

APAC Monthly Update

September 2013

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

Regulatory Activities

China:

On September 11, ISDA met with the People's Bank of China to discuss local law issues relating to trade reporting and central clearing.

Singapore:

On September 24, ISDA met with the Monetary Authority of Singapore (MAS) to discuss regulatory developments related to swap execution facilities (SEFs) and trade reporting.

On September 30, ISDA made a presentation to the ASEAN Working Committee on Capital Market Development on OTC derivatives, capital flows and ISDA documentation.

Committee/Working Group Activities

North Asia L&R

On September 30, ISDA held its North Asia L&R meeting in Hong Kong. Topics discussed include an update on ISDA's recent trip to China, the interpretive rules issued by the China's Supreme Court on September 5 relating to the Enterprise Bankruptcy Law, the HKMA circular dated September 11 on Interim Reporting Requirements for OTC derivative transactions and the enrolment status of HKTR membership, the Joint Supplemental Consultation Conclusions on the OTC Derivatives Regime in Hong Kong published by the SFC and HKMA on September 6, the FAQs on Basel III implementation published by HKMA on September 4 and the FSC's authorization of KRX as an OTC derivatives central counterparty on September 13.

ISDA also updated members on the consultation paper released by ASX on August 28 on Draft Operating Rules for the ASX 24 Exchange Traded Derivatives and OTC Interest Rate Derivatives Client Clearing Service, Article 25 of EMIR and application for ESMA recognition of CCIL, and the impact of the NDF market on the Indian onshore spot market. The meeting also considered the MAS Consultation Paper released on September 20 on Amendments to Corporate Governance Regulations, the MAS Consultation Paper released on September 17 on Draft Regulations pursuant to the SFA and FAA (regarding the sale and marketing of listed and unlisted investment products), ISDA's publication of the 2013 Multilateral Amendment Agreement for Certain Swap and other Transactions (Rates-MAA) and MAS' response dated August 23 to ISDA's letter on CFTC NAL 13-41.

ISDA also provided an update on recent ISDA efforts including ISDA and Markit's publication of the Cross-Border Representations Letter on ISDA Amend, the draft Discontinued Rates Maturities Protocol,

the Working Group on Legal Opinions for Cleared Derivatives, the ISDA and BBA response to ESMA Draft RTS on contracts having a direct, substantial and foreseeable effect within the European Union and the non-evasion provisions of EMIR, the Cross-Border Swaps Representation Letter for U.S. Banks published by ISDA on September 16, the public webinar hosted by ISDA on September 13 on Cross-Border Representations on ISDA Amend, the Dodd-Frank March 2013 Protocol (DFP2) to EMIR Top-Up Agreement published by ISDA on September 10, the ISDA Arbitration Guide published by ISDA on September 9 and the Form of Change of Status Notice for the ISDA 2013 EMIR NFC Representation Protocol also published by ISDA on September 9.

ISDA also provided an update on global developments including the FSB reports to G20 Leaders on September 5 on financial regulatory progress, the FSB report dated September 2 on Progress and Next Steps Towards Ending “Too-Big-To-Fail”, the FSB report dated September 2 on OTC Derivatives Reforms Progress, the BCBS Report dated August 27 to G20 Leaders on monitoring implementation of Basel III regulatory reforms, ESMA’s advice dated September 3 to the European Commission on Equivalence of Non-European Derivatives Rules, the final document released by BCBS-IOSCO on September 2 on margin requirements for non-centrally cleared derivatives, the Report to G20 dated August 30 issued by the OTC Derivatives Regulators Group and the Assessment Methodology for the Key Attributes of Effective Resolution Regimes for Financial Institutions dated August 28 published by the FSB.

South Asia L&R

On September 26, ISDA held its South Asia L&R meeting in Singapore. Topics discussed include an update on ISDA’s recent trip to China, the interpretive rules issued by the China’s Supreme Court on September 5 relating to the Enterprise Bankruptcy Law, the HKMA circular dated September 11 on Interim Reporting Requirements for OTC derivative transactions and the enrolment status of HKTR membership, the Joint Supplemental Consultation Conclusions on the OTC Derivatives Regime in Hong Kong published by the SFC and HKMA on September 6, the FAQs on Basel III implementation published by HKMA on September 4 and the FSC’s authorization of KRX as an OTC derivatives central counterparty on September 13.

ISDA also updated members on the consultation paper released by ASX on August 28 on Draft Operating Rules for the ASX 24 Exchange Traded Derivatives and OTC Interest Rate Derivatives Client Clearing Service, Article 25 of EMIR and application for ESMA recognition of CCIL, the RBI circular dated September 4 on Risk Management and Inter Bank Dealings on cancellation and rebooking of forward contracts, RBI’s Annual Report 2012 – 2013 and the impact of the NDF market on the Indian onshore spot market.

The meeting also considered the MAS Consultation Paper released on September 20 on Amendments to Corporate Governance Regulations, the MAS Consultation Paper released on September 17 on Draft Regulations pursuant to the SFA and FAA (regarding the sale and marketing of listed and unlisted investment products), ISDA’s publication of the 2013 Multilateral Amendment Agreement for Certain Swap and other Transactions (Rates-MAA) and MAS’ response dated August 23 to ISDA’s letter on CFTC NAL 13-41.

ISDA also provided an update on recent ISDA efforts including ISDA and Markit’s publication of the Cross-Border Representations Letter on ISDA Amend, the draft Discontinued Rates Maturities Protocol, the Working Group on Legal Opinions for Cleared Derivatives, the ISDA and BBA response to ESMA Draft RTS on contracts having a direct, substantial and foreseeable effect within the European Union and the non-evasion provisions of EMIR, the Cross-Border Swaps Representation Letter for U.S. Banks published by ISDA on September 16, the public webinar hosted by ISDA on September 13 on Cross-Border Representations on ISDA Amend, the Dodd-Frank March 2013 Protocol (DFP2) to EMIR Top-Up

Agreement published by ISDA on September 10, the ISDA Arbitration Guide published by ISDA on September 9 and the Form of Change of Status Notice for the ISDA 2013 EMIR NFC Representation Protocol also published by ISDA on September 9.

ISDA provided an update on global developments including IOSCO's Strategic Plan for 2015 -2000 presented at the IOSCO Annual Conference, the updated version of the EMIR implementation timetable published by ESMA on September 13, the FSB reports to G20 Leaders on September 5 on financial regulatory progress, the FSB report dated September 2 on Progress and Next Steps Towards Ending "Too-Big-To-Fail", the FSB report dated September 2 on OTC Derivatives Reforms Progress, the BCBS Report dated August 27 to G20 Leaders on monitoring implementation of Basel III regulatory reforms, ESMA's advice dated September 3 to the European Commission on Equivalence of Non-European Derivatives Rules, the final document released by BCBS-IOSCO on September 2 on margin requirements for non-centrally cleared derivatives, the Report to G20 dated August 30 issued by the OTC Derivatives Regulators Group and the Assessment Methodology for the Key Attributes of Effective Resolution Regimes for Financial Institutions dated August 28 published by the FSB.

Operations/Market Infrastructure

On September 2, ISDA held its APAC Portfolio Reconciliation sub working group meeting to discuss the portfolio reconciliation issues in the region.

On September 5, ISDA held its APAC Interest Rates Derivatives Operations Working Group meeting to brief members on the latest regional developments on rates. The group also discussed the addition / amendment of floating rate options/matrices, the confirmation practice, the upcoming changes in certain rate fixings and the treatment of a country business day.

On September 12, ISDA held its APAC Equity Derivatives Operations Working Group meeting to discuss the confirmation matching requirements in US and Europe, the dividend adjustment of volatility/ variance swap, the practice of executing a confirmation and the latest update of adding certain disclaimers or representations in a confirmation.

On September 24, ISDA held its AEJ Data and Reporting Compliance – reporting nexus sub-group meeting to discuss the trade reporting matters in the region.

Members' / Other Activities

On September 12, ISDA hosted a public webinar on the Rates-MAA to update members and market participants on what need to know about the Rates-MAA.

On September 19, ISDA gave a talk to the Risk Management Association (Singapore Chapter) on an in-depth look at clearing and the challenges faced by the industry.

On September 25 and 26, Keith Noyes, Cindy Leiw and Erryan Abdul Samad of ISDA spoke at the 4th Pan-Asian Regulatory Summit hosted by Thomson Reuters in Singapore.

Regulatory Developments

Australia: ASX consults on operating rules for exchange-traded derivatives and OTC interest rate derivatives client clearing

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

On August 28, the Australian Securities Exchange (ASX) released a consultation paper on the Draft Operating Rules for the ASX 24 Exchange Traded Derivatives and OTC Interest Rate Derivatives Client Clearing Service (the Consultation Paper). This is the first of two consultation papers in which ASX seeks stakeholders' input on the draft Operating Rules for its Client Clearing Service for ASX 24 Exchange Traded Derivatives and OTC Interest Rate Derivatives. Deadline for comments is October 2. Main points of the consultation paper are as follows:

- ASX plans to initially offer 2 different "client account" types: Omnibus Account and Individual Client Account (ICA). A Clearing Participant (CP) may choose whether to offer their Clients one account type or both. The ICA structure is modeled on, but is not the same, as 'LSOC without excess'. ASX plans to offer these two client account structures by March 31, 2014.
- For an Omnibus Account, a Client's positions and collateral are held in a single client account of the CP and ASX calculates initial margin (IM) on the net position in that account. In the event of a CP's default, the IM calculated will be protected from losses on the defaulting CP's house positions and on positions in other client accounts, but it will not be protected from losses of other Clients in the Omnibus Account.
- For Individual client account 'without excess', a Client's positions are segregated from those of other Clients and IM is calculated on the basis of the Client's positions exclusively. The aim is to allow ASX to port Client's positions and associated IM in the event of a CP's default. If the Client's position is not ported, ASX will close out the positions and return the associated IM to the Client directly, less any losses, costs and expenses attributable to closing out the positions. Collateral is not segregated at the ICA level and therefore collateral held by the clearing house in excess of the IM requirement with respect to the Client's position cannot be ported with the positions and associated IM.
- Client positions will be netted within each Omnibus Account or ICA for the purposes of calculating the IM requirement with respect to the account. Collateral will be posted to ASX as margin by CP and not by the Clients directly. As CP will post collateral to ASX in respect of a single IM obligation for all client accounts maintained by them, ASX will not be able to determine which non-cash collateral (if any) came from which client. Upon a CP default, ASX will liquidate any non-cash collateral in order to realize the IM requirement calculated by ASX in respect of each client account. The cash value of IM that ASX ports or returns in respect of each client account will not include any portion of the value of excess collateral. Excess collateral may be used by ASX to offset the losses incurred upon close-out or termination of positions in any client account and any shortfalls in the liquidated value of non-cash/ cross-currency collateral as a consequence of insufficient collateral haircuts. Under ASX's account structure, end-of-day payments to and from each CP's Client Clearing Account are netted to a single flow per currency per day. This means each CP has only one client collateral account with ASX, irrespective of how many Omnibus and ICA it has.
- Upon a CP default, ASX will communicate the details of the positions in the account to any Alternate CP(s) nominated by the Client and will request confirmation from the Alternate CP if it accepts the positions. An Alternate CP will have 48 hours after ASX's declaration of default to confirm its acceptance of Client positions. If the Alternative CP agrees to accept all positions in a client account, ASX will transfer all positions, and the cash value of IM calculated by ASX in respect of the account to the Alternate CP. The positions transferred will include any positions recorded in the client account since the defaulting CP's last end-of-day IM settlement. It is possible that the Alternate CP may be credited with an amount of collateral that is less than the IM requirement for those positions. In such an instance, the Alternate CP will be required to make up the difference to ASX. If an Alternate CP does not confirm within 48 hours, ASX will close-out the client positions and return directly to the Client or the defaulting CP's external

administrator the cash value of IM calculated by ASX for the account, less any losses, costs and expenses attributable to closing out of those positions.

- Under an Omnibus account, clients will not have the ability to nominate an Alternate CP. Upon a CP default, ASX may in its discretion transfer the positions of all Clients holding positions in the account, the associated IM, to a non-defaulting CP, provided that all Clients holding positions in the account agree to port to the same CP and that CP confirms acceptance of all positions in the account.
- Client Protection Model (the Model) refers to the legal relationships established between a Client, its CP and ASX. The Model recognizes that a CP is acting as agent for its Client. The CP remains fully liable as principal to ASX in connection with its clients' contracts. ASX agrees to not take any action against the Client personally for the performance of any obligation owed by the CP. A Client may enforce its rights and entitlements against ASX directly on one of three bases: (i) as a party to cleared contracts; (ii) as the party on whose behalf the CP holds those rights and entitlements; or (iii) as a "person aggrieved" by the failure of any person who is under an obligation to comply with or enforce the Operating Rules. In the ordinary course of events, ASX will deal only with the CP in relation to position registration and maintenance. Only in the event of a CP's default, will Clients of the CP be entitled to communicate directly with ASX.
- The OTC Client Clearing Service will only be available initially to 'wholesale clients' (as defined in the Corporations Act) connected with Australia. A Client must be connected to Australia in that they are: (a) incorporated/ carrying on business in Australia; or (b) acting on behalf of an entity or entities, in respect of contracts to be registered in the client account maintained for the Client, that are incorporated / carrying on business in Australia.
- ASX proposes to clarify that positions held by a CP on behalf of a Client that is a related body corporate, where the Client acts, directly or through a chain of entities in the same corporate group, as agent for unrelated end user clients, these positions must be designated as 'Client' positions; and may be allocated by the CP to either an Omnibus Account or an ICA; and where the Client acts in any other capacity (i.e. as principal or as agent for other related bodies corporate only), these positions may be designated as 'House' or 'Client' positions. In such an instance, if it is designated as 'House' positions, it must be allocated to the House Account and if it is designated as 'Client' positions, it must be allocated to an ICA for each such related entity.
- ASX proposes to require CP to (i) maintain 1 or more Client's Segregated Accounts (outside the clearing facility) for monies the CP receives from Clients; (ii) perform daily and monthly reconciliation of client monies in the Client's Segregated Account(s); and (iii) submit an annual director's declaration and auditor's report.
- ASX proposes to require CP to maintain a separate Client's Segregated Accounts for monies the CP receives from a Clients that is a related bodies corporate where the Client's positions have been designated as 'Client' positions
- The Risk Committee is to comprise of representatives of Clearing Participants and will have an independent, member-elected chairperson.
- ASX proposes initially to require non-cash collateral for IM to be absolutely transferred to it by the CPs, in accordance with existing practice for ASX 24 Exchange Traded Derivatives
- ASX proposes a new Part 11(Security Interest Provisions) of the Futures Rules, that will apply to the acceptance by ASX of property from a CP as IM where ASX is granted a security interest in the property rather than an absolute transfer.

Hong Kong:

HKMA & SFC publish conclusion on regulating derivatives

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On September 6, the Hong Kong Monetary Authority (HKMA) and the Securities and Futures Commission (SFC) jointly published their conclusions on a joint supplemental consultation (the

“Consultation Conclusions”) regarding the proposed scope of activities to be regulated under the new over-the-counter (OTC) derivatives regime, and regulatory oversight of systemically important participants. The HKMA and SFC's proposals in relation to these two areas are already included in some detail in the Securities and Futures (Amendment) Bill 2013 (the "Bill") introduced to the Legislative Council on June 28, 2013. The bill is anticipated to come into effect in early 2014. The Consultation Conclusions explained the regulators' rationale in framing the new regulated activities and summarized their responses to public comments. The new regulated activities, Type 11 RA and Type 12 RA, were proposed to be introduced under Schedule 5 to the Securities and Futures Ordinance (SFO). Type 11 RA would cover the activities of dealers and advisers and Type 12 RA would cover the activities of clearing agents. Additionally, the existing Type 7 RA and Type 9 RA were proposed to be expanded to cover OTC derivatives.

HKMA publishes FAQs on Basel III implementation

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On September 4, the Hong Kong Monetary Authority (HKMA) published a supplementary guidance in the form of Frequently Asked Questions (FAQs) to facilitate a consistent application of the Banking (Capital) Rules and the Banking (Disclosure) Rules (also known as Basel III implementation). These are FAQs on the counterparty credit risk framework under the Banking (Capital) Rules and are intended to be explanatory in nature. They do not seek to introduce any new requirements into, or replace any requirements specified in, the Banking (Capital) Rules. Highlights include:

- When applying to the HKMA for approval to use the Internal Models Method (IMM) approach, an Authorized Institution (AI) should discuss and agree with the HKMA the approach/ methodology for determining and reviewing the stress period.
- The standard supervisory haircut applicable in consequence of a currency mismatch (8%) should be applied to each element of the collateral that is provided in a currency different from that of the exposure.
- The supervisory floors set out in Section 226M are minimum requirements. The actual margin period of risk that should be used in the determination of default risk exposures may be longer than the supervisory minima if the liquidity of the positions concerned warrants it.
- Inter-company transactions between an AI and its subsidiaries subject to consolidation can be excluded from the calculation of the solo-consolidated/ consolidated capital adequacy ratio. These transactions include CVA hedges that are with an internal desk.
- For the purposes of Section 226P(6) paragraph (e) in Formula 23F, as the market convention is to use a fixed recovery rate for CDS pricing purposes, the AI may use this information to calculate the LGD_{MKT} if both a market instrument of the counterparty concerned and an appropriate proxy spread are not available and there is no other information.
- Under Section 226T(1)(e), hedges that depend on cross-default are not eligible CVA hedges.
- It is the primary responsibility of the AI to determine whether a CCP is qualifying. In Hong Kong, the HKMA and the SFC announced in March 2013 their commitment to comply with the PFMI. Therefore AIs can regard CCPs overseen by the SFC as QCCPs for capital adequacy purposes. If a CCP regulator has not made any public statement about its intention to implement the PFMI during 2013, or a CCP regulator has yet to implement the PFMI (regardless of whether a public statement has been made) after 2013, AIs should determine whether a CCP regulated by the CCP regulator is qualifying based on the criteria set out in the definition of “qualifying CCP” in Section 226V(1).
- Although a CCP's documentation may not prohibit client trades from being carried over and continued, other evidence such as the criteria in Section 226ZA(6)(c) is necessary to make this claim.

- The requirement set out in Section 226ZA(6)(a) means that upon insolvency of the clearing member, there is no legal impediment to the transfer of the collateral belonging to the AI to the CCP, to one or more of the other surviving clearing members or to the AI or the AI's nominee.

India: RBI allows exporters and importers to cancel and rebook forward contracts

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On September 4, the Reserve Bank of India (RBI) issued a circular on Risk Management and Inter Bank Dealings. With a view to providing operational flexibility to importers and exporters to hedge their foreign exchange risk, the RBI has reviewed market conditions and decided to allow exporters to cancel and rebook forward contracts to the extent of 50 percent of the contracts booked in a financial year for hedging their contracted export exposures. Additionally importers are now allowed to cancel and rebook forward contracts to the extent of 25 percent of the contracts booked in a financial year for hedging their contracted import exposures.

Korea: KRX clears KRW-denominated IRS

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

On September 11, Korea Exchange (KRX) received authorization on over-the-counter (OTC) derivatives clearing business from the Financial Services Commission (FSC). KRX will be the central counterparty for both exchange traded and OTC market products. The mandatory clearing of KRW-denominated interest rate swaps will come into effect on June 30, 2014. KRX plans to launch their clearing services for KRW-denominated IRS from December 2.

Upcoming committee and working group meetings/conferences

Meetings:

APAC IRD Operations Meeting Call	Oct 2
APAC Legal & Regulatory Advisory Group Meeting	Oct 8
Public Webinar on CFTC Cross-Border Final Guidance	Oct 10
Sydney Members' Meeting	Oct 16
Asian Steering Committee Meeting	Oct 21
North Asia L&R Meeting	Oct 29
South Asia L&R Meeting	Oct 31

Conferences:

2013 ISDA Annual Australia Conference – Sydney	Oct 17
U.S. and European Swap regulations - Who they apply to and how they are addressed by ISDA Protocols and ISDA Amend by Markit – Sydney	Oct 18
U.S. and European Swap regulations - Who they apply to and how they are addressed by ISDA Protocols and ISDA Amend by Markit – Hong Kong	Oct 21
2013 ISDA Annual Asia Pacific Conference – Hong Kong	Oct 22

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

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