ISDA® Safe, Efficient Markets

Date: 16 May 2013

Ms Karen Kemp
Executive Director (Banking Policy)
Hong Kong Monetary Authority
55th Floor, Two International Financial Centre
8 Finance Street, Central
Hong Kong

By Email and Post

Dear Karen,

HKMA Consultation on reporting requirements for OTC derivatives transactions

Introduction

We refer to the HKMA's letter dated 2 May 2013 ("**HKMA's Letter**") responding to ISDA's submissions dated 15 April 2013.

We are very appreciative for the helpful discussions which have taken place between us as well as your explanations of the approach taken to the introduction of the proposed interim trade reporting regime ("**Phase 1**") in Hong Kong. ISDA and the industry support the G20 commitments including the need for regulators to have increased transparency regarding the international OTC derivatives markets and we are committed to providing regulators with the information required to meet such G20 commitments.

The cross-border nature of the OTC derivatives markets often presents unique challenges to regulators worldwide in forming effective regulation while preserving the principle of international comity. We value the leadership role Hong Kong is seeking to play.

We thank the HKMA for clarifying the industry's queries under the Annex to the HKMA's Letter ("**Annex**"). We are grateful for this opportunity to seek further clarification with respect to the proposals under Phase 1 and have set out both our views and concerns. We have identified two key areas of concerns, namely, the scope of Phase 1 interim trade reporting and transitional arrangements. For ease of reference, we have adopted the numbering set out in the Annex.

1. Regulatory Status of Counterparty – List of Licensed Banks

As interim trade reporting requirements will *only* apply to reportable transactions between two Licensed Banks, the regulatory status of each counterparty is vitally important for ascertaining whether or not a transaction is caught by the mandatory reporting requirement under Phase 1.

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We welcome and support the HKMA's willingness to adopt the industry's suggested approach for the HKMA to (a) notify reporting Licensed Banks who are using the trade repository established and operated by the HKMA for the purposes of collection of data relating to OTC derivatives transactions ("**HKMA-TR**") of any changes to the regulatory status of their counterparties; and (b) provide an up-to-date list of Licensed Banks on the HKMA website which can be downloaded for cross-checking. We should be grateful if the HKMA would clarify whether or not this means that the industry may rely on this information as being definitive. i.e. a Licensed Bank will not be considered to have breached the mandatory interim reporting obligations if both (a) the list of Licensed Banks is not up to date or the website is not working; and (b) the HKMA has not notified such Licensed Bank of any changes to the regulatory status of its counterparty.

We look forward to our continued dialogue with the HKMA on the logistics and specifics to the List of Licensed Banks.

2. Scope of Phase 1 Interim Trade Reporting

"Transfer Bookings"

We understand that except for 'transfer bookings', interbranch transactions (i.e. reportable transactions between the Hong Kong branch of a Licensed Bank and the London Branch of the Licensed Bank) would not be subject to interim trade reporting. Transfer bookings, on the other hand, would be subject to interim trade reporting. As described in paragraph 6 of Annex A to the HKMA's letter dated 14 March 2013, a transfer booking is where the Hong Kong branch of a Licensed Bank enters into a reportable transaction with the foreign branch of the same Licensed Bank such that the original transaction between the foreign branch of the Licensed Bank and the third party counterparty is 'transferred' and booked into the Hong Kong branch. In these circumstances, the Hong Kong branch of the Licensed Bank should include details of the third party counterparty in its report to the HKMA-TR.

We note from SN2(a) of the Annex that 'transfer bookings' would only capture a transaction that is either novated into the Hong Kong branch of a Licensed Bank or novated out of the Hong Kong branch of a Licensed Bank. It would not include a transaction where only the risk is 'transferred' to the Hong Kong branch (i.e. a back to back transaction).

We note that where the Hong Kong branch of a Licensed Bank is the transferee under a novation (i.e. the party stepping into the transaction), the Hong Kong branch of the Licensed Bank should report the transaction to the HKMA-TR as a 'new deal'. Where the Hong Kong branch of a Licensed Bank is the transferor under a novation (i.e. the party stepping out of the transaction), the Hong Kong branch of the Licensed Bank should report the transaction to the HKMA-TR as a 'withdrawal event'.

Based on our understanding of the scope of reporting set out above, "transfer bookings" would already be captured under the general scope for Phase 1, i.e. a Licensed Bank ("**Bank 1**") should only be subject to trade reporting requirements with respect to a reportable transaction (i.e. plain vanilla single currency interest rate swaps and FX non-deliverable forwards) with another

Licensed Bank ("**Bank 2**") where such transaction is booked onto Bank 1's balance sheet in Hong Kong. Bank 2 will not be required to report such a transaction unless it also books the transaction onto its balance sheet in Hong Kong. Therefore, we should be grateful if the HKMA would clarify whether or not it is the HKMA's intention that a Licensed Bank should report each novation irrespective of (a) whether or not the counterparty is also a Licensed Bank and (b) whether or not the counterparty is a different branch within the same legal entity. In other words, we should be grateful if the HKMA would clarify whether or not "transfer bookings" is a subset of the general scope of Phase 1 interim reporting or it has a different scope to Phase 1 interim reporting.

3. Transitional Arrangements

(a) Back loading

The industry welcomes a one month extension to the grace period such that reportable transactions will only be required to be reported on a T+2 basis from 9 December 2013.

The industry also welcomes the HKMA's revised proposal under Appendix 2 of the HKMA's Letter. We understand from the revised proposals that prior to 8 December 2013, a Licensed Bank is required to report only the latest post trade event (i.e. the position as of the reporting date) with respect to reportable transactions that are (a) outstanding as of 5 August 2013 and/or (b) entered into between 5 August 2013 and 8 December 2013. This alternative proposal would be consistent with the approach taken by the US and Japan.

Nevertheless, the industry is still facing considerable system constraints and would be grateful if the HKMA would consider allowing during the period from 5 August 2013 to 8 December 2013 for Licensed Banks to report only those transactions that are "alive" as of the reporting date and not historical transactions.

(b) Trade report reconciliation – data matching

With the evolving developments of trade reporting mandates in different jurisdictions, the industry supports a “one-sided reporting” regime with the option for non-reporting parties to voluntarily report their transactions. However, the industry recognises the HKMA’s objective of maintaining data accuracy and integrity of the HKMA -TR records by relying on a two-party reporting model. We remain concerned that high volumes of ‘false positives’ impair the quality and control objectives of the HKMA, increase turn-around times and costs for firms and potentially duplicate existing controls related to bi-lateral confirmation and reconciliation processes.

Notwithstanding the above, we acknowledge the HKMA's preferred approach for Phase 1 and long term mandatory reporting and are committed to supporting the implementation of the trade linking and matching model. To assist parties in meeting the objectives and to improve efficiency, we request the following be considered for both Phase 1 and longer term mandatory trade reporting should the HKMA proceed with the two-party reporting model:

1. We propose HKMA-TR to only match trades where both parties have mandatory reporting obligations by adopting rule-based matching logic.

2. In order to allow for timing differences in submissions where both parties have an obligation to report, we propose that trade linking and matching and associated exception management reports are triggered no earlier than T+2 in respect of each reportable business event.

3. To assist reporting firms with resource planning in support of the new processes and to provide opportunities for collaboration in making the process as efficient as possible, we request the HKMA provides further opportunity for reporting firms to participate in dedicated information sessions/workshops set up to address and detail the proposed functionality, matching rules and associated user interfaces for performing trade linking and matching and exception handling processes. This should be supplemented by the preparation of detailed user interface guides.

(c) Unique Trade Identifier ("UTI")

The industry supports the making the use of UTI mandatory where these are available.

Conclusion

The industry welcomes and supports the pragmatic approach set out in the Phase 1 proposals and the clarifications in the HKMA's Letter. We believe the Phase 1 proposal is more aligned with international standards and provides greater certainty. We have highlighted a number of concerns and suggested alternative proposals and should be grateful if the HKMA would consider such alternative proposals.

We appreciate that finding a solution which balances the information desired by the regulators and the level of detail firms can provide in the short-to-medium term is a significant challenge. The industry would value the opportunity to meet with the HKMA as soon as possible to discuss Phase 1 in further detail. ISDA and its members look forward to further the dialogue with HKMA on this subject matter.

If you have any questions on this letter, please do not hesitate to contact Jeffrey Kan (jkan@isda.org).

Yours faithfully

Jeffrey Kan
Director of Infrastructure Management, Asia Pacific
ISDA