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Dear Sirs

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

The International Swaps and Derivatives Association, Inc. ("ISDA") welcomes the opportunity to respond to the consultation paper on the Securities and Futures (OTC Derivative Transactions – Reporting and Record Keeping) Rules ("**Consultation Paper**") issued by the Hong Kong Monetary Authority ("HKMA") and the Securities and Futures Commission ("SFC") on 18 July 2014.

Since 1985, ISDA has worked to make the global over-the-counter (OTC) derivatives markets safer and more efficient. Today, ISDA has over 800 member institutions from 64 countries. These members include a broad range of OTC derivatives market participants including corporations, investment managers, government and supranational entities, insurance companies, energy and commodities firms, and international and regional banks. In addition to market participants, members also include key components of the derivatives market infrastructure including exchanges, clearinghouses and repositories, as well as law firms, accounting firms and other service providers. Information about ISDA and its activities is available on the Association's web site: www.isda.org.



ISDA is actively engaged with providing input on regulatory proposals in the United States, Canada, the European Union and Asia. Our response is derived from this international experience and dialogue in addition to consultation with ISDA members operating in the Asia Pacific region. We hope to assist the HKMA and the SFC in developing a mandatory reporting regime for Hong Kong which achieves your policy objectives and is in alignment with the mandatory reporting regime being introduced in comparable leading financial centres.

ISDA commends the HKMA and the SFC for your careful consideration of the issues involved in implementing the G20 commitments regarding mandatory reporting of OTC derivative transactions. We strongly support your objectives to improve overall transparency and strengthen market stability in the Hong Kong OTC derivatives market.

We are appreciative of the opportunities which you have given the industry to provide input on the draft rules ("**Draft Rules**") contained in the Consultation Paper and we hope to have continued dialogue between the industry and the HKMA and the SFC to work together to develop best practices and to address any implementation issues that may arise from trade reporting.

This Response sets out our comments in relation to the specific questions posed in the Consultation Paper. While our members have sought to form a consensus on the questions raised under the Consultation Paper, there are certain issues on which individual members may have their own views. This Response represents the majority view of the industry on the issues covered by the Consultation Paper, and certain members may provide their comments to the HKMA and the SFC independently.

Our Response is set out underneath each question. Terms defined or given a particular construction in the Consultation Paper have the same meaning in this Response unless a contrary indication appears. The headings used below correspond to the headings used in the Consultation Paper.

RESPONSE TO SPECIFIC QUESTIONS RAISED IN THE CONSULTATION PAPER

1. PERSONS (OTHER THAN AIS/AMBS/LCS) THAT WILL BE SUBJECT TO MANDATORY REPORTING

Q1. Do you have any comments or concerns about the proposed definition of "Hong Kong person", "RCH" and "ATS-CCP"?

- 1.1 We have no comments on the proposed definition of "Hong Kong person", "RCH" and "ATS-CCP".

2. OTC DERIVATIVE TRANSACTIONS THAT WILL BE SUBJECT TO MANDATORY REPORTING

Q2. 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?

NDFs over precious metals

- 2.1 Paragraph 58(b) of the Consultation Paper provides that NDFs will include "*transactions in specified currencies and precious metals*". We submit that the term NDF has traditionally been used by the markets to refer to foreign exchange ("FX") transactions relating to non-deliverable currencies only. It should be noted that it is uncommon for precious metals to be caught in scope under the classification of being a NDF. There may be instances in which a precious metal, such as bullion, may be structured as a NDF transaction, however, this is fairly uncommon in the market. In general, and consistent with industry practice, precious metals would be structured and classified as commodity derivatives. We seek clarification that only in instances where a precious metal transaction is structured in a bespoke manner as a NDF transaction would it be a reportable transaction. In all other instances, we request confirmation that precious metals are characterised as commodity derivatives, and therefore not reportable as a NDF under the reporting obligations. We request either the deletion of the reference to precious metals in this definition or additional guidance that expressly confirms the above distinction that precious metals (unless plainly structured as an NDF) are commodity derivatives.

Clarifications on types of OTC derivative transactions subject to mandatory reporting

- 2.2 The industry supports the HKMA and the SFC's prescriptive approach in defining the types of OTC derivative transactions that are subject to mandatory reporting. As such, please confirm our understanding in respect of each of the below transactions:

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- (a) overnight index swaps, whilst not specifically referred to as reportable transactions under the interim reporting rules, are considered to be a type of "plain vanilla IRS" and therefore are in scope as reportable transactions under the Draft Rules; and
- (b) equity / hybrid derivatives containing embedded NDF components are not reportable under the Draft Rules.

Spot contracts

- 2.3 Whilst we appreciate that the Consultation Paper does not specifically request industry feedback on the definition of spot contracts, we would like to submit our suggestion in anticipation of the expanded scope of reportable FX derivative transactions in the future.
- 2.4 We would like to request that the current definition of "spot contract" in the Securities and Futures (Amendment) Ordinance 2014 be expanded to cover:

Contracts for the exchange of currencies used for the purchase or sale of a transferable security should be regarded as bona fide spot contracts. The longer settlement period of these transactions is normally due to the securities settlement aspect which may differ depending on the local jurisdiction. A broadened interpretation of spot contracts should be used to address this type of spot transactions. We note that in the United States and in Canada, a FX transaction that is entered into solely to effect the purchase or sale of a foreign security, are considered as bona fide spot transactions and therefore outside the scope of the mandatory reporting regime.¹ We also note that a letter from Mr. Jonathan Faull, European Commission Director for Internal Market and Services, to Mr. Steven Maijoor, Chair of the European Securities and Markets Authority also included a reference to foreign exchange contracts used for the sale of a transferrable security when discussing the definition of FX spot contracts in the context of the EMIR reporting obligations.² We request that a similar approach be adopted under the Hong Kong reporting regime to expressly cater for the inclusion of these transactions as FX spot trades.

Q3. Do you have any comments or concerns as to how IRS and NDF are proposed

¹ See the definition of "Securities Conversion Transaction" under the CFTC rules at <http://www.gpo.gov/fdsys/pkg/FR-2012-08-13/pdf/2012-18003.pdf>.

² See http://www.esma.europa.eu/system/files/ec_letter_to_esma_on_classification_of_financial_instruments_23_07_2014.pdf

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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?

- 2.5 Our members have suggested several amendments to the current definition of "non-deliverable forward contract" in Part 1 of Schedule 1 to the Draft Rules to provide further clarity on the types of OTC derivative transactions caught under this definition. These include:
- (a) providing that the purchase of the currency takes place on a future date (for example, at least one business day post trade date) to ensure that only true forward contracts are captured by the definition; and
 - (b) providing that the NDF has only one value or settlement date. At present, the definition of "non-deliverable forward contract" captures any trade involving the purchase of a reference currency, thereby bringing non-deliverable swaps into the scope of the definition.
- 2.6 The industry submits that it is important that the reportable product classes are clearly defined to provide certainty as to the scope of the mandatory reporting regime. We consider that additional clarity may be achieved through these amendments.

3. REPORTING OBLIGATIONS OF AIS, AMBS AND LCS

Q4. 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

- 3.1 Members are supportive of the background and explanation provided by the HKMA and the SFC to the terms "conducted in Hong Kong" and "affiliate" in the Consultation Paper.
- 3.2 As Singapore is looking to introduce a limb of reporting that is similar to "conducted in Hong Kong", the industry hopes that, as far as possible, alignment is attained between Hong Kong and Singapore on the definition. We appreciate the Hong Kong regulators' understanding of the industry's concerns regarding the nexus definition and we commend HKMA and SFC in their efforts to align, as far as possible, with Singapore for the nexus definition.
- 3.3 We are very appreciative and strongly commend the HKMA and the SFC for engaging in international regulatory coordination and cooperative efforts with

regulators of other jurisdictions regarding mandatory reporting obligations. This will undoubtedly ensure that our members can implement a cost-effective and practical reporting system across these jurisdictions.

Guidance

- 3.4 It is our understanding that the HKMA and the SFC will publish guidance in relation to the "*conducted in Hong Kong*" limb of mandatory reporting prior to the finalisation of the Draft Rules. The industry is supportive of the regulators providing further clarity in the form of FAQs rather than addressing these issues in the Draft Rules.
- 3.5 The industry would welcome the opportunity to assist the HKMA and the SFC in the development of the FAQs on key topics (such as (a) the treatment of trades entered into through electronic trading platforms and (b) whether a trader who is "performing his functions substantially in Hong Kong" may be left to the discretion of a reporting entity to determine).
- 3.6 On a separate note, our understanding is that "inter-branch transactions" (arrangements / transactions between separate branches within the same legal entity) and "intra-branch transactions" (arrangements / transactions between separate desks within the same branch) will not fall within the reporting regime, as "inter-branch transactions" and "intra-branch transactions" do not constitute legal contracts. We note the helpful guidance provided by the HKMA to the industry on such transactions in the interim reporting regime and would be grateful if the HKMA and the SFC could confirm that this guidance is equally applicable to the final reporting regime.

Q5. 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?

- 3.7 Members are generally supportive of the proposal to require AIs and LCs that are registered/licensed for Type 9 regulated activity to report trades that they have entered into in their capacity as fund managers.
- 3.8 However, the industry seeks further clarification on the phrase "*enters into the transaction*" in rule 9(1)(c)(iii) of the Draft Rules. Members query whether this phrase refers to the decision to enter into the relevant derivative transaction or whether it relates to the execution of the transaction. For example, if an LC makes the investment decision but delegates its trade execution function to an offshore affiliate, it would be helpful to receive guidance on whether the LC or the offshore affiliate "*enters into the transaction*" on behalf of the fund.

Q6. 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.

- 3.9 Members have concerns about requiring reporting of transactions where an AI or LC, registered or licensed for Type 9 regulated activity, merely plays an advisory role in relation to the transaction. In our view it is impractical to extend trade reporting to transactions that the AI or LC has advised a counterparty on, as the AI or LC may not even know whether the counterparty subsequently executes the trade based on the advice received from the AI or LC.

4. REPORTING OBLIGATION OF CCPS

Q7. Do you have any comments or concerns about how the reporting obligation in respect of CCPs has been cast?

- 4.1 We are in principle supportive of the proposal to subject CCPs to reporting obligations. However, the industry seeks confirmation that:

- (a) there will be no obligation on AIs, AMBs, LCs and Hong Kong persons to ensure that a RCH or an ATS-CCP complies with its reporting obligations; and
- (b) the introduction of the Hong Kong reporting regime will not lead to the placement of restrictions on local AIs clearing with overseas CCPs pending the overseas CCPs receiving authorisation as ATS-CCPs. Our understanding is that draft rules will in due course be released for the introduction of mandatory clearing in Hong Kong, and rules under which overseas CCPs can apply for authorisation as ATS-CCPs will be introduced thereafter. In connection with this, the industry also seeks assurance that there will be sufficient time for overseas CCPs to receive authorisation as ATS-CCPs, and designation as ATS-CCPs under section 101J of the Securities and Futures (Amendment) Ordinance, prior to the commencement of mandatory clearing in Hong Kong.

5. REPORTING OBLIGATION OF HONG KONG PERSONS

Q8. Do you have any comments or concerns about the proposed approach to be taken in respect of the different types of Hong Kong persons?

- 5.1 Members have no contrary views on the proposed approach to be taken in respect of the different types of Hong Kong persons.

Q9. 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.

- 5.2 We support the proposals provided by the HKMA and the SFC in the Consultation Paper relating to the reporting obligations applicable to funds.

Q10. Do you have any comments or concerns about the proposed methodology for calculating if the reporting threshold or exit threshold has been reached?

- 5.3 Members are generally supportive of the proposed calculation methodology as set out in the Consultation Paper which determines whether the reporting threshold or exit threshold has been reached.

Q11. Do you have any comments or concerns about the proposed levels of the reporting threshold and exit threshold?

- 5.4 Members consider the proposed levels of the reporting threshold and exit threshold to be appropriate. Members agree that the statistics provided by the HKMA and the SFC in the Consultation Paper, which suggest that the vast majority of Hong Kong persons will not reach the proposed thresholds, seem accurate.

Q12. Do you have any comments or concerns about the proposed reductions to the reporting threshold and exit threshold at a later stage?

- 5.5 We have no objection to the proposed reductions to the reporting threshold and exit threshold at a later stage and would welcome consultation on the appropriate threshold further with the industry.

6. APPLICATION TO CROSS BORDER TRANSACTIONS

Q13. 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.

- 6.1 We support the proposed application of the mandatory reporting obligation to cross-border transactions. However, the industry would like to express its support for substituted compliance determinations to be made where appropriate and across jurisdictions where equivalent or similar reporting regimes are in place and therefore requests that the possibility of allowing substituted compliance in the future be left open in the Draft Rules. We encourage the HKMA and the SFC to work with regulators in other jurisdictions in the region in order to attain substituted compliance for their respective jurisdictions.

6.2 Given that foreign entities will be subject to reporting obligations in their home jurisdictions, the ability to apply substituted compliance will reduce the implementation costs as these entities will not need to undertake additional developmental costs. Substituted compliance determinations will streamline their reporting functions whilst remaining compliant with the reporting obligations in the jurisdictions in which they operate.

7. EXEMPTIONS AND OTHER RELIEF FROM THE REPORTING OBLIGATION

Q14. Do you have any comments or concerns about the proposed exemptions and reliefs, and the criteria for triggering them?

7.1 Members are supportive of the proposed exemptions and reliefs, and the criteria for triggering them.

Reporting by affiliates

7.2 With respect to transactions that become reportable by virtue of the "*conducted in Hong Kong*" test, members seek clarification on the exemption available to AIs, AMBs and LCs where they receive a confirmation from their affiliate, in good faith, that the affiliate has reported the relevant transaction.

7.3 In particular, where a counterparty to the transaction is an overseas affiliate of an overseas-incorporated AI, members submit that the affiliate should be permitted to report its trades through the AI's HKMA trade repository ("**HKTR**") member account. This would eliminate the unnecessary burden of requiring all affiliates to register as HKTR members.

7.4 If reporting were to be allowed via the overseas-incorporated AI's HKTR member account, members seek clarity on whether an agency agreement would need to be signed between the affiliate and the overseas-incorporated AI for the purposes of the reporting function to the HKTR, and whether the HKMA and the SFC would require outsourcing requirements to be fulfilled prior to reporting.

7.5 Members further submit that if the HKMA and the SFC are inclined to classify that arrangement as an outsourcing arrangement, then the affiliate and the overseas-incorporated AI should be exempt from complying with the outsourcing requirements by reason of the arrangement pertaining to entities within the same group.

Governments, central banks and governmental agencies

7.6 Moreover, we suggest that OTC derivative transactions with governments, central banks and governmental agencies ("**Special Entities**") should not be subject to the

reporting mandate. Whilst we understand that this exemption has been adopted only in Singapore, the industry would ask the HKMA and the SFC to consider the merits of this carve-out particularly given Hong Kong's close proximity to Singapore as a financial centre. Our members consider this exemption to be necessary due to the sensitive nature of OTC derivative transactions with Special Entities, which in the experience of the industry has meant that it is often impossible to obtain consent for reporting of trades entered into with them. We would also note that, due to the size and nature of trades involving Special Entities, the ability to mask data when reporting their trades does not always provide sufficient comfort for such Special Entities.

Q15. 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?

7.7 Members do not object to the proposal to exclude from the exempt person relief for IRS and NDF those licensed banks which are already reporting to the HKMA pursuant to the HKTR under the interim reporting requirement and have outstanding reportable transactions on the commencement of the Draft Rules.

7.8 It is our understanding that market participants which have not yet reported to the HKMA via the HKTR but have built the necessary infrastructure to facilitate reporting to the HKTR will not be disqualified from relying on the exempt person relief. We believe market participants should not be disqualified from such exemption in such circumstances since it would disincentivise them from establishing the infrastructure to ensure their operational readiness to report under the new regime. The industry would be grateful for confirmation on this issue.

Q16. 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.

7.9 We have no comments on this proposal.

8. BACKLOADING REQUIREMENT FOR OUTSTANDING TRANSACTIONS

Q17. 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.

8.1 Members have no objection to the Draft Rules proposed by the HKMA and the SFC relating to the backloading requirement for outstanding transactions.

8.2 However, members request clarification on whether the HKMA and the SFC will allow all outstanding trades to be backloaded even if they are due to mature or are terminated before the expiry of the grace period. We note that in Singapore, over-reporting is permitted, and a reporting entity can volunteer to report information beyond the required scope (i.e. it is free to backload all outstanding trades regardless of maturity if it wishes to do so).

Q18. 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.

8.3 Members have no views on this proposal.

Q19. 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.

8.4 Members have no views on this proposal.

9. TIME FOR REPORTING AND GRACE PERIODS

Q20. Do you have any comments or concerns about how the concession period and grace period are proposed to operate?

Trades booked in Hong Kong

9.1 We are supportive of the proposal to introduce a concession period and a grace period. However, members submit that the first phase of the reporting mandate in Hong Kong (which will cover trades booked in Hong Kong) should commence on the later of:

(a) 1 May 2015 (after including the designated concession period); and

(b) 180 days after the Draft Rules are finalised.

9.2 The reasoning for our proposed reporting commencement timeline is provided below:

(a) There are a number of other jurisdictions in the Asia Pacific region that are scheduled to expand their reporting regimes at the beginning of next year, such as Australia and Singapore. Due to resourcing constraints, a reporting commencement date in Hong Kong that coincides with the expansion of the reporting obligations in other Asia Pacific jurisdictions will be extremely difficult to achieve. Please see **Appendix 1** to this Response for further details

relating to the reporting commencement dates for Australia and Singapore in the first half of 2015.

- (b) Due to the multitude of jurisdictions implementing their reporting obligations concurrently, resources will need to be deployed to meet the various reporting commencement dates. Some members will be required to implement certain reporting requirements across multiple jurisdictions and will therefore face constraints in resources from both an information technology perspective as well as from a staffing perspective if trade reporting in Hong Kong were to begin in the first quarter of 2015.
- (c) For example, if trade reporting in Hong Kong were to commence in the first quarter of 2015, firms would need to engage in simultaneous simulation tests in respect of Australia, Singapore and Hong Kong, which all have different reporting regimes, to resolve any information technology related issues arising from each jurisdiction. For firms that have not yet participated in trade reporting in any other jurisdiction, this will pose an even greater challenge.
- (d) In addition, the industry recommends at least a 6 month lead time from the enactment of the Draft Rules before the trade reporting regime can commence. The lead time is to allow firms sufficient time to calibrate their reporting systems (from both a technological and operational perspective) in accordance with the requirements. It should also be noted that any subsequent change to the requirements would require another round of testing (which includes resource allocation, system calibration, user testing, program release etc.), and would require additional time to complete.
- (e) We recognise and are very appreciative of the efforts made by the HKMA and the SFC in achieving compatibility with international principles and with the regulations being implemented in other jurisdictions. The harmonisation of reporting requirements and implementation timetables across jurisdictions will reduce the differences in trade reporting requirements and allow market participants to leverage off existing infrastructure thereby lowering costs and increasing data quality. We respectfully request the HKMA and the SFC to consider a 6 month lead period in Hong Kong from the finalisation of the Draft Rules to the trade reporting commencement date.
- (f) In arriving at the proposed reporting commencement date referred to in paragraph 9.1 above, members have considered the significant operational, technological and regulatory infrastructure challenges posed by the implementation of the reporting mandate. We are also concerned with the potential operational risk that may arise if a market participant has to

commence reporting to three different trade repositories in three different locations in close succession.

- (g) Finally, without sufficient time for implementation of the trade reporting mandate we would expect (i) the HKMA and the SFC to receive numerous requests for relief which will prevent the HKMA and the SFC from receiving a set of data that reflects the whole Hong Kong OTC derivatives market; (ii) incorrect or missing data to be transmitted to the HKTR which will have a detrimental impact on the quality of the data analysed by the HKMA and the SFC; and (iii) longer periods of remediation for reporting issues which will divert resources away from implementing other aspects of the Hong Kong OTC derivatives regulatory framework.

- 9.3 Based on the foregoing reasons, we recommend that the first phase of the reporting mandate in Hong Kong be implemented by 1 May 2015 (including the designated concession period) or 180 days after the Draft Rules are finalised, whichever is the later. This will enable market participants to reduce their operation risk and will ensure that they can deploy sufficient resources to meet the various trade reporting commencement dates around the world, including in Hong Kong.

Trades "conducted in Hong Kong"

- 9.4 Although many members firms reported that they would need a minimum of 180 days to complete the relevant enhancement for reporting trades conducted in Hong Kong, we note that some members would require more time to meet this reporting obligation. We respectfully request the HKMA and the SFC to consider granting a longer relief (concession) period for trades "conducted in Hong Kong" such that those trades would only become reportable 6 months after the reporting of trades "booked in Hong Kong". This is in line with the industry's submissions to the Monetary Authority of Singapore asking for an additional six month grace period (i.e. from April 2015 to October 2015) before the commencement of reporting of OTC derivative transactions "traded in Singapore".
- 9.5 Unlike trades booked in Hong Kong (which are easier to capture from an operational perspective), the process for creating a technological and operational solution to the identification of trades "conducted in Hong Kong" is much more challenging for member firms. Whilst the industry appreciates the regulators' efforts in regularly engaging the industry's views on the definition of "conducted in Hong Kong", many member firms are unable to obtain approval to dedicate substantial resources towards the construction of a reporting system in the absence of finalised rules and guidance.

New product types

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- 9.6 The industry submits that the 3 month concession period may not be sufficient for certain new product types that may fall under the reporting regime in Hong Kong. In particular, for new product types that require the definition of additional fields to correctly capture all of the characteristics of such transactions, a 6 month concession period may be necessary in order to allow reporting entities sufficient time to become operationally prepared.

Additional requests

- 9.7 Our members also respectfully make the following two requests:
- (a) we would be grateful for an assurance from the HKMA and the SFC that the HKTR will have adequate operational support to cater for onboarding of AIs, AMBs, LCs and Hong Kong persons since the industry predicts that many market participants will need to link up with the HKTR in a short period of time; and
 - (b) we would appreciate an indication of timing as to when the Draft Rules are likely to be finalised in order to be in a better position to prepare our mandatory reporting implementation plans.

Q21. 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?

- 9.8 Members are concerned, based on the reasons set out in paragraph 9.2(f) above, that entities attaining regulated status during or after the concession period or ceasing to be exempt persons during or after the concession period will not have sufficient time to prepare for compliance with the mandatory reporting regime, as it is currently proposed that they will not benefit from the concession period. We urge the HKMA and the SFC to consider giving those entities a three month period after which time they would become subject to the Hong Kong mandatory reporting regime.

10. FORM AND MANNER OF REPORTING OBLIGATION

Q22. 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?

- 10.1 Members are, in general, agreeable to the proposed types of transaction information required to be reported for the purposes of the reporting obligation. However, members also request the HKMA and the SFC to clarify the following:

- (i) *Interest Payments* – in paragraph 8(a) of Schedule 2 of the Draft Rules, we do not anticipate that “*the series of interest payments to be paid by each counterparty*” would include identification of interest payments details (for example, interest amount, interest amount payment date), as this is not current practice in other regimes;
- (ii) *Alignment* – we would like to confirm that all reportable data fields (including valuation) and the manner in which they need to be reported are the same as the corresponding requirements stipulated under EMIR.

Q23. Do you have any comments or concerns about the proposal to require the reporting of valuation transaction information in the future?

- 10.2 We welcome the proposal of the HKMA and the SFC to require reporting of valuation transaction information in the future.
- 10.3 However, the industry considers that the proposed lead-in timeframe of three months that currently applies to reporting of transaction information is too short. We would recommend the HKMA and the SFC to institute an additional three month lead-in period (excluding the concession period) before valuation transaction information becomes reportable. It is critical that market participants have sufficient time and resources to meet compliance deadlines. We urge the HKMA and the SFC to give the market at least six months to prepare their reporting systems before valuation transaction information becomes reportable.
- 10.4 Additionally, if in the future collateral reporting becomes mandatory, or AIDG changes are made, we would like to request a 180 day grace period which would take effect from the time collateral reporting/the AIDG change is proposed to be implemented, as market participants will need time and resources to build the necessary reporting infrastructures to deal with those developments.
- 10.5 Further, where an entity is required to perform daily valuation transaction information reporting and the valuation data is sourced from an overseas system, in the event the valuation data is not updated because it is a holiday in the overseas location, we seek clarification on whether it will be acceptable to submit the previous day’s valuation figures in such a situation.

Q24. 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?

- 10.6 Members have no objection to the proposal on how subsequent events are to be reported, and when they will cease to be reportable.
- 10.7 Members also express concern about the wide range of activities that may be captured

by the term "subsequent event". Current operational builds amongst the industry are set up to report modifications to terms originally reported, including any unscheduled early termination. However, we understand that the use of the term "subsequent event" could require a much wider set of information to be reported.

- 10.8 As such, we request that the HKMA and the SFC consider replacing the reference to "subsequent event" in the Draft Rules with a reference to "any modification". This will reduce ambiguity as to the meaning of the term "subsequent event" and will assist the industry in developing an operational build that complies with this requirement.

Q25. Do you have any comments or concerns about the proposals on masking counterparty information under certain circumstances as a temporary measure?

Masking where a reporting entity has obtained a reasoned legal opinion

- 10.9 The industry understands the importance of providing the HKMA and the SFC with transaction information to enable them to develop a more complete view of OTC derivatives market activity and thereby enhance their ability to oversee the market and its participants. The industry is committed to providing as much of the required transaction information to the HKMA and the SFC as it is legally able to do.

- 10.10 At the same time, it is important that market participants are protected from the potentially severe legal consequences of reporting confidential client transaction information to the HKTR arising from local data protection and client confidentiality laws. We welcome the proposal to allow masking of counterparty particulars where:

- (a) the laws of an overseas jurisdiction (which will be designated by the SFC with the HKMA's consent), or an authority or regulatory organisation in that jurisdiction, prohibit the disclosure of such information; or
- (b) in the case of only historical transactions, the person cannot disclose such information without the consent of the other counterparty, and despite reasonable efforts, such consent cannot be obtained.

- 10.11 However, we are of the view that a third scenario allowing data masking should be included in the Draft Rules relating to trades which are subject to the laws of a jurisdiction not specified on the SFC list and in respect of which there exists an impediment for a reporting entity to report such transactions in Hong Kong. This scenario may apply where a reporting entity conducts OTC derivative transactions with a new client established in a jurisdiction which the HKMA and the SFC may not have considered for inclusion on the list to be prepared in accordance with rule 31(3).

- 10.12 To ensure that reporting entities are not required to illegally report counterparty particulars under the Hong Kong reporting regime in such circumstances, we consider

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the best solution to be adding a third limb to the two limb test outlined in paragraph 10.11 above, which would enable masking of counterparty particulars on the condition that the reporting entity obtains a reasoned legal opinion setting out why disclosure of the counterparty particulars would be contrary to the laws of that jurisdiction or prohibited by an authority or regulatory organisation in that jurisdiction.

Consent from counterparties for reporting

- 10.13 In relation to the proposal to limit the ability to mask counterparty particulars to historical transactions in instances where consent has not yet been obtained from a counterparty, the industry's experience has been that certain counterparties are invariably reluctant to give their consent. In particular, the ultimate clients of a fund manager will probably have stringent confidentiality requirements in their investment mandates that would prohibit such disclosure. Dealers may be under similar constraints *vis-a-vis* their own clients. Although ISDA has published several protocols by signing up to which parties may waive confidentiality requirements, dealers have found that some counterparties are reluctant to give the confidentiality waiver despite numerous requests made by the dealers.
- 10.14 As such, we request that the relief described in paragraph 10.10(b) above be extended to new transactions (i.e. not limited to historical transactions) in circumstances where a reporting entity demonstrates that it has made reasonable efforts to obtain counterparty consent and, despite such efforts, it still has not been able to obtain the counterparty's consent.
- 10.15 Finally, members seek further clarity on the references in the Consultation Paper to data masking being a "temporary measure" given that the time limitation is not apparent from the Draft Rules. Members note that where a country has a blocking statute in place, reporting will not be permitted until a change of law occurs. This is not in the control of the reporting entities and, as such, the industry submits that any relief in this regard should not be constrained by time.
- 10.16 We have included in our Response (under **Appendix 2**) an indicative list of jurisdictions where the reporting of counterparty identifying information is prohibited under the laws of that jurisdiction, or by the authorities or regulators in that jurisdiction. This list has been compiled based on extensive research conducted by our members in preparation for their mandatory reporting obligations globally.
- 10.17 The industry would be grateful for confirmation on whether any jurisdictions will be added to or removed from the list in Appendix 2, and a tentative date on which the SFC is likely to publish its finalised list.

Q26. Do you have any comments or concerns about the proposals for subsequently

reporting information when the pre-requisites for masking cease to exist?

- 10.18 We have no views on this proposal, other than those views expressed in Question 25 above.

11. SPECIFIED SUBSIDIARIES OF LOCALLY-INCORPORATED AIS

Q27. 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?

- 11.1 We reserve our comments on the proposal to require AIs to report transactions entered into by their specified subsidiaries until such time as the HKMA releases its guidance on this issue. However, the industry foresees difficulties in complying with this requirement without sufficient lead time being afforded to it to build the necessary infrastructure to support compliance with this requirement. As such, the industry respectfully requests an indication of when the guidance on this issue is likely to be published.

12. PROPOSED MANDATORY RECORD KEEPING OBLIGATION

Q28. Do you have any comments or concerns about the proposed record keeping requirements in relation to mandatory reporting?

- 12.1 The members have no concerns about the proposed record keeping requirements in relation to mandatory reporting.

Q29. 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?

- 12.2 Rule 36(1) of the Draft Rules requires records to be kept in a manner that enables the records to be readily searchable and identifiable by reference to the transaction and the counterparty. If paragraph 3 of Part 1 of Schedule 3 of the Draft Rules is intended to also reference phone records, members submit that there would be difficulty in being able to search such phone records on current systems by reference to the transaction and the counterparty. Member firms have no other objection to the types of records proposed to be kept, and the manner in which they are kept.

Q30. Do you have any comments or concerns about the duration for which the records are proposed to be kept?

- 12.3 We note that the duration of 7 years for which records are proposed to be kept is longer than the equivalent record keeping requirements of Australia, Singapore, the



European Union and the United States of America (all of which prescribe a duration of 5 years). The industry submits that the duration should be aligned with the requirements in these jurisdictions.

- 12.4 We would like to clarify with regulators whether paragraph 2 of Part 1 of Schedule 3 referring to “records showing particulars of the execution, including orders, ledger and confirmations” includes electronic communications such as emails and Bloomberg messages through which an order is placed. If the regulators’ intention is to cover those communications, some members are concerned that the requirement of keeping those records for 7 years after the maturity or termination of the relevant OTC derivative transaction would be too onerous in relation to long-dated transactions. For long-dated transactions (e.g., a 30-year swap), the proposed requirement would go well beyond the current SFC requirement to retain records for 7 years from the date of the relevant order or email.
- 12.5 In addition, the requirement in paragraph 3 of Part 1 of Schedule 3 of the Draft Rules to keep records evidencing the communications and instructions that resulted in the transaction being executed goes beyond the corresponding record keeping requirements in Singapore and Australia, and appears broad enough to include telephone recordings. We note that at present, the SFC Code of Conduct requires telephone records to be kept for only six months. The proposal to prescribe a minimum period of 7 years for the retention of records goes significantly beyond the current SFC requirement with respect to telephone recordings. To solve the issues mentioned in paragraph 12.2 and this paragraph, we submit that paragraph 3 of Part 1 of Schedule 3 of the Draft Rules be deleted as it is not relevant to the mandatory reporting regime and is not consistent with similar obligations in other jurisdictions such as Singapore and Australia.

Yours faithfully

For the International Swaps and Derivatives Association, Inc.

APPENDIX 1

This Appendix sets out the relevant reporting commencement dates occurring in Australia and Singapore in early 2015.

	Australia	Singapore
2 February 2015	Phase II Reporting Entities to commence reporting for transactions entered into in Australia	
1 April 2015		<p>Reporting to commence for FX derivatives booked in Singapore by banks</p> <p>Reporting to commence for credit and interest rate derivatives "traded in Singapore" by banks, merchant banks, other financial institutions (including Singapore incorporated banks) and significant derivatives holders</p> <p>Reporting to commence for UTI for paper trades in Singapore</p> <p>Reporting to commence for additional data fields ("Part IA") including valuation</p>
13 April 2015	Phase 3A Reporting Entities are expected to commence reporting of interest rate and credit derivatives at the earliest on this date	



APPENDIX 2

This Appendix sets out the jurisdictions of which we are aware where the reporting of counterparty identifying information is prohibited under the laws of that jurisdiction, or by the authorities or regulators in that jurisdiction.

1. Algeria
2. Argentina
3. Austria
4. Bahrain
5. Belgium
6. France
7. Hungary
8. India
9. Indonesia
10. Israel
11. Luxembourg
12. Pakistan
13. People's Republic of China
14. Samoa
15. Singapore
16. South Korea
17. Switzerland
18. Taiwan