

BY EMAIL

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

Email: otcconsult@sfc.hk

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

Email: fss@hkma.gov.hk

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Dear Sirs and Madams,

Joint Consultation Paper on the Prescription of Additional Markets and Clearing Houses and Prescription of Delta One Warrants under the OTC Derivatives Regulatory Regime (Consultation Paper)

The International Swaps and Derivatives Association, Inc. ("ISDA") welcomes the opportunity to respond to the Consultation Paper, which covers important matters to our members and puts forth well-considered proposals to ensure that the Hong Kong OTC derivatives mandatory reporting regime remains aligned with the overall goals of the Hong Kong Monetary Authority ("HKMA") and Securities and Futures Commission ("SFC") (collectively, "the Regulators") in terms of the scope of information considered relevant and important to the mandate. We wish to express our gratitude for the constructive and efficient engagement with the regulators on these issues to date. We would also like to thank the regulators for addressing this matter expediently and for their intention to conclude the consultation in advance of 1 July 2017.

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

ISDA is 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 note at the outset that our members are broadly supportive of the proposals in the Consultation Paper, and have no comments on Questions 1 and 2. Regarding Question 3, members agree with the proposal to exclude Delta One Warrants and have provided some suggestions and refinements to the proposals, based on their experience in issuing institutional Delta One Warrants to the market, to ensure that the regulatory scope is appropriate.

Question 3

Members have primarily provided responses to us around paragraphs 17 to 20 of the Consultation Paper, and we have summarised these responses along the thematic lines below.

Paragraph 17(a) - Call warrants

One member would like to request that put warrants also be included along with call warrants, as they are also fully-funded Delta One products, but which are equivalent to the holder selling the underlying. There is typically an early termination event before the underlying reaches 2 times the initial price, to avoid the holder being out-of-the-money.

Paragraph 17(d) - Synthetic exposure

One member has noted that other rationales may exist for the issuance of Delta One Warrants in addition to the rationale stated, and that Delta One Warrants may be issued over underlying asset(s) in open markets as well. We would request that this be taken into consideration when the legislative definition of Delta One Warrants is crafted by the Department of Justice, although we understand that it is the features in paragraph 20 of the Consultation Paper (rather than paragraph 17) which the Department of Justice will define.

Paragraph 20(a) - Right to purchase underlying assets

We would like to clarify the intention of the Regulators behind this feature, which we read to mean the option of physical settlement. We believe that this may be contrary to the characteristics of a large proportion of the Delta One Warrants in existence across the market, which although may be physically settled, are usually and typically cash settled. Please refer

to the second paragraph under the heading “Request for Relief – Delta One Warrants” in our letter of 31 March 2017 for further detail.

In paragraph 17(d) of the Consultation Paper, the Regulators note that Delta One Warrants “enable clients to gain synthetic exposure to assets in closed or difficult-to-access markets”. Given that the underlying asset(s) may be in closed or restricted markets, it may not always be possible for the Delta One Warrant to give the holder the right to purchase the underlying asset(s), as the holders may be prevented by law from directly holding the physical underlying asset(s). Access products such as Delta One Warrants give the holder the economic benefit attached to holding the underlying asset(s), and are often used where market or regulatory barriers prohibit directly holding the underlying assets.

Separately, one member has also requested that the Regulators make explicit mention of warrants which are settled in a currency different from the currency of the underlying assets.

Considering these responses collectively, and for the proposed prescribed relief to have the most utility and value for members and participants more broadly, we would request that the Regulators consider recharacterising the feature in paragraph 20(a) to read:

“it gives the holder the right to gain synthetic exposure to the underlying assets, whether in the same or a different currency from the currency of the underlying assets”.

Paragraph 20(b) - Strike price

One member has responded that the terms and conditions of a Delta One Warrant may not specify that it has a zero strike price. Rather, the “Cash Settlement Amount” may simply be defined as “the Settlement Price” (less commission and/or fees). This is in effect equivalent to saying that the Cash Settlement Amount is equal to the Settlement Price minus a strike price that is zero. We would welcome clarification by the Regulators on whether the absence of the specification of a strike price of zero would present any concerns with regard to the ability to rely on the proposed relief.

Paragraph 20(c) - Underlying subject matter

Members agree that the underlying subject matter of a Delta One Warrant may be anything, including any type, or any combination of types, of underlying asset(s). Members request that the precise language for describing Delta One Warrants clarify that Delta One Warrants may be linked to a single underlying asset, or a basket of underlying assets.

Paragraph 20(d) - Transferability, restrictions and limitations

While members agree that, by nature, Delta One Warrants are transferrable securities, they also note that, similar to other forms of securitized products, institutional warrants do in fact contain certain restrictions. For example, restrictions may exist on the offer, sale and delivery of

warrants to domestic investors in certain closed or difficult-to-access markets, or on the distribution of offer materials relating to the warrants in certain jurisdictions. Issuers of Delta One Warrants may therefore impose contractual restrictions on the transfer of such products (for example, by requiring holders to obtain the prior consent of the issuer before effecting a transfer, so as to allow the issuer to conduct know-your-client and/or anti-money laundering checks on the potential transferee to ensure that it satisfies the relevant investor eligibility requirements). Investors purchase the warrants subject to representations and undertakings on these restrictions on re-sale.

For example, Delta One Warrants which are India Offshore Derivative Instruments (“ODIs”) are only transferrable with the issuer’s consent, given that all transfers are required to be reported by the issuer to the Securities and Exchange Board of India. Also, an ODI cannot be transferred to a person of Indian origin under Indian law.

We would respectfully request that the Regulators consider that Delta One Warrants may not possess a feature of unfettered transferability, and that there may be potential conditions or restrictions that apply, depending on the underlying asset(s) in question. In stating this however, we note that such restrictions are in the form of a bilateral agreement between the issuer and the holder, whereas the Delta One Warrant itself technically remains a transferable instrument. Therefore, while we agree with the proposed feature that a Delta One Warrant should not have any restriction or limitation to the effect that it can only be transferred or sold to the issuer, we would also propose the following recharacterisation:

“it is transferrable, and there is no restriction or limitation (other than restriction or limitation which may be imposed by the issuer for the purposes of complying with applicable laws and regulations) to the effect that the warrant can only be transferred or sold to the issuer.”

Paragraph 20(e) - Documentation

Members agree with the characterisation of this feature, however query whether it may be more appropriate to change the word “warrant” to “security”, for improved clarity.

Thank you again for allowing us to respond to this Consultation Paper, which has been well-received and welcomed by members. We look forward to continuing our dialogue with you over the coming weeks and months. Please do not hesitate to contact

to discuss further.

Yours sincerely,