

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

(March 2023)

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Clearing and Record Keeping Obliga tion
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transaction is 1 July 2017, 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.

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 an AI, an AMB or an LC. The clearing and record-keeping obligations apply to the following:

- (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
transactions are cleared in accordance
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 it follows any of the following:

- (a) The AI, AMB or LC has reached the clearing threshold. (Please see 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 the first time for the first time (or for the first time again).

The clearing threshold is set out in Schedule 2 to the Clearing Rules. It is currently at US\$ 20 billion for all calculation periods specified in the rules, but may be lowered in the 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 applicable position) w

The person is regarded as having reached the clearing threshold at all times thereafter even if the person's applicable position falls below the clearing threshold for that calculation period, until an exit notice is given. (Please see Q3536 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 – please see the latest update under the section “List of prescribed persons that have reached the clearing threshold for the purposes of Mandatory Clearing”:

<https://www.hkma.gov.hk/eng/standards/OTC-derivativesregulationregime.htm>

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, 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, 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, the position is calculated based on the position booked in the person's Hong Kong branch.

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

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

Group to

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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

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range of entities. In

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perspective.

The performance annual update of the list of financial services provider

Item	C u r r e n c y	Floa i n g r a e i n d e x	T e n o r	O p t i o n a l i t y	C o n s a n t n o t i o n a l
3.	GBP	L I B O R	28 days to 10 years	N	Yes
4.	JPY	L I B O R	28 days to 10 years	N	Yes
5.	HKD	H I B O R	28 days to 10 years	N	Yes

(b) a fixed - floating swap that has all of the features specified for an item in a row

Item	C u r r e n c y	Floa i n g r a e i n d e x	T e n o r	O p t i o n a l i t y	C o n s a n t n o t i o n a l
1.	USD	L I B O R	28 days to 10 years	N	Yes
2.	EUR	EUR I B O R	28 days to 10 years	N	Yes
3.	GBP	L I B O R	28 days to 10 years	N	Yes
4.	JPY	L I B O R	28 days to 10 years	N	Yes
5.	HKD	H I B O R	28 days to 10 years	N	Yes

(c) an overnight index swap of the table below -

Item	C u r r e n c y	Floa i n g r a e i n d e x	T e n o r	O p t i o n a l i t y	C o n s a n t n o t i o n a l
1.	USD	F e d F u n d s	7 days to 2 years	N	Yes
2.	EUR	E O N	7 days to 2 years	N	Yes
3.	GBP	S O N	7 days to 2 years	N	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 entered into on or after the prescribed day that corresponds to the calculation period for the first time (or the first time again after giving an exit notice) and the 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?

As an option to enter into a transaction, and is not itself a transaction. As it does not fall under the clearing rule, 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 _____ subject to clearing: _____ w

- (a) it falls within the specified criteria set out in Schedule 1 to the Clearing Rules, and
- (b) the corresponding s e3 (n)-2 (e)4 (r)-7 (e)4 i1-1 (is)Tj 0 Tcn107 0 T4 (y v

s I f falls

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w

(b) the date from _____ 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 _____
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,
if an exempt jurisdiction is removed from the list, it may only be reinscribed into the
exempt jurisdiction list one more time

In other _____
can never be added back to the list and no _____ transactions booked in that jurisdiction
after the second removal

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 exemption 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 exemption
jurisdiction but also all other exemption jurisdictions on the list. Therefore,
persons should remove any exemption jurisdiction that
5% threshold in advance, so that the exemption in respect of the other exemption
jurisdictions on the list _____.

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. The person can continue to utilise the exemption.

It is therefore critical that the list of exempt jurisdictions is 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 unable to meet the requirements in the near future, they 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
- (b) the date from which the jurisdiction and the date must not be backdated, i.e. it must not be earlier than the day when

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 transaction must be entered into by a person as a result of a multilateral portfolio compression exercise and participant in the exercise that

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 is entered into by a person, the transaction may be subject to more than one set of clearing requirements (from Hong Kong, the jurisdiction in which the person is incorporated) and the differences of requirements may be duplicative or conflicting. Substituted compliance addresses such potential duplication or conflict by confirming that compliance

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

- (a) under the law of the jurisdiction in which the transaction is cleared ;
- (b) the transaction has been cleared in accordance with the law of a 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?

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. This includes taking the following steps:

- (a) The person must have taken all reasonable steps to ensure that the transaction complies with the clearing obligation. For example, it must at least have complied with the requirements of the clearing obligation. The person 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 the requirements of the clearing obligation.

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 B 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 specified OTC derivative transactions 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 transaction.

Consequences of breaches

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

Compliance w
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, w
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 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. Korea
20. Lithuania
21. Luxembourg
22. Malaysia
23. Mexico
24. Netherlands
25. New Zealand
26. Norway
27. Poland
28. Portugal
29. Romania
30. Singapore
31. Slovakia
32. Slovenia
33. South Africa
34. Spain
35. Sweden
36. Switzerland
37. Taiwan
38. Thailand
39. Turkey
40. United Kingdom
41. United States
42. Uruguay
43. Venezuela

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Annex 2

List of Designated CCPs

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