

**Joint consultation conclusions paper on enhancements to the OTC derivatives regime for Hong Kong to – (1) mandate the use of Legal Entity Identifiers for the reporting obligation, (2) expand the clearing obligation and (3) adopt a trading determination process for introducing a platform trading obligation**

**June 2018**



HONG KONG MONETARY AUTHORITY  
香港金融管理局



SECURITIES AND  
FUTURES COMMISSION  
證券及期貨事務監察委員會

**TABLE OF CONTENTS**

**Introduction..... 1**

**Executive Summary..... 1**

**Comments and Conclusions on Mandating the Use of Legal Entity Identifiers for the Reporting Obligation ..... 3**

*Scope and Implementation Timeline ..... 3*

*First Phase ..... 3*

*Second Phase ..... 5*

*Overriding Principle ..... 6*

*Clarification of other issues..... 6*

**Comments and Conclusions on Phase 2 Clearing..... 8**

*Expansion of Product Scope to include certain standardized interest rate swaps denominated in Australian Dollars ..... 8*

*Proposal not to add other new products (other than certain standardized AUD IRS) for Phase 2 Clearing ..... 9*

*Scope of Prescribed Person ..... 10*

*Criteria for Financial Services Providers (FSP), proposed revised FSP list and updating the FSP list..... 12*

*Proposal to maintain the Clearing Threshold ..... 13*

*Proposal to maintain the Calculation Method, frequency of and length of Calculation Periods and the addition of eight Calculation Periods. 13*

**Comments and Conclusions on Adoption of a Trading  
Determination Process for Introducing a Platform Trading  
Obligation..... 14**

**Concluding Remarks and Way Forward..... 15**

**Appendix A - Proposed List of Financial Services Providers.... 16**

**Appendix B - List of Respondents ..... 19**

## **Introduction**

1. In March 2018, the Hong Kong Monetary Authority (**HKMA**) and the Securities and Futures Commission (**SFC**) issued a joint consultation paper (**Consultation Paper**) on enhancements to the OTC derivatives regime for Hong Kong to – (1) mandate the use of Legal Entity Identifiers for the reporting obligation, (2) expand the clearing obligation and (3) adopt a trading determination process for introducing a platform trading obligation.
2. The deadline for submission of comments was 27 April 2018. We received a total of 20 written submissions. A list of respondents (other than those that requested to remain anonymous) is set out at [Appendix B](#) and the full text of their comments (unless requested to be withheld from publication) can be viewed on the websites of the [HKMA](#) and the [SFC](#).
3. This conclusions paper (**Conclusions Paper**) summarises the comments received to the Consultation Paper, our responses to such comments and our conclusions. This Conclusions Paper should be read together with the Consultation Paper and the comments received.

## **Executive Summary**

### ***Mandating the use of Legal Entity Identifiers for reporting obligation***

4. We initially proposed mandating the use of Legal Entity Identifiers (**LEIs**) for trade reporting over two phases. We received broad support for our proposal for the first phase and will proceed with the entity coverage as proposed in the Consultation Paper.
5. Based on market feedback, we have revised and clarified our proposal for the first phase as follows –
  - (a) Scope of entities: We would like to clarify that the first phase only applies to parties on the reporting entity's side of a transaction. Reporting entities are not required to verify whether their counterparty to a transaction falls under the list of entities to which the first phase applies;
  - (b) Scope of transaction reports: Our original proposal required the use of LEIs in reporting new trades and life-cycle events that take place on or after the implementation date as well as daily valuation information reported on or after the implementation date. In response to market concerns over technical difficulties in using LEIs in reporting life-cycle events of outstanding trades, we now propose to require the use of LEIs in respect of reporting of new trades and daily valuation information only. This gives reporting entities more flexibility to deal with existing entity identifiers for outstanding trades; and

- (c) *Implementation timeline*: Pursuant to market feedback that participants require more time for system enhancement and preparation work, we will change the implementation for the first phase of mandating the use of LEIs to 1 April 2019, ie, around nine months after the publication of this Conclusions Paper.

Further details are set out in paragraphs 14 to 20 below.

6. In response to concerns about our proposal to extend the requirement to use LEIs in trade reporting to transacting parties that are not covered in the first phase, we will provide more flexibility so that parties may continue to be identified in accordance with the waterfall of identifiers set out in the Supplementary Reporting Instructions for OTC Derivative Transactions (**SRI**). This means that, if the entity has an LEI, the LEI must be used to identify it in trade reporting. If it does not have an LEI, it can continue to be identified by other entity identifiers in the priority set out in the SRI. That said, reporting entities are expected to put in place a process to request LEIs from their clients after the implementation of the first phase on 1 April 2019. For those clients which do not already have LEIs, this process also includes educating their clients about LEI and encouraging or assisting them to obtain one. Please see paragraphs 21 to 26 below for further details.

### ***Phase 2 Clearing***

7. We received overwhelming support for our proposal to only expand the product scope to certain standardized interest rate swaps denominated in Australian Dollars (**AUD IRS**) for Phase 2 Clearing. We will proceed to propose a revision of the Securities and Futures (OTC Derivative Transactions – Clearing and Record Keeping Obligations and Designation of Central Counterparties) Rules (**Clearing Rules**) accordingly.
8. We believe the commencement of AUD IRS clearing 12 months after the gazettal of the amended Clearing Rules should give market participants and central counterparties (**CCPs**) sufficient time to prepare. Taking into account the required legislative work, we do not expect mandatory clearing of AUD IRS would commence before Q4 2019. Please see paragraphs 37 to 48 below for further details.
9. We received overwhelming support in respect of the other proposals on Phase 2 Clearing. We intend to proceed as proposed in the Consultation Paper, with some fine tuning. Further details are set out in paragraphs 49 to 69 below.

### ***Adoption of trading determination process for introducing a platform trading obligation***

10. We received overwhelming support for the proposed trading determination process and criteria for considering which products are appropriate to be subject to a platform trading obligation in Hong Kong.

11. The proposed trading determination process and criteria are therefore adopted, and are being used in the process to determine which products may be appropriate for Hong Kong to introduce a platform trading obligation. Please see paragraphs 70 to 75 for further details.

## **Comments and Conclusions on Mandating the Use of Legal Entity Identifiers for the Reporting Obligation**

### ***Scope and Implementation Timeline***

12. We received broad support for the proposal to mandate the use of LEIs in OTC derivatives trade reporting. In the Consultation Paper, we specified the below list of in-scope entities and proposed that the use of LEIs for entities in categories (a) to (e) be implemented in the first phase whereas those in category (f) be implemented in the second phase –
  - (a) reporting entities (ie, the entities that are subject to reporting obligation);
  - (b) transacting parties that reporting entities report or act for (ie, transacting parties under the “Reporting For” data field);
  - (c) Hong Kong Trade Repository (**HKTR**) members;
  - (d) CCPs;
  - (e) providers of clearing services; and
  - (f) other entities that are transacting parties to reportable trades but do not fall into any of the above categories.
13. Several respondents sought clarification of the precise scope of our proposed entity coverage for the first phase of mandatory use of LEIs in trade reporting, and some also expressed concerns about implementing the second phase.

### ***First Phase***

14. Clarification of the scope of entities: There was no objection to the categories of entities covered in the first phase of implementation but some respondents expressed concerns that they may not always know whether their counterparty to a transaction falls under categories (a) to (e) above. For example, they may not know that their counterparty is a provider of clearing services for other market participants.
15. We wish to clarify that entities caught under categories (a) to (e) in paragraph 12 above only refer to parties on the reporting entity’s side of a transaction. Reporting entities are not required to verify whether their counterparty to a transaction falls under any of these categories. In addition, we wish to clarify that categories (d) and (e) only apply to situations where the reporting entity (or the transacting party that it reports for) is a CCP or a provider of clearing services, or when the reporting entity needs to fill in the data field for the CCP or the clearing broker to indicate how the transaction will be cleared on the reporting entity’s side.

16. Change in the scope of transaction reports: We proposed that the use of LEIs be applicable to reporting new trades and life-cycle events that take place on or after the implementation date as well as daily valuation information reported on or after the implementation date. Some respondents highlighted potential system and operational issues that could arise for reporting entities using the services of reporting agents to replace the existing entity identifier with an LEI when reporting a life-cycle event.
17. We would like to clarify that the current design of the HKTR does not require reporting entities to withdraw and backload outstanding trades for replacing the existing entity identifier with an LEI when reporting life-cycle events. That said, we acknowledge that technical difficulties may exist due to specific requirements imposed by some service providers. However, we do not think such technical difficulties apply to daily valuation reporting as the Valuation template only requires the identification of the reporting entity and not any of the transacting parties. As such, we now propose that the requirement to use LEIs will only apply to reporting new trades and daily valuation information, but not life-cycle events. However, reporting entities may report life-cycle events with LEIs if they wish to do so.
18. Based on information in the HKTR, the level of long-dated transactions is not significant. Accordingly, the problem with using different entity identifiers for the same transacting party will eventually fade away. In addition, we expect that some reporting entities will ultimately maintain only one system of entity identifiers (ie, LEIs) and over time, all their outstanding trades will be identified using LEIs, where available. We are therefore comfortable that the revised proposal to give reporting entities more flexibility in dealing with the existing entity identifiers used for outstanding trades will not have significant impact on data aggregation and analysis in the long run.
19. Change in the implementation timeline: We received feedback suggesting a longer implementation period for system enhancement, ranging from 12 months to 18 months. Some respondents noted that reporting entities would require a significant period of time to obtain LEIs from their counterparties and to verify them, or to build a system to block trades with counterparties without LEIs.
20. As mentioned above, the requirement to use LEIs for trade reporting only applies to the first phase entities. Consequently, it will not be necessary to build a system to block trades with counterparties without LEIs. Having said that, we acknowledge that there may still be some system enhancements required to cater for the first phase of mandatory use of LEIs in trade reporting. We will therefore change the first phase implementation date from the originally proposed six months after publication of this Conclusions Paper to 1 April 2019, ie, around nine months after publication. This allows more time for any necessary preparation work and avoids implementation around the freeze period for system development at the end of the calendar year.

## **Second Phase**

21. Revised approach: Regarding the second phase of mandatory use of LEIs in trade reporting, several respondents noted that some entities falling under category (f) in paragraph 12 above may be less ready to adopt the use of LEIs as they are incorporated in jurisdictions where there is no requirement to use LEIs in trade reporting. As such, a few respondents proposed a further staggered approach by imposing different implementation timelines for entities incorporated in countries where the use of LEIs has already been mandated and for entities incorporated in other countries.
22. One respondent suggested providing an exemption for small and medium-sized entities executing transactions for economic hedging purposes and with aggregate notional amounts below certain quantitative thresholds. This will avoid imposing an excessive regulatory burden arising from the costs of the issuance, annual renewal and administration of LEIs.
23. More importantly, we also received comments from respondents suggesting that regulators should coordinate a harmonised approach to requiring the use of LEIs in the Asia Pacific region to avoid regulatory arbitrage or an uneven playing field for market participants in Hong Kong.
24. In response to these concerns, we will provide more flexibility in the implementation of the mandatory use of LEIs in trade reporting with respect to transacting parties that are not first phase entities so that these entities may continue to be identified in accordance with a waterfall of identifiers in the SRI (see paragraph 26 below). This means that, if the entity has an LEI, the LEI must be used to identify it in trade reporting. If it does not have an LEI, it can continue to be identified by other entity identifiers in the priority set out in the SRI.
25. That said, after implementation of the first phase on 1 April 2019, reporting entities are expected to put in place a process to request LEIs from their clients. For those clients which do not already have LEIs, this also includes educating their clients about LEIs and encouraging or assisting them to obtain one. We will maintain close dialogue with reporting entities in this regard and monitor the progress on the adoption rate of LEIs via the HKTR data. We will also keep international development in view to evaluate the need to make any further requirements for the use of LEIs in trade reporting. If we consider there is such a need, we will adopt a coordinated approach with other regulators in the Asia Pacific region where appropriate. In that event, we expect reporting entities will be able to achieve a relatively swift and smooth implementation since they have already been engaging with their clients about the use of LEIs for a period of time.

## ***Overriding Principle***

26. In cases where the use of LEIs in trade reporting is not mandatory, the use of identifiers for entities which are not private individuals should follow the waterfall outlined under the section on “Identifiers for transactions and counterparties” in the SRI (the latest version dated August 2017) published on the HKTR website. As HKTR members will have obtained LEIs when the first phase commences, we will remove HKTR member codes (which currently have the same priority as LEIs) from the waterfall of identifiers in the SRI on 1 April 2019. Accordingly, the waterfall of identifiers in the SRI will be revised with LEIs being the only first priority starting from 1 April 2019. This means that, when an entity (including an entity that is a counterparty to a transaction) has an LEI, the reporting entity must use the LEI to identify the entity concerned. HKTR members should also notify the HKTR in a timely manner of any change to their entity identifier information.

## ***Clarification of other issues***

27. Registration Status of LEIs: We received comments regarding the registration status of LEIs. A few responses suggested that regulators should specify requirements for the registration status of LEIs, ie, requiring current and valid LEIs in trade reporting. Clarification was also sought as to whether reporting entities would be responsible for ensuring that the LEIs of their counterparties are renewed on an annual basis. We have also received a request to clarify HKTR’s LEI validation rule.
28. To align with requirements in other jurisdictions, we expect reporting entities to take reasonable steps to verify the LEIs that they obtain from their counterparties. This means that reporting entities should ensure that the LEIs they obtain pertain to the entities concerned and are included in the Global LEI database. Although we do not expect reporting entities to check the registration status of their counterparty’s LEI before reporting each trade, they should have appropriate arrangements in place for their counterparty to update them if there is any change in the counterparty’s LEI status. In any case, reporting entities should ensure that current and valid LEIs are maintained and used for their own groups of companies in trade reporting. Regarding HKTR’s validation rule, we clarify that the HKTR contains rules to validate the format of the LEIs reported.
29. Early Termination and Error Corrections: As mentioned in paragraph 16 above, some respondents related difficulties in replacing the existing entity identifier with an LEI when reporting a life-cycle event of an outstanding trade. One respondent also noted that under our initial proposal, reporting entities may not be able to unwind a trade if their counterparty refuses to obtain an LEI since they will not be able to report such a life-cycle event without an LEI. We wish to reiterate that our proposal for the mandatory use of LEIs in the first phase applies only to parties on the reporting entity’s side of a transaction. Under the revised scope of the transaction reports, the mandatory use of LEIs does not apply to the reporting of life-cycle events (such as early termination).

We therefore believe that the respondent's concerns are no longer relevant. Also, we would like to take this opportunity to clarify that the requirement to use LEIs will not apply to error corrections.

30. *Masking Relief:* We were asked to confirm whether transactions eligible for masking relief would be affected by the requirement to use LEIs. As mentioned in the Consultation Paper, the masking relief currently applicable under the Securities and Futures (OTC Derivative Transactions – Reporting and Record Keeping Obligations) Rules (**Reporting Rules**) will not be affected by the mandatory use of LEIs in trade reporting. Transactions currently eligible for masking relief should be reported according to the instructions outlined under the section on “Identifiers for transactions and counterparties” in the SRI. In view of the recommendations of the Financial Stability Board (**FSB**) calling for the removal of reporting barriers by June 2018, we intend to look into the appropriateness of continuing to provide masking relief at a later stage.
31. *Fund Allocation:* We received some comments regarding the reporting of LEIs for transactions with a fund manager. Respondents sought clarification as to whether they should report the LEIs of the order placers/fund managers or the LEIs of the principals/funds. We were also asked to confirm whether provision of the LEIs of the fund managers would be acceptable prior to fund allocation of the trade. We wish to clarify that the reported LEI should pertain to the counterparty of the transaction. If the reporting entity reports the transaction after the allocation, the report should contain the LEI of the correct counterparty of the transaction (or transactions as the case may be) at the fund level. If, however, the report is submitted to the HKTR prior to fund allocation, reporting entities should report the counterparty information according to the instructions outlined under the section on “Fund allocation” in the SRI.
32. *Daily Valuation Reporting:* One respondent sought clarification as to whether the LEIs of the transacting parties were required when submitting daily valuation information to the HKTR and whether any new fields would be added to the Valuation template. We confirm that the Valuation template requires the identification of the reporting entity only and not any of the transacting parties. This means that the identifying information (whether LEI or otherwise) of any of the transacting parties is not required when reporting a transaction's daily valuation information. Reporting entities should follow the instructions outlined under the section on “Information and particulars relating to the valuation of the transaction” in the SRI when reporting the daily valuation information.
33. *Publication of the list of in-scope entities:* A few respondents requested that regulators maintain and publish a list of in-scope entities for the first phase of mandatory use of LEIs. We believe that the clarifications in paragraphs 14 and 15, together with the list of HKTR members published on the HKTR website, would provide sufficient clarity to reporting entities and remove the need for such a list.
34. *Legislative effect of the LEI requirement:* One respondent suggested that compelling clients to subscribe for LEIs could be easier if the mandatory use of

LEIs in trade reporting is given statutory effect. To clarify, the requirement to use LEIs as the entity identifier will be reflected in the SRI which, per Rule 21(2) of the Reporting Rules, must be complied with when reporting via the HKTR. The revised approach after the implementation of the first phase also means this suggestion is no longer relevant.

35. *Background on the LEI:* A few respondents requested that we provide a detailed background on the LEI to explain the purpose of its use and the governance framework for its providers. As mentioned in the Consultation Paper, the creation and adoption of a global LEI system was supported by the G20 Leaders after the 2008 global financial crisis to help authorities and market participants identify and manage financial risks. The Global LEI System (**GLEIS**) was subsequently created by regulators and private-sector entities based on the recommendations of the FSB which were endorsed by the G20 Leaders. The GLEIS, and its operational arm, the Global LEI Foundation (**GLEIF**) are coordinated and overseen by the LEI Regulatory Oversight Committee (**LEI ROC**), a group of more than 70 public sector authorities, including the HKMA. Market participants should refer to the websites of the LEI ROC and the GLEIF for further details of the governance framework of the GLEIS.
36. As LEIs are now widely adopted in various FSB jurisdictions to support regulatory activities, we believe information is widely available to market participants about the use and the registration of LEIs. We suggest reporting entities that have difficulties obtaining such information approach their respective industry association for further guidance.

## **Comments and Conclusions on Phase 2 Clearing**

### ***Expansion of Product Scope to include certain standardized interest rate swaps denominated in Australian Dollars***

37. We received overwhelming support for our proposal to add certain standardized AUD IRS to our list of products mandated for clearing under Phase 2 Clearing. We will therefore proceed to propose a revision of the Clearing Rules on this basis.
38. One respondent requested clarification of the process for a CCP that is already a designated CCP (under section 101J of the Securities and Futures Ordinance (Cap.571) (**SFO**)) to also provide clearing services for AUD IRS for meeting the clearing obligation.
39. Although Section 101J of the SFO provides that the SFC may designate a recognised clearing house or an authorized automated trading services (**ATS**) provider as a designated CCP in respect of OTC derivative transactions generally or for a class or description of OTC derivative transactions specified in the designation, we are minded to do so only for specified classes of OTC

derivative transactions for the time being. Consequently, both a new CCP and an existing designated CCP who wishes to be designated for AUD IRS would need to make a new application under section 101J of the SFO. The process will be similar to that for the designation of CCPs in respect of the current specified classes of OTC derivative transactions.

40. In respect of a new CCP that has yet to be authorized as an ATS provider, as with Phase 1 Clearing, we will be mindful of the time required to process the application to ensure that sufficient CCPs are designated for providing clearing services in AUD IRS when Phase 2 Clearing comes into effect. We will therefore process applications with the implementation timeline in mind.
41. One respondent requested clarification of the commencement date for transactions in AUD IRS to be subject to clearing obligation. Another respondent asked regulators to bear in mind that some banks incorporated in mainland China may have difficulty accessing client clearing because some service providers may consider the Mainland as a non-netting jurisdiction. Accordingly, the respondent asked for sufficient time for banks to prepare for implementation.
42. Having regard to the above, we believe the commencement of AUD IRS clearing 12 months after the gazettal of the amended Clearing Rules would give market participants and CCPs enough time to get ready. Taking into account the required legislative work, we do not expect mandatory clearing of AUD IRS to commence before Q4 2019.
43. One respondent reiterated its support for an exemption from the clearing obligation for “new administrative transactions” arising from post-trade risk reduction activities. It suggested that the exemption should include the proposed AUD IRS, Phase 1 clearing products and any further products subject to the clearing obligation in the future. We confirm that exemptions from the clearing obligation currently set out in the Clearing Rules will be available to transactions in AUD IRS and further products subject to clearing obligation in the future if the conditions for exemption are met. However, we currently provide an exemption for transactions resulting from multilateral trade compression and not for other types of post-trade risk reduction activities. We will keep in view international developments and consider the appropriateness of expanding the clearing exemption to other types of post-trade risk reduction services accordingly.

***Proposal not to add other new products (other than certain standardized AUD IRS) for Phase 2 Clearing***

44. Other than one respondent, we received overwhelming support for not expanding the proposed scope of products for Phase 2 Clearing other than including certain standardized AUD IRS. We will therefore proceed to only include such AUD IRS as an additional product in Phase 2 Clearing.

45. The respondent suggested that regulators consider expanding the tenors for fixed-to-floating IRS in G4 currencies to include swaps duration of up to 50 years (or 30 years for JPY) and to coordinate with global regulators to consider if certain foreign exchange non-deliverable forwards (**FX NDFs**) are now suitable for the clearing mandate.
46. As noted by the respondent, there remains only minimal activity in long dated fixed-to-floating IRS transactions in Hong Kong. Based on the latest data reported to HKTR, outstanding positions of fixed-to-floating IRS with long dated tenors in Hong Kong continue to be insignificant and are unlikely to be a source of systemic risk. Therefore, we do not propose to include additional tenors for fixed-to-floating IRS in Phase 2 Clearing. We will continue to monitor HKTR data to ensure that the scope of products remains appropriate and relevant at all times.
47. We appreciate the respondent's comments on FX NDF. From time to time, we coordinate with global regulators to consider the appropriateness of products for the clearing obligation. However, we do not propose to lead the way in mandating FX NDF, given that Hong Kong is not the leading market in that product.
48. Another respondent noted that while it agrees not to introduce products that account for a small outstanding gross notional value for the clearing mandate, it provided a caveat in situations where the volume of the transaction is significantly higher. We note the comment. Although we are not aware of a situation other than trade compression where the volume of the trades is significantly higher than the corresponding outstanding gross value, we will stay vigilant and monitor market activities from this perspective.

### ***Scope of Prescribed Person***

49. Other than one respondent, we received overwhelming support to maintain the current scope of Prescribed Person. We will therefore proceed with maintaining the current scope of Prescribed Person.
50. The respondent referred to information set out in the *ISDA Asia Pacific OTC Derivatives Study* published in November 2017 (**ISDA Study**), and noted that the ISDA Study stated that "*other financial institutions*" (ie, non-dealers) accounted for approximately 36% of IRD trading activity in Hong Kong in 2016. Consequently, the respondent was of the view that regulators should consider expanding the scope of Prescribed Person so that more liquid and standardized OTC derivatives transactions entered into in Hong Kong will fall within the clearing obligation.
51. In response to the above, we note that the analysis in the ISDA Study is based on data from the Bank for International Settlements (**BIS**) Triennial Central Bank Survey of foreign exchange and OTC derivatives markets, which is based on turnover data reported by the sales desks of reporting dealers, regardless of where a trade is booked. This means the BIS Survey may

include trades of reporting dealers which were not conducted or booked in Hong Kong but whose salesmen were based in Hong Kong.

52. Consequently, we believe that, in assessing the percentage of IRS activity in Hong Kong by different category of persons, it would be more appropriate to use updated information submitted to the HKTR.
53. We have already explained in our Consultation Paper that, based on data reported under Phase 2 Reporting, the OTC derivatives market in Hong Kong continues to be dominated by inter-dealer trades and these are mainly authorized institutions (**AIs**) and licensed corporations (**LCs**), with AIs being the dominant players. Based on a conservative estimate, approximately 87% of outstanding IRS transactions were transactions between a Prescribed Person and another Prescribed Person or a Financial Services Provider (**FSP**). Consequently, we believe that the current scope of Prescribed Person remains appropriate. We also believe that extending the scope of Prescribed Person to more market participants would not yield benefit substantial enough to compensate for the increased compliance burden.
54. The respondent also noted that a recent analysis of data from the HKTR found that, following the implementation of Phase 1 Clearing, only approximately 40% of the new fixed-to-floating IRS trades reported to the HKTR are reported as “intended-to-be cleared”.
55. If the quoted clearing rate was calculated directly from published HKTR data, the result should be interpreted with caution because the data would have included transactions outside our clearing regime, ie, transactions conducted in Hong Kong but booked outside Hong Kong, intragroup transactions and transactions entered into before the commencement of the clearing obligation.
56. According to data reported to the HKTR, of the fixed-to-floating IRS transactions which were booked in Hong Kong and outstanding at the end of 2017, after eliminating intragroup transactions and legacy transactions entered into before commencement of the local clearing obligation, less than 10% were not cleared.
57. As noted in the paragraph 53 above, market participants outside the scope of Prescribed Person represent a small proportion of our OTC derivative markets. Consequently, they do not pose any material systemic risk.
58. Further, we need to weigh the costs and benefits to other market participants should they be included within the scope of Prescribed Person. In view of the potential difficulties arising from the availability of client clearing service providers and the costs associated with these services, we do not believe we should subject these market participants to mandatory clearing which may potentially limit the counterparties that they could deal with or their ability to properly hedge their risk exposure. Nonetheless, these market participants are welcome to carry out voluntary clearing should they wish to take advantage of the benefits derived from central clearing.

59. We would therefore maintain the current scope of Prescribed Person. That said, we intend to observe developments in this area, including international developments with respect to the availability of client clearing service providers, and from time to time will assess the appropriateness of expanding the scope of Prescribed Persons.
60. *Request for updated list of Prescribed Persons:* Separately, one respondent requested an updated list of Prescribed Persons so that FSPs would know whether a transaction would be subject to the clearing obligation. Since the publication of the list of Prescribed Persons that have reached the Clearing Threshold, the regulators have not received any notification from Prescribed Persons that would cause changes to be made to the list. We can therefore confirm that the current list remains valid. We will ensure that the market is informed of any future changes to the list.

***Criteria for Financial Services Providers (FSP), proposed revised FSP list and updating the FSP list***

61. We received overwhelming support on the following related proposals on FSP –
- (a) to maintain the FSP criteria;
  - (b) to revise the FSP list as proposed; and
  - (c) to update the FSP list annually.

We will therefore proceed on the basis proposed in the Consultation Paper. The proposed FSP list is set out in [Appendix A](#).

62. One respondent noted that regulators should not extend the extraterritorial reach of the Hong Kong clearing mandate to include entities which are not required to clear in their home country should we decide to expand the FSP criteria in the future. We will bear this in mind.
63. Another respondent requested that a specific date be set for an annual update of the FSP list, so that a newly named FSP would be given at least six months to react and comply. As we have explained in our Consultation Paper, we will take a snapshot of the entities that fall within the FSP criteria at the end of each calendar year and consult the market within Q1 of the following year. Instead of the updated FSP list taking effect on 1 September the following year, we now propose to align the effective date to the Prescribed Day of the Calculation Period nearest to when the consultation conclusion is published. For example, if the consultation is in Q1 2019 and the conclusion is published in Q2 2019, the effective date of the FSP list will be 1 January 2020, the Prescribed Day of the Calculation Period of 1 March 2019 to 31 May 2019. That should give Prescribed Persons who trade with new FSPs adequate time to get ready.

### ***Proposal to maintain the Clearing Threshold***

64. Other than one respondent, we received overwhelming support to maintain the Clearing Threshold. We will therefore proceed with maintaining the current Clearing Threshold of US\$ 20 billion.
65. The respondent suggested that the Clearing Threshold should be reduced to EUR 8 billion to align with the initial margin requirements on financial institutions.
66. In response, we would like to clarify that the methodologies for formulating the Clearing Threshold and the threshold for initial margin take different factors into account. When formulating a Clearing Threshold, we need to consider additional factors such as access to clearing including client clearing for market participants that need to comply with the clearing obligation. Therefore, we do not believe it is correct to align the two thresholds, particularly as access to client clearing remains an open issue.

### ***Proposal to maintain the Calculation Method, frequency of and length of Calculation Periods and the addition of eight Calculation Periods***

67. We received overwhelming support for the following related proposals –
  - (a) to maintain the current Calculation Method for outstanding positions to be measured against the Clearing Threshold;
  - (b) to maintain the current frequency of two Calculation Periods in a year;
  - (c) to maintain the length of three months for each Calculation Period; and
  - (d) to add eight additional Calculation Periods.

We will proceed on this basis.

68. One respondent requested clarification of whether there is a Calculation Period from 1 September 2018 to 30 November 2018. We confirm that in view of the time needed to complete the consultation and the necessary legislative process, we have proposed that the first new Calculation Period will commence on 1 March 2019. In other words, there will not be a Calculation Period between 1 September 2018 and 30 November 2018.
69. The respondent also requested that regulators consider whether the proposed Calculation Periods may be made permanent such that additional consultations for new Calculation Periods will not be required after 2022. We are not able to commit at the moment. We will closely monitor HKTR data, and determine at the appropriate juncture whether the current number of Calculation Periods is adequate to serve the purpose of capturing new dealers in our market.

## **Comments and Conclusions on Adoption of a Trading Determination Process for Introducing a Platform Trading Obligation**

70. We received overwhelming support for our proposed trading determination process and criteria for considering which products are appropriate to be subject to a platform trading obligation in Hong Kong.
71. The proposed trading determination process and criteria are therefore adopted, and are being used in the process to determine which products may be appropriate for Hong Kong to introduce a platform trading obligation.
72. Two respondents proposed that we include the following criteria in our trading determination –
  - (a) whether imposing a trading obligation in relation to the product is necessary and desirable in all the circumstances, having regard to the availability of less onerous regulatory requirements; and
  - (b) whether the product pricing is fair, reliable and generally acceptable for trading.
73. In respect of the suggested criterion in paragraph 72(a), we would like to clarify that if we decide to proceed with implementing a platform trading obligation, we would have taken this into consideration. In respect of the suitability for a product to be subject to a trading obligation, we would then look at the six factors that we have proposed.
74. We wish to confirm that we have already included the suggested criterion in paragraph 72(b) in our clearing determination process. One factor in our trading determination process is whether the product is already subject to the central clearing obligation in Hong Kong. Consequently, this criterion is already embedded within the process.
75. We would like to thank the respondents for setting out various factors that regulators would need to consider when designing and implementing a trading obligation. Should we decide to proceed with imposing a trading obligation, we will take into consideration the various issues raised by respondents in formulating our proposal which we will consult the market in due course.

## **Concluding Remarks and Way Forward**

76. We take this opportunity to thank everyone who took the time and effort to comment and assist us in finalising our proposals.
77. The SRI, and where appropriate, the Frequently Asked Questions and gazetted data fields for mandatory reporting will be amended accordingly to implement our proposals in LEIs.
78. To implement our proposals on Phase 2 Clearing, we will –
  - (a) publish the revised FSP list for implementation on 1 January 2019, the Prescribed Day for the last Calculation Period of 1 March 2018 to 31 May 2018; and
  - (b) work with the government on the legislative process for the revised Clearing Rules to add certain standardized AUD IRS to the scope of products subject to the clearing obligation and to add eight additional Calculation Periods.

We will continue to maintain close dialogue with the industry as we consult on other proposals regarding the OTC derivatives regulatory regime in future.

## **Appendix A - Proposed List of Financial Services Providers**

The following entities are proposed to be designated as Financial Services Providers for the purposes of the Clearing Rules.

### **Name of the entities**

(in alphabetical order)

1. Abbey National Treasury Services plc
2. Agricultural Bank of China Limited
3. Banco Santander S.A.
4. Bank of America, N.A.
5. Barclays Bank PLC
6. Barclays Capital Inc.
7. BNP Paribas Fortis SA/NV
8. BNP Paribas SA
9. BNP Paribas Securities Corp.
10. CACEIS Bank SA
11. Citibank, N.A.
12. Citigroup Global Markets Inc.
13. Citigroup Global Markets Japan Inc.
14. Citigroup Global Markets Limited
15. Credit Agricole Corporate and Investment Bank
16. Credit Foncier de France
17. Credit Suisse (Schweiz) AG
18. Credit Suisse AG
19. Credit Suisse International
20. Credit Suisse Securities (Japan) Limited
21. Credit Suisse Securities (USA) LLC
22. Deutsche Bank AG
23. Deutsche Bank Securities Inc.
24. Deutsche Postbank AG
25. Goldman Sachs & Co. LLC
26. Goldman Sachs Bank USA
27. Goldman Sachs Financial Markets Pty Ltd
28. Goldman Sachs International
29. Goldman Sachs Japan Co., Ltd.
30. HSBC Bank plc
31. HSBC Bank USA, N.A.

32. HSBC France
33. HSBC Securities (USA) Inc.
34. ING Bank N.V.
35. ING Bank Śląski S.A.
36. ING-DiBa AG
37. JPMorgan Chase Bank, N.A.
38. JPMorgan Securities Japan Co., Ltd.
39. J.P. Morgan Securities LLC
40. J.P. Morgan Securities plc
41. Merrill Lynch Capital Services Inc.
42. Merrill Lynch International
43. Merrill Lynch Japan Securities Co., Ltd.
44. Merrill Lynch, Pierce, Fenner & Smith Incorporated
45. Mitsubishi UFJ Morgan Stanley Securities Co., Ltd.
46. Mizuho Bank, Ltd.
47. Mizuho Capital Markets LLC
48. Mizuho International plc
49. Morgan Stanley & Co. International plc
50. Morgan Stanley & Co. LLC
51. Morgan Stanley Capital Services LLC
52. Morgan Stanley MUFG Securities Co., Ltd.
53. MUFG Securities EMEA plc
54. NATIXIS
55. Nomura Financial Products & Services, Inc.
56. Nomura Global Financial Products, Inc.
57. Nomura International plc
58. Nomura Securities Co., Ltd.
59. Nomura Securities International, Inc.
60. Nordea Bank AB
61. RBC Capital Markets, LLC
62. RBC Europe Limited
63. Royal Bank of Canada
64. Santander Investment Securities Inc.
65. SG Americas Securities LLC
66. SMBC Capital Markets Inc.
67. SMBC Nikko Securities Inc.
68. Societe Generale

69. Societe Generale International Limited
70. Standard Chartered Bank
71. Sumitomo Mitsui Banking Corporation
72. Sumitomo Mitsui Trust Bank, Limited
73. The Bank of New York Mellon
74. The Bank of Tokyo-Mitsubishi UFJ, Ltd.
75. The Royal Bank of Scotland plc
76. UBS AG
77. UBS Limited
78. UBS Securities LLC
79. UniCredit Bank AG
80. UniCredit Bank Austria AG
81. UniCredit S.p.A.
82. Wells Fargo Bank, N.A.
83. Wells Fargo Securities, LLC

## **Appendix B - List of Respondents**

(in alphabetical order)

### **Respondents whose comments are published on the websites of the HKMA and the SFC in full**

1. Bloomberg, L.P. – Open Symbology Group
2. Citadel LLC
3. Depository Trust & Clearing Corporation, The
4. DTC Association, The
5. Global Financial Markets Association
6. Global Financial Markets Association – Global Foreign Exchange Division
7. Global Legal Entity Identifier Foundation
8. Hong Kong Association of Banks, The
9. Hong Kong Bar Association
10. International Organization for Standards (ISO) TC68/AG2
11. International Swaps and Derivatives Association, Inc.
12. Japanese Bankers Association
13. LCH Group
14. State Street Corporation
15. SWIFT
16. Tradeweb Europe Limited

### **Respondents who requested their names and comments to be withheld**

17. Anonymous
18. Anonymous
19. Anonymous
20. Anonymous