INDUSTRY PHASE 2 FINAL ISSUES – FEEDBACK TO REGULATORS

Following an ISDA call with the HKMA/SFC/HKTR (the Regulators) on 28 November 2017, the Regulators provided their initial feedback on each of the issues below. In many cases, the Regulators wanted to further understand the issue, question why a particular fact pattern exists or push back on an industry position. The initial industry submission and the Regulators' responses are below.

ISDA has now aggregated member feedback to the Regulators' responses in blue below. ISDA thanks the Regulators for their continued consideration of these matters, and would welcome any additional feedback which the Regulators may have.

HKTR 2702 Reports

1A. Industry Initial Submission

Members have advised that the report currently highlights trades with missing valuations from T (Trade Date), however a number of circumstances may result in firms not being able to submit valuations for T:

- We understand that reporting agents timestamp a trade valuation in GMT, then add 8 hours to convert to HKT due to local requirements. This, in some circumstances, has the effect of registering the valuation as being on the day after, which causes the system to believe that a valuation for the previous date was not submitted. We understand that the report is accumulative.
    - For example, HK nexus trades booked late in the US timezone are unlikely to have a valuation available for T in HK.

1B. Regulators' Response

- In this circumstance, the Regulators are comfortable for the industry to input the valuation for T+1 for the value date of T, to the extent that participants' systems allow.
- The Regulators would also like to understand how the industry deals with this situation for other reporting regimes including Singapore and Australia.

1C. Industry Response

- Most members are comfortable with the proposed approach to input the valuation for T+1 for T, however some members have advised that their systems do not allow this to occur and that system builds would be required to support this.
- To provide further context, members have advised the following scenarios where a valuation may not be available for T:
    - Trades inputted after T, such as late trades and held-over trades (ie; trades which cannot be inputted into the system due to system cut offs);
    - Currency holidays (such as 4 July in the US);
    - Local holidays (such as the week-long holiday in June in Indonesia);
    - Certain trades with underliers in other regions (such as the US or EU), where the underlying's daily price based on EOD market close may only be known at around midnight (HK time);
    - Trades by US-based entities, where the process of MTM and valuation is completed at EOD (NY time) for all trades by the entity globally (in these cases, the valuation report is

submitted the next day to the reporting agent with the Valuation DateTime stamp of the previous day).

- For trades reportable under the regimes of Singapore and Australia, there is no requirement to convert to local time, and therefore this issue does not arise. Reporting agents timestamp a trade as it is received by submitting entities. As an example:
  - If a trade was executed on 14 Dec 2017, the valuation report may be submitted to the reporting agent on the next day (ie; 15 Dec 2017), with the Valuation DateTime as 20171214T23:59:59Z.
  - For ASIC and MAS reportable trades, reporting agents record this as the Valuation DateTime and no adjustment is made for local time.
  - For HK reportable trades, reporting agents must convert to HKT, and therefore this Valuation DateTime is recorded as 20171215T07:59:59Z
- As a general measure (and not limited to trade date), the industry would like to request whether the Regulators would be comfortable for reporting entities to submit the next available valuation, where a valuation for a particular day is not available or cannot be generated.

2A. Industry Initial Submission

- For block trades with allocations done on T+1, a valuation for T may not be available (and may be of limited value).

2B. Regulators' Response

- The Regulators would like more detail from industry on this. They are not of the view that a block trade will not be valued while it remains a block, as this unallocated block still carries risk and therefore needs to be prudently risk managed. Blocks may take longer than 1 day to be allocated, and therefore their understanding is that risk management should take place from the moment the block is traded. They would like to better understand the interaction between the pre-allocation block trade and risk management.

2C. Industry Response

- While one member has advised that it reports the valuation for a pre-allocation block trade while it is still unallocated or partially allocated, most other members have advised that they may book a pre-allocation block trade to an internal counterparty as a placeholder trade first, before allocating out to the actual external counterparty portfolios. These members' systems are designed to capture the valuation only once the counterparty account is available, and thus pre-allocation trades will not have that information in order to produce the valuation.
- With regard to the interaction between the pre-allocation block trade and risk management, some members advised that their trading teams complete a hedge after the block trade is executed, such that the risk is managed pre-allocation. In addition, there is daily monitoring of late allocations internally, as late allocations not only impact regulatory reporting, but also a number of other areas such as settlements and confirmations.

3A. Industry Initial Submission

- For cleared trades, the CCP may not provide a valuation for the clearing date itself.

3B. Regulators' Response

- The Regulators queried how a CCP can charge initial margin on the clearing date if it does not value the trade, and would like to know which CCPs do not provide a valuation on the clearing date. In the case of those CCPs, the Regulators would like to know whether participants would be able to report an internal valuation for the time up until that CCP provides a valuation.

3C. Industry Response

- Member practices are mixed on this issue. While some members note that they have the capability to report internal valuations until the CCP provides a valuation, other members advised that they do not report a valuation until they receive one from the CCP.
- These members noted that a requirement to report internal valuations for a short amount of time prior to receiving the CCP valuation would be challenging, and would bring about misalignment with other jurisdictions.

4A. Industry Initial Submission

- Where counterparty consent to unmask identifying particulars has been obtained, withdrawal and resubmission of those trades from the original trade date with those particulars unmasked generates a new HKTR trade reference, with valuations flagged as missing from the trade date.

4B. Regulators' Response

- The Regulators have advised instead of using the Withdraw function, participants should use the Amendment template, or use the Quit function and then resubmit the trade as a Backloading event with the latest position date. This should avoid triggering the problem of missing valuations. The recommended method is the Quit method, and the Regulators will consider changing the SRI to allow for this.
- For those participants whose system functionality only allows them to use the Withdraw method, the Regulators understand that the missing valuations are a 'false alarm', do not need to be re-reported and can be 'bypassed'. Participants should contact the HKTR or their respective regulator and advise that the Withdraw is for unmasking purposes.
- The HKTR will also look to enhance its system functionality to better support this as part of their scheduled system upgrades next year.

4C. Industry Response

- One member noted 2 additional circumstances where such 'false alarm' valuations may be produced by the system, and would like to request whether a similar stance could be adopted by the Regulators in these situations:
    - Situations were a reporting entity needs to amend a trade through a cancel and rebook, whereby a Withdrawal is submitted followed by a New trade (thereby generating 'false alarm' missing valuations for the dates between the Trade Date and rebook date); and
    - Retrospectively reporting historical valuations for trades which are matured or terminated.

5A. Industry Initial Submission

- Members would like to request whether it would be possible for the 2702 report to only be generated for trades with missing valuations from T+2 onwards (ie; not for T or T+1). They further advised that the current 2702 report is accumulative, and the growing size of the file has been causing file transfer problems when downloading from the HKTR to member systems.

5B. Regulators' Response

- The reporting rules require valuations to be reported daily, including for T and T+1. Reporting entities have 2 days after the value date to report the valuation, and should ensure that they have the means and systems to do so, as late valuations are a breach of the rules. Reporting entities should prioritise late valuations for reporting. Having said that, the Regulators welcome further industry suggestions on how to minimise misleading alert 'noise' for valuations in HKTR 2702 which are not actually late.

5C. Industry Response

- The industry would welcome any system enhancements that the HKTR could make to ensure that late valuation report alerts are only generated for valuations not submitted within 2BD of the day in question. However, members noted that this enhancement will not suppress alerts for trades which are booked on T+1, and hence do not have a valuation for T.

HKTR Supported FRO/FRI Values

Industry Initial Submission

Members advised that the validations for floating rate options/indices (FROs/FRIs) are leading to rejected trades when the FRO is not on a list of maintained by the HKTR. While it is understood that the HKTR is basing its reference data on those FROs that are in the ISDA Definitions, members requested whether the HKTR validation can be relaxed to free-format. Members understand that this would allow a number of previously-rejected trades to be successfully reported in quick time.

Members believe that expanding the list of FROs would be a less optimal solution, as the list would need to be kept constantly up to date. They have also advised that reporting requirements in foreign jurisdictions generally allow free-format FRO submission, and do not validate the FRO against a list of reference FROs.

Regulators' Response

The Regulators understand that some reporting entities have to use the Others template where the particular FRO/FRI is not supported in the drop-down list in the Standard template, and that in these cases the reporting entities tend to leave the FRI field blank and populate the FRI in the Underlying Asset field.

At this point, the HKTR is only able to support FROs in the ISDA Definitions. The HKTR FRI validation list was last updated in 2016, and going forward the HKTR intends to align the FRI list to the FROs in the ISDA Definitions every 6 months. In response, ISDA advised that it does not have any current plans to expand the list of FROs in the ISDA Definitions, as the process for doing so is time and resource intensive, and can only be considered for FROs which are widely used across the derivatives market.

Therefore, in the next system enhancement, the HKTR will add an additional value called 'Others' to the list of drop-down values in the FRI field in the Standard template. Until this is implemented, the Regulators do not expect participants to report trades where the only reason they cannot be supported in the Standard template is because the FRI value is not supported by the HKTR. After the system enhancement is implemented, reporting entities should take the following actions:

New trades where the FRI is not a supported value in the Standard template → Report using the 'Others' drop-down FRI value in the Standard template.

New trades where the FRI is a supported value in the Standard template → Report using the FRI value.

Existing trades rejected by the HKTR only due to the FRI value not being a supported value in the Standard template, and this remains the case → Backload using the 'Others' drop-down FRI value.

Existing trades rejected by the HKTR only due to the FRI value not being a supported value in the Standard template, and the FRI is now in the list → These can remain unreported as long as there are no post-trade events. If a post-trade event occurs, report the trade using the FRI value in the Standard template.

Trade amendments where the FRI is not a supported value in the Standard template, and this remains the case → Report the amendment with the 'Others' drop-down FRI value.

Structured products which need to reported in the Others template → These should have already been reported, as the FRI is not validated in the Others template.

Industry Response

Members support the proposed approach, and requested that HKTR provide ample notice ahead of the enhancement, as reporting entities will need to make internal system changes to support this enhancement. A reporting agent also noted the need to work closely with the industry in relation to this system enhancement, to ensure that any FRI submission errors (such as misspellings or typographical errors) are isolated from genuine FRIs which do belong under the 'Others' dropdown.

One member also queried whether historical trades reported under the Others template with the FRI field blank would need to be re-reported when the system enhancement is completed, however based on ISDA's understanding, the HKTR system enhancements will only be made to the Standard template and therefore no changes would be required to be made to trades reported using the Others template. We would be grateful for clarification from the Regulators on this, and any associated actions which need or do not need to be taken.

Underlier Types – Proposed Hierarchy

Industry Initial Submission

The SRI (paras 127-128 and 135-136) refer to the list of underlier types that may be used when reporting. While the ISIN has been stipulated as the top-order identifier type, members have largely agreed a proposed hierarchy for the remaining types, and would like to check if the Regulators would be comfortable with the below proposed approach:

Equity Underlying Asset Identifier Type: ISIN > RIC > SEDOL > VALOREN > CUSIP > Bloomberg > Instrument Name:

Credit Reference Obligation Id Type: ISIN > RED > CUSIP > Bloomberg:

Regulators' Response

The Regulators are agreeable, and support industry efforts to agree a waterfall.

The Regulators also suggested that ISDA and industry propose these waterfalls to the CPMI-IOSCO Critical Data Elements (CDE) Harmonisation Group. The Regulators will also encourage reporting entities to comply with the industry-agreed best practice waterfalls above, in the SRI.

Industry Response

Members thank the Regulators for their agreement and will proceed to implement the waterfall as a best practice.

Entity Name Validation

Industry Initial Submission

While members understand the intent behind SRI para 122, they have also advised that submissions of entity names which match the ones stored in the Global LEI System (GLEIS) are being rejected. Given the LEI's wide-ranging, multi-jurisdictional adoption, strong governance structure and robustness of reference data, members would like to request if validation of entity names can be done against the GLEIS.

Regulators' Response

As part of HKTR onboarding, reporting entities are required to provide their LEI and legal name, however there are cases where the name uses other language characters (eg; Japanese). The Regulators understand that this may be the source of the issue, and noted that the Global LEI Foundation (GLEIF) provides translations into English names. The Regulators would also like to understand how reporting entities deal with this issue when using reporting agents.

ISDA advised that the issue seems to be wider than foreign character translations, and noted that even a difference of one character in the legal name (eg; a missing full stop or extra space) seems to lead to a rejection. More broadly, validation should only be done against the LEI code. Other entity data such as the legal name should not be validated, but rather viewed as reference data to be obtained from the GLEIS.

Industry Response

Members believe that while character translation differences may contribute a small proportion of the rejections, the larger proportion of errors are due to syntax. To provide some examples:

- While SRI paragraph 122 states that the name should be reported as "Bank of East Asia, Limited (The)", the GLEIS record (LEI: CO6GC26LCGGRTUESIP55) is "The Bank of East Asia, Limited".
- A member was advised by HKTR staff that the registered legal name for "AB (HK) Unit Trust Series - AB (HK) European Income Portfolio" should be "AB (HK) UNIT TRUST SERIES : AB (HK) EUROPEAN INCOME PORTFOLIO" according to the Business Registration. However, the GLEIS record (LEI: 5493002VW0FBOKK61873) is "AB (HK) Unit Trust Series - AB (HK) European Income Portfolio".

A reporting agent advised that it does not validate entity names, except to reject unsupported characters.

Members would again note that validation against any other set of records than the GLEIS (where an LEI is available) will inevitably lead to these differences, which are very minor in scope (often just a difference of a character or a few), but have a major impact in terms of the trade being rejected for reporting. We would submit that it would be much more efficient to relax the validation and allow a number of trades to be reported in quick time, than to maintain the validation and constantly encounter rejections due to minute and inconsequential character differences. Members would therefore again request that the legal name not be validated where an LEI exists and is reported.

Use of Others Template

Industry Initial Submission

At a strategic level, members also wished to communicate and highlight the operational complexities involved in switching from using the Standard template to the Other template for a particular trade type, and explore with the Regulators where efforts could be undertaken to reduce the amount of times where a trade has to be reported using the Other template due to a particular feature or validation. Members noted that changing the template for STP reporting based on certain trade characteristics is not a simple feat, including for firms using reporting agents where the template is driven by the taxonomy.

Using reporting of zero notional swaps as an example, a member noted that since the notional amount is a required field under the IRS Standard template, reporting entities have to first report this type of trade by using the IRS Other template, where the notional amount can be left blank. Subsequently, when the initial exchange rate is reset, reporting entities should report the corresponding notional amount per the reset rate with the Amendment template. The member noted that this appears to be one of a number of cases where using different a template is suggested as a solution to reporting information that is not supported within the Standard template, and highlighted that changing the template to be used may not be the most effective or optimal solution.

Regulators' Response

In the case of zero notional swaps, the Regulators advised that it does not need to be reported back in Standard template once the notional size is known, but can rather stay in the Others template. Nevertheless, the Regulators appreciate that standard templates may exist for these within the GTR (for those using DTCC) but must be reported using the Others template for reporting to HKTR (an example of which is swaptions). If a significant volume of a particular trade type is reported, the HKTR will consider building a Standard template to support that product. The Regulators are happy to receive suggestions as to which products are best-placed for this transition to the Standard template.

Industry Response

Members welcome the Regulators' proposal to consider building Standard templates for particular products, and ISDA will seek further member feedback on which products would be best-placed for migration. Against this backdrop however, members wished to reiterate that in a number of scenarios generally, the SRI/AIDG require the Others template to be used due to a particular feature or validation not being accommodated in the Standard template. There are significant technical and operational complexities involved in shifting workflows from using the Standard template to the Others template, including for reporting agents which need to support both Standard and Others templates for the same product type (eg; IRS). Therefore, members would request the HKTR to assess a more strategic solution which involves updating the Standard template for existing product types, instead of defaulting to the Others template. We would warmly welcome further discussions with the Regulators on this matter.

Applying this approach to zero notional swaps, one solution could be that where the notional is not known at the time of booking, the HKTR could accept a dummy value, value of zero or provisional/estimated notional in the Standard template. The notional could then be updated once the exchange rate is set.