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

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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

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.

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 HVV8 T097(V)1 1 -.484 Tw 1.355 0 Td ( )Tj -0.04 Tc 0.04 Tw 3.5481-1.25[(an)-3BIe t d in

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 continue tprTw -32(t)(pr)2(T(w)-6/Reference

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-

45. The respondent suggested that regulators consider expanding the tenors for

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

52.

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

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

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 Slaski 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.

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