

18 August 2014

By mail and email

Supervision of Markets Division
The Securities and Futures Commission
35/F Cheung Kong Center
2 Queen's Road Central
Hong Kong

Dear Sir,

Consultation paper on the Securities and Futures (OTC Derivative Transactions – Reporting and Record Keeping) Rules (the “Consultation Paper”)

We refer to the Consultation Paper issued by the Hong Kong Monetary Authority (“HKMA”) and the Securities and Futures Commission (the “Commission”) in July 2014 inviting interested parties to submit written comments on the proposals set out in the Consultation Paper.

The Hong Kong Trustees' Association (the “HKTA”) is a professional association representing trustees and members of the trust and fiduciary services industry in Hong Kong. We are interested in the present consultation to the extent that it affects funds that are structured as trusts.

We set out below our responses to the questions set out in the Consultation Paper for your consideration. In relation to any questions which we have not provided any responses, please be informed that the HKTA does not have any particular view on the particular arrangement or issue specified in that question.

A. Reporting Obligations

We understand that trustees will have reporting obligations where it acts as trustee of a trust governed by Hong Kong law and the trust enters into a relevant OTC derivative transaction, unless an exemption applies.

We understand that one of the exemptions is that trustees would not be required to report a relevant OTC derivative transaction if an LC, AI or AMB is required to report the transaction. An LC / AI / AMB is required to report in the following circumstances:

- (i) where it is a counterparty to the transaction (which, in the case of an overseas AI, means the transaction is booked to the Hong Kong branch of the AI)

- (ii) where it conducted the transaction in Hong Kong on behalf of a counterparty that is an affiliate of the LC / AI / AMB (or, in the case of an overseas AI, the head office or another overseas branch of the overseas AI), or
- (iii) (for LC / AI only) if it is licensed / registered for type 9 regulated activity and in conducting this regulated activity it (1) manages a portfolio of assets for another person (e.g. trustee), (2) enters into a relevant OTC derivative transaction on behalf of that person, and (3) that other person is a counterparty to the transaction.

Whilst we understand the rationale of the above proposals, we still have the following concerns on the above exemption:-

- **Trustees may not know whether an LC / AI / AMB is “required to report” under (i) or (ii) above** – Trustee may not have sufficient information to know whether an LC / AI / AMB is required to report a transaction under (i) or (ii) above and it is doubtful whether trustees could rely on this exemption in practice.
- **Delegation by LC / AI** - It is not clear whether an LC / AI "enters into" a relevant OTC derivatives transaction if it delegates to a non-type 9 LC / AI (e.g. an overseas affiliate) and it is the overseas affiliate that executes the transaction.
- **No exemption where LC / AI provides advice only** - The Consultation Paper currently contemplates that an LC / AI will not be required to report if it provides advice on a relevant OTC derivative transaction only. If legally the LC / AI only provides advice but in fact that advice is always followed (subject to compliance with investment guidelines, etc) then it is not unreasonable to require the LC / AI to report in these circumstances as well.
- **Exemption only applies where LC / AI "required to report"** - If an LC / AI is not required to report (e.g. because it gives advice rather than "enters into" the transaction) but does in fact report, then trustees will still have an obligation to report.

Due to our concerns above, we have provided our responses to questions 5, 6, 9 and 14 of the Consultation Paper.

Questions	Responses
<p>Question 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?</p>	<p>Whilst we understand that the Consultation Paper suggested to capture not only transactions booked with an affiliate of the AI, AMB or LC but also transactions of any other entity on whose behalf an AI, AMB or LC had full discretion and authority to agree the terms of the transactions,</p> <p>Please clarify and confirm that, where:</p> <p>(a) a type 9 LC / AI has been authorised with discretionary authority to enter into OTC derivative transactions on behalf of the Hong Kong person (either directly by the Hong Kong Person or as a result of delegation from another investment manager, which may be outside Hong Kong), and</p>

	<p>(b) either the type 9 LC / AI (i) delegates (or sub-delegates) that authority to a third party that is not required to report (e.g. an overseas investment manager), or (ii) delegates (or sub-delegates) execution of a reportable transaction to a third party that is not required to report (e.g. central dealing desk of an affiliate outside Hong Kong),</p> <p>then the type 9 LC / AI will be deemed to have “entered into the transaction on behalf of” the Hong Kong person and so will be required to report the transaction.</p> <p>Proposed wording - new Para. (4) of Rule 9, 10:-</p> <p>“For the purpose of paragraph (1)(c) of Rule 9 / 10, a prescribed person is deemed to have entered into a transaction on behalf of person who is a Hong Kong person if the prescribed person is authorized with discretionary authority to enter into the transaction on behalf of the Hong Kong Person (either directly by the Hong Kong Person or as a result of delegation from another investment manager, which may be outside Hong Kong) has delegated (or sub-delegated) that authority to a third party, and the third party enters into or execute the transaction on behalf of the Hong Kong person.”</p>
<p>Question 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.</p>	<p>We believe there are certain circumstances where it would be appropriate for an LC / AI that provides advice on OTC derivative transactions to be subject to the mandatory reporting obligation. For example, the appointment of an investment manager by a Hong Kong person may be structured as the appointment of an overseas manager, which then obtains investment advice from an affiliated LC / AI in Hong Kong. In these circumstances, it will be the overseas manager that enters into relevant transactions on behalf of the Hong Kong person.</p> <p>We request that the reporting obligation for LCs / AIs is extended to the situation where:</p> <ul style="list-style-type: none"> • an LC / AI provides advice to a third party that is not required to report (e.g. because the third party is outside Hong Kong) • a reportable transaction is entered into as a result, and • the counterparty to the transaction is a Hong Kong person.

	<p>Where the third party is an affiliate, this reporting obligation could be satisfied by the affiliate making the report in accordance with Rule 21.</p> <p>Proposed wording:</p> <p>“A prescribed person that is [a licensed corporation] [an authorized financial institution] must report a specified OTC derivative transaction to the Monetary Authority if the person –</p> <p>(d) provides advice in relation to the transaction to a third party, where:</p> <ul style="list-style-type: none"> (i) the third party carries on activities outside Hong Kong equivalent to Type 9 regulated activity and is not licensed or registered in Hong Kong; (ii) in the course of carrying on the activity, the third party manages a portfolio of assets for a Hong Kong person; (iii) in the course of managing the portfolio, the third party enters into the transaction on behalf of the Hong Kong person; and (iv) the Hong Kong person is a counterparty to the transaction.”
<p>Question 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.</p>	<p>We understand that the Consultation Paper suggested where a transaction is reportable by both a fund and its fund manager/sub-manager – i.e. where the fund is a Hong Kong person and is managed by an AI or LC, the fund will be exempted from reporting by virtue of the exemption under Rule 20 of the Draft Rules as discussed under paragraph 108 of the Consultation Paper. However, this exemption will not apply where the fund is a Hong Kong person, but not managed by an AI or LC. In such cases, the reporting obligation will remain with the legal owner of the fund (i.e. the trustee or partners in the case of a fund established as a trust or partnership).</p> <p>1. We recommend that the exemption for reporting by funds be extended to where the fund is a Hong Kong person and managed by a fund manager/sub-manager/investment adviser who are based in a jurisdiction with an inspection</p>

	<p>regime acceptable to the SFC as stipulated in 5.1 of the Code on Unit Trusts and Mutual Funds. The transactions for the fund will be reportable by such fund manager/sub-manager/investment adviser.</p> <p>2. Where the reporting obligation will remain with the legal owner of the fund (ie the trustee in the case of a fund established as a trust) where exemption cannot apply, we recommend imposing a requirement on the fund manager to sufficiently furnish the trustee with the relevant data required for the reporting. The recommendation is based on practical reasons and the fact that the primary obligation to maintain, calculate the threshold/exposure etc for the OTC derivatives transactions rest with the fund manager as part of their investment responsibility.</p>
<p>Question 14 – Do you have any comments or concerns about the proposed exemptions and reliefs, and the criteria for triggering them?</p>	<p>1. A Hong Kong person may not always know whether an LC / AI / AMB is “required to report” (e.g. whether the transaction was booked in the AI’s Hong Kong branch or whether the transaction was conducted in Hong Kong on behalf of an affiliate) and so may not know whether it can rely on the exemption in Rule 20. To close this gap and reduce the compliance burden on Hong Kong persons, we recommend that the Rules include a requirement that an LC / AI / AMB that is required to report must notify the counterparty that it is required to do.</p> <p>2. We believe that the exemption in Rule 20 should be extended so Hong Kong persons do not need to report where an LC / AI / AMB has in fact reported (whether or not it is “required” to report). This extension can be similar to proposed Rule 21(2) for affiliate reports. Proposed wording:</p> <p>“Where a prescribed person that is a Hong Kong person is required by rule 15 to report a specified OTC derivative transaction to the Monetary Authority, the person is taken to have complied with the requirement to report the transaction if a licensed corporation, an authorised financial institution or an approved money broker has confirmed to the person, in good faith, that it has reported the transaction to the Monetary Authority.”</p>

B. Practical issues relating to membership of HKTR

Where trustees have reporting obligations, trustees would need to become a member of the Hong Kong Trade Repository ("HKTR") whether or not trustees appoint an agent (e.g. the manager) to report on behalf of the trust. In such situation, trustees will need to become a member separately for each such trust because each is a separate "Hong Kong person". This is impractical given that some trustees in Hong Kong may have hundreds of funds under its trusteeship. The HKMA and the Commission should discuss with HKTR to see whether trustee could open only 1 member account for all trust funds under its trusteeship.

Backloading of information for historic transactions

The Consultation Paper provides that the rules require reporting of relevant OTC derivative transactions entered into prior to the "starting date" for the reporting obligation that remain outstanding on the starting date (referred to as "backloading"). We understand that the specific exemption mentioned in section A above does not apply in relation to such reporting and so trustees would need to report such transactions unless other exemptions applies. We also understand that such reporting must be made within 6 months of the starting date.

In respect of the above requirement, we consider that type 9 LCs / AIs should be required to report in relation to historic transactions that they entered into on behalf of Hong Kong persons i.e. the exemption mentioned in section A above should apply for historic transactions as well as future transactions. This would align the arrangement for reporting of historic and future transactions.

Due to our concerns above, we have provided our response to question 17 of the Consultation Paper.

<p>Question 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.</p>	<p>We believe that a type 9 LC / AI should be required to backload historical transactions that it has entered into on behalf of a Hong Kong person, where the Hong Kong person is a counterparty to the transactions. That is consistent with the intended operation of the Rules for new transactions.</p> <p>We believe it will not be unduly burdensome for a type 9 LC / AI to identify historical transactions it has entered into on behalf of Hong Kong persons. It also avoids the need for Hong Kong persons to devote time and resources to review transactions entered into by a type 9 LC / AI on its behalf to determine whether such transactions need to be backloaded.</p> <p>It also has the consequence that the type 9 LC / AI will be the party responsible for reporting subsequent events relating to these transactions, which reflects the reality that as part of their ongoing management of the portfolio</p>
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	they will be the party actively monitoring these OTC derivative positions.
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C. Reporting of “subsequent events”

The Consultation Paper provides that where an OTC derivative transaction has been reported to the Monetary Authority, the person that submitted the report (e.g. LC / AI or trustees) must also report any "subsequent event" relating to that transaction. "Subsequent event" is defined to mean "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".

In the situation where a type 9 LC / AI retires / resigns / is terminated and is replaced with another type 9 LC / AI, we have concerns that the reporting obligations may then fall on trustees as Hong Kong Person instead. We do not believe that this is the intention of the rules and it would be most appropriate that the reporting obligations should fall with the replacement type 9 LC / AI.

Due to our concerns above, we have provided our response to question 24 of the Consultation Paper.

<p>Question 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?</p>	<p>We believe that Rule 29 should be amended to clarify that, where a type 9 LC / AI (the “original manager”) ceases to manage assets of a Hong Kong person and is replaced by another type 9 LC / AI (the “new manager”), the new manager should be required to report subsequent events relating to transactions entered into by the original manager on behalf of the Hong Kong person.</p> <p>Proposed wording (new Rule 29(4)):</p> <p>“Where a Hong Kong person appoints a licensed corporation licensed for Type 9 regulated activity or an authorized financial institution registered for Type 9 regulated activity in place of a person in Subrule (3)(a)(ii), and the person in Subrule (3)(a)(ii) had previously submitted, or been required to submit, transaction information to the Monetary Authority in respect of transactions the person entered into on behalf of the Hong Kong person (each a “relevant transaction”), the new licensed corporation or authorized financial institution must submit transaction information relating to a subsequent event for a relevant transaction that occurs after its appointment.”</p>
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	Further, the definition of “subsequent event” is broad and vague. For ease of compliance, we recommend it is revised to identify specific events that need to be reported, such as assignments, novations, exchanges, transfers, amendments, conveyances or extinguishing of rights.
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D. Treatment of offshore funds

Currently, the Consultation Paper states that offshore funds that are not managed by a type 9 LC / AI and that are not registered as a non-Hong Kong company with the Hong Kong Companies Registry will not be subject to any reporting obligations in Hong Kong. We agree with this approach and so we have provided the following responses to question 9 of the Consultation Paper.

Question 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 support the proposed treatment of offshore funds.
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We would appreciate if the Commission and the HKMA could consider our responses set out above.

Yours faithfully,

Hong Kong Trustee’s Association Ltd