

**Frequently Asked Questions on the Implementation and Operation of the  
Mandatory Clearing Regime**

**(January 2021)**

*These FAQs elaborate on how the mandatory clearing regime under the Securities and Futures (OTC Derivative Transactions – Clearing and Record Keeping Obligations and Designation of Central Counterparties) Rules (**Clearing Rules**) will operate and are intended to help market participants better understand their obligations and responsibilities under the Clearing Rules so that they are better able to prepare for implementation of the new regime and ensure compliance going forward.*

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## **Definitions and interpretation**

*Unless the context otherwise requires, terms defined in Schedule 1 to the SFO or in the Clearing Rules bear the same meaning when used in the questions and answers below, and the following terms bear the following meanings:*

- *“HKMA” refers to the Hong Kong Monetary Authority;*
- *“Clearing Rules” means the Securities and Futures (OTC Derivative Transactions – Clearing and Record Keeping Obligations and Designation of Central Counterparties) Rules (Chapter 571AN, Laws of Hong Kong) ;*
- *“SFC” refers to the Securities and Futures Commission;*
- *“SFO” refers to the Securities and Futures Ordinance (Chapter 571, Laws of Hong Kong);*
- *“specified OTC derivative transaction” means an OTC derivative transaction that is specified in section 2 of Schedule 1 to the Clearing Rules, which will be subject to mandatory clearing if certain criteria are satisfied.*

## **Legislation and technical guidance**

### **Q1. Where are the clearing and record keeping requirements set out?**

The broad framework for clearing and record keeping obligations is contained in Part IIIA of the SFO, and the detailed requirements are set out in the Clearing Rules.

These documents are accessible at the Hong Kong e-Legislation database website:  
[www.elegislation.gov.hk](http://www.elegislation.gov.hk).

## **Commencement date**

### **Q2. When did the clearing and record keeping obligations start to operate?**

The requirements for clearing and record keeping obligations came into operation on 1 September 2016.

## **Transitional arrangement**

### **Q3. Is there any transitional arrangement for complying with the mandatory clearing requirements?**

No, there is no provision for transitional arrangement under the Clearing Rules. That said, the first date a person may be required to clear a specified OTC derivative transaction is 1 July 2017, i.e. there is a gap of 10 months from the date the Clearing Rules come into operation on 1 September 2016. This is explained in Q6 below.

#### **Persons subject to clearing and record keeping obligations**

##### **Q4. Who would be subject to the mandatory clearing and related record keeping requirements?**

The Clearing Rules at present are intended to cover specified OTC derivative transactions entered into between major dealers. The clearing and record-keeping obligations apply to the following persons:

- (a) an authorized institution (**AI**);
- (b) an approved money broker (**AMB**); or
- (c) a licensed corporation (**LC**).

In respect of an AI and AMB that is incorporated overseas, the obligations apply only to the transactions that are recorded in the Hong Kong books of that AI and AMB, and transactions that are not recorded in the Hong Kong books are not subject to the obligations.

AIs, AMBs and LCs will need to ensure that their specified OTC derivative transactions are cleared in accordance with the Clearing Rules if circumstances for triggering mandatory clearing are met.

#### **Circumstances clearing obligation is triggered**

##### **Q5. Under what circumstances are specified OTC derivative transactions subject to clearing obligation?**

An AI, AMB or LC must centrally clear a specified OTC derivative transaction if the following circumstances are all met –

- (a) The AI, AMB or LC has reached the clearing threshold. (Please see Q6 to Q10 on clearing threshold, calculation of average total position and average local total position, and types of transactions to be included in the calculation.)

- (b) The transaction is entered into on or after the prescribed day for the calculation period in respect of which the AI, AMB or LC reached the clearing threshold for the first time (or for the first time again after giving an exit notice). (Please see Q6 on calculation period and prescribed day and Q35 and Q36 on exit notice.)
- (c) The counterparty is an AI/AMB/LC and is also required to clear the transaction concerned (i.e. circumstances (a) and (b) above are applicable to that counterparty), or the counterparty is a financial services provider. (Please see Q11 below for the definition of a financial services provider.).

### **Calculation period, prescribed day and clearing threshold**

#### **Q6. What is a calculation period and what is a prescribed day in relation to a calculation period?**

A calculation period is the period in which a person's applicable position in OTC derivatives is calculated to determine whether it has reached the clearing threshold. Please see Q8 to Q10 for further information. There are multiple calculation periods. Each calculation period is three months in duration and there is in general a six-month interval between the start of one calculation period and the start of the next one. We may extend this six-month gap in future as appropriate.

A prescribed day in relation to a calculation period is the day which is seven months after the end of the calculation period. For a person who has reached the clearing threshold for the first time in a calculation period, the clearing obligation will only apply to future transactions entered into on or after the prescribed day for that calculation period. This is to allow one month for the calculation of the applicable position and six months for setting up the infrastructure and completing the documentation and on-boarding exercise for central clearing.

When mandatory clearing was implemented, there were four calculation periods specified in Schedule 2 to the Clearing Rules, each with its corresponding prescribed day. The first calculation period ran from 1 September 2016 to 30 November 2016. The first prescribed day was 1 July 2017, seven months after 30 November 2016. This explains the 10-month gap between the commencement of the Clearing Rules and the first date a person may be required to clear a specified OTC derivative transaction. We have since added eight new calculation periods to Schedule 2 (with effect from 1 March 2019).

A simplified table of the calculation periods and their corresponding prescribed days is set out below for easy reference -

	Calculation period	Prescribed day
1.	1 September 2016 to 30 November 2016	1 July 2017
2.	1 March 2017 to 31 May 2017	1 January 2018
3.	1 September 2017 to 30 November 2017	1 July 2018
4.	1 March 2018 to 31 May 2018	1 January 2019
5.	1 March 2019 to 31 May 2019	1 January 2020
6.	1 September 2019 to 30 November 2019	1 July 2020
7.	1 March 2020 to 31 May 2020	1 January 2021
8.	1 September 2020 to 30 November 2020	1 July 2021
9.	1 March 2021 to 31 May 2021	1 January 2022
10.	1 September 2021 to 30 November 2021	1 July 2022
11.	1 March 2022 to 31 May 2022	1 January 2023
12.	1 September 2022 to 30 November 2022	1 July 2023

**Q7. What is the clearing threshold for an AI/AMB/LC?**

The clearing threshold is set out in Schedule 2 to the Clearing Rules. It is currently set at US\$ 20 billion for all calculation periods specified in the rules. We may lower the threshold in future as appropriate.

**Q8. When is a person regarded as having reached the clearing threshold?**

A person has reached the clearing threshold if its applicable position for a calculation period equals or exceeds the clearing threshold for that calculation period. (Please see Q9 below for the calculation of the applicable position)

The person is regarded as having reached the clearing threshold at all times thereafter, even if the person's applicable position falls below the threshold for a subsequent calculation period, until an exit notice is given. (Please see Q35 and Q36 in relation to exit notice.)

The HKMA and the SFC jointly published the list of prescribed persons that have reached the clearing threshold on the SFC website:

<https://www.sfc.hk/web/EN/files/SOM/OTC/List%20of%20Institutions%20that>

**Average total position and average local total position**

**Q9. How should a person calculate its applicable position in relation to its clearing threshold?**

For a person that is a local AI/AMB/LC, its applicable position is its average total position which is calculated by taking a simple arithmetic average of the three month-end snapshots of the total position of the person over the 3-month calculation period.

For a person that is an overseas AI/AMB/LC, its applicable position is its average local total position which is calculated by taking a simple arithmetic average of the three month-end snapshots of the person's local total position over the 3-month calculation period. In other words, this calculation only takes into account the position that is booked in the person's Hong Kong branch.

Total position and total local position are the aggregate of notional amounts of applicable trades, calculated on a gross basis, i.e. without netting. Please see further elaboration in Q10.

**Q10. What transactions are included in the calculation of the total position?**

Whilst only certain types of plain vanilla Interest Rate Swap (**IRS**) transactions are subject to mandatory clearing, for the purposes of calculation of the total position, *all* outstanding OTC derivative transactions are to be counted, *except for* transactions in deliverable FX forwards and deliverable FX swaps which the Clearing Rules have specifically excluded. Outstanding OTC derivative transactions refer to transaction which have not been matured or early terminated and to which the person is a counterparty.

Accordingly, this means that outstanding transactions –

1. that are entered into before and during the calculation period;
2. that are exempted; or
3. that are outside the scope of the first phase of clearing mandate

must also be included in the calculation of total position or local total position, as applicable.

For avoidance of doubt, any OTC derivative transactions not required to be cleared (whether by reason that the person has not yet reached the clearing threshold, the transactions are not specified OTC derivative transactions, or by any other reason) will still have to be included in the calculation.

However, intra-company transactions between (i) two trading desks or (ii) branches/offices of the same entity do not have to be included in the calculation.

## **Financial services providers**

### **Q11. Who are financial services providers?**

A financial services provider refers to a person that is designated by the SFC with the HKMA's consent pursuant to Rule 3(1) of the Clearing Rules. The current list of designated financial services providers has been published in the Government gazette and is reproduced in Annex 1 to this FAQ for ease of reference.

As we intend to cover only dealer-to-dealer transactions for now, only persons that meet the following criteria are included in the current gazette list of financial services providers –

1. persons that are clearing members of the largest IRS central counterparties (CCPs) in the US, Europe, Japan and Hong Kong; and
2. persons that belong to a group of companies appearing on the list of global systemically important banks published by the Financial Stability Board, and/or on the list of dealer groups which undertook to the OTC Derivatives Supervisors Group to work collaboratively with CCPs, infrastructure providers and global supervisors to continue to make structural improvement to the global OTC derivatives markets.

The factors that are relevant to determining the list of financial services providers may also change when we expand our clearing obligation in the future to cover a wider range of entities. We will review the list of financial services providers from this perspective.

We perform an annual update of the list of financial services provider based on a snapshot of the entities that would fall within the criteria at the end of each calendar year, and consult the market within Q1 of the following year. The effective date for the revised list of financial services providers will be the Prescribed Day that corresponds to the Calculation Period that is nearest to when the consultation conclusion is published.



Point to note:

If the clearing obligation is applicable to a transaction between an AI/AMB/LC and a financial services provider, the responsibility for ensuring compliance with clearing obligation rests with the AI/AMB/LC and not with the financial services provider.

### **Transactions subject to mandatory clearing**

#### **Q12. What OTC derivative transactions are subject to the clearing obligation?**

Only specified OTC derivative transactions which are set out in Schedule 1 to the Clearing Rules are subject to clearing obligation under the Clearing Rules (reproduced below for ease of reference) –

- (a) a basis swap that has all of the features specified for an item in a row of the table below –

Item	Currency	Floating rate index	Tenor	Optionality	Constant notional
1.	USD	LIBOR	28 days to 10 years	No	Yes
2.	EUR	EURIBOR	28 days to 10 years	No	Yes
3.	GBP	LIBOR	28 days to 10 years	No	Yes
4.	JPY	LIBOR	28 days to 10 years	No	Yes
5.	HKD	HIBOR	28 days to 10 years	No	Yes

- (b) a fixed-to-floating swap (except an overnight index swap) that has all of the features specified for an item in a row of the table below –

Item	Currency	Floating rate index	Tenor	Optionality	Constant notional
1.	USD	LIBOR	28 days to 10 years	No	Yes
2.	EUR	EURIBOR	28 days to 10 years	No	Yes
3.	GBP	LIBOR	28 days to 10 years	No	Yes
4.	JPY	LIBOR	28 days to 10 years	No	Yes
5.	HKD	HIBOR	28 days to 10 years	No	Yes

- (c) an overnight index swap that has all of the features specified for an item in a row of the table below -

Item	Currency	Floating rate index	Tenor	Optionality	Constant notional
1.	USD	Fed Funds	7 days to 2 years	No	Yes
2.	EUR	EONIA	7 days to 2 years	No	Yes
3.	GBP	SONIA	7 days to 2 years	No	Yes

**Q13. Are historical transactions subject to clearing obligation?**

No, historical transactions are not subject to clearing obligation under the Clearing Rules. Only specified OTC derivative transactions which the person entered into on or after the prescribed day that corresponds to the calculation period with respect to which the person reached the clearing threshold for the first time (or for the first time again after giving an exit notice) will be subject to the clearing obligation when other criteria are satisfied (see Q5 above). Please see Q6 above for the different calculation periods and their corresponding prescribed days.

**Q14. Is a swaption subject to clearing obligation?**

A swaption is an option to enter into a swap transaction, and is not itself a swap transaction. As it does not fall within the definition of IRS in the Clearing Rules, it is not subject to clearing.

**Q15. Is an IRS entered into pursuant to the physical exercise of a swaption subject to clearing obligation?**

An IRS entered into on or after the relevant prescribed day pursuant to the physical exercise of a swaption may be subject to clearing if:

1. it falls within the definition of IRS under the Clearing Rules and its features meet the specified criteria set out in Schedule 1 to the Clearing Rules, and
2. the corresponding swaption is entered into on or after 1 September 2016, the commencement date of clearing requirement.

**Q16. Will an IRS become subject to mandatory clearing as a result of an amendment to its original terms or the occurrence of certain life cycle events?**

Amendments to an IRS transaction may or may not make the transaction become subject to mandatory clearing, and this depends on whether a new transaction is created because of the amendment. Much will depend on the nature and scope of the amendment. A simple amendment normally does not constitute a new transaction. However, an amendment that substantially changes the terms and conditions of the transaction would result in a new transaction and hence may be subject to clearing obligation.

A pragmatic approach should be adopted when assessing if an amendment results in a new transaction that is subject to clearing obligation.

For example, genuine and necessary amendments to legacy IRS transactions entered into before the commencement of mandatory clearing and which are made solely to give effect to benchmark reforms such as –

- (i) the inclusion of fallback provisions that would apply upon the permanent discontinuation of an existing benchmark or the non-representativeness of the benchmark as determined by the benchmark administrator or the relevant authority in a jurisdiction; and
  - (ii) the replacement of an existing benchmark with the alternative benchmark,
- will not be considered new contracts for the purposes of clearing obligation.

**Q17. Is an IRS that forms part of a larger, complex or packaged structure subject to clearing obligation?**

When an IRS that falls within Schedule 1 to the Clearing Rules is a transaction on its own, and is combined with other separate transactions to make up a larger, complex or packaged structure, that particular IRS transaction will be caught by our clearing requirements.

However, if the larger, complex or packaged structure is a single transaction with different components and one of the components is similar to an IRS, we do not intend to require the single transaction to be broken down into its individual components and subject the component which is similar to an IRS to clearing obligation.

Also, if the larger, complex or packaged structure is in fact an embedded derivative, i.e. a simple instrument (e.g. shares, bonds, notes) with the IRS being merely an embedded feature that makes the structure a “structured product” (as

defined in the SFO), the structure itself falls outside the scope of “OTC derivative product” (as defined in the SFO). The IRS, being only an embedded feature of the structure, will not be subject to mandatory clearing.

**Q18. Is an IRS created as a result of novation subject to clearing obligation?**

An IRS transaction that results from a novation will be subject to clearing if its features meet the specified criteria set out in Schedule 1 to the Clearing Rules. As these features are likely to be the same for both the original transaction and the new transaction resulting from the novation, it follows that if the original transaction was subject to clearing, the new transaction will be subject to clearing also.

Additionally, the new IRS transaction may be subject to clearing even if the old transaction was not. This can happen when the old transaction is a historical transaction executed prior to the prescribed day for a calculation period and the novation may happen after the relevant prescribed day.

**Q19. Is a zero coupon swap subject to mandatory clearing?**

A zero coupon swap is an exchange of income streams in which the stream of floating rate interest payments is made periodically, but the stream of fixed rate payments is made as one lump-sum payment at maturity instead of periodically over the life of the swap. It falls within the definition of fixed-to-floating swap in Schedule 1 to the Clearing Rules. It will be subject to mandatory clearing if it has the features specified in Schedule 1 to the Clearing Rules.

**Q20. What are the applicable floating rate indexes for IRS?**

The applicable floating rate indexes are set out in Schedule 1 to the Clearing Rules. References to floating rate indexes include all valid quoting sources.

However, certain indexes may not be relevant if they are no longer maintained. For example, we do not expect HIBOR-ISDC will be used as it is no longer maintained by the International Swap and Derivatives Association.

The list of indexes may evolve over time but changes will be subject to consultation and the industry will be given time to make necessary arrangements before changes are implemented.

**Q21. Are intra-company transactions subject to mandatory clearing?**

Intra-company transactions between (i) two trading desks or (ii) branches/offices of the same entity are not subject to mandatory clearing.

**Exemptions from clearing obligation**

**Q22. Are there any exemptions from the clearing obligation?**

Yes. There are three exemptions available and they are -

- (a) transactions with an exempt affiliate – Rule 8 of the Clearing Rules (see Q23 to Q25 below);
- (b) transactions recorded in the books of an exempt jurisdiction – Rule 9 of the Clearing Rules (see Q26 to Q29 below); and
- (c) transactions resulting from multilateral portfolio compression cycle – Rule 10 of the Clearing Rules (see Q30 below).

The three exemptions are subject to certain requirements being fulfilled as set out in the Clearing Rules.

**Exempt affiliate exemption**

**Q23. How does an exempt affiliate exemption under Rule 8 operate and what are the requirements?**

Transactions with an exempt affiliate do not have to be subject to mandatory clearing if -

1. the accounts of the person and the exempt affiliate are consolidated in full by the holding company; and
2. the risk evaluation, measurement and control procedures applicable to the person and the exempt affiliate are centrally overseen and managed within the group.

In respect of (a), the consolidated accounts of the holding company must be prepared in compliance with the accounting standards issued by the Hong Kong Institute of Certified Public Accountants or the International Accounting Standards Board, or the standards of accounting practices applicable to the holding company in its place of incorporation.

In respect of (b), we would expect that, for instance, there is a centralised evaluation, measurement and control function to oversee the risks relating to OTC derivative transactions of the person and its exempt affiliates for which the exemption is being sought.

**Q24. What does a person have to do in order for an affiliate to become an exempt affiliate under Rule 8 of the Clearing Rules?**

The person must send an exemption notice to either the HKMA or the SFC. The exemption notice should specify –

- (a) the identity of the affiliate(s) to be regarded as an exempt affiliate and more than one affiliate may be included in the exemption notice; and
- (b) the date from which the exemption is to take effect and that date must not be backdated, i.e. it must not be earlier than the day the notice is received by the HKMA or SFC.

The exemption will only apply to transactions that are entered into by the person with the relevant exempt affiliate(s) on or after the effective date(s) as specified in the exemption notice.

Point to note:

An *affiliate* of a person is a corporation that is in the same group of companies as the person, except a corporation that is a collective investment scheme.

**Q25. What should a person do if it becomes aware that an affiliate will no longer meet the requirements set out in Rule 8(2) of the Clearing Rules after an exemption notice has been sent in respect of that affiliate to the HKMA or the SFC?**

When a person becomes aware that an affiliate will no longer meet the requirements, it should give a cessation notice to the HKMA or the SFC. A cessation notice must specify the following –

- 1. the identity of the affiliate(s) that will no longer be regarded as an exempt affiliate; and
- 2. the date from which the affiliate is no longer an exempt affiliate and the date must not be backdated, i.e. it must not be earlier than the day the notice is received by the HKMA or the SFC.

It is the responsibility of the person (that otherwise has the clearing obligation) to ensure that it is entitled to benefit from the exemption. As and when an exempt affiliate ceases to meet the requirements under Rule 8(2) of the Clearing Rules, if a cessation notice has not been sent to the relevant regulator, any new transaction between the person and that affiliate cannot benefit from the exempt affiliate exemption.

Point to note:

Only transactions after the affiliate stops meeting the requirements under Rule 8(2) of the Clearing Rules are not exempted from clearing. Historical transactions prior to that date are not affected.

### **Exempt jurisdiction exemption**

#### **Q26. How does an exempt jurisdiction exemption under Rule 9 operate, and what are the procedures to follow if a person wishes to benefit from the exemption?**

An exempt jurisdiction exemption is available to an LC or a local AI/AMB. This exemption applies to the transactions of such an institution that are booked in its branch in certain overseas jurisdictions provided that the conditions in Rule 9(2) are met. (Please see Q28 below.)

To benefit from the exemption, a person must send an exemption notice to the relevant regulator (if it is an LC, to the SFC, and if it is a locally incorporated AI or AMB, to the HKMA). The exemption notice should specify –

1. the jurisdiction(s) that is to be regarded as exempt jurisdiction(s) and more than one jurisdiction may be included in the exempt jurisdiction list; and
2. the date from which the exemption is to take effect and the date must not be backdated, i.e. it must not be earlier than the day the notice is received by the HKMA or the SFC.

Point to note:

There is no need to provide a similar exemption for overseas incorporated AI/AMB because OTC derivative transactions that are booked overseas for an overseas incorporated AI/AMB are not subject to the Clearing Rules.

The exemption will only apply to transactions that are entered into on or after the effective date(s) specified in the exemption notice.

**Q27. Can a person change the list of exempt jurisdictions in its previously submitted exemption notice?**

A person may change its list of exempt jurisdictions from time to time. However, when an exempt jurisdiction is removed from the list, it may only be reinstated into the exempt jurisdiction list *one more time*.

In other words, if an exempt jurisdiction is removed from the list the second time, it can never be added back to the list and new transactions booked in that jurisdiction after the second removal will not be able to benefit from the exemption under Rule 9. This is set out in Rule 9(5) of the Clearing Rules.

**Q28. What are the conditions under Rule 9(2) of the Clearing Rules that must be satisfied in respect of the exempt jurisdiction exemption?**

Rule 9(2) requires that the total position of the person for *each* exemption jurisdiction does not exceed 5% of the total position of the person and the total position for all exemption jurisdictions added together does not exceed 10% of the total position of the person.

If the total position of the person for any *one* exempt jurisdiction on the list specified in the exemption notice exceeds the 5% threshold, then the requirement under Rule 9(2)(a) is not met, and consequently, the exemption for not only that exempt jurisdiction but also *all other* exempt jurisdictions on the list will cease. Therefore, a person should remove any exempt jurisdiction that will not be able to comply with the 5% threshold in advance, so that the exemption in respect of the other exempt jurisdictions on the list will not be affected.

Similarly, if any increase of the total position of one exempt jurisdiction on the list is going to bring the total position of all exempt jurisdictions above the 10% threshold, the person should take action (e.g. remove that particular exempt jurisdiction) in advance to bring the total position down, so that the person can continue to utilise the exemption.

It is therefore critical that the list of exempt jurisdictions is kept up-to-date at all times and the person that is relying on the exemption closely monitors the level of activity in each exempt jurisdiction.

**Q29. How can a person remove an exempt jurisdiction from the list?**



When a person becomes aware that total position of an exempt jurisdiction will not be able to meet the requirements in the near future, it should give a cessation notice in respect of that jurisdiction as soon as possible to the HKMA or the SFC, as applicable. The cessation notice must specify the following –

1. the jurisdiction(s) that will no longer be regarded as exempt jurisdiction(s); and
2. the date from which the jurisdiction is no longer regarded as an exempt jurisdiction and the date must not be backdated, i.e. it must not be earlier than the day the notice is received by the HKMA or the SFC, as applicable.

It is the responsibility of the person (that otherwise has the clearing obligation) to ensure that it is entitled to benefit from the exemption. As and when the total position of an exempt jurisdiction or the total position of all exempt jurisdictions (as the case may be) ceases to meet the requirements under Rule 9(2) of the Clearing Rules, even if a cessation notice has not been sent to the relevant regulator, any new transaction in respect of *all* exempt jurisdictions on the list cannot benefit from the exempt jurisdiction exemption.

Point to note:

Only new transactions after the total position of an exempt jurisdiction stops meeting the requirements under Rule 9(2) of the Clearing Rules are not exempted from clearing. Historical transactions prior to that date are not affected.

### **Exemption for transactions resulting from multilateral portfolio compression cycle**

#### **Q30. What are the requirements in order for transactions resulting from multilateral portfolio compression cycle to benefit from the exemption?**

The transaction must satisfy the criteria set out in Rule 10(2) of the Clearing Rules, i.e. –

1. the transaction is entered into as a result of a multilateral portfolio compression cycle between two participants of the compression cycle; and
2. the multilateral portfolio compression cycle
  1. is conducted in accordance with the rules of the operator of the multilateral portfolio compression cycle;

2. involves more than 2 participants and the operator cannot be a participant (i.e. a bilateral compression will not be able to benefit from the exemption); and
3. is conducted in compliance with the risk tolerance levels set by the participants in the cycle.

### **Substituted compliance**

#### **Q31. Relief in the form of substituted compliance is available. What does this mean and how does it provide relief to a person subject to clearing obligation?**

When a cross-border transaction is entered into by a person, the transaction may be subject to more than one set of clearing requirements (from Hong Kong or the jurisdiction in which one of the counterparties to the transaction is based or incorporated) and the different sets of requirements may be duplicative or conflicting. Substituted compliance addresses such potential duplication or conflict by confirming that compliance with the overseas clearing requirements will suffice.

Rule 11 of the Clearing Rules essentially provides that clearing obligation is taken to have been complied with if the transaction has been cleared under the laws of a comparable jurisdiction through a designated CCP. Specifically, a transaction is taken to have complied with the Clearing Rules if –

- (a) under the laws of the comparable jurisdiction, that transaction is required to be cleared with a CCP;
- (b) the transaction has been cleared with a CCP in accordance with the laws of the comparable jurisdiction; and
- (c) that CCP is a CCP that has been designated by the SFC under section 101J of the SFO.

#### **Q32. What does the “stricter rule” approach under the substituted compliance framework mean and how does it work?**

The substituted compliance framework operates on a stricter rule approach. By that, it means if a transaction is exempted from clearing in a comparable jurisdiction, substituted compliance is not applicable. That transaction will have to be cleared under the Clearing Rules.

This can happen, for example, when a comparable jurisdiction has in place a clearing obligation, but that particular transaction is exempted from mandatory clearing, for example, due to exemption on the types of persons or particular products that we do not provide similar exemption or relief for. In such a situation, under our stricter rule approach, we will then require the transaction to be cleared under the Clearing Rules.

**Q33. Which jurisdictions are on the list of comparable jurisdictions?**

The list of comparable jurisdictions has been gazetted and the initial list comprises of member jurisdictions of the OTC Derivatives Regulators Group (ODRG). They are set out in Annex 2.

**Q34. Will more jurisdictions be added to the list of comparable jurisdictions?**

We have used member jurisdictions of ODRG as a starting point for the list of comparable jurisdictions. We anticipate that more jurisdictions will be added to the list as the global regulatory reform in respect of OTC derivative markets makes further progress. We will continue to monitor international developments in this area and consider whether new jurisdictions should be added to the list. The market will be consulted before the list is expanded.

**Exit from clearing obligation**

**Q35. What is an exit threshold and how does it work?**

An exit threshold serves to determine how a person can exit from its clearing obligation when, for instance, there is a permanent change in the person's trading profile or business model. An exit notice may be given by a person under Rule 6(3) when its applicable position (on a gross basis) as at the last day of each month falls below the exit threshold of US\$14 billion (70% of the clearing threshold of US\$20 billion) for a *period of 12 consecutive months*.

A person that has reached the exit threshold may give an exit notice to the HKMA or the SFC (as applicable) confirming that its applicable position is below US\$14 billion for 12 consecutive months and specifying the 12-month period and its applicable position on the last day of each month during the 12-month period. It must also confirm that its applicable position has not equalled or exceeded the exit threshold between the last day of the last month included in the 12-month period and the day on which the exit notice is given.

Once an exit notice is given, the person will no longer be regarded as having reached the clearing threshold and thus released from the clearing obligation.

Points to note:

For the purpose of determining whether a person has reached the exit threshold, the applicable position refers to: -

1. For a person that is a local AI/AMB/LC, the “total position” as defined in the Clearing Rules, being the aggregate notional amounts of all outstanding OTC derivative transactions (other than deliverable FX forwards and deliverable FX swaps);
2. For a person that is an overseas AI/AMB/LC, the “local total position” as defined in the Clearing Rules, being the aggregate notional amounts of all outstanding OTC derivative transactions (other than deliverable FX forwards and deliverable FX swaps), excluding every outstanding trade that is recorded in the person’s overseas books. In other words, this calculation only counts the position that is booked at the person’s Hong Kong branch.

Calculation of the applicable position is on a “gross” notional basis, without any netting.

**Q36. What happens when the person subsequently reaches the clearing threshold again, after it has given an exit notice to the relevant regulator?**

If the person subsequently reaches the clearing threshold after giving an exit notice, it will become subject to clearing obligation again. The calculation methodology for determining whether a person has reached the clearing threshold again will be the same as that for determining whether a person has reached the clearing threshold for the first time. In practice, we do not expect such a situation to arise since the exit mechanism is intended and designed for persons who have permanently changed their business model or trading profile. We will monitor the filing of exit notice and take appropriate action to stem any abuse.

**How to comply with clearing obligation**

**Q37. What are the steps a person needs to take to comply with clearing obligation under the Clearing Rules?**

When a person has determined that the transaction it has entered into is subject to clearing obligation, it should ensure that the transaction is submitted to a designated CCP for central clearing, and that the transaction has been accepted for clearing by that CCP within the allowed timeframe. This includes taking the following steps-

- (a) The person must have taken all reasonable steps to ensure that the transaction will be cleared by the designated CCP. For example, it must at least have complied with all the relevant requirements of the CCP's rules so that the CCP is not entitled to reject the transaction on account of anything that the person has done or failed to do.
- (b) The person must have followed up on whether the transaction has been accepted for clearing by the designated CCP, and if not, it must have taken all reasonable steps to ensure that the transaction is cleared as soon as possible within the timeline, including through another designated CCP if necessary.

Point to note:

The list of designated CCPs is set out in Annex 3.

### **Time allowed to clear**

#### **Q38. What is the time allowed to comply with clearing obligation?**

A transaction has to be cleared with a designated CCP within one business day after the transaction has been entered into, i.e. on a T+1 business day basis. The term "business day" refers to a business day in Hong Kong.

#### **Q39. What happens if a person is not able to clear the specified OTC derivative transaction in time?**

If the transaction remains uncleared due to factors outside the person's control, the person may have to terminate the transaction with its counterparty within the T + 1 business day timeframe, in order to avoid breaching the Clearing Rules.

### **Record keeping requirements**

#### **Q40. What records do I need to keep in relation to the clearing obligation?**

The list of records to be kept is set out in Part 3 of the Clearing Rules, and in particular, Rule 14 sets out the types of records to be kept.

**Q41. For how long must the records be kept?**

Records required to be kept in relation to a specified OTC derivative transaction must be kept for at least 5 years after maturity or termination of the transaction.

**Q42. Are transactions of an overseas AI or overseas AMB that are booked outside of Hong Kong subject to the record keeping requirements?**

Rule 6(1)(a)(ii) of the Clearing Rules excludes a transaction of an overseas AI or overseas AMB that is booked outside of Hong Kong from clearing obligation. Accordingly, there is also no record keeping obligation for such a transaction.

**Consequences of breaches**

**Q43. What are the consequences of breaching the clearing or record keeping obligation?**

Compliance with the clearing and record keeping obligations is a legal requirement. In the event of a breach, the HKMA (in the case of a breach by an AI or AMB) or the SFC (in the case of a breach by any other person) may apply to the Court of First Instance, which may then inquire into the case. If satisfied that there is no reasonable excuse for the breach, the Court may impose a financial penalty of up to HKD 5 million. Additionally, the HKMA (in the case of a breach by an AI or AMB) and the SFC (in the case of a breach by an LC) may take disciplinary action against the person in respect of the breach.

**Q44. What is the consequence when a person has obtained confirmation from a counterparty that it has not reached the clearing threshold, and subsequently it comes to light that the counterparty has in fact reached the clearing threshold at the relevant time?**

Where the person has received the confirmation in good faith, the confirmation should provide a reasonable excuse (in the case of any action under section 101F or 101G of the SFO) and a mitigating factor (in any disciplinary proceedings against the person) for not having centrally cleared the transaction in question.

Hong Kong Monetary Authority  
Securities and Futures Commission

## **Annex 1**

List of designated financial services providers (effective on 1 January 2021)

1. Agricultural Bank of China Limited
2. Banco Santander S.A.
3. Bank of America, N.A.
4. Bank of America Merrill Lynch International Designated Activity Company
5. Bank of China (UK) Ltd
6. Banque Palatine S.A.
7. Barclays Bank Ireland Plc
8. Barclays Bank PLC
9. Barclays Bank UK PLC
10. Barclays Capital Inc.
11. BNP Paribas Fortis SA/NV
12. BNP Paribas SA
13. BNP Paribas Securities Corp.
14. BofA Securities Europe SA
15. BofA Securities, Inc.
16. CACEIS Bank SA
17. Citibank, N.A.
18. Citibank Europe Plc
19. Citigroup Global Markets Europe AG
20. Citigroup Global Markets Inc.
21. Citigroup Global Markets Japan Inc.
22. Citigroup Global Markets Limited
23. Credit Agricole Corporate and Investment Bank
24. Credit Foncier de France
25. Credit Suisse (Schweiz) AG
26. Credit Suisse AG
27. Credit Suisse International
28. Credit Suisse Securities (Japan) Limited
29. Credit Suisse Securities Sociedad de Valores, S.A.
30. Credit Suisse Securities (USA) LLC
31. DB Privat- und Firmenkundenbank AG
32. Deutsche Bank AG
33. Deutsche Bank Securities Inc.



34. Goldman Sachs & Co. LLC
35. Goldman Sachs Bank Europe SE
36. Goldman Sachs Bank USA
37. Goldman Sachs Financial Markets Pty Ltd
38. Goldman Sachs International
39. Goldman Sachs Japan Co., Ltd.
40. HSBC Bank plc
41. HSBC Bank USA, N.A.
42. HSBC France
43. HSBC Securities (USA) Inc.
44. HSBC UK Bank plc
45. ING Bank N.V.
46. ING Bank Śląski S.A.
47. ING-DiBa AG
48. J.P. Morgan AG
49. J.P. Morgan Securities LLC
50. J.P. Morgan Securities plc
51. JPMorgan Chase Bank, N.A.
52. JPMorgan Securities Japan Co., Ltd.
53. Merrill Lynch Capital Services Inc.
54. Merrill Lynch International
55. Merrill Lynch Japan Securities Co., Ltd.
56. Mitsubishi UFJ Morgan Stanley Securities Co., Ltd.
57. Mizuho Bank, Ltd.
58. Mizuho Capital Markets LLC
59. Mizuho International plc
60. Mizuho Securities USA LLC
61. Morgan Stanley & Co. International plc
62. Morgan Stanley & Co. LLC
63. Morgan Stanley Capital Services LLC
64. Morgan Stanley Europe SE
65. Morgan Stanley MUFG Securities Co., Ltd.
66. MUFG Bank, Ltd.
67. MUFG Securities EMEA plc
68. National Westminster Bank Plc
69. NATIXIS
70. NatWest Markets N.V.
71. NatWest Markets plc

72. Nomura Financial Products & Services, Inc.
  73. Nomura Global Financial Products, Inc.
  74. Nomura International plc
  75. Nomura Securities Co., Ltd.
  76. Nomura Securities International, Inc.
  77. Nordea Bank Abp
  78. RBC Capital Markets, LLC
  79. RBC Europe Limited
  80. Royal Bank of Canada
  81. Santander Financial Services Plc (previously stated as “Abbey National Treasury Services plc”)
  82. Santander Investment Securities Inc.
  83. SG Americas Securities LLC
  84. SMBC Capital Markets Inc.
  85. SMBC Nikko Securities Inc.
  86. Societe Generale
  87. Societe Generale International Limited
  88. Standard Chartered Bank
  89. Sumitomo Mitsui Banking Corporation
  90. Sumitomo Mitsui Trust Bank, Limited
  91. TD Bank, N.A.
  92. TD Bank USA, N.A.
  93. The Bank of New York Mellon
  94. The Toronto-Dominion Bank
  95. UBS AG
  96. UBS Europe SE
  97. UBS Securities LLC
  98. UBS Switzerland AG
  99. UniCredit Bank AG
  100. UniCredit Bank Austria AG
  101. UniCredit S.p.A.
  102. Wells Fargo Bank, N.A.
  103. Wells Fargo Securities, LLC
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## Annex 2

### List of comparable jurisdictions

1. Australia
2. Austria
3. Belgium
4. Brazil
5. Bulgaria
6. Canada
7. Croatia
8. Czech Republic
9. Denmark
10. Estonia
11. Finland
12. France
13. Germany
14. Greece
15. Hungary
16. Ireland
17. Italy
18. Japan
19. Latvia
20. Lithuania
21. Luxembourg
22. Malta
23. Netherlands
24. Poland
25. Portugal
26. Republic of Cyprus
27. Romania
28. Singapore
29. Slovakia
30. Slovenia
31. Spain
32. Sweden
33. Switzerland
34. United Kingdom
35. United States

### **Annex 3**

#### List of designated CCPs

1. Chicago Mercantile Exchange Inc
2. Japan Securities Clearing Corporation
3. LCH.Clearnet Limited
4. OTC Clearing Hong Kong Limited