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Dear Sirs and Madams,

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

The International Swaps and Derivatives Association, Inc. ("**ISDA**"), the Futures Industry Association Asia ("**FIA**"), and the Asia Securities Industry & Financial Markets Association ("**ASIFMA**", and together with ISDA and FIA, the "**Associations**") welcome the opportunity to respond to the consultation paper on introducing mandatory clearing and expanding mandatory reporting for OTC derivatives transactions ("**Consultation Paper**") issued by the Hong Kong Monetary Authority ("**HKMA**") and the Securities and Futures Commission ("**SFC**") on 30 September 2015.

Since 1985, ISDA has worked to make the global derivatives markets safer and more efficient. Today, ISDA has over 850 member institutions from 68 countries. These members include a broad range of 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, intermediaries, clearing houses and repositories, as well as law firms, accounting

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firms and other service providers. Information about ISDA and its activities is available on the ISDA's web site: www.isda.org.

FIA represents a diverse group of exchange-traded and centrally cleared derivatives industry participants from across the Asia-Pacific region. Its members include banking organisations, clearing houses, exchanges, brokers, market infrastructure providers, vendors and trading participants. Under FIA Global, FIA with its affiliate associations FIA Americas and FIA Europe are the primary global industry association for centrally cleared futures, options and swaps. Further information is available at www.fia.org.

ASIFMA is an independent, regional trade association with over 80 member firms comprising a diverse range of leading financial institutions from both the buy and sell side, including banks, asset managers, law firms and market infrastructure service providers. Through the GFMA alliance with SIFMA in the United States and AFME in Europe, ASIFMA also provides insights on global best practices and standards to benefit the region.

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

The Associations commend the HKMA and the SFC for your careful consideration of the issues involved in implementing the G20 commitments regarding mandatory clearing and 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 proposals 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 the proposals set out in the Consultation Paper.

This letter ("**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.

## KEY PROPOSALS ON MANDATORY CLEARING

### 1. PRODUCTS TO BE SUBJECT TO MANDATORY CLEARING

***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.***

We agree with the proposed clearing determination process.

***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.***

We agree with the proposed types of IRS that should be subject to mandatory clearing.

***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.***

We request clarification on whether mandatory clearing applies to the following transactions: (i) swaptions; (ii) IRS entered into pursuant to the physical exercise of swaptions; (iii) IRS that becomes subject to mandatory clearing as a result of an amendment to its original terms or occurrence of certain lifecycle events; (iv) IRS that forms part of a larger complex or package structure; and (v) IRS created as a result of novation due to restructuring of a corporate group.

***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.***

If the HKMA and the SFC include G4 currency denominated IRS within its clearing mandate, the industry requests that the timeline for introducing the mandatory clearing regime in Hong Kong takes into account the timeline (including any delays) for introducing mandatory clearing under the European Market Infrastructure Regulation ("**EMIR**"). It should be noted that implementation for clearing obligations under EMIR will be phased in based on the categories of counterparties. Accordingly, our members will be subject to different implementation dates under EMIR based on their respective categories and we submit that the timeline of the Hong Kong clearing regime should, at the very least, take into account the implementation dates for Category 1 and Category 2 counterparties. This will prevent "front running" the EMIR mandatory clearing obligation, which is important as internationally active dealers have planned their infrastructure development timetable around the expected

timeline for introducing mandatory clearing under EMIR.

Further, as not all G4 currencies are clearable in Hong Kong, in order to avoid unintended consequences to the market, it is important that there would be a minimum of two designated CCPs that are international CCPs authorised under the clearing regimes in the European Union and/or the U.S. (such as, but not limited to, (i) LCH Clearnet Limited, (ii) CME Clearing Europe Limited, (iii) Eurex Clearing AG, (iv) Japan Securities Clearing Corporation and (v) NASDAQ OMX Clearing AB) for each class of OTC derivative products, taking into account the currency of the products supported by such CCPs, when the mandatory clearing obligations become effective.

We recommend a minimum number of two designated CCPs for the following reasons:

(a) *To avoid the risk of monopoly situations*. If a clearing obligation is imposed on a class of products where there is only one designated CCP, such CCP will have no incentive to continue to develop to meet international risk and safety standards as it will not face any competition in the market;

(b) *To avoid 'bottleneck' situations*. A single CCP may not have the capacity to clear all the contracts in the class for which it is the only designated CCP;

(c) *To mitigate the impact on clearing members if a CCP's designation is revoked or a designated CCP stops clearing a particular class of product*. If one CCP's designation is revoked or if a designated CCP stops clearing certain products, there will at least be one other designated CCP to allow porting to occur, giving a clearing member the ability to minimize the impact on its capital requirements; and

(d) *To mitigate systemic risk in clearing member default and/or CCP resolution scenarios*. Where a clearing member defaults, clearing participants may choose to clear products with another designated CCP while the affected designated CCP resolves the default positions. The existence of a second designated CCP is also important in a CCP resolution scenario as a successful resolution process for a failed CCP is likely to involve the transfer of positions to other designated CCPs.

Please also refer to our more detailed responses to Q5 and Q31 below.

***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.***

To ensure that there is sufficient liquidity in the market and to prevent placing undue burden on market participants, we are of the view that the HKMA and the SFC should not mandate HKD IRS for clearing until a range of designated CCPs (both locally and internationally) are actively clearing HKD IRS. At an absolute minimum, at least two designated CCPs (with a reasonable number of clearing members and level of liquidity) should be actively clearing HKD IRS before the HKMA and the SFC considers mandating such specified OTC derivatives transactions for clearing.

***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.***

We agree with the proposal to only cover IRS that feature floating rate indexes set out in paragraphs 64 and 65.

The industry would welcome clarification as to whether and/or how the list of indexes contained in the Consultation Paper would evolve over time.

***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.***

We refer to our response in Q4 and submit that the introduction of mandatory clearing of OIS should be contemporaneous with the introduction of the applicable rules under EMIR, and that there should be a range of international CCPs designated that support the clearing of such OIS prior to or upon the effective date of such clearing obligations.

In addition, we suggest that the maximum tenors which such OIS would feature should be aligned with those that are subject to mandatory clearing under EMIR and in the U.S.

***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.***

The industry considers that it would reduce the compliance burden of market participants if the range of tenors match with those proposed under EMIR. This would avoid imposing a requirement on prescribed persons to develop multiple infrastructure systems to cater for clearing requirements under both EMIR and Hong Kong.

We would welcome clarification as to whether and/or how the range of tenors listed in the Consultation Paper would evolve over time.

***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 not to cover NDF transactions under phase 1 clearing.

## 2. 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.***

We agree with the proposal to restrict mandatory clearing to only dealer-to-dealer transactions in the first phase.

We support the approach to monitor global developments on clearing capacity prior to expanding the scope of the mandatory clearing obligations.

The relevant global developments include those that relate to the Basel III regulatory capital rules and their current treatment of segregated margin. The current treatment imposes potentially significant negative impacts on the availability of client clearing services. As noted in FIA's letter to the Basel Committee on Banking Supervision[1], a significant increase in required capital will increase costs for end-users and may result in banks withdrawing from providing clearing services or being unable to take on new clients. Therefore, it may be difficult for some derivatives participants to access client clearing services at a price that makes economic sense. This trend is already being observed. As a result, some of these institutions may reduce or cease their derivatives trading activity. These concerns have also been highlighted by CFTC Chairman, Timothy Massad, in a number of his recent speeches[2]. We understand that the CFTC is working with banking regulators to see if any modifications can be made to existing capital rules and we strongly urge the HKMA and the SFC to similarly consider these issues.

***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.***

Based on the industry's experience with similar requirements under the Dodd-Frank Act and EMIR, the obligation to liaise with and obtain written confirmation from counterparties as to (a) their regulatory status and (b) their average position will be very challenging operationally.

Furthermore, the industry notes that this obligation is continuing as, with respect to each calculation period, a prescribed person will need to monitor the average position of all of their counterparties that (a) are a prescribed person or financial services provider and (b) have not exceeded the clearing threshold.

Given the foregoing, market participants would like to suggest that legal reliance be allowed based on an "official list" identifying all of the prescribed persons that have exceeded the applicable clearing threshold, which is published and maintained by the

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1 Letter from FIA Global, CCP12 and the World Federation of Exchanges to the Basel Committee on Banking Supervision dated 18 November 2014 (https://fia.org/articles/fia-global-requests-segregated-margin-be-excluded-basel-iii-capital-requirements).

2 Please refer to comments made by Timothy Massad in relation to leverage ratio in his recent speeches, including Keynote Address by Chairman Timothy Massad before the Institute of International Bankers dated 2 March 2015 (http://www.cftc.gov/PressRoom/SpeechesTestimony/opamassad-13) and Remarks of Chairman Timothy Massad before the National Grain and Feed Association 119th Annual Convention dated 17 March 2015 (http://www.cftc.gov/PressRoom/SpeechesTestimony/opamassad-15).

HKMA and/or the SFC[3]. This would place the clearing obligation on prescribed persons that have exceeded the applicable threshold by requiring them to notify the HKMA and the SFC within a prescribed timeframe (of no less than one month) following the end of a calculation period. The official list would then be updated by the HKMA and/or the SFC to include any such new prescribed persons and the date on which they become subject to mandatory clearing. The Australian Securities and Investments Commission has proposed this in its consultation on introducing a mandatory clearing regime in Australia. This suggestion has also been made by us to the Singapore regulators in relation to their recent proposals on introducing a mandatory clearing regime in Singapore.

We would also welcome, to the extent available, more details on the intended scope of transactions that will be subject to mandatory clearing in the second phase.

***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.***

The industry welcomes the proposal to limit the scope of the clearing obligation for overseas incorporated AIs and AMBs to specified OTC derivatives transactions booked in Hong Kong. However, we note that Singapore and Australia have taken a different approach in their proposed clearing regimes. We encourage the Hong Kong regulators to adopt an approach that does not impose extra-territorial clearing obligations.

Further, we submit that the scope of the clearing mandate should not extend beyond transactions between prescribed persons. Industry participants understand that the HKMA and the SFC are seeking to capture major dealers who operate outside Hong Kong and who may conduct transactions with dealers located in Hong Kong. However, trying to capture these entities using the current definition of "financial services provider" disproportionately increases the complexity of the clearing mandate and the compliance burden placed on prescribed persons.

The Consultation Paper provides that it is expected for prescribed persons to obtain written confirmation from counterparties regarding their regulatory status and whether their average position has crossed the clearing threshold. Given the wide definition of "financial services provider", this may require a prescribed person to obtain written confirmation from all of its counterparties even though the intent of the obligation is only meant to capture a narrow set of individuals (i.e. internationally active dealers).

As potential financial service providers have no operations in Hong Kong it will be a significant request to require them to provide a prescribed person with confirmation

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[3] Please see our response to Q12 below in relation to the treatment of financial services providers.

that (a) they do not fall within the definition of a financial services provider; and (b) they are below the clearing threshold, in both cases based on concepts and definitions set out in the Hong Kong legislation they will not be familiar with as they may not have any interaction with Hong Kong at all.

As a result, contrary to the regulatory intent, overseas entities that are not dealers will be subject to the mandatory clearing regime. This is because a prescribed person may be forced to cease trading with a counterparty that is not a clearing member of a designated CCP if: (i) it cannot independently determine whether such counterparty is a financial services provider; or (ii) such counterparty does not agree to clearing of a specified OTC derivatives transaction on a designated CCP.

If "financial service providers" were to remain in scope, we request that this definition be amended so that financial services providers can be identified based on information already publicly available or being collected by dealers under foreign clearing mandates such as EMIR and the Dodd-Frank Act.

By way of example, Australia has linked their mandate to US registered Swap Dealers. Another approach would be to define financial service providers as Category 1 entities under the EMIR clearing mandate (i.e. entities that are already direct clearing members of recognized CCPs) or to globally systemically important banks ("**GSIBs**"). Such an approach would provide prescribed persons increased comfort around which counterparties they need to approach for clearing threshold representations. If financial service providers are limited to GSIBs then the threshold element could also be removed.

Finally, we would like to seek clarification on whether the scope of the clearing obligation is intended to capture overseas branches of Hong Kong incorporated AIs.

## 3. CLEARING THRESHOLD AND ITS CALCULATION

***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.***

The industry would welcome clarification from the regulators whether the following types of transactions are excluded when assessing if the clearing threshold is crossed: (i) intra-group transactions, including any intra-company transactions between different branches of AI or LC; and (ii) transactions for hedging commercial risks of end users; (iii) all exchange-traded derivative transactions, irrespective of whether they are traded on a recognized futures market or a futures market prescribed under section 392A of the Securities and Futures Ordinance; and (iv) deliverable FX swaps that comprise of either a FX spot and a FX forward, or two FX forwards.

***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.***

We agree with the proposal to set clearing thresholds by reference to a calculation period.

***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.***

We propose there to be a 12-month gap between the commencement of one calculation period and the commencement of the next one. Given the calculation is based on outstanding positions, it is difficult and thus highly unlikely for a market participant to adjust its positions below the threshold so as to avoid complying with mandatory clearing obligations. We think 12 months would be a reasonable interval for a market participant to grow its portfolio to a size that crosses the threshold.

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

Market participants have expressed concern that overseas-incorporated prescribed persons are required to monitor both a USD20 billion threshold for trades booked in Hong Kong as well as a USD1 trillion threshold for their global position. It is submitted that the latter threshold should be removed. An overseas-incorporated prescribed person with a large global position may conduct only minimal trading activity in Hong Kong and therefore poses minimal risk to the financial stability of the local OTC derivatives market. We consider that it would impose undue burden for an overseas-incorporated prescribed person to be subject to mandatory clearing if it trades only a small number of specified OTC derivatives products solely because of its global activities.

***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.***

We request confirmation that the phrase "sum of person's total positions" should be interpreted to refer to the gross notional of all relevant OTC derivative transactions, without the application of any netting to the positions.

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

We welcome further clarity on the timeframe for lowering the clearing thresholds in the future and the opportunity to be consulted before the new thresholds become effective.

***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 agree with the proposal that only future transactions should be subject to mandatory clearing.

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

We note the reasons given in the proposal for not including an exit threshold. We think the inclusion of an exit threshold would place undue administrative burden on market participants as they would be required to monitor such threshold in relation to their counterparties. If the regulators are to introduce an exit threshold, then such threshold should only be introduced if the official list referred to in our response in Q11 is published and maintained by the HKMA and/or the SFC.

Instead of an exit threshold, we propose that any persons subject to mandatory clearing should be given the right to make a request to the regulators to have their clearing obligations ceased based on their particular circumstances. For example, if a person's average position consistently falls below the threshold for a prolonged period as a result of a permanent change in its trading profile or business model, such person should be permitted by the regulators to "exit" from its clearing obligations.

## 4. 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.***

Please refer to our response to Q11 in relation to our proposal on the requirement for a prescribed person to notify the HKMA and the SFC if it has exceeded the applicable clearing threshold.

***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.***

In relation to paragraph 114(c) of the Consultation Paper, we note that, in practice, market participants do not terminate uncleared trades due to the high unwinding costs. The industry proposes to treat such uncleared trades as exceptions that are reportable to the HKMA and the SFC.

***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.***

The industry considers that there may be potential issues with the proposed T+1 timeframe for clearing where "business day" is defined to mean a business day in Hong Kong.

We note that, for many international dealers, the middle and back offices responsible for the operational aspects of central clearing may be located in a jurisdiction other than Hong Kong. This has been an issue which the industry has raised with Australian regulators (who are also proposing a T+1 timeframe).

We also note that LCH Clearnet Limited is open except on Christmas and New Year's Day. However, other potential foreign designated CCPs are not open for clearing unless it is a business day where it operates (e.g. Japan Securities Clearing Corporation). It is submitted that the definition of "business day" should be defined by reference to the business day of the place in which the relevant CCP is located.

Further, the proposed T+1 timeframe would only work if major international CCPs become designated CCPs when the mandatory clearing obligations come into effect.

***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.***

We welcome the proposal not to cover specified subsidiaries of locally incorporated AIs under phase 1 clearing.

## 5. 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.***

Since prescribed persons are subject to (a) a mandatory reporting obligation and (b) a recordkeeping obligation in respect of specified OTC derivatives transactions that benefit from the intra-group exemption, the industry submits that there is little benefit in the pre-notification requirement set out under Rule 7(3) of the Draft Clearing Rules. We consider that the HKMA and the SFC will receive and have access to sufficient information relating to transactions benefiting from the intra-group exemption so it would be preferable to avoid imposing any additional administrative burdens in relation to this exemption.

The industry would also welcome further clarity from the HKMA and the SFC on the requirement of "*risk evaluation, measurement and control procedures which are centrally overseen and managed within the group of companies to which they belong*" under Rule 7(2)(b) of the Draft Clearing Rules.

***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.***

We note that under paragraph 139(d), prescribed persons are required to monitor the activities of their exempt jurisdictions closely to ensure that they all, individually and collectively, stay within the required limits. Tracking the limits for each jurisdiction can be a complex exercise. Members therefore submit that crossing the 5% limit for a single jurisdiction should not affect the validity of the exemption for trades booked in other exempt jurisdictions.

Some members have entities or branches that operate in multiple jurisdictions and such jurisdictions may impose conflicting clearing obligations. Given that there is already a 5% limit imposed on each exempt jurisdiction, we request the removal of the 10% limit applicable to all exempt jurisdictions.

## 6. 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.***

We submit that OTC derivative transactions that are created as part of either a multilateral trade compression cycle or bilateral trade compression process should be exempted from the mandatory clearing requirements. New and amended derivative transactions that result from systemically risk-reducing processes such as compression should not be subject to the clearing mandate if the original trades were themselves not subject to the clearing mandate. If such post-trade risk reduction derivative transactions are not exempted, this would act as a significant disincentive for market participants to participate in such compression exercises and introduce new pricing risks for market participants. In addition, it would have the effect of undermining the risk mitigation requirements already faced by foreign firms under EMIR and the Dodd-Frank Act.

## 7. 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.***

The industry strongly supports the introduction of a substituted compliance regime to enable prescribed persons to fulfil the Hong Kong mandatory clearing obligation by complying with the rules of a comparable jurisdiction. However, we are concerned that the substituted compliance mechanism has been structured in a manner which will undermine its intended benefit to market participants.

In particular, the inclusion of the requirement to clear through a designated CCP, paired with a "stricter rule" overlay, effectively obliterates any potential benefit that may be derived from such a substituted compliance regime. The current framework effectively requires each prescribed person to put in place systems to identify whether all trades that are subject to mandatory clearing in Hong Kong are also in fact cleared in all other jurisdictions where such prescribed person has mandatory clearing obligations, and whether the CCPs in all such other jurisdictions are designated CCPs. The processes for identifying such trades are highly complex, and would effectively deter any prescribed person from placing reliance on the substituted compliance framework, running counter to the legislative intent to address duplicative and/or conflicting regulations. This approach is also not consistent with the approach taken in EMIR under Article 13. Article 13 looks at the equivalence of the clearing requirements of a foreign jurisdiction and do not impose further local requirements. It is submitted that market participants should be able to fulfil their clearing obligations in Hong Kong by complying with the clearing obligations of comparable jurisdictions that meet the criteria and standards set by the HKMA and the SFC without the "stricter rule" overlay.

We would also like to seek clarification if there would be any notification requirements in relation to substituted compliance.

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

The industry would encourage the HKMA and the SFC to consider South Korea for the list of comparable jurisdictions.

## 8. 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.***

We think the requirement to keep records for at least 5 years after maturity or termination of the specified OTC derivative transactions is long, and would impose significant cost on prescribed persons, especially when such records have to be readily accessible. We recommend the alignment of any record keeping requirements with similar international requirements (e.g. the U.S.).

We would also like to seek clarification whether Rule 12 (b) of the Draft Clearing Rules is intended to cover the requirement to demonstrate that Rule 5(4) of the Draft Clearing Rules was not satisfied.

The industry would welcome further clarification on the details necessary to demonstrate compliance when a transaction is not subject to, or is exempt from, mandatory clearing.

## 9. 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.***

For many market participants, their ability to comply with the mandatory clearing regime as set out in the Consultation Paper is dependent on the recognition of certain foreign CCPs (such as, but not limited to, (i) LCH Clearnet Limited, (ii) CME Clearing Europe Limited, (iii) Eurex Clearing AG, (iv) Japan Securities Clearing Corporation and (v) NASDAQ OMX Clearing AB).

For the industry, it is imperative that these CCPs become designated CCPs prior to the commencement of mandatory clearing in Hong Kong. If the clearing mandate of the HKMA and the SFC has the effect of limiting major international dealers to clear certain specified OTC derivatives transactions through only a local CCP in Hong Kong, then this is likely to lead to unintended consequences, including reduced volume of in-scope IRS that international dealers may choose to book locally in Hong Kong as well as artificially bifurcating the existing swap market between swaps that are to be cleared through a local CCP in Hong Kong (which will necessarily be a much smaller proportion of the whole) and swaps that may be cleared outside Hong Kong at venues which may attract larger volumes and greater volume related efficiencies.

Whilst we appreciate that the designation of such CCPs is dependent on the CCPs in question applying to the SFC for designation, the industry encourages the SFC to engage with the CCPs listed above and to keep market participants informed of the application status (and timeline for approval) of CCPs to the extent possible. This is particularly the case as substituted compliance is available only where the specified OTC derivatives transaction is cleared through a designated CCP. Going forward, it

would be very useful for the industry if the SFC is able to publish and maintain a list of designated CCPs for the purposes of compliance with the mandatory clearing regime in Hong Kong.

***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.***

We do not have any comments on the proposal to implement only the clearing leg of the extended definition of "ATS".

***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.***

Our members consider that it is very important for Hong Kong to extend insolvency override protections to overseas CCPs in order to facilitate the onboarding of Hong Kong incorporated institutions as clearing members of such overseas CCPs. Whilst we appreciate the concerns raised by the HKMA and the SFC under paragraph 164 of the Consultation Paper, our concern is that in the absence of such insolvency override protection, it might be possible that certain aspects of an overseas CCP's default management procedure (e.g. porting) could be challenged if applied to Hong Kong incorporated clearing members. This may potentially prevent or otherwise deter the overseas CCP from accepting a Hong Kong incorporated institution as a clearing member. It would be helpful for the HKMA and the SFC to shed further light on this issue as, based on our understanding, a number of overseas CCPs do not risk manage on a portfolio basis. To the extent possible, we would recommend that the insolvency override protection as introduced by the Amendment Ordinance be applied to OTC derivative contracts cleared by overseas CCPs.

## KEY PROPOSALS ON EXPANDING MANDATORY REPORTING

As noted in ISDA's previous submissions[4], we reiterate the importance of cross-border regulatory harmonization, and strongly encourage the HKMA and the SFC to adopt a trade reporting regime that is, to the maximum extent possible, aligned with similar regimes in other jurisdictions, especially in major Asia-Pacific jurisdictions (such as Singapore) to minimize undesirable regulatory outcomes that threaten the efficient functioning of markets and businesses.

As noted in ISDA's white paper entitled "Improving Regulatory Transparency of Global

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[4] ISDA comment letters to the HKMA and the SFC dated 18 August 2014 and 23 December 2014.

Derivatives Market: Key Principles"[5], one of the key principles for improving regulatory transparency in a meaningful way is the harmonisation of regulatory reporting requirements for derivative transactions within and across borders. We note that the task of regulators to monitor the positions of globally-active institutions across jurisdictions cannot be efficiently achieved when bespoke, jurisdiction-specific data reporting and/or formatting requirements exist. At a time when all major jurisdictions across the globe are focussing on harmonising their data reporting requirements to achieve one global data set, it would not be in the interest of the Hong Kong regulators to impose unique requirements on their market participants.

We also wish to note the global efforts that ISDA is undertaking to develop standardised reporting practices and processes that will ultimately yield a more consistent data set for regulators to use. In particular, we highlight ISDA's ongoing efforts to establish standards for identifiers (for transactions and products), its work around other data elements and the industry standard language, Financial Products Markup Language (FpML). We believe that Hong Kong regulators should embrace and adopt the use of such standards in their design of the expanded reporting regime.

## 10. 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.***

*Transactions involving prescribed exchange or prescribed CCP*

The industry understands that a product traded on a non-prescribed exchange or cleared through a non-prescribed CCP[6] will be in-scope for mandatory reporting. We would welcome clarification as to the application of the mandatory reporting regime if the relevant exchange or CCP subsequently becomes prescribed. For example, would the obligation to report life-cycle events in respect of such trades cease?

*Harmonisation of reportable products*

Members have raised significant concerns about what products are subject to mandatory reporting and under which asset classes such products are classified. We strongly recommend that all reportable products and their respective asset classes be listed and published, based on the ISDA taxonomies[7]. These taxonomies have benefitted from broad, comprehensive input from industry stakeholders and a thorough governance process to develop a standard that can be leveraged globally.

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5 http://www2.isda.org/attachment/NzI4NQ==/Improving%20Regulatory%20Transparency%20FINAL.pdf

6 As listed in the Securities and Futures (Stock Markets, Futures Markets and Clearing Houses) Notice

7 The ISDA OTC Derivatives Products Taxonomies can be found at http://www2.isda.org/functional-areas/technology-infrastructure/data-and-reporting/identifiers/upi-and-taxonomies/.

Furthermore, the industry considers that it is very important for the types of reportable transactions to match those already mandated for reporting under EMIR. This is critical to facilitate global harmonisation and sharing of information between regulators, which the industry understands to be one of the central aims of mandatory reporting of OTC derivatives.

*UPI/Symbology*

ISDA has also launched a new industry data project, aimed at developing an open-source standard derivatives product identification system that can be applied consistently and comprehensively across all derivatives facilities, including trading venues, clearing houses, repositories and other infrastructures. [8] The consortium of participating entities will initially work to produce globally standardized symbols for credit, rates and equity derivatives in 2015. This project leverages the work and existing initiatives that some participants have previously been involved in.

*Reporting of "structured" transactions*

A concern has been raised by our industry members in relation to reporting of "structured" transactions. At the moment, we consider that there is no common method or convention within the industry to which reporting entities can adhere, which is likely to give rise to mismatched or unlinked reports since two counterparties to a trade may apply different reporting methodologies. We would welcome the regulators' suggestions on how to address the reporting of "structured" transactions. However, we also note that particularly for entities with multiple reporting obligations across jurisdictions, it is absolutely critical that regulators agree globally on a consistent method for the reporting of these transactions, and therefore we would strongly encourage the HKMA and the SFC to engage with their counterparts in various jurisdictions.

*Exclusion of FX securities settlement / conversion transactions*

In terms of the expanded scope of OTC derivative products to be captured under phase 2 mandatory reporting, the industry would encourage the HKMA and the SFC to consider excluding the below transactions from the scope of reportable transactions: (i) foreign exchange contracts with a settlement date falling no more than 3 business days after the date on which the contract is entered into; and (ii) foreign exchange contracts which are entered into for the purpose of settling a sale or purchase of securities denominated in a foreign currency and have a settlement period of no more than 7 business days. This is consistent with the positions adopted in

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[8] See http://www2.isda.org/news/isda-launches-new-industry-initiative-for-a-derivatives-product-identification-standard .

Singapore[9] and Australia[10], and our members would greatly benefit from consistency between the mandatory reporting regimes for these major Asia-Pacific jurisdictions.

## 11. 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.***

Please refer to our answer to question 36 below.

***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.***

We note that the US$30 million limit currently proposed to apply to all product classes is the same as the limit previously applied on a per product class basis. Accordingly, a person who is entitled to the "exempt person" relief under phase 1 reporting may no longer be entitled to this relief under phase 2, even if the aggregate notional amount of its outstanding OTC derivative transactions remains unchanged. This effectively equates to a significant lowering of the threshold and will unfairly penalise participants with relatively low levels of OTC derivative exposures who are unlikely to contribute to systemic risk in the market. The increase in the scale of products subject to the threshold should be matched by an appropriate increase in the level of the threshold itself, as discussed in paragraph 172(a) of the Consultation Paper.

***Q37. Do you have any comments or concerns about our proposal to do away with***

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[9] See the definition of "excluded currency contract" in the Securities and Futures (Reporting of Derivatives Contracts (Amendment No. 2) Regulations 2014 (http://www.mas.gov.sg/~/media/MAS/Regulations%20and%20Financial%20Stability/Regulations%20Guidance%20and%20Licensing/Securities%20Futures%20and%20Fund%20Management/Regulations%20Guidance%20and%20Licensing/Regulations/Securities%20and%20Futures%20Reporting%20of%20Derivatives%20Contracts%20Amendment%20No%20%202%20Regulations%202014.pdf).

[10] See Exemption 9 of ASIC Corporations (Derivative Transaction Reporting Exemption) Instrument 2015/844 (https://www.comlaw.gov.au/Details/F2015L01530) and the definition of "foreign exchange contract" under Regulation 7.1.09 of the Corporations Regulations and section 761D of the Corporations Act 2001 (http://www5.austlii.edu.au/au/legis/cth/consol_reg/cr2001281/s7.1.04.html and http://www.austlii.edu.au/au/legis/cth/consol_act/ca2001172/s761d.html).

***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.***

As the expansion of the mandatory reporting regime extends to all classes of OTC derivatives, the industry submits that additional time is required for the system build-out in order to comply with this expanded scope. In particular, it is noted that certain market participants who were not caught by phase 1 reporting (as they did not trade vanilla IRS or NDF) will now be required to prepare for phase 2 reporting without the benefit of any prior preparation. We further note that any estimation of the required time to put in place reporting systems, connections and processes will not be accurate without knowing the final list of data fields which must be submitted. This timing should be revisited once the potential impact is better understood. We advocate a deferral of commencement of phase 2 reporting for a minimum of 12 months after enactment of the rules to allow market participants sufficient time to be ready.

## 12. 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 are concerned that the data fields may be subject to changes with little or no prior notice. We request that the regulators make a clear commitment to subject any proposed changes to mandatory, meaningful and sufficient industry consultation and give no less than 12 months' notice before any changes become effective. There should be a clear regulatory case made for any proposed change to data fields, with due consideration given to the costs and benefits of any such proposal.

In addition, since the Frequently Asked Questions, Supplementary Reporting Instructions and HKMA trade repository manuals are also critical to guiding the system build of a reporting entity, the industry submits that the consultation process should cover these documents as well.

***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 on the data fields set out in the tables of Appendix D in a separate letter before the comment deadline, 30 November 2015, however at a broad level, we wish to highlight the availability and widespread market usage of the Financial Products Markup Language (FpML) as the common data standard and schema for reporting, as well as other electronic templates (such as those maintained by SWIFT) which already contemplate the various data fields and definitions required for both vanilla and exotic products. The regulators should look to adopt these standards to the maximum extent.

We also highlight here that the requirement to upload a PDF file for information that

cannot be captured by the data templates is complex and bespoke. Our members have advised that this is not required in other jurisdictions, and note that this will not assist in data aggregation or position monitoring. In view of the extreme operational complexity and lack of meaningful regulatory benefit, this requirement should be removed.

A further point to note is that guidance has not been provided about whether each of the proposed data fields is required, conditionally required or optional. In view of recent industry discussions which saw different interpretations and understanding of the requirements, we think this should be made very clear in subsequent documentation. We reiterate that to minimise the number of unmatched transactions in the HKTR and avoid unnecessary operational burden, the authorities should not seek to match trades on non-required fields, and should also be aware of which fields are less likely to match (eg; fields relating to valuation and date/time) and factor this into HKTR system design.

## 13. 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.***

*Cleared transactions*

The industry considers that for transactions cleared on a designated CCP, the responsibility for reporting valuations should be placed solely on the relevant designated CCP. This is in line with recent CFTC proposed amendments[11] and would avoid duplicative reporting by a designated CCP as well as market participants. This would also minimize any timing issues in reporting as the information is reported directly by the CCP. It is also to be noted that many market participants do not currently have systems that store CCP valuations for cleared transactions and therefore this requirement may be practically difficult to implement.

*Margined transactions*

The industry considers that the requirement to report a mutually-agreed valuation for non-centrally cleared transactions where the counterparties have agreed to exchange margin should not be implemented prior to the final implementation of rules for margin for non-centrally cleared swaps, since the valuation of such transactions is dependent on such rules.

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[11] https://www.federalregister.gov/articles/2015/08/31/2015-21030/amendments-to-swap-data-recordkeeping-and-reporting-requirements-for-cleared-swaps#h-14

Furthermore, with respect to transactions that are non-centrally cleared where the counterparties have agreed to exchange margin, the industry would welcome clarification from the HKMA and the SFC on whether it is possible for a reporting entity to first report its internal valuation in the event that the counterparties are unable to agree on a valuation within the T+2 reporting timeframe, and to update this report once the counterparties have reached agreement. We also seek guidance from the authorities about how to proceed if agreement cannot be reached.

***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.***

As mentioned in ISDA's previous submission [12], if the transaction involves an overseas currency and it is a holiday in the overseas jurisdiction, reporting entities will not be able to source valuation data from such jurisdiction.

Furthermore, for certain "packaged" transactions, bespoke or exotic transactions, the valuation may be provided by the counterparty to a reporting entity rather than generated by the reporting entity itself. If the counterparty fails to provide daily valuations to the reporting entity, it will be impossible for the reporting entity to comply with its obligation to report daily valuations.

Under the circumstances described above, reporting entities should be allowed to submit the previous day's valuation figures.

## 14. 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 to leave the record keeping obligations unchanged.

## 15. 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.***

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[12] ISDA comment letter to the HKMA and the SFC dated 18 August 2014.

We agree with the proposal to have a single grace period under phase 2 that applies across all products and product types.

***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.***

Members have expressed significant concerns on the requirements to backload additional transaction information with respect to historical transactions, the process of which would be extremely operationally challenging and time-consuming as the historical data may not have been captured. In no other Asia-Pacific jurisdiction has this been required, even when there have been recent expansions of data fields. For example, on 1 November 2015, the trade reporting regime in Singapore was expanded and additional data fields were required to be reported, but the expanded regime does not have retrospective effect. There should be a clear distinction between the requirements of phase 1 and those of phase 2, and the requirements of phase 2 should not be retrospective – this undermines the very notion of 'phase 2'.

With respect to transactions reported under phase 1 of the mandatory reporting regime, the back-loading obligation should be restricted to those transactions that are outstanding at the time of the commencement of phase 2 to reduce the compliance burden for market participants. In addition, where such transactions have undergone lifecycle events, we would suggest that the backloading of additional information should be based on the latest terms of the transactions as of the backloading date (rather than based on the requirements set out in paragraph 203(f)(iii) of the Consultation Paper.

Furthermore, the industry would welcome confirmation that the following transactions are not subject to backloading requirements: (i) transactions that are outstanding as of the start date for phase 2 reporting but were booked outside Hong Kong under phase 1; and (ii) nexus transactions that are not reportable under phase 1 but are outstanding as of the start date for phase 2. In relation to (ii), as highlighted to the HKMA and the SFC previously in relation to phase 1, the identification of nexus trades is subject to ongoing system enhancements and enriched data capture at point of trade. The necessary data to determine nexus trades was not available historically and therefore it would be highly problematic to include a backloading requirement with respect to nexus transactions that are not reportable under phase 1. It is the industry's understanding that Rules 10(2A), 11(2A), 12(2A) and 13(2A) (together with paragraph 203(f)(i) of the Consultation Paper) should be interpreted to exclude nexus transactions that are not reportable under phase 1.

In addition, if the HKMA and the SFC include a backloading window for reporting, then it should be permissible for such backloaded trades to be reported masked to the extent consent has not been obtained from the counterparty for such historical activity.

On the issue of masking, the industry supports the approach of HKMA and the SFC to allow masking in respect of certain specified jurisdictions where local laws prohibit disclosure of information even with client consent. It is submitted that the ability to mask under such conditions is critical to allow reporting entities to comply with the

reporting obligation in Hong Kong without breaching confidentiality or other related laws in another jurisdiction.

***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.***

We do not have any comments on the proposals relating to how the single grace period under phase 2 applies.

We look forward to continuing our dialogue with you. Please do not hesitate to contact

related to mandatory reporting.

Yours faithfully,

For the International Swaps and Derivatives Association, Inc.

For the Futures Industry Association Asia

For the Asia Securities Industry & Financial Markets Association