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Ladies and Gentlemen

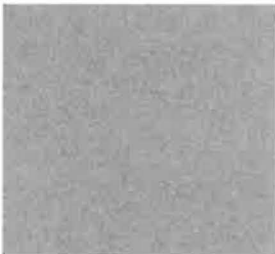
Consultation response to the HKMA and SFC joint consultation on enhancements to the OTC derivatives regulatory regime

Thank you for your email of 26 April 2019 and the accompanying consultation paper on enhancements to the OTC derivatives regime for Hong Kong to (1) mandate the use of Unique Transaction Identifiers for the reporting obligation, (2) revise the list of designated jurisdictions for the masking relief of the reporting obligation and (3) update the list of Financial Services Providers under the clearing obligation ("Consultation Paper").

The Hong Kong Association of Banks is pleased to provide its comments and queries on proposals 1 and 2, as **enclosed**.


For any enquiries, please do not hesitate to contact our Manager 


Yours faithfully



Secretary

Enc.

Chairman Standard Chartered Bank (Hong Kong) Limited
Vice Chairman Bank of China (Hong Kong) Limited
The Hongkong and Shanghai Banking Corporation Limited
Secretary 

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HKAB response to proposals 1 and 2 of the HKMA and SFC joint consultation on enhancements to the OTC derivatives regulatory regime

24 June 2019

Introduction

This paper sets out the views of The Hong Kong Association of Banks (“HKAB”) in relation to the “Joint consultation paper on enhancements to the OTC derivatives regime for Hong Kong to (1) mandate the use of Unique Transaction Identifiers (“UTI”) for the reporting obligation, (2) revise the list of designated jurisdictions for the masking relief of the reporting obligation and (3) update the list of Financial Services Providers under the clearing obligation” (“**Consultation Paper**”).

Assisted by King & Wood Mallesons, HKAB has examined the proposals set out in the Consultation Paper dated March 2018, issued by the Hong Kong Monetary Authority (“HKMA”) and the Securities and Futures Commission (“SFC”). Our views are set out in the “HKAB’s response” section of this written submission, with our key suggestions summarised in the “Executive summary”.

We would be pleased to engage in further discussions with the HKMA and SFC in relation to the proposed changes and to provide further industry input where necessary.

Unless otherwise defined, terms used in our response have the meaning and construction given to them in the Consultation Paper.

Executive summary

On the whole, HKAB supports the intent of the Consultation Paper and some proposals. Specifically, HKAB agrees with the importance of keeping up with international developments, ensuring that Hong Kong’s reporting and clearing regimes remain relevant and appropriate. However, HKAB proposes the following recommendations to ensure that the proposals are ultimately practicable:

- (a) **Bilateral agreement to generate UTI** – HKAB strongly urges the HKMA and SFC to reconsider this proposal. HKAB expects that there will be operational difficulties executing this proposal, particularly for reporting parties with large counterparty bases as well as for smaller regional banks. HKAB also believes cross jurisdictional conflicts may arise, highlighting the importance of jurisdictional alignment.
- (b) **Annex 1 as an alternative option** – HKAB recommends further clarity to Annex 1. Given the complexity and implementation challenges which may arise when attempting to align all parties, there may be different adherence levels to Annex 1 of the Consultation Paper resulting in potential non-compliance from both parties.
- (c) **Grace period** – for several reasons, HKAB strongly recommends extending implementation to at least one year from the date the Conclusion Papers are concluded and released. A key reason for this is that internal systems cannot be enhanced and transformed in a period of less than a year. Moreover counterparties and client outreach and agreement processes are very time consuming.
- (d) **Designated List** – HKAB agrees with the approach to remove 17 jurisdictions, leaving only People’s Republic of China (“PRC”) on the designated list. However, HKAB believes that a longer period of six months would be more suitable for firms to remediate their existing positions.

Further details are set out in the “HKAB’s response” section below.

Please let us know if you have any questions.

HKAB's response

	Question	HKAB's response
1	<p>Do you have any comments or concerns about our proposals to mandate the use of UTIs in OTC derivatives trade reporting, in particular, the interim measure and to allow counterparties to bilaterally agree on the responsibility to generate a UTI prior to adopting the list of factors recommended in the Technical Guidance?</p> <p>If you foresee any operational difficulties in implementing the proposals, please provide specific details.</p>	<p>Proposed responsibility for generating UTIs for transactions</p> <p>HKAB strongly believes that it will not be practically feasible for counterparties to bilaterally agree on which party generates the UTI for respective transactions. The reasons for this view are set out below:</p> <p>(a) Operational difficulties – HKAB believes that there will be operational difficulties to execute the proposed requirement for allocation of responsibility, particularly for reporting parties with a large counterparty base. Parties will have varying responsibilities – that is, they can be responsible for generating a UTI in one transaction but be required to follow counterparties' UTI in another transaction, meaning that the reporting party cannot generate UTIs for all transactions subject to trade reporting. Identifying which transactions the reporting party should generate UTIs in respect of, and which transactions the reporting party should follow counterparties' UTI, is likely to cause significant operational burden and confusion.</p> <p>Furthermore, counterparties may have different preferences on the approach to generating UTIs. This coupled with different bargaining power in respect of transactions, may lead to unfair or inconsistent requirements. HKAB clearly sees foreseeable challenges between parties on this front, particularly when dealing with smaller local or regional banks.</p> <p>(b) Jurisdictional conflicts – a bilateral agreement could potentially cause conflicts for deals that are eligible for multiple jurisdiction reporting, as potentially two UTIs could be created for a single deal. If the reportable trade is with a counterparty that does not have a reporting obligation to Hong Kong (only one-sided reporting), then the trade will never be matched and bilateral agreement will be very challenging, especially where reporting party does not have visibility of whether the other party is also obliged to report the trade under the HKTR regime. In addition, there may be a potential issue for overseas branches to report the UTI, especially trading with counterparties which are subject to same reporting requirement.</p> <p>(c) Annex 1 of the Consultation Paper – HKAB believes that the fall back criteria outlined in Annex 1 are a more effective and certain means to determine UTI generation if all market participants are adhering to them. Given the complexity and implementation challenges which may arise when aligning all parties, there may be different adherence levels resulting in potential non-compliance from both parties. For example, one party may implement all the necessary effort to ensure the UTI is paired and shared, however the other party may not be able to align resulting in non-compliance.</p> <p>Furthermore, some of the factors listed in Annex 1 are relatively unclear or conflicting with each other. HKAB suggests including a waterfall diagram / decision tree, which highlights the level of priority market participants should consider in generating a UTI. HKAB recommends that any flowchart should consider the</p>

comments raised in the paragraph below, titled “clarity regarding Annex 1 / Technical Guidance factors”. A flowchart will serve as a quick reference, and also may help to emphasise the order of priority to be followed.

- (d) **Ensuring consistency globally** – HKAB notes the success of the proposed arrangement is dependent on regulators globally moving towards harmonised reporting requirements. If this does not occur, there may be a mismatch on UTI generation logic. For example, should the European Market Infrastructure Regulation (“EMIR”) or the US Commodity Futures Trading Commission (“CFTC”) use the logic proposed by the IOSCO guidance, then there may be a different UTI generated for the same trade. HKAB wishes to emphasise the importance for all regulators to adopt a similar approach to ensure clarity and consistency.

Clarity regarding Annex 1 / Technical Guidance factors

Annex 1 to the Consultation Paper seeks to adopt the same format and factors as set out in the Technical Guidance (namely the factors and flowchart set out at pages 11 to 14 of the Technical Guidance).

It is HKAB’s view that it is still unclear how the Technical Guidance should be implemented in practice even though it has been released since February 2017. This is largely because the factors require an assessment of the counterparty’s circumstances, many of which are not practical or readily available to the reporting entity.

Regarding adopting the list of factors recommended in the Technical Guidance and Annex 1, HKAB has the following comments:

- (a) It is not practical in all instances for the reporting entity to identify if the transaction is cross-jurisdictional and subject to more than one jurisdiction’s reporting rules (see item 4 of Annex 1). HKAB recommends that this should not be a relevant factor, or alternatively should not represent a decision to be determined very early on in the decision tree.
- (b) It is not practical for the reporting entity to confirm if counterparties’ jurisdiction employs a counterparty-status-based approach.
- (c) The reporting entity does not know the counterparties’ regulatory status for UTI generation purposes.
- (d) The reporting entity does not know the counterparties’ jurisdiction deadline.

Based on the above, HKAB urges the HKMA and SFC to reconsider this proposal, given that it is likely to cause unnecessary complexity and costs.

Proposed approaches to UTIs

With respect to paragraph 26(c)(iii), HKAB’s view is that this specific requirement of using a new UTI would not be practical as banks’ systems will not be able to distinguish whether such counterparty change in the system is due to input error or new counterparty to be faced.

With respect to paragraph 26(d)(iii), HKAB believes that it will be difficult and complex operationally to determine whether new or old UTI under different scenarios should be used. Disputes may arise among counterparties as both sides will have different definitions or views.

Additional comments

To avoid confusion, HKAB suggests formulating a matrix table to specify clearly when, which types of executed trades as well as under what kind of circumstances are eligible to use the following for reporting:

- (a) Either USI, UTI or TID can be used.
- (b) Both USI and UTI / TID are required to report.
- (c) Only UTI / TID is allowed for reporting.

HKAB also recommends clearly specifying which party is obliged / responsible to generate UTIs and TIDs for reporting when facing non-US and non-EU counterparties, as well as when facing with corporate clients and individuals.

HKAB also suggests providing an instruction guide to confirm the methodology and source of subscribing UTI / TID for transparency and standardisation. Based on existing operations, values can only be provided by counterparties on or after trade date and sometimes passed value date or maturity date. As a result, reported deals cannot be updated with UTI / TID values for matching. Accordingly, HKAB suggests improving the existing mechanism of HKTR applications.

2 Will you have any difficulties adopting the use of UTIs in OTC derivatives trade reporting in the proposed timelines as stated above? If so, please provide specific details.

Extending the grace period

HKAB strongly recommends a grace period of at least one year for the following reasons:

International alignment – the EU and US are yet to align any changes to the Technical Guidance. While HKAB assumes that they will in due course, if they do not, there will be significant difficulties for banks in Hong Kong who are required to implement such requirements. Furthermore, if and when the EU and US make changes, those will also flow through to the Hong Kong regime via the USI / TID. As such, we suggest that the HKMA only finalises the implementation date upon certainty that the US and EU are implementing the Technical Guidance in the same manner.

Moreover, the ISDA previously published a UTI whitepaper outlining UTI tiebreaker logic, which some firms have implemented globally. This combined with the adoption of a new standard under CPMI and/or IOSCO, may result in complex global systems and process adaptation. Accordingly, given the global nature of the OTC derivatives markets, HKAB recommends harmonising the timelines of the global standard adoption (including CPMI and IOSCO) across key jurisdictions in the EU, US and Asia Pacific. This will streamline the approach and result consistent implementation across the industry.

- (a) **Enhancing internal systems** – most internal systems do not have the flexibility to cope with update requirements of UTI / TID

immediately. Similarly, the systems do not have the functionality to download, interface and store provided UTI / TID unless system developments can be arranged. However, system implementation and project planning in this respect can take a long time to implement correctly.

The fact that HKTR covers a broad range of derivatives classes increases the difficulties in implementing changes to all platforms and the lead time for building additional services layer to capture UTI for standardising. Accordingly, transition will take longer than six months.

- (b) ***Vast numbers of trades not using USI / UTI / TID*** – currently some banks have several thousands of trades not using USI, UTI or TID as identifier for OTC derivatives trade reporting. To migrate and process these would take over a year.
- (c) ***Infrastructure providers*** – infrastructure providers (eg confirmation platforms and clearing houses) also provide UTIs to banks. As banks use these providers extensively and have built their systems to use UTI from them, these providers will also likely need significant system changes to adopt the Technical Guidance structure and format.
- (d) ***Less developed parties*** – there are some less sophisticated counterparties where the confirmation process (including agreeing to a UTI) will go beyond the proposed timeline. We request the HKMA and SFC continue to provide flexibility with regard to such counterparties.

Bearing the above in mind, HKAB strongly urges the HKMA and SFC to consider revising the implementation timeline to at least the end of 2020. Moreover, HKAB believes that reporting entities should report a UTI with the structure and format consistent with the Technical Guidance in the designated data field in the HKTR template only to new trades *after* the interim measure. This will significantly reduce operational burden.

Additional comments

While we ask the HKMA and SFC to reconsider this proposal, in the meantime, we seek clarification on the interpretation of the proposed grace period – that is, whether banks will have six months:

- (a) after both the US and the EU have *adopted* the international standard on UTIs; or
- (b) after both the US and the EU have *formally announced* that they will be adopting the international standard on UTIs (but before the mandatory date of adoption).

HKAB also seeks clarification on the approach where different timelines are issued in US and EU.

HKAB also asks the HKMA and SFC to carry out further consultations on the implementation and practice adoption to assist market participants.

3	Do you have any comments or concerns about the proposed revision to the Designated List for the purposes of the masking relief?	<p>HKAB agrees that 17 jurisdictions should be removed, leaving only the PRC on the Designated List.</p> <p>Currently under the Reporting Rules, prescribed persons have a grace period of up to three months to submit “transaction information” (as defined in the Reporting Rules), following after the jurisdictions are removed from the designated list.</p> <p>The HKMA has indicated that it intends to publish the revised list no earlier than 1 October 2019 giving firms up to 31 December 2019 to unmask counterparties from the 17 jurisdictions. HKAB believes that a longer period of six months would be more suitable for firms to remediate their existing positions.</p>
4	Are you aware of any jurisdiction which should not be removed from the Designated List? If so, please provide specific details of the relevant legal or regulatory requirements with supporting information and other proof.	<p>HKAB is not aware of any jurisdiction which should remain on the Designated List.</p>
5	Do you have any comments or concerns about our proposed implementation timeline to gazette the revised Designated List no earlier than 1 October 2019? If so, please provide specific details.	<p>Subject to the response to question 3, HKAB does not have any specific comments in respect of the implementation timeline to gazette the revised Designated List.</p>
6	Do you have any comments or concerns about our proposed snapshot approach to unmasking? If so, please provide the specific details of any operational difficulties you anticipate.	<p>In general, HKAB welcomes the snapshot approach to unmasking. However, HKAB notes that system enhancements will be required to operate the snapshot approach. Accordingly, HKAB seeks more time for system enhancements for the snapshot approach. Specifically, HKAB requests a six month period after the revised Designated List rather than the suggested three months.</p>
7	Other comments	<p>Structure and format of UTIs</p> <p>As mentioned in the Consultation Paper, a UTI is required to be constructed as a concatenated combination of the LEI of the generating entity at the point of generation and a unique value created by that entity. Given the current practice by some counterparties, HKAB requests that the SFC allow flexibility for counterparties to use UTI prefix instead of LEI as the component of UTI.</p> <p>HKTR reporting</p> <p>HKAB suggests implementing a “partial match and link” button as part of the HKTR system to clear minor disputed mismatch items with counterparties. The suggestion is made for the following reasons:</p>

- (a) For the reporting of equity derivatives, RIC and ISIN codes are also accepted by HKTR, however these cannot be matched or linked and resulted in mismatch records found at HKTR system.
- (b) Those reported trades which have been matured cannot be matched or linked with counterparties again and result in mismatch records found at HKTR system.

Further, since trade details of reported trades can only be viewed online from HKTR system but cannot be extracted or downloaded in excel format for reconciliation, HKAB recommends adding a new function to allow market participants to view and download reported trades in excel format.

Next steps

Thank you very much for the opportunity to provide feedback on the Consultation Paper. We would be delighted to discuss any aspect of our comments or to provide feedback on any further proposals.