ISDA® Safe, Efficient Markets

APAC Monthly Update

November 2011

APAC Monthly Update summarizes important regulatory developments, meetings, committee activities and conferences in the region.

Regulatory Activities

On November 8, ISDA met with the Malaysian Securities Commission to discuss the amended Capital Markets and Services (Amendment) Act 2011 and other global issues.

On the same day, ISDA held a CCP training session with BNM to highlight the issues surrounding central clearing.

On November 14, ISDA made a presentation in Manila to Deputy Governor/Head of Treasury of Bangko Sentral ng Pilipinas (the Philippine central bank) on global regulatory reform of derivative markets.

On November 16, ISDA and ASIFMA held a Q&A session in Hong Kong with Marisa Lago, Assistant Secretary, International Markets and Development, US Department of the Treasury, focusing on Asian capital market regulation and reform.

On November 23,

- ISDA met with Julia Leung, Undersecretary of the Treasury, Hong Kong to discuss European sovereign CDS questions.

- ISDA held a call with the Australian regulators to discuss the Australian Financial Market Infrastructure Reform proposals.

- ISDA attended the SFEMC Synthetic Bond Taskforce meeting to discuss the documentation requirements and details for such a product.

On November 25, ISDA had a call with Perbadanan Insurans Deposit Malaysia (PIDM) to discuss the outstanding netting issues in Malaysia.

On November 29,

- ISDA wrote a letter to the President of the Legislative Council ("LegCo") in Hong Kong about an amendment proposed by a LegCo member in relation to the Securities and Futures (Professional Investor) Rules (Cap 571D). In the letter, ISDA urges the LegCo to consider the potentially damaging consequences of the proposed amendment. The proposal was discussed at the LegCo meeting on 30 November and was rejected by the majority of the LegCo members.

- ISDA made a closed-door presentation on implementation of G20 commitments in Asia to senior derivative regulators from Asia Pacific and to regulators from the CFTC, the NY FED and the Chicago FED.

On November 30, ISDA participated in a panel on Dodd Frank Regulation at an FIA Asia Conference, with CFTC Commissioner O'Malia one of the panelists.

Committee/Working Group Activities

On November 11, ISDA held its Commodities Working Group Meeting. Topics discussed included the determination of ring prices in the London Metals Exchange, an update on the new ICCC rules of arbitration, the revised regulatory framework for transacting commodity derivatives with SoEs in China and an update on the Sub Annex A.

L&R SA meeting

On November 24, ISDA held its monthly L&R meeting in Singapore. At the meeting, ISDA briefed members on the latest regulatory and documentation developments in this region. Topics discussed regarding South Asia included the Australian discussion paper on Handling and Use of Client Money in relation to OTC derivatives, an update on the draft response to the Australian Financial Market Infrastructure Regulation, the Reserve bank of New Zealand's consultation paper on the implementation of Basel III, RBI's circular on Comprehensive Guidelines on OTC Foreign Exchange Derivatives – Foreign Currency – INR Swaps, the new banking regulator in Indonesia, update on ISDA's trip to KL, ISDA's submission to the SC on the Capital Markets and Services (Amendment) Act 2011, an update on the FATCA Market Education Call, update on use of arbitration under an ISDA MA and ISDA's effort in standardizing the CSA.

L&R NA meeting

On November 29, ISDA held its monthly L&R meeting in Hong Kong. At the meeting, ISDA briefed members on the latest regulatory and documentation developments in this region. Topics discussed regarding North Asia include SAFE's new circular on RMB FX combined options, CBRC's consultation on new measures on liquidity management of commercial banks, HKMA's report on logistical and technical arrangements for reporting of OTC derivatives transactions to Hong Kong trade repository, and the HKMA and SFC consultation paper on the proposed regulatory regime for OTC derivatives market and the related ISDA submission.

Market Infrastructure

On November 15, ISDA held a APAC Credit Derivatives Operations Working Group meeting to address the latest operations development in India

On November 17, ISDA held a APAC Equity Derivatives Operations Working Group meeting to address the counterparty on-boarding issue, the documentation of local taxes in China H-stock, MSCI swap and Pan-asia interdealer swap.

On November 18, ISDA held a APAC Implementation Group meeting to discuss the trade repository development in the region.

On November 21, ISDA held a APAC Interest Rates Derivatives Operations Working Group meeting to address a number of floating rate options draft for KRW, INR, AUD, CNY , the replacement of a NZD rate page and also the electronic confirmation format of onshore CNY swaps.

Regulatory Developments

Australia:

Financial Market Infrastructure Reform Proposals

Contact: Keith Noyes (knoyes@isda.org) / Jacqueline Low (jlow@isda.org) / Cindy Leiw (cleiw@isda.org)

The Council of Financial Regulators has issued a consultation paper on proposals to enhance the supervision of Australia's critical financial market infrastructure (FMI). The proposals include new powers to require systemically-important market infrastructure to have key aspects of their operations located in Australia, and overseen by "fit and proper" persons. For example: the Council proposes that if the systemic importance of a facility increases, such as with a CCP, the CCP may be required to locate its default resources and margin funds in Australia.

The proposal also increases the power of regulators to intervene in the event of an FMI experiencing substantial difficulties. The Council proposes that either ASIC (in the case of an AML) or RBA (in the case of a CFSL), in consultation with the Treasurer, appoint a statutory manager. This statutory manager would seek to protect financial stability through the continuation of the FMI's services. In an extreme example of a shortfall of assets to meet obligations as a result of an insolvency, the statutory manager may cancel or suspend obligations (e.g. a CCP clearing member failing in a period of extreme market volatility). ISDA will submit a comment to the Council by the December 2 deadline.

Implementing Basel III Liquidity Reforms in Australia

Contact: Keith Noyes (knoyes@isda.org) / Cindy Leiw (cleiw@isda.org)

On November 16, APRA released a discussion paper and draft on Prudential Standard APS 210 Liquidity (APS 210). APS 210 aims to ensure that an authorized deposit-taking institution (ADI) adopts prudent practices in managing its liquidity risks and maintains an adequate level of liquidity to meet its obligations in times of stress. An ADI must have (i) a risk management framework to manage, measure and monitor liquidity risk that is commensurate with the nature, scale and complexity of the institution; (ii) maintain a portfolio of high-quality liquid assets sufficient in size to enable the institution to withstand a severe liquidity stress; and (iii) maintain a robust funding structure appropriate for its activities. APRA proposes to introduce the Basel III liquidity reforms with only minor modifications. These modifications relate to items where national supervisory discretion is allowed or where clarification is required for Australian circumstances.

APRA is proposing that APS 210 be strengthened by requiring the operational independence of a liquidity risk management oversight function, with the skills and seniority to challenge liquidity management practices when appropriate, a formal role for internal audit or equivalent independent function in relation to liquidity risk management and a requirement that the Board articulate its tolerance for liquidity risk. ADIs must also have a process that explicitly quantifies liquidity costs and benefits and appropriately

allocates these costs and benefits to the business and product. ADIs with retail deposits must have in place a retail run plan that would focus on paying out customers as soon as possible.

For the Liquidity Coverage Ratio, APRA will exercise its national discretion on (i) the treatment of self-managed superannuation funds (SMSFs) as retail customers; (ii) an additional retail deposit category for high run-off less stable deposits; (iii) run-off rates for various contingent funding obligations; (iv) recognition of head office liquidity support for foreign bank branches in Australia under certain conditions; and (v) recognition of New Zealand dollar liquid assets nominated by the Reserve Bank of New Zealand. For example: APRA proposes a run-off rate of 10% and 30% for less stable deposits. Where an ADI has a material banking subsidiary in a jurisdiction that does not implement Basel III, APRA proposes to apply the cashflow assumptions in draft APS 210. APRA also proposes to recognized a committed funding line from head office of a foreign bank branch for inclusion in the branch's cashflow from day 16 of the LCR scenario. The degree of head office support allowed will be approved by APRA on a case-by-case basis.
For the Net Stable Funding Ratio (NSFR), APRA proposes for debt securities a 10% Required Stable Funding (RSF) factor will be applied. For self-securitizations, a 65%, 85% or 100% RSF factor will apply depending on the underlying loans.

Australia will follow the internationally agreed timetable and implement the Liquidity Coverage Ratio by January 1, 2015 and the NSFR by Jan 1, 2018. Following the submissions received, APRA intends to issue a final APS 210 in mid-2012 and qualitative requirements will come into effect immediately following the release of the final APS 210. Deadline for submissions is February 17, 2012.

Discussion paper on client money in OTC Derivatives
Contact: Keith Noyes (knoyes@isda.org) / Jacqueline Low (jlow@isda.org) / Cindy Leiw (cleiw@isda.org)

On November 19, the Australian Treasury released a discussion paper on Handling and Use of Client Money in Relation to Over-The-Counter (OTC) Derivatives Transactions. The purpose of the paper is to discuss the issues relating to the holding of client money in connection to OTC derivatives transactions and to review whether client monies provisions of the Corporations Act 2001 (the Act) provide sufficient protection for investors. This paper only applies to retail clients (as identified in section 761G of the Act) and excludes wholesale clients.

The paper seeks comments on four reform options:

(i) Restriction of the use of client money: A legislative requirement would be inserted into current law to restrict or prohibit the ability of client money from being used for margining of a hedging transaction by a licensee.
(ii) Adopt the UK approach: In the UK, client money rules require companies to act as trustee in respect of client money it holds and to ensure such money is held separately from its own funds and is provided for in the Client Assets Sourcebook (CASS). Recently, FSA amended its rules to prevent investment firms from using 'title transfer collateral arrangements' with retail clients, hence, stopping firms from treating client money as their own working capital. CASS also specifies where companies are allowed to deposit client money. If companies do not deposit client money with a central bank, they are obliged to exercise all due skill, care and diligence in selecting, appointment and periodic review of the credit institution, bank or qualifying money market fund where the client money is deposited. CASS also requires a firm to keep records and accounts, such that it may distinguish client money held for one client from any other client and from the firm's own money. Also, under CASS, when a firm opens a client bank account, it must give written notice to the bank requesting the bank to acknowledge that the firm is acting as a trustee.

(iii) Impose a statutory trust fund: to provide clarity on the interpretation of certain aspects of the current law such as, whether a licensee use the client money for hedging its own position. A possible reform option is to impose a comprehensive statutory trust which would prevent a licensee from using a client's money to hedge its own position in derivatives.
(iv) Adopt segregated individual accounts: A reform option to require individual client monies be kept and maintained in segregated accounts.

The future reform, subject to stakeholder's views, may potentially be a mix of a single reform option or a combination of the four reform options. The current law allows a licensee to use a client's money to meet its obligations incurred in connection with margining, guaranteeing, securing, transferring, adjusting or settling dealings in derivatives (including dealings on behalf of people other than the client). Deadline for submission is Jan 27, 2012.

Prudential Standard APS 121 Covered Bonds
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The Australian Prudential Regulation Authority (APRA) has released a discussion paper together with a draft of Prudential Standard APS 121 Covered Bonds (APS 121), on its proposals to introduce a new prudential standard for Authorized Deposit-Taking Institutions (ADIs) that issue covered bonds. The discussion paper and draft APS 121 reflect the recent amendments to the Banking Act 1959, which allows ADIs to issue covered bonds. The discussion paper and draft APS 121 aim to ensure ADIs adopt prudent practices when issuing covered bonds and managing risks associated with exposure to a covered bond special purpose vehicle. For example, the Board and senior management of an ADI would be expected to demonstrate due diligence in assessing the risks and consequences, under stress scenarios, of issuing covered bonds.

APRA also proposes requiring issuing ADIs to maintain certain registers for prudential purposes and such registers would provide a clear record of those assets that have been provided as collateral to covered bond holders and other parties. Additionally, an ADI may not issue covered bonds if the combined value of Australian assets in cover pools securing those covered bonds exceed 8% of the value of the ADI's assets in Australia, or such percentage as prescribed in the regulations. Following consideration of submissions received, APRA will finalize APS 121, with the view to implement in early 2012.

China:
New regulator heads
Contact: Keith Noyes (knoyes@isda.org) / Jing Gu(jgu@isda.org)

China appointed new heads to its top banking, securities and insurance regulators on October 29. Shang Fulin, former chairman of the China Securities Regulatory Commission (CSRC), has been appointed as chairman of the China Banking Regulatory Commission. Guo Shuqing, former chairman of the China Construction Bank has replaced Shang as chairman of CSRC. Xiang Junbo, former chairman of the Agricultural Bank of China, has been appointed as chairman of the China Insurance Regulatory Commission.

Liquidity coverage in commercial banks
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China Banking Regulatory Commission (CBRC) has released a consultation draft of new measures on liquidity management of commercial banks, including measures specifically for wholly-owned locally incorporated banks (WFO banks). The consultation paper introduces the Liquidity Coverage Ratio (LCR)

and Net Stable Funding Ratio (NSF) as the new liquidity indicators and provides guidance on the calculation of those ratios. Below are a few points to note:

Banks are required to have LCR of not less than 100%; NSF of not less than 100%; a loan-to-deposit ratio not exceeding 75%; and a liquidity ratio of not less than 25%. Banks will be required to calculate the above ratios using the consolidated financial information of their groups. Banks will be required to assess their liquidity risk on a consolidated basis and to consider liquidity risk in respect of particular currencies separately if these foreign denominated liabilities account for more than 5% or more of its total liabilities.

Banks will be required to submit quarterly stress test reports to CBRC. Additionally a WFO bank will be subject to additional reporting requirements in the event that its domestic RMB and foreign currency assets are less than its domestic RMB and foreign currency liabilities or the ratio of its cross-border net capital outflow within the group exceeds 25%. A Chinese branch of a foreign bank will be required to report to the CBRC within 2 business days if the ratio of its cross-border net capital outflow exceeds 50%. The new rules are expected to take effect from January 1, 2012 and will provide a grace period for banks to meet the LCR by end-2013 and NSF by end-2016.

RMB FX combined options
Contact: Keith Noyes (knoyes@isda.org) / Jing Gu (jgu@isda.org)

The State Administration of Foreign Exchange (SAFE) issued a circular on November 11 which allows banks in China to offer RMB FX combined options to clients for the purpose of increasing the number of instruments available to hedge exchange risks.

According to the circular, "RMB FX combined options" means two European options sold and purchased by a client concurrently, both of which share the same currency, term and notional amount. The circular provides that the option fee of the option sold by the client must not be higher than that of the option it purchases. The circular requires a bank to verify the underlying commercial transaction and ensure that the client complies with the hedging principle when offering RMB FX combined options. According to the circular, when exercising the options, the client should have priority; therefore, if the client elects to exercise the option it buys, the bank should give up exercising its option. If both the client and the bank decide not to exercise the options, the client may conduct a RMB FX spot transaction after presenting the relevant documents evidencing the underlying commercial transaction. Banks licensed to trade RMB FX options in the inter-bank market and trade the same with clients, are allowed to offer RMB FX combined options to clients; and the relevant rules on RMB-FX options issued in February 2011 will also apply to RMB FX combined options.

India:
Modifications to Comprehensive Guidelines on Derivatives
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The Reserve Bank of India (RBI) has issued a circular on the modifications made to the Comprehensive Guidelines on Derivatives, effective January 1, 2012. In the revised guidelines, market-makers may offer structured derivative products to users as long as they do not contain any derivative instrument as underlying, and have specifically been permitted by RBI. FX forward contracts, forward rate agreements, plain vanilla interest rate caps and floors, plain vanilla put and call options, interest rate swaps and currency swaps including cross-currency swaps may be treated as generic derivative products. Instruments which are a combination of either a cash instrument and one or more generic derivative products or an instrument that is a combination of two or more generic derivative products will be treated

as a structured derivative product. The guidelines will be applicable to all permitted generic and structured derivative products but will exclude FX forward contracts.

Banks will no longer need to obtain a Board resolution authorizing an official to undertake a derivative transaction on behalf of the company. However, before offering any derivative product to a client, a bank should obtain a Board resolution which (a) explicitly mentions the limit assigned by the corporate to the bank, netting of long and short positions will not be allowed for the purpose of compliance with this limit; (b) states the names and designation of the company officials authorized to undertake particular derivative transactions for the company; (c) states the names of people to whom the transactions should be reported by the bank and these personnel should be distinct from those authorized to undertake the transactions; and (d) states the specific products that the company can transact in by the designated personnel. This Board resolution must be signed by a person other than the persons authorized to undertake the transactions.

Another modification is that a bank is required to obtain a Board resolution from a corporate which wants to deal in structured derivative products that states the corporate has a Risk Management Policy in place that has been approved by its Board. This risk management policy should also contain the designation of personnel authorized to undertake the transactions and limits per transaction assigned to them and a requirement that the assignment of limits to said personnel would be on a per transaction basis. The policy should also contain guidelines on risk identification, measurement and control. These guidelines and procedures are to be followed with respect to revaluation and monitoring of positions and accounting policy and disclosure norms to be followed for derivatives transactions. The policy should also have a requirement to disclose MTM valuations appropriately, ensure separation of duties between front, middle and back office and a mechanism of reporting data to the Board, including financial position of transactions etc. Banks may not undertake a structured derivative transaction with users until they are provided with a Board or equivalent forum resolution stating they have in place a Board-approved Risk Management Policy and contains the details as above.

Another modification is that banks will require its compliance officer to submit a monthly report to the Board of Directors of the bank on compliance failures, if any, during the preceding month and consequential losses and regulatory action and the steps taken to avoid such a recurrence.

Hong Kong:
Trade repository report
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On November 8, the Hong Kong Monetary Authority (HKMA) issued a report on the consultation on logistical and technical arrangements for reporting to the Hong Kong trade repository. The report responded to the comments raised by the industry on approach, process, format and contents. HKMA intends to align the reporting templates with the global trade repository template. Though the Hong Kong trade repository intends to apply the forthcoming global legal entity identifier (LEI), a local LEI will be introduced as a placeholder. The repository does not support snapshot reporting and expects the industry to report by lifecycle. Backloading is required.

New Zealand:
Implementation of Basel III
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On November 8, the Reserve Bank of New Zealand issued a consultation paper, Implementation of Basel III Capital Adequacy requirements in New Zealand. The paper focuses on the definition of capital and the leverage ratio. The proposals in it will take effect from January 1, 2013 and will not be phased in as

suggested by the Basel guidelines, unless there are compelling reasons for a phased in approach. The total minimum capital requirement remains unchanged at 8%. Tier 1 capital has been increased from 4% to 6%.

The Reserve Bank intends to consult on other elements of Basel III capital in 2012, such as the conservation buffer, countercyclical buffer and counterparty credit risk requirements. The Reserve Bank requests all locally incorporated banks to complete and submit a quantitative impact assessment (QIS) of the proposals. Some of the changes are listed below:

Common Equity Tier 1 (CET1): recognition of the part of partially paid in shares that has been paid, will no longer be recognized. Retained earnings will no longer be required to be audited or reviewed, removing the "off-quarter" and "on-quarter'" distinction, and will be recognized in CET1. The current treatment of changes in revaluation reserves and foreign currency translation reserves and the defined benefit superannuation schemes will be retained and counted towards CET1 under accumulated other comprehensive income and other disclosed reserves. Minority interests will not be recognized in CET1;
Additional Tier 1 (AT1): the only hybrid instrument allowed would be perpetual non-cumulative fully-paid up preference shares. These shares cannot be callable and can only contribute up to 25% of Tier 1 capital. The Reserve bank will adopt the Basel III requirements for AT1 minority interests;
Tier 2: the Reserve Bank will allow instruments that meet the 5yr minimum requirement but not the right to exercise a call as this would provide the Reserve Bank some flexibility in forming a view on whether to grant supervisory approval for a call option. Minority interests will not be recognized in Tier 2 capital.
The Reserve Bank will adopt 10 of the 13 regulatory adjustments.

The Reserve Bank does not propose to implement a leverage ratio requirement as it believes a one-size-fits-all aspect is poorly targeted and may give a misleading picture of risk in some situations and may undermine the value of the existing risk-based approach to the calculation of required capital. Deadline for submissions is Jan 27, 2012. After submissions, the Reserve Bank will then release draft requirements for consultation in the first quarter of 2012.

Submission

ISDA made the following submissions in November:

- November 3, ISDA submission to Securities Commission Malaysia on Capital Markets and Services (Amendment) Act 2011.
- November 28, ISDA submission to The Treasury on Council of Financial Regulators Discussion Paper 'Review of Financial Market Infrastructure Regulation'.
- November 30, ISDA submission to The Hong Kong Monetary Authority and Securities and Futures Commission on the joint consultation paper on the proposed regulatory regime for Hong Kong's OTC derivatives market

Upcoming committee and working group meetings/conferences

Meetings:

APAC IRD Operation Working Group Meeting	Dec 1
APAC Collateral Operation Working Group Meeting	Dec 5
L&R Advisory Meeting	Dec 6
PRC Members Meeting	Dec 6
APAC Equity Operation Working Group Meeting – Singapore	Dec 15

Indian Members Meeting – Mumbai	Dec 15

Conferences:

Understanding the ISDA Master Agreements and Credit Support Documents Conference – Mumbai	Dec 12
Documenting and Confirming Credit Derivative Transactions Conference – Mumbai	Dec 13

ISDA APAC Monthly Update
Please direct comments and questions about APAC Monthly Update to Donna Chan, dchan@isda.org
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