

**Legislative Council of Hong Kong
Subcommittee on Three Pieces of Subsidiary Legislation Relating to
Over-the-counter Derivative Transactions**

**Consultation on subsidiary legislation relating to over-the-counter
derivative transactions**

Submission of The Hong Kong Association of Banks

22 June 2015

Introduction

The Hong Kong Association of Banks (“**HKAB**”) was grateful to receive an invitation from this Legislative Council Subcommittee (“**Subcommittee**”) to give its views on the Three Pieces of Subsidiary Legislation Relating to Over-the-counter Derivative Transactions (“**Subsidiary Legislation**”).

We understand that the Subsidiary Legislation will accompany changes made to the Securities and Futures Ordinance (“**SFO**”) pursuant to the Securities and Futures (Amendment) Ordinance 2014 (“**Amendment Ordinance**”) in relation to the provisions establishing a regulatory framework for the over-the-counter (“**OTC**”) derivative market in Hong Kong. We understand that this comprises of the:

- (a) proposed Securities and Futures (OTC Derivative Transactions – Reporting and Record Keeping) Rules (“**Draft Rules**”);
- (b) Securities and Futures (Amendment) Ordinance 2014 (Commencement) Notice 2015; and
- (c) Securities and Futures (Stock Markets, Futures Markets and Clearing Houses) Notice.

Assisted by King & Wood Mallesons, HKAB has examined the proposals set out in the Subsidiary Legislation and explained in the Conclusions on Further Consultation on the Securities and Futures (OTC Derivative Transactions – Reporting and Record Keeping Obligations) Rules (“**Further Consultation Conclusions**”) dated May 2015 issued by the Hong Kong Monetary Authority (“**HKMA**”) and the Securities and Futures Commission (“**SFC**”). These views are set out in the “HKAB’s response” section of this written submission, with our key suggestions summarised in the “Executive summary”.

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

Unless otherwise defined, terms used in our response have the meaning given to them in the Draft Rules.

Executive summary

First, HKAB wishes to acknowledge the significant effort involved in building the OTC derivatives framework to date. In addition, we appreciate the willingness of the Subcommittee, the HKMA and the SFC to consult with the financial services industry on this important topic, as well as the efforts made to date to address our concerns and take into account our suggestions.

HKAB has a small number of comments on the Subsidiary Legislation, namely the Draft Rules. The key comments are as follows:

- (a) **Eligibility for masking relief** – further guidance is sought on the expectation of market participants to independently verify that the submission of counterparty particulars is prohibited in the counterparty's jurisdiction in order to submit masking particulars. HKAB also requests clarification on whether a legal opinion is adequate to satisfy the requirement.
- (b) **Reporting of UTI** – secondly, HKAB requests reconsideration of the requirement to report unique transaction identifier (“**UTI**”) numbers in light of the compliance burden.

We welcome the opportunity to discuss any aspect of the Subsidiary Legislation further.

HKAB's response

A Reporting of valuation transaction information

1. Methodology for reporting valuation to be the subject of further consultation

- 1.1 As previously noted,¹ HKAB is supportive of the proposal to report valuation transaction information. However, in light of the concerns that we have raised² regarding the proposed reporting time frame and valuation methodology, we appreciate that the HKMA and the SFC have refrained from implementing the requirement until they have conducted further consultation on the details of this requirement.³
- 1.2 We look forward to commenting on those proposals during the next consultation process to confirm alignment with market practice. We would appreciate clarity as soon as is reasonably practicable.

B Masking relief

2. What does "reasonable due diligence" entail?

- 2.1 Pursuant to section 26(1)(a) of the Draft Rules, parties may submit masking particulars if the counterparty jurisdiction is on the designated list **and** the submission of counterparty particulars is prohibited in that jurisdiction. HKAB members are uncertain about the extent of the due diligence required to satisfy the latter requirement. Effectively this means that market participants must independently verify that reporting the counterparty particulars is prohibited.
- 2.2 The HKMA and SFC have noted in the Further Consultation Conclusions that they do not expect market participants to obtain a formal legal opinion, but that market participants "should carry out some "reasonable due diligence" to ensure that barriers to disclosure still exist in the relevant jurisdiction, and that those barriers still prevent disclosure of counterparty identifying particulars in respect of the particular transaction in question".⁴
- 2.3 HKAB would appreciate further guidance on what would be considered "reasonable due diligence" in this context. Given the fluid nature of laws and regulations prohibiting the submission of counterparty particulars and market participants' reliance upon external legal advice in counterparty jurisdictions, "keeping abreast of developments which effectively allow reporting of counterparty particulars", as suggested in the Further Consultation Conclusions,⁵ creates practical difficulties. In particular, we would appreciate guidance on the frequency with which market participants should satisfy themselves that the barriers to disclosure still exist in the relevant jurisdiction.

¹ Paragraph 1.2 of the HKAB submissions dated 23 December 2014.

² Paragraph 1.2 -1.9 of the HKAB submissions dated 23 December 2014.

³ Paragraph 36 of the Further Consultation Conclusions.

⁴ Paragraph 39 of the Further Consultation Conclusions.

⁵ Paragraph 39 of the Further Consultation Conclusions.

C Prescribed stock/futures markets and clearing houses

3. Future reassessment of the proposed list of prescribed stock/futures markets and clearing houses

3.1 HKAB previously requested that the following entities be added to the proposed list of prescribed stock/futures markets and clearing houses for the purpose of section 1B(2)(c) of Part 1 of Schedule 1 to the SFO:

- (a) China Foreign Exchange Trading System; and
- (b) Shanghai Clearing House, "Interbank Market Clearing House Co., Ltd."⁶

3.2 We note that the HKMA and SFC do not consider their inclusion suitable at this stage, as set out in the Further Consultation Conclusions.⁷ However, we would appreciate if this position could be reassessed at an appropriate time.

D Reporting of UTI numbers

4. Use of UTI numbers

4.1 As previously noted,⁸ members have expressed concern that reporting UTI numbers would complicate their workflow, and require enhancement to existing compliance systems. This is particularly true with non-clearing trades, which would require establishing systems to exchange this information outside of the existing clearing house infrastructure. For streamlined compliance, HKAB suggested that UTI numbers only be reported in respect of trades cleared via a CCP.

4.2 HKAB understands from the Further Consultation Conclusions⁹ that the HKMA and SFC insist that UTIs must be included in all trade reports, but we wish to reiterate our members' concerns regarding the significant compliance burden which they face in light of this requirement.

Next steps

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

⁶ Paragraph 3.1 of the HKAB submissions dated 23 December 2014.

⁷ Paragraph 49 of the Further Consultation Conclusions.

⁸ Paragraph 4.1 of the HKAB submissions dated 23 December 2014.

⁹ Paragraph 65 of the Further Consultation Conclusions.