FEATURE ARTICLE

Results of surveys on selected debt securities and off-balance sheet exposures to derivatives and securitisations

by the Banking Policy Department

At the end of June 2013, the total market value of selected debt securities held by authorized institutions (AIs) remained at a broadly similar level to that in June 2012. However, there was a change in the composition of the debt securities in terms of their issuers in that the proportion of debt securities issued by sovereigns dropped significantly as against those issued by banks and corporates. AIs' activities in derivatives continued to trend upward with a moderate growth.

Substantial progress has been made locally in strengthening the regulatory framework for the over-the-counter (OTC) derivatives market. This includes the implementation of the enhanced regulatory capital framework for counterparty credit risk (CCR) and central counterparties (CCPs) under Basel III[1] on 1 January 2013 and the introduction of the Securities and Futures (Amendment) Bill 2013 into the Legislative Council in July 2013 to provide the legal framework for mandatory clearing and reporting of OTC derivatives transactions.

Introduction

The HKMA introduced two half-yearly surveys in November 2008 – the Survey on Selected Debt Securities and the Survey on Off-balance Sheet Exposures in Derivatives and Securitisation Transactions – to help strengthen its oversight of the banking sector's exposure to structured credit products and OTC derivatives. The surveys collect data on AIs' exposures respectively in selected debt securities and in securitisation and derivatives transactions, including credit derivatives.

In total, 175 AIs[2] participated in the Survey on Selected Debt Securities and 199 AIs[3] participated in the Survey on Off-balance Sheet Exposures in Derivatives and Securitisation Transactions for the 6-month periods ended December 2012 and June 2013.[4] This article presents the results of the surveys, covering the reported exposures of the surveyed AIs at the end of the two periods.

Highlights of major findings

The surveys showed that:

1. The total market value of the selected debt securities[5] held by the surveyed AIs decreased slightly to HK$1,708 billion at the end of June 2013 (0.5% lower than June 2012), given that a

[1] See "Basel III: A global regulatory framework for more resilient banks and banking systems" issued by the Basel Committee on Banking Supervision in December 2010 (updated in June 2011).

[2] Representing all licensed banks and restricted licence banks in Hong Kong of which the total assets at the end of June 2013, in the aggregate, accounted for 99.7% of the total assets of the banking sector.

[3] Representing all AIs (i.e. licensed banks, restricted licence banks and deposit taking companies) in Hong Kong.

[4] The results of the surveys conducted for the positions at the end of December 2011 and June 2012 were published in the *HKMA Quarterly Bulletin* in December 2012.

[5] Selected debt securities are debt securities other than Exchange Fund Bills and Notes, US Treasury bills, notes and bonds, and debt securities issued by multilateral development banks.

moderate increase of 6.5% during the second half of 2012 was more than offset by a reduction in the first half of 2013. Of these securities 96.3% were non-structured securities, which were mainly issued by banks, sovereigns and corporates. During the period, there was a reduction in AIs' holdings of non-structured securities issued by sovereigns, which was partially offset by an increase in those issued by banks and corporates. The selected debt securities were held mainly for investment purposes.

2. The total market value of AIs' holdings of structured securities[6] grew slightly to HK$62 billion at the end of June 2013, 0.8% higher than a year ago. This was mainly attributable to increased investments in residential mortgage-backed securities by a few locally incorporated AIs. Nevertheless, the holdings remained insignificant, representing only 0.8% of the total assets of the investing AIs. As in previous years, most of the structured securities (56.8%) were backed by residential mortgage loans. The proportion of securities backed by non-prime residential mortgage loans[7] further reduced to 1.9% (3.7% in June 2012).

3. The total notional amount of outstanding derivatives contracts (other than credit derivatives) has been increasing since June 2009. The amount stood at HK$61,501 billion at the end of June 2013, representing a year-on-year growth of 5.5%. The increase was mainly in foreign exchange forwards and swaps. Exchange-rate and interest-rate contracts remained the main types of contracts traded.

4. Continuing its downward trend, the total notional amount of credit derivatives further dropped to HK$386 billion at the end of June 2013, accounting for merely 0.6% of all the outstanding derivatives contracts reported. The holdings of credit derivatives were still highly concentrated in a few AIs.

5. The off-balance sheet securitisation exposures of AIs, which mainly consisted of liquidity facilities, credit enhancements and interest rate and currency derivatives provided to securitisation transactions, remained minimal.

Details of major findings

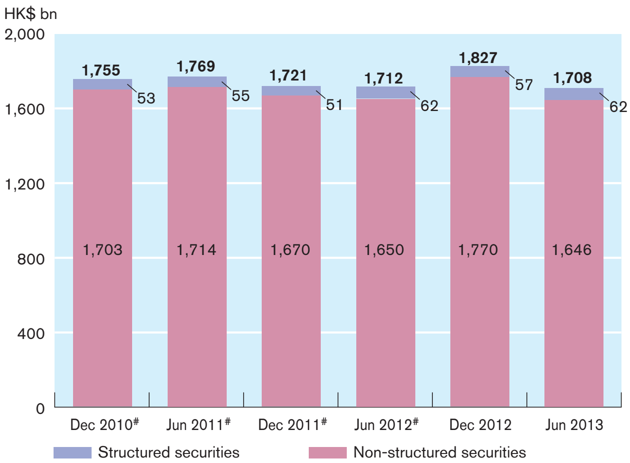
Selected debt securities held

The aggregate market value of selected debt securities held by all surveyed AIs decreased slightly year-on-year by 0.5% to HK$1,708 billion at the end of June 2013 (Chart 1). The growth over the second half of 2012 was completely offset by a decrease in the first six months of 2013, which was mainly due to the maturity of investment-grade sovereign debt held by several AIs. The selected debt securities as a percentage share of the AIs' total assets was 10.2% at end-June 2013 (10.9% at the end of June 2012).

AIs' holdings of structured securities remained small at HK$62 billion at the end of June 2013, representing a slight year-on-year increase of 0.8%. As in the previous year, none of the AIs with holdings in structured securities were the originators of those securities.

CHART 1

Market value of selected debt securities held by all surveyed AIs



Revised figures.

[6] Structured securities include asset-backed securities (ABSs), mortgage-backed securities (MBSs), collateralised debt obligations (CDOs), notes issued by structured investment vehicles (SIV notes), asset-backed commercial paper (ABCP) and any other similar structured products, but exclude credit-linked notes.

[7] "Non-prime" refers to Alt-A and sub-prime, or their equivalents in the case of non-US markets.

The aggregate market value of selected debt securities held by local banks[8] recorded a 1.8% year-on-year decline to HK$1,233 billion at the end of June 2013. Of these debt securities, 4.0% (or HK$49 billion) were structured securities, which was 27.6% higher than the amount of HK$38 billion at the end of June 2012. The increase in structured securities was mainly due to new investments in asset-backed securities that were backed by claims on residential mortgage loans and personal lending other than credit card receivables. The holdings represented 11% of the aggregate capital base of the local banks concerned at the end of June 2013 (9.9% at the end of June 2012).

The following analysis illustrates the distribution of debt securities reported by the surveyed AIs:

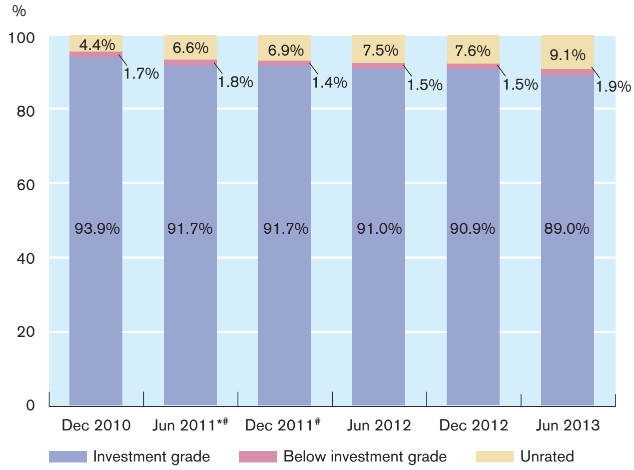
Non-structured securities

By type of issuer or reference entity[9]:
Within the three largest categories of non-structured securities by type of issuer or reference entity (i.e. banks, sovereigns and corporates), the percentage share of sovereigns reduced sharply to 27.7% in June 2013 from 36.5% in June 2012 (Table 1). This was attributed to the lower yields of sovereign debt during the surveyed period, which prompted some AIs not to replenish matured sovereign debt.

By credit quality:
AIs' holdings of non-structured securities continued to be of high credit quality, with 89.0% of the securities (90.9% in December 2012) having investment-grade credit ratings (Chart 2) and 78.4% (80.9% in December 2012) having a single-A rating or above. Investment-grade securities were mainly issued by banks and sovereigns while unrated securities were mainly issued by corporates. The decline in percentage share of investment-grade securities was the combined result of a reduction in

CHART 2

Percentage share by credit quality of non-structured securities



* Figures do not add up to 100% due to rounding.
\# Revised figures.

TABLE 1

Percentage share by type of issuer or reference entity

	All surveyed AIs					
Issuer or reference entity	**Jun 2013**	**Dec 2012**	**Jun 2012*#**	**Dec 2011#**	**Jun 2011#**	**Dec 2010#**
Sovereigns	27.7%	37.0%	36.5%	36.3%	29.4%	28.4%
Public sector entities	6.9%	6.2%	6.6%	7.2%	7.8%	8.1%
Banks	45.5%	41.0%	41.4%	41.8%	48.2%	49.5%
Non-bank financial institutions[10]	3.8%	3.2%	3.1%	3.5%	4.4%	4.9%
Investment funds and highly leveraged institutions (e.g. hedge funds)	0.0%	0.0%	0.0%	0.0%	0.1%	0.0%
Corporates	15.6%	12.1%	11.6%	10.4%	9.2%	8.5%
Others	0.5%	0.5%	0.7%	0.8%	0.9%	0.6%

* Figures do not add up to 100% due to rounding.
\# Revised figures.

8 Local banks refer to licensed banks incorporated in Hong Kong.

9 When the securities held by an AI are credit-linked notes or when the credit risk of the securities held by an AI is hedged by credit derivatives contracts, the AI is required to report the type of the reference entity of the credit-linked notes or credit derivatives contracts concerned instead of the type of the issuer of the securities.

10 Including securities firms, insurance companies, investment banks and fund houses.

holdings of sovereign securities with single-A rating or above by a few local banks and an increase in holdings of non-investment-grade and unrated securities issued by corporates by some AIs.

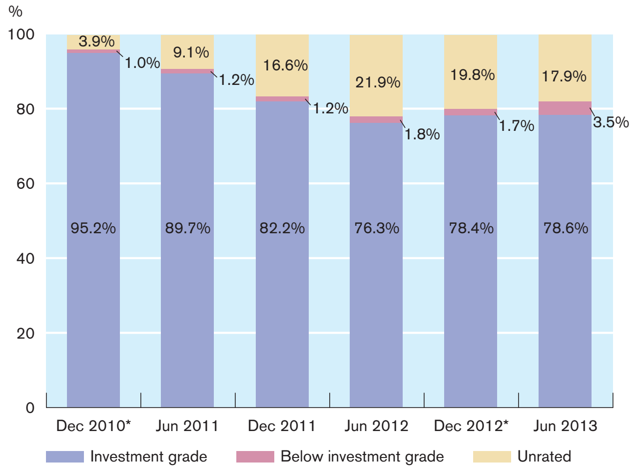
Structured securities

By type of product:
The number of surveyed AIs with holdings in structured securities reduced to 22 (26 AIs in June 2012). The holdings were concentrated in a few AIs, with the top five (mostly local banks) accounting for 88.5% of the total market value of structured securities reported. Consistent with the observation in previous years, the holdings were mainly in relatively simple securitisation products, such as MBSs (Table 2). The rise in percentage shares of Sukuk[11] and asset-backed commercial paper in the first half of 2013 was primarily due to an increase in the holdings of one local bank.

By credit quality:
The aggregate market value of investment-grade structured securities increased by 3.8% to HK$49 billion from the end of June 2012 to end of June 2013, while that of non-investment-grade structured securities rose by 94.1% to HK$2 billion. New investments made during the period were mostly triple-A rated ABSs. The increase in rated structured securities, coupled with a year-on-year decline of 17.5% in the aggregate market value of unrated structured securities, led to a noticeable decrease in the percentage share of unrated structured securities (Chart 3).

By underlying asset:
Residential mortgage loans remained the main type of asset (56.8%) underlying the structured securities held by AIs. Since new structured securities purchased in the first half of 2013 were mostly backed by claims on sovereigns and non-bank financial institutions and credit card receivables, there was a noticeable growth in the percentage shares of securities backed by these types of

CHART 3
Percentage share by credit quality of structured securities



* Figures do not add up to 100% due to rounding.

TABLE 2
Percentage share by type of product

Structured product	All surveyed AIs					
	Jun 2013	Dec 2012*	Jun 2012*	Dec 2011*	Jun 2011*	Dec 2010*
ABSs (including MBSs)	87.1%	90.0%	89.1%	87.2%	86.9%	86.0%
CDOs	3.7%	4.9%	6.2%	7.5%	7.1%	7.8%
SIV notes	1.2%	3.4%	3.1%	3.7%	4.1%	4.3%
Re-securitisation[12]	1.1%	0.2%	0.4%	1.0%	1.8%	1.9%
Sukuk	3.4%	1.4%	1.1%	0.5%	0.2%	0.1%
ABCP	3.5%	–	–	–	–	–

* Figures do not add up to 100% due to rounding.

[11] Sukuk is an Islamic financial instrument broadly equivalent to bonds in the conventional financial market.

[12] Re-securitisation is defined in the survey as a transaction in which the underlying assets are mainly (50% or more) securitisation or structured products.

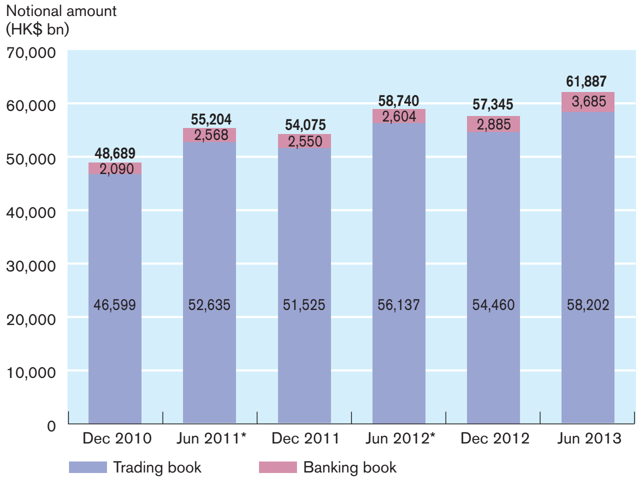
underlying asset during the period. AIs' indirect exposure to non-prime assets (mainly sub-prime residential mortgage loans) through holdings of securities backed by such assets continued to decline, with the proportion of those securities to the total portfolio of structured securities further reducing to 2.1% at the end of June 2013 from 3.6% at the end of December 2012 (Table 3).

Exposures in derivatives

In line with the general trend observed globally, derivatives activities of the surveyed AIs have picked up over the past four years. The total notional amount of outstanding derivatives contracts held by all surveyed AIs at the end of June 2013 amounted to HK$61,887 billion, 5.4% higher than the level at the end of June 2012 (Chart 4). Most of the contracts were held for trading purposes. The 5.4% increase was mainly the result of a net increase in foreign exchange contracts, partially offset by a net reduction in interest rate contracts, which were both largely driven by derivatives activities of AIs incorporated outside Hong Kong (mainly branches of foreign banks). The holdings of derivatives contracts remained dominated by a small group of AIs, with the positions of the top five AIs accounting for 67.8% of the total notional amount.

CHART 4

Derivatives contracts held by all surveyed AIs



* Figures do not add up to total due to rounding.

TABLE 3

Percentage share by type of underlying asset

Type of underlying asset	All surveyed AIs Jun 2013*	Dec 2012*	Jun 2012	Dec 2011*	Jun 2011	Dec 2010
Claims on sovereigns	3.4%	1.4%	1.2%	0.6%	0.2%	0.1%
Claims on public sector entities	16.4%	17.4%	17.8%	12.0%	4.5%	0.2%
Claims on banks	0.1%	0.4%	0.4%	0.5%	0.9%	1.1%
Claims on non-bank financial institutions	3.5%	0.1%	0.1%	0.2%	0.2%	0.3%
Claims on corporates	1.2%	1.5%	0.6%	0.8%	1.6%	2.4%
Commercial mortgages	1.7%	2.3%	3.0%	4.3%	4.6%	5.1%
Residential mortgages	56.8%	60.6%	55.3%	58.1%	62.4%	62.9%
of which non-prime	1.9%	3.3%	3.7%	5.4%	6.3%	7.0%
Credit card receivables	7.2%	5.5%	11.6%	11.4%	10.1%	9.0%
of which non-prime	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Other personal lending	4.6%	4.5%	3.4%	6.9%	9.7%	12.8%
of which non-prime	0.2%	0.3%	0.5%	0.9%	1.1%	1.5%
Others	5.2%	6.2%	6.6%	5.4%	5.8%	6.1%

* Figures do not add up to 100% due to rounding.

Of the total notional amount of outstanding derivatives contracts held by all surveyed AIs, 61% (or HK$37,773 billion with a year-on-year increase of 3.4%) was held by local banks.

The following analysis illustrates the distribution of outstanding derivatives contracts reported by the surveyed AIs:

Type of product

As in previous years, swaps and forwards were the major types of OTC derivatives contracts held, representing 58.4% and 29.4% respectively of the total notional amount of all derivatives contracts held at the end of June 2013 (Table 4). AIs' holdings of exchange-traded derivatives were still minimal.

Type of underlying risk

Interest rate risk and foreign exchange risk remained the two largest categories of underlying risk of derivatives contracts held at the end of June 2013 (Table 5). The notional amount of foreign exchange contracts held increased year-on-year by 13.2% to HK$33.3 billon, leading to a rise in the percentage share of such contracts in AIs' portfolios of derivatives contracts. A driver of this growth was a greater demand for renminbi foreign exchange contracts, including to meet customers' demand for hedging, prompted by an expectation of renminbi appreciation. In contrast with the aggregate position of all surveyed AIs, most derivatives contracts held by local banks were interest rate contracts (51.3%) as opposed to exchange rate contracts (44.6%).

TABLE 4

Percentage share by type of product

Derivatives product	All surveyed AIs					
	Jun 2013	Dec 2012	Jun 2012	Dec 2011	Jun 2011	Dec 2010
Exchange-traded derivatives	2.6%	2.4%	3.0%	3.2%	5.2%	5.2%
OTC derivatives	97.4%*	97.6%	97.0%*	96.8%	94.8%*	94.8%*
of which						
Forwards	29.4%	28.6%	28.6%	27.9%	24.7%	25.1%
Swaps	58.4%	61.5%	59.4%	60.9%	60.4%	60.1%
Options	8.5%	6.6%	7.8%	6.7%	6.8%	5.7%
Credit derivatives	0.6%	0.7%	0.8%	0.9%	1.0%	1.2%
Others	0.6%	0.2%	0.5%	0.4%	2.0%	2.8%

* Figures do not add up to total due to rounding.

TABLE 5

Percentage share by type of underlying risk

Underlying risk	All surveyed AIs					
	Jun 2013*	Dec 2012	Jun 2012	Dec 2011*	Jun 2011*	Dec 2010*
Interest rate risk	43.3%	46.2%	47.1%	50.3%	53.5%	54.5%
Foreign exchange risk	53.8%	51.3%	50.0%	46.9%	43.4%	42.8%
Equity risk	2.2%	1.7%	2.0%	1.7%	1.7%	1.3%
Commodity risk	0.1%	0.1%	0.1%	0.0%	0.0%	0.0%
Credit risk	0.6%	0.7%	0.8%	0.9%	1.0%	1.2%
Other risks	0.1%	0.0%	0.0%	0.0%	0.3%	0.1%

* Figures do not add up to 100% due to rounding.

Type of counterparty

Accounting for 52.6% of the total notional amount of derivatives contracts reported, derivatives transactions with banks as counterparties remained the most common (Table 6). There was, however, an upward trend in the percentage share of transactions entered into with non-bank financial institutions and corporates, their total notional amounts rising year-on-year by 44.3% and 31.9% respectively.

Credit derivatives

The credit derivatives positions of the surveyed AIs (i.e. both in terms of buying and selling protection) have been shrinking over the past few years. These positions were mainly held for trading purposes. The total notional amount of outstanding credit derivatives, which were held by only 10 AIs (17 AIs in June 2012) including three local banks, further dropped year-on-year by 17.8% to HK$386 billion at the end of June 2013 (Chart 5). The holdings of these contracts were dominated by several AIs, with the top three accounting for 90.2% of the total notional amount.

CHART 5

Credit derivatives held by all surveyed AIs

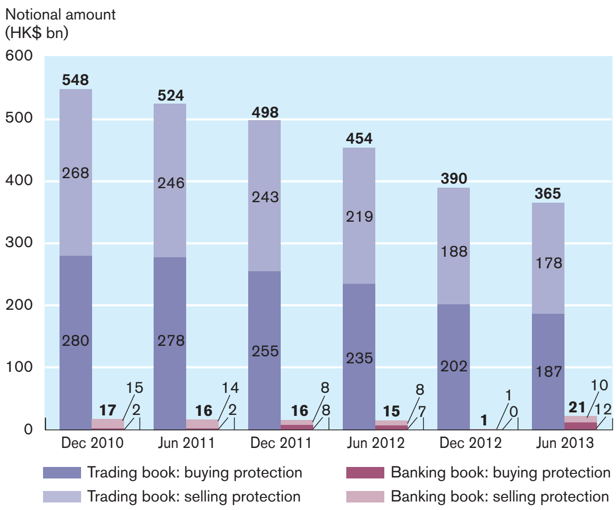


TABLE 6

Percentage share by type of counterparty

Counterparty	All surveyed AIs					
	Jun 2013	Dec 2012	Jun 2012	Dec 2011	Jun 2011	Dec 2010
Related parties	25.3%	26.5%	25.3%	25.4%	25.4%	25.4%
Independent parties						
of which	74.7%	73.5%*	74.7%	74.6%*	74.6%	74.6%*
Banks	52.6%	55.1%	56.6%	57.4%	57.8%	58.2%
Non-bank financial institutions	11.0%	9.3%	8.0%	7.1%	4.5%	4.5%
Investment funds and highly leveraged institutions	0.2%	0.3%	0.3%	0.2%	0.2%	0.2%
Corporates	7.6%	5.9%	6.0%	5.9%	6.5%	5.0%
Others (e.g. individuals)	3.3%	3.0%	3.8%	4.1%	5.6%	6.8%

* Figures do not add up to total due to rounding.

Reference entity

By type:

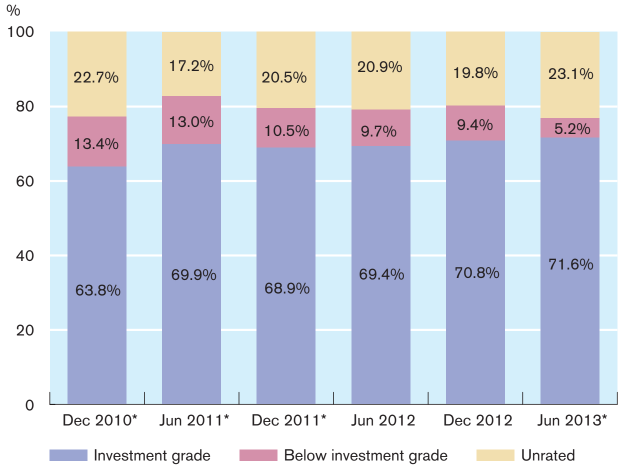
There was no significant change in the composition by type of reference entity. Corporates (46.9%), sovereigns (35.0%) and banks (13.3%) remained the major types of reference entity (Table 7). The notional amounts of contracts referenced to corporates and sovereigns both declined over the 12-month period to the end of June 2013, the latter reducing by a much smaller extent than the former. This resulted in a slight decrease in the percentage share of contracts referenced to corporates and a moderate increase in the percentage share of contracts referenced to sovereigns.

By credit quality:

There was a reduction in notional amount in all categories. Similar to last year, most of the credit derivatives (71.6%) were linked to reference entities with investment-grade credit ratings (Chart 6) and 54.8% (51.5% in June 2012) to those with a single-A rating or above. The share of credit derivatives linked to unrated reference entities increased year-on-year to 23.1% from 20.9% because there was a disproportionate reduction in the notional amounts of those linked to reference entities with non-investment-grade ratings. As in previous years, unrated reference entities were mainly corporates while reference entities with non-investment-grade ratings were mostly sovereigns.

CHART 6

Percentage share by credit quality of reference entity



* Figures do not add up to 100% due to rounding.

Off-balance sheet securitisation exposures

Off-balance sheet securitisation exposures of the surveyed AIs remained minimal, with an aggregate amount of HK$7.0 billion at the end of June 2013 (HK$4.0 billion in June 2012). The exposures were mainly held by a few AIs and the growth was mainly due to increased exposures of one local bank in the form of interest rate and currency derivative contracts entered into in relation to securitisation transactions.

TABLE 7

Percentage share by type of reference entity

	All surveyed AIs					
Reference entity	**Jun 2013***	**Dec 2012**	**Jun 2012**	**Dec 2011**	**Jun 2011**	**Dec 2010**
Sovereigns	35.0%	35.4%	30.4%	27.2%	28.9%	25.8%
Public sector entities	0.2%	0.2%	0.4%	0.3%	0.3%	0.3%
Banks	13.3%	12.8%	13.9%	12.7%	13.8%	12.9%
Non-bank financial institutions	4.7%	5.1%	5.5%	5.7%	6.0%	5.9%
Investment funds or highly leveraged institutions	–	–	–	–	–	–
Corporates	46.9%	46.5%	47.0%	51.5%	50.9%	55.1%
Tranches of MBSs, ABSs or CDOs	–	–	2.8%	2.6%	–	–
Others	–	–	0.0%	0.0%	0.1%	0.0%

* Figures do not add up to 100% due to rounding.

Conclusion

AIs' holdings of non-structured debt securities recorded a slight year-on-year reduction at the end of June 2013 as a noticeable increase in the second half of 2012 was more than offset by the decrease in the first half of 2013. There was no significant change in the composition in terms of credit quality. It is expected that AIs will continue to adjust the composition of their investment portfolios in the light of developments in relation to the US Federal Reserve's quantitative easing policy, global economic conditions and interest rate movements. AIs' holdings of structured debt securities and credit derivatives remained insignificant. The implementation of the enhanced risk-weighting frameworks under Basel III for the treatment of counterparty credit risk and banks' exposures to central counterparties in 2013 does not so far seem to have had a significant impact on AIs' OTC derivatives activities as revealed by the survey results. The legal framework for the mandatory clearing and reporting of OTC derivatives is expected to come into effect in mid-2014. The HKMA will continue to monitor the impact of these regulatory measures on AIs' derivatives activities through the two half-yearly surveys.

See separate box on regulatory developments.

Regulatory developments

Basel III

The HKMA implemented the first phase of Basel III requirements from 1 January 2013 through the enactment of the Banking (Capital) (Amendment) Rules 2012. This includes an enhanced capital framework for counterparty credit risk (CCR). The most important enhancements introduced by Basel III in this regard are a credit valuation adjustment (CVA) capital charge for non-centrally cleared OTC derivatives and a set of capital requirements for exposures to central counterparties (CCPs). The aggregate risk-weighted amount (RWA) for CVA of all locally incorporated AIs at the end of June 2013, calculated on a solo or solo-consolidated basis[13], accounted for 2.7% of their aggregate RWA for credit risk and 2.3% of their aggregate total RWA (i.e. the total of the RWAs for credit risk, market risk and operational risk). Since only a few of the AIs had exposures to CCPs, the aggregate RWA for exposures to CCPs as a percentage of the aggregate RWA for credit risk and of the aggregate total RWA were merely 0.23% and 0.20% respectively. Recognising that there are significant weaknesses in both the current exposure method (CEM) and the standardised method (SM), two of the three existing methods for the calculation of exposures to CCR within the Basel regulatory capital framework, and that further refinements are needed in the capital framework for exposures to CCPs, the Basel Committee on Banking Supervision (BCBS) issued two consultative documents in June 2013 on revised approaches in these areas: *The non-internal model method for capitalising CCR exposures* and *Capital treatment of bank exposures to central counterparties.* The first document introduces a proposed calculation methodology, which is not based on the use of banks' own internal models and which is intended to replace the CEM and SM. The second document covers proposed enhancements to the capital treatment of bank exposures to CCPs, in particular, the methodology for the calculation of capital charges for banks' contributions to CCPs' default funds.

OTC derivatives market reform

As mentioned in the survey results published in December 2012, the HKMA and the Securities and Futures Commission (SFC) have been working closely to strengthen the regulatory framework and infrastructure for OTC derivatives activities in Hong Kong. The proposed framework, to be set out under the Securities and Futures Ordinance, will in its initial phase prescribe mandatory clearing of certain specified OTC derivative transactions through a designated CCP and mandatory reporting of certain specified OTC derivative transactions to the trade repository operated by the HKMA (HKTR). While the proposed legislation will also include a mandatory trading platform requirement, it is envisaged that this part of the legislation will not be brought into effect until further studies confirm that its implementation is warranted by sufficient local market liquidity.

To provide the legal framework for the new regulatory regime, the Securities and Futures (Amendment) Bill 2013 was gazetted and introduced into the Legislative Council (LegCo) on 28 June and 10 July 2013 respectively. The regulators are working on detailed requirements to be set out in related subsidiary legislation, a draft of which is targeted to be issued

[13] "Solo basis" means the calculation covers positions of the AI (including its branches) only. "Solo-consolidated basis" means the calculation covers positions of the AI (including its branches) and positions of any of the AI's wholly-owned subsidiaries that have been approved by the HKMA for inclusion in the calculation on that basis, as an alternative to the solo basis. To be eligible for inclusion in the solo-consolidated basis of calculation, a subsidiary must meet the following criteria –

(a) it is managed as if it were an integral part of the AI;

(b) it is wholly financed by the AI such that it has no depositors or other external creditors except external creditors for audit fees; company secretarial services; and sundry operating expenses; and

(c) there are no regulatory, legal or taxation constraints on the transfer of the subsidiary's capital to the AI.

in the first quarter of 2014 for consultation. Subject to the passage of the relevant legislation by LegCo, the new requirements are expected to take effect in the middle of 2014 at the earliest.

In order to meet the Financial Stability Board's expectation of its member jurisdictions putting in place trade reporting requirements by July 2013, the HKMA issued a set of interim reporting requirements in June 2013 as a transitional measure pending the revised legislation coming into effect. Under the interim reporting requirements, all licensed banks have been required to report specified OTC derivative transactions to the HKTR with effect from 5 August 2013. Banks were given a four-month grace period to set up the necessary system linkages with the HKTR, and a further two-month grace period for completing any backloading or reporting of reportable transactions entered into by the banks on or before 8 December 2013.

To support mandatory clearing under the proposed regime, Hong Kong Exchanges and Clearing Limited has set up a local clearing house, OTC Clearing Hong Kong Limited (OTC Clear), which commenced its services for clearing OTC derivative contracts in November 2013.

Other regulatory initiatives

Other regulatory developments which are expected to have a bearing on AIs' derivatives activities include –

(a) the final framework on margin requirements for non-centrally-cleared derivatives issued by the BCBS and the International Organization of Securities Commissions in September 2013. All financial firms and systematically important non-financial entities that engage in non-centrally-cleared derivatives are required to exchange initial and variation margin to reduce systemic risks as well as to promote central clearing. The requirement to exchange variation margin will become effective on 1 December 2015 while the exchange of initial margin will be phased in over a four-year period, beginning in December 2015. The HKMA will update its prudential framework for AIs as appropriate to align with the new international standards; and

(b) the Interpretive Guidance and Policy Statement Regarding Compliance with Certain Swap Regulations (Guidance) issued by the Commodity Futures Trading Commission (CFTC) of the US in July 2013. The Guidance, which is intended to finalise the proposed interpretive guidance and policy statement issued in July 2012, sets forth the general policy of the CFTC in interpreting how the swaps provisions of the Commodity Exchange Act (CEA) apply to cross-border activities. As mentioned in the survey results published in December 2012, the Guidance could subject non-US persons (such as AIs) to certain requirements under the Dodd-Frank Wall Street Reform and Consumer Protection Act of the US.