

## APAC Monthly Update

**February 2014**

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

### **Regulatory Activities**

#### **New Zealand**

On February 11, ISDA participated in APEC Financial Forum and APEC Business Advisory Committee meetings in Auckland. ISDA was engaged in the capital markets work and presented a study of netting laws and collateral laws across the APEC jurisdictions. ISDA highlighted netting concerns impeding mutual recognition of Asian CCPs and also discussed concerns that have arisen out of the Jakarta courts interpretation of "Law 24" with regard to mandatory use of Bahasa language in financial contracts.

On February 12, ISDA visited the Reserve Bank of New Zealand to discuss NZ regulatory reforms and global regulatory developments.

#### **Taipei**

On February 18, ISDA held a conference in Taipei regarding the U.S. and European swap regulations. A number of regulators from the Banking Bureau, the Securities and Futures Bureau of the Financial Supervisory Commission and the Central Bank of Taiwan attended the conference together with industry participants.

### **Committee/Working Group Activities**

#### **North Asia L&R**

On February 24, ISDA held its L&R meeting in Hong Kong. Topics discussed included the King & Wood Mallesons' memorandum on close-out netting enforceability under Chinese law, SAFE consultation on Regulations regarding Foreign Exchange Control over Cross-border Security, PBOC's notice on mandatory central clearing of RMB interest rate swaps, progress on Hong Kong's regulatory reforms in respect of OTC derivatives, draft letter to KRX on review of clearing house risk management procedures, FATCA and ongoing documentation and the FCA's deadline of 30 April 2014 relating to plans on achieving compliance with EMIR portfolio reconciliation, dispute resolution and compression requirements.

The meeting also discussed the announcement in Australia of its Final Terms of reference for the Financial Inquiry System, CCIL's Consultation Paper on Intra-day Mark to Market margin collection in CCIL's CCP Cleared Segments, RBI's Guidelines on Management of Intra-Group Transactions and Exposures, ISDA's submission to the Indonesian regulators on Indonesian Law No. 24, and the publication of the ISDA 2014 Credit Derivatives Definitions.

## **South Asia L&R**

On February 27, ISDA held its L&R meeting in Singapore. Topics discussed included the KWM memorandum on close-out netting enforceability under Chinese law, the use of ISDA documentation in Vietnamese, FATCA and ongoing documentation and the FCA's deadline of 30 April 2014 relating to plans on achieving compliance with EMIR portfolio reconciliation, dispute resolution and compression requirements.

The meeting also discussed the announcement in Australia of its Final Terms of reference for the Financial Inquiry System, CCIL's Consultation Paper on Intra-day Mark to Market margin collection in CCIL's CCP Cleared Segments, RBI's Guidelines on Management of Intra-Group Transactions and Exposures, ISDA's submission to the Indonesian regulators on Indonesian Law No. 24, major changes to authorized currency for Vietnamese onshore contracts, the discontinuation of IDR VWAP (IDR03) and transitioning process and the publication of the ISDA 2014 Credit Derivatives Definitions.

## **Operations/Market Infrastructure**

On February 13, 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 recent industry operational practice for China clearing.

On February 18 and 25, ISDA held its AEJ Data and Reporting Compliance – reporting nexus sub-group meeting to discuss the reporting nexus matters in the region.

On February 18 and 27, ISDA held its AEJ Data and Reporting Compliance – Asia identifiers sub-group meeting to discuss the application of trade identifiers in Australia, HK and Singapore and the current technological limitations.

On February 24, ISDA held its AEJ Data and Reporting Compliance working group meeting to discuss the trade reporting progress in the region. The meeting also discussed the regulatory updates in HK, Singapore and Australia.

On February 25, ISDA held its APAC Equity Derivatives Operations Working Group meeting to discuss the confirmation matching requirements in US and Europe, the practice of executing a confirmation, the latest updates of adding certain disclaimers or representations in a confirmation, the documentation practice of certain products and the electronic confirmation migration of a vendor.

## **Members' / Other Activities**

### **Hong Kong**

On February 27, ISDA presented on global regulatory reform at the Citibank Investor Conference in Hong Kong.

### **New Zealand Members' Meeting**

On February 12, ISDA held a New Zealand members' meeting in Wellington. Issues discussed included NZ regulatory reform, Australian trade reporting issues faced by NZ banks and global regulatory developments.

## **Regulatory Developments**

### **China:**

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### **Central clearing of RMB IRS starts in July**

On January 28, the Peoples' Bank of China (PBOC) issued a notice to banks regarding central clearing of RMB interest rate swaps. The notice provides that all RMB interest rate swaps referencing 7-day repo, overnight SHIBOR or 3-month SHIBOR which are entered into after July 1, 2014 between financial institutions and have a tenor of no more than 5 years must be submitted to Shanghai Clearing House (SCH) for central clearing, as long as the transactions satisfy SCH's requirements regarding counterparties and contracts.

### **SAFE consults on FX control over cross-border security arrangements**

On February 13, the State Administration of Foreign Exchange (SAFE) has published a consultation draft (Chinese) of the "Provisions for Foreign Exchange Control over Cross-border Security". The regulations are intended to identify the issues subject to foreign exchange control, significantly reduce the types of cross-border security arrangements subject to quantitative limit, and implement a regime using registration as the main regulatory tool and removing all prior approval requirements.

The draft regulations define a "cross-border security" as an undertaking made by an entity which uses its own assets, rights or credits to secure obligations owed by itself or a third party by way of a security whether in the form of a guarantee, mortgage, pledge or other forms recognized under Chinese law. The regulations divide cross-border security into two types according to the nature of the secured obligations: financing and non-financial security. The draft regulations further categorize cross-border security into outbound security, inbound security and other cross-border security based on the registration place of various parties in a transaction and set out different rules accordingly.

For outbound security (i.e., a security arrangement where the security provider is in China and the debtor and creditor/secured party are located outside China):

- financial institutions would not be required to obtain annual quotas for their financing security business, to the extent that the balance amount of the outbound security does not exceed 50% of audited net assets as at the end of the preceding year;
- non-financial institutions would not need to seek prior approval or quota from SAFE for provisions of outbound security;
- certain eligibility requirements (e.g., debt-to-assets ratio and affiliated relationship) would be removed;
- the approval requirement regarding performance of an outbound security would be removed;
- if the secured obligations arise from a derivatives transaction, the derivative transaction entered into by the overseas debtor should be for hedging purpose and should have been duly authorized by its shareholders.
- individuals can provide outbound security by following the same rules as non-financial institutions.

For inbound security:

- the secured obligations must be RMB or foreign currency facilities or credits extended by a PRC financial institution to a PRC non-financial institution;
- the PRC financial institutions can directly receive the payment under the inbound security and, if any currency conversion is necessary, prior approval from SAFE should be sought;
- and

- the performed inbound security would not be subject to the limit of foreign debts that can be borrowed by a non-financial institution, provided that the outstanding principal amount does not exceed its net assets.

The explanatory note of the draft regulations emphasizes that FX exchange control should be delinked from legality and validity of the security contract. Article 30 provides that registration or filing with SAFE is not a condition to the effectiveness of a cross-border security contract. Submission deadline is March 10.

#### **India:**

##### **CCIL consults on intra-day mark-to-market margin collection**

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

On February 18, the Risk Management Department of The Clearing Corporation Ltd. (CCIL) released its Consultation Paper on “Intra-day Mark-to-Market Margin Collection in CCIL’s CCP Cleared Segments”. CCIL currently revalues all the outstanding trades of its members at 12.00pm (noon) using the latest available mark-to-market (MTM) prices/ rates. If there is an increase in MTM margin beyond a threshold (currently set at 50% of Initial Margin), additional margin is collected as intra-day MTM margin. In its Securities, CBLO and Forex Forwards segments, CCIL currently subjects all outstanding trades to MTM margining once at the end of day and re-assesses the applicability of MTM margin again on these trades on an intra-day basis at 12.00pm (noon) the next day.

The Consultation Paper proposes to restructure the process of assessing the applicability of intra-day MTM margins across all segments where CCIL offers CCP Clearing services to facilitate multiple intra-day MTM margins as needed. Currently, intra-day MTM margin is assessed for trades outstanding as at the previous end-of-day (EOD). As a result, new trades are not part of the assessment for intra-day MTM margin calculation. CCIL proposes the following as it pertains to the Forex segment, the Forex Forward segment and the Rupee Derivatives segment:

- To change this method of assessing intra-day margin by assessing all trades at the point of calculation of intra-day margin;
- To include volatility margin (VM) as part of its initial margin (IM) for assessing the intra-day margin calculation, i.e., intra-day MTM margin will be charged only if intra-day MTM losses exceed 50% of IM, including VM, if any, collected from the clearing member;
- To release intra-day margin to a clearing member’s account if the latest assessment of intra-day MTM margin calculation is less than the intra-day MTM margin already collected;
- For the Forex Forwards and Rupee Derivatives segments, net MTM gains of trades in these segments will be notionally credited to clearing member’s account and treated as margin made available. Any intra-day reduction in MTM gain will be treated as notional loss for intra-day MTM margining purposes. This type of value reduction will also be considered as a case of loss in MTM value for intra-day MTM margin imposition. However, such intra-day MTM margin amount will not be required to be deposited by a clearing member unless it has utilized the margin credit to meet its other margin requirements;
- For the Forex segment, CCIL proposes multiple collection of intra-day MTM margin as needed. For the Forex Forward segment, CCIL proposes changing the time of assessment from 11.00am to 2.00pm, with the right to impose margin thereafter on the same process, as needed. For the proposed CCP clearing of Rupee Derivatives, intra-day MTM margin will be collected multiple times a day and will include the reduction in MTM credit as intra-day MTM loss for MTM margining purposes.

## **RBI releases guidelines on intra-group transactions and exposures**

Contact: Keith Noyes (knoyes@isda.org) / Erryan Abdul Samad (eabdulsamad@isda.org)

On February 11, the Reserve Bank of India (RBI) released its “Guidelines on Management of Intra-Group Transactions and Exposures” (Guidelines). The RBI decided to prescribe these Guidelines based on, among others, comments received on its draft guidelines issued on August 14, 2012. These Guidelines contain certain quantitative limits on financial intra-group transactions and exposures (ITEs) and prudential limits for non-financial ITEs to ensure that banks engage in ITEs in a safe and sound manner in order to contain concentration and contagion risks arising out of ITEs. The Guidelines set out that banks should adhere to the following intra-group exposure limits:

### Single Group Entity Exposure

- 5% of paid-up capital and reserves in the case of non-financial companies and unregulated financial services companies; or
- 10% of paid-up capital and reserves in the case of regulated financial services companies.

### Aggregate Group Exposure

- 10% of paid-up capital and reserves in the case of all non-financial companies and unregulated financial services companies taken together; or
- 20% of paid-up capital and reserves in the case of the group i.e. all group entities (financial and non-financial) taken together.

Banks should also put in place a board approved comprehensive policy on monitoring and managing of ITEs. The policy should lay down effective systems and processes to identify, assess and report risk concentrations and material ITEs. The policy should also be reviewed at least annually.

The Guidelines also provide that banks should not enter into cross-default clauses whereby a default by a group entity on an obligation (whether financial or otherwise) is deemed to trigger a default of the bank on its obligations. This requirement will be applicable from the effective date of the Guidelines. Such agreements which have already been executed by banks would be exempted from this requirement. However, the existing agreements should not be renewed by banks.

The Guidelines become effective from October 1, 2014. Banks should accordingly submit data on intra-group exposures to the RBI from the quarter ending December 31, 2014. In the event a bank’s current intra-group exposure is more than the limits stipulated in the Guidelines, it should bring down the exposure within the limits at the earliest but not later than March 31, 2016. The exposure beyond permissible limits subsequent to March 31, 2016, if any, would be deducted from Common Equity Tier 1 capital of the bank.

## **South Korea: Government plans to levy capital gains tax on derivatives**

Contact: Keith Noyes (knoyes@isda.org) / Claire Kim (ckim@isda.org)

On February 17, the Tax Reform Subcommittee, under the umbrella of the Strategy and Finance Committee, announced (in Korean) that the ruling and the opposition parties agreed to levy a capital gains tax on derivatives. Though there would be further discussions, the plan to include a 10 percent capital gains tax rate on derivatives with an exemption for the first Won 2.5 million of annual capital gains is most likely. This plan will be ratified in a provisional session of the National Assembly in April after simulations for its alignment with the policy direction, effects on tax revenue and impacts on Korean economy and stock market.

In response, KRX's CEO and Chairman Choi Kyoung Soo recommended delaying the derivatives tax until after the market recovers. Given the stagnant Korean derivatives market, it would be best not to impose tax on derivatives. However, if it is unavoidable for tax fairness, such taxation should be delayed until 2016 or 2017 when the stock market may bounce back.

The FSC will be preparing their opinions on this plan after analyzing the background of this consensus and gleaning market participant views. The FSC will also announce a plan to revitalize the Korean derivatives market in March and it is unknown how the FSC will be dealing with this capital gains tax in their plan.

### **Upcoming committee and working group meetings/conferences**

#### **Meetings:**

Asian Public Policy Meeting Call	Mar 3
ISDA Mumbai Members' Meeting	Mar 11
APAC Commodity Meeting	Mar 13
ISDA Beijing Members' Meeting	Mar 18
Industry Call with MAS	Mar 21
North Asia L&R Meeting	Mar 25
APAC CCP Risk call	Mar 26
South Asia L&R Meeting	Mar 27

#### **Conference:**

Transaction Reporting Conference Asia Pacific Requirements – Singapore	Mar 12
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#### **APAC Monthly Update**

Please direct comments and questions about APAC Monthly Update to Donna Chan, [dchan@isda.org](mailto:dchan@isda.org)

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