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Dear Sir / Madam,

**Consultation Paper on Introducing Mandatory Clearing and Expanding Mandatory Reporting for OTC Derivatives Transactions**

Deutsche Bank (DB) welcomes the opportunity to provide feedback on the consultation on the introduction of mandatory clearing and expansion of mandatory reporting.

We appreciate the continued dialogue with the industry to support the authorities' implementation of OTC derivatives reforms in Hong Kong in a way which seeks to address risks in this market while taking into account the cross-border nature of these activities and delivering the objectives of improving transparency and market stability.

Our detailed comments in response to the questions posed are included in the appendix. We would like to highlight the following key points:

**Mandatory clearing**

- We welcome the authorities' approach to address cross border issue with the introduction of a substituted compliance regime. In support of this, the mandatory clearing requirement should take effect only after formal confirmation of designated CCP status of foreign CCPs to avoid market disruption.
- With respect to the timing, the regime should provide flexibility to take into account developments in other jurisdictions with respect to mandatory clearing of G4 currency denominated IRS, so that infrastructure developments can be managed (e.g. if EMIR regime is delayed) and timelines can be aligned to support substituted compliance.
- Both the availability of designated CCPs and the authorities having flexibility to align with timelines in other jurisdictions will also be highly relevant in the context of any additional products or overnight index swaps (OIS) being included in the scope of mandatory clearing requirements.
- DB agrees that the scope of the clearing obligation for overseas incorporated AIs should be limited to specified OTC derivatives transactions booked in Hong Kong.
- Recognising the systemic importance in the context of Hong Kong of HKD IRS and that this should be subject to mandatory clearing in due course, we recommend not including this in phase 1 on the basis of the current level of market liquidity and the limited availability of CCPs.



- There are significant operational challenges arising from the need to determine whether counterparties are 'prescribed persons' or 'financial services providers'. We suggest a pragmatic approach such that the status can be provided once and shared with market participants as needed. In addition, for identification of counterparties as 'financial service providers' it would be helpful to be able to utilise public information or allow reference to status under other regimes where appropriate.

#### **Trade reporting**

- Drawing on experience of implementation of Phase 1 of the reporting requirements in Hong Kong and requirements in other jurisdictions, it is imperative for successful implementation that there is sufficient lead time from the point at which the rules are considered final. We consider that this should be a minimum of twelve months. Therefore, if the intention is that this regime may apply from early 2017 (e.g. 2Q), the requirements will need to be finalised as early as possible in 2016 and absolutely no later than June.
- We understand the authorities' intention that information categories will be set out in the subsidiary legislation and the authorities will separately publish specific data fields using a (non-statutory) Gazette notice. It nonetheless remains important that there still be consultation with the industry and then a sufficient notice period prior to revised HKMA Trade Repository Manuals coming in to effect (i.e. nine months), which relate to changes to information categories and/or Supplementary Reporting Instructions. We are contributing to the data fields level analysis coordinated by ISDA and will be submitting our feedback via the trade association.
- Backloading obligations should be limited and only apply to transactions "booked in Hong Kong" that are outstanding at the time of the commencement of phase 2.

Please let us know if you would like to discuss further any aspect of our response and we look forward to continuing to contribute to the development of the regime. If you have any questions on the points raised please contact

DB has also provided input to the joint industry response prepared by the trade associations (i.e. ISDA, the FIA and ASIFMA).

Yours sincerely

Deutsche Bank AG Hong Kong



## Appendix

Key proposals on mandatory clearing
<b>Products to be subject to mandatory clearing</b>
<b><i>Q1. Do you have any comments or concerns regarding the proposed clearing determination process, or any of the factors included in that process? If so, please provide specific details.</i></b>
We agree with the process outlined in paragraph 55. We suggest that as well as the consideration outlined in 55(g) (which explains that the authorities will take into consideration "whether any CCP authorised by the SFC offers, or is proposing to offer, services for clearing such product") this should be expanded to include also the availability of designated CCPs.
<b><i>Q2. Do you have any comments or concerns about our proposals on the types of IRS that should be subject to mandatory clearing? If you do, please provide specific details.</i></b>
No comments.
<b><i>Q3. Do you have any comments or concerns about our proposals to only include plain vanilla IRS with constant notional amounts and no optionality? If so, please provide specific details.</i></b>
No comments.
<b><i>Q4. Do you have any comments or concerns about our proposal to include IRS denominated in any of the G4 currencies under phase 1 clearing? If you do, please provide specific details.</i></b>
<p>As recognised by the authorities in the paper, not all G4 currencies can be cleared in Hong Kong. As such, it is important that the mandatory clearing requirement takes effect only after formal confirmation that appropriate foreign CCPs have become designated CCPs to avoid any disruption to the market.</p> <p>With respect to the timing, it would also be helpful for planning purposes if the authorities would provide flexibility to take into account developments in other jurisdictions with respect to mandatory clearing of G4 currency denominated IRS, so that infrastructure developments can be managed. In particular we highlight that this flexibility may be needed for alignment with the timeline for EMIR mandatory clearing obligation in the context of potential delay.</p>
<b><i>Q5. Do you have any comments or concerns about our proposal to mandate HKD denominated IRS for clearing under phase 1 clearing? If you do, please provide specific details.</i></b>
We understand that HKD IRS is systemically important in the context of Hong Kong and should be subject to mandatory clearing in due course. However, taking into account the criteria identified by the authorities for determining which products should be subject to the requirements, we consider that it is too early to include HKD IRS, on the basis of the level of market liquidity and the limited availability of CCPs at this stage. We recommend this be kept under review and re-proposed in due course should circumstances merit this.
<b><i>Q6. Do you have any comments or concerns about our proposal to only cover IRS that feature the indexes set out in the two tables above? If you do, please provide specific details.</i></b>



We agree with this proposal.

***Q7. Do you have any comments or concerns about our proposals on whether OIS should be covered under phase 1 clearing, and in what circumstances? If you do, please provide specific details.***

The timing of the introduction of mandatory clearing of overnight index swaps (OIS) should, as for other products, be dependent on the availability of designated CCPs, and include flexibility to align with timelines in other jurisdictions (e.g. under EMIR).

***Q8. Do you have any comments or concerns about our proposal that mandatory clearing should apply to IRS that feature the range of tenors described above? If you do, please provide specific details.***

We propose that the range of tenors prescribed in the Hong Kong regime mirror those proposed under EMIR, to support the development of integrated infrastructure and reduce the risks and costs associated with fragmented systems.

***Q9. Do you have any comments or concerns about our proposal not to cover NDF transactions under phase 1 clearing? If so, please provide specific details.***

We agree with the proposal that Phase 1 does not include requirements for NDF transactions.

**Only dealer-to-dealer transactions to be subject to mandatory clearing in first phase**

***Q10. Do you have any comments or concerns about our proposal to restrict mandatory clearing to only dealer-to-dealer transactions in the first phase? If you do, please provide specific details.***

No comments.

***Q11. Do you have any comments or concerns about our proposed criteria for scoping dealer-to-dealer transactions? If you do, please provide specific details.***

The scope of the dealer-to-dealer transactions requires a prescribed person to determine the status of its counterparties as either 'prescribed persons' or 'financial services providers' and know the level of their activities. To make this workable, there are practical considerations to be taken into account.

The status of an individual legal entity can be checked with reference to the SFC or HKMA websites to determine if it meets definitions set out under the SFO with respect to being a prescribed person. However, further bilateral checks would be required in the form of written confirmations regarding the counterparty's status and with respect to the threshold, on a continuing basis.

To minimise the operational burden on market participants, it would be helpful to centralise this process such that for each market participant, the information regarding their status would be submitted only once and made accessible to all prescribed persons. In order that this can be relied upon for regulatory purposes and considered comprehensive, this could be made a notification requirement to supplement the rules requiring market participants to perform the threshold calculations. The list maintained by the HKMA and/or SFC would then be a source of some of the static data required by firms within their systems. Such an approach is under consideration in other jurisdictions (e.g. Australia and Singapore) and would to some extent alleviate potential operational difficulties previously encountered (e.g. for EMIR) in categorising some counterparties.





**Q12. Do you have any comments or concerns about our proposed scope for “prescribed persons” and “financial services providers”? If you do, please provide specific details.**

DB agrees that the scope of the clearing obligation for overseas incorporated AIs should be limited to specified OTC derivatives transactions booked in Hong Kong.

As under Q11 counterparty designation poses operational challenges. In the consultation paper, it is explained that the definition of “financial service provider” is intended to capture only major dealers which are not “prescribed persons”. In this context, it would be helpful for the authorities to consider how the identification process could be adjusted to reduce complexity – e.g. utilisation of public information or allowing reference to status under other regimes where appropriate. There should be further dialogue between the authorities and the industry to consider how best this can be achieved.

**Q13. Do you have any comments or concerns about our proposal to look at all OTC derivative transactions, other than deliverable FX forwards, when assessing if the clearing threshold has been crossed? If you do, please provide specific details.**

No comments.

#### **Clearing threshold and its calculation**

**Q14. Do you have any comments or concerns about our proposal to set clearing thresholds by reference to a calculation period? If you do, please provide specific details.**

No comments.

**Q15. Do you have any comments or concerns about our proposal to use multiple calculation periods and multiple thresholds? If you do, please provide specific details.**

No comments.

**Q16. Do you have any comments or concerns about our proposed threshold variations for different market participants? If you do, please provide specific details.**

It would be helpful to provide more detail on what is to be included or excluded from the calculation for the purpose of the global threshold .

**Q17. Do you have any comments or concerns regarding our proposed formula for calculating the “average position”, i.e. the position that is to be measured against the clearing threshold? If you do, please provide specific details.**

No comments.

**Q18. Do you have any comments or concerns about the proposed threshold levels? If you do, please provide specific details.**

No comments.

**Q19. Do you have any comments or concerns about our proposal that only future transactions should be subject to mandatory clearing? If you do, please provide specific details.**

We support this approach.



**Q20. Do you have any comments or concerns about our proposal not to include an exit threshold? If you do, please provide specific details.**

There may be some situations where the ability to change status is warranted, such as situations where business models change significantly or if the threshold is passed due to unusual levels of activity, which can be demonstrated not to be the norm over a longer period. The introduction of an exit threshold would require calibration such that counterparties are not changing status frequently, posing operational challenges for other market participants and running counter to the authorities underlying intention to ensure that clearing is increasingly the market practice. That said, potentially limited to “prescribed person” status and in keeping with the suggested notification requirement set out in response to Q11, there could be the option for counterparties to exit on an exceptional basis if agreed with the authorities.

#### **Complying with the clearing obligation**

**Q21. Do you have any comments or concerns regarding the matters to be checked by a prescribed person? If you do, please provide specific details.**

No comments.

**Q22. Do you have any comments or concerns regarding a prescribed person’s obligations vis-à-vis following up on transactions that have been submitted for clearing? If you do, please provide specific details.**

No comments.

**Q23. Do you have any comments or concerns about the proposed T + 1 timeframe for clearing, and our proposal to define “business day” to mean a business day in Hong Kong? If you do, please provide specific details.**

No comments.

**Q24. Do you have any comments or concerns about our proposal not to cover specified subsidiaries of locally incorporated AIs under phase 1 clearing? If you do, please provide specific details.**

No comments.

#### **Exemptions from the clearing obligation**

**Q25. Do you have any comments or concerns regarding our proposed intra-group exemption or any aspect of it? If you do, please provide specific details.**

No comments.

**Q26. Do you have any comments or concerns regarding our proposed jurisdiction-based exemption or any aspect of it? If you do, please provide specific details.**

No comments.

#### **Position on de-clearing**



**Q27. Do you have any comments or concerns regarding our proposal not to cover de-clearing and trade compression expressly under the rules? If you do, please provide specific details.**

DB agrees that de-clearing and trade compression should be possible. While this may not be explicitly stated within the regulation for the reasons outlined by the authorities, this expectation should be included in relevant guidance or FAQs to confirm this position.

#### **Substituted compliance**

**Q28. Do you have any comments or concerns about our proposed substituted compliance framework, or any aspect of it? If you do, please provide specific details.**

We fully support the implementation of a regime recognising that compliance with the rules of a "comparable jurisdiction" will fulfil the Hong Kong mandatory clearing obligation, which is intended to address potential cross-border issues. We appreciate the authorities taking a pragmatic and constructive approach with respect to outcomes and building on the work of the OTC Derivatives Regulators Group (ODRG) in identifying its initial list of jurisdictions and the approach to identifying designated CCPs.

Ensuring sufficient flexibility on timing will be important to avoid any issues arising from sequencing or misalignment between timing of requirements in different jurisdictions.

**Q29. Do you have any comments or concerns about our proposed list of "comparable jurisdictions"? If you do, please provide specific details.**

No comments.

#### **Clearing related record keeping requirements**

**Q30. Do you have any comments or concerns about our proposed record keeping requirements for demonstrating compliance with the clearing obligation? If you do, please provide specific details.**

No comments.

#### **Designation and regulation of CCPs**

**Q31. Do you have any comments or concerns about our proposed processes for designating CCPs or for revoking a CCP designation? If you do, please provide specific details.**

Due to the structure of DB's operations, our compliance with the requirements will largely be contingent on designation of specific foreign CCPs at a point before the commencement of mandatory clearing in Hong Kong. Recognising that this decision is contingent on application by the CCP and engagement of its home regulator, we appreciate the authorities doing their utmost to engage at as early a stage as possible with those institutions and taking a pragmatic view with respect to timing.

**Q32. Do you have any comments or concerns about our proposal to implement only the clearing leg of the extended definition of "ATS" at this stage? If you do, please provide specific details.**

No comments.



**Q33. Do you have any comments or concerns about our proposal to defer implementation of the changes to the definition of “market contract” to cover CCPs that are authorized ATS providers and designated CCPs? If you do, please provide specific details.**

No comments.

#### **Key Proposals on Mandatory Expanding Mandatory Reporting**

##### **Expanded product scope**

**Q34. Do you have any comments or concerns about our proposal to include all OTC derivative products in the next phase of mandatory reporting? If you do, please provide specific details.**

We understand the need to require all OTC derivative products in the next phase. However, we suggest implementing this using staggered asset class compliance dates to mitigate the risks associated with a “big bang” delivery across multiple asset classes.

##### **Implications of removing “product class” and “product type”**

**Q35. Do you have any comments or concerns about our proposal that the “exempt person” relief should be extended to cover all OTC derivative products, but that it should no longer apply on a product class basis? If you do, please provide specific details.**

No comments.

**Q36. With respect to the criteria for triggering the “exempt person” relief, do you have any comments or concerns about our proposal that the limit on the aggregate notional amount should stay at US\$30 million? If you do, please provide specific details.**

No comments.

**Q37. Do you have any comments or concerns about our proposal to do away with the concession period and defer commencement of phase 2 reporting until 6 months after the rules are enacted? If you do, please provide specific details.**

Drawing on experience of implementation of Phase 1 of the reporting requirements in Hong Kong and other requirements under different national regimes, it is imperative that there is sufficient lead time from the point at which the rules are declared final. We consider that this should be a minimum of twelve months. Therefore, if the intention is that this regime may apply from early 2017 (for example, 2Q) the requirements will need to be finalised as early as possible in 2016 and absolutely no later than June.

This reflects that the new requirements will need to be included in our strategic global reporting architecture. Factors which need to be worked through include: analysis of IT systems involved for additional products; lead time for resource mobilisation; budget approval; requirements analysis; solution design; cross-border data transfer regulatory approval; client consents; system build out and integrations, hardware capacity planning and provisioning, system testing, onboarding and integration with reporting agents and trade repository, new control procedures design and implementation, and user trainings, building a system that captures Nexus trades is inevitably longer and more complex than building a system that supports reporting trades that are booked in a specific office / balance sheet. Currently the system build release cycle is set as every 3 months (March, June, and September, with no releases scheduled in December due to year end “code freeze” to ensure system





stability).

The industry and individual firms will also need to work with DTCC to ensure their readiness.

#### **Transaction information to be reported under Phase 2 reporting**

***Q38. Do you have any comments or concerns about our proposal to only set out the information categories in the subsidiary legislation, and separately publish, by way of a (non-statutory) Gazette notice, the specific data fields to be completed when reporting transaction information to the HKTR? If you do, please provide specific details.***

We understand the authorities' intention that information categories will be set out in the subsidiary legislation and the authorities will separately publish specific data fields using a (non-statutory) Gazette notice. It nonetheless remains important that there still be consultation with the industry and then a sufficient notice period prior to revised HKMA Trade Repository Manuals coming in to effect (i.e. nine months), which relate to changes to information categories and/or Supplementary Reporting Instructions. We are contributing to the data fields level analysis coordinated by ISDA and will be submitting our feedback via the trade association.

***Q39. Do you have any comments or concerns about the specific data fields set out in the tables at Appendix D? If you do, please provide specific details, including suggestions for alternative ways to capture the relevant information.***

We will provide comments via ISDA in due course.

#### **Reporting of valuation transaction information**

***Q40. Do you have any comments or concerns about our revised proposal on the reporting of valuation transaction information? If you do, please provide specific details.***

For transactions cleared on a designated CCP, the responsibility for reporting valuations should be placed solely on the relevant designated CCP, avoiding duplicative reporting.

For uncleared transactions subject to margin requirements, the requirement to report a mutually-agreed valuation for non-centrally cleared transactions should not be implemented prior to the final implementation of rules for margin for non-centrally cleared swaps.

***Q41. In what circumstances do you envisage it will be necessary to submit the previous day's valuation figures, and why? Please provide specific details including the practices adopted and the particular difficulty encountered in view of such practices.***

Reporting entities will not be able to source valuation data relating to transactions referencing the currency of jurisdiction X where there is a holiday in that jurisdiction. As such, the previous day's valuation figures should be used.

#### **Mandatory record keeping obligation**

***Q42. Do you have any comments or concerns about our proposal to expand the mandatory record keeping obligation so that it applies in respect of the expanded product scope, but to leave the obligation otherwise unchanged? If you do, please provide specific details.***

We agree with the proposal.



**Implications that proposed changes will have for different reporting entities**

***Q43. Do you have any comments or concerns about our proposal to have a single grace period under phase 2 that applies across all products and product types? If you do, please provide specific details.***

We agree with the proposal.

***Q44. Do you have any comments or concerns about our proposals for how the single grace period under phase 2 will apply in respect of persons who are already reporting under phase 1? If you do, please provide specific details.***

We consider that requiring backloading of additional information for all trades outstanding at the commencement date will prove challenging both in terms of obtaining the information and operationally. The additional information required to meet new requirements may not have been captured at trade inception and back-filling the information undermines the pragmatic approach taken by the authorities.

As such obligations should be limited and only apply to transactions "booked in Hong Kong" that are outstanding at the time of the commencement of phase 2. In addition, where transactions have undergone lifecycle events, backloading of additional information should be based on the latest terms as of the backloading date.

***Q45. Do you have any comments or concerns about our proposals for how the single grace period under phase 2 will apply in respect of persons who became subject to mandatory reporting under phase 1 but whose grace period under phase 1 is still running when phase 2 reporting takes effect? If you do, please provide specific details.***

No comments.