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23 December 2014

By e-mail: fss@hkma.gov.hk and post

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

Dear Sirs,

**Further consultation on the Securities and Futures (OTC Derivative Transactions – Reporting and Record Keeping Obligations) Rules**

We refer to the further consultation on the proposed introduction of the Securities and Futures (OTC Derivative Transactions – Reporting and Record Keeping) Rules (“**Draft Rules**”), as set out in the Consultation Conclusions and Further Consultations on the Securities and Futures (OTC Derivative Transactions – Reporting and Record Keeping Obligations) Rules (“**Further Consultation**”).

The Hong Kong Association of Banks (“**HKAB**”) has considered the proposals in the Further Consultation in consultation with its members.

In summary, HKAB has the following concerns with the Draft Rules:

- A Valuation reporting** – parties should be able to submit separate valuations for non-centrally cleared transactions where the parties have not agreed to exchange margin.
- B Designated jurisdictions for masking relief** – Saudi Arabia, Kuwait and Brunei should be added to the list of designated jurisdictions, and secondly, reporting entities should be able to take their own view that a jurisdiction does not allow disclosure of counterparty identifying particulars by obtaining a legal opinion from external counsel.
- C Prescribed stock/futures markets and clearing houses** – two Mainland Chinese exchanges are proposed to be added and secondly, transparency is sought in relation to the process by which new exchanges are to be prescribed.

*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 香港上海滙豐銀行有限公司  
渣打銀行（香港）有限公司  
秘書



**D Other comments** – unique transaction identifier numbers should only be reported in respect of trades cleared via a CCP as such a requirement would complicate workflows and existing compliance systems.

We would be pleased to engage in further discussions with the Hong Kong Monetary Authority and the Securities and Futures Commission in relation to the Further Consultation if required.

Thank you again for this opportunity to provide you with HKAB's feedback. Should you have any questions, please contact

Yours faithfully

Enc.

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

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

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

**23 December 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”) as set out in the Consultation Conclusions (“Consultation Conclusions”) and Further Consultation on the Securities and Futures (OTC Derivative Transactions – Reporting and Record Keeping Obligations) Rules (“Further Consultation”), 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 Further Consultation Paper dated November 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”.

Our previous work in relation to the proposed OTC derivatives regime during previous consultation rounds has included responding to the consultation process considering the Amendment Ordinance and the Draft Rules.

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 is grateful that the Consultation Conclusions addressed many of the points we raised and took into account many of our suggestions.

HKAB is pleased to provide suggestions on the points raised by the Further Consultation:

- (a) **valuation reporting** – parties should be able to submit separate valuations for non-centrally cleared transactions where the parties have not agreed to exchange margin;
- (b) **designated jurisdictions for masking relief** – Saudi Arabia, Kuwait and Brunei should be added to the list of designated jurisdictions and secondly, reporting entities should be able to take their own view that a jurisdiction does not allow disclosure of counterparty identifying particulars by obtaining an appropriate legal opinion from external counsel; and
- (c) **prescribed stock/futures markets and clearing houses** – two Mainland Chinese exchanges are proposed to be added and secondly, transparency is sought in relation to the process by which new exchanges are to be prescribed.

We welcome the opportunity to discuss these comments further.

## HKAB's response

### A Reporting of valuation transaction information

- 1 **Regarding the reporting of valuation transaction information, we further discuss in paragraphs 122 to 125 below the details of this requirement, including the proposed reporting timeframe, implementation timetable and approach, and would welcome any views on the proposed requirements.**
- 1.2 HKAB is supportive of the proposal to report valuation transaction information. However, a number of issues arise in relation to its implementation. HKAB would be grateful for the opportunity to discuss the proposed timeframe and approaches to valuation.
- 1.3 In particular, HKAB is concerned that, for non-centrally cleared transactions other than those where the counterparties have agreed to exchange margin, the proposal is that the valuation should be based on a methodology mutually agreed between counterparties.
- 1.4 This method of agreeing valuation runs against current market practice. Current market practice is that each counterparty to a transaction arrives at its own separate valuation rather than on mutual agreement. We understand that this is the position under the European Market Infrastructure Regulation ("EMIR"), which does not require mutual agreement. Although the United States Commodity Futures Trading Commission ("CFTC") does require the counterparties to have an "agreed process" in their documentation, we note that the CFTC has previously stated that differing valuations, that are only the opinion of one party, would still be a valuable tool in monitoring systematic risk.<sup>1</sup>
- 1.5 Furthermore, the requirement to mutually agree valuation between parties creates practical difficulties. Counterparties may not possess the necessary infrastructure to use the methodology preferred by the other party, even if one of the counterparties is an AI. It would greatly reduce the compliance burden on institutions if counterparties were allowed to adopt separate valuation criteria.
- 1.6 Preparing a framework under which counterparties must mutually agree on a valuation methodology will be a significant regulatory exercise in its own right. CFTC rules §§23.500 – 23.505 (the "CFTC Rules") require that counterparties agree on the valuation methodology, an alternative methodology in the event of the failure of the first, as well as a valuation dispute resolution mechanism. Given the complexities, HKAB would like to see confirmed that it is possible for counterparties to mutually agree that they will each report using their own separate valuation methodology.<sup>2</sup>
- 1.7 With regards to the timing of valuation reporting, HKAB asks if it would be possible to report valuation and transaction information separately within the T+2 timeframe. In particular, HKAB seeks clarification that it would be possible to report trade details prior to valuation information.
- 1.8 HKAB would also appreciate further guidance on the acceptable methodology to value foreign exchange transaction and associated margin exchange, given the fluid nature of foreign exchange changes.
- 1.9 Given the outstanding challenges articulated above, HKAB is of the view that more time is needed for implementation. As a result, the Q1 2016 timeframe is not feasible for valuation transaction reporting.

<sup>1</sup> CFTC 17 CFR Part 45, Swap Data Recordkeeping and Reporting Requirements; Final Rule, [Doc No: 2011-33199]

<sup>2</sup> 17 CFR 23.504 - Swap trading relationship documentation

## **B Designated jurisdictions for masking relief**

- 2 For the purpose of the masking relief, we propose to designate the list of jurisdictions which is set out in paragraph 126 below, and would welcome comments on such proposed list.**
- 2.1 HKAB asks that the following jurisdictions be added to this list of jurisdictions for masking relief:
- (a) Saudi Arabia;
  - (b) Kuwait; and
  - (c) Brunei.
- 2.2 The reason for the inclusion of these jurisdictions is that the application of local privacy and confidentiality rules is uncertain in those jurisdictions, where Islamic law applies. We note that Saudi Arabia is a prescribed jurisdiction in Australia for the purpose of masking relief on the basis that the jurisdiction has blocking statutes.<sup>3</sup>
- 2.3 We would also like to take this opportunity to address a masking requirement which is particularly difficult for our members to satisfy. Among other requirements, masking relief will only be available in relation to a reportable transaction if the submission of the counterparty information is prohibited under the laws of, or by an authority or regulatory organisation in, a jurisdiction.<sup>4</sup>
- 2.4 We understand from the Consultation Conclusions that the SFC and the HKMA do not intend to allow reporting entities to rely on a legal opinion for the purpose of satisfying this requirement on the basis that it could create uncertainty and inconsistencies between various market participants. However, we invite the SFC and the HKMA to reconsider its position as it is inconsistent with the regulators in Australia and the United States.
- 2.5 Under the Australian regime, a reporting entity may rely on masking relief provided that it:
- (a) is of the reasonable view that reporting the identifying information to the trade repository would cause it to breach a law or regulation of the counterparty's jurisdiction;
  - (b) has a written opinion of external legal counsel that supports this view (which it must provide to the Australian Securities and Investments Commission on request); and
  - (c) is reasonably satisfied that the law or regulation the subject of the written legal opinion has not changed in any relevant respect since the date the opinion was issued.<sup>5</sup>
- 2.6 Similarly, the CFTC will not commence enforcement action against a reporting counterparty for failure to report counterparty identifying particulars for any swap for which the reporting counterparty has:<sup>6</sup>

<sup>3</sup> Please see the 'Summary of transitional exemptive relief given in connection with the commencement of Phase 2 of the trade reporting obligation' issued by the Australian Securities and Investments Commission.

<sup>4</sup> Draft Rules, 26(1)(a)(i).

<sup>5</sup> ASIC Instrument [14/0234], Class Exemption 2.

<sup>6</sup> US Commodity Futures Trading Commission, CFTC Letter No. 12-46.

- (a) a reasonable belief that is based on either:
    - (i) a written opinion of outside legal counsel, stating that statutory or regulatory prohibitions in non-US jurisdictions preclude the reporting counterparty from reporting the identifying particulars required; or
    - (ii) a written opinion of outside legal counsel, stating that the common law in a non-US jurisdiction could expose the reporting counterparty to criminal or civil liability for reporting the identifying particulars, and the Reporting counterparty determines that there is a material risk that the non-reporting Counterparty or regulatory authority may initiate litigation;
  - (b) not yet obtained consent from such non-reporting counterparty or the relevant non-US regulatory authorisation to disclose the identifiers; and
  - (c) made reasonable and demonstrable efforts to obtain such consent or regulatory authorisation.
- 2.7 We therefore urge a reconsideration of the Draft Rules to allow reporting entities to obtain a legal opinion for the purposes for satisfying themselves that a jurisdiction prohibits the disclosure of counterparty identifying particulars.
- 2.8 On timing, HKAB supports that that masking relief has been extended to cover new transactions entered into within the first six months after the Rules are implemented. However, given the heavy demands facing AIs implementing OTC derivative reporting systems across a number of jurisdictions, along with other heavy compliance requirements across the board, HKAB members would be grateful if the period for obtaining client consent could be extended to one year.

## C Prescribed stock/futures markets and clearing houses

- 3 The definition of “OTC derivative product” under section 1B of Part 1 of Schedule 1 to the SFO excludes products that are traded on a “prescribed” stock or futures market, and cleared through a “prescribed” clearing house. For this purpose, we propose to recommend to the Financial Secretary that he prescribe the list of stock/futures markets and clearing houses set out in Appendix B, and would welcome views on the proposed list.**
- 3.1 HKAB requests that the following entities be added to the proposed list:
- (a) China Foreign Exchange Trading System; and
  - (b) Shanghai Clearing House, “Interbank Market Clearing House Co., Ltd”.
- 3.2 HKAB also requests more transparency in the process for a new stock market, futures market or clearing house to become “prescribed”. We understand that the Financial Secretary may, by notice published in the Gazette, prescribe any stock market, futures market or clearing houses pursuant to section 392A of the Amendment Ordinance.
- 3.3 Our members would specifically like more details regarding:
- (a) the process by which market participants may make recommendations to the Financial Secretary for stock market, futures market or clearing houses to become prescribed;
  - (b) the information that the Financial Secretary may require in order to prescribe certain markets or clearing houses; and

- (c) the time frame in which the Financial Secretary will respond to recommendations.

## D Other comments

### 4 Use of unique transaction identifier (“UTI”) numbers

- 4.1 HKAB members have expressed concern that reporting UTI numbers would complicate their workflow, and require enhancement to existing compliance systems. This is particularly true with non-clearing trades, which would require establishing systems to exchange this information outside of the existing clearing house infrastructure. For streamlined compliance, HKAB suggests that UTI numbers only be reported in respect of trades cleared via a CCP.

## Next steps

Thank you very much for the opportunity to again 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.