ISDA® Safe, Efficient Markets

Date: 15 April 2013

Mr Edmond Lau
Executive Director, Monetary Management Department
Hong Kong Monetary Authority
55th Floor, Two International Financial Centre
8 Finance Street, Central
Hong Kong

By Email and Post

Dear Edmond,

HKMA Consultation on reporting requirements for OTC derivatives transactions

Introduction

We refer to the presentation to the Treasury Markets Association on 1 March 2013 (the "**TMA Meeting**") together with the HKMA's Consultation on interim trade reporting requirements for OTC derivatives transactions dated 14 March 2013 ("**Phase 1 Proposal**").

International Swaps and Derivatives Association (ISDA)[1] appreciates greatly 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.

As set out in our letter dated 5 April 2013, the industry broadly welcomes the Phase 1 Proposal. We appreciate the pragmatic approach undertaken by the HKMA in meeting international commitments and achieving consistency. We support that during Phase 1, a Licensed Bank ("**Bank 1**") should only be subject to trade reporting requirements with respect to a reportable

[1] Since 1985, ISDA has worked to make the global over-the-counter (OTC) derivatives markets safer and more efficient. Today, ISDA has over 800 member institutions from 60 countries. These members include a broad range of OTC derivatives market participants including corporations, investment managers, government and supranational entities, insurance companies, energy and commodities firms, and international and regional banks. In addition to market participants, members also include key components of the derivatives market infrastructure including exchanges, clearinghouses and repositories, as well as law firms, accounting firms and other service providers. Information about ISDA and its activities is available on the Association's web site: www.isda.org.

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 transaction unless it also books the transaction on its balance sheet in Hong Kong. This would be consistent with the approach being taken in the US and EU and would also reduce the scope of differing interpretations and confusion. Our understanding is that under Phase 1, licensed corporations, restricted licensed banks and deposit-taking companies will not be subject to the proposed interim trade reporting.

Nevertheless, as set out in our letter dated 5 April 2013, we believe further clarity is necessary with respect to the detailed proposals under Phase 1. We appreciate greatly this opportunity to set out views and concerns with respect to Phase 1. We have identified three key areas of concerns, namely, the regulatory status of the counterparty, the scope of interim trade reporting and transitional arrangements.

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. We appreciate that the HKMA publishes a list of Authorized Institutions on their website on a monthly / bimonthly basis.

The industry welcomes the HKMA's willingness, through the TMA, to work with the industry in ensuring that there is an up-to-date list of Licensed Banks. The industry's suggested approach is 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**") 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.

2. Scope of Phase 1 Interim Trade Reporting

(a) interbranch transactions

We note from the Phase 1 Proposal and subsequent further clarification by the HKMA that intra-branch transactions (i.e. a transaction between two desks of the Hong Kong branch of a Licensed Bank) will not be covered within the scope of Phase 1. Furthermore, we understand unlike intra-branch transactions, intragroup transactions will not be exempted from the scope of Phase 1 and thus will be reportable.

We understand also that subject to the scenario highlighted under paragraph 6 of Annex A to the Phase 1 Proposal ("**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) will not be subject to interim trade reporting.

We understand further that transfer bookings would be subject to interim trade reporting. A transfer booking is where the Hong Kong branch of a Licensed Bank enters into a reportable transaction with the foreign branch of a Licensed Bank such that the transaction between the foreign branch of a Licensed Bank and the third party counterparty will be '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.

The industry would like to clarify with the HKMA if it is the intention of the HKMA for transfer bookings to only capture a transaction that is novated to the Hong Kong branch of a Licensed Bank or whether this should also include a transaction where the risk is 'transferred' to the Hong Kong branch (i.e. back to back transactions).

(b) Reporting of Transactions that are cleared through a CCP

The industry appreciates that the HKMA has addressed the industry's concerns in paragraph 16 of the Annex to the Phase 1 proposals with respect to reporting transactions that are centrally cleared. The industry notes that under the Phase 1 Proposals, a reporting Licensed Bank should report the 'business events' with reference to the existing transaction after the original transaction has been novated for central clearing. The industry would like now to clarify with the HKMA whether or not a reportable transaction pending clearing will still need to be reported on a T+2 basis?

3. Transitional Arrangements

(a) Back loading

The industry appreciates the HKMA's recognition that a six month grace period is required for back-loading of reportable transactions that are outstanding as of 5 August 2013 and also for those entered into between 5 August 2013 and 4 November 2013.

Under the Phase 1 Proposal, for each back loaded reportable transaction all post trade 'business events' must also be reported to the HKMA-TR. The industry would like to seek further clarity on the requirements to reporting such post-trade 'business events'.

For reportable transactions that are outstanding as of 5 August 2013, the industry proposes an alternative approach where Licensed Banks are allowed to report the latest position of such transactions as of 4 November 2013. This alternative would be an option available to the original proposal, i.e. Licensed Banks are permitted to choose reporting either the outstanding position as of 5 August 2013 plus each post trade 'business event' or just the latest position as of 4 November 2013 which is the result of incorporating all post trade 'business events' occurring between 5 August 2013 and 4 November 2013 into the 5 August 2013 outstanding position . This alternative proposal would be consistent with the approach taken by the US and Japan. It would not only be consistent with international standards but would also assist market participants greatly in meeting their reporting requirements during the transitional period.

(b) Trade report reconciliation – data matching

The industry notes that the HKMA-TR will perform daily linking and matching of trades from 5 August 2013. The industry is of the view that the HKMA-TR should not conduct daily linking and matching of trades during Phase 1 for a number of reasons:

(i) A Licensed Bank must become a CMU Trade Repository member before it can use the trade reporting service. Not all Licensed Banks will be a CMU Trade Repository member by 5 August 2013. During the period of 5 August 2013 and 7 November 2013, a reportable transaction between a CMU Trade Repository member and a Licensed Bank (who is not yet a CMU Trade Repository Member) will be treated as a single–sided trade. It is not clear how the HKMA-TR can conduct data matching of back loaded transactions once the non CMU Trade Repository Member becomes a CMU Trade Repository Member. This may result in a high volume of unmatched trades and trade discrepancies.

(ii) We note that a Licensed Bank is permitted to report a reportable transaction anytime between T to T+2. As the two reporting Licensed Banks may choose to report the same transaction on different dates, this will cause large volumes of unlinked trades, particularly for the party who chooses to report on the later date. We believe this would be a concern for both back loaded trades and those transactions entered from 5 November 2013 onwards.

(iii) We note that the HKMA has introduced the flexibility of allowing Licensed Banks not to report a reportable transaction where such transaction has been cancelled / terminated within T+2. As certain Licensed Banks would choose to report the cancelled / terminated transaction and the fact that it has been cancelled / terminated, whilst other Licensed Banks will choose not to make a report, this will undoubtedly create further unmatched transaction reports. We also understand that the original expectation (following the publication of the Hong Kong Trade Repository Administration and Interface Development Guide in December 2013) from HKMA was to report the cancelled / termination event, without any conditional requirement. The industry suggests that the HKMA should adopt a consistent approach with respect to whether or not reportable transactions that have been terminated within T+2 should be reported to avoid further mismatches.

(c) Unique Trade Identifier ("UTI")

The industry appreciates that the HKMA would not mandate, at this stage, the use of UTI for reporting purposes. Nonetheless, it is the industry's view that whilst the sharing of UTIs is not mandatory, it should be encouraged where these are available.

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Conclusion

The industry welcomes and supports the pragmatic approach set out in the Phase 1 proposals. 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) at +852 22005907.

Yours faithfully,

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