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**27 April 2018**

Dear Sirs and Madams,

**Re: Joint consultation paper on enhancements to the OTC derivatives regime for Hong Kong to– (1) mandate the use of Legal Entity Identifiers for the reporting obligation, (2) expand the clearing obligation and (3) adopt a trading determination process for introducing a platform trading obligation (Consultation Paper)**

The International Swaps and Derivatives Association, Inc. (“**ISDA**”) welcomes the opportunity to respond to the Consultation Paper, which covers important matters to our members and puts forth well-considered proposals to ensure that the Hong Kong OTC derivatives regime remains aligned with the overall goals of the Hong Kong Monetary Authority (“**HKMA**”) and Securities and Futures Commission (“**SFC**”) (collectively, “**the Regulators**”), as well other OTC derivative regimes regionally and globally. We also take this opportunity to express our thanks for the constructive and efficient engagement with the Regulators on these issues to date.

Since 1985, ISDA has worked to make the global derivatives markets safer and more efficient. Today, ISDA has more than 900 member institutions from 68 countries. These members comprise a broad range of 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, such as

exchanges, intermediaries, clearing houses 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 website: [www.isda.org](http://www.isda.org). Follow us on Twitter @ISDA.

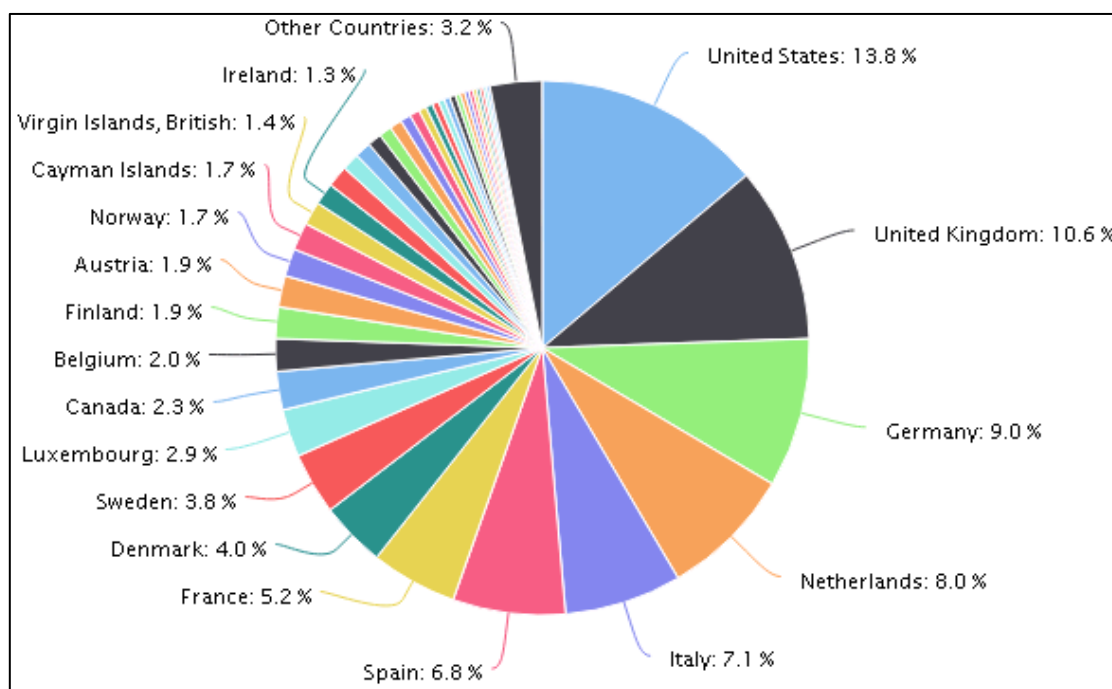
ISDA is actively engaged with providing input on regulatory proposals in the United States (“US”), Canada, the European Union (“EU”) and across the Asia-Pacific region. Our response is derived from this international experience and dialogue in addition to consultation with our members operating in the Asia-Pacific region.

We believe that the proposals within the Consultation Paper are sound and are in line with the G20’s overall commitments to improve transparency in the derivatives markets, mitigate systemic risk, and protect against market abuse.

## **MANDATING THE USE OF LEGAL ENTITY IDENTIFIERS FOR THE REPORTING OBLIGATION**

On the whole, members are supportive of the proposed LEI requirement in Hong Kong, and believe this will align Hong Kong with other international financial centres such as the EU, US and India. Adoption of the LEI requirement will assist entities subject to overseas reporting regimes which require the use of the LEI, and will simplify operational aspects of identifying counterparties. Further, members note that the LEI is an internationally-recognised identifier which will contribute to the standardisation of data reporting requirements on a global level. This will greatly assist regulators in their ability to monitor market conduct and analyse systemic risk. Members are also generally supportive that the implementation timing should be in phases based on entity readiness.

Increasing the level of uptake of LEIs across the Asia-Pacific region has been a challenge to date, representing less than 3.2% of total LEI issuance globally, and with no Asia-Pacific jurisdictions featuring in the top 18 jurisdictions by LEI issuance, as shown in the following chart:

**Chart 1: LEI issuance by country**

Source: GLEIF website: "[LEI Statistics](#)"

The industry has nevertheless engaged in consistent and extensive awareness and outreach efforts ahead of the commencement of the EU MiFID II / MiFIR regime, including through the publication of an ISDA-GFMA LEI outreach factsheet <sup>1</sup>, which was distributed to a large number of members, chambers of commerce, accounting associations and treasury associations. Notwithstanding this, the number of LEIs in the region has not increased dramatically. To this end, we would encourage the Regulators to engage in discussion with their peers across the region, with a view to harmonising the requirement for an LEI, and to discuss a possible coordinated approach to implementation and implementation timeline for requiring the LEI. However, it may not be necessary to align the timeline for LEI mandate in HK with other jurisdictions.

We set out members' responses to the individual questions in the Consultation Paper below.

<sup>1</sup> [https://www.isda.org/a/c0IDE/ISDA\\_GFMA\\_LEI\\_FAQ\\_Outreach\\_2017\\_PUBLIC\\_ENGLISH.pdf](https://www.isda.org/a/c0IDE/ISDA_GFMA_LEI_FAQ_Outreach_2017_PUBLIC_ENGLISH.pdf)

**Q1: Do you have any comments or concerns about how we propose to mandate the use of LEIs in OTC derivatives trade reporting? Where appropriate, please separate your comments and concerns for the two phases and the treatment of trades that have already been reported to the HKTR.**

*No LEI, No Trade*

The proposed prohibition on entering into a reportable transaction if the reporting entity is not able to identify its transacting party by an LEI is similar to the prohibition on entering into a reportable transaction without a client LEI under the MiFID II / MiFIR regime. Experience with the implementation of that regime suggests that firms may face some challenges in getting certain counterparties to obtain an LEI, even by the extended 2020 deadline. Once the mandate is final, ISDA urges the Regulators to closely monitor the progress that the industry is making in obtaining LEIs for clients in the region to ensure that the mandatory 2020 deadline will be met, and to provide some flexibility, if needed, for a small number of clients that may still be outliers when the deadline is at hand. This may be more pronounced for where there is a more limited or no impact of an existing LEI mandate in another jurisdiction. A similar approach was used in the MIFID II /MiFIR regime, and has proven to be effective in allowing trading to continue while firms continue to work diligently to obtain LEIs for these clients.

*Ability to manage positions*

The Consultation Paper makes clear that trades already reported to the HKTR do not need to be replaced upon implementation of the new LEI mandate, however, the Regulators would require the LEI to be obtained in the event of a lifecycle change to the existing position. There is some concern that firms may have more difficulty obtaining an LEI for such a lifecycle change if the counterparty has not obtained, or is refusing to obtain, an LEI. Entities may still have an obligation to the counterparty to keep the position, unwind it, or enter into an equal and opposite transaction to cancel out the existing position. This could include, for example, the situation where existing positions exist with a counterparty with which there is no longer a trading relationship. In such scenarios, we would welcome clarification that the entity would not be held liable for incorrect reporting due to the actions of a transacting party over which it does not have control.

Members recognise that continued reporting of lifecycle events for long-dated positions without an LEI may give rise to failed reports. However, given the need for some form of transitional period to address existing client positions with no LEI, members would request that the Regulators consider introducing an interim period during which a “No LEI, No New Trade” policy would apply, but lifecycle events for existing trades could continue to be managed effectively, using the original identifier.

Members also note that for entities using the services of reporting agents, replacing a counterparty identifier in an existing transaction with the LEI when a lifecycle event occurs

may require a withdrawal of the existing position and a backload of the transaction with the new information, which may be a manual and operationally cumbersome process. If a party to the transaction delays lifecycle event reporting due to the requirement to use the LEI, this may lead to a situation where unlinked and/or unmatched trades are created in the Hong Kong Trade Repository (“**HKTR**”), for transactions which have previously been linked and matched. We urge the Regulators to give further thought to how the occurrence of such situations may be minimised as much as possible.

### *Interaction with masking relief*

We thank the Regulators for the clarification that the current masking relief will not be affected by the proposal to mandate the use of LEIs in trade reporting. Members understand that this means that transactions containing an internal client code will not be rejected by the HKTR.

### *Local Operating Units*

To help with implementation of the new mandate once it is finalised, we urge the Regulators to help market participants understand how an LEI can be obtained. For example, by bringing awareness to the market as to which Local Operating Units (“**LOUs**”) service the APAC region, and furthering awareness that some global LOUs will provide an expedited, intraday service for obtaining an LEI. Further, the Regulators may want to consider if an LEI issuing entity could or should be established in Hong Kong to serve the markets in this region, either as an LOU or as an LEI Registration Agent. Such an approach could smooth the adoption of the LEI in the region, as market participants may be more apt to want to deal with a local entity for obtaining their LEI.

### *Treatment of affiliates*

One member notes that it may not always be clear when a counterparty is a “transacting party which reporting entities report or act for”. For example, Counterparty A (which is a reporting entity in Hong Kong) may not be aware when transacting with Counterparty B that it is actually Counterparty B’s Hong Kong affiliate which is reporting the trade to the HKTR, as the transaction was “conducted in Hong Kong”. In this instance it may be difficult for Counterparty A to report Counterparty B’s affiliate’s LEI, however, from the perspective of Counterparty B, the affiliate itself should report Counterparty B’s LEI. The member would welcome confirmation that the LEI requirement in this instance does not apply to counterparties, but only applies where the reporting entity itself is reporting on behalf of another transacting party.

### *Treatment of order placers and funds*

One member requests clarification on the situation where there is an order placer, and whether the LEI of the transaction party refers to the LEI at the principal level or the order placer level,

taking into account global consistency with regimes such as the European Markets Infrastructure Regulation (“**EMIR**”).

The member notes that where there is a requirement for the transacting party to provide an LEI before entering into a transaction, the global practice is to seek an LEI from the order placer. The current industry practice does not require an order placer to identify the LEI of all principals at the time of execution of the transaction. Therefore, the member would like to confirm that it would be acceptable to report the LEI of the order placer at the time of execution, as long as the LEI of the principal is reported within T+2.

Members would further like to request whether provision of the LEI of an investment manager would be acceptable in the absence of a fund-level LEI, noting that in many pre-allocation trades, only the LEI at the initial margin level may be available.

### *Transparency*

Although the scope of the proposed obligation is clear, small-sized entities may not recognise the scope implications, or be aware of their obligations. Experience suggests that a single source of clear and impartial information on the obligation provided by a recognised regulatory authority would be beneficial in conveying the extent of the new rules and impressing the need for small-sized entities to obtain an LEI. Further public information about the new obligation and the process for obtaining an LEI which can be used to ensure that end clients receive a consistent message will facilitate orderly implementation.

To this end, it may be beneficial to provide further clarifications and examples of the delineation between categories (a) to (e) of paragraph 28 of the Consultation Paper. Some members also suggest that publication of a list of in-scope entities under the various categories would help to achieve unified implementation in the market.

Separately, we would encourage the Regulators to continue dialogue with the industry on how they intend to use LEI information and data to enhance market transparency.

**Q2: Will you have any difficulties adopting the use of LEIs in OTC derivatives trade reporting according to the proposed timelines? If so, please provide details of your difficulties.**

### *Timelines*

As discussed earlier, increasing the level of uptake of LEIs across the Asia-Pacific region has been a challenge to date, and an appropriate balance against current realities is important. As recognised by the Regulators, one of the areas where the issue may be particularly pronounced is in the context of smaller clients who may still fall within the first phase, where continued

outreach and awareness efforts will be necessary. The Regulators may wish to also retain a degree of flexibility in this respect, as discussed previously.

## **PHASE 2 CLEARING**

Members are supportive of the well-considered proposals in the Consultation Paper.

The Regulators may wish to give thought to updating the list of Prescribed Persons, in order for Financial Services Providers (“FSPs”) to be aware as to which counterparties they will be required to clear with.

## **ADOPTING A TRADING DETERMINATION PROCESS FOR INTRODUCING A PLATFORM TRADING OBLIGATION**

Members are generally supportive of the proposed trading determination process, and agree with the proposed factors in paragraph 72 of the Consultation Paper. However, looking ahead beyond adoption of the process, it is vitally important that the Regulators take into account, and seek to prevent, some of the difficulties and complexities experienced with implementation of platform trading requirements in other jurisdictions. ISDA has been active in responding to various overseas consultations on platform trading obligations, including the recent European Securities and Markets Authority (“ESMA”) consultation on the trading obligation for derivatives<sup>2</sup> in August 2017, and the Monetary Authority of Singapore’s (“MAS”) Consultation Paper on Draft Regulations for Mandatory Trading of Derivatives Contracts in March 2018.

Additionally, in February 2017, ISDA also published a set of principles<sup>3</sup> for achieving comparability determinations between US and EU trading platforms. Underpinning the analysis is the principle that regulators should focus on broad outcomes and similarities, rather than conduct a granular, rule-by-rule comparison of the two frameworks. ISDA and its members would strongly support the adoption of an identical approach in the context of trading platform comparability determinations between those based in the Asia-Pacific and those further afield.

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<sup>2</sup> <https://www.isda.org/category/infrastructure/trading/>

<sup>3</sup> <https://www.isda.org/2016/02/24/isda-publishes-principles-for-useu-trading-platform-recognition/>

**Q12: Do you have any comments or concerns regarding our proposed trading determination process and criteria? If you do, please provide specific details.**

Members welcome the statement that further consultation will occur on the feasibility, scope and timing for implementing a platform trading obligation in Hong Kong. It is important that market participants have the chance to comment on the details of the trading obligation regime in Hong Kong to make sure that it can be smoothly implemented.

*International alignment*

As discussed, members would like to highlight the critical importance of alignment with mandatory platform trading obligations in other jurisdictions (such as the EU, the US and Japan), as well as providing for mechanisms such as substituted compliance, mutual recognition and/or venue equivalence. These will avoid the potential for market fragmentation, low trading liquidity and/or regulatory inconsistency. Key to the success of this alignment will be clear and early recognition of overseas trading venues, well-ahead of the commencement of any potential platform trading obligation in Hong Kong. Such venues should include, but not be limited to, Swap Execution Facilities (“SEFs”) under the US regime, and Multilateral Trading Facilities (“MTFs”) under the EU regime. Similarly, members suggest that further clarification and guidance be given on what constitutes a trading platform or venue.

In keeping with this theme of international alignment, the Regulators are encouraged to consider the scope for any potential exemptions from any platform trading obligation, such as for block trades, package trades, derivative contracts arising from trade compression, and swaps resulting from the exercise of a swaption. Members note that other jurisdictions have had to grapple with these issues, sometimes on a drawn-out basis, due to a lack of upfront clarity and/or full consideration of the issues at play. We consider that the Regulators have an opportunity to benefit from these experiences in foreign jurisdictions, to ensure that similar issues do not arrive in the context of any platform trading obligation in Hong Kong/

*Potential scope*

Members would strongly believe that an analysis of the factors in paragraph 72 of the Consultation Paper would lead the Regulators to conclude that any future platform trading mandate should be limited to transactions in the dealer market.

Similarly, to avoid undue operational burden, implementation complexity and confusion, members would strongly suggest that the scope of any future platform trading mandate apply to transactions booked in Hong Kong only, and not to transactions conducted in Hong Kong (otherwise known as “nexus” transactions). Members have expressed very strong concerns that any requirement to execute “nexus” transactions in Hong Kong would likely present significant challenges in implementation effort. As an example, it would be overly burdensome if pre-trade checks had to be conducted not just by members themselves to assess if they may be



subject to the trading obligation, but also on their respective counterparties (including on a trade-by-trade basis).

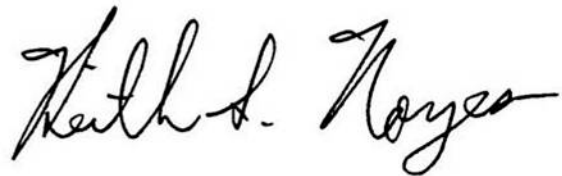
These comments are in line with ISDA responses to other recent consultations regarding a potential mandatory platform trading obligation in the Asia-pacific region. We would welcome the opportunity to provide further detail on this matter, in the event that the Regulators are considering a mandatory platform trading obligation at this point in time.

Thank you again for allowing us to respond to this Consultation Paper, which has been well-received and welcomed by members. We look forward to continuing our dialogue with you over the coming weeks and months. Please do not hesitate to contact Rishi Kapoor, Director, Policy, Asia-Pacific ([rkapoor@isda.org](mailto:rkapoor@isda.org); +852 2200 5907) to discuss further.

Yours sincerely,



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