

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

(1 March 2019)

These FAQs elaborate on how the mandatory clearing regime under the Securities and Futures (OTC Derivative Transactions Clearing and Record Keeping Obligations and Designation of Central Counterparty) Rules (Clearing Rules) will operate and are intended to help market participants better understand their obligations and responsibilities under the Clearing Rules so that they are better able to prepare for implementation of the new regime and ensure compliance going forward.

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No, there is no provision for transitional arrangement under the Clearing Rules. That said, the first data person may be required to clear a specified OTC derivative 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.

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 major dealers. The clearing and record keeping obligations apply to the following persons

- (a) an authorized institution

A simplified table of the calculation periods and their corresponding prescribed days is set out below for easy reference -

	Calculation period	Prescribed day
1.	1 September 2016 to 30 November 2016	1 July 2017
2.	1 March 2017 to 31 May 2017	1 January 2018
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

Q7. What is the clearing threshold for an AI/AMB/LC?

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

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For avoidance of doubt, any OTC derivative transactions not required to be cleared (whether by reason that the person has not yet reached the clearing threshold, the transactions are not specified OTC derivative transactions, or by any other reason) will s

- (a) it falls within the definition of IRS under the Clearing Rules and its features meet the specified criteria set in Schedule 1 to the Clearing Rules, and
- (b) the corresponding swaption is entered into on or after 1 September 2016, the commencement date of clearing requirement

Q16. Will an IRS become subject to mandatory clearing as a result of an amendment to its original terms or the occurrence of certain life cycle events?

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derivative product” (as defined in the SFO). The IRS, being only an embedded

Q21. Are intra-company transactions subject to mandatory clearing?

Intra-company transactions between (i) two trading desks or (ii) branches/offices of the same entity are not subject to mandatory clearing.

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 exempt jurisdiction Rule 9 of the Clearing Rules (see Q26 to Q29 below); and
- (c) transactions resulting from multilateral portfolio compression cycle Rule 10 of the Clearing Rules (see Q30 below).

The three exemptions are subject to certain requirements being fulfilled as set out in the Clearing Rules.

Exempt affiliate exemption

Q23. How does an exempt affiliate exemption under Rule 8 operate and what are the requirements?

Transactions with an exempt affiliate do not have to be subject to mandatory clearing if -

- (a) the accounts of the person and the exempt affiliate are consolidated in full by the holding company; and
- (b) the risk evaluation, measurement and control procedures applicable to the

In respect of (b), we would expect that, for instance, there is a centralised evaluation, measurement and control function to oversee risks relating to OTC derivative transactions of the person and its exempt affiliates for which the exemption is being sought.

Q24.

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, even 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.

Point to note:

Only transactions after the affiliate stops meeting the requirements under Rules 8(2) of the Clearing Rules are not exempted from clearing. Historical transactions prior to that date are not affected.

Exempt jurisdiction exemption

Q26. How does an exempt jurisdiction exemption under Rule 9 operate, and what are the procedures to follow if a person wishes to benefit from the exemption?

An exempt jurisdiction exemption is available to an LC or a local AI/AMB. This exemption applies to the transactions of such an institution that are booked in its branch in certain overseas jurisdictions provided that the conditions in Rule 9(2) are met. (Please see Q28 below.)

To benefit from the exemption, a person must send an exemption notice to the relevant regulator (if it is a LC, to the SFC, and if it is a locally incorporated AI or AMB, to the HKMA). The exemption notice should specify –

- (a) the jurisdiction(s) that is to be regarded as exempt jurisdiction and no more than one jurisdiction may be included in the exempt jurisdiction list
- (b) the date from which the exemption is to take effect 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. overseas incorporated AI/AMB are not subject to the Clearing Rules

The substituted compliance framework operates on a stricter rule approach. By that, it means if a transaction is exempted from clearing in a comparable jurisdiction, substituted compliance is not applicable. That transaction will have to be cleared under the Clearing Rules.

This can happen, for example, when a comparable jurisdiction has in place a clearing obligation, but that particular transaction is exempted from mandatory clearing, for example, due to exemption on the types of person or particular products that we do not provide similar exemption or relief for. In such a situation, under our stricter rule approach, we will then require the transaction to be cleared under the Clearing Rules.

Q33. Which jurisdictions are on the list of comparable jurisdictions?

The list of comparable jurisdictions has been gazetted and the list comprises of member jurisdictions of the OTC Derivatives Regulators Group (ODRG). They are set out in Annex 2.

Q34. Will more jurisdictions be added to the list of comparable jurisdictions?

We have used member jurisdictions of ODRG as a starting point for the list of comparable jurisdictions. We anticipate that more jurisdictions will be added to the list as the global regulatory reform in respect of OTC derivative markets makes further progress. We will continue to monitor international developments in this area and consider whether new jurisdictions should be added to the list. The market will be consulted before the list is expanded.

Exit from clearing obligation

Q35. What is an exit threshold and how does it work?

An exit threshold serves to determine how a person can exit from its clearing obligation when, for instance, there is a permanent change in the person's trading profile or business model. An exit notice may be given by a person under Rule 6(3) when its applicable position (on a gross basis) as at the last day of each month falls below the exit threshold of US\$1 billion (70% of the clearing threshold of US\$20 billion) for a period of 12 consecutive months.

A person that has reached the exit threshold may give an exit notice to the HKMA or the SFC (as applicable) confirming that its applicable position is

below US\$14 billion for 12 consecutive months and specifying the 12th period and its applicable position on the last day of each month during the 12-month period. It must also confirm that its applicable position has not equalled or exceeded the exit threshold between the last day of the last month included in the 12-month period and the day on which the exit notice is given.

Once an exit notice is given, the person will no longer be regarded as having reached the clearing threshold and thus released from the clearing obligation.

Points to note:

For the purpose 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 in the Clearing Rules, being the aggregate notional amounts of all outstanding OTC derivative transactions (other than deliverable FX forwards and deliverable FX swaps) excluding every outstanding trade that is recorded in the person’s overseas books. In other words, this calculation only counts the position that is booked at the person’s Hong Kong branch.

Calculation of the applicable position on a “gross” notional basis, without any netting

Q36. What happens when the person subsequently reaches the clearing threshold again, after it has given an exit notice to the relevant regulator?

If the person subsequently reaches the clearing threshold after giving an exit notice, it will become subject to clearing obligation again. The calculation methodology for determining whether a person has reached the clearing threshold again will be the same as that for determining whether a person has reached the clearing threshold for the first time. In practice, we do not expect such a situation to arise since the exit mechanism is intended and designed for persons who have permanently changed their business model or trading profile.

We will monitor the filing of exit notice and take appropriate action to stem any abuse.

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 within the allowed timeframe. This includes taking the following steps

- (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 complied with all the relevant requirements of the CCP's rules so that the CCP 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 up on whether the transaction has been accepted for clearing by the designated CCP, and if not, it must have taken all reasonable steps to ensure that the transaction is cleared as soon as possible within the timeline, including through another designated CCP if necessary.

Point to note:

The list of designated CCPs is set out in Annex 3.

Time allowed to clear

Q38. What is the time allowed to comply with clearing obligation?

A transaction has to be cleared with a designated CCP within one business day after the transaction has been entered into, i.e. on a T+1 business day basis. The term "business day" refers to a business day in Hong Kong.

Q39. What happens if a person is not able to clear the specified OTC derivative transaction in time?

If the transaction remains uncleared due to factors outside the person's control, the person may have to

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

31. HSBC Bank USA, N.A.
32. HSBC France
33. HSBC Securities (USA) ~~inc.~~ ^{plc.}
34. ING Bank N.V.
35. ING Bank Śląski 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. Merrill Lynch International
43. Merrill Lynch Japan Securities Co., Ltd.
44. Merrill Lynch, Pierce, Fenner & Smith Incorporated
45. Mitsubishi UFJ Morgan Stanley Securities Co., Ltd.
46. Mizuho Bank, Ltd.
47. Mizuho Capital Markets LLC (formerly known as Mizuho Capital Markets Corporation)
48. Mizuho International plc
49. Morgan Stanley & Co. International plc
50. Morgan Stanley & Co. LLC
51. Morgan Stanley Capital Services LLC
52. Morgan Stanley MUFG Securities Co., Ltd.
53. MUFG Bank, Ltd. (formerly known as The Bank of Tokyo-Mitsubishi UFJ, Ltd.)
54. MUFG Securities EMEA plc (formerly stated as ~~MO~~ Securities EMEA PLC)
55. NATIXIS
56. NatWest Markets plc (formerly known as The Royal Bank of Scotland plc)
57. Nomura Financial Products & Services, Inc.
58. Nomura Global Financial Products, Inc.
59. Nomura International plc
60. Nomura Securities Co., Ltd.
61. Nomura Securities International, Inc.
62. Nordea Bank Abp (formerly known as Nordea Bank) AB

63. RBC Capital Markets, LLC
 64. RBC Europe Limited
 65. Royal Bank of Canada
 66. Santander Investment Securities Inc.
 67. SG Americas Securities LLC
 68. SMBC Capital Markets Inc.
 69. SMBC Nikko Securities Inc.
 70. Societe Generale
 71. Societe Generale International Limited (formerly known as Societe Generale Newedge UK Limited)
 72. Standard Chartered Bank
 73. Sumitomo Mitsui Banking Corporation
 74. Sumitomo Mitsui Trust Bank, Limited
 75. The Bank of New York Mellon
 76. UBS AG
 77. UBS Limited
 78. UBS Securities LLC
 79. UniCredit Bank AG
 80. UniCredit Bank Austria AG
 81. UniCredit S.p.A.
 82. Wells Fargo Bank, N.A.
 83. Wells Fargo Securities, LLC
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Annex 3

List of designated CCPs

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