

APAC Monthly Update

June 2012

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

Regulatory Activities

China

On June, 11 ISDA:

- met with China Foreign Exchange Trading to discuss the development of its electronic confirmation matching platform.
- visited China Banking Regulatory Commission in Shanghai to discuss implementation of Basel III standards, especially in relation to CCPs, as well as the US regulatory developments and their potential impact on Chinese banks.

On June 12, ISDA:

- visited Shanghai Clearing House to discuss the June 7 submission letter that raised member's concerns with Shanghai Clearing House's ability to meet with the CPSS-IOSCO standards for CCPs.
- visited People's Bank of China in Shanghai to discuss CCP regulation and global regulatory developments.

Hong Kong

On June 19, ISDA joined a panel discussion at the Hong Kong Monetary Authority/Treasury Market Association symposium on the future of OTC clearing at Hong Kong Exchange.

On June 27, the HKMA and the SFC made a presentation at the ISDA Board of Directors meeting in Hong Kong about Hong Kong's regulatory framework for meeting G20 clearing and reporting requirements.

On June 29, ISDA met with Hong Kong Monetary Authority to discuss technical arrangements at Hong Kong Trade Repository.

India

On June 4, ISDA met with the following departments of Reserve Bank of India:

- Internal Debt Management Department to discuss the CDS market in India.

- Financial Markets Department to discuss trade repositories, the reporting requirements of other jurisdictions, the global trade repositories and the reporting data required.

Committee/Working Group Activities

North Asia L&R

On June 26, ISDA held its L&R Members' meeting in Hong Kong. Topics discussed included ISDA's letter to Shanghai Clearing House regarding central clearing of IRS denominated in RMB, the Measures for Commercial Banks' Capital issued by CBRC, SAFE Notice on Adjusting Regulation of Certain Inter-bank FX Businesses and HKMA Circular on Selling of Investment Products to Private Banking Customers. Issues relating to South Asia, such as RBI's circular on mandatory reporting to CCIL's platform for OTC foreign exchange and interest rate derivatives, and ISDA's submission to MAS's consultation paper on the Proposed Amendments to the SFA were also discussed at the meeting. ISDA also updated members on ISDA's FATCA protocol and DFA protocol, the FSB's third progress report on Implementation of the OTC derivatives market reforms and IOSCO's final report on International Standards for Derivatives Market Intermediary Regulation.

South Asia L&R

On June 28, ISDA held its L&R Members' meeting. Topics discussed included ISDA's submission to the Australian Treasury's consultation paper on the G20 OTC Derivatives Legislative Framework; RBI's circular on mandatory reporting to CCIL's platform for OTC foreign exchange and interest rate derivatives; update on the discussions with CCIL regarding the Forex Forward Segment; SEBI's FAQs on QFI; update on India's services tax; update on the developments in India's CDS market; update on ISDA's trip to India; update on the appointment of Pak Muliaman Hadad as Chairman of OJK; ISDA's submission to MAS's consultation paper on the Proposed Amendments to the SFA; highlights of the MAS consultation paper on Review of Regulatory Framework for Unlisted Margined Derivatives Offered to Retail Investors; summary of Personal Data Protection Bill and highlights on Thailand's notification of the Capital Market Supervisory Board on Offer for Sale of Newly Issued Debentures issued by Financial Institution in the Category of Structured Debentures or Debentures Imposing Obligation on Debenture Holder. Other topics discussed included FIMMDA's circular on Bilateral Agreement for discontinuation of Exchange of Interbank confirmations for IRS trades; update on ISDA's FATCA protocol and DFA protocol; IOSCO's report on the CDS market; the FSB's third progress report on Implementation of the OTC derivatives market reforms and IOSCO's final report on International Standards for Derivatives Market Intermediary Regulation.

Operations/Market Infrastructure

On June 7, ISDA held its APAC Interest Rates Derivatives Operations Working Group meeting to discuss the confirmation template for Asian currencies swaption and the addition / amendment of floating rate options / matrices.

On June 15, ISDA held its APAC Credit Derivatives Operations Working Group meeting to discuss the treatment of a name change event and the coupon of legacy transactions.

On June 21, ISDA held its APAC Equity Derivatives Operations Working Group meeting to discuss the documentation of MSCI swap and AEJ Variance Swap and the Asia Ex-Japan reference price source matrix.

Country Working Group

On June 5, ISDA held its Mumbai Members' Working Group meeting. Topics discussed included ISDA's publication of the Indian Corporate Bond CDS documentation; RBI's circular on risk

management and inter-bank dealings; the opening remarks by the Finance Minister Shri. Pranab Mukherjee at the beginning of the discussion on Finance Bill 2012; ISDA's submissions to the Ministry of Finance regarding the services tax, indirect transfer tax and GAAR; RBI's final guidelines on Implementation of Basel III Capital Regulations in India; RBI's guidelines on CDS for Corporate Bonds – Permitting All India Financial Institutions; ISDA's drafts of Indicative and Final Term-Sheets, Generic Risk Disclosure Statement, MTM Valuation Disclaimer and Board resolutions to meet RBI's Comprehensive Guidelines on Derivatives and FEDAI's circular for member banks to join CCIL's Forex Forward Guaranteed settlement. Other topics discussed included the update on ISDA's proposed FATCA Protocol and DFA Protocol; the standard CSA project; ISDA's AGM in Chicago and the possible review of the ISDA credit derivatives definitions.

Regulatory Developments

Australia:

Basel III capital reforms reporting requirements

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On June 8, Australian Prudential Regulation Authority (APRA) released a discussion paper on implementing Basel III Capital Reforms in Australia: Reporting Requirements. APRA proposes two reporting standards for Reporting standard ARS 110.0 Capital Adequacy and Reporting standard ARS 111.0 Fair Values APRA, and intends to issue the final reporting standards later in 2012 with an effective date of January 1, 2013.

APRA proposes to amend Reporting Form ARF 110.0.1 Capital Adequacy (Level 1) (ARF 110.0.1) and Reporting Form ARF 110.0.2 Capital Adequacy (Level 2) (ARF 110.0.2) to reflect the proposed changes in the eligibility criteria of the components of capital under Basel III and the predominant focus on Common Equity Tier 1 (CET1) capital. Under the existing prudential framework, there are four categories of capital: Fundamental Tier 1 capital, Residual Tier 1 capital, Upper Tier 2 capital and Lower tier 2 capital. Under Basel III, these four categories will be replaced with Tier 1 capital (CET1 and Additional tier 1) and Tier 2 capital. ARF 110.0.1 and ARF 110.0.2 will be amended to reflect the changes in the number of categories of capital. APRA also proposes:

- amending the reporting standard for ARF 110.0 forms and instructions. One such amendment would be the moving away from 'gross' and 'net' to 'Total Capital', which is net of adjustments. Another adjustment for ARF 110.0 would be the requirement for most adjustments to be made to CET1 instead of the current deductions from Tier 1 and Tier 2 capital. A new line item will be introduced to adjust both ARF 110.0.1 and ARF 110.0.2 to capture the assets held in a covered bond pool, in excess of 8% of the Authorized Deposit Taking Institutions' (ADI) assets in Australia to be deducted from CET1;
- ADIs' adoption of the same accounting treatment (i.e. equity accounting) for joint operations and joint ventures. This would result in a full deduction of equity investment as a regulatory adjustment to capital;
- a requirement for quarterly reporting of cumulative gross unrealized gains and losses for all fair values. Fair value reporting will be required at both the ADI on a stand alone basis and at the level of the group of which the ADI is a member, as appropriate. ADIs are to submit their fair value information from January 1, 2013 onwards on a 'best endeavors' basis until AASB 13 has been adopted for public reporting for annual reporting periods beginning on or after January 1, 2013.

Respondents are also requested to provide an assessment of the impact of the proposed changes and the marginal and compliance costs the ADIs are likely to face. Submission deadline is August 3.

ISDA's comments on OTC framework for G20 commitments

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On June 15, ISDA submitted its comments to the Australian Treasury on its consultation paper on Implementation of a framework for Australia's G20 over-the-counter derivatives commitments (the submission is not public). The consultation paper proposed to allow the market to drive the move towards reporting, clearing and trade execution, and to recognize foreign trade repositories (TRs), central clearing counterparties (CCPs) and trading platforms.

ISDA's submission highlighted the industry's concern regarding the Treasury's proposal to extend the Financial Markets Infrastructure (FMI) framework to foreign trade repositories and trading platforms. If the FMI framework were to be applied to foreign CCPs, there should be specific parameters and processes in place such that a foreign CCP will be able to comply with the location requirements. Legislation should also allow market participants to continue to clear their transactions through foreign CCPs and reduce the fragmentation of trading volumes and netting benefits across different CCPs as well as increased margining costs.

The submission supported the general form of the legislation except for certain exceptions, such as terms of transactions types and participants, that should be enshrined in the Corporations Act or overarching regulations but not left to the derivatives transaction rules (DTRs). Some of these exceptions would include foreign exchange spots, forwards and swaps and end users. The submission also highlighted the industry's concern for the regulators to avoid mandating duplicative, overlapping requirements and/or infrastructure where sufficient alternatives exist. The industry did not object to the Australian Securities and Investments Commission (ASIC) being given the rule-making powers via the DTRs. However, ASIC should be required to give its stakeholders sufficient time for consultations before any DTRs take effect.

China: delays implementation of Basel III capital requirements

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China will delay the implementation of the Basel III capital requirements to January 1, 2013 as opposed to its previous announcement of January 1, 2012 (Chinese language announcement). This would bring it in-line with the Basel timeline. Banks are allowed a step-by-step approach in implementing the Measures, with full implementation by end-2018.

On June 7, The China Banking Regulatory Commission (CBRC) issued the Measures for Commercial Banks' Capital (Trial Implementation). These Measures will apply to commercial banks established in China and sets out the requirements for the capital adequacy ratio (CAR). The Measures follow the Basel guidelines and do not provide any exceptional deviation from the Basel guidelines. The CAR will consist of 5% Core Equity Tier 1, 6% Tier 1 and 8% for Total Capital.

A Conservation Buffer of 2.5% of Core Tier 1 capital and a Countercyclical Buffer of 0%-2.5% Core Tier 1 capital will be applied. Additionally, domestic systemically important banks will have to hold an additional 1% of Core Tier 1 capital. A systemically important bank will need to hold a total of 11.5% capital while the non-systemically important banks will need to hold 10.5% capital. Banks should develop and implement a step-by-step compliance plan to meet the new capital requirements and will need to report it to CBRC for approval. CBRC has the right to take regulatory action if banks do not meet their capital requirements.

The Measures also sets out the definition of what constitutes Core Tier 1 capital, Tier 1 capital and Tier 2 capital, and have listed which items may be deducted from the CAR, such as goodwill and sales from asset securitization. Additionally, guidance on credit risk, market risk and operational risk are provided in the Measures.

Hong Kong: report on Lehman minibonds

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On June 6, the Legislative Council Subcommittee issued a report critical of Hong Kong's "largely ineffective" regulatory framework that led to billions of dollars of losses by ordinary investors, suffered due to irregularities in Lehman's minibonds and structured financial products. The report claimed that because the Hong Kong Monetary Authority (HKMA) and the Securities and Futures Commission (SFC) were separate entities, there was a gap in regulatory coverage and neither body acted to prevent the selling of high-risk products by local banks to ordinary investors. The HKMA regulates banks' securities business while the SFC regulates brokers and approves financial products. The report recommends examining "the feasibility of placing the securities business conducted by banks under the regulation of the SFC."

The politically tinged report singled out for criticism then HKMA head Mr. Joseph Yam for "failing to detect and rectify problems related to the sale of investment products before they became widespread..." It also expressed "great disappointment" with former SFC chief executive Martin Wheatley and "disappointment" with Financial Secretary John Tsang Chun-way and Financial Services and Treasury Secretary Professor Chan Ka-cheung for failing to "initiate improvements to the regulatory framework" as structured products became more popular in the years before Lehman's collapse. The report also noted that sales staff at the 16 banks involved in the sale of Lehman Brothers-related financial products may not have adequately explained the products to investors.

Approximately 43,000 investors in Hong Kong purchased HK\$20.2 billion of Lehman Brothers products, including HK\$11.2 billion of minibonds, HK\$2.2 billion of credit-linked "Constellation notes," and HK\$6.3 billion of equity-linked, market-linked and principal-protected notes and other notes sold by private placement. Around 35,000 of these investors have since received compensation ranging from 60% to 97.5% of par. Compensation deals excluded those defined as professional or experienced investors. Approximately 2,500 investors have received no compensation.

One weakness of the report is that it depicts most of the investors as victims, ignoring the possibility that they were motivated by the search for higher yield in a low interest rate environment. The complexity of the products was not the real issue; rather few considered the possibility of Lehman's collapse when investing. Holders of plain vanilla Lehman bonds or stock also lost everything but did not receive the same compensation.

India: RBI's circular on OTC derivatives reporting platform

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On June 22, RBI issued a circular on the Reporting Platform for OTC Foreign Exchange and Interest Rate Derivatives, which mandates all interbank OTC foreign exchange derivatives transactions to be reported onto Clearing Corporation of India Limited's (CCIL) platform. This platform is expected to be in operation from July 9. All Authorized Dealer category-I banks are required to report all their inter-bank OTC USD/INR forwards, FX swaps, and FCY/INR options in hourly batches within 30 minutes from completion of the hour. Trades with a bank's own overseas branch need not be reported. Client trades will be phased-in and RBI will issue guidance at a later date.

Submissions

In June, ISDA made the following submissions:

- to Shanghai Clearing House on Clearing proposal regarding interest rate swaps (IRS) denominated in RMB on June 5
- to The Australian Treasury regards to the Consultation Paper on the “Implementation of a framework for Australia’s G20 over-the-counter derivatives commitments” on June 15
- to Monetary Authority of Singapore regards to Consultation Paper I on the Proposed Amendments to the Securities and Futures Act on Regulation of OTC Derivatives on June 22

Upcoming committee and working group meetings/conferences

Meetings:

APAC IRD Operation Working Group Meeting	Jul 6
APAC Credit Operation Working Group Meeting	Jul 12
APAC Equity Operation Working Group Meeting	Jul 19
L&R South Asia Meeting	Jul 26
L&R North Asia Meeting	Jul 31

Conferences:

Understanding the ISDA Master Agreements Conference Including Close-outs under the ISDA Master Agreement – Hong Kong	Jul 17
Understanding Collateral Arrangements and the ISDA Credit Support Documents Conference Including Close-outs under the ISDA Credit Support Annex – Hong Kong	Jul 18

ISDA APAC Monthly Update

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