

# Consultation paper on the Securities and Futures (OTC Derivative Transactions – Reporting and Record Keeping) Rules

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HONG KONG MONETARY AUTHORITY  
香港金融管理局



SECURITIES AND  
FUTURES COMMISSION  
證券及期貨事務監察委員會

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## FOREWORD

In line with global efforts, the Hong Kong Monetary Authority (**HKMA**) and the Securities and Futures Commission (**SFC**) have been working with the Hong Kong Government and stakeholders on developing a regulatory regime for the over-the-counter (**OTC**) derivatives market in Hong Kong.

To that end, and subsequent to two consultation exercises (conducted in October 2011 and July 2012), the Securities and Futures (Amendment) Ordinance 2014 was passed by the legislature in March 2014. This piece of legislation has yet to come into operation. Among other things, it introduces mandatory reporting, clearing, trading and record keeping obligations in respect of OTC derivative transactions. It also envisages that the precise ambit of these obligations, and their related details, will be set out in rules to be made by the SFC with the HKMA's consent and after consultation with the Financial Secretary.

This paper sets out the HKMA's and SFC's detailed proposals for the mandatory reporting and related record keeping obligations. A draft of the proposed rules on these obligations is also attached at **Appendix A**. Interested parties are invited to submit written comments by any one of the following methods on or before **18 August 2014**. This paper should be read in conjunction with papers relating to the two earlier consultation exercises.

By online submission at: <http://www.sfc.hk/edistributionWeb/gateway/EN/consultation/>

By email to: [fss@hkma.gov.hk](mailto:fss@hkma.gov.hk) or [otcconsult@sfc.hk](mailto:otcconsult@sfc.hk)

By fax to: (852) 2878 7297 or (852) 2521 7917

By post to one of the following:

Financial Stability Surveillance Division	Supervision of Markets Division
Hong Kong Monetary Authority	The Securities and Futures Commission
55/F Two International Finance Centre	35/F Cheung Kong Center
8 Finance Street, Central	2 Queen's Road Central
Hong Kong	Hong Kong

Any person wishing to submit comments on behalf of any organization should provide details of the organization whose views they represent.

**Please note that the names of commentators and the contents of their submissions may be published by the HKMA and / or SFC on their respective websites and in other documents to be published by them. In this connection, please read the Personal Information Collection Statement attached to this consultation paper.**

**You may not wish your name and / or submission to be published by the HKMA and / or SFC. If this is the case, please state that you wish your name and / or submission to be withheld from publication when you make your submission.**

July 2014

# PERSONAL INFORMATION COLLECTION STATEMENT

1. This Personal Information Collection Statement (**PICS**) is made in accordance with the guidelines issued by the Privacy Commissioner for Personal Data. The PICS sets out the purposes for which your Personal Data<sup>1</sup> will be used following collection, what you are agreeing to with respect to the HKMA's and / or SFC's use of your Personal Data and your rights under the Personal Data (Privacy) Ordinance (Cap. 486) (**PDPO**).

## Purpose of collection

2. The personal data provided in your submission to the HKMA and / or SFC in response to this consultation paper may be used by the HKMA and SFC for one or more of the following purposes –
  - (1) to administer –
    - (a) in the case of the HKMA, the provisions of the Banking Ordinance (Cap. 155) and guidelines published pursuant to the powers vested in the HKMA; and
    - (b) in the case of the SFC, the relevant provisions<sup>2</sup> and codes and guidelines published pursuant to the powers vested in the SFC;
  - (2) in performing –
    - (a) in the case of the HKMA, statutory functions under the provisions of the Banking Ordinance (Cap. 155) and the Securities and Futures Ordinance (Cap. 571); and
    - (b) in the case of the SFC, its statutory functions under the relevant provisions;
  - (3) for research and statistical purposes; or
  - (4) for other purposes permitted by law.

## Transfer of personal data

3. Personal data may be disclosed by the HKMA and / or SFC to members of the public in Hong Kong and elsewhere as part of the public consultation on this consultation paper. The names of persons who submit comments on this consultation paper,

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<sup>1</sup> Personal data means personal information as defined in the Personal Data (Privacy) Ordinance (Cap. 486).

<sup>2</sup> The term "relevant provisions" is defined in section 1 of Part 1 of Schedule 1 to the Securities and Futures Ordinance (Cap. 571) and refers to the provisions of that Ordinance together with certain provisions in the Companies (Winding Up and Miscellaneous Provisions) Ordinance (Cap. 32), the Companies Ordinance (Cap. 622) and the Anti-Money Laundering and Counter-Terrorist Financing (Financial Institutions) Ordinance (Cap. 615).

together with the whole or any part of their submissions, may be disclosed to members of the public. This will be done by publishing this information on the HKMA and / or SFC website and in documents to be published by the HKMA and / or SFC during the consultation period or at its conclusion.

## **Access to data**

4. You have the right to request access to and correction of your personal data in accordance with the provisions of the PDPO. Your right of access includes the right to obtain a copy of your personal data provided in your submission on this consultation paper. The HKMA and SFC have the right to charge a reasonable fee for processing any data access request.

## **Retention**

5. Personal data provided to the HKMA and / or SFC in response to this consultation paper will be retained for such period as may be necessary for the proper discharge of the HKMA's and SFC's respective functions.

## **Enquiries**

6. Any enquiries regarding the personal data provided in your submission on this consultation paper, or requests for access to personal data or correction of personal data, should be addressed in writing to –

In the case of the HKMA –

Personal Data Privacy Officer  
Hong Kong Monetary Authority  
55/F Two International Finance Centre  
8 Finance Street  
Central  
Hong Kong

In the case of the SFC –

The Data Privacy Officer  
The Securities and Futures Commission  
35/F Cheung Kong Center  
2 Queen's Road Central  
Hong Kong

7. A copy of the Privacy Policy Statement adopted by the HKMA and SFC is available upon request.

## EXECUTIVE SUMMARY

1. The Hong Kong Monetary Authority (**HKMA**) and the Securities and Futures Commission (**SFC**) have been working on developing a regulatory regime for the OTC derivatives market in Hong Kong.
2. To that end, and subsequent to two consultation exercises (conducted in October 2011 and July 2012), the Securities and Futures (Amendment) Ordinance 2014 (**Amendment Ordinance**) was passed by the legislature in March 2014. This piece of legislation has yet to come into operation. Among other things, it introduces mandatory reporting, clearing, trading and record keeping obligations in respect of OTC derivative transactions. It also envisages that the precise ambit of these obligations, and their related details, will be set out in rules to be made by the SFC with the HKMA's consent and after consultation with the Financial Secretary.
3. We propose to implement the mandatory obligations in phases starting first with mandatory reporting and related record keeping obligations. Our detailed proposals on the requirements are set out in this Consultation Paper, which also includes (at **Appendix A**) a draft of the proposed Securities and Futures (OTC Derivative Transactions – Reporting and Record Keeping) Rules (**Draft Rules**).
4. The proposals in this consultation paper have been developed jointly by the SFC and the HKMA, and with input from the industry.
5. In brief, our proposals for mandatory reporting are as follows.

### **Reportable transactions**

6. The reporting obligation will only apply in respect of certain transactions (**reportable transactions**). We propose that at the initial stage these will only comprise the following types of OTC derivative transactions (**product types**) falling within the following classes (**product classes**) –

<b>Product class</b>	<b>Product type</b>
Interest rate swaps ( <b>IRS</b> )	- plain vanilla IRS (floating vs. fixed) - plain vanilla basis swap (floating vs. floating) in each case, in currencies and floating rate indices to be specified by the HKMA <sup>3</sup>
Non-deliverable forwards ( <b>NDF</b> )	- non-deliverable forward transactions in currencies (including some precious metals) to be specified by the HKMA <sup>4</sup>

<sup>3</sup> The current intention is to specify only those currencies and floating rate indices listed in the International Organization for Standardization (**ISO**) 4217 currency list and FpML Coding Schemes-5.76 Floating Rate Index Scheme respectively, and supported by the HKMA's electronic trade reporting system.

7. The Draft Rules will describe reportable transactions by reference to both their product class and product type. They will also set out the day on which a particular product class is first specified (**product class specification day**) and the day on which a particular product type is first specified (**product type specification day**).

### ***Reporting entities***

8. Under the Amendment Ordinance, mandatory reporting will apply to authorized institutions (**AIs**), approved money brokers (**AMBs**), licensed corporations (**LCs**) and other persons to be prescribed by subsidiary legislation. In relation to such other persons, we propose to prescribe –
  - (a) central counterparties (**CCPs**) that provide clearing services to persons in Hong Kong, and
  - (b) other persons that are based in or operate from Hong Kong (**Hong Kong persons**).
9. More specifically, we will only capture CCPs that are recognized clearing houses (**RCHs**), or authorized under section 95(2) of the SFO to provide automated trading services (**ATS-CCP**). We will also only capture such entities when they are acting in their capacity as a CCP. In other words, they will only need to report transactions that they have entered into as part of the clearing process.
10. As for Hong Kong persons, we propose that this should capture the following –
  - (a) all Hong Kong residents and all entities established under Hong Kong law (including all partnerships, trusts, companies and other entities established under Hong Kong law), and
  - (b) all overseas companies registered, or required to be registered, under the Companies Ordinance (**non-Hong Kong companies**).
11. However, it will not include non-corporate entities established overseas, even if they are registered or have a presence here (e.g. overseas partnerships, trusts, etc). We expect that such operations, other than hedge funds which we deal with separately under paragraph 13 below, are unlikely to be active in the OTC derivatives market here, and hence do not propose to include them in the initial stage.

### ***Reporting obligation for AIs, AMBs and LCs***

12. We propose that in the case of AIs, AMBs and LCs there should be three reporting limbs, i.e. they should report reportable transactions that –
  - (a) they are a counterparty to (and, in the case of an overseas AI, this means that the transaction must be booked with a Hong Kong branch),

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<sup>4</sup> The current intention is to specify only those currencies and precious metals listed in the ISO 4217 currency list, and supported by the HKMA's electronic trade reporting system.

- (b) they have conducted in Hong Kong on behalf of an affiliate (and, in the case of an overseas AI, this limb will be slightly different in that: (i) it will only cover transactions conducted by a Hong Kong branch; and (ii) it will cover both transactions conducted on behalf of an affiliate and those conducted on behalf of the AI's head office or other non-Hong Kong branches), or
  - (c) they have entered into on behalf of a counterparty in their capacity as a person licensed or registered to carry on Type 9 regulated activity (asset management) for that counterparty.
13. The proposals described in paragraphs 12(b) and 12(c) above are different from those exposed in the earlier consultations. The changes take into account further discussion with the industry. We believe the revised proposals should be acceptable to most market participants. We also note that the proposal described in paragraph 12(c) above will mean that although an offshore fund might not itself be subject to mandatory reporting under Hong Kong law, its positions might still be reportable if it is managed by an AI, AMB or LC that is licensed or registered to carry on Type 9 regulated activity.

### ***Reporting obligation for CCPs***

14. After a transaction is accepted for clearing, the original transaction is terminated by the two counterparties and two new transactions are then entered into between the CCP and the clearing members. In the case of CCPs that operate here as an RCH, we propose that they should report all transactions that have been entered into by them as part of the clearing process and that they are thus a counterparty to.<sup>5</sup> In the case of CCPs that operate here as an ATS-CCP, we propose that the reporting obligation should only apply where the other counterparty is a Hong Kong incorporated company. This is because ATS-CCPs will invariably be based overseas and primarily regulated in their home jurisdiction. Moreover, many of the transactions cleared through such CCPs are likely to have no connection to Hong Kong. It would therefore be disproportionate to require them to report all of their transactions.
15. The proposal to require CCPs to report is new – in our earlier consultations, we had indicated that CCPs would not be required to report. However, given that CCPs in many major markets are required to report, we consider it appropriate for Hong Kong to adopt a similar approach. We note also that this proposal will not subject CCPs to unreasonable costs. This is because while the HKMA will charge a fee for reporting through an electronic reporting system developed and operated by or on behalf of the HKMA (**HKTR**), the fee is not excessive (HK\$3 for each transaction reported to the HKMA that is still outstanding on the last business day of the month), and is also capped (at HK\$1 million per reporting entity per annum).

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<sup>5</sup> In fact, under the Amendment Ordinance, persons other than AIs, AMBs and LCs can only be required to report transactions to which they are a counterparty.

### ***Reporting obligation for Hong Kong persons***

16. In the case of Hong Kong persons, again we propose that they should only report transactions to which they are a counterparty. We also propose that they only be subject to reporting if their transactions in a particular product class exceed a specified reporting threshold, and thereafter stay above a specified exit threshold. The proposed reporting/exit thresholds are US\$3 billion/US\$2.1 billion for IRS, and US\$1 billion/US\$0.7 billion for NDF. We estimate that approximately 95% of Hong Kong persons will be exempted from reporting their reportable IRS and NDF transactions if the thresholds are set at these levels. We propose to lower the thresholds at a later stage, albeit no earlier than 2017.

### ***Reporting obligation to include “backloading”, and subsequent events***

17. The reporting obligation will apply in respect of both –
- (a) new transactions, i.e. reportable transactions entered into from the day they become subject to reporting, and
  - (b) historical transactions, i.e. reportable transactions entered into before that day, but which are still outstanding on that day – the reporting of such historical transactions is commonly referred to as “backloading”.
18. There will however be the following limitations in respect of the backloading requirement –
- (a) For a Hong Kong person that is a non-Hong Kong company, only transactions entered into before the person reached the reporting threshold but after the relevant product class specification day will have to be backloaded.
  - (b) For an AI, AMB or LC, only transactions that they are a counterparty to will have to be backloaded (and, in the case of an overseas AI, this means only transactions that are booked with the AI’s Hong Kong branch). Transactions that the AI, AMB or LC has conducted in Hong Kong, or entered into on behalf of a person whose assets they manage (as described in paragraphs 12(b) and 12(c) above), will not have to be backloaded.
  - (c) Transactions that mature or are terminated before the expiry of the 3 to 6 month period allowed for backloading (described in paragraph 21 below) will not have to be backloaded.
19. Additionally, where a transaction has been reported, subsequent events relating to that transaction (e.g. changes in the economic terms or counterparty of the contracts) will also have to be reported to the HKMA via the HKTR.

### ***Time for reporting and backloading***

20. In general, we propose that new transactions and subsequent events must be reported on a T + 2 basis, except that new transactions entered into within 3 months from the product type specification day may be reported at any time within 6 months from that day.
21. For backloading, in general we propose that this must be completed –
  - (a) within 6 months in the case of Hong Kong persons, and
  - (b) within between 3 to 6 months in the case of other reporting entities.
22. The range of 3 to 6 months for backloading in respect of persons other than Hong Kong persons is to cater for different situations, such as –
  - (a) whether an AI, AMB or LC is entitled to the exempt person relief (discussed in paragraphs 26(b) and 27 below),
  - (b) whether and when an AI, AMB or LC ceases to be entitled to the exempt person relief, and
  - (c) when an entity becomes an AI, AMB, LC, RCH or ATS-CCP.

### ***Exemptions and reliefs***

23. We propose the following exemptions and reliefs from the reporting obligation.
24. A ***Hong Kong person*** will not have to report a transaction that is also reportable by an AI, AMB or LC. Hence, for example, if the counterparty to its transaction is an AI, AMB or LC, the Hong Kong person will not have to report it. In the context of funds, this also means that where a fund manager that is an AI or LC has to report a transaction, the fund will not have to report it as well. We hope that this exemption will further reduce the compliance burden for Hong Kong persons.
25. Additionally, for a Hong Kong person that is a partner of a partnership, so long as one partner, or another person authorized by the partnership, has reported a transaction, all partners will be taken to have complied with the reporting obligation.
26. In the case of an ***AI, AMB or LC***–
  - (a) It will be taken to have complied with the reporting obligation in respect of a transaction that it has conducted in Hong Kong on behalf of an affiliate, if the affiliate has confirmed, in good faith, that it has reported the transaction.
  - (b) It will be exempted from the reporting obligation if it is an “***exempt person***” in respect of the relevant product class, i.e. it meets the following criteria in respect of that product class –
    - (i) Its OTC derivative activities do not include those described in paragraphs 12(b) or 12(c) above, i.e. they do not include conducting

transactions in Hong Kong on behalf of an affiliate, or entering into transactions on behalf of another in the course of managing the other's assets.

- (ii) Its outstanding OTC derivative transactions in that product class do not exceed 5 in number, nor do they have an aggregate gross notional value of more than US\$30 million. Moreover, the counterparty to those transactions must not be a Hong Kong person. This is to avoid overlap between this relief and the exemption proposed for Hong Kong persons in paragraph 24 above.

27. The exempt person relief is a new proposal that was not exposed in the earlier consultations. It is designed to ensure that AIs, AMBs and LCs that are not active participants in the OTC derivatives market, and that wish to enter into OTC derivative transactions only intermittently, or for commercial hedging reasons are not discouraged from doing so because of the introduction of mandatory reporting – e.g. because they are unable to set up a connection with the HKTR in time. Given the rationale for the relief, entities that have already set up a connection with the HKTR for reporting transactions in a certain product class will be excluded from the exempt person relief for that product class. Specifically, this refers to the licensed banks that have already reported to the HKMA via the HKTR under the interim reporting requirement (see paragraph 44(a) below) and have outstanding reportable transactions in the product classes of IRS or NDF on the commencement of the Draft Rules. However, they will be entitled to the exempt person relief for any new product class specified in the future if they meet the necessary criteria for that product class.
28. Additionally, where a reporting entity has an extended period to report a transaction, i.e. –
- (a) more than the general T+2 business days to report a new transaction entered into within the first 3 months from the relevant product type specification day (as described in paragraph 20 above), or
  - (b) 3 to 6 months to complete any backloading (as described in paragraphs 21 and 22 above),
- and the transaction expires or reaches maturity within that extended period, then the transaction need not be reported.

### ***Form, manner and contents of reports***

29. It is proposed that in all cases where a transaction is reportable, it must be reported to the HKMA via the HKTR. It does not suffice to report to another trade repository (TR) outside Hong Kong. However, as market participants can report their transactions to the HKMA via an agent, it is open to them to report their transactions to an overseas TR and then appoint that TR as its agent for onward reporting to the HKMA.

30. In terms of the contents of any reporting, the details to be provided are set out in Schedule 2 to the Draft Rules and these include matters such as –
- (a) identifying the product class and product type to which the transaction belongs,
  - (b) particulars of the counterparty, subject to any masking relief under specific circumstances (discussed under paragraph 32 below),
  - (c) the effective date and maturity date of the transaction,
  - (d) information relating to the platform (if any) where the transaction is executed or centrally cleared, and
  - (e) details of the transaction – e.g. notional principal amount; underlying currency, precious metal or rate, etc.
31. We also propose to require the daily reporting of certain information relating to the valuation of transactions. However, this requirement will only apply to reporting entities other than Hong Kong persons. Moreover, it will only come into effect at a later date, possibly in or after 2015.
32. We propose to allow the masking of counterparty particulars in the following circumstances, i.e. –
- (a) where disclosure of such particulars is prohibited under the laws of an overseas jurisdiction, or by an authority or regulatory organization in that jurisdiction (and a list of such jurisdictions will be designated by the SFC, with consent from the HKMA), and
  - (b) in respect of historical transactions only (i.e. transactions entered into before the Draft Rules first take effect), where disclosure of the particulars requires the consent of the counterparty, and despite reasonable efforts, such consent cannot be obtained.
33. We further propose that once the limitation on disclosure is removed (e.g. if the prohibition under the relevant laws, or the requirement to obtain consent is uplifted, or once the necessary consents are obtained), then the counterparty particulars should be reported. In general, this should be done within 3 months after the uplifting of a prohibition, and within 1 month after obtaining the relevant consent.

#### ***Use and disclosure of data collected by the HKTR***

34. We intend that data collected by the HKMA via the HKTR will be used solely for regulatory and market surveillance purposes. The Amendment Ordinance provides the necessary disclosure gateways to enable the sharing of the data in the HKTR with relevant authorities and TRs, including authorities and TRs outside Hong Kong. Additionally, any public disclosure of data held with the HKTR will be in summary form so as to prevent particulars relating to the business or identity of any person from being ascertained from it.
35. We are considering the details of the mechanism for the sharing and public disclosure of TR data. We will closely monitor the international regulatory

development and maintain a close dialogue with overseas authorities on the global sharing of TR data.

### ***Related record keeping requirements***

36. In order that the HKMA and SFC may more effectively monitor and ascertain compliance with the mandatory reporting obligation, it will be supplemented by related record keeping requirements. This aspect of the regime was not discussed in our earlier consultations but proposed subsequently in light of global developments – we note that other jurisdictions have also included similar requirements when implementing OTC derivatives regulation.
37. For Hong Kong persons, we propose that they keep at least the following –
- (a) in respect of transactions that they must report, sufficient records to demonstrate compliance with their reporting obligation (and these should include the records specified in Part 2 of Schedule 3),
  - (b) where they are relying on not having reached the reporting threshold (or on having fallen below the exit threshold), sufficient records to demonstrate that they have not reached (or have fallen below) that threshold (including records of calculations performed in this regard), as well as records evidencing the transaction and its main economic terms,
  - (c) where they are relying on the exemption for Hong Kong persons (i.e. that the transaction is reportable by an AI, AMB or LC), records evidencing the transaction and its main economic terms, and
  - (d) where they are relying on the relief in respect of transactions that have matured or been terminated during the extended period for reporting (as described in paragraph 28 above), records evidencing the transaction and its main economic terms.
38. For all other reporting entities, we propose that they keep at least the following –
- (a) in respect of transactions that they must report, sufficient records to demonstrate compliance with their respective reporting obligation (and these should include the records specified in Part 1 of Schedule 3<sup>6</sup>),
  - (b) where they are relying on the exempt person relief, the records specified in Part 1 of Schedule 3, and other records sufficient to demonstrate that it was entitled to such exemption (including records of calculations performed in this regard),
  - (c) where they are relying on the relief in respect of transactions reported by an affiliate, the confirmation received from the affiliate,
  - (d) where they are relying on the relief in respect of transactions that have matured or been terminated during the extended period for reporting (as

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<sup>6</sup> The list under Part 2 of Schedule 3 (for Hong Kong persons) is less detailed than the list under Part 1 of Schedule 3 (for other reporting entities). This reflects that reporting entities that are regulated entities (i.e. that are not Hong Kong persons) will be subject to more stringent record keeping obligations.

described in paragraph 28 above, the records specified in Part 1 of Schedule 3, and

- (e) where the reporting was done through an agent, records relating to the agent's appointment and to demonstrate that the agent's compliance was monitored.

39. In all cases, we propose that records required to be kept must be kept for at least 7 years after the transaction has reached maturity or has been terminated.

# INTRODUCTION

## *Background*

40. In the wake of the 2008 global financial crisis, regulators around the world have been taking steps to reform the OTC derivatives market, with a view to improving transparency and reducing systemic risk in the OTC derivatives market. The G20 Leaders committed to reforms that would require –
- (a) OTC derivative transactions to be reported to trade repositories (**TRs**),
  - (b) standardised OTC derivative transactions to be centrally cleared through central counterparties (**CCPs**),
  - (c) standardised OTC derivative transactions to be traded on exchanges or electronic trading platforms where appropriate, and
  - (d) non-centrally cleared OTC derivative transactions to be subject to higher capital and margin requirements.

In respect of non-centrally cleared derivatives, a number of other risk mitigation techniques may be employed alongside margin requirements to further reduce risk in the market. We will closely monitor any international regulatory development in this area and adopt international standards where appropriate.

## *Reform efforts thus far*

41. Many major markets have been working towards implementing the G20 commitments. In Hong Kong, the Hong Kong Monetary Authority (**HKMA**) and the Securities and Futures Commission (**SFC**) have been working with the Hong Kong Government to do likewise. We have conducted consultations on a proposed regulatory regime for the OTC derivatives market in Hong Kong as summarised below –
- (a) In October 2011, we issued a joint consultation paper (**October 2011 Consultation Paper**) inviting views on a proposed regulatory regime for the OTC derivatives market.
  - (b) In July 2012, we issued a joint consultation conclusions paper (**July 2012 Consultation Conclusions**) together with a supplemental consultation (**Supplemental Consultation**) seeking further views on proposals for regulating key players<sup>7</sup> in the OTC derivatives market. Our conclusions on the Supplemental Consultation were issued in September 2013.

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<sup>7</sup> The focus here was on: (i) persons who perform some sort of intermediary or service provider role (e.g. as dealers, advisers, clearing services providers, portfolio managers or platform providers); and

42. Based on the results of these earlier consultations, an Amendment Bill (**Bill**) was published in the Government Gazette on 28 June 2013. The Bill sought to amend the Securities and Futures Ordinance (Cap. 571, **SFO**) to provide for the regulation of activities and other matters relating to the OTC derivatives market in Hong Kong. The Bill was introduced into the Legislative Council (**LegCo**) in July 2013, and passed (with amendments) in March 2014. The final version, incorporating amendments approved by LegCo, was gazetted in April 2014 as the Securities and Futures (Amendment) Ordinance 2014 (**Amendment Ordinance**).

### ***Summary of new regime***

43. In broad terms, the new regulatory regime put in place by the Amendment Ordinance is as follows –
- (a) Activities in the OTC derivatives market in Hong Kong will be jointly overseen and regulated by the HKMA and SFC.
  - (b) Certain OTC derivative transactions (as prescribed by subsidiary legislation) will be subject to mandatory reporting, i.e. they will have to be reported to an electronic trade reporting system developed and operated by or on behalf of the HKMA (**HKTR**).
  - (c) Certain standardised OTC derivative transactions (as prescribed by subsidiary legislation) will be subject to mandatory clearing, i.e. they will have to be centrally cleared through a designated CCP.
  - (d) Certain OTC derivative transactions (as prescribed by subsidiary legislation) will be subject to mandatory trading, i.e. they will have to be executed on a designated exchange or designated electronic trading platform.
  - (e) These mandatory reporting, clearing and trading obligations will essentially apply to four groups of persons: (i) authorized institutions (**AIs**); (ii) approved money brokers (**AMBs**); (iii) licensed corporations (**LCs**); and (iv) other persons as may be prescribed by subsidiary legislation.
  - (f) In order that the HKMA and SFC may more effectively monitor and ascertain compliance with these mandatory obligations, each obligation will be supplemented by related record keeping requirements. This aspect of the regime was not discussed in the earlier consultations but proposed subsequently in light of global developments – we note that other jurisdictions have also included similar requirements when implementing OTC derivatives regulation.

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(ii) persons whose positions or activities in the OTC derivatives market might raise concerns about potential systemic risk.

- (g) The precise scope and details of each of the mandatory obligations and related record keeping requirements (such as, to whom they apply, under what circumstances, in respect of which OTC derivative transactions, and subject to what exemptions and reliefs) will be set out in subsidiary legislation, i.e. in rules to be made under the SFO. The Amendment Ordinance accordingly empowers the SFC, with the consent of the HKMA and after consultation with the Financial Secretary, to make rules to provide for such details.
  - (h) In order to strengthen the regulation of intermediaries in the OTC derivatives market, the Amendment Ordinance expands the licensing regime under the SFO by introducing two new regulated activities (**RAs**),<sup>8</sup> and widening the scope of two existing RAs.<sup>9</sup>
  - (i) Under the new regime, the HKMA and SFC will have a degree of regulatory oversight in respect of systemically important participants (**SIPs**), i.e. persons who are not already regulated by either the HKMA or SFC but whose positions or activities in the OTC derivatives market might raise concerns of potential systemic risk. Some of the more detailed aspects of the SIP regime will be set out in subsidiary legislation. The Amendment Ordinance therefore empowers the SFC, with the consent of the HKMA and after consultation with the Financial Secretary, to make such subsidiary legislation as well.
44. Two further points regarding the mandatory reporting obligation described in paragraph 43(b) above are worth noting at this point –
- (a) **Interim reporting requirements:** As an interim measure (and prior to the new legislation coming into effect), the HKMA introduced interim reporting requirements in June 2013 under the Banking Ordinance (Cap. 155). These required licensed banks to report certain OTC derivative transactions (i.e. certain interest rate swap agreements (**IRS**) and non-deliverable forward contracts (**NDF**) entered into between licensed banks) to the HKMA via the HKTR. The interim reporting requirements became effective on 5 August 2013, and have been in full force since 4 February 2014 after the expiration of the transitional arrangements.
  - (b) **Fees for reporting via HKTR:** Fees will be chargeable (on a cost recovery basis) for reporting via the HKTR. The fees will be set out in subsidiary legislation to be made by the Chief Executive in Council, and will thus also be

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<sup>8</sup> The two new RAs are: (i) Type 11 RA (dealing in OTC derivative products or advising on OTC derivative products); and (ii) Type 12 RA (providing client clearing services for OTC derivative transactions).

<sup>9</sup> The two existing RAs that were expanded are: (i) Type 9 RA (asset management); and (ii) Type 7 RA (provision of automated trading services).

subject to negative vetting by LegCo. The Amendment Ordinance therefore includes provisions enabling the Chief Executive in Council to make such subsidiary legislation. Our current thinking is to charge a monthly fee of HK\$3 for each transaction reported to the HKMA that is still outstanding on the last business day of the month. This will however be subject to a proposed cap of HK\$1 million per reporting entity per annum.

### ***Phased implementation of new regime***

45. The Amendment Ordinance has not yet been brought into effect. The HKMA and SFC propose to do this in phases. In particular, we propose to defer implementation of the new and expanded RAs until a later date. This is because amendments are needed to various SFC rules, codes and guidelines before the new and expanded RAs can be implemented, and further time is needed to finalise these.
46. With respect to the mandatory obligations, we propose to proceed first with mandatory reporting, then mandatory clearing and finally mandatory trading. The main reasons for this phased approach are as follows –
  - (a) In the case of mandatory clearing, we feel that market participants that are not active in the OTC derivatives market should not be made subject to mandatory clearing until the new Type 12 RA is implemented. To do otherwise, would essentially compel them to use the services of an AI or of a non-AI that is unregulated. Accordingly, we propose to introduce only a limited form of mandatory clearing initially, i.e. one that essentially applies only to market participants that are more active in this market, and that are regulated by the HKMA or SFC. However, we are still considering how best to cast this limited form of mandatory clearing. Given this, and in order not to hold up implementation of mandatory reporting, we propose to proceed with mandatory reporting first.
  - (b) In the case of mandatory trading, this will be implemented at a later stage as further study is needed to assess how best to implement any such requirement in Hong Kong. Implementation of mandatory reporting will also assist in this regard as data received by the HKTR will provide useful information about activity in the OTC derivatives market here.
47. As for the record keeping obligation, as this is intended to supplement the mandatory reporting, clearing and trading obligations, it will be implemented in phases with the relevant mandatory obligation, i.e. the record keeping obligation relating to mandatory reporting will be implemented in the first phase together with mandatory reporting. For the record keeping obligations relating to mandatory clearing and mandatory trading, these will be implemented at a later stage when mandatory clearing and mandatory trading (respectively) come into effect.

48. For completeness, we note that the subsidiary legislation prescribing the fees to be paid to the HKMA for reporting via the HKTR (discussed under paragraph 44(b) above) will also need to be implemented in the first phase together with mandatory reporting. As for the regulation of SIPs, we aim to introduce this shortly after mandatory reporting.

***Focus of this consultation – mandatory reporting and related record keeping***

49. This consultation paper focuses on our proposals for introducing mandatory reporting and related record keeping obligations. It invites interested parties to comment on the draft rules which set out the proposed scope and details of these obligations. Consultation on the draft rules for mandatory clearing and trading, and related record keeping obligations will be conducted separately at a later stage, as will consultation on rules relating to SIP regulation.

50. This paper is divided into the following main sections.

- (a) Sections A and B discuss some key concepts, such as the range of persons (other than AIs, AMBs and LCs), and the range of products/transactions, that will be subject to mandatory reporting in the initial phase.
- (b) Sections C to F describe the specific circumstances under which AIs, AMBs LCs and other persons will be subject to mandatory reporting, including where the transactions are cross-border in nature.
- (c) Section G describes proposed exemptions and relief from mandatory reporting.
- (d) Section H discusses the detailed requirements for reporting outstanding transactions (i.e. backloading).
- (e) Section I describes the proposed time limits and grace periods for reporting and for backloading.
- (f) Section J describes the technical aspects of reporting, such as how to report, the details to be reported, and the reporting of subsequent events.
- (g) Section K discusses the obligations of AIs that are required to ensure reporting by specified subsidiaries.
- (h) Section L sets out our current thinking on the use and public disclosure of the data collected via the HKTR.
- (i) Section M discusses the related record keeping obligations.
- (j) Lastly, we set out our concluding thoughts and remarks.

51. The draft reporting and related record keeping rules (**Draft Rules**) are attached to this paper as **Appendix A**.

- (a) Part 1 of the Draft Rules explains key concepts and terms. It also defines the range of persons and transactions to which the reporting obligation and related record keeping obligation apply.
- (b) Part 2 of the Draft Rules sets out the details of the reporting obligation. Division 1 sets out how the reporting obligation applies in respect of different persons. Division 2 sets out the circumstances in which the reporting obligation does not apply or is taken to have been complied with. Division 3 provides for technical details such as the manner and form of reporting, and the time period within which the reporting obligation must be fulfilled.
- (c) Part 3 of the Draft Rules provides the details of the record keeping requirement in relation to the mandatory reporting obligation.
- (d) Part 4 of the Draft Rules explains how the reporting obligation and related record keeping requirement apply in respect of transactions entered into by a subsidiary of a locally-incorporated AI.
- (e) Schedule 1 to the Draft Rules sets out the specific classes and types of OTC derivative transactions that will be subject to mandatory reporting. The Schedule also sets out threshold levels for determining whether certain persons are to be regarded as subject to the reporting obligation or not.
- (f) Schedule 2 to the Draft Rules describes in more detail the types of information that must be reported.
- (g) Schedule 3 to the Draft Rules describes in more detail the records that must be kept.

A point to note is that the Draft Rules are subject to review by the Department of Justice, and so may be subject to further drafting changes.

52. This paper should be read in conjunction with the papers relating to the two earlier consultation exercises (described in paragraph 41 above).

## KEY PROPOSALS

### **A. PERSONS (OTHER THAN AIs/AMBS/LCs) THAT WILL BE SUBJECT TO MANDATORY REPORTING**

53. The new reporting obligation will apply to AIs, AMBs and LCs. It will also apply to the following persons as provided for in Rule 5 of the Draft Rules, i.e. –
- (a) CCPs that provide clearing services to persons in Hong Kong, i.e. CCPs that are either: (i) recognized as a clearing house under section 37 of the SFO (**RCH**); or (ii) authorized as an ATS provider under section 95 of the SFO (**ATS-CCP**), and
  - (b) other persons who are essentially based in, or operate from, Hong Kong (**Hong Kong persons**).
54. We propose that the term “Hong Kong person” should cover the following –
- (a) All Hong Kong residents and all entities established under Hong Kong law (including therefore all partnerships, trusts, companies and other entities established under Hong Kong law).
  - (b) All overseas companies registered, or required to be registered, under Part 16 of the Companies Ordinance (Cap. 622) – referred to in that Ordinance and in this paper as “**non-Hong Kong companies**”. However, for such companies, the reporting obligation will only apply in respect of transactions entered into by them in Hong Kong – see paragraph 82 below.
  - (c) As for non-corporate entities established overseas but registered or having a presence here (e.g. overseas partnerships, trusts, etc), they will not be subject to mandatory reporting, at least not in the initial phase. We expect such operations, with the exception of hedge funds (which we deal with separately in paragraph 83 below), are unlikely to be active in the OTC derivatives market here. We therefore do not propose to include them at the initial stage.
55. The definition of “Hong Kong person” is set out in Rule 5(2) of the Draft Rules. As will be seen, we have avoided using terms such as “based in”, “operated from” and “managed in or from” in the definition. This is in light of earlier concerns (noted in the July 2012 Consultation Conclusions) that such terms may raise doubt and uncertainty.
56. A final point to note in this context is that the reporting obligation in respect of CCPs will only apply when the entity in question is acting in its capacity as a CCP, e.g. it will not apply in respect of transactions entered into for proprietary trading purposes. This

is reflected in the definitions of “RCH” and ATS-CCP” in Rule 2 of the Draft Rules. However, such transactions may nevertheless be reportable if the CCP also falls within the definition of “Hong Kong person”.

**Q1. Do you have any comments or concerns about the proposed definition of “Hong Kong person”, “RCH” and “ATS-CCP”?**

## **B. OTC DERIVATIVE TRANSACTIONS THAT WILL BE SUBJECT TO MANDATORY REPORTING**

57. As explained in the July 2012 Consultation Conclusions, the mandatory reporting obligation will initially cover only certain types of IRS and NDF. This will subsequently be extended, in phases, to cover other types of IRS and NDF, as well as other OTC derivative product classes such as other rate and foreign exchange derivatives and equity derivatives. Any such extension will be subject to public consultation before implementation. We note that respondents to the earlier consultation supported this approach.
58. We propose that the following types of IRS and NDF should be subject to the reporting obligation in the initial phase –
- (a) **IRS:** plain vanilla IRS (floating vs. fixed) and plain vanilla basis swap (floating vs. floating) – in each case, for currencies and floating rate indices specified by the HKMA by notice in the Gazette. The current intention is to specify only those currencies and floating rate indices that are on the International Organization for Standardization (ISO) 4217 currency list (<http://www.currency-iso.org/en/home/tables/table-a1.html>) and FpML Coding Schemes – 5.76 Floating Rate Index Scheme (<http://www.fpml.org/spec/coding-scheme/index.html>) respectively, and supported by the HKTR.
  - (b) **NDF:** non-deliverable forward transactions in specified currencies and precious metals, such currencies and precious metals to be specified by the HKMA by notice in the Gazette. The current intention is to specify only those currencies and precious metals that are on the ISO 4217 currency list and supported by the HKTR.
59. The above is reflected in Rule 7, read together with Part 3 of Schedule 1 to the Draft Rules.
- (a) Part 3 of Schedule 1 identifies the transactions to be reported. These are described by reference to both: (i) the product class to which they belong, e.g.

IRS, NDF, etc (referred to in the Draft Rules as a “**product class**”); and (ii) a more detailed description of the type of transaction they are, e.g. floating vs. fixed, fixed vs. floating, etc (referred to in the Draft Rules as a “**product type**”).

- (b) Rule 7 confirms that only transactions falling within one of the product types specified in Part 3 of Schedule 1 are reportable. Such transactions are referred to in the legislation as “specified OTC derivative transactions” – see new section 101A of the SFO (as amended by the Amendment Ordinance) and Rule 7 of the Draft Rules. For simplicity, we refer to them as **reportable transactions** in this paper.

**Q2. Do you have any comments or concerns about the proposed types of IRS and NDF that will be subject to the mandatory reporting obligation in the initial phase of implementation?**

**Q3. Do you have any comments or concerns as to how IRS and NDF are proposed to be defined in Part 1 of Schedule 1 to the Draft Rules, or how the reportable transactions, or the class to which they belong, have been described in Part 3 of Schedule 1?**

### **C. REPORTING OBLIGATIONS OF AIs, AMBs AND LCs**

60. Rules 9 to 12 of the Draft Rules describe the circumstances under which AIs, AMBs and LCs will be subject to the mandatory reporting obligation.

61. In the October 2011 Consultation Paper and the July 2012 Consultation Conclusions, we proposed that an AI, AMB or LC should report a reportable transaction that it: (i) is a counterparty to, or (ii) has “originated or executed”.

(a) For an overseas incorporated AI, limb (i) above was further qualified such that the AI is only required to report transactions to which it is a counterparty if the transaction is recorded in the form of an entry in the books of a local (i.e. Hong Kong) branch of the AI. The intention was (and remains) to capture only transactions booked in the local branch in respect of which the HKMA has the primary regulatory responsibility as host regulator.

(b) However, with respect to limb (ii) above, we have revisited the scope of the “originated or executed” limb after further discussion with the industry. Our revised proposals on this are discussed in paragraphs 63 to 74 below. As will be seen, we have also divided this concept into two distinct parts with one covering related party transactions (i.e. transactions entered into by affiliates), and the other covering the management of third party assets. Moreover, in the

case of overseas incorporated AIs, we propose to only capture transactions where the Hong Kong branch is involved. This would be in keeping with the approach taken in respect of transactions to which the AI is a counterparty (as discussed in paragraph (a) above).

62. Separately, the October 2011 Consultation Paper also proposed that, in the case of a locally-incorporated AI, the AI should also ensure the reporting of transactions entered into by those of its subsidiaries that have been specified by the HKMA. This proposal is reflected in new section 101B(3) to (6) of the SFO (as amended by the Amendment Ordinance). Details on how this reporting obligation should be fulfilled are discussed separately under paragraphs 144 to 149 below.

### ***“Origination or execution”***

63. As explained in the July 2012 Consultation Conclusions, it is necessary to require an AI, AMB or LC to report transactions that it has entered into in Hong Kong even though the transactions are recorded in the books of an affiliate rather than in the books of the AI, AMB or LC’s business establishment in Hong Kong. The OTC derivatives market in Hong Kong is characterized by the presence of many globally active international banking groups whose activities constitute a significant share of the local market. This requirement underpins the objective of improving transparency, in particular the local activities of such international banking groups in Hong Kong. It is therefore important to capture transactions under the reporting obligation to enable regulators to monitor whether they might have implications for the monetary and financial stability of Hong Kong. In the July 2012 Consultation Conclusions, these transactions were referred to as having been “originated or executed” in Hong Kong. (An institution was considered to have “originated or executed” a transaction in Hong Kong if: (i) the institution had agreed with the counterparty the normal economic terms of the transaction, either directly or through an intermediary; and (ii) a party related to the institution had been designated as the final contracting party to the transaction.) The July 2012 Consultation Conclusions went on to propose that an “originated or executed” transaction should be reportable to the HKMA only if it had a Hong Kong nexus.
64. The industry acknowledges the regulatory need to subject the “originated or executed” transactions to mandatory reporting and has, since the publication of the July 2012 Consultation Conclusions, engaged the HKMA and SFC to discuss how the requirements in this respect might be cast. They suggested further refining the scope of “originated or executed” for better legal certainty and operational practicality. They also emphasized the importance of aligning our proposed “originated and executed” concept with similar regulations in other Asia Pacific jurisdictions (where the OTC derivatives market shares similar characteristics) so as to minimise the need for system customisation.
65. We have taken into account the industry’s suggestions regarding the “originated or executed” limb of the reporting obligation. To that end, we now propose that this limb

should only capture transactions that the AI, AMB or LC has conducted in Hong Kong on behalf of an affiliate with the involvement of a trader based in Hong Kong. Accordingly, we no longer propose to use the term “originated or executed” to describe this limb. The revised language is reflected in Rules 9(1)(b), 10(1)(b), 11(1)(c) and 12(1)(b) of the Draft Rules. (For easy reference, we refer to this limb in this paper as the “**conducted in Hong Kong**” limb.)

66. Underpinning the concept of “conducted in Hong Kong” (which is defined under Rule 4 of the Draft Rules) are 4 major criteria –
- (a) ***The transaction must have been conducted on behalf of an affiliate of the AI, AMB or LC.*** The term “affiliate”, which is defined in Rule 2, will encompass any entity within the same group as the reporting institution.
  - (b) ***One of the individuals making the decision to enter into the transaction must be a trader.*** We intend to let the term “trader” take on its ordinary meaning. The intention is to refer (in all cases) to persons who make the trading decision, i.e. the trader. So, for example, we do not wish (in the case of client trades) to refer to persons who are acting solely as the salesperson. We have cast the provision carefully with a view to achieving this.
  - (c) ***The trader must be employed or engaged by the AI, AMB or LC.*** As the industry has different practices, we do not propose to require the trader to be an employee of the AI, AMB or LC. Rather, the provision covers any trader so long as he is employed or engaged by the AI, AMB or LC. We expect this will also capture traders who are employed or engaged by an overseas affiliate but on secondment in Hong Kong (since they will also need some form of employment or engagement letter with the AI, AMB or LC in Hong Kong).
  - (d) ***The trader must be performing his functions substantially in Hong Kong.*** This is to ensure that the reporting obligation applies to a transaction entered into by a Hong Kong trader who is predominantly based in Hong Kong, irrespective of his location at the time of entering into the transaction. This aims to avoid doubt or uncertainty in cases where the transaction may have been conducted by a Hong Kong trader who is temporarily outside Hong Kong, say during one of his business trips. The inclusion of this criterion also addresses industry concerns that excluding transactions entered into by a Hong Kong trader while outside Hong Kong will in fact cause more difficulty as information about the trader’s location at the time of entering into a transaction may not be readily available. It follows however that transactions entered into in Hong Kong by traders who are predominantly based overseas (e.g. transactions entered into during business trips to Hong Kong) will not be captured. Likewise, transactions entered into by traders who are employed or engaged by the AI, AMB or LC but seconded to work outside Hong Kong will not be captured.

67. In the case of an overseas incorporated AI, we propose to extend the “conducted in Hong Kong” concept so that it also applies where the transaction is conducted on behalf of its head office or a non-Hong Kong branch. In other words, where the Hong Kong branch of an overseas incorporated AI conducts a reportable transaction on behalf of its head office or other branch outside Hong Kong, it will also have to report the transaction. This is reflected in Rule 11(1)(b) of the Draft Rules.<sup>10</sup>
68. A further point to note is that transactions reportable under the “conducted in Hong Kong” limb will not need to fulfil an additional Hong Kong nexus requirement. The fact that the transaction was “conducted in Hong Kong” is sufficient to demonstrate relevance to Hong Kong. This change also takes into account earlier industry feedback that compliance would in fact be easier without the Hong Kong nexus requirement.

**Q4. Do you have any comments or concerns about how the terms “conducted in Hong Kong” and “affiliate” are proposed to be construed, or how this limb of the reporting obligation is cast? In particular, do you have concerns as to how this proposal might impact entities that keep a global book?**

***Expanded scope of circumstances under which AIs and LCs will be required to report***

69. Our earlier proposals on the “originated or executed” limb aimed to capture not only transactions booked with an affiliate of the AI, AMB or LC, but also transactions of any other entity on whose behalf an AI, AMB or LC had full discretion and authority to agree the terms of the transaction. A particular focus here was to capture transactions entered into by fund managers who negotiate transactions on behalf of the funds that they manage.
70. We intend to retain this proposal, but in more specific terms so that it only applies –
- (a) to AIs or LCs that: (i) are registered or licensed to carry on Type 9 RA; and (ii) manage assets for one or more other persons, and
  - (b) in respect of transactions that they have entered into on behalf of such other person(s).

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<sup>10</sup> Both Rules 11(1)(b) and 11(1)(c) cover transactions conducted by a local branch of an overseas incorporated AI – the former covers transactions conducted on behalf of its head office or a branch other than a Hong Kong branch; while the latter covers transactions conducted on behalf of an affiliate.

71. Since it is the case that the Type 9 RA in relation to an overseas incorporated AI is only applicable to activities carried out by its Hong Kong branch, it follows that the requirement in paragraph 70 above applies only to transactions entered into by its Hong Kong branch. The Draft Rules therefore do not include specific provisions spelling out the role of the Hong Kong branch.
72. This proposal is reflected in Rules 9(1)(c), 10(1)(c) and 11(1)(d) of the Draft Rules.
- (a) The provisions refer to the AI or LC managing assets for any other person, and could therefore capture: (i) situations where the other person constitutes a collective investment scheme (**CIS**), such as a hedge fund; as well as (ii) situations where the AI or LC is simply managing the assets as a managed account for one or more other persons.
  - (b) The provisions are deliberately cast by reference to AIs and LCs that are registered or licensed for Type 9 RA. This is to make clear that the objective is to capture transactions entered into by fund managers. Moreover, this limb of the reporting obligation is not included in Rule 12 (which sets out the reporting obligation of AMBs). This is because AMBs would in any event have to be licensed for Type 9 RA if they are serving as fund managers (i.e. their AMB status alone is not sufficient). It is unnecessary and inappropriate therefore to include this limb in Rule 12.
  - (c) The provisions are currently cast by reference to transactions entered into by the AI or LC, i.e. it does not capture transactions where the AI or LC has played an advisory role only. We are however considering whether to cover the latter as well, and would welcome views on whether such an approach might create particular difficulties for market participants.
73. A point to note here is that the person (including any CIS) whose assets are being managed by the AI or LC may itself be subject to a reporting obligation in respect of the same transaction, i.e. as a Hong Kong person. In such cases, it will be exempted from the reporting obligation by virtue of Rule 20 of the Draft Rules. This is discussed in paragraphs 104 and 108 below.
74. A further point to note is that this limb of the reporting obligation will also apply where the AI or LC is only a sub-manager, i.e. where the fund manager is only providing services in respect of a sub-fund under an umbrella fund. Additionally, for offshore funds, even though they may not be subject to mandatory reporting themselves (i.e. because they are not registered here and thus not Hong Kong persons), their transactions will have to be reported by the fund manager (or sub-fund manager) if the fund manager entered into the transaction on behalf of the fund and is an AI or LC registered or licensed for Type 9 RA.

- Q5. Do you have any comments or concerns about how we have cast the proposal that AIs and LCs that are registered/licensed for Type 9 RA must report transactions that they have entered into in their capacity as fund managers?**
- Q6. Do you envisage any specific difficulties if this proposal were to be extended to also require an AI or LC that is registered/licensed for Type 9 RA to report transactions that it has advised a counterparty on, i.e. even though it has not entered into the transaction on behalf of that counterparty? If so, please provide details of the specific difficulties envisaged.**

#### ***D. REPORTING OBLIGATION OF CCPs***

75. We had indicated in our July 2012 Consultation Conclusions that where a reportable transaction was entered into by a CCP as part of the clearing process, the CCP would not be required to report the transaction. We note however that in most major markets, CCPs are required to report such transactions. We therefore now propose to require CCPs to report transactions to the HKMA as well.
76. As noted in paragraph 53(a) above, this reporting obligation will only apply to CCPs that are: (i) recognized as a clearing house under section 37 of the SFO; or (ii) authorized as an ATS provider under section 95 of the SFO. Specifically –
- (a) CCPs that are recognized as a clearing house will need to report all reportable transactions that have been entered into by them as part of the clearing process. As such CCPs are expected to essentially be based in Hong Kong, we feel it is appropriate to require that all such transactions entered into by them be reported to the HKMA via the HKTR.
  - (b) However, CCPs that are authorized as an ATS provider under section 95 of the SFO will only need to report reportable transactions that have been entered into by them as part of the clearing process, and where the other counterparty is a Hong Kong incorporated company. We do not expect other types of Hong Kong entities to become members of a CCP. Such CCPs are expected to essentially be based overseas and primarily regulated by regulators in their home jurisdiction. We also expect that many transactions entered into by such CCPs may have no nexus to Hong Kong, i.e. they may relate to transactions entered into outside Hong Kong, and by persons who have no connection to Hong Kong. We believe it would be disproportionate to require such CCPs to report all such transactions to the HKMA. A more measured approach would be to require such CCPs to only report transactions that can be readily identified as being related to Hong Kong. We therefore propose to require that they only report reportable transactions that they have entered into as part of the clearing process, and where the counterparty to the transaction is a Hong Kong incorporated company. The

requirement for the counterparty to be a Hong Kong incorporated company has been carefully cast so as to cater for both CCPs that adopt the principal model, and those that adopt the agency model.

77. The reporting obligations of CCPs are reflected in Rules 13 and 14 of the Draft Rules. As noted in paragraph 56 above, the reporting obligations under these rules will only apply when the CCP is acting in its capacity as a CCP. The definitions of “RCH” and “ATS-CCP” in Rule 2 have been cast to make this clear. The definition of “ATS-CCP” also takes into account that although section 95(2) of the SFO allows for the authorization of both trading platforms and clearing platforms, the intention here is to only capture the latter.
78. For completeness, we would also note that the proposal to require CCPs to report will not be unduly burdensome in terms of costs given that the fees chargeable by the HKMA for reporting via the HKTR are fairly low, and in any event capped at HK\$1 million per year per reporting entity.

**Q7. Do you have any comments or concerns about how the reporting obligation in respect of CCPs has been cast?**

## ***E. REPORTING OBLIGATION OF HONG KONG PERSONS***

79. Rule 15 of the Draft Rules sets out the circumstances under which Hong Kong persons have the obligation to report a reportable transaction. The rule provides that a Hong Kong person must report transactions that it is a counterparty to if the person's positions in the specified product class to which the transaction belongs have reached the reporting threshold for that class.
80. Part 3 of Schedule 1 identifies the product class to which each type of reportable transaction (i.e. each product type) belongs. So, for example, a plain vanilla IRS (floating vs. fixed) and plain vanilla basis swap (floating vs. floating) would all come under the same product class (i.e. IRS), but an NDF in a specified currency would not.
81. A point to note is that certain types of Hong Kong persons may be holding positions in more than one capacity. For example, a partner of a partnership may hold positions in his capacity as a partner, and in his own capacity as an individual. Likewise, an individual or a corporation may hold positions in his or its personal capacity and also in his or its capacity as a partner or a trustee. Rules 15(1)(c) to (e) therefore seek to clarify that the positions are to be viewed separately in respect of each capacity.
82. Additionally, in the case of a Hong Kong person that is a non-Hong Kong company, we propose that only those transactions entered into by it in Hong Kong should be

taken into account, i.e. those entered into outside Hong Kong should be excluded. This qualification (which is reflected in Rule 15(1)(f) of the Draft Rules) is largely aimed at multinational corporations that have a presence here but that are also active in other markets and jurisdictions. In such cases, we believe it may be both unreasonable and disproportionate to require the company to report transactions on a worldwide basis. We acknowledge that by only taking into account transactions entered into in Hong Kong, we will not get a full picture of the potential risk posed by the overseas entity. On the other hand however, even if their global positions are counted, our ability to take effective regulatory action in respect of their overseas activities and positions is likely to be limited. We therefore propose to limit their obligation only to transactions that they are counterparty to and have entered into in Hong Kong. That said, going forward, should we find that circumstances warrant expanding this obligation to cover transactions entered into outside Hong Kong, we will consider doing so and this will be subject to further consultation.

**Q8. Do you have any comments or concerns about the proposed approach to be taken in respect of the different types of Hong Kong persons?**

### ***Reporting obligation vis-à-vis funds***

83. The position of funds is more complex as they may take different forms and thus may fall into the definition of “Hong Kong person” under different limbs. They therefore deserve special mention.

- (a) For funds that are domiciled in Hong Kong (i.e. onshore funds), and whether structured in the form of a partnership, company, trust or other vehicle, they will come under the definition of “Hong Kong persons” and be subject to mandatory reporting – see paragraph 54(a) above. (In the case of a fund, structured as a trust or partnership, the obligation would fall on the trustee or partners as the legal owner of the fund.)
- (b) For funds domiciled overseas (i.e. offshore funds), they will only be caught if they are structured in the form of a company and registered, or required to be registered, under the Companies Ordinance (Cap. 622) – see paragraphs 54(b) and 54(c) above. That said, we expect that offshore funds (whether structured as a company, trust, partnership or other vehicle) are unlikely to be carrying on business here and hence unlikely to be registered here. They are therefore unlikely to be subject to mandatory reporting under Hong Kong law, although they may be subject to a similar obligation under the laws of their home jurisdiction. Nevertheless, their positions might still be reportable to the HKMA, albeit not by the fund itself. This is because (as discussed in paragraphs 69 to 74 above) if the offshore fund is managed, or sub-managed, by an AI or LC that is registered or licensed for Type 9 RA, the transactions

entered into by the AI or LC on behalf of the fund will have to be reported to the HKMA by the AI or LC.

- (c) We acknowledge that under the above proposals, there may be cases where a transaction is reportable by both a fund and its fund manager/sub-manager – i.e. where the fund is a Hong Kong person and is managed by an AI or LC. In such cases, the fund will be exempted from reporting by virtue of the exemption under Rule 20 of the Draft Rules as discussed under paragraph 108 below. However, this exemption will not apply where the fund is a Hong Kong person, but not managed by an AI or LC. In such cases, the reporting obligation will remain with the legal owner of the fund (i.e. the trustee or partners in the case of a fund established as a trust or partnership).

**Q9. Do you have any comments or concerns about how the reporting obligation will apply to funds? Do you envisage that funds may face practical difficulties in complying with this obligation? If so, please provide details of the specific difficulties envisaged.**

### ***Operation of reporting threshold and exit threshold***

84. In the context of Hong Kong persons, the Draft Rules introduce the concept of –
- (a) a reporting threshold, which determines when a Hong Kong person becomes subject to a reporting obligation, and
  - (b) an exit threshold, which determines when he ceases to be subject to that obligation.
85. The purpose of these thresholds is to lessen the compliance burden for Hong Kong persons. In particular, the reporting threshold will ensure that only the more significant players in the market are subject to reporting, while the exit threshold will ensure that persons whose positions tend to fluctuate around the level of the reporting threshold are not constantly alternating between having to report their positions and not having to report their positions, thereby making compliance difficult. The exit threshold can also help secure a more complete record of the positions held by Hong Kong persons by reducing gaps in the data record that would otherwise arise as a result of temporary fluctuations around the level of the reporting threshold.
86. Both the reporting threshold and the exit threshold will apply on a product class basis. So, for example, a Hong Kong person may have reached the reporting threshold for IRS but not NDF, in which case they would have to report their reportable IRS transactions only, and not their reportable NDF transactions. Likewise, the person may have reached the exit threshold for IRS but not NDF, in which case

they may cease reporting their reportable IRS transactions, but have to continue reporting their reportable NDF transactions.

87. Both thresholds will also be calculated in the same way, i.e. by reference to the average gross notional value of a person's outstanding positions for the previous six months based on his month-end position. So, for example, to determine if a person has reached the reporting threshold for a particular product class (e.g. IRS or NDF) –
- (a) We will refer to their “month-end positions” in that product class for the previous six months, and calculate the average. The “month-end positions” refers to the notional principal value of the person's gross positions in the relevant product class as at the last day of the calendar month. Because we only propose to look at month-end positions, it follows that changes to a person's positions (even if substantial) that occur during a month will not have an immediate impact on a person's reporting obligation. Rather, it will be necessary to wait till the end of the month to see if the reporting threshold has been crossed, and the reporting obligation thus triggered.
  - (b) It should be noted that all transactions falling within a particular product class, whether or not of a product type that is reportable (i.e. whether or not also matching the descriptions in the third column of Part 3 of Schedule 1 to the Draft Rules) must be included in the calculation of the reporting threshold. In other words, although only reportable transactions will have to be reported, non-reportable transactions that fall within the same product class must also be taken into account when determining if the reporting threshold has been reached. So, for example, if after commencement of the Draft Rules a person enters into a plain vanilla IRS (floating vs fixed), a plain vanilla basis swap (floating vs floating), and an amortizing IRS, then all three (i.e. including the amortizing IRS even though it is not reportable in the initial phase – see paragraph 58(a) above), will have to be taken into account when ascertaining if the person has reached the reporting threshold.
88. Rules 16 and 17 of the Draft Rules provide for the operation of the reporting threshold and the exit threshold. Rule 16 sets out the formula for calculating if the thresholds have been reached. Rule 17 clarifies which transactions must be taken into account when assessing if the thresholds have been reached, and which transactions must not. It also clarifies that where a Hong Kong person holds positions in more than one capacity, the threshold calculations are to be performed separately in respect of each capacity. So, for example –
- (a) If the Hong Kong person is a partner, the threshold calculation for the partnership should include only the gross positions attributable to that partnership. Positions attributable to the partner in any other capacity, or in respect of other partnerships of which he is also a partner, should not be included. Instead, the threshold calculation for each of these should be performed separately – see Rule 17(4).

- (b) This applies similarly where the Hong Kong person is a trustee, i.e. the threshold calculation should be performed separately in respect of each trust, and in respect of positions held in the trustee's own (personal) capacity – see Rule 17(5). The same applies in respect of individuals and corporations, where they may also be partners or trustees – see Rule 17(3).
- (c) Likewise, where the Hong Kong person constitutes two or more CIS, the gross positions attributable to each CIS should be treated separately – see Rule 17(6). With respect to sub-funds under an umbrella fund, the threshold calculation for each sub-fund should be performed separately.

### ***Threshold calculation in respect of non-Hong Kong companies***

89. Additionally, we believe the threshold calculation should apply differently where the Hong Kong person is a non-Hong Kong company in that –
- (a) We should only count transactions that it has entered into in Hong Kong. This would be consistent with our proposal under paragraphs 54(b) and 82 above that such entities should only have to report transactions entered into in Hong Kong.
  - (b) We should only count transactions entered into after the product class to which they belong has been included in Part 2 of Schedule 1 to the Draft Rules. (For the avoidance of doubt and easy reference, the day on which the product class is so included (**product class specification day**) will also be set out in Part 2 of Schedule 1.) This recognizes that a non-Hong Kong company may be unable to retrospectively identify which of its past transactions (i.e. those entered into before the relevant product class specification day) were entered into in Hong Kong, and which were not. However, it should be able to take steps to identify its Hong Kong transactions going forward (i.e. after the relevant product class specification day). Given that the threshold calculations are intended to take into account all transactions falling within the same product class, we consider it appropriate to set the cut-off date as the product class specification day.
90. Accordingly, when assessing if a non-Hong Kong company has reached the threshold for a particular product class, we will count those of the company's transactions that: (i) belong to the same product class; and (ii) were entered into after the product class specification day.
91. So for example, even if only plain vanilla IRS (floating vs. fixed) is specified as being reportable from 1 January 20XX, any amortizing IRS, or any other (non-reportable) IRS transactions, entered into by a non-Hong Kong company in Hong Kong after 1 Jan 20XX (but not before) will also have to be taken into account when assessing if the threshold has been reached.

### **Proposed threshold levels**

92. The proposed reporting thresholds and exit thresholds are set out in Part 4 of Schedule 1 to the Draft Rules. We propose to introduce separate reporting and exit thresholds for IRS and NDF, as set out below –

	<b>Reporting threshold (USD million)</b>	<b>Exit threshold (USD million)</b>
<b>IRS</b>	3,000	2,100
<b>NDF</b>	1,000	700

93. In proposing the above thresholds, we have taken into account data collected from surveys conducted in 2011 and 2013, as well as our longer term plan on setting thresholds (discussed under paragraph 95 below). The reporting thresholds proposed at this stage are calibrated by reference to the positions maintained by small to medium-sized local banks. (The earlier surveys included most of the players in the local OTC derivatives market, i.e. all the active banks in this market.) We believe a Hong Kong person holding this level of positions in IRS and NDF should be captured by the reporting regime. As for the exit thresholds, we propose to set these at 70% of the reporting thresholds. We believe that, at this level, they will provide an adequate cushion against temporary fluctuations around the reporting threshold level.
94. Based on the client profile information provided by banks during the earlier surveys, we estimate that over 95% of Hong Kong persons engaging in IRS and NDF will be exempted from the mandatory reporting obligation if the thresholds are set at the levels proposed above. For the remaining approximately 5%, they too may be exempted from the reporting obligation if their transaction is also reportable by an AI, AMB or LC – this exemption is discussed under paragraphs 104 to 108 below. Therefore we believe the proposed reporting obligation in respect of Hong Kong persons is reasonable and appropriate.
95. Before leaving the discussion on thresholds, there is one final point that we would like to mention. Our intention is to align the reporting thresholds with the clearing thresholds (when the latter are introduced). As noted above, we expect that mandatory clearing will be introduced in phases starting first with trades between entities that are regulated by the HKMA or SFC. We therefore expect the initial clearing thresholds to be set at a fairly high level. In view of this, we have set our initial reporting thresholds at a fairly high level also. However, we do intend to lower these at a later date. At this stage, we expect that the thresholds will be lowered to the levels set out below, and that this will take effect no earlier than 2017.

	<b>Reporting threshold (USD million)</b>	<b>Exit threshold (USD million)</b>
<b>IRS</b>	1,000	700
<b>NDF</b>	500	350

**Q10. Do you have any comments or concerns about the proposed methodology for calculating if the reporting threshold or exit threshold has been reached?**

**Q11. Do you have any comments or concerns about the proposed levels of the reporting threshold and exit threshold?**

**Q12. Do you have any comments or concerns about the proposed reductions to the reporting threshold and exit threshold at a later stage?**

## ***F. APPLICATION TO CROSS BORDER TRANSACTIONS***

96. The OTC derivatives market is a global one. In order for regulators to collect relevant data for effective market surveillance, it is inevitable that the mandatory reporting obligation will cover cross-border transactions.

97. To remove any doubt in this regard, Rule 19 of the Draft Rules clarifies that a reporting entity must report a reportable transaction, even if one or more counterparties to the transaction is a person outside Hong Kong or the transaction was entered into wholly or partially outside Hong Kong. This will however be subject to the following qualifications –

- (a) in the case of transactions reportable by an overseas incorporated AI, the Hong Kong branch of the AI must be involved either as the booking centre or as the party conducting the transaction in Hong Kong (as described in paragraphs 63 to 68 above) or managing the assets of another person (as described in paragraphs 69 to 74 above), for the reasons discussed in paragraphs 61(a), 67 and 71 above,
- (b) in the case of transactions reportable by an ATS-CCP, the counterparty must be a Hong Kong incorporated company – see paragraph 76(b) above, and

- (c) in the case of a Hong Kong person that is a non-Hong Kong company, the transactions must be entered into by the Hong Kong person in Hong Kong – see paragraph 82 above.

The above qualifications are reflected in Rules 11(1), 14(1) and 15(1)(f) of the Draft Rules.

**Q13. Do you have any comments or concerns about the proposed application of the mandatory reporting obligation to cross-border transactions? If so, please provide specific details.**

## **G. EXEMPTIONS AND OTHER RELIEF FROM THE REPORTING OBLIGATION**

98. The Draft Rules provides for a number of circumstances where the reporting obligation will not apply or will be taken to have been complied with. These are summarised below.

### ***Exemption for less active AIs, AMBs and LCs (exempt persons)***

99. In the July 2012 Consultation Conclusions, we proposed that AIs, AMBs and LCs should report all of their reportable transactions. However, on reflection, we believe such a requirement would be too harsh, particularly in the case of AIs, AMBs and LCs that may not be active participants in the OTC derivatives market, and that may be entering into OTC derivative transactions only intermittently, or for commercial hedging reasons. If they were to be subject to reporting obligations that are as stringent as those imposed on the more active AIs, AMBs and LCs, they may be discouraged from entering into OTC derivatives transactions at all. Alternatively, they may be unable to enter into such transactions because they have not set up connections with the HKTR in time.
100. To avoid the unintended consequences of an end user not being able to hedge its commercial risks as a result of the mandatory reporting obligation, we propose to introduce a limited relief for AIs, AMBs and LCs. Specifically, so long as an AI, AMB or LC meets each of the criteria listed below, it will not be subject to the reporting obligation under the counterparty limb, i.e. under Rules 9(1)(a), 10(1)(a), 11(1)(a) or 12(1)(a) of the Draft Rules. (As will be seen later, this relief is proposed to be granted on a product class basis, and hence the criteria below are cast by reference to the relevant product class specification day.)
- (a) ***Not involved in “conducting” or “fund management”***: The AI, AMB or LC must not at any time on or after the relevant product class specification day have conducted OTC derivative transactions in Hong Kong on behalf of an

affiliate (i.e. as discussed in paragraphs 63 to 68 above), nor entered into transactions on behalf of another person whose assets it manages (i.e. as discussed in paragraphs 69 to 74 above). We expect that AIs, AMBs and LCs that participate in such activities will likely be more active in the OTC derivatives market and will have to set up the necessary connection with the HKTR for reporting of such transactions anyway. Hence they should be subject to the reporting obligation in respect of their proprietary transactions too. Conversely, those that do not participate in such activities, should (subject to the further criteria discussed below) be entitled to some relief.

- (b) **Maximum 5 transactions outstanding:** The AI, AMB or LC must not at any time on or after the relevant product class specification day have had more than 5 OTC derivative transactions (belonging to the same product class) outstanding. We believe the number of transactions entered into serves as an indicator of an AI, AMB or LC's level of activity in the OTC derivatives market. The proposed limit of 5 is not referenced to anything in particular, and hence we welcome views on whether it may present difficulties.
- (c) **Aggregate gross notional not more than US\$30 million:** The aggregate gross notional value of the AI, AMB or LC's outstanding OTC derivative transactions (again, on a per product class basis) must not at any time on or after the relevant product class specification day have exceeded US\$30 million. Again, this is intended to serve as an indicator of an AI, AMB or LC's level of activity in the OTC derivatives market. We believe the proposed limit of US\$30 million is appropriate. We would however welcome views on whether this level may present difficulties.
- (d) **Counterparty is not a Hong Kong person:** In the case of each such OTC derivative transaction that is outstanding on or after the product class specification day, the other counterparty must not be a Hong Kong person. This criterion is included to avoid overlap between this relief and the exemption proposed for Hong Kong persons (discussed under paragraphs 104 to 108 below).
- (e) **Application in respect of overseas incorporated AI:** In the case of an overseas incorporated AI, the criteria described in paragraphs (a) to (d) above only apply in respect of the Hong Kong branch, i.e. the overseas incorporated AI will be eligible for the relief if: (i) the AI's Hong Kong branch was not involved as the party "conducting the transaction" or managing the assets of another person; and (ii) the maximum number and maximum aggregate gross notional value of transactions (on a per product class basis) in the book of the Hong Kong branch are 5 and US\$30 million respectively, and these transactions are not with Hong Kong persons.

101. AIs, AMBs and LCs that are entitled to this proposed relief are referred to in the Draft Rules as "**exempt persons**". The relief is accordingly reflected in –

- (a) Rule 3, which defines “exempt person” by reference to the criteria discussed in the preceding paragraph, and
  - (b) Rules 9(3), 10(3), 11(3) and 12(3), each of which confirms that the obligation to report transactions to which the AI, AMB or LC is a counterparty does not apply in respect of an exempt person.
102. The exempt person relief is new. It was not proposed in earlier consultations. A particular point to highlight about this relief is that once lost, it cannot be revived. In other words, once the AI, AMB, LC fails to meet any of the above criteria in respect of a particular product class, it will permanently cease to be entitled to this relief in respect of that class. So for example, if an AI, AMB or LC at any time has six or more IRS outstanding – even if only for a very short period – it will no longer be entitled to this relief in respect of its IRS. It is important therefore for an AI, AMB or LC who wishes to rely on this relief to monitor its positions closely, particularly if it is already close to the limits of one or more of the criteria (e.g. if its aggregate gross notional value in a particular product class is already very close to US\$30 million, or if it already has five OTC derivative transactions outstanding in a particular product class). For the same reason, an AI, AMB or LC wishing to amend an existing OTC derivative transaction by increasing the notional value of that transaction should be careful to ensure that this will not take it over the US\$30 million limit.
103. There is one qualification to the exempt person relief. This relates to licensed banks that have reported to the HKMA via the HKTR under the interim reporting requirement (discussed under paragraph 44(a) above). The rationale for providing the relief is to reduce compliance burden so that there is no need to set up the arrangement for reporting to the HKTR. However, we do not believe this should apply to licensed banks that have already set up the necessary arrangement to report their transactions for a particular product class. Consequently, we propose that an AI that has already reported to the HKMA via the HKTR under the interim reporting requirement, and that has outstanding reportable transactions in the product classes of IRS or NDF on the commencement of the Draft Rules should not be eligible for the exempt person relief for that product class. However, it will be entitled to the exempt person relief for any new product class specified in the future if it meets the necessary criteria for that product class. This qualification to the exempt person relief is reflected in Rule 3(4).

***Exemption for Hong Kong persons where transaction is reportable by an AI, AMB or LC***

104. The reporting obligation in respect of Hong Kong persons is already subject to a reporting threshold. To further reduce their reporting obligation, Rule 20 of the Draft Rules provides that a Hong Kong person will not need to report a reportable transaction if the transaction is also subject to reporting by an AI, AMB or LC. In other words, a Hong Kong person will not need to report if –

- (a) the other counterparty to the transaction is an AI, AMB or LC,
- (b) the other counterparty to the transaction is an affiliate of an AI, AMB or LC, and the AI, AMB or LC has conducted the transaction in Hong Kong on behalf of that affiliate, or
- (c) the other counterparty to the transaction is a person whose assets are managed by an AI or LC registered or licensed for Type 9 RA, and that AI or LC has entered into the transaction on behalf of such person.

105. We acknowledge that where a Hong Kong person is seeking to rely on this exemption, it may need to make some enquiries, particularly if it is relying on the matters described in paragraphs 104(b) or 104(c) above. This is because while the Hong Kong person may be aware that an AI, AMB or LC is involved, it may not always be apparent that the transaction is reportable by the AI, AMB or LC. Rule 20 does not specify what specific enquiries need to be made, as this may differ from case to case. However, we expect persons to act reasonably and pragmatically if they wish to rely on this exemption. We believe this is also in keeping with the approach taken under the Amendment Ordinance, i.e. that (pursuant to new sections 101F and 101G of the SFO) where a Hong Kong person has breached the reporting obligation, a Court may impose a financial penalty only if it is satisfied that there is “no reasonable excuse” for the breach.

106. It is worth highlighting that the relief under Rule 20 will not apply in the following cases.

- (a) It will not apply where the Hong Kong person has entered into the transaction with an AI incorporated outside Hong Kong via its overseas office directly, i.e. without involvement of the Hong Kong office. This is because in such cases the AI does not have an obligation to report the transaction to the HKMA.<sup>11</sup>
- (b) For the same reason, its application will be limited where a Hong Kong person also clears the reportable transaction, but does so using client clearing services provided by a person other than an AI (in the case of an overseas incorporated AI, not through its Hong Kong branch), AMB or LC. In such cases, even though –
  - (i) the Hong Kong person might be exempted from reporting the original transaction (e.g. because its counterparty was an AI, AMB or LC), and

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<sup>11</sup> As noted in paragraphs 61(a), 67 and 71 above, an overseas incorporated AI is only required to report transactions where its involvement in the transaction is via its Hong Kong branch, and not where it is via its home office or other non-Hong Kong branches.

- (ii) the subsequent transaction entered into as part of the clearing process is reportable by the CCP (e.g. because it is an authorized ATS provider),

any back-to-back transaction between the Hong Kong person and its clearing services provider (i.e. the CCP member) as part of the clearing process will still have to be reported by the Hong Kong person.

- (c) The Hong Kong person will also be unable to rely on this exemption merely on the grounds that the transaction has been cleared through a CCP that is an RCH or ATS-CCP and is thus reportable by such CCP. This is because the exemption under Rule 20 is limited to transactions involving an AI, AMB or LC. It does not extend to transactions involving only an RCH or ATS-CCP.
107. For completeness, we would also note here that the scope of the exemption under Rule 20 differs from what was proposed in our earlier consultations as a result of: (i) the removal of the “Hong Kong nexus” requirement (as discussed in paragraph 68 above); and (ii) the revised “conducted in Hong Kong” limb (discussed in paragraphs 63 to 68 above). The former widens the exemption for Hong Kong persons (because all transactions reportable by an AI, AMB or LC will be exempted, i.e. irrespective of whether or not the transaction has a Hong Kong nexus), while the latter narrows it (because the new “conducted in Hong Kong limb” only covers transactions that are executed here and not those that are originated here).

### ***Exemption for Hong Kong person where fund manager has reported***

108. For the avoidance of doubt, we clarify that the exemption under Rule 20 will also apply in respect of a Hong Kong person that is the legal owner of a fund or managed account such that where a transaction is reportable by both a fund manager (as discussed in paragraphs 69 to 74) and the legal owner of the assets under management (i.e. as discussed under paragraph 83), the latter will be exempted from reporting that transaction.

### ***Relief for AI, AMB or LC where affiliate has reported***

109. With respect to transactions that an AI, AMB or LC has “conducted in Hong Kong” (i.e. transactions that are reportable under Rules 9(1)(b), 10(1)(b), 11(1)(c) or 12(1)(b)), it is acceptable for the affiliate to report the transaction to the HKMA via the HKTR directly. In that event, the AI, AMB or LC will no longer have to report the transaction as well. To that end, Rule 21 of the Draft Rules provides that the AI, AMB or LC will be taken to have complied with the reporting requirement if the affiliate has confirmed to the AI, AMB or LC, in good faith, that the affiliate has reported the transaction. This is similar to what was proposed in the July 2012 Consultation Conclusions in order to reduce the compliance burden of AIs, AMBs and LCs.

### ***Relief for partners where one partner or authorized person has reported***

110. In the case of transactions entered into on behalf of a partnership, each partner in the partnership will be liable individually for the reporting obligation. However, it is not necessary for the HKMA to receive reports from all partners. Accordingly, Rule 22 of the Draft Rules provides that where one of the partners of a partnership, or another person authorized by all of those partners, has reported the transaction to the HKMA, all of those partners will be taken to have complied with the requirement to report the transaction.

**Q14. Do you have any comments or concerns about the proposed exemptions and reliefs, and the criteria for triggering them?**

**Q15. Do you have any comments or concerns about the proposal to exclude from the exempt person relief for IRS and NDF those licensed banks which have already reported to the HKMA via the HKTR under the interim reporting requirement and have outstanding reportable transactions on the commencement of the Draft Rules?**

**Q16. With respect to the relief for AIs, AMBs and LCs that are less active in the OTC derivatives market, do you consider the proposed criteria of 5 transactions per product class, and aggregate gross notional value of US\$30 million to be appropriate? If not, please provide specific details of why they may be inappropriate and what alternative criteria should be adopted.**

### ***No express exemption in respect of central banks, governments, etc***

111. A few further points on the issue of exemption and reliefs are worth noting.
- (a) We had indicated in our July 2012 Consultation Conclusions that we were prepared to consider exempting from the reporting obligation: (i) central banks; (ii) monetary authorities or other public bodies charged with responsibility for the management of public debt and reserves and the maintenance of market stability; and (iii) global institutions such as the International Monetary Fund, Bank for International Settlements, etc. However, we no longer consider any such express exemption to be necessary given that the reporting obligation only applies to AIs, AMBs, LCs, RCHs, ATS-CCPs and Hong Kong persons, and entities such as central banks, monetary authorities, etc are unlikely to fall within any of these categories. For the same reason, foreign governments are also not expressly exempted.
  - (b) As for sovereign wealth funds, in line with other major jurisdictions, we have no intention to exempt these from the reporting obligation. That said, we also

acknowledge that they are unlikely to have a presence in Hong Kong, and hence are unlikely to be subject to the reporting obligation in the first place, although if the fund is managed by an AI or LC that is registered or licensed for Type 9 RA, the AI or LC will need to report transactions that it has entered into on behalf of the fund.

## **H. BACKLOADING REQUIREMENT FOR OUTSTANDING TRANSACTIONS**

112. Consistent with international practice, and as proposed in the October 2011 Consultation Paper, the Draft Rules incorporate a requirement to backload transactions, i.e. to report transactions entered into previously and still outstanding when the reporting obligation takes effect.
113. Backloading is essential if regulators are to obtain a complete picture of a person's exposure in OTC derivatives. We therefore propose that the backloading requirement should generally apply to all AIs, AMBs, LCs, RCHs, ATS-CCPs and Hong Kong persons. The backloading requirement is accordingly reflected in Rules 9(2), 10(2), 11(2), 12(2), 13(2), 14(2) and 15(2) of the Draft Rules, all of which confirm that transactions to which an AI, AMB, LC, RCH, ATS-CCP or Hong Kong person is a counterparty, and that are still outstanding on the "**starting day**", must also be reported.

### **Concept of "starting day"**

114. The term "starting day" is critical to the backloading requirement, and has been carefully crafted to take into account the following –
- (a) **Term has dual purpose:** The term has a dual purpose: (i) it is the day from when the reporting obligation in respect of a particular product type takes effect; and (ii) it is also the day that determines which historical transactions need to be backloaded. Hence, even though a person may not be subject to the backloading requirement (e.g. because it has no prior transactions), the term "starting day" will still be relevant (e.g. because it has entered into a reportable transaction after the starting day).
  - (b) **Different starting days for different product types:** As discussed in paragraphs 57 to 58 above, mandatory reporting will take effect in phases, starting first with certain types of IRS and NDF only, and extending to other types of transactions at a later stage after public consultation. The starting day will therefore differ for different product types, and these will also be set out in Part 3 of Schedule 1 to the Draft Rules (i.e. as the **product type specification day**). This is reflected in the definition of "starting day" in Rule 2, where the term is cast by reference to **product type specification day**, being the day on which a particular product type is specified.

- (c) ***Different starting days for different Hong Kong persons:*** In the case of Hong Kong persons, the reporting obligation will only apply if they have also crossed the relevant reporting threshold. The starting day for a particular product type will therefore differ for different Hong Kong persons, i.e. a Hong Kong person that crosses the reporting threshold for a particular product type on an earlier day will have an earlier starting day. Moreover, a Hong Kong person's starting day in respect of a particular product type may change over time if it has previously crossed the reporting threshold, fallen under the exit threshold, and then crossed the reporting threshold again. This is reflected in paragraph (b) of the definition of "starting day" in Rule 2. In contrast, AIs, AMBs and LCs (subject to two exceptions discussed below) will have a single starting day in respect of a particular product type. This is reflected in paragraph (a) of the definition of "starting day" in Rule 2.
- (d) ***Different starting days for AIs, AMBs and LCs that were previously exempt persons:*** In the case of AIs, AMBs and LCs that are able to benefit from the exempt person relief discussed under paragraphs 99 to 103 above, the starting day will depend on when they cease to qualify for that relief. Hence, the starting day will differ in respect of different AIs, AMBs and LCs that previously qualified for this relief. This is reflected in the definition of "regulated prescribed person" and paragraph (a) of the definition of "starting day", both in Rule 2.
- (e) ***Different starting days for entities that become AIs, AMBs, LCs, RCHs or ATS-CCPs after the reporting obligation takes effect:*** In the case of an entity that becomes an AI, AMB, LC, RCH or ATS-CCP after the day the reporting obligation takes effect, its starting day will be the day it becomes an AI, AMB, LC, RCH or ATS-CCP. This too is reflected in the definition of "regulated prescribed person" and paragraph (a) of the definition of "starting day", both in Rule 2.

### ***Exceptions and limitations to backloading***

115. We also propose the following exceptions or limitations to the backloading requirement.

- (a) ***Transactions of Hong Kong persons that are non-Hong Kong companies:*** In the case of a Hong Kong person that is a non-Hong Kong company, we propose that the backloading requirement should not apply to transactions that were entered into before the product class specification day. The reasons for this are explained in paragraph 116 below. This is reflected in Rule 15(3) of the Draft Rules.
- (b) ***Transactions that an AI, AMB or LC has "conducted in Hong Kong" or entered into on behalf of a person whose assets it manages:*** In the case of an AI, AMB or LC, the backloading requirement will only apply in respect of

transactions to which it is a counterparty (and for an overseas incorporated AI, only if the transactions are also recorded in the form of an entry in the books of the Hong Kong branch of the AI). In other words, transactions that are “conducted in Hong Kong” will not be subject to the backloading requirement. Likewise, transactions entered into by an AI or LC that is registered or licensed for Type 9 RA and on behalf any CIS or other person whose assets they are managing, will not be subject to the backloading requirement. This is reflected in Rules 9(2), 10(2), 11(2) and 12(2) of the Draft Rules, each of which only refers to the obligation to report a transaction to which the reporting entity is a counterparty.

- (c) ***Transactions that mature or are terminated within the relevant grace period:*** As discussed under paragraphs 121(b)(iii) and 121(c)(iii) below, we propose to introduce a grace period for backloading. In view of this, we also propose that where a transaction expires or is terminated before the end of such grace period, the backloading requirement will cease to apply. This is reflected in Rules 26(5) and 27(5) of the Draft Rules.

116. As mentioned before, we recognize that a non-Hong Kong company may not be able to retrospectively identify which of its past transactions were entered into in Hong Kong. Consequently, with respect to paragraph 115(a) above, we propose that in the case of a Hong Kong person that is a non-Hong Kong company, the backloading requirement should only apply in respect of transactions that were entered into in Hong Kong, and entered into on or after the relevant product class specification day but before the relevant threshold has been reached. This would be consistent with our proposals for reporting new transactions (see paragraphs 54(b) and 82 above) and performing the threshold calculations (see paragraphs 89 to 91 above). It also strikes an appropriate balance between –

- (a) imposing no backloading requirement in respect of non-Hong Kong companies – this would hamper our ability to get a clearer picture of the company’s exposure in OTC derivatives, and
- (b) requiring such companies to report all of their outstanding transactions, irrespective of whether or not they were entered into in Hong Kong – this would be unduly harsh and disproportionate.

117. With respect to paragraph 115(b) above however, we propose that the backloading requirement should not apply in respect of transactions that an AI, AMB or LC “conducted in Hong Kong” prior to the starting day. Again, we appreciate that an AI, AMB or LC may not be able to readily identify which of its past trades were “conducted in Hong Kong”, and it would be disproportionate to require all past trades to be reported. Moreover, unlike non-Hong Kong companies, an AI, AMB or LC is not subject to any reporting threshold (and hence there is no need for it to distinguish which (non-reportable) transactions were entered into in Hong Kong and which were not). We therefore do not feel that the approach taken in respect of non-Hong Kong

companies as described in paragraph 116 above (i.e. requiring backloading of transactions entered into after the product class specification day) can be adopted in respect of transactions that an AI, AMB or LC has “conducted in Hong Kong”. The same applies in respect of transactions entered into by an AI or LC that is registered or licensed for Type 9 RA, and that manages the assets of another person.

**Q17. Do you have any comments or concerns about how the proposed backloading requirement will apply to transactions outstanding on the starting day? If so, please provide specific details.**

**Q18. Do you have any comments or concerns about the proposal to have different starting days in respect of different types of reportable transactions? If so, please provide specific details.**

**Q19. Do you have any comments or concerns about how the starting day might impact AIs, AMBs and LCs that previously qualified for the exempt person relief? If so, please provide specific details.**

## ***I. TIME FOR REPORTING AND GRACE PERIODS***

118. In general, we propose that a reporting obligation must be fulfilled within 2 business days, i.e. on a T + 2 basis. This is reflected in Rule 28(1) of the Draft Rules.

### ***Concession period and grace period***

119. However, we propose to give some additional leeway when a particular product type first becomes reportable. In this regard, we had said in the July 2012 Consultation Conclusions that –

- (a) a period of up to 3 months would be given to reporting entities to set up their reporting channel to the HKTR, and
- (b) a period of up to 6 months (including the aforesaid 3 months) would be given to reporting entities to complete any backloading.

120. We remain of the view that such proposed periods are appropriate to ensure a smooth transition to the reporting requirement, and have accordingly provided for them in the Draft Rules. These describe the 3 month period mentioned in paragraph 119(a) as a “**concession period**”, and the 6 month period mentioned in paragraph 119(b) as a “**grace period**” – see Rule 23. A few points to note in this regard –

- (a) The 3 month concession period and 6 month grace period will apply each time a new product type becomes reportable. This recognizes that a systems upgrade or adjustment may be needed when a new product type becomes reportable.
- (b) In the case of a Hong Kong person, the concession period and grace period will always be 3 months and 6 months respectively – see paragraph (c) of the definition of concession period under Rule 23, and paragraph (d) of the definition of grace period under that rule.
- (c) However, in the case of an AI, AMB, LC, RCH or ATS-CCP, the lengths of these periods may differ – the concession period may range from 0 day to 3 months, while the grace period may range from 3 months to 6 months. Paragraphs 123 to 124 below discuss the factors that will affect the actual duration of the concession period and grace period in a particular case.
- (d) The two periods tie in with the “starting day” (discussed under paragraph 114 above) in that a reporting entity’s starting day will always mark the beginning of both its concession period (if any) and its grace period.

### **Reporting timeframes**

121. In light of the proposed concession period and grace period, the reporting timeframes will be as follows –

- (a) **For transactions that were reported under the interim reporting arrangement (i.e. before the relevant starting day):** Licensed banks that have reported their interbank transactions under the interim reporting requirement issued by the HKMA in June 2013, will be deemed to have reported those transactions that are still outstanding on the starting day of the mandatory reporting obligation under the new regime. This is reflected in Rule 26(6). We further propose that any subsequent events in respect of these transactions must be reported within 2 business days after the event. This is reflected in Rule 29(1).
- (b) **For backloading transactions that are still outstanding on the relevant starting day:** We propose that such backloading must be completed by no later than the last day of the grace period. This is reflected in Rule 26(1) and (3)(a). Additionally –
  - (i) If the transaction information is reported within the concession period, we propose that the information reported should reflect the net effect of all subsequent events which have occurred since the transaction was entered into and up to a time no earlier than 2 business days before the date of reporting – see Rule 26(4)(a).

- (ii) If the transaction information is reported after the concession period, we propose that it should comprise: (A) transaction information as at the end of the concession period, and this should reflect the net effect of all subsequent events which have occurred since the transaction was entered into; and (B) transaction information (in chronological order) in respect of each subsequent event which has occurred since the end of the concession period and up to a time no earlier than 2 business days before the day of reporting – see Rule 26(4)(b).
  - (iii) There will be no backloading requirement in relation to a transaction that has reached its maturity date or been terminated before the end of the grace period – see Rule 26(5).
- (c) ***For transactions entered into during concession period:*** Such transactions must be reported no later than the last day of the grace period. This is reflected in Rule 26(1) and (3)(b) of the Draft Rules. Additionally –
  - (i) If the transaction information is reported within the concession period, we propose that the information reported should reflect the net effect of all subsequent events which have occurred since the transaction was entered into and up to a time no earlier than 2 business days before the date of reporting – see Rule 26(4)(a).
  - (ii) If the transaction information is reported after the concession period, we propose it should comprise: (A) transaction information as at the end of the concession period, and this should reflect the net effect of all subsequent events which have occurred since the transaction was entered into; and (B) transaction information (in chronological order) in respect of each subsequent event which has occurred since the end of the concession period and up to a time no earlier than 2 business days before the day of reporting – see Rule 26(4)(b).
  - (iii) There will be no reporting obligation in relation to a transaction that has reached its maturity date or been terminated before the end of the grace period – see Rule 26(5).
- (d) ***For transactions entered into after concession period:*** Such transactions must be reported within 2 business days after the transaction is entered into, and any subsequent event must be reported within 2 business days after the event. This is reflected in Rule 28(1) of the Draft Rules.

122. The above arrangements, though complex, are designed to give market participants some flexibility while also taking into account the wider objectives and application of the mandatory reporting regime.

### ***Adjustments to reporting timeframes in certain circumstances***

123. As noted in paragraph 120(d) above, a person's starting day marks the beginning of both his concession period and grace period. In the case of a reporting entity other than a Hong Kong person, their starting day is determined by reference to the following –
- (a) the relevant product type specification day,
  - (b) whether the person was already an AI, AMB, LC, RCH or ATS-CCP on that day, and if not, when it attained that regulated status, and
  - (c) whether, in the case of an AI, AMB or LC, the person qualified for the exempt person relief on the relevant product type specification day, and if so, when it ceased to so qualify.
124. Accordingly, and to cater for these variations, we propose that the duration of the concession period and grace period should be adjusted as follows –
- (a) ***Entity attains regulated status during concession period:*** For an entity that becomes an AI, AMB, LC, RCH or ATS-CCP within 3 months after the product type specification day, its concession period will effectively be shortened. This is because their concession period will start on the day they became an AI, AMB, LC, RCH or ATS-CCP, but still end on a day which is 3 months after the product type specification day. The rationale for the shorter concession period is that an entity seeking to become an AI, AMB, LC, RCH or ATS-CCP should be well aware that such entities are required to set up a reporting channel to the HKTR. It should therefore be able to satisfy this requirement as part of the approval process for becoming an AI, AMB, LC, RCH or ATS-CCP. That said, if the concession period for system set up is still running at the time the entity attains this status, the entity should not be deprived of this benefit. This is reflected in paragraph (b) of the definitions of “concession period” and “grace period” under Rule 23.
  - (b) ***Entity ceases to be exempt person during concession period:*** The same applies in respect of an AI, AMB or LC that was previously an exempt person but ceased to be so within 3 months after the product type specification day. The rationale for this is the same also. This too is reflected in paragraph (b) of the definitions of “concession period” and “grace period” under Rule 23.
  - (c) ***Entity attains regulated status after concession period:*** For an entity that becomes an AI, AMB, LC, RCH or ATS-CCP more than 3 months after the product type specification day, it will not benefit from a 3 month period for setting up its reporting channel to the HKTR. It will however have a period of 3 months (from the day of becoming an AI, AMB, LC, RCH or ATS-CCP) to

backload previous transactions. The rationale here is that an entity seeking such regulatory status should be well aware that such entities are required to set up a reporting channel to the HKTR. It should therefore be able to satisfy this requirement as part of the approval process for becoming an AI, AMB, LC, RCH or ATS-CCP. However, it should still have three months for backloading, in line with all other persons who first become subject to reporting a product type. This is reflected in paragraph (c) of the definition “grace period” under Rule 23, and the fact that the definition of “concession period” in that rule does not provide for this situation.

- (d) ***Entity ceases to be exempt person after concession period:*** The same applies in respect of an entity that was previously an exempt person but ceased to be so more than 3 months after the product type specification day. The rationale for this is the same also. This is reflected in paragraph (c) of the definition “grace period” under Rule 23, and the fact that the definition of “concession period” in that rule does not provide for this situation.

### ***Transition from interim reporting arrangement***

125. To avoid any interruption in the reporting of interbank transactions by licensed banks under the interim reporting requirement during the grace period, the HKMA plans to issue guidance to extend the interim reporting requirement so that it continues to apply in respect of the IRS and NDF currently reportable under the interim reporting requirements, and continues until the end of the grace period for those product types under the Draft Rules. In other words, licensed banks will have to continue to report new interbank transactions and subsequent events falling under the interim reporting requirement to the HKMA on a T+2 basis without regard to the concession period or grace period provided for in the Draft Rules. However, licensed banks will still be entitled to the concession period and grace period for transactions not covered by the interim reporting requirement (such as transactions that were “conducted in Hong Kong”, or transactions with Hong Kong persons).

**Q20. Do you have any comments or concerns about how the concession period and grace period are proposed to operate?**

**Q21. Do you have any comments or concerns about how the grace periods will vary in respect of entities that become an AI, AMB or LC at a later date, or that cease to be an exempt person at a later date?**

## **J. FORM AND MANNER OF REPORTING OBLIGATION**

### **What to report**

126. Rule 24 of the Draft Rules provides that a report made to the HKMA via the HKTR for discharging the reporting obligation must include certain information relating to the transaction (**transaction information**). Schedule 2 to the Draft Rules sets out the types of transaction information required to be reported. This includes information relating to **subsequent events**, i.e. events relating to the transaction that have occurred after the transaction was entered into (e.g. increase or decrease in the notional amount, partial or full termination, etc).
127. It should be noted that, for administrative purposes, the HKMA may also require reporting entities to submit information additional to the transaction information (e.g. name of submitting party, etc). The relevant requirements are set out in the user manual issued by the HKTR, which is available on the HKMA website. A report that fails to contain the information required for administrative purposes may run the risk of being rejected by the HKTR and therefore failing to meet the reporting obligation.

**Q22. Do you have any comments or concerns about the proposed types of transaction information required to be reported for the purposes of the reporting obligation, or as to how these have been expressed in Schedule 2?**

### **Reporting of “valuation transaction information”**

128. In our earlier consultations, we had proposed that the mandatory reporting obligation would require a transaction to be reported at the time it is entered into, and whenever a subsequent event in relation to it occurs (e.g. changes in the economic terms or counterparty of the contract). In terms of the value of the transaction, we had proposed that only the notional principal amount would have to be reported initially. However, drawing reference from the reporting requirements of other major jurisdictions, we see merit in expanding our mandatory reporting obligation so as to also require certain persons (namely, AIs, AMBs, LCs, RCHs and ATS-CCPs) to provide, on a daily basis, a mark-to-market valuation of all transactions reported to the HKMA, as long as the transactions remain outstanding. In other words, there will be a higher level of requirements in terms of both information content and frequency of reporting. We consider that it may not be proportionate to impose this new requirement on non-regulated entities, since they are not major participants in the OTC derivatives market.<sup>12</sup> However, we may consider extending this requirement to

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<sup>12</sup> We accept however that, pending implementation of the new and expanded RAs (assuming it commences after implementation of the requirement to provide “valuation transaction information”), some major market participants may be unregulated and benefit from not having to provide daily valuations. However, this will only be for an interim period pending such implementation.

the non-regulated entities after further consultation if future market developments so warrant.

129. The HKMA is enhancing its reporting system (i.e. the HKTR) to include fields that support the reporting of certain information relating to the valuation of transactions (described as “**valuation transaction information**” in the Draft Rules) on a daily basis. We will also give the market reasonable lead time to get their reporting systems in place for reporting these fields. Therefore, our current thinking is not to require the daily reporting of valuation transaction information at the initial stage of the regime implementation, but at a subsequent phase in the future, possibly in or after late 2015. The HKMA and SFC will further consider the implementation timetable of this proposed requirement. Our proposals on the reporting of valuation transaction information are reflected in Rule 30 of the Draft Rules, read together with Item 6 of Schedule 2 to those rules.
130. Item 6 of Schedule 2 describes the proposed types of valuation transaction information that will have to be reported. These include the valuation type (i.e. whether it is mark-to-market based or mark-to-model based), valuation date, valuation of the transaction and the currency used for the valuation.
131. However, as discussed in paragraph 129 above, the intention is not to require the reporting of valuation transaction information at the initial stage of the regime implementation, but at a subsequent phase in the future. Accordingly, Rule 1(2) of the Draft Rules envisages a separate commencement in respect of Rule 30.

**Q23. Do you have any comments or concerns about the proposal to require the reporting of valuation transaction information in the future?**

### ***How to report***

132. The HKMA has developed the HKTR to facilitate the reporting of OTC derivative transactions. The HKTR’s matching and confirmation function was launched in December 2012 to support voluntary clearing at the local CCP developed by Hong Kong Exchanges and Clearing Limited. The reporting function of the HKTR was launched in July 2013 to support implementation of the interim reporting requirements.
133. We remain of the view that reportable transactions must be reported to the HKMA via the HKTR. This requirement is reflected in Rule 25 of the Draft Rules. This is to ensure that Hong Kong regulators can obtain relevant OTC derivatives information as quickly and directly as possible. Moreover, it is acceptable for market participants to appoint a third party (including a global TR) as an agent for the purpose of reporting to the HKMA via the HKTR – it will be noted in this regard that the Draft Rules do not prohibit reporting via an agent.

134. As for the concern expressed earlier (and noted in the July 2012 Consultation Conclusions) that appropriate protection should be given to institutions that use reporting agents so that they are only liable for breaches arising from their own actions, we believe the regulatory regime under the SFO (as amended by the Amendment Ordinance) will provide sufficient flexibility for relevant matters in this regard to be taken into account. In particular –

- (a) Under the SFO, where the HKMA or SFC considers that an AI, AMB, LC, RCH, ATS-CCP or Hong Kong person may have breached the reporting obligation, the HKMA or SFC may either apply to the Court (under new section 101F or 101G of the SFO), or (in the case of an AI, AMB or LC only) initiate disciplinary proceedings.
- (b) In either case, any final decision on liability would be made after taking into account all relevant facts and circumstances, including any facts and circumstances relating to what the reporting agent, did or did not do, and should or should not have done. This is reflected in the following –
  - (i) new sections 101F(3) and 101G(3) of the SFO – these provide that the Court may, on an application from the HKMA or SFC, impose a financial penalty only after being satisfied that there is “no reasonable excuse” for the breach,
  - (ii) new section 203A(4) of the SFO – this provides that in deciding whether and what disciplinary action to take against an AI or AMB, the HKMA may have regard to any information or material in its possession that is relevant to the decision, and
  - (iii) section 201(1) of the SFO – this provides that in deciding whether and what disciplinary action to take against an LC, the SFC may have regard to any information or material in its possession that is relevant to the decision.

135. The HKMA may publish reporting guidelines on its website, which will provide information on the form and manner for reporting via the HKTR.

### ***Reporting of subsequent events***

136. Rule 29(1) of the Draft Rules requires that a person who has reported (or is required to report) transaction information to the HKMA in accordance with the Draft Rules, must report transaction information relating to all subsequent events to the HKMA within two business days after the event occurs. As set out in Rule 29(2), where a person is required to submit transaction information relating to a subsequent event, and more than one subsequent event occurs on the same day, the person is only required to submit transaction information once in respect of that day provided the

information submitted incorporates all of the subsequent events which occurred on that day. This confirms that we accept reporting under both the life-cycle approach and the snapshot approach.

137. Rule 29(3) of the Draft Rules provides that the requirement to report subsequent events in respect of a transaction, which has not matured or been terminated, will not apply to a reporting entity if one of the following has occurred –
- (a) the entity has ceased to be an AI, AMB, LC, RCH, ATS-CCP or Hong Kong person (as the case may be),
  - (b) the entity is an AI or LC registered or licensed for Type 9 RA, but has ceased to manage the assets of the person on whose behalf the transaction was entered into, or
  - (c) the entity is a Hong Kong person and Rule 15 has ceased to apply to that person in respect of a particular product class, because its positions in that product class are below the exit threshold and therefore he no longer has a reporting obligation.
138. Additionally, and for better control of data collected by the HKTR, the reporting obligation will only cease to apply as described in paragraph 137 above, if the reporting entity has notified the HKMA that it should no longer be regarded as subject to reporting. This is also reflected in Rule 29(3) of the Draft Rules.

**Q24. Do you have any comments or concerns about our proposals on how subsequent events are to be reported, and when they will cease to be reportable?**

### ***Barriers to reporting counterparty identifying information (Masking)***

139. We appreciate that there may be situations where a conflicting confidentiality obligation (or other requirements) under the laws of another jurisdiction might prevent a person from reporting certain counterparty information to the HKMA via the HKTR even though this is necessary to fulfil the mandatory reporting obligation in Hong Kong.
140. In view of such potential difficulty, and pending some level of international consensus on the issue, we propose to build a degree of flexibility into our regime, but only as a temporary measure. Accordingly, Rule 31 of the Draft Rules provides that a reporting entity may mask certain counterparty identifying information when reporting transaction information to the HKMA via the HKTR, but only if –

- (a) the laws of an overseas jurisdiction (which is designated by the SFC with the HKMA's consent), or an authority or regulatory organization in that jurisdiction prohibit the disclosure of such information, or
  - (b) in the case of historical transactions only (i.e. transactions entered into before the Draft Rules first take effect), the person cannot disclose such information without the consent of the other counterparty, and despite reasonable effort, such consent cannot be obtained.
141. With respect to paragraph 140(a) above, we propose to designate jurisdictions only if we are satisfied that the reporting of counterparty identifying information is prohibited under the laws of that jurisdiction, or by the authorities or regulators in that jurisdiction. This is reflected in Rule 31(3) of the Draft Rules. The list will be prepared after taking into account the approach adopted by regulators in other markets, and input from the industry. We also understand that regulators across the globe are working towards removing barriers that may prevent the reporting of counterparty identifying information to TRs. We will closely monitor international regulatory developments in this area, and revoke any designation of a jurisdiction where appropriate.
142. With respect to paragraph 140(b) above, we propose that the masking relief should apply in respect of historical transactions only. This is because while it may be difficult to obtain consent retrospectively (i.e. in respect of transactions entered into before the reporting rules first take effect), going forward, market participants should be aware of the need for consent (or potential need for consent, in the case of transactions that are not yet subject to reporting) and hence work towards obtaining it at the time of entering into the transaction itself.
143. Additionally, counterparty identifying information that was previously masked must be reported to the HKMA via the HKTR –
- (a) within 3 months of the revocation of a designation (unless consent of the other counterparty is still needed and despite reasonable effort, such consent cannot be obtained), and
  - (b) within 1 month after the relevant consent has been obtained, or the requirement for consent is uplifted,

unless the transaction has matured or been terminated before the end of such 3-month or 1-month period. This is reflected in Rule 31(2) of the Draft Rules.

**Q25. Do you have any comments or concerns about the proposals on masking counterparty information under certain circumstances as a temporary measure?**

**Q26. Do you have any comments or concerns about the proposals for subsequently reporting information when the pre-requisites for masking cease to exist?**

## ***K. SPECIFIED SUBSIDIARIES OF LOCALLY-INCORPORATED AIs***

144. As proposed in the July 2012 Consultation Conclusions, an AI incorporated in Hong Kong will have to ensure that any of its subsidiaries that are specified by the HKMA report certain OTC derivative transactions to which it is a counterparty. (This is reflected in new section 101B of the SFO, as amended by the Amendment Ordinance.) This requirement aims to address the risk that an AI incorporated in Hong Kong may seek to bypass the reporting obligation by entering into OTC derivative transactions through subsidiaries.
145. A point to emphasise here is that, under new section 101B, the obligation to report transactions entered into by a specified subsidiary is imposed on the AI incorporated in Hong Kong, and not on the specified subsidiary itself – unless, of course, the subsidiary is subject to the reporting obligation itself, e.g. because it is an LC, or because it falls within the definition of Hong Kong person and has crossed the relevant reporting threshold, etc. Consequently, it is the AI, and not the subsidiary, that will be liable if the specified subsidiary fails to report.
146. As for the details relating to the reporting of transactions of a specified subsidiary – e.g. which transactions are to be reported, how and by when they are to be reported, what exemptions and reliefs are available, etc – we propose that these should essentially be the same as for transactions to which the AI is itself a counterparty. In other words, any requirement that applies to a locally-incorporated AI as a counterparty to a reportable transaction should apply likewise to the AI in respect of reportable transactions to which its specified subsidiary is a counterparty. This is reflected in Rule 39(1) of the Draft Rules.
147. So, for example, the AI will need to ensure that the specified subsidiary reports and backloads only reportable transactions to which the specified subsidiary is a counterparty, and does so in the form and manner, and providing the transaction information (including information on subsequent events), as discussed in paragraphs 126 to 138 above.
148. Additionally, it is possible that a transaction to which a specified subsidiary of a locally-incorporated AI is a counterparty, may also be a transaction that the AI has “conducted in Hong Kong”. In other words, it is possible that the same transaction is: (i) subject to reporting by the AI under Rule 10(1)(b); and (ii) one that the AI is required to ensure is reported under Rule 39(1). In such a case, we propose that the AI should be released from the latter obligation, i.e. it should not need to ensure reporting under Rule 39(1). This is reflected in Rule 39(6) of the Draft Rules

149. The HKMA will issue separate guidance (tentatively in the form of a module of Supervisory Policy Manual) on the criteria that the HKMA will adopt when specifying subsidiaries of AIs incorporated in Hong Kong for the purposes of new section 101B of the SFO.

**Q27. Do you have any comments or concerns about the proposal that an AI's reporting obligations in respect of transactions entered into by its specified subsidiaries should be the same as its reporting obligations in respect of transactions to which it is a counterparty itself?**

***L. USE AND PUBLIC DISCLOSURE OF DATA COLLECTED BY THE HKMA VIA THE HKTR***

150. One of the key objectives of the global efforts to reform the OTC derivatives market is to improve market transparency and reduce systemic risk. To that end, it is important to ensure that data stored in various TRs globally can be accessed promptly and sufficiently by relevant regulators for the purposes of effective market surveillance and risk monitoring. The Amendment Ordinance provides the necessary disclosure gateways to share the data stored in the HKTR with relevant authorities and overseas TRs. We will ensure effective regulatory access to the data stored in the HKTR, with reference to the international guidance provided in the report on authorities' access to TR data published by the Committee on Payment and Settlement Systems (**CPSS**) and International Organization of Securities Commissions (**IOSCO**). The HKMA will also maintain a close dialogue with overseas authorities and strive to adhere to international standards on sharing data with overseas authorities and TRs.
151. As it is likely that OTC derivatives data will be reported to TRs located in different jurisdictions, it is important to have the ability to aggregate data on a global basis in order to obtain a more comprehensive and accurate picture of the OTC derivatives market. Internationally, the regulatory community is exploring possible approaches for aggregating the data held in different TRs. The Financial Stability Board (**FSB**) set up the Aggregation Feasibility Study Group (**AFSG**) to study the feasibility of various options for aggregating TR data. In February 2014, the AFSG published a consultation paper on its proposed approaches for aggregating OTC derivatives TR data. The consultation closed on 28 February 2014, and we will closely monitor development in this area.
152. As explained in the July 2012 Consultation Conclusions, the data collected by the HKMA via the HKTR will be used solely for regulatory and market surveillance purposes. Moreover, any public disclosure of such data will initially be on an aggregate basis only. We are considering the details of the mechanism for the public

disclosure of TR data. We will closely monitor the international regulatory development in this area.

## **M. PROPOSED MANDATORY RECORD KEEPING OBLIGATION**

153. Part 3 of the Draft Rules sets out the proposed record keeping obligations that will supplement the reporting obligation discussed above, i.e. the records to be kept to demonstrate compliance with the reporting obligation. By virtue of section 101E(7) and (8) of the SFO (as amended by the Amendment Ordinance), these records must be made available to the HKMA (in the case of AIs and AMBs) and the SFC (in the case of other reporting entities) upon request.
154. Rules 6 and 8 of the Draft Rules clarify that the record keeping obligation applies in respect of the same persons and transactions as those subject to the reporting obligation.

### ***Records to be kept***

155. The purpose of the record keeping obligation is to ensure that adequate records are maintained as evidence of a person's compliance with the reporting obligation. To that end, Rules 34 and 35, as read with Schedule 3 to the Draft Rules, require as follows –
- (a) For Hong Kong persons, they must keep at least the following –
- (i) in respect of transactions that they must report, sufficient records to demonstrate compliance with their reporting obligation (and these should include the records specified in Part 2 of Schedule 3),
  - (ii) where they are relying on not having reached the reporting threshold (or on having reached the exit threshold), sufficient records to demonstrate that they have not (or have) reached that threshold (including records of calculations performed in this regard), as well as records evidencing the transaction and its main economic terms,
  - (iii) where they are relying on the exemption for Hong Kong persons (i.e. that the transaction is reportable by an AI, AMB or LC), records evidencing the transaction and its main economic terms, and
  - (iv) where they are relying on the relief in respect of transactions that have matured or been terminated during the grace period, records evidencing the transaction and its main economic terms.
- (b) For all other reporting entities, they must keep at least the following –

- (i) in respect of transactions that they must report, sufficient records to demonstrate compliance with their respective reporting obligation (and these should include the records specified in Part 1 of Schedule 3<sup>13</sup>),
- (ii) where they are relying on the exempt person relief, the records specified in Part 1 of Schedule 3, and other records sufficient to demonstrate that it was entitled to such exemption (including records of calculations performed in this regard),
- (iii) where they are relying on the relief in respect of transactions reported by an affiliate, the confirmation received from the affiliate,
- (iv) where they are relying on the relief in respect of transactions that have matured or been terminated during the grace period, the records specified in Part 1 of Schedule 3, and
- (v) where the reporting was done through an agent, records relating to the agent's appointment and to demonstrate that the agent's compliance was monitored.

***Manner in which and duration for which records must be kept***

156. Additionally, Rules 36 and 37 of the Draft Rules require reporting entities (other than Hong Kong persons) to keep their records in the following manner and for the following period –

- (a) During the first 9 months from the relevant product class specification day, the records may be kept in any form or manner so long as they are readily searchable and identifiable by reference to the transaction and the counterparty.
- (b) After the first 9 months, records should be kept in electronic form and stored in a computer or other electronic system save that: (i) records created and maintained in paper form may be kept in paper form; and (ii) audio recordings may be stored in a sound recording media.
- (c) The records must be maintained for a period of no less than 7 years after the maturity or termination of the relevant OTC derivative transaction.

157. In the event that a locally-incorporated AI is required to ensure that those of its subsidiaries specified by the HKMA comply with the mandatory reporting obligation,

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<sup>13</sup>The list under Part 2 of Schedule 3 (for Hong Kong persons) is less detailed than the list under Part 1 of Schedule 3 (for other reporting entities). This reflects that reporting entities that are regulated entities (i.e. that are not Hong Kong persons) will be subject to more stringent record keeping obligations.

the AI will also be required to ensure that those specified subsidiaries comply with the record keeping obligation in relation to the reporting obligation. A specified subsidiary of an AI must therefore keep the same types of records and in the same manner and for the same period as per the record keeping rules applicable to the AI. This is reflected in Rule 39(3) and (4) of the Draft Rules.

158. As for Hong Kong persons, the current intention is to subject them to a simpler record keeping requirement. Accordingly, Rules 35, 36(3) and 37 of the Draft Rules propose to only require that Hong Kong persons maintain their records in a legible and retrievable form, and for no less than 7 years after the maturity or termination of the relevant specified OTC derivative transaction.

**Q28. Do you have any comments or concerns about the proposed record keeping requirements in relation to mandatory reporting?**

**Q29. Do you have any comments or concerns about the types of records proposed to be kept, and the manner in which they are to be kept?**

**Q30. Do you have any comments or concerns about the duration for which the records are proposed to be kept?**

## **CONCLUDING REMARKS**

159. The HKMA and SFC are working towards implementing the regulatory regime for the OTC derivatives market in Hong Kong. This paper marks the first of a series of consultations on the detailed rules for implementing the new regime.
160. The proposals in this paper have been developed in light of similar reform efforts in other major markets including the US, the EU, Japan, Australia and Singapore, and taking into account local features and characteristics. We believe the proposals strike the right balance, but as always we welcome market views on where proposals may be problematic or result in unintended consequences.
161. Subject to the completion of this first consultation, we aim to finalise the Draft Rules and issue a consultation conclusions paper in Q4 2014, and to introduce the final rules into the Legislative Council for negative vetting in Q4 2014.
162. We will provide an indicative implementation time table for other aspects of the OTC derivatives regime when we publish the consultation conclusions in Q4 2014. We are mindful of the need to give market participants reasonable lead time to get their systems and procedures in place to comply with the new regulations.

Rule

**Securities and Futures (OTC Derivative  
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# Securities and Futures (OTC Derivative Transactions - Reporting and Record Keeping) Rules

(Made by the Securities and Futures Commission under sections 101L(1) and 101P(1) of the Securities and Futures Ordinance (Cap. 571) with the consent of the Monetary Authority and after consultation with the Financial Secretary)

## Part 1

### Preliminary

#### 1. Commencement

- (1) Subject to subrule (2), these Rules come into operation on 201 .
- (2) Rules 14 and 30 come into operation on a day<sup>1</sup> to be appointed by the Securities and Futures Commission by notice published in the Gazette.

#### 2. Interpretation<sup>2</sup>

In these Rules –

**affiliate** ( ), in relation to a prescribed person that is a licensed corporation, an authorized financial institution or an approved money broker, means a corporation<sup>3</sup> that is in the same group of companies<sup>4</sup> as the person;

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<sup>1</sup> If rules 14 and 30 do not commence on the same day, the SFC will publish separate notices for each rule.

<sup>2</sup> Note: Certain terms used in these Rules are defined in Schedule 1 to the SFO or in section 101A of the SFO (as amended by the Securities & Futures (Amendment) Ordinance 2014). They include: **reporting obligation** – an obligation imposed by section 101B; **specified OTC derivative transaction** – in relation to the reporting obligation means a transaction specified in the reporting rules for the purposes of that obligation; **OTC derivative transaction** - a transaction in an OTC derivative product; and **OTC derivative product** – a structured product other than one of those specified in section 1B(2) of Schedule 1 to the SFO.

<sup>3</sup> Defined in Schedule 1 to the SFO

<sup>4</sup> Defined in Schedule 1 to the SFO

**ATS-CCP** ( ) means a person authorized under section 95(2) of the Ordinance to provide automated trading services, but only when the person is –

- (a) performing services that it is authorized to provide; and
- (b) acting in its capacity as a central counterparty;

**conducted a transaction in Hong Kong on behalf of an affiliate** ( ), in relation to a prescribed person that is a licensed corporation, an authorized financial institution or an approved money broker, has the meaning given by rule 4;

**exempt person** ( ) has the meaning given by rule 3;

**Hong Kong person** ( ) means a person referred to in rule 5(2);

**local branch** ( ), in relation to an authorized financial institution incorporated outside Hong Kong, has the meaning given by section 2(1) of the Banking Ordinance (Cap. 155) except that it includes its principal place of business in Hong Kong;

**product class** ( ) means a class of OTC derivative transactions specified in column 2 of Part 2 of Schedule 1;

**product class specification day** ( ), in relation to a product class, means the day specified in column 3 of Part 2 of Schedule 1;

**product type** ( ) means a type of OTC derivative transaction within a product class, specified in column 3 of Part 3 of Schedule 1;

**product type specification day** ( ), in relation to a product type, means the day specified in column 4 of Part 3 of Schedule 1;

**RCH** ( ) means a person that is a recognized clearing house, but only when it is acting in its capacity as a central counterparty;

**regulated prescribed person** ( ) means the following prescribed persons –

- (a) an RCH;
- (b) an ATS-CCP;

- (c) a licensed corporation that is not an exempt person;
- (d) an authorized financial institution that is not an exempt person; and
- (e) an approved money broker that is not an exempt person;

**reporting threshold** ( ) has the meaning given by rule 16(4);

**specified position** ( ), and **specified position that has reached the reporting threshold** ( ), in relation to a Hong Kong person, have the meaning given by rule 16;

**starting day** ( ) means –

- (a) in relation to a regulated prescribed person, the later of the product type specification day and the day on which the person became a regulated prescribed person; or
- (b) in relation to a Hong Kong person –
  - (i) the first day on or after the product type specification day on which the person has a specified position in the product class to which the product type belongs that has reached the reporting threshold; or
  - (ii) where the person previously had, but ceased to have, a specified position referred to in subparagraph (i), the first day on which the person subsequently has a specified position referred to in subparagraph (i);

**still outstanding** ( ), in relation a transaction on a particular day, means has not, as at that day, matured or been terminated;

**subsequent event** ( ) means an event that occurs after a transaction in an OTC derivative product is entered into, and which affects the product, the terms or conditions on which the transaction was entered into or the persons involved in entering into the transaction;

**terminated** ( ), in relation to a transaction, means terminated in accordance with the terms or conditions of the transaction or by agreement between the counterparties to the transaction, before the transaction matures;

**transaction information** ( ) means the information and particulars specified in Schedule 2 relating to a specified OTC derivative transaction (including information and particulars relating to a subsequent event and valuation transaction information), and the persons involved in the transaction, which must be submitted for complying with the reporting obligation;

**valuation transaction information** ( ) means the information and particulars specified in item 6 of Schedule 2.

### 3. Meaning of exempt person

(1) Subject to subrule (4), for the purposes of rules 9(1)(a), 10(1)(a), 11(1)(a) and 12(1)(a), a prescribed person that is a licensed corporation, an authorized financial institution or an approved money broker, is to be regarded as an **exempt person** ( ) in relation to a product class, if the person satisfies all of the requirements in subrule (2) in relation to that product class.

(2) The requirements are that, on or after the product class specification day, the prescribed person –

(a) except in the circumstances described in subrule (3), does not enter into a class transaction as a counterparty, or have an outstanding class transaction to which it is a counterparty, where the other counterparty is a Hong Kong person;

(b) does not conduct a class transaction in Hong Kong on behalf of an affiliate, as described in rule 9(1)(b), 10(1)(b), 11(1)(c) or 12(1)(b) (as applicable);

(c) if it is an authorized financial institution incorporated outside Hong Kong, does not enter into a class transaction, as described in rule 11(1)(b);

(d) if it is a licensed corporation licensed for Type 9 regulated activity or an authorized financial institution registered for Type 9 regulated activity, does not enter into a class transaction, as described in rule 9(1)(c), 10(1)(c) or 11(1)(d) (as applicable); and

(e) except in the circumstances described in subrule (3), does not have outstanding class transactions to which it is a counterparty –

(i) exceeding 5 in number; and

(ii) having in aggregate a total gross notional value exceeding US\$ 30 million.

- (3) The circumstances referred to in subrules (2)(a) and (2)(e) are that the prescribed person is an authorized financial institution incorporated outside Hong Kong, and its local branch was not involved in the transaction.
- (4) Despite subrule (1), a prescribed person that is a bank within the meaning of section 2 of the Banking Ordinance (Cap. 155), is not to be regarded as an exempt person for the purposes of rules 10(1)(a) or 11(1)(a) (as applicable) in relation to a product class if, on the day on which these Rules commence –
- (a) the person has a specified OTC derivative transaction in the product class which is still outstanding; and
  - (b) in respect of which the person submitted to the Monetary Authority transaction information (or information which in the opinion of the Monetary Authority is substantially similar to transaction information) before the day on which these Rules commence.
- (5) In this rule –

**class transaction** ( ) means an OTC derivative transaction in the product class to which a specified OTC derivative transaction referred to in rule 9(1)(a), 10(1)(a), 11(1)(a) or 12(1)(a) (as applicable) belongs.

#### 4. Meaning of conducted a transaction in Hong Kong on behalf of an affiliate

For the purposes of rules 9(1)(b), 10(1)(b), 11(1)(c) and 12(1)(b), a prescribed person is regarded as having **conducted a transaction in Hong Kong on behalf of an affiliate** ( ) if –

- (a) the transaction is recorded in the form of an entry in the books of the affiliate; and
- (b) one of the individuals who made the decision for the affiliate to enter into the transaction –
  - (i) acted in his or her capacity as a trader; and
  - (ii) was employed or engaged by the prescribed person to perform a substantial part of his or her duties in Hong Kong.

**5. Persons specified as prescribed persons (Hong Kong persons and central counterparties) for reporting obligation**

(1) For the purposes of paragraph (a)(iv) of the definition of **prescribed person** ( ) in section 101A of the Ordinance, the following persons are specified as being subject to the reporting obligation –

(a) an RCH;

(b) an ATS-CCP; and

(c) a person referred to in subrule (2).

(2) Subject to subrule (3), the following persons (**Hong Kong persons**) are the persons referred to in subrule (1)(c) –

(a) an individual who is resident in Hong Kong;

(b) a partner of a partnership which is established under Hong Kong law;

(c) a trustee of a trust which is established under Hong Kong law;

(d) a company<sup>5</sup>;

(e) a non-Hong Kong company<sup>6</sup>; and

(f) any other entity which is established under Hong Kong law.

(3) Subrule (2) does not include the following persons –

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<sup>5</sup> Defined in Schedule 1 to the SFO as meaning a company as defined in section 2(1) of the Companies Ordinance (Cap. 622).

<sup>6</sup> Defined in Schedule 1 to the SFO as having the meaning given by section 2(1) of the Companies Ordinance (Cap. 622), (i.e., a company incorporated outside Hong Kong that — (a) establishes a place of business in Hong Kong on or after the commencement date of Part 16; or (b) has established a place of business in Hong Kong before that commencement date and continues to have a place of business in Hong Kong at that commencement date). This definition covers both non-Hong Kong companies that have registered and those that are required to register but have not yet registered.

- (a) a licensed corporation;
- (b) an authorized financial institution;
- (c) an approved money broker;
- (d) an RCH; and
- (e) an ATS-CCP.

**6. Persons specified as prescribed persons (Hong Kong persons and central counterparties) for record keeping obligation**

For the purposes of paragraph (d)(iv) of the definition of ***prescribed person*** ( ) in section 101A of the Ordinance, the persons specified as being subject to the record keeping obligation are the persons specified under rule 5 as being subject to the reporting obligation.

**7. Transactions that are specified OTC derivative transactions for reporting obligation**

For the purposes of paragraph (a) of the definition of ***specified OTC derivative transaction*** ( ) in section 101A of the Ordinance, an OTC derivative transaction in a product type specified in Part 3 of Schedule 1 is specified for the purposes of the reporting obligation.

**8. Transactions that are specified OTC derivative transactions for record keeping obligation**

For the purposes of paragraph (d) of the definition of ***specified OTC derivative transaction*** ( ) in section 101A of the Ordinance, an OTC derivative transaction in a product type specified in Part 3 of Schedule 1 is specified for the purposes of the record keeping obligation.

## Part 2

### Reporting Obligation

#### Division 1 - OTC Derivative Transactions Required to be Reported by Prescribed Persons

##### 9. Transactions to be reported by licensed corporations

- (1) A prescribed person that is a licensed corporation must report a specified OTC derivative transaction to the Monetary Authority if the person –
  - (a) subject to subrule (3), is a counterparty to the transaction;
  - (b) subject to rule 21, conducted the transaction in Hong Kong on behalf of a counterparty to the transaction that is an affiliate of the person; or
  - (c) is licensed for Type 9 regulated activity and –
    - (i) in the course of carrying on the activity, manages a portfolio of assets for another person;
    - (ii) in the course of managing the portfolio, enters into the transaction on behalf of the other person; and
    - (iii) the other person is a counterparty to the transaction.
- (2) A transaction referred to in subrule (1)(a) includes a transaction that is still outstanding on the starting day.
- (3) Subrule (1)(a) does not apply to an exempt person.

## **10. Transactions to be reported by authorized financial institutions incorporated in Hong Kong**

- (1) A prescribed person that is an authorized financial institution incorporated in Hong Kong must report a specified OTC derivative transaction to the Monetary Authority if the person –
  - (a) subject to subrule (3), is a counterparty to the transaction;
  - (b) subject to rule 21, conducted the transaction in Hong Kong on behalf of a counterparty to the transaction that is an affiliate of the person; or
  - (c) is registered for Type 9 regulated activity and –
    - (i) in the course of carrying on the activity, manages a portfolio of assets for another person;
    - (ii) in the course of managing the portfolio, enters into the transaction on behalf of the other person; and
    - (iii) the other person is a counterparty to the transaction.
- (2) A transaction referred to in subrule (1)(a) includes a transaction that is still outstanding on the starting day.
- (3) Subrule (1)(a) does not apply to an exempt person.

## **11. Transactions to be reported by authorized financial institutions incorporated outside Hong Kong**

- (1) A prescribed person that is an authorized financial institution incorporated outside Hong Kong must report a specified OTC derivative transaction to the Monetary Authority if the person –
  - (a) subject to subrule (3), is a counterparty to the transaction and the transaction is recorded in the form of an entry in the books of a local branch of the person;
  - (b) is a counterparty to the transaction and –

- (i) the transaction is recorded in the form of an entry in the books of –
    - (A) the person's principal place of business outside Hong Kong; or
    - (B) a branch (other than a local branch) of the person; and
  - (ii) one of the individuals who made the decision for the person to enter into the transaction –
    - (A) acted in his or her capacity as a trader; and
    - (B) was employed or engaged by the person to perform a substantial part of his or her duties in Hong Kong;
  - (c) subject to rule 21, conducted the transaction in Hong Kong on behalf of a counterparty to the transaction that is an affiliate of the person; or
  - (d) is registered for Type 9 regulated activity and –
    - (i) in the course of carrying on the activity, manages a portfolio of assets for another person;
    - (ii) in the course of managing the portfolio, enters into the transaction on behalf of the other person; and
    - (iii) the other person is a counterparty to the transaction.
- (2) A transaction referred to in subrule (1)(a) includes a transaction that is still outstanding on the starting day.
- (3) Subrule (1)(a) does not apply to an exempt person.

## **12. Transactions to be reported by approved money brokers**

- (1) A prescribed person that is an approved money broker must report a specified OTC derivative transaction to the Monetary Authority if the person –
  - (a) subject to subrule (3), is a counterparty to the transaction; or

- (b) subject to rule 21, conducted the transaction in Hong Kong on behalf of a counterparty to the transaction that is an affiliate of the person.
- (2) A transaction referred to in subrule (1)(a) includes a transaction that is still outstanding on the starting day.
- (3) Subrule (1)(a) does not apply to an exempt person.

### **13. Transactions to be reported by RCHs**

- (1) A prescribed person that is an RCH must report a specified OTC derivative transaction to the Monetary Authority if the person is a counterparty to the transaction.
- (2) A transaction referred to in subrule (1) includes a transaction that is still outstanding on the starting day.

### **14. Transactions to be reported by ATS-CCPs**

- (1) A prescribed person that is an ATS-CCP must report a specified OTC derivative transaction to the Monetary Authority if the person is a counterparty to the transaction and the other counterparty is a company.
- (2) A transaction referred to in subrule (1) includes a transaction that is still outstanding on the starting day.

### **15. Transactions to be reported by Hong Kong persons**

- (1) Subject to rules 20 and 22, a prescribed person that is a Hong Kong person must report a specified OTC derivative transaction to the Monetary Authority if –
  - (a) the person has a **specified position** in the product class to which the transaction belongs, and the specified position has reached the reporting threshold for the product class;
  - (b) subject to paragraphs (c), (d), (e) and (f), the person is a counterparty to the transaction;

- (c) in the case of a person referred to in rule 5(2)(a), (d), (e) or (f) (a Hong Kong person other than a partner or a trustee), the person entered into the transaction in a capacity other than as a partner of a partnership or as a trustee of a trust;
  - (d) in the case of a person referred to in rule 5(2)(b) (a partner), the person entered into the transaction in their capacity as a partner of the partnership to which the transaction is attributable;
  - (e) in the case of a person referred to in rule 5(2)(c) (a trustee), the person entered into the transaction in their capacity as a trustee of the trust to which the transaction is attributable; and
  - (f) in the case of a person referred to in rule 5(2)(e) (a non-Hong Kong company), the person entered into the transaction in Hong Kong.
- (2) Subject to subrule (3), a transaction referred to in subrule (1)(b) includes a transaction that is still outstanding on the starting day.
  - (3) Subrule (2) applies to a person referred to in rule 5(2)(e) (a non-Hong Kong company), only in relation to transactions which the person entered into in Hong Kong on or after the product class specification day.

## 16. Hong Kong persons - meaning of specified position

- (1) For the purposes of rule 15(1)(a) and subject to rule 17, the **specified position** ( ) that a Hong Kong person has in a product class is calculated in accordance with the following formula –

$$S \div 6$$

Where –

**S** is the sum of the notional principal values of the person's gross positions in a product class, calculated as at the last day of each of the preceding 6 calendar months;

**notional principal value** means the amount agreed by the counterparties to a transaction to be the basis on which, or the amount by reference to which, any payment under the transaction is calculated.

- (2) For the purposes of rule 15(1)(a), a Hong Kong person is taken to have a specified position in a product class that has reached the reporting threshold for the product class –

- (a) from the first day of the calendar month immediately following the day on which the person has a specified position that reaches the reporting threshold; and
  - (b) until the first day (being the last day of a calendar month) on which the person has a specified position that is below the exit threshold.
- (3) When determining whether a specified position in a product class has reached the reporting threshold or is below the exit threshold, reference is to be made to the reporting threshold or exit threshold for that product class on the last day of the last calendar month (the 6<sup>th</sup> month) included in the calculation of the specified position.
- (4) In this rule –

**reporting threshold** ( ), in relation to a product class, means the amount specified in column 3 of Part 4 of Schedule 1 (or an equivalent amount in a currency other than the currency specified in that column);

**exit threshold** ( ), in relation to a product class, means the amount specified in column 4 of Part 4 of Schedule 1 (or an equivalent amount in a currency other than the currency specified in that column).

## 17. Hong Kong persons - certain positions to be included in specified position

- (1) Subject to subrules (2), (3), (4), (5) and (6), a Hong Kong person, when calculating the person's specified position in a product class, must include only the positions attributable to transactions to which the person is a counterparty.
- (2) Transactions referred to in subrule (1) include –
- (a) transactions to which a counterparty is a person outside Hong Kong;
  - (b) except in the case of a person referred to in rule 5(2)(e) (a non-Hong Kong company), transactions which the person entered into before the product class specification day;
  - (c) in the case of a person referred to in rule 5(2)(e) (a non-Hong Kong company), only transactions which the person entered into in Hong Kong on or after the product class specification day; and
  - (d) subject to paragraph (c), transactions which were entered into wholly or partially outside Hong Kong.

- (3) A person referred to in rule 5(2)(a), (d), (e) or (f) (a Hong Kong person other than a partner or a trustee) must include only the gross positions attributable to the person in a capacity other than as a partner of a partnership or as a trustee of a trust.
- (4) A person referred to in rule 5(2)(b) (a partner) must –
  - (a) include only the gross positions attributable to the partnership of which the person is a partner; and
  - (b) if the person is a partner of more than one partnership, treat separately and not aggregate the gross positions attributable to each partnership.
- (5) A person referred to in rule 5(2)(c) (a trustee) must –
  - (a) include only the gross positions attributable to the trust of which the person is a trustee; and
  - (b) if the person is a trustee of more than one trust, treat separately and not aggregate the gross positions attributable to each trust.
- (6) A Hong Kong person that constitutes more than one collective investment scheme must treat separately and not aggregate the gross positions attributable to a particular collective investment scheme and those attributable to another collective investment scheme.

## **18. Prescribed persons to report all transaction events**

- (1) A prescribed person that is required by rule 9, 10, 11, 12, 13, 14 or 15 to report a specified OTC derivative transaction to the Monetary Authority, must report the transaction to the Monetary Authority in accordance with Division 3 in each of the circumstances described in subrule (2).
- (2) The circumstances are –
  - (a) when rule 9, 10, 11, 12, 13, 14 or 15 first begins to apply to the person in relation to the transaction; and
  - (b) when a subsequent event occurs while the transaction is still outstanding.

**19. Prescribed persons to report even if counterparty, or transaction entered into, outside Hong Kong**

For the purposes of rules 9, 10, 11, 12, 13, 14 and 15, a prescribed person must report a specified OTC derivative transaction to the Monetary Authority even if –

- (a) a counterparty, or more than one counterparty, to the transaction is a person outside Hong Kong; or
- (b) subject to rule 15(1)(f), the transaction was entered into wholly or partially outside Hong Kong.

**Division 2 - Circumstances in which Requirement to Report Does Not Apply or is Taken to be Complied With**

**20. Hong Kong person not required to report if licensed corporation, authorized financial institution or approved money broker also required to report**

A Hong Kong person is not required to report a specified OTC derivative transaction to the Monetary Authority if a prescribed person that is a licensed corporation, an authorized financial institution or an approved money broker is required to report the transaction.

**21. Licensed corporation, authorized financial institution or approved money broker taken to report if affiliate reports**

- (1) Where a prescribed person that is a licensed corporation, an authorized financial institution or an approved money broker is required by rule 9(1)(b), 10(1)(b), 11(1)(c) or 12(1)(b) to report a specified OTC derivative transaction to the Monetary Authority in a circumstance referred to in rule 18(2)(a) or (b), the person is taken to have complied with the requirement to report the transaction in that circumstance if the requirement in subrule (2) is satisfied.
- (2) The requirement is that the person's affiliate has confirmed to the person, in good faith, that the affiliate has reported the transaction to the Monetary Authority in accordance with Division 3 (as Division 3 applies to the person in relation to the circumstance).

**22. Partners (that are Hong Kong persons) taken to report if one partner, or person authorized by partners, reports**

- (1) Where more than one partner of a partnership is required to report a specified OTC derivative transaction to the Monetary Authority in a circumstance referred to in rule 18(2)(a) or (b), all of the partners of the partnership are taken to have complied with the requirement to report the transaction in that circumstance if the requirement in subrule (2) is satisfied.
- (2) The requirement is that the transaction is reported to the Monetary Authority in accordance with Division 3 (as Division 3 applies to the partners in relation to the circumstance) by one of the partners, or by another person authorized by the partners.

**Division 3 - Reporting to the Monetary Authority**

**23. Interpretation of Division 3**

In this Division –

**concession period** ( ), in relation to –

- (a) a person that is a regulated prescribed person on the product type specification day, means the period of 3 months beginning on the product type specification day;
- (b) a person that becomes a regulated prescribed person within 3 months after the product type specification day, means the period beginning on the day on which the person becomes a regulated prescribed person and ending on the day that is 3 months after the product type specification day; and
- (c) a Hong Kong person, means the period of 3 months beginning on the starting day;

**grace period** ( ), in relation to –

- (a) a person that is a regulated prescribed person on the product type specification day, means the period of 6 months beginning on the product type specification day;
- (b) a person that becomes a regulated prescribed person within 3 months after the product type specification day, means the period beginning on the day on which the person becomes a regulated prescribed person and ending on the day that is 6 months after the product type specification day;

- (c) a person that becomes a regulated prescribed person more than 3 months after the product type specification day, means the period of 3 months beginning on the day on which the person becomes a regulated prescribed person; and
- (d) a Hong Kong person, means the period of 6 months beginning on the starting day.

#### **24. Transaction information to be reported to Monetary Authority in accordance with Division 3**

A prescribed person that is required to report a specified OTC derivative transaction to the Monetary Authority must submit the transaction information (including, subject to rule 30, daily valuation transaction information about the transaction) to the Monetary Authority in accordance with this Division.

#### **25. Reporting to be via Monetary Authority's electronic reporting system**

- (1) A report that is required to be submitted to the Monetary Authority under these Rules is to be regarded as duly submitted only if it is submitted by means of the electronic reporting system referred to in subrule (2).
- (2) The electronic reporting system is the electronic system operated by or on behalf of the Monetary Authority for submitting and receiving reports on specified OTC derivative transactions for the purposes of section 101B of the Ordinance and these Rules.

#### **26. Reporting outstanding transactions and transactions entered into during concession period**

- (1) Subject to subrules (5) and (6), a person referred to in subrule (2) and to whom a requirement referred to in subrule (3) applies, must submit the transaction information referred to in subrule (4) to the Monetary Authority no later than the last day of the grace period.
- (2) Subrule (1) applies to –
  - (a) a person who is a regulated prescribed person on the product type specification day;

- (b) a person who becomes a regulated prescribed person within 3 months after the product type specification day; and
  - (c) a Hong Kong person who has a specified position that has reached the reporting threshold.
- (3) The requirement referred to in subrule (1) is a requirement to report to the Monetary Authority a specified OTC derivative transaction –
  - (a) that is still outstanding on the first day of the grace period; or
  - (b) that is entered into during the concession period.
- (4) The transaction information referred to in subrule (1) is –
  - (a) if the information is submitted during the concession period, transaction information as at a time which is not earlier than 2 business days before the time it is submitted, reflecting the net effect of all subsequent events that have occurred since the transaction was entered into; or
  - (b) if the information is submitted after the concession period, transaction information comprising –
    - (i) transaction information as at the end of the concession period, reflecting the net effect of all subsequent events that have occurred since the transaction was entered into; and
    - (ii) in chronological order, transaction information in respect of each subsequent event that has occurred since the end of the concession period until a day that is not earlier than 2 business days before the day on which the information is submitted.
- (5) A prescribed person is not required to submit transaction information to the Monetary Authority in respect of a specified OTC derivative transaction that has matured or been terminated before the end of the grace period.
- (6) A prescribed person that is an authorized financial institution is deemed to have submitted transaction information in respect of a specified OTC derivative transaction referred to in subrule (3)(a) to the Monetary Authority under subrule (1) on the day on which these Rules commence if –
  - (a) the person is a bank within the meaning of section 2 of the Banking Ordinance (Cap. 155); and

- (b) before the day on which these Rules commence, the person submitted to the Monetary Authority transaction information (or information which in the opinion of the Monetary Authority is substantially similar to transaction information) in respect of the transaction.

## **27. Reporting outstanding transactions where no entitlement to concession period**

- (1) Subject to subrule (5), a person referred to in subrule (2) and to whom the requirement referred to in subrule (3) applies, must submit the transaction information referred to in subrule (4) to the Monetary Authority no later than the last day of the grace period.
- (2) Subrule (1) applies to a person who becomes a regulated prescribed person more than 3 months after the product type specification day.
- (3) The requirement referred to in subrule (1) is a requirement to report to the Monetary Authority a specified OTC derivative transaction that is still outstanding on the first day of the grace period.
- (4) The transaction information referred to in subrule (1) is transaction information comprising –
  - (a) transaction information as at the day on which the person becomes a regulated prescribed person, reflecting the net effect of all subsequent events that have occurred since the transaction was entered into; and
  - (b) in chronological order, transaction information in respect of each subsequent event that has occurred since the day on which the person became a regulated prescribed person until a day that is not earlier than 2 business days before the day on which the information is submitted.
- (5) A prescribed person is not required to submit transaction information to the Monetary Authority in respect of a specified OTC derivative transaction that has matured or been terminated before the end of the grace period.

## **28. Reporting transactions entered into after concession period, or where no entitlement to concession period**

- (1) A person referred to in subrule (2) and to whom a requirement referred to in subrule (3) applies, must submit the transaction information to the Monetary Authority within 2 business days after the transaction is entered into.

- (2) Subrule (1) applies to –
  - (a) a person referred to in rule 26(2); and
  - (b) a person referred to in rule 27(2).
- (3) The requirement referred to in subrule (1) is a requirement to report to the Monetary Authority a specified OTC derivative transaction –
  - (a) for a person referred to in subrule (2)(a), that is entered into after the end of the concession period; and
  - (b) for a person referred to in subrule (2)(b), that is entered into on or after the day on which the person becomes a regulated prescribed person.

## **29. Reporting subsequent events**

- (1) Subject to subrules (2) and (3) and rule 31, a prescribed person that has submitted, or is required to submit, transaction information to the Monetary Authority in accordance with rule 26, 27 or 28 (including a person that has submitted transaction information about a transaction despite rule 26(5) or 27(5)), must submit transaction information relating to a subsequent event to the Monetary Authority within 2 business days after the event occurs.
- (2) Where a prescribed person is required to submit transaction information relating to a subsequent event to the Monetary Authority under subrule (1), and more than one subsequent event occurs on the same day, the person is only required to submit transaction information once in respect of that day provided that the information submitted incorporates all of the subsequent events that occurred on that day.
- (3) Subrule (1) does not require a prescribed person to submit transaction information relating to a subsequent event that has occurred in respect of a transaction that has not matured or been terminated if –
  - (a) the person –
    - (i) has ceased to be a regulated prescribed person;

- (ii) is a licensed corporation licensed for Type 9 regulated activity or is an authorized financial institution registered for Type 9 regulated activity and rule 9(1)(c), 10(1)(c) or 11(1)(d) (as the case may be) has ceased to apply to it by reason of it ceasing to manage assets for the person on whose behalf it entered into the transaction;
  - (iii) has ceased to be a Hong Kong person; or
  - (iv) is a Hong Kong person but rule 15 has ceased to apply to the person by reason of the person ceasing to have a specified position that has reached the reporting threshold; and
- (b) the prescribed person has notified the Monetary Authority that this subrule applies to the person in relation to the transaction.

### **30. Reporting valuation transaction information**

A regulated prescribed person must submit valuation transaction information to the Monetary Authority each day until the day on which the specified OTC derivative transaction matures or is terminated.

### **31. Reporting counterparty identity in certain circumstances**

- (1) A prescribed person that is required to report a specified OTC derivative transaction to the Monetary Authority may submit counterparty masking particulars instead of counterparty identifying particulars in relation to a counterparty to the transaction (other than the prescribed person) if –
- (a) the submission of the counterparty identifying particulars is prohibited under the laws of, or by an authority or regulatory organization in, a jurisdiction that is a jurisdiction designated by the Commission in accordance with subrule (3); or
  - (b) both of the following requirements are satisfied –
    - (i) the transaction is still outstanding on the day on which these Rules commence; and
    - (ii) the counterparty consent limitation applies to the person in relation to the transaction.

- (2) A prescribed person that has submitted counterparty masking particulars must submit counterparty identifying particulars within the following period, unless the transaction has matured or been terminated by the last day of the period –
- (a) if the person submitted the counterparty masking particulars under subrule (1)(a), the longer of –
    - (i) 3 months after the day on which the Commission revokes the designation of the jurisdiction under subrule (4); and
    - (ii) if the counterparty consent limitation applies to the person in relation to the transaction, 1 month after the day on which the counterparty consent limitation ceases to apply to the person; or
  - (b) if the person submitted the counterparty masking particulars under subrule (1)(b), 1 month after the day on which the counterparty consent limitation ceases to apply to the person in relation to the transaction.
- (3) For the purposes of subrule (1)(a), the Commission may, with the consent of the Monetary Authority and by notice published in the Gazette, designate any jurisdiction outside Hong Kong if the Commission is satisfied that it is likely that the laws of that jurisdiction, or an authority or regulatory organization in that jurisdiction, would prohibit the submission of counterparty identifying particulars in relation to a counterparty to a specified OTC derivative transaction.
- (4) The Commission may, with the consent of the Monetary Authority and by notice published in the Gazette, revoke the designation of a jurisdiction made under subrule (3).
- (5) A notice published by the Commission under subrule (3) or (4) is not subsidiary legislation.
- (6) In this rule –

**counterparty consent limitation** ( ), in relation to a prescribed person that is required to report a specified OTC derivative transaction to the Monetary Authority, means the person cannot submit counterparty identifying particulars because the person is required to obtain consent from the counterparty to the submission of the particulars and, despite reasonable efforts, the person has been unable to obtain consent from the counterparty;

**counterparty identifying particulars** ( ) means transaction information referred to in item 3 of Schedule 2 relating to a transaction from which the identity of a counterparty to the transaction may be ascertained;

**counterparty masking particulars** ( ) means particulars of a counterparty to the transaction which describe the counterparty in a way which prevents the ascertainment of the identity of the counterparty.

## **Part 3**

### **Record Keeping Obligation**

#### **32. Prescribed persons to keep records in relation to transactions**

- (1) A prescribed person (other than a Hong Kong person) must, in relation to a specified OTC derivative transaction, keep the records specified in rule 34 in the form and manner specified in rule 36(1), for the period specified in rule 37.
- (2) A prescribed person that is a Hong Kong person must, in relation to a specified OTC derivative transaction, keep the records specified in rule 35 in the manner specified in rule 36(3), for the period specified in rule 37.

#### **33. Prescribed persons to keep records even if counterparty, or transaction entered into, outside Hong Kong**

Rule 32 applies to a specified OTC derivative transaction even if –

- (a) a counterparty, or more than one counterparty, to the transaction is a person outside Hong Kong; or
- (b) the transaction was entered into wholly or partially outside Hong Kong.

#### **34. Records to be kept by prescribed persons (other than Hong Kong persons)**

The records that a prescribed person (other than a Hong Kong person) must keep in relation to a specified OTC derivative transaction are –

- (a) records sufficient to demonstrate that the person has complied with rule 9, 10, 11, 12, 13 or 14 (as applicable) and rule 24;
- (b) without limiting paragraph (a) –

- (i) the records specified in Part 1 of Schedule 3 relating to the transaction; and
- (ii) if the person engaged an agent to report the transaction to the Monetary Authority on its behalf –
  - (A) records relating to the agreement between the person and its agent; and
  - (B) records sufficient to demonstrate that the person monitored the reporting by the agent;
- (c) if rule 9, 10, 11 or 12 (as applicable) does not apply to the person in relation to the transaction because the person is an exempt person –
  - (i) the records specified in Part 1 of Schedule 3, relating to the transaction; and
  - (ii) records sufficient to demonstrate that the person satisfied the requirements in rule 3(2) at the time the person would, but for rule 3, have been required to report the transaction to the Monetary Authority, including records of any calculation performed for the purpose of ascertaining whether the person satisfied the requirement in rule 3(2)(e);
- (d) if rule 21 applies to the person in relation to the transaction (the person's affiliate has reported the transaction), the confirmation received from the affiliate; and
- (e) if rule 26(5) or 27(5) applies to the person in relation to the transaction (the transaction has matured or been terminated before the end of the grace period), the records specified in Part 1 of Schedule 3, relating to the transaction.

### **35. Records to be kept by Hong Kong persons**

The records that a prescribed person that is a Hong Kong person must keep in relation to a specified OTC derivative transaction are –

- (a) records sufficient to demonstrate that the person has complied with rules 15 and 24;
- (b) without limiting paragraph (a), the records specified in Part 2 of Schedule 3, relating to the transaction;
- (c) if rule 15 does not apply to the person in relation to the transaction because the person does not have a specified position that has reached the reporting threshold –

- (i) the records specified in item 1 of Part 2 of Schedule 3, relating to the transaction;
- (ii) records sufficient to demonstrate that rule 15 did not apply to the person at the time the person would, but for the person's specified position not having reached the reporting threshold, have been required to report the transaction to the Monetary Authority; and
- (iii) without limiting subparagraph (ii) –
  - (A) records of any calculation performed for the purpose of ascertaining the person's specified position; and
  - (B) records sufficient to demonstrate that the calculation is accurate, including records relating to the OTC derivative transactions in the product class to which the transaction belongs which constitute the person's specified position;
- (d) if rule 20 applies to the person in relation to the transaction (a licensed corporation, an authorized financial institution or an approved money broker is required to report), the records specified in item 1 of Part 2 of Schedule 3, relating to the transaction; and
- (e) if rule 26(5) applies to the person in relation to the transaction (the transaction has matured or been terminated before the end of the grace period), the records specified in item 1 of Part 2 of Schedule 3, relating to the transaction.

### **36. Form and manner in which records to be kept**

- (1) A prescribed person (other than a Hong Kong Person) must keep the records specified in rule 34 –
  - (a) in a manner that enables the records to be readily searchable and identifiable by reference to the transaction and the counterparty; and
  - (b) subject to subrule (2), in electronic form and stored in a computer or other electronic system.

(2) Despite subrule (1)(b) –

- (a) records that were created in paper form and are maintained by the person only in paper form, may be kept in paper form;
- (b) a record of a telephone conversation may be kept as a tape or digital audio file and may be stored in a sound recording media; and
- (c) during the period of 9 months beginning on the product class specification day, the records may be kept in any form and manner.

(3) A prescribed person that is a Hong Kong person must keep the records referred to in rule 35 in a manner that enables the records to be readily retrieved.

### 37. Period for which records to be kept

A prescribed person must keep the records specified in rule 34 or 35 (as applicable) for not less than 7 years after the specified OTC derivative transaction has matured or been terminated.

## Part 4

### Subsidiaries Specified by Monetary Authority under section 101B(5) or 101E(5) – Reporting and Record Keeping Obligations

### 38. Interpretation of Part 4

In this Part –

**cessation day** ( ), in relation to a specified subsidiary, means the day notified by the Monetary Authority to the authorized financial institution of which it is a subsidiary as the day on which the specification of the subsidiary is to cease to have effect for the purposes of section 101B(3) or 101E(3) (as applicable) of the Ordinance;

**effective day** ( ), in relation to a specified subsidiary, means the later of –

- (a) the day on which the Monetary Authority's notice under section 101B(5) or 101E(5) (as applicable) of the Ordinance is served on the authorized financial institution of which it is a subsidiary; and
- (b) the day specified in the notice referred to in paragraph (a) as the day on which the specification of the subsidiary is to take effect for the purposes of section 101B(3) or 101E(3) (as applicable) of the Ordinance;

**specified subsidiary** ( ), in relation to a prescribed person that is an authorized financial institution incorporated in Hong Kong, means –

- (a) in relation to the reporting obligation, a subsidiary specified by the Monetary Authority under section 101B(5) of the Ordinance for the purposes of section 101B(3) of the Ordinance;
- (b) in relation to the record keeping obligation, a subsidiary specified by the Monetary Authority under section 101E(5) of the Ordinance for the purposes of section 101E(3) of the Ordinance.

**39. Reporting and record keeping obligations applicable to authorized financial institution in respect of specified subsidiary**

- (1) Subject to subrule (6), for the purposes of section 101B(3) of the Ordinance, a prescribed person that is an authorized financial institution incorporated in Hong Kong must ensure that a specified subsidiary of the institution complies with the requirement in subrule (2).
- (2) The requirement referred to in subrule (1) is that, subject to the modifications described in subrule (5), the subsidiary complies with rules 10, 18 and 24 in relation to a specified OTC derivative transaction to which it is a counterparty, as if it were an authorized financial institution incorporated in Hong Kong to which rule 10(1)(a) applies.
- (3) For the purposes of section 101E(3) of the Ordinance, a prescribed person that is an authorized financial institution incorporated in Hong Kong must ensure that a specified subsidiary of the institution complies with the requirement in subrule (4).
- (4) The requirement referred to in subrule (3) is that, subject to the modifications described in subrule (5), the subsidiary complies with rule 34 in relation to a specified OTC derivative transaction to which it is a counterparty, as if it were an authorized financial institution incorporated in Hong Kong to which rule 34 applies.

- (5) The modifications referred to in subrule (2) and (4) are –
- (a) a reference to a regulated prescribed person or to a prescribed person that is an authorized financial institution incorporated in Hong Kong (other than an exempt person) is to be construed as a reference to a specified subsidiary;
  - (b) a reference to a day on which a person is or becomes a regulated prescribed person is to be construed in relation to a specified subsidiary as a reference to the effective day; and
  - (c) a reference to a day on which a person ceases to be a regulated prescribed person is to be construed in relation to a specified subsidiary as a reference to the cessation day.
- (6) This rule is not to be construed as requiring an authorized financial institution incorporated in Hong Kong to ensure that a specified subsidiary complies with rule 24 in relation to a specified OTC derivative transaction to which the subsidiary is a counterparty, if rule 10(1)(b) requires the authorized financial institution to report the same transaction to the Monetary Authority<sup>7</sup>.

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<sup>7</sup> This subrule addresses the situation where an AI has conducted a transaction in Hong Kong on behalf of an affiliate which is also a specified subsidiary, and thus has two reporting obligations in respect of the same transaction, i.e.: (i) an obligation, under rule 10(1)(b), to report the transaction; and (ii) an obligation under rule 39(1) to ensure that the specified subsidiary reports the transaction. This rule 39(6) clarifies that in such cases, the AI need only comply with the obligation under rule 10(1)(b). It should be noted however, that under rule 21, if the subsidiary does in fact report the transaction (even though it is not obliged to), then the AI will be taken to have complied with its obligation to report (under rule 10(1)(b)).

# Schedule 1

## OTC Derivative Transactions to which these Rules Apply

[rules 2, 7, 8 and 16]

### Part 1

#### Interpretation

##### 1. Interpretation

In this Schedule –

**interest rate swap agreement** ( ) means an OTC derivative transaction in respect of interest rates whereby 2 counterparties to the transaction agree to exchange 2 series of interest payments based on a notional principal amount which is denominated in a single currency that is a specified currency;

**non-deliverable forward contract** ( ) means an OTC derivative transaction in respect of a purchase of a currency (**the reference currency**) by one party from the other and where the 2 counterparties to the transaction agree that –

- (a) on settlement of the transaction (**the value date**), the settlement is to be on a net cash payment basis (without physical delivery of the reference currency) in a currency (**the settlement currency**) that is not the same as the reference currency; and
- (b) the amount of the payment referred to in paragraph (a) is to be calculated as the difference between the value, in the settlement currency, of the reference currency –
  - (i) based on the agreed currency exchange rate or price, whether express or implied; and
  - (ii) based on the prevailing market rate or price as determined on an agreed future date (the fixing date);

**specified currency** ( ) means a currency or precious metal that is specified by the Monetary Authority by notice in the Gazette (**a specified currency notice**);

**specified floating rate index** ( ) means a floating rate index specified by the Monetary Authority by notice in the Gazette (**a specified floating rate index notice**).

## 2. Monetary Authority notices not subsidiary legislation

A specified currency notice and a specified floating rate index notice are not subsidiary legislation.

## Part 2

### Specified Product Classes

Item	Product class	Product class specification day
1.	Interest rate swap agreement	The day referred to in rule 1(1).
2.	Non-deliverable forward contract	The day referred to in rule 1(1).

## Part 3

### Specified Product Types

Item	Product class	Product Type	Product type specification day
1.	Interest rate swap agreement	The 2 series of interest payments are calculated by reference to –  (a) an agreed fixed interest rate applied to a specified currency; and  (b) a specified floating rate index applied to the same specified currency.	The day referred to in rule 1(1).

- |    |                                  |   |                                   |
|----|----------------------------------|---|-----------------------------------|
| 2. | Interest rate swap agreement     | The 2 series of interest payments are calculated by reference to 2 specified floating rate indexes which are both denominated in the same specified currency. | The day referred to in rule 1(1). |
| 3. | Non-deliverable forward contract | The currency is a specified currency.   | The day referred to in rule 1(1). |

## Part 4

### Thresholds for Product Classes

Item	Product class	Reporting threshold referred to in rule 16(4)	Exit threshold referred to in rule 16(4)
1.	Interest rate swap agreement	US\$3 billion	US\$2.1 billion
2.	Non-deliverable forward contract	US\$1 billion	US\$700 million

## Schedule 2

### Transaction Information to be Reported

[rules 2 and 31]

1. The product class and product type to which the transaction belongs.
2. The dates on which the transaction –
  - (a) was entered into;
  - (b) starts or otherwise becomes effective; and
  - (c) matures.

3. Particulars of the counterparties to the transaction.
4. Information relating to confirmation of the transaction, including particulars of –
  - (a) the platform through which, or the manner in which, the transaction was confirmed; and
  - (b) any identifying reference assigned to the transaction by the platform.
5. Information relating to clearing of the transaction, including particulars of –
  - (a) whether the transaction has been, or is intended to be, cleared through a central counterparty;
  - (b) the central counterparty through which the transaction was cleared or is intended to be cleared; and
  - (c) any client clearing services provider involved in, or intended to be involved in, clearing the transaction.
6. Information relating to valuation of the transaction, including particulars of –
  - (a) whether the transaction is valued on a mark-to-market basis or a mark-to-model basis;
  - (b) when the transaction was last valued and the valuation on that date; and
  - (c) the currency used for valuing the transaction.
7. Information relating to a subsequent event, including particulars of –
  - (a) the date on which the event occurred and any agreement relating to the event;
  - (b) the nature of the event;
  - (c) the changes to any of the matters described in any other item of this Schedule as a result of the event;
  - (d) the outstanding notional principal amount after the event; and
  - (e) the specified currency in which the outstanding notional principal amount is denominated.
8. Where the transaction is an interest rate swap agreement, particulars of –
  - (a) the series of interest payments to be paid by each counterparty;
  - (b) the notional principal amount;
  - (c) the specified currency in which the notional principal amount is denominated;
  - (d) the specified currency in which the transaction is to be settled, if it is not the same currency as the currency referred to in paragraph (c);
  - (e) any agreed fixed interest rate; and
  - (f) all agreed floating rate indexes, tenors and spreads.

9. Where the transaction is a non-deliverable forward contract, particulars of –
  - (a) the specified currencies to be exchanged by each counterparty;
  - (b) the amount of reference currency being purchased;
  - (c) the agreed currency exchange rate;
  - (d) the agreed price;
  - (e) the fixing date; and
  - (f) the value date.
  
10. Particulars of any identifying references assigned to the transaction.

### **Schedule 3**

#### **Records to be kept by Prescribed Persons**

[rules 34 and 35]

#### **Part 1**

#### **Records to be Kept by Prescribed Persons (other than Hong Kong Persons)**

1. Records evidencing the existence and nature of the transaction, including all agreements relating to the transaction.
  
2. Records showing particulars of the execution of the transaction, including orders, ledgers and confirmations.
  
3. Records evidencing the communications and instructions that resulted in the transaction being executed.
  
4. Records showing particulars of the terms of the transaction, including particulars relating to all payments and margin requirements relating to the transaction.
  
5. Records sufficient to demonstrate that the transaction information submitted to the Monetary Authority under Division 3 of Part 2 of these Rules was accurate.

## **Part 2**

### **Records to be Kept by Hong Kong Persons**

1. Records evidencing the existence of the transaction and its main economic terms, including the transaction confirmation and all agreements relating to the transaction.
2. Records sufficient to demonstrate that the transaction information submitted to the Monetary Authority under Division 3 of Part 2 of these Rules was accurate.