

18 August 2014

Financial Stability Surveillance Division  
Hong Kong Monetary Authority  
55/F Two International Finance Centre  
8 Finance Street, Central  
Hong Kong

Dear Sir/Madam,

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

The consultation paper jointly released by the Hong Kong Monetary Authority (“HKMA”) and the Securities and Futures Commission (“SFC”) on 18 July 2014 (the “Paper”) proposed the detail requirements relating to the mandatory reporting and related record keeping obligations in respect of OTC derivative transactions. CLP Holdings Limited fully support the effort to further strengthen the resilience of the financial system, including the enhancement of the reporting and record keeping of financial transactions so long as the requirements are rational. Our views and comments on the captioned subject are hereby listed out below for your consideration.

**About CLP Group**

CLP Holdings Limited is a company listed on the Hong Kong Stock Exchange. It is the holding company for the CLP Group, which is one of the largest investor-owned power businesses in the Asia-Pacific. Through our major subsidiary, CLP Power Hong Kong Limited, we operate a vertically integrated electricity supply business in Hong Kong. Outside Hong Kong, CLP holds investment in the energy sector in Mainland China, India, Southeast Asia and Taiwan, as well as Australia. CLP’s diversified portfolio of generating assets uses a wide range of fuels including coal, gas, nuclear and renewable sources; and the Group companies adopt very prudent financial management in managing finance-related economic exposures such as foreign exchange, interest rate and energy risks by way of OTC derivative instruments.

**Our Views in General**

CLP supports the commitment of the HKMA and SFC in pursuing higher level of transparency, reducing systemic risks and protecting related parties from market abuse in trading OTC derivatives in Hong Kong and the global markets. We also share the view to take a phased-in approach for the reporting obligation, by product class and product type so as to smooth out the transitional period. We understand that under the proposal, each of the counterparties shall report as long as the mandatory reporting obligation applies unless exemption is available.

Based on the definition set out in Rule 5(2) of the Draft Rules, we believe most of the CLP companies registered in Hong Kong will be classified as Hong Kong Persons. These companies will be subject to mandatory reporting obligation if transactions in particular product class will stay above the proposed reporting thresholds but can be eligible for exemption and reliefs from such reporting obligation as long as they are transacting with the licensed corporation (LC), authorized financial institution (AI) or approved money broker (AMB) who are required to report in accordance to the Draft Rules. Nevertheless, we have a few comments that we expect will further optimize the proposed reporting requirements, without undermining the principle of the Draft Rules:

1. Excluding genuine economic hedge transactions and intra-group transactions from determination of reporting thresholds
2. Avoiding potential breach of reporting obligation
3. Streamlining the record keeping process
4. Exempting Hong Kong Persons to report valuation transaction information in the future
5. Providing detail guidance for calculation of reporting thresholds

### **Our Views in Details**

CLP Group is highly prudent (commercially and financially) in managing its business, funding and risk exposures. Our Group companies seek diversification in funding activities with an objective to raising cost effective, diversified (lending base, tenor, market, debt maturity) funding to support the Hong Kong and overseas businesses; and maintain a material HKAS39 hedge effective portfolio of OTC derivative instruments in mitigating most of the foreign exchange and interest rate risks.

For instance, CLP Power Hong Kong, the utility company supplying 80% of electricity to the city, involves in cross border, multi-currency debt raising as it seeks for the most optimal terms of borrowing amid a limited size of the Hong Kong dollar debt market. The company also participates in OTC derivative markets (foreign exchange, interest rate) to hedge genuine economic exposure with a view to enhancing the stability and certainty of electricity tariff so that it can fence off potentially adverse outcome to the electricity customers.

Therefore, CLP's continued ability in applying OTC derivative instruments, in a commercially rationale way, will be important in facilitating the Group companies to meet the expectation of its stakeholders including customers, authorities and shareholders.

#### **1. Excluding genuine economic hedge transactions and intra-group transactions from determination of Reporting Thresholds**

We believe most companies (notably blue-chip companies) in Hong Kong nowadays are highly disciplined in entering into OTC derivatives for genuine economic hedge but not trading. However, the Draft Rules, in its current form, makes no distinction between genuine hedging and trading activities in recommending the reporting thresholds. CLP considers it will be more meaningful to exclude genuine economic hedging and intra-group transactions by corporates in measuring the portfolio against the exemption thresholds for reportable transactions. This would

not undermine the objective of the Draft Rules but instead will enable the regulators to focus on those OTC derivative transactions which may generate potential systemic risks and market abuse in the Hong Kong market.

## **2. Avoiding potential breach of reporting obligation**

Hong Kong Persons are expected to act reasonably and pragmatically if they wish to rely on the exemption under Rule 20. However, the wordings in the Draft Rules as it is today is quite abstract and it is difficult to ensure that the reportable transactions by corporates will be/have been reported by their counterparties (AI, AMB or LC) as corporates will have limited control or knowledge on how and when the counterparties have fulfilled their reporting obligations. Also, it will be unreasonable, if not impractical, for Hong Kong Persons to check from time to time whether the respective traders in an AI, AMB or LC are employed or engaged to perform a substantial part of his or her duties in Hong Kong. We are caution that in such circumstance, Hong Kong Persons can easily fall into the trap of breaching the reporting obligation and subject to financial penalty due to “no reasonable excuse” for the breach when it leverages on the counterparties for the exemption to report.

In view of the above, we suggest to develop a list of AI/AMB/LC which are obligated to submit all reportable obligations entered into through or via their Hong Kong offices (either legal entities or branch offices) with the Hong Kong Persons for the OTC derivative transactions. With such designated list, Hong Kong Persons would be able to transact OTC derivatives with relevant counterparties without facing penalty for situations that they cannot control in good faith.

## **3. Streamlining the record keeping process**

We fully acknowledge the importance of good record keeping practices. However, we are not fully clear about the transaction information to be reported specified under Schedule 2. Some of the information including those related to the confirmation platform, central clearing counterparty and valuation of the transaction which may not be directly relevant to Hong Kong Persons that are corporates. In normal circumstances, all corporates should have kept all relevant details of OTC transactions for Companies Ordinance and audit purposes. We, therefore, would like to propose that, for Hong Kong Persons like corporates, the keeping of all details of OTC transactions as required under the Companies Ordinance and audit purposes would have allow them to meet the requirements under the Draft Rules.

## **4. Exempting Hong Kong Persons to report valuation transaction information in the future**

It is noted that, the HKMA and SFC are under consideration as to whether the reporting of valuation transaction information will apply to Hong Kong Persons in the future. We consider corporate should not be required to provide such information. Corporates manage genuine economic exposure by entering into hedging through effective OTC derivatives which we look for long-term performance of contractual obligations by the counterparties but not short-term valuation movements of those positions. Generally, corporates do not mark-to-market OTC

derivative transactions on a frequent basis like the AI because corporates do not view OTC derivative transactions as short-term trades that will report profit or loss before the maturity date. Thus, we would urge the HKMA and SFC to distinguish between corporates and AI which enter into OTC derivatives with different objectives and exempt Hong Kong Persons to report valuation transaction information in the future.

#### **5. Providing detail guidance for calculation of reporting thresholds**

In order to meet the requirements of the Draft Rules in calculating the reporting thresholds, we expect the HKMA and SFC will provide further guidance on the methods to determine the notional amount of certain OTC derivatives such as amortising IRS and the exchange rate to be applied for OTC derivatives like non-USD transactions.

#### **Summary**

We thank you for your effort in the consultation process and the kind attention to this matter. We strongly recommend the HKMA and SFC to further distinguish those requirements to be put forward to the corporates under the classification of Hong Kong Persons from that of the AI, as the situation permits, in finalizing the Draft Rules and the associated requirements. We believe such distinction will not undermine the principle in further enhancing the integrity of the financial system in the Draft Rules but instead can enable the authorities to focus more on the OTC derivatives that arise from trading or other proprietary purposes. We look forward to further elaborating our views if appropriate.

Yours sincerely,