Guardian

30th August, 2012

Supervision of Markets Division
Securities and Futures Commission
8th floor Chater House
8 Connaught Road Central
Hong Kong

Dear Sir/Madam,

Supplemental Consultation on the OTC Derivatives Regime for Hong Kong – Proposed Scope of New/Expanded Regulated Activities and Regulatory Oversight of Systemically Important Players ("the Consultation Paper")

We have reviewed the Consultation Paper and we welcome the initiatives to modernize the regime of regulation of over-the-counter derivatives market. Whilst we support the overall objectives of the Consultation Paper, our major concerns and views over the proposal are stated herein this letter.

Question 1

Do you have any comments or concerns about our proposals for the initial ambit of the new Type 11 RA should be cast, and the specific activities to be excluded from its scope?

According to Recommendation 1 in the International Organization of Securities Commissions ("IOSCO")'s Report on International Standards for Derivatives Market Intermediary Regulation issued in June 2012 ("IOSCO Report"), OTC derivative market intermediaries (DMIs) are defined as including those "who are in the business of dealing, making a market or intermediating transactions in OTC derivatives". In the same report, it also commented that DMIs should be "subject to registration or licensing and applicable substantive regulations and/or requirements and standards once registered or licensed in some form by the relevant market authority or authorities". Therefore, it is deemed necessary for Hong Kong to develop and implement measures (which are in line with the IOSCO's objectives of improving the OTC derivative markets), by introducing a new Type 11 RA regulatory regime.

The IOSCO Report also suggested that under certain circumstances, full application of substantive regulations and/or requirements and standards may not be appropriate for certain types of entities". In line with this, it is proposed in the Consultation Paper that the new Type 11 RA will need to include a number of carve-outs, particularly to address overlap with, and in some cases to replicate some of the carve-outs to, existing RAs. This is also in line with the current regime of "incidental exemption", as contemplated in the Commission's Licensing Information Booklet.

Question 2

Do you have any comments or concerns about our proposals on how the provision of ATS (for OTC derivatives) by AIs and AMBs should be regulated?

We have no particular comments on this question.

Question 3

Do you have any comments or concerns about our proposals for how the initial ambit of the new Type 12 RA should be cast, and the specific activities to be excluded from its scope?

In accordance with Recommendation 9 in the IOSCO Report, "for cleared OTC derivatives transactions, DMIs should segregate collateral belonging to clients from their own proprietary assets and employ an account structure that enables the efficient identification and segregation of positions and collateral belonging to DMI clients". Therefore, the proposed new Type 12 RA regulations imposed on agents of a CCP member are in line with the recommendations put forward in the IOSCO Report.

Question 4

Do you have any comments or concerns about our proposals for expanding the scope of the existing Type 9 RA?

The proposed expansion of the scope is in line with the existing incidental exemption provided in the SFC Licensing Information Booklet.

Question 5

Do you have any comments or concerns about our proposed transitional arrangements for the new Type 11 and Type 12 RAs, and for the expanded Type 9 RA?

Under these arrangements, the applicants who have already been licensed for Type 9 (asset management) regulated activity and, have confirmed that they have engaged in managing portfolios of OTC derivatives in Hong Kong for a certain period of time (2 years as proposed) before the coming into effect of the new OTC derivative regime, must modify the conditions on the existing license before they are permitted to manage OTC portfolios. In other words, certain rights granted will be taken away from the applicants, who have legitimate expectation that they are permitted to manage OTC derivative portfolios at the time of submission of application. This may cause inconvenience and hassles to the applicants when running their business.

We are of the view that a "grandfathered arrangement" could be introduced and thus, exemption could be granted to all the corporations licensed by the Commission who are permitted to carry on Type 9 (asset management) regulated activity before the new regime comes into effect.

Question 6

Do you have any comments or concerns about our proposals for how SIPs should be identified and regulated?

There is no indication in the ISOCO Report that regulations of SIPs are necessary.

In the Consultation Paper

The definition of SIP is unclear for the purpose of this proposed provision and therefore, further clarification is required before implementation of regulation of their activities.