Frequently Asked Questions on

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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:

- "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);*
- "HKMA" *refers to the Hong Kong Monetary Authority;*
- "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.

Commencement date

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

The requirements for clearing and record keeping obligations came 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.

<u>Persons subject to clearing and record keeping obligations</u>

Q4. Who would be subject to the mandatory clearing and related record keeping

(c) The counterparty is an AI/AMB/LC and is also required to clear the transaction

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

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?

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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.

<u>Financial services providers</u>

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Transactions subject to mandatory clearing

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

Only

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

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
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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

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 –

(a) the identity of the affiliate(s) that will no longer be regarded as an exempt affiliate; and

(b) 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.

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 eachexemption 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 oneexempt 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% threshola0s6-.002 Tc5tS 0 Td (f)4 (bl)- .02. (pl)8.t (i)-2 (c)tej-10 (c(C (e)()-1 (o -1 .89 02 (ur)3

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 –

(a) the jurisdiction(s) that will no longer be regarded as exempt jurisdiction(s); and

(b) 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 exercise

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

According to Rule 10(1) of the Clearing Rules, (a) the transaction must be entered into by a person as a result of a multilateral portfolio compression exercise and with a participant in the exercise that was a counterparty to one or more of the compressed transactions; and (b) Rule 6(1) of the Clearing Rules did not apply to the person to any of the compressed transactions, under the multilateral portfolio compression exercise.

The meaning of a multilateral compression exercise is set out in Rule 10(3) of the Clearing Rules.

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

Points to note:

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

(a) 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);

(b) For a person that is an overseas AI/AMB/LC, the “local total position” as defined

(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

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.

33. Deutsche Bank Securities Inc.
34. Goldman Sachs & Co. LLC
35. Goldman Sachs Bank Europe SE
36. Goldman Sachs Bank USA
37.

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

Annex 3

List of designated CCPs

1. Chicago Mercantile Exchange Inc

2. Japan Securities Clearing Corporation

3. LCH Limited

4. OTC Clearing Hong Kong Limited