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Comments on the joint consultation paper on enhancements to the OTC derivatives regime for Hong Kong issued by the Hong Kong Monetary Authority and Securities and Futures Commission

Dear Sirs/Madams:

We, the Japanese Bankers Association (JBA), would like to express our gratitude for this opportunity to comment on the joint consultation paper on enhancements to the OTC derivatives regime for Hong Kong issued on March 27, 2018 by the Hong Kong Monetary Authority (HKMA) and Securities and Futures Commission (SFC) (collectively, "the Regulators").

Proposals within the joint consultation paper on mandating the use of Legal Entity Identifiers (LEIs) for the reporting obligation, expanding the clearing obligation and adopting a trading determination process/criteria for introducing a platform trading obligation would contribute to the further enhancement of market transparency in Hong Kong OTC derivatives market.

However, there are some areas of concern in the proposals as specified below and we respectfully expect that the following comments will contribute to your further discussion.

1. Question 2:

Will you have any difficulties adopting the use of LEIs in OTC derivatives trade reporting according to the proposed timelines? If so, please provide details of your difficulties.

(Our comments)

Given regulations in the U.S. and EU, we have no objection to the use of LEIs for trade reporting purposes.

Nevertheless, the Regulators are requested to allow financial institutions about six months to one year grace period for implementing the first phase after the publication of the conclusions for financial institutions to confirm LEIs with their counterparties and to complete other necessary compliance actions.

While there is no particular issue with the timeline for the second phase the Regulators should consider taking some actions to encourage small-sized entities to obtain LEIs.

(Rationale)

The joint consultation paper proposes timelines for implementing the mandatory use of LEIs in trade reporting, classifying entities falling within paragraphs 28(a) to (e) into the first phase (a six-month gap between publication of the conclusions and the implementation) and entities falling under paragraph 28(f) into the second phase (after January 2020), respectively.

Recently in complying with EU MiFID II / MiFIR, some reporting entities had failed to obtain LEIs from all of their counterparties (particularly from non-EU entities) before January 2018, and as a result, the authorities have determined to allow entities an additional period of six months under certain conditions[1]. As can be seen from this case, financial institutions would require a significant period of time to establish a framework for obtaining LEIs from counterparties and verifying them (including ensuring of any renewals). Therefore it is not easy in practice to commence the use of LEIs with six-month gap only, just because a number of outstanding transactions were reported with LEIs as described in the joint consultation paper. In order to enable smooth preparation (e.g. verification of LEIs of counterparties) by those financial institutions subject to the reporting obligation, we believe that about at least six months to one year grace period would be necessary between publication of the conclusion and implementation of the requirement to use LEIs.

In this regard, it is considered that the proposed timeline for the second phase provides a sufficient period of time for preparation. On the other hand, since there is a relatively weak incentive for small-sized entities falling into paragraph 28(f) to obtain LEIs, we believe that

[1] https://www.esma.europa.eu/press-news/esma-news/esma-issues-statement-lei-implementation-under-mifid-ii

outreach by the Regulators, such as public relations activities, would be beneficial for smooth implementation.

2. Question 12:

Do you have any comments or concerns regarding our proposed trading determination process and criteria? If you do, please provide specific details.

(Our comments)

We have no objection to the six factors set out in paragraph 72 to be taken into account in the trading determination process for considering which products are appropriate to be subject to trading obligation. Nevertheless, in selecting products subject to the obligation, it is requested that the Regulators propose a well-balanced regulation, not overly focusing on only one of the factors, and taking into account relevant regulations of other jurisdictions.

(Rationale)

Similar criteria are taken into account under regulations of other jurisdictions as well. However, some products do not necessarily meet all of such factors. For example, while major currency denominated interest rate swaps (such as USD, EUR) traded on SEF (Swap Execution Facility) or MTF (Multilateral Trading Facility) would meet many of the factors, HKD denominated interest rate swaps may meet the factor (b) and/or (d) in paragraph 72 but would not meet the factor (e). If the HKD-IRS is subject to the platform trading obligation, additional burdens will be imposed on both trading platform operators and financial institutions. It should be noted that such costs may offset regulatory benefits or may undermine international alignment which the Regulators place emphasis on.

In this view, the Regulators are requested to propose a well-balanced platform trading obligation by not overly focusing on just one of the factors in the process of drafting rules and performing an in-depth analysis of regulations in other jurisdictions and regulatory burdens of involved parties.

Sincerely yours,

Vice Chairman and Senior Executive Director