



香港場外結算有限公司
(香港交易及結算所有限公司附屬公司)
OTC Clearing Hong Kong Limited
(A subsidiary of Hong Kong Exchanges and Clearing Limited)

30 October 2015

Supervision of Markets Division
The Securities and Futures Commission
35/F Cheung Kong Center
2 Queen's Road Central
Hong Kong

Attention:

Dear ,

RE: Consultation paper on introducing mandatory clearing and expanding mandatory reporting (the "Consultation Paper")

OTC Clearing Hong Kong Limited ("**OTC Clear**") welcomes the opportunity to set out our views on the Consultation Paper, which was jointly released by the Hong Kong Monetary Authority ("**HKMA**") and the Securities and Futures Commission ("**SFC**") on 30 September 2015.

As the first recognized clearing house ("**RCH**") in Hong Kong for the clearing of over-the-counter ("**OTC**") derivatives transactions, OTC Clear strongly supports the ongoing efforts of HKMA and the SFC to develop a regulatory regime for the OTC derivatives market in Hong Kong, and remains committed to working with both bodies to achieve the goal of reducing systemic risk and ultimately enhancing the safety of the Hong Kong financial markets.

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OTC Clear believes that Interest Rate Swaps (“IRS”) in systemically important currencies for Hong Kong; namely the US dollar, Hong Kong dollar and the Chinese renminbi should be included in the first phase of mandatory clearing. Additionally we would urge HKMA and the SFC look at ways to expedite the introduction of the first phase of mandatory clearing. The significant delays to the initial timeline proposed for OTC derivative reforms have had a continuing and detrimental impact on the Hong Kong market.

In our detailed response to the Consultation Paper we have only addressed those questions which directly or indirectly impact the operation of OTC Clear, or where we feel that our experiences gained as a Financial Markets Infrastructure provider in Hong Kong can add value to the ongoing development of the regulatory regime for the broader OTC derivatives market. Our comments below thus relate to 14 of the 45 questions posed in the Consultation Paper and are detailed in the Appendix.

OTC Clear appreciates having the opportunity to provide our comments on the Consultation Paper. Please do not hesitate to contact

with any questions on this submission.

Yours faithfully

For and on behalf of

OTC Clearing Hong Kong Limited

Responses to Specific Questions Raised in the Consultation Paper

- 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.**

OTC Clear supports the clearing determination process defined in the Consultation Paper. Recognising the need to consider the specific characteristics and nuances of the Hong Kong OTC derivatives market and its participants, OTC Clear particularly supports the need for the careful consideration by HKMA and SFC of factor d) “*the level of systemic risk posed by the product to Hong Kong*”.

Whereas certain derivative instruments traded in Hong Kong form a relatively small proportion of overall global OTC derivatives volumes, they constitute a crucial part of local markets and will particularly benefit from the transparency, oversight and the overall reduction in systemic risk provided by central clearing. We note that recently published statistics¹ based upon derivatives reported to the Hong Kong Trade Repository (“HKTR”) indicate that IRS constituted on the Hong Kong dollar and Chinese renminbi are respectively ranked second and fourth (by gross notional) of IRS reported to HKTR. Additionally NDF based upon renminbi account for over half (by gross notional) of all NDF reported to HKTR.

- 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.**

OTC Clear would support the inclusion of any IRS instruments denominated in G4 currencies if warranted by the consistent application of the clearing determination process defined in the Consultation Paper.

- 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**

¹ “A first analysis of derivatives data in the Hong Kong Trade Repository”. Hong Kong Monetary Authority Quarterly Bulletin June 2015

specific details.

OTC Clear supports HKMA and SFC's proposal to mandate HKD denominated IRS for clearing under phase 1. We support the view expressed in the Consultation Paper that HKD is systemically important to Hong Kong given its use in commercial and financial activities here.

We note that a large portion of trading volumes in HKD denominated OTC derivatives are provided by non-bank participants and any disruption in this market would likely cause market-wide disruption in Hong Kong. The changing trend is captured in recently published statistics on Authorised Institution counterparties² which illustrate the increasing prominence of non-bank financial institutions in the Hong Kong derivatives markets.

Given market participants use these products (in part) for hedging business risks including domestic and cross-border borrowing, lending and business flows, any disruptions would have a knock-on effect on funding markets and in turn potentially affect asset pricing in other areas of the economy.

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.

OTC Clear would support the inclusion of OIS if warranted by the consistent application of the clearing determination process defined in the Consultation Paper.

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.

OTC Clear would support the application of mandatory clearing to the range of tenors described in the Consultation Paper if warranted by the consistent application of the

² "Results of surveys on selected debt securities and off-balance sheet exposures to derivatives and securitisations". The Hong Kong Monetary Authority Quarterly Bulletin December 2014.

clearing determination process defined in the Consultation Paper.

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.

OTC Clear has taken note of recent discussions involving market participants in other major jurisdictions and recognizes that neither the US or EU has any immediate plans to implement mandatory clearing for NDF. We thus support the proposal not to include NDF in the first phase of clearing.

OTC Clear agrees on the importance of international consistency when implementing mandatory clearing for NDF and on the need to align the implementation schedules of different jurisdictions to minimize market disruptions. OTC Clear would request that HKMA and SFC ensure that an eventual clearing mandate for NDF in Hong Kong is closely coordinated with those in other jurisdictions to ensure that there are no unintended consequences for what is an important OTC derivatives market segment in Hong Kong, as a consequence of global regulatory inconsistencies.

Notwithstanding the proposal of SFC and HKMA not to mandate NDF clearing at this stage, OTC Clear notes that it currently offers clearing services for the four most popular NDF products in Asia; namely NDF in renminbi, Indian rupee, South Korean Won and Taiwanese dollar. The availability of clearing for these products allows participants of OTC Clear to submit NDF transactions for clearing on a voluntary basis, to take advantage of the netting and capital efficiencies and the counterparty credit risk mitigation benefits that central clearing provides.

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.

OTC Clear endorses the phased approach to the introduction of mandatory clearing. OTC Clear would however request that HKMA and SFC publish revised, clear timelines on the expected subsequent phases of mandated clearing. This will provide market participants, including CCPs, with the information required to make the necessary preparations and investments in, their services on a timely and efficient basis.

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.

OTC Clear has concerns about the practical implications of the proposal that only future transactions should be subject to mandatory clearing.

We note the proposal that the “prescribed” day for a given calculation period should be the date that falls seven months after the end of that calculation period. Given that the initial calculation period of three months will commence on the day that phase 1 clearing comes into effect, which we understand to be no earlier than mid-2016 following negative vetting of subsidiary legislation by the Legislative Council, we thus infer that the earliest “prescribed” day for mandatory clearing to practically commence will be Q2 2017 or ten months after the date that phase 1 clearing comes into effect. This date is significantly behind the intended schedule envisaged in the original G20 commitments and will mean that Hong Kong fulfils its obligations long after other regional and global jurisdictions.

OTC Clear notes that the timescale for mandatory clearing to become effective following the enforcement of clearing obligations in other comparable APAC jurisdictions is typically within six months, as is the case in the EU. Furthermore our understanding is that clearing mandates in the EU and in other comparable APAC jurisdictions namely Australia and Singapore will all practically commence within 2016.

The extended implementation period maintains a state of flux and uncertainty for market participants in Hong Kong and for the infrastructure providers that operate therein. OTC Clear would recommend an adjustment to the initial calculation and concession periods to ensure that the eventual “prescribed” date for mandatory clearing falls within 2016. Alternatively OTC Clear suggests that all transactions established after the initial calculation period should be required to be eventually, retrospectively cleared by the “prescribed date”.

We note that given the revised and increased thresholds that have been proposed within

the Consultation Paper, most prescribed persons will be dealers who are very familiar with clearing obligations in other jurisdictions and should not require an extensive period to set up systems and complete the documentation and on-boarding exercise to access clearing facilities necessary to comply with the clearing obligation.

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.

OTC Clear does not have any concerns regarding a prescribed person's obligations and notes that the current OTC Clear clearing service has been developed to provide participants with the various tools and reports that will facilitate their ability to fulfil the proposed obligations i.e. to determine whether a transaction was in fact accepted for clearing or remained uncleared due to externalities beyond the person's control.

Additionally OTC Clear has developed a client clearing service (whose implementation is subject to the approval of the SFC). This service will allow a prescribed person to fulfil their clearing obligations through a third-party provider.

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.

OTC Clear does not have any concerns about the proposed T+1 timeframe for clearing and the proposed definition of "business day" and believe this timeframe is consistent with timeframes imposed in other jurisdictions.

OTC Clear notes that its service operates every Monday to Friday, including Hong Kong public holidays other than 1st January each year.

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.

OTC Clear has no concerns about the proposed processes for designating CCPs. We note

the statement relating to a forthcoming consultation on the Amendment to ATS guidelines.

Additionally we note and support the stated intention of SFC and HKMA to ensure that provisions for designated CCPs will be based on international standards, including the Principles for Financial Market Infrastructures and that the successful authorization and designation of an overseas CCP will be dependent on whether the oversight and regulation of the overseas CCP in its home jurisdiction is consistent with international standards.

Given previous comments in response to Question 19 on the overall schedule for the implementation of mandatory clearing in Hong Kong against initial expected timescales, OTC Clear would request that SFC and HKMA ensure that deliberations on the processes for the designation of overseas CCPs do not further impact the implementation schedule for mandated clearing in Hong Kong.

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.

OTC Clear supports the proposal to include all OTC derivative products in the next phase of mandatory reporting.

We note the value that enhanced transparency from reporting has provided to OTC derivative markets in international jurisdictions and echo comments which we made in August 2014, in response to the Consultation Paper on the Securities and Futures (OTC Derivative Transactions- Reporting and Record Keeping) Rules, namely that reporting and clearing obligations are closely connected and should ideally complement each other.

The provision to the market of granular information about the OTC derivatives transacted therein can provide market participants, including CCPs, with appropriate information for the necessary risk and liquidity analysis and will assist in the determination of whether a particular product type is suitable for central clearing.

OTC Clear recommends that that data on OTC derivatives reported should be made available to the public in a usable format. We note that IOSCO and CPSS published (in August 2011) a consultative report: Report on OTC Derivatives Data Reporting and Aggregation Requirements (the “TR Report”). Amongst other things the TR Report states that public dissemination of Trade Repository data will improve transparency of OTC derivative markets and thus promote understanding of OTC derivative markets by all stakeholders, promote and underpin investor protection and facilitate the exercise of market discipline

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.

OTC Clear notes the extended deadline of 30 November 2015 to provide comments on the specific data fields set out in Appendix D and will respond with any comments or concerns prior to that deadline.

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.

OTC Clear has no immediate concerns about the revised proposal on the reporting of valuation transaction information, subject to the review of Appendix D as noted in the response to Question 39) above. Valuation transaction information originating from OTC Clear will be provided to clearing participants on the same day that the trade is submitted to OTC Clear for clearing.

Additional Comment

OTC Clear notes and agrees with the perspective of HKMA and SFC in the Consultation Paper that both HKD and USD are systemically important currencies to Hong Kong as they are commonly used in commercial and financial activities here. OTC Clear strongly supports the inclusion of IRS denominated in these currencies under phase 1 clearing.

OTC Clear also notes the increasing prominence of the offshore renminbi and renminbi non-deliverables markets to Hong Kong over recent years and contends that the renminbi is also systemically important to the Hong Kong market.

Hong Kong has played a significant role in the internationalization of the renminbi over the past decade and remains the most significant centre for offshore renminbi liquidity. OTC Clear contends that this competitive advantage will be maintained by ensuring that the risk standards applied to derivatives based on renminbi are equivalent to those in place for G4 currencies, including the requirement for central clearing of the most liquid related derivatives to reduce systemic risks.

OTC Clear observes that recently published statistics from the HKTR indicate that IRS constituted against the renminbi are ranked fourth by gross notional value, behind USD, HKD and JPY and represent approximately 8% of IRS reported to HKTR. OTC Clear also notes the results of the most recent triennial survey of Hong Kong³ which indicate that the major proportion of renminbi denominated IRS comprise of non-deliverable derivatives based on onshore renminbi. OTC Clear thus recommends that non deliverable interest rate swaps (NDIRS) denominated in renminbi are also included in the first phase of mandatory clearing.

Furthermore OTC Clear notes that the most common NDF currency traded in Hong Kong is in the renminbi, accounting for 57% of gross notional volumes reported to HKTR. Notwithstanding our support for the non-inclusion of NDF in phase 1 clearing (see response to Question 9), OTC Clear recommends that HKMA and SFC continue to closely monitor this market and at the appropriate time and in co-ordination with other jurisdictions mandate NDF in renminbi for CCP clearing

³ "The foreign exchange and derivative market in Hong Kong", Hong Kong Monetary Authority Quarterly Bulletin. December 2013