APAC Monthly Update

September 2012

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

Regulatory Activities

China

On September 6, ISDA met with:

- the China Banking Regulatory Commission (CBRC) to discuss the latest developments of CCPs in the Asia Pacific region and the potential impact of the Dodd-Frank Act on Chinese financial institutions.
- the People's Bank of China (PBOC) to discuss the proposed central clearing of RMB IRS by Shanghai Clearing House. At the meeting, ISDA raised members' concerns with Shanghai Clearing House's ability to meet CPSS-IOSCO standards for CCPs and discussed with PBOC possible solutions to these issues.

Indonesia

On September 10, ISDA met with Bank Indonesia to discuss the G20 commitments, global regulatory developments and the Indonesian derivatives market.

India

On September 24, ISDA met with the Joint Secretary of the Central Board of Direct Taxes to discuss the Report on General Anti Avoidance Rules (GAAR) in Income-tax Act, 1961 and the recommendations of the committee.

On September 24, ISDA met with the Joint Secretary of the Financial Services to discuss the global developments, the Indian CDS market, regulatory capital and netting in India.

Singapore

On September 27, ISDA spoke at a conference on OTC derivatives for regulators from 10 ASEAN countries hosted by the Monetary Authority of Singapore. ISDA provided an "Update on Implementation of OTC Derivatives Market Reforms". The other presenters at the conference were Singapore Exchange who spoke on "Central Clearing" and DTCC who presented on "Trade Repositories".

Committee/Working Group Activities

North Asia L&R

On September 25, ISDA held its North Asia L&R meeting in Hong Kong. Topics discussed included CSRC's public consultation on Administrative Regulations on Securities Companies Selling Financial

Products on Commission, matching and confirmation service for OTC derivatives transactions to be offered by HKMA and central clearing in Korea. ISDA also briefed members on the latest regulatory developments in Southeast Asia, including, for example, the Corporations Legislation Amendment (Derivative Transactions) Bill 2012 in Australia, ASIC's consultation paper on Amendments to Clearing and Settlement Facilities Guidance as well as the proposed submission on bilateral netting in India. Additionally, ISDA updated members on the new ISDA IIGC structure, the updated comparison of EU and US regulatory changes affecting the OTC derivatives market prepared by ISDA and Clifford Chance, the Dodd-Frank Protocol and the extension of the compliance date for external business conduct rule, the Joint Association response to HMT's informal consultation on Segregation and Portability, the publication of the Cleared Derivatives Addendum by FIA and ISDA, the response from CTFC staff on timing of Swap Dealer registration rules and UK FSA's consultation on changes to the client money and custody assets regime. The meeting also discussed two recent Indian cases, being *Bharat Aluminium v Kaiser Aluminium* and *HDFC Bank v Satpal Singh Bakshi*.

South Asia L&R

On September 27, ISDA held its L&R Members' meeting in Singapore. Topics discussed included the Corporations Legislation Amendment (Derivative Transactions) Bill 2012, the Australian Treasury's consultation paper on Strengthening APRA's Crisis Management Powers, ASIC's consultation paper on Amendments to Clearing and Settlement Facilities Guidance as well as the Australian Treasury's request for industry comments on the Intergovernmental Agreement to Implement FATCA. ISDA also provided an update on its recent trip to Delhi, the proposed submission on bilateral netting, FIMMDA's Bilateral Agreement for discontinuation of exchange of interbank confirmations for IRS and FRA trades settled through CCIL, the on-boarding of CCIL's FX forward clearing segment, RBI's draft Supplementary Guidance on Treatment of Illiquid Positions, the RBI circular on Comprehensive Guidelines on Over the Counter (OTC) Foreign Exchange Derivatives – Cost Reduction Structure, the Expert Committee's Report on General Anti Avoidance Rules (GAAR) in Income-tax Act, 1961, the RBI circular on Foreign Investments by Qualified Foreign Investors (QFIs) – Hedging Facilities and the address by Dr Duvvuri Subbarao, Governor RBI on Basel III in international and Indian contexts. ISDA also updated members on Dr Zeti Akhtar Aziz's keynote address on Asian Market Integration and Financial Innovation and the MAS response to Parliamentary Question on Singapore Interbank Offered Rate (SIBOR) set by Singapore Banks. Additionally, ISDA updated members on the new ISDA IIGC structure, the updated comparison of EU and US regulatory changes affecting the OTC derivatives market prepared by ISDA and Clifford Chance, the Dodd-Frank Protocol and the extension of the compliance date for EBC Rule, the Joint Association response to HMT's informal consultation on Segregation and Portability, the publication of the Cleared Derivatives Addendum by FIA and ISDA, IOSCO's creation of the Board Level Task Force on Financial Market Benchmarks, the response from CTFC staff on timing of Swap Dealer registration rules and the GFMA's principles for financial benchmarks to the global regulatory community. The meeting also discussed two recent Indian cases, being *Bharat Aluminium v Kaiser Aluminium* and *HDFC Bank v Satpal Singh Bakshi*.

Operations/Market Infrastructure

On September 6, ISDA held its APAC Interest Rates Derivatives Operations Working Group meeting to discuss the addition / amendment of floating rate options / matrices, the electronic confirmation format for CNH IRS product and the market practice of unscheduled holiday.

On September 20, ISDA held its APAC Equity Derivatives Operations Working Group meeting to address the documentation of MSCI swap and AEJ Variance Swap, the group also discussed the AEJ reference price source matrix.

Country Working Group

On September 6, ISDA held its China Working Group meeting in Beijing. Topics discussed included the CSRC revised Rules on Implementation of Measures on Administration of Domestic Securities Investments of QFIIs, central clearing in China, ISDA's publication of the 2012 FATCA Protocol, Dodd-Frank Protocol and Illegality/Force Majeure Protocol. Other topics discussed included regulatory changes in the US, in particular, the Volcker Rule and the Interpretive Guidance on Cross-Border Application of the Swaps Provisions of the Dodd-Frank Act proposed by CFTC. ISDA also updated members on its work regarding standardized client clearing documentation.

Regulatory Developments

Australia:

Treasury requests comments on intergovernmental agreement

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

The Australian Treasury is requesting submissions on the advantages and disadvantages of an intergovernmental agreement (IGA) with the US (based on the published US Model IGA) as an alternative to individual agreements between Australian financial institutions and the US Internal Revenue Service. This is in response to concerns about the impact of FATCA compliance on Australian financial institutions and the economy as a whole. The agreement aims to minimize the compliance costs for Australian stakeholders while enhancing the cooperation between the countries. The submission deadline is September 28.

RBA consults on New Financial Stability Standards

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

On August 29, RBA RBA released a Consultation on New Financial Stability Standards. In accordance with powers under the Corporations Act 2001 (the Act), RBA has determined Financial Stability Standards (FSSs) for central counterparties (CCPs) and for securities settlement facilities (SSFs). The consultation seeks views on a proposal to revoke existing FSSs and determine new FSSs for both CCPs and SSFs. The aim is to align the Australian regime for regulation of licensed clearing and settlement (CS) facilities with the new CPSS-IOSCO's Principles for Financial Market Infrastructures (FMIs). The proposed FSSs will also implement key elements of the Council of Financial Regulators' framework for ensuring Australian regulators have appropriate influence over cross-border CS facilities. FSSs determined by the Act will only apply to licensed CS facilities and only in matters concerning the stability of the Australian financial system.

Attachment 2 of the Consultation Paper, focuses on the Draft Guidance – Financial Standards for Central Counterparties, which contains 21 standards including: legal basis; governance; framework for the comprehensive management of risks; credit risk; collateral; margin; liquidity risk; settlement finality; money settlements; physical deliveries; exchange-of-value settlements; participant-default rules and procedures; segregation and portability; general business risk; custody and investment risks; operational risk; access and participation requirements; tiered participation arrangements; FMI links; disclosure of rules, key policies and procedures, and market data; and regulatory reporting. ISDA plans to make a submission by the October 19 deadline.

ASIC consultation paper proposes amended guidance
Contact: Keith Noyes (knoyes@isda.org) / Jacqueline Low (jlow@isda.org)

On September 10, the Australian Securities and Investments Commission (ASIC) issued a consultation paper proposing amendments to its regulatory guidance for clearing and settlement facilities. Similar to a consultation paper put out by the Reserve Bank of Australia earlier this month, the ASIC paper's goal is to align its oversight with international best practices published in the April 2012 CPSS-IOSCO "Principles for Market Infrastructures." ASIC also intends to put in place measures and update its existing guidance to ensure appropriate regulatory influence over cross-border clearing and settlement facilities. Submission deadline is October 19.

Treasury issues consultation on crisis management powers
Contact: Keith Noyes – (knoyes@isda.org) / Jacqueline Low (jlow@isda.org)

On September 12, the Australian Treasury released a consultation paper, "Strengthening APRA's crisis management powers" to set out a range of options on:

- strengthening APRA's crisis management powers in relation to authorised deposit-taking institutions (ADIs), superannuation entities and general and life insurers;
- simplifying APRA's regulatory powers across the various Acts it administers in the banking, insurance, and superannuation sectors, given that many firms operate across sectors;
- making a series of minor and technical amendments to enhance the effectiveness of legislation administered by APRA; and
- aligning Australia's regulatory regime with international best practice following the GFC.

It includes a chapter discussing the appropriateness of applying certain proposals for reforms of APRA's crisis management and directions powers with respect to ADIs, insurers and superannuation entities to financial market infrastructures (FMIs) as part of a future crisis management regime for FMIs. Submission deadline is December 14.

Hong Kong:
HKMA intends to offer matching and confirmation service
Contact: Keith Noyes (knoyes@isda.org) / Jeffrey Kan (jkan@isda.org)

On September 11, the Hong Kong Monetary Authority (HKMA) announced it intends to offer a matching and confirmation service in December for market participants to transmit their OTC derivatives transactions to the HK Exchange CCP for voluntary clearing.

India:

Expert committee issued report to defer GAAR tax
Contact: Keith Noyes (knoyes@isda.org) / Jacqueline Low (jlow@isda.org)

On September 1, the expert committee on General Anti Avoidance Rules (GAAR) published a report recommending the deferment of the GAAR tax provision by three years until 2017. The committee is mandated to submit a finalized GAAR guidelines and roadmap for implementation to the Indian government by September 30. The committee made the following recommendations:

- the Income Tax Act, 1961 be amended to abolish the tax arising from the transfer of listed securities, whether in the nature of capital gains or business income, for both residents and non-residents;
- GAAR provisions should be subject to an overarching principle that (a) tax mitigation is to be distinguished from tax avoidance before invoking GAAR; (b) an illustrative list of tax mitigation or a negative list for the purposes of invoking GAAR should be specified; (c) GAAR should not be invoked in intra-group transactions; and (d) GAAR is only applicable to cases of abusive, contrived and artificial arrangements;
- GAAR provisions should be applied only if the monetary threshold of tax benefits is Rs 3 crore or more;
- all investments by residents or non-residents as on the date of commencement of the GAAR provisions should be grandfathered on exit on or after this date;
- GAAR provisions in the statute and the rules should be explained through a circular on the following issues: (a) GAAR will only apply to the income received, accruing or arising, or deemed to accrue or arise, to the taxpayers on or after the date GAAR provisions come into force; (b) with regards to Mauritius, GAAR provisions shall not apply to examine the genuineness of the residency of an entity setup in Mauritius; and (c) when the Assessing Officer invokes GAAR, he should inform the assesse of the factors that contributed to the invocation of GAAR provisions.
- until the abolition of the tax transfer of listed securities, the Tax Residence Certificate (TRC) issued by the Mauritius authorities may be retained.

RBI allows QFIs to hedge currency risk
Contact: Keith Noyes – (knoyes@isda.org) / Jacqueline Low (jlow@isda.org)

On August 31, RBI released a circular allowing QFIs to hedge their currency risk of their permissible investments with the AD Category-I bank with which they have a rupee account for such investment. The eligibility of the hedge may be determined on the basis of the declaration of the QFI with periodic review undertaken by the AD Category-I bank based on the investment value provided/ certified by QDP of the QFI at quarterly intervals. If the hedge becomes naked in part or in full, the hedge will be allowed to continue until original maturity, if so desired. However, once the contracts are cancelled, they cannot be rebooked. Forward contracts may be rolled over on or before maturity.

For IPO-related transient capital flows, QFIs may undertake foreign currency-rupee swaps only for hedging the flows relating to the IPO. The amount of the swap cannot exceed the proposed amount to be invested in the IPO, the tenor of swap should not exceed 30 days and once the contracts are cancelled, they cannot be rebooked. Rollovers will not be permitted for IPO-related capital flows.

RBI issued guidance on illiquid positions treatment
Contact: Keith Noyes (knoyes@isda.org) / Cindy Leiw (cleiw@isda.org)

On Sep 17, RBI released the draft Supplementary Guidance on Treatment of Illiquid Positions, which seeks to provide indicative guidelines to banks to define illiquid positions and the subsequent valuation adjustments through Tier 1 capital. The guidance also contains additional valuation adjustments to be made to the derivatives portfolio. For example: an indicator of concentration could be "percentage of the size of the bank's position to total size of issue", or "percentage of the size of the bank's position to the average daily volumes trades of the security during the last three months". As such, banks would need to make a downward adjustment to the fair value of their positions to reflect this uncertainty as they may be exposed to idiosyncratic risk.

The guidance suggests a two-step approach in the valuation of positions. First, the basic valuation needs to be robust, without considering illiquidity discount. This would mean a valuation using: quoted/ traded prices; inputs published by FIMMDA; non-current prices; or valuation models.

Second, the adjustment for illiquidity should be determined in an appropriate manner, even if these adjustments are based on proxies to quantify illiquidity impact until the banks are able to use their own internal measures to capture this. Banks are encouraged to start collecting the necessary data to support such measurement systems.

RBI has prescribed values for this adjustments based on the category of the instrument such as (a) instruments quoted/ traded in active markets; (b) instruments quoted/ traded in markets other than active markets; (c) unquoted cash instruments; (d) actively traded currencies; (e) currencies not actively traded; and (f) derivatives. Banks may use a hybrid approach in respect of some of the parameters indicated in the Tables provided by RBI and their internal estimates. The guidance also requires additional valuation adjustments for derivatives positions with respect to incurred CVA losses; operational risks; early termination, investing and funding costs; future administrative costs; and model risk. Submission deadline is Oct 19.

Upcoming committee and working group meetings/conferences

Meetings:

APAC IRD Operations Meeting	Oct 4
APAC L&R Advisory Meeting	Oct 9
APAC Equity Derivatives Operations Meeting	Oct 10
APAC Credit Derivatives Operations Meeting	Oct 11
ISDA Asian Steering Meeting	Oct 22
South Asia L&R Meeting	Oct 25
North Asia L&R Meeting	Oct 30

Conferences:

2012 ISDA Annual Australia Conference	Oct 18
Advanced OTC Derivatives Clearing – Sydney	Oct 19
2012 ISDA Annual Asia Pacific Conference	Oct 22
Advanced OTC Derivatives Clearing – Singapore	Oct 23
2012 ISDA Annual Japan Conference	Oct 25
Advanced OTC Derivatives Clearing – Tokyo	Oct 26

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