction if it is satisfied that it would not be possible to disclose counterparty identifying particulars in accordance with the laws of that jurisdiction.

25.2 The list of designated jurisdictions is of significant importance to HKAB. We would be grateful for a list of relevant designated jurisdictions as a matter of priority in order to assess its engagements with counterparties in these jurisdictions. It is also appropriate that details of how this list is established and maintained are made available to market participants.

25.3 We note that certain HKAB members have been involved in assessing the impact of restrictions on counterparty information and would be pleased to share with the HKMA and SFC details of jurisdictions that prevent disclosure. We consider that it is very important that the list of jurisdictions designated under the Draft Rules is comprehensive and reflects appropriate, global due diligence.

25.4 In addition, as it is possible that jurisdictions may introduce new laws, or a view may be taken in respect of a jurisdiction that does not align with the HKMA's own legal advice, we recommend that the Draft Rules contain a process for participants to take their own view that a jurisdiction does not allow disclosure of counterparty identifying particulars. This may include the condition that the participant obtains a legal opinion from the relevant jurisdiction demonstrating the relevant legal impediment or restriction on reporting counterparty information.

***Subsequent transactions***

25.5 While Draft Rule 31(1)(b), which provides for relief from reporting where consent of the counterparty has not been obtained, only applies to transactions still outstanding on the day on which the Draft Rules commence, we suggest that this should extend to a specific period after that date. It will be a significant task to negotiate consent to disclosures from all counterparties and this may be an issue of concern for certain counterparties that must be managed and discussed. We therefore suggest that the period under Draft Rule 31(1)(b)(i) extend to transactions entered into within a certain period of time after the Draft Rules take effect to provide participants with a grace period to align their counterparty contracts.

25.6 In addition, where a jurisdiction was designated under Draft Rule 31(3) but the designation is subsequently revoked due to a change in law, members may be required to reengage with their counterparties in those jurisdictions to obtain the necessary consent. We therefore suggest that a transitional period be applied in respect of these relationships.

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

26.1 As noted in response to Question 25, a change to the designation of a country may raise further issues in respect of the terms of the customer relationship itself. It may also be difficult to track the impact of the changes and how this applies to existing customer arrangements.

26.2 Members will only be in a position to subsequently report previously masked data where there has been a positive change to the underlying country legislation that prevented the reporting of unmasked counterparty information in the first place. We are strongly of the view that any removal of masking relief for a particular country should only occur following a positive change to the underlying country legislation. Only historical data should be required to be reported where permitted to do so by law, including where necessary consents have been received.



## K Specified subsidiaries of locally-incorporated AIs

**27 Do you have any comments or concerns about the proposal that an AI's reporting obligations in respect of transactions entered into by its specified subsidiaries should be the same as its reporting obligations in respect of transactions to which it is a counterparty itself?**

27.1 While we note that this obligation to report on specified subsidiaries will be subject to separate guidance, we would be grateful for an indication of the timing when such guidance will be available.

27.2 In addition, in designating a subsidiary under Draft Rule 39, we draw to the HKMA and SFC's attention the following issues:

(a) *technology impacts* - in many cases, subsidiaries will be operating under their own technology infrastructure. Therefore, requiring subsidiaries to report in the same manner as the AI may have significant technological and process impacts – it should not be assumed that subsidiaries will easily be able to adopt and use the AI's existing technology; and

(b) *local law restrictions* - subsidiaries in overseas jurisdictions will be subject to separate local laws. This may prevent those subsidiaries from complying with the Draft Rules, particularly in relation to information sharing, data privacy and confidentiality. We query how these local law issues will be addressed in applying Draft Rule 39.

## 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?**

At this stage, we have no comments on the record keeping requirements in relation to mandatory reporting.

**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?**

While we are generally supportive of the record keeping obligations proposed under the Draft Rules, we are concerned that there may be real technology and cost implications in implementing some of the measures. In particular, keeping "readily searchable" telephone conversations is an obligation which will be difficult to implement. At present there are real concerns that the relevant tape or audio file would not be capable of being searched in the manner suggested by the Draft Rules (ie by reference to the transaction and the counterparty).<sup>10</sup>

<sup>10</sup>

Draft Rule 36.

**30 Do you have any comments or concerns about the duration for which the records are proposed to be kept?**

HKAB is concerned that the 7 year period for retaining records is out of step with the record keeping obligations otherwise applying to market participants in Hong Kong (such as the requirement to retain phone records for 6 months as prescribed in the Code of Conduct for Persons Licensed by or Registered with the SFC) as well the record keeping obligations applying in other jurisdictions. In particular, while we recognise that record keeping is an important aspect of demonstrating compliance with the reporting requirements, Australia and Singapore have both adopted a document retention requirement of 5 years.

We therefore request the HKMA and SFC to revisit the 7 year time period for retaining records.

**Other comments**

**31 Scope of product classes – definition of “spot contract”**

31.1 We note that the Draft Rules, in the context of FX transactions, only focus on mandatory reporting of NDFs.<sup>11</sup>

31.2 While not currently relevant to the scope of products captured by the Draft Rules, we would like to take this opportunity to draw the HKMA and SFC’s attention to the definition of “spot contracts” contained in the definition of “OTC derivative products” in section 52(4) of the Amendment Ordinance.<sup>12</sup>

31.3 While we welcome the exclusion of spot contracts from this definition, we submit that the definition should be expanded to cover any foreign exchange contract that is executed:

- (a) for the purpose of settling a securities transaction; or
- (b) as a result of another security-related transaction, such as a corporate action or income repatriation.

These trades should be considered as bona fide spot transactions, and given that the settlement period for securities transactions may differ across different jurisdictions, a broadened definition of “spot contract” should be adopted.

31.4 In this regard we note that the CFTC considers foreign exchange transactions with a longer settlement period concluding with the actual delivery of the relevant currency, and a foreign exchange transaction that is

<sup>11</sup> Item 3, Part 3, Schedule 1, Draft Rules.

<sup>12</sup> *spot contract (現貨合約)* means a contract for the sale of any type or combination of types of securities, commodity, index, property, interest rate or currency exchange rate under the terms of which the settlement of the contract is scheduled to be made within the longest of the following periods—  
(a) if the contract is—  
(i) entered into in Hong Kong, 2 business days after the date of entering into the contract; or  
(ii) settled outside Hong Kong, 2 days on which each settlement facility necessary to settle the transaction is open for business, after the date of entering into the contract;  
(b) the period generally accepted in the market for that type or combination of types of securities, commodity, index, property, interest rate or currency exchange rate as the standard delivery period.

entered into solely to effect the purchase or sale of a foreign security, as spot foreign exchange transactions even if the T+2 settlement period is exceeded.<sup>13</sup>

31.5 We urge the HKMA and SFC to assist in advocating for a similar approach to defining spot contracts under the Amendment Ordinance.

#### Next steps

Thank you very much for the opportunity to provide feedback on the Draft Rules. We would be delighted to discuss any aspect of our comments or to provide feedback on any further proposals.

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<sup>13</sup> See Security-Based Swap Agreement Recordkeeping, 77 FR 48208, 48256-58 (Aug. 13, 2012)