

MEMO# 28545

December 2, 2014

HK Authorities Issue Consultation Conclusions and Further Consultation on Reporting and Recordkeeping Obligations for OTC Derivative Transactions

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TO: DERIVATIVES MARKETS ADVISORY COMMITTEE No. 83-14
ICI GLOBAL MEMBERS No. 55-14
ICI GLOBAL TRADING & MARKETS COMMITTEE No. 3-14
INTERNATIONAL COMMITTEE No. 40-14 RE: HK AUTHORITIES ISSUE CONSULTATION CONCLUSIONS AND FURTHER CONSULTATION ON REPORTING AND RECORDKEEPING OBLIGATIONS FOR OTC DERIVATIVE TRANSACTIONS

Recently, the Hong Kong Monetary Authority (“HKMA”) and the Securities and Futures Commission (“SFC”) issued a paper on reporting and recordkeeping rules for OTC derivative transactions. [\[1\]](#) The Consultation Paper includes a summary of comments received on the proposals for the mandatory reporting and related recordkeeping requirements for OTC derivatives, [\[2\]](#) the HKMA and the SFC’s responses to those comments, their conclusions, and a request for further comment on three particular matters. The proposed rules (revised to reflect certain comments) will be submitted through the legislative process, and it is expected that the mandatory reporting and related recordkeeping requirements for regulated entities would begin in the first quarter of 2015.

This memorandum briefly describes those areas of the Consultation Paper that would be of interest to members and discusses the three matters on which the HKMA and the SFC request further comment. Comments on the further consultation are due by December 23.

Reporting Obligation for Fund Managers

In the Original Consultation, the HKMA and the SFC proposed to require authorized institutions (“AIs”) and licensed corporations (“LCs”) to report OTC derivative transactions that they have entered into on behalf of a counterparty in their capacity as a person

registered/licensed to carry on Type 9 RA (asset management) services for that counterparty. Recognizing the difficulties in reporting these transactions as expressed by commenters (including ICI Global), the HKMA and the SFC have determined that more time is needed to address these issues. The regulators have decided not to include this requirement in the first phase of the implementation. The HKMA and the SFC intend to consult on this matter again at a later stage.

“Conducted in Hong Kong”

In the Consultation Paper, as requested by ICI Global and others, the HKMA and the SFC clarify the requirement to report transactions “conducted in Hong Kong.” Specifically, the HKMA and the SFC discuss how this requirement would apply with respect to transactions that are booked in a global book, executed on an electronic trading platform, or subject to an order routing arrangement. The HKMA and the SFC intend to prepare FAQs to provide further guidance on the requirement to report transactions “conducted in Hong Kong.”

In its comment letter, ICI Global requested confirmation that the reporting obligation would not apply to non-Hong Kong (“HK”) fund managers if only execution functions related to derivatives contracts are carried out in Hong Kong. Similarly, ICI Global also sought confirmation that where an HK fund manager delegates functions to an entity outside of Hong Kong and retains only execution functions (or no trading functions), the reporting obligation would not apply to the HK fund manager. In the Consultation Paper, the HKMA and the SFC clarify that the “reporting requirement in respect of transactions ‘conducted in Hong Kong’ is not aimed at catching fund managers.”

Substituted Compliance

ICI Global requested that the HKMA and the SFC implement a “substituted compliance” or “equivalence” regime so that a counterparty that is required to report in another “equivalent” jurisdiction would be deemed to have complied with any reporting obligation under HK law as long as the HK authorities are able to obtain the data from the foreign jurisdiction. ICI Global further requested that the HKMA and the SFC permit reporting entities to report to any trade repository that could transmit data to the HKMA and the SFC rather than just to the HKTR.

The HKMA and the SFC declined to adopt the substituted compliance approach with respect to reporting because they were of the view that HK regulators should have unfettered access to the data for regulatory and market surveillance purposes and should be able to obtain relevant OTC derivatives information as quickly and directly as possible. The HKMA and the SFC, however, have considered the concerns expressed by commenters and have determined that reporting entities may report their transactions via an agent (which can be an overseas trade repository or “TR”).

One-Sided Reporting

ICI Global requested that the HKMA and the SFC expand the proposed exemption in the Original Consultation for HK persons (HK persons include, inter alia, HK-domiciled funds) for transactions that are reportable by their HK AI counterparties. Specifically, ICI Global requested that the regulators adopt a one-sided reporting obligation on AIs with respect to transactions to which AIs are a counterparty. As discussed above, the HKMA and the SFC have decided to defer mandatory reporting for HK persons to a later stage and therefore

will consider these issues when they finalize their proposals for HK persons.

Compliance Period

The Original Consultation proposed to allow reporting entities a concession period of up to 3 months to set up their reporting channel to the HKTR and a grace period of up to 6 months to complete any backloading. As requested by commenters, the HKMA and the SFC have extended the concession period to 6 months and the grace period will be extended to a maximum of 9 months to backload historical transactions.

Further Consultation

The HKMA and the SFC invite further comments on three matters.

First, in the Original Consultation, the HKMA and the SFC proposed to require the reporting of daily valuation transaction information. In the Consultation Paper, the HKMA and the SFC provide additional details of this requirement, including the proposed reporting timeframe and implementation timetable and approach, and request comment on the proposed requirements. The requirement to report valuation transaction information will not be implemented at the initial stage of the reporting regime but will likely be effective first quarter of 2016.

Second, in the Original Consultation, the HKMA and the SFC proposed that, as a transitory measure, certain counterparty information could be masked if there was a statutory barrier that prohibited their disclosure or if the disclosure required the consent of the relevant counterparty. The HKMA and the SFC now seek comment on the list of jurisdictions (for which reporting of counterparty identifying information is prohibited under the laws of that jurisdiction or by authorities in that jurisdiction) for the purpose of the masking relief. [3]

Third, the term “OTC derivative product” is intended to exclude products (and therefore not subject to mandatory reporting under the HK regime) that are traded on a stock or futures market. For products traded on a market that is based outside Hong Kong, HK law permits these to be excluded from the definition of “OTC derivative product” but only if the market is a stock or futures market that satisfy certain criteria. The HKMA and the SFC seek comment on the proposed list of markets and clearinghouses for purposes of the definition of “OTC derivative product.” The proposed list of markets is included as Appendix B to the Consultation Paper. According to the HKMA and the SFC, they currently do not believe that products traded on US swap execution facilities and EU multilateral trading facilities should be included in the proposed list.

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endnotes

[1] Consultation Conclusions and Further Consultation on the Securities and Futures (OTC Derivative Transactions – Reporting and Record Keeping Obligations) Rules (November 2014), available at <http://www.sfc.hk/edistributionWeb/gateway/EN/consultation/conclusion?refNo=14CP6> (“Consultation Paper”).

[2] Consultation paper on the Securities and Futures (OTC Derivative Transactions – Reporting and Record Keeping) Rules (July 2014), available at <http://www.sfc.hk/edistributionWeb/gateway/EN/consultation/openFile?refNo=14CP6> (“Original Consultation”). For a summary of ICI Global’s comment letter on the Original Consultation, see ICI Memorandum No. 28349 (Aug. 28, 2014), available at http://www.ici.org/my_ici/memorandum/memo28349.

[3] The list includes Algeria, Argentina, Austria, Bahrain, Belgium, France, Hungary, India, Indonesia, Israel, Luxembourg, Pakistan, People’s Republic of China, Samoa, Singapore, South Korea, Switzerland, and Taiwan.

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