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6th November, 2015

Re: Consultation paper on introducing mandatory clearing and expanding mandatory reporting

Dear Sir/Madam,

The Global Foreign Exchange Division (GFXD) of the Global Financial Markets Association (GFMA) welcomes the opportunity to comment on behalf of its members on the *Consultation Paper on Introducing Mandatory Clearing and Expanding Mandatory Reporting* issued by the Hong Kong Monetary Authority ('HKMA') and the Securities and Futures Commission ('SFC') on 30 September, 2015.

The GFXD was formed in co-operation with the Association for Financial Markets in Europe (AFME), the Securities Industry and Financial Markets Association (SIFMA) and the Asia Securities Industry and Financial

Markets Association (ASIFMA). Its members comprise 24 global foreign exchange (FX) market participants,[1] collectively representing more than 90% of the FX inter-dealer market.[2] Both the GFXD and its members are committed to ensuring a robust, open and fair marketplace and welcome the opportunity for continued dialogue with global regulators.

The FX market is the world's largest financial market. Effective and efficient exchange of currencies underpins the world's entire financial system. Many of the current legislative and regulatory reforms have had, and will continue to have, a significant impact upon the operation of the global FX market, and the GFXD wishes to emphasise the desire of our members for globally co-ordinated regulation which we believe will be of benefit to both regulators and market participants alike.

The FX market is also the basis of the global payments system. The volume of transactions is therefore very high and these transactions are often executed by market participants across geographical borders. As reported by the Bank of International Settlements in their 'Triennial Central Bank Survey: Foreign Exchange Turnover in April 2013' over 75% of the FX activity was executed by market participants across 5 global jurisdictions, hence the continued view from the GFXD that regulations should be harmonised at the global level.

Cross border markets cannot operate in conflicting regulatory landscapes and the natural outcome, should this be the case, is unwanted fragmentation of what is an already highly automated and transparent FX market.

We fully support the HKMA and SFC in implementing the G20 commitments to reform the OTC derivative markets and specifically the mandatory clearing and transaction reporting obligations. The GFXD is actively engaged in representing its members by providing input to regulatory proposals and looks forward to assisting the HKMA and SFC in developing mandatory clearing and the expanded reporting obligation.

We are supportive of the approach outlined in the consultation paper and provide here a summary of our responses to your questions with full responses shown below. Given the above, we particularly welcome the fact that relevant international developments and the clearing and reporting requirements introduced in other jurisdictions have been taken into account.

Proposed Phase 1 exclusion of FX

We fully support the proposal not to include NDF transactions in the first phase of mandatory clearing thereby continuing the global co-ordination of clearing mandates. Whilst central clearing is designed to mitigate counterparty credit risk, the predominant risk associated with FX transactions is settlement risk. In addition, unlike IRS and CDS which began voluntary clearing in 1999 and 2009 respectively, NDF voluntary clearing was first introduced in 2011/2012 and as a consequence the market infrastructure and processes for managing events such as counterparty default has not been fully established. Furthermore, there are key technical matters that remain unresolved, such as the limited number of CCPs offering NDF clearing, the application of standardised terms and the management of currency disruption events. Therefore, we believe that implementing a mandatory clearing regime for NDF transactions at this stage would introduce new risks

[1] Bank of America Merrill Lynch, Bank of New York Mellon, Bank of Tokyo Mitsubishi, Barclays Capital, BNP Paribas, Citi, Credit Agricole, Credit Suisse, Deutsche Bank, Goldman Sachs, HSBC, JP Morgan, Lloyds, Mizuho, Morgan Stanley, Nomura, RBC, RBS, Société Générale, Standard Chartered Bank, State Street, UBS, Wells Fargo and Westpac.

[2] According to Euromoney league tables.

to what is already a well-functioning and transparent asset class while not providing a material risk mitigation benefit.

Scope of Counterparties subject to the Clearing Obligation

We are concerned that the scope of counterparties subject to the clearing obligation is unclear and that entities that are not major dealers, are located outside of Hong Kong and fall outside of the regulatory jurisdiction of Hong Kong, but trade with prescribed persons in Hong Kong could be unintentionally caught by the clearing obligation. Therefore, we submit that financial services providers be excluded from the mandate, or that as with foreign incorporated prescribed persons, only OTC derivative transactions booked in Hong Kong are subject to the clearing mandate.

Substituted Compliance

Whilst we support the proposals regarding substituted compliance, we are concerned that the requirement to clear through a Hong Kong 'designated" CCP will undermine any benefit of the substituted compliance framework. There is a risk that a transaction with a counterparty in a comparable jurisdiction that does not operate an HKMA/SFC designated CCP may not be able to be cleared, and, as a result, it is likely that the transaction will not be executed. This may have the unintended consequence of a bifurcation of the market and a consequent reduction in liquidity.

Extended Scope of Reporting

- Complex and bespoke products present a particular challenge that should be taken into account in the final rules, due to the limited standardisation of representation for these products in the marketplace and limited support in Financial products Markup Language (FpML) for trade reporting.
- Expanding the scope of reporting highlights the need to resolve the issue of FX Security Conversions. Under the current drafting, these transactions would be considered FX Forwards, and therefore subject to the full OTC derivatives regime, exposing bank custodians, broker-dealers and their customers to needless operational, price, credit and other risks. The GFXD recommends granting an exemption, in harmony with other major jurisdictions, such as the US and Canada.
- Requiring reporting entities to report all specified OTC derivative transactions that are conducted in Hong Kong, regardless of counterparty type, will capture some banks' transactions with retail clients. This represents a potentially significant increase in reporting burden for retail banks, and the GFXD suggests that relief should be provided until such a time as Hong Kong persons (retail or corporate clients) are subject to a reporting obligation.

Implementation Timing

- The GFXD welcomes the HKMA/SFC's very measured approach in implementing key derivatives reforms thus far, allowing both regulators and market participants to test the new requirements and address problems at an early stage.
- A similarly phased approach to the greatly expanded regime presented in this consultation paper would be welcomed by the industry, given both the changes required to market participants' Hong Kong operations, and other ongoing global deliverables.
- In particular, the period of implementation following the publication of the final rules (including detailed field specifications) should be longer than 6 months for optimal building, testing and implementation of the new regime.

Publication of Detailed Field Specifications

- The HKMA and SFCs proposal to publish the detailed field specifications in the Gazette raises concerns, given the non-statutory nature of the Gazette.

- The high volume and number of participants in the FX market concentrates the need for explicit guidance to ensure consistent interpretation and compliance of reporting rules, and to maximise the quality of the data available to regulators for market oversight.

Q1. Do you have any comments or concerns regarding the proposed clearing determination process, or any of the factors included in that process? If so, please provide specific details.

The GFXD fully supports the proposed clearing determination process for deciding which products should be subject to mandatory clearing. In particular, with respect to item 55.(f), we agree that, for the sake of global harmonization, the HKMA/SFC should take into account whether other jurisdictions have considered particular products suitable for mandatory clearing when assessing the appropriateness of any such regime in Hong Kong.

In relation to FX non-deliverable forwards (NDF), and any potential consultation in respect of such products in a future clearing phase, as ESMA noted in its determination on NDF mandatory clearing, in cross-border markets, participants are concerned that the enforcement of clearing mandates should be globally synchronised to the greatest extent possible. In this regard, we welcome the reference in the Consultation Paper to the HKMA/SFC bearing in mind whether regulators in other jurisdictions consider particular products to be suitable for mandatory clearing, in reviewing when it may be appropriate to mandate particular products for clearing in Hong Kong.

The Consultation Paper states that it adopts both a top-down and bottom-up approach to determining which products should be subject to mandatory clearing. If the HKMA/SFC were to consider proposing mandatory clearing of NDF in a future clearing phase, in our view, whilst a 'bottom-up approach' is appropriate for determining the clearing obligation for products that have an existing and mature infrastructure, such as IRS and CDS, for markets that are within their relative infancy with regard to clearing, such as NDF,[3] a 'top-down' approach is especially important. This is because a mandate focused too heavily on bottom-up considerations might enable a very small number of authorised CCPs to clear NDF contracts without having first demonstrated an appropriate level of maturity in and experience with its service offering, including the proper bedding down of practices and resolution of key unresolved issues.

To summarise, determination of mandatory clearing for markets with an immature clearing infrastructure would be better analysed substantively through a 'top-down' rather than 'bottom-up approach'.

Q2. Do you have any comments or concerns about our proposals on the types of IRS that should be subject to mandatory clearing? If you do, please provide specific details.

The GFXD has no comments in response to this question.

Q3. Do you have any comments or concerns about our proposals to only include plain vanilla IRS with constant notional amounts and no optionality? If so, please provide specific details.

The GFXD has no comments in response to this question.

[3] In Europe the cleared NDF volume is believed to be only approximately 3% of total NDF volume. http://www.esma.europa.eu/system/files/esma-2014-1185.pdf

Q4. Do you have any comments or concerns about our proposal to include IRS denominated in any of the G4 currencies under phase 1 clearing? If you do, please provide specific details.

The GFXD has no comments in response to this question.

Q5. Do you have any comments or concerns about our proposal to mandate HKD denominated IRS for clearing under phase 1 clearing? If you do, please provide specific details.

The GFXD has no comments in response to this question.

Q6. Do you have any comments or concerns about our proposal to only cover IRS that feature the indexes set out in the two tables above? If you do, please provide specific details.

The GFXD has no comments in response to this question.

Q7. Do you have any comments or concerns about our proposals on whether OIS should be covered under phase 1 clearing, and in what circumstances? If you do, please provide specific details.

The GFXD has no comments in response to this question.

Q8. Do you have any comments or concerns about our proposal that mandatory clearing should apply to IRS that feature the range of tenors described above? If you do, please provide specific details.

The GFXD has no comments in response to this question.

Q9. Do you have any comments or concerns about our proposal not to cover NDF transactions under phase 1 clearing? If so, please provide specific details.

Whilst the GFXD acknowledges the benefits that central counterparty clearing can bring to the OTC derivatives markets in terms of operational efficiencies and counterparty credit risk mitigation, we strongly support the Consultation Paper's proposal not to include NDF in the first phase of mandatory clearing.

The Consultation Paper highlights a number of concerns raised by market participants to previous consultations undertaken in the US, Europe and Singapore. We reinforce the significance of these concerns and provide our perspective on these and other concerns regarding an NDF clearing mandate below:

Global co-ordination in respect of clearing mandates is vital. The FX market is a central component of the global payment system and thus cross-border in nature. As reported by the BIS in its 2013 Triennial Survey, over 75% of FX activity was executed by counterparties across five global jurisdictions; hence our continued view that FX regulations should be harmonized at the global level.

The GFXD emphasises the importance of ensuring that the regulatory treatment of FX products remains internationally consistent. Cross-border markets cannot operate in conflicting regulatory landscapes and the natural outcome, should this be the case, is unwanted fragmentation of what is an already highly automated, transparent and well-functioning FX market. For instance, how would counterparties to a trade manage their regulatory obligations, should only one party be required to clear? The outcome would likely take one of three paths:

- execution and thus liquidity would become concentrated with counterparties that have a mandatory clearing obligation;

- the party that is not required to clear would be forced to clear, and incur extra costs (such as clearing and operational costs); or

- the trade is not executed, impacting the end-user's ability to hedge.

Clearly, in a global, cross-border market, any increased bifurcation of liquidity is not desirable. Furthermore, situations where there is a clearing requirement in one counterparty's jurisdiction but not the other's could lead to conflicts of law, inconsistencies and legal uncertainty. All this could have possible negative impacts on competition as market participants select their counterparties on the basis of regulatory rather than business factors.

The predominant risk associated with FX transactions is settlement risk[4] and not counterparty credit risk, which is the risk that central clearing is designed to mitigate. Settlement risk is far less acute in non-deliverable products, i.e. cash settled products such as NDFs, as compared to physically settled products and has been significantly mitigated in the FX market by the creation of CLS Bank in 2002. Consequently, a clearing mandate for NDF transactions at this time does not suitably address the objective of reducing systemic risk. While mandating NDF clearing would transfer a certain amount of bilateral exposure between market participants to CCPs, the amount of credit risk in the NDF market is orders of magnitude less than for IRS and CDS given the short-dated nature of NDF transactions.

NDFs represent circa 2.4% of the average daily turnover of the global OTC FX market, with approximately $2.8 trillion in notional outstanding and approximately $90 billion in market value (see Table 1). Gross credit exposures between dealers, after taking into account legally enforceable netting agreements, is a fraction of the market value.

Therefore, we believe that an NDF clearing mandate would result in the mutualisation of counterparty risk within CCPs of only a fraction of the $90 billion market risk figure and which would be reflected in a similar reduction of bilateral counterparty credit risk.

NDF clearing is in its infancy and therefore has not achieved the same depth as IRS and CDS clearing had when the clearing mandate was introduced for those products. In contrast to voluntary NDF clearing which first became possible in 2011/2012, IRS and CDS contracts began voluntarily clearing in 1999 and 2009.

When the first IRS and CDS clearing mandates were introduced, approximately 60% of IRS contracts and 30% of CDS contracts were being voluntarily cleared.[5] Voluntary clearing has not reached the same level for NDFs; cleared NDFs represent just 3.6% of the average daily turnover of the NDF product.

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[4] Settlement risk comprises approximately 94% of the maximum loss exposure in FX products with maturities of less than one year, and approximately 89% for FX products with maturity of greater than a year. Oliver Wyman Analysis.

[5] See CFTC GMAC meeting, October 9, 2014 (presentation by Rodrigo Buenventura, ESMA).

Table 1. Cleared and Uncleared Volumes (*Figures in billions)*

OTC Derivatives[6]	Rates	Credit	FX NDFs
Average daily turnover	$2,000		$127
Cleared	$1,700-1,800 (76-79%)		$4.6 (3.6%)
Uncleared	$500-600 (21-24%)		$122.4 (96.4%)
Total market value	$14,000	$700	$90
Total notional outstanding	$584,000	$21,000	$2,800
Cleared	$443,000-461,000 (76-79%)	$5,500 (26%)	$101 (4%)
Uncleared	$123,000-141,000 (21-24%)	$15,500 (74%)	$2,700 (96%)
Tenor of total notional outstanding			*Based on DTCC dataset*[7]
Less than three months			$2,520 (90%)
Over three months up to six months	*$198,302 (34%)*	$3,655 (17%)	$224 (8%)
Over six months up to one year			$28 (1%)
Over one year up to five years	$234,284 (40%)	$16,162 (77%)	$28 (1%)
Over five years	$151,778 (26%)	$1,203 (6%)	

Clearing services for IRS and CDS contracts were able to mature and, through experience and time, resolve a number of issues before clearing mandates were ultimately imposed/considered for those markets as a result of G20 derivatives reform. The ability for market infrastructures to develop to support NDF clearing, and implement processes for managing events such as a counterparty default, has not been established or, more importantly, tested. Premature introduction of mandatory clearing may unnecessarily introduce additional risk to the market and, as a result, undermine the benefits of central clearing.

Such considerations were relevant in ESMA's recent response to its NDF clearing consultation in Europe.[8] ESMA determined that the European NDF market was not yet ready to support a mandatory clearing obligation at that time.

Key technical matters remain unresolved. Whilst we expect the volume of NDFs being voluntarily cleared to grow over time, especially as other regulations, such as the exchange of margin for non-centrally

[6] See BIS Monetary and Economic Department, *Statistical release, OTC derivatives statistics at end-December 2013* (May 2014) ("BIS December 2013 Stats") at http://www.bis.org/publ/otc_hy1405.pdf; Consultation Paper at http://www.esma.europa.eu/system/files/esma-2014-1185.pdf; and *Size and Uses of the Non-Cleared Derivatives Market: An ISDA Study* (April 2014) ("ISDA April 2014 Study") at http://www2.isda.org/attachment/NjQ0MA==/FINAL%20-%20Size%20and%20Uses%20of%20the%20Non-Cleared%20Derivatves%20Market.pdf.

[7] See Consultation Paper, page 32. Figures in the table above exclude CNY (one of the less liquid FX NDF currencies among the 11 considered by this Consultation Paper) where the share of trades with a maturity between six months and 1 year is 10%.

[8] http://www.esma.europa.eu/system/files/2015-esma-234_-feedback_statement_on_the_clearing_obligation_of_non_deliverable_forward.pdf

cleared OTC derivatives, become live, we want to highlight certain key technical matters which need to be resolved before determining the scope of any NDF clearing mandate. These include:

- Proper and uniform adoption / application of standardised terms. It is critical that certain terms concerning fixing source and pricing references in a disruption event, which are key elements of the NDF contract, are incorporated into any clearing mandate (these are discussed below).

- Additional CCPs offering clearing. The Consultation Paper notes that there is currently only one CCP authorised to clear NDFs in Europe, but that two others are in the process of listing contracts for clearing. Should these additional CCPs not offer NDF clearing, it would be imprudent to mandate clearing through a single CCP due to the concentration risk issues raised in our response to Question 3.

- Management of currency disruption events. It is important that CCPs develop expertise in managing disruption events which affect the valuation and settlement of FX contracts. Disruption events may include suspension of trading, sovereign default, an unexpected bank holiday or other significant disruption to valuation, payment or settlement processes. Especially as clearing occurs in greater volume, the ability of CCPs to manage disruption events and the unavailability of fixing sources, including over a prolonged period of time, will be of critical importance. To our knowledge, no CCP has yet had to respond to a disruption event. In contrast, dealers have a long history and therefore experience in managing these circumstances in a non-centrally cleared environment.

- Designated CCPs. As noted in the Consultation Paper, for substituted compliance to be available a transaction needs to clear through a designated CCP. There are a number of third country CCPs that will need to apply to become designated.

The GFXD believes it is imperative that any clearing mandate be sufficiently clear and granular in identifying the instruments subject to a clearing obligation. As part of their commitment to derivatives reform, the G20 Leaders agreed that all standardised contracts would be cleared through CCPs. To ensure the level of standardisation achieved to date in the NDF market is preserved, any clearing mandate for NDF contracts should be sufficiently clear that it only applies to standardised contracts which incorporate industry standardised currency templates in the form published by the Trade Association for the Emerging Markets (EMTA) (i.e., without modification).Standardisation has been achieved in the NDF market due to development and use of industry standards memorialised in EMTA templates. The market for NDF contracts widely relies upon well-established industry terms and conditions, templates and fallbacks in the form of currency specific EMTA templates published at www.emta.org. Each provision contained in an EMTA template is an essential part of the overall risk component of NDF contracts and thus material to the parties, including CCPs. Each EMTA currency template provides (i) a primary fixing source to be used for valuing the contract for settlement, and (ii) fall-back conventions which address the risk of potential market/sovereign events disrupting the value or settlement of the emerging market currencies underlying these contracts (e.g., suspension of trading, sovereign default, an unexpected bank holiday or other significant disruption to valuation, payment or settlement processes).

In circumstances where an EMTA template is modified, the standardisation developed by the industry for a given currency pair is compromised and can result in discrepancies in the valuation and settlement of the contract, including when the specified fixing source publishes or, importantly, fails to publish, a fixing price. This also creates asymmetric risk between a bank's NDF contracts with a client which are cleared with a CCP

under non-standard EMTA terms, and NDF contracts with a client that chooses not to centrally clear (and is exempt from clearing) under standard EMTA terms.

The G20 commitment to clearing and trading mandates relies on standardisation in contracts, which is compromised by unilateral modifications to EMTA templates. Therefore, it is important for regulatory authorities in Europe, US and the Asia Pacific region to coordinate to ensure that there is sufficient agreement concerning NDF contract specifications, including the adoption of these templates, before any NDF clearing mandate determinations are introduced in their respective jurisdictions.

Q10. Do you have any comments or concerns about our proposal to restrict mandatory clearing to only dealer-to-dealer transactions in the first phase? If you do, please provide specific details.

This proposal is in line with the clearing mandates issued/proposed in the other major jurisdictions, but we would highlight that in both Europe and the US the population of impacted counterparties is clearly defined. In Europe the Phase 1 population is limited to existing clearing members, i.e. Category 1 entities, and in the US to "Swap Dealers". Currently, it is not clear which market participants will be impacted by the clearing obligation in Hong Kong.

The GFXD emphasises the importance of ensuring that the international regulatory environment applied to the clearing obligation is consistent. Cross-border markets cannot operate in conflicting regulatory landscapes and the natural outcome, should this be the case, is unwanted fragmentation. This is particularly relevant to the FX market which is already highly automated, transparent and well-functioning.

In a global, cross-border market inconsistent application of a clearing mandate and its phasing, either by product or by counterparty type, would impact how counterparties execute cross-border transactions.

Furthermore, situations where counterparties are faced with a clearing obligation in one jurisdiction but not the other could lead to conflicts of law, inconsistencies and legal uncertainty. This could have possible negative impacts on competition as market participants need to consider regulatory factors when determining which counterparties to trade with.

Q11. Do you have any comments or concerns about our proposed criteria for scoping dealer-to-dealer transactions? If you do, please provide specific details.

It is important that the definition of counterparties caught by the clearing obligation in different jurisdictions is consistent in order to avoid market fragmentation.

Given the costs and overheads associated with clearing, it is unlikely that a prescribed person that falls below the clearing threshold will trade with an overseas incorporated prescribed person that is either required to clear in its home market or locally in Hong Kong. This unintended consequence will lead to a bifurcation of the market resulting in reduced liquidity and an increase in transaction costs.

Currently, it is not clear which market participants will be impacted by the clearing obligation in Hong Kong, Europe or Singapore due to the different terminology and definitions used.

Q12. Do you have any comments or concerns about our proposed scope for "prescribed persons" and "financial services providers"? If you do, please provide specific details.

We would request that financial service providers are removed from the mandate, or that the counterparties subject to the Hong Kong clearing mandate are consistent with those counterparties subject to clearing mandates in other jurisdictions and that there is a similar phase-in of counterparties.

The intent of the clearing obligation is to capture a narrow set of local entities, i.e. prescribed persons, as well as major dealers operating outside Hong Kong but entering into transactions with locally incorporated or regulated dealers in Hong Kong. However, given the wide definition of a financial services provider and the requirement for a prescribed person to obtain written confirmation from all of its counterparties, this will significantly add to the complexity of the clearing obligation and the overheads placed on the prescribed persons.

Furthermore, as potential financial service providers provide their services outside of Hong Kong and are not required to be authorised or licensed in Hong Kong, there would be no obligation for them to provide a prescribed person with confirmation that they (i) they do not fall within the definition of a financial services provider; and (ii) are below the clearing threshold, in both cases based on concepts and definitions set out in the Hong Kong legislation, of which they may not be familiar as they may not have any interaction with Hong Kong. Therefore, a prescribed person may not be able to determine whether such a counterparty is a financial services provider and will need to cease trading with counterparties that are not existing clearing members of a designated CCP. The impact of this is that entities located outside Hong Kong that are not major dealers but who trade with prescribed persons would be unintentionally caught under this clearing obligation.

Alternative approaches that could be adopted are those used in Australia (where the clearing mandate has been linked to US registered Swap Dealers) or in Europe (where Category 1 entities under the EMIR clearing mandate have been defined as existing direct clearing members), or to define financial services providers as GSIBs. Such approaches would provide prescribed persons with some level of comfort in determining who they would need to approach to obtain the necessary representations.

If financial services providers were to remain in scope, we request that the proposal be amended to clarify that, as with foreign-incorporated prescribed persons, the clearing obligations in relation to financial services providers will be triggered only for specified OTC derivative transactions booked in Hong Kong. Such clarification would be consistent with the HKMA/SFC's intent stated elsewhere in the Consultation Paper that its oversight of overseas incorporated entities focuses on their activities in Hong Kong and could also limit the extra territorial impact of these regulations in line with HKMA/SFC's intent.

Q13. Do you have any comments or concerns about our proposal to look at all OTC derivative transactions, other than deliverable FX forwards, when assessing if the clearing threshold has been crossed? If you do, please provide specific details.

The GFXD believes that the OTC derivative transactions that should be included in the assessment should be limited to those that fall within the scope of the clearing obligation. We also seek clarification from the HKMA/SFC on the inclusion of deliverable FX swaps in the calculation of the clearing threshold. A deliverable FX swap is either a spot and a forward trade or two forward trades with differing maturities executed at the same time with equal and opposite notionals. Given the nature of this product we suggest that it too is excluded from the threshold calculation.

In addition, and as stated in the consultation paper, the clearing determination process should entail taking into account, amongst other things, the following factors:

- The level of standardisation of the product;
- The availability of fair, reliable and generally acceptable pricing sources; and
- The nature, depth and liquidity of the market for a particular product.

On this basis, products that do not meet the above criteria such as the more complex non-standard OTC derivatives should also not be included in the assessment as they will also not be the focus of mandatory clearing.

Furthermore, we would request that intra-group transactions should be excluded from the assessment as this would be consistent with the HKMA's proposal to exempt intra-group transactions for the clearing obligation. We seek clarification on whether exchange traded derivatives are excluded if they are not traded on a recognised futures market or a futures market prescribed under Section 329A of the SFO.

The GFXD would request that the HKMA provide guidance on the treatment of notionals that incorporate a degree of optionality and therefore have a dependency on something that is not set at the time the transaction is executed or at the time the assessment of the clearing obligation is made. Conditional notional amounts vary over time and indeed can be zero if the conditional event materialises.

Q14. Do you have any comments or concerns about our proposal to set clearing thresholds by reference to a calculation period? If you do, please provide specific details.

The GFXD supports the joint response submitted by ISDA/FIA/ASIFMA on 5th November, 2015.

Q15. Do you have any comments or concerns about our proposal to use multiple calculation periods and multiple thresholds? If you do, please provide specific details.

The GFXD supports the joint response submitted by ISDA/FIA/ASIFMA on 5th November, 2015.

Q16. Do you have any comments or concerns about our proposed threshold variations for different market participants? If you do, please provide specific details.

The GFXD supports the joint response submitted by ISDA/FIA/ASIFMA on 5th November, 2015.

Q17. Do you have any comments or concerns regarding our proposed formula for calculating the "average position", i.e. the position that is to be measured against the clearing threshold? If you do, please provide specific details.

The GFXD supports the joint response submitted by ISDA/FIA/ASIFMA on 5th November, 2015.

Q18. Do you have any comments or concerns about the proposed threshold levels? If you do, please provide specific details.

Whilst the members of the GFXD are supportive of the proposals that promote the safe, transparent and efficient working of financial markets including a clearing obligation, such proposals need to accompanied by

a strong and robust clearing infrastructure, which includes client clearing solutions, sufficient to support all market participants caught by the clearing obligation threshold. The Basel III regulatory capital rules and the current treatment of segregated margin impose potentially significant negative impacts on the availability of client clearing solutions. The continued increase in capital requirements will increase costs for service providers and may result in banks withdrawing their client clearing services or prevent them from being able to take on new clients.

In order to ensure that there continues to be a robust clearing infrastructure, the GFXD would strongly recommend the HKMA/SFC to work with other regulators to see if any modifications can be made to the existing capital rules.

Q19. Do you have any comments or concerns about our proposal that only future transactions should be subject to mandatory clearing? If you do, please provide specific details.

The GFXD fully supports the proposal that only future transactions should be subject to mandatory clearing.

Q20. Do you have any comments or concerns about our proposal not to include an exit threshold? If you do, please provide specific details.

The GFXD supports the joint response submitted by ISDA/FIA/ASIFMA on 5th November, 2015.

Q21. Do you have any comments or concerns regarding the matters to be checked by a prescribed person? If you do, please provide specific details.

If the obligation to determine whether a counterparty is subject to the clearing obligation falls on the prescribed person, there needs to be very clear guidance provided by the HKMA/SFC to all market participants of their responsibilities. This guidance should address:

- The ability of a market participant to rely on its counterparty's representation or other confirmation of their clearing status; and
- The presumption in the absence of counterparty representation or confirmation.

The GFXD would recommend the adoption of a market classification letter and central database similar to the one set up by the International Swaps and Derivatives Association (ISDA) and Markit for maintaining the Protocols required under Dodd Frank and EMIR.

However, we would also recommend that the category of financial services provider is either removed from the clearing obligation or is simplified.

The intent of the clearing obligation is meant to capture a narrow set of local entities, i.e. prescribed persons, as well as major dealers operating outside Hong Kong but entering into transactions with locally incorporated or regulated dealers in Hong Kong. However, given the wide definition of a financial services provider and the requirement for a prescribed person to obtain written confirmation from all of its counterparties, this will significantly add to the complexity of the clearing obligation and the overheads placed on the prescribed persons,

Furthermore, as potential financial service providers provide their services outside of Hong Kong and are not required to be authorised or licensed in Hong Kong, there would be no obligation for them to provide a prescribed person with confirmation (i) they do not fall within the definition of a financial services provider; and (ii) are below the clearing threshold, in both cases based on concepts and definitions set out in the Hong Kong legislation of which they may not be familiar as they may not have any interaction with Hong Kong. Therefore, a prescribed person may not be able to determine whether such a counterparty is a financial services provider and will need to cease trading with counterparties that are not existing clearing members of a designated CCP. The impact of this is that entities located outside Hong Kong that are not major dealers but who trade with prescribed persons would be unintentionally caught under this clearing obligation.

By way of example, Alternative approaches that could be adopted are those used in Australia which has linked their clearing mandate to US registered Swap Dealers. Another approach or in Europe where would be to define financial service providers as Category 1 entities under the EMIR clearing mandate, i.e. have been defined as existing direct clearing members, or to define financial services providers as GSIBs. Such an approach would reduce the risk that a prescribed person may omit to collect all the necessary clearing threshold representations. It would also simplify the clearing mandate if financial service providers were limited to GSIBs as there would be no requirement to have a clearing threshold.

It is important that the definition of counterparties caught by the clearing obligation in different jurisdictions is consistent in order to avoid fragmentation of the market. There is a concern that mandating counterparties to clear in Hong Kong when they are not mandated to clear in their home market will result in a bifurcation of the market due to the increased costs resulting in reduced liquidity.

Q22. Do you have any comments or concerns regarding a prescribed person's obligations vis-à-vis following up on transactions that have been submitted for clearing? If you do, please provide specific details.

The GFXD supports the joint response submitted by ISDA/FIA/ASIFMA on 5th November, 2015.

Q23. Do you have any comments or concerns about the proposed T + 1 timeframe for clearing, and our proposal to define "business day" to mean a business day in Hong Kong? If you do, please provide specific details.

The GFXD fully supports the view of the HKMA/SFC that the global nature of the market should be considered, as should the fact that transactions are executed across borders and time zones and that trades can be cleared through designated CCPs located in different time zones. However, we propose that the definition of "business day" be defined to mean a business day in the jurisdiction in which the CCP is located.

Q24. Do you have any comments or concerns about our proposal not to cover specified subsidiaries of locally incorporated AIs under phase 1 clearing? If you do, please provide specific details.

The GFXD fully supports the proposal not to cover specified subsidiaries of locally incorporated AIs under phase 1.

Q25. Do you have any comments or concerns regarding our proposed intra-group exemption or any aspect of it? If you do, please provide specific details.

The GFXD supports the joint response submitted by ISDA/FIA/ASIFMA on 5th November, 2015.

Q26. Do you have any comments or concerns regarding our proposed jurisdiction-based exemption or any aspect of it? If you do, please provide specific details.

The GFXD supports the joint response submitted by ISDA/FIA/ASIFMA on 5th November, 2015.

Q27. Do you have any comments or concerns regarding our proposal not to cover de-clearing and trade compression expressly under the rules? If you do, please provide specific details.

Members would welcome an exemption from the clearing requirements for derivative transactions that are created as part of either a multilateral trade compression cycle or bilateral trade compression process. New and amended derivative transactions that result from systemically risk-reducing processes such as compression should not be subjected to the clearing mandate if the original trades were themselves not subject to the clearing mandate.

If these post-trade risk reduction derivative transactions are not exempted this would act as a significant disincentive for market participants to participate in such compression exercises and introduce new pricing risks for market participants. In addition, it would have the effect of undermining the risk mitigation requirements already faced by foreign firms under EMIR and Dodd-Frank.

Q28. Do you have any comments or concerns about our proposed substituted compliance framework, or any aspect of it? If you do, please provide specific details.

The GFXD supports the HKMA/SFC's proposed substituted compliance when clearing in comparable jurisdictions and note that this is aligned with the regulatory regimes of other major jurisdictions

However, we are concerned that the additional requirement to clear through a Hong Kong "designated" CCP undermines any true benefit of the substituted compliance framework. This is of particular concern as the designation process requires CCPs to become either an RCH or ATS-CCP.

We believe that reliance should be placed on the approval of a CCP by its home regulator in comparable jurisdictions. There is a risk that a transaction with a counterparty in a comparable jurisdiction that does not operate an HKMA/SFC designated CCP may not be able to be cleared resulting in a Hong Kong prescribed person breaching the clearing mandate. As a result, it is likely that this transaction would not be executed thus placing at least one of the counterparties to the proposed trade at risk if they are unable to trade elsewhere. Furthermore, this would impact the global nature of the markets resulting in a bifurcation and consequent reduction in liquidity.

Q29. Do you have any comments or concerns about our proposed list of "comparable jurisdictions"? If you do, please provide specific details.

The GFXD supports the joint response submitted by ISDA/FIA/ASIFMA on 5th November, 2015.

Q30. Do you have any comments or concerns about our proposed record keeping requirements for demonstrating compliance with the clearing obligation? If you do, please provide specific details.

The GFXD supports the joint response submitted by ISDA/FIA/ASIFMA on 5th November, 2015.

Q31. Do you have any comments or concerns about our proposed processes for designating CCPs or for revoking a CCP designation? If you do, please provide specific details.

The GFXD supports the joint response submitted by ISDA/FIA/ASIFMA on 5th November, 2015.

Q32. Do you have any comments or concerns about our proposal to implement only the clearing leg of the extended definition of "ATS" at this stage? If you do, please provide specific details.

The GFXD has no comments in response to this question.

Q33. Do you have any comments or concerns about our proposal to defer implementation of the changes to the definition of "market contract" to cover CCPs that are authorized ATS providers and designated CCPs? If you do, please provide specific details.

The GFXD has no comments in response to this question.

Q34. Do you have any comments or concerns about our proposal to include all OTC derivative products in the next phase of mandatory reporting? If you do, please provide specific details.

The GFXD would like to raise concerns regarding the lack of explicit guidance as to what constitutes an OTC derivative for FX. The key proposals section of the consultation paper and the draft regulations in Appendix B reference Section 101a and Schedule 1 (1B) of the SFO. Both of these references define OTC derivative by what is not included in the term, rather than by what is. We have understood these definitions to mean that for FX, 'all OTC derivative products' means all FX Forwards, FX NDFs, FX Swaps and FX Options, in all currencies, but we would welcome further clarification on this point.

The products listed above are currently reportable in other major jurisdictions, notably the US and Europe. Therefore including these products in scope should not present a major challenge for GFXD member banks. However, there are a few issues that we would like to bring to the attention of the regulators:

Complex/bespoke products

The GFXD would like to raise the issue of complex and bespoke products, and in particular the operational constraints that still exist for the reporting of these products. Complex and bespoke products are not traded electronically, cleared or confirmed through electronic matching platforms. There is limited standardisation of representation for these products in the marketplace and limited support in Financial products Markup Language (FpML)[9] for trade reporting. Market participants are currently reporting these products using the Generic Product Template in FpML for US and European regulatory requirements.

The GFXD has recently completed work on standardising the representation of 26 complex and bespoke products in FpML. However, the templating of products within FpML is a challenging and time-consuming

[9] More information available at http://www2.isda.org/functional-areas/technology-infrastructure/fpml/

process and should not be considered to be an 'over-night' solution to trade reporting issues – the use of FpML is also typically limited to the more sophisticated market participants.

The process to create a new FpML template typically works as follows: consensus is firstly sought between market participants to ensure that there is a standard interpretation of how a product works, what its data attributes are, what cash-flows are generated and how the legal confirmation template should be structured. Such factors are then considered for the actual templating within FpML. A working group consisting of market practitioners will then look to draft a proposed FpML template. Iterations of a template will be subject to scrutiny from an oversight group, which are ultimately accountable for the final approval of the template, subsequent to it being published on the FpML website and thus being available to the market as a whole. Once the FpML template is published, market participants, including trade repositories, will then need to perform their own systemic changes (including testing) to ensure that the new FpML template can be used in day-to-day production.

The entire process as described above can take approximately 12 months. While this has been completed for a number of complex and bespoke products, there are many more for which the process has not yet begun. The GFXD would therefore encourage the HKMA/SFC to take this into account when creating final rules for the reporting of these products.

FX Security Conversions

Since the list of products in scope for the expanded reporting rules now includes FX forwards, we would like to bring to the regulators' attention the issue of FX Security Conversions[10]. These can be defined as: the purchase or sale of a foreign currency for the sole purpose of effecting a purchase or sale of a security denominated in a foreign currency, when the settlement period for such FX transaction is within the settlement cycle for such security.

Many of our members act as custodian for the securities of, in the case of broker-dealers, their customers and, in the case of banks, for their customers and those of their affiliated broker-dealers. Due to the increased access and investor interest in foreign markets, growing numbers of these customers are invested in foreign securities. To facilitate the purchase or sale of these foreign securities, bank custodians and broker-dealers, as part of their duties, often enter into a FX transaction that is incidental to and for the sole purpose of effecting the foreign securities transaction. For example, when a non-US customer wishes to purchase a US dollar-denominated security, its broker-dealer or bank custodian will enter into a corresponding FX transaction to have US dollars on hand to meet the cash currency requirements necessary for the customer to complete its purchase of the securities. These FX transactions are an integral part of the settlement process. Typically, the settlement cycle for most securities denominated in major currencies is trade date plus three days (T+3).[11] Accordingly, the bank custodian or broker-dealer would enter into a FX transaction on a T+3 basis as well. However in some securities markets, especially emerging markets e.g. South Africa, the settlement cycle can take up to seven days (T+7).

[10] We raised this issue in our response to the SFC-HKMA 2014 consultation on OTC Derivatives Transactions Reporting and Record Keeping, available at http://www.gfma.org/correspondence/item.aspx?id=616

[11] See www.sec.gov/investor/pubs/tplus3.htm

To date, regulatory authorities in each of the United States and Canada have defined transactions used solely to fund the purchase or sale of a foreign security where the settlement period is greater than T+2 days as an FX spot contract and are thus outside the scope of OTC derivatives regulation within those jurisdictions. We are currently expecting the same outcome in Europe by means of a clarification in the MiFID II Delegated Acts, and note that both Singapore and Australia have granted waivers for FX Security Conversions for the present. Hence, we suggest that the HKMA/SFC should apply the same treatment to these transactions and not consider them as foreign exchange derivatives.

Subjecting these transactions, that are incidental to related securities transactions, to OTC derivatives regulation would expose bank custodians, broker-dealers and their customers to needless operational, price, credit and other risks. As a result, participants may restrict FX Security Conversions to T+2 FX spot contracts, even when the securities settlement takes longer, thereby exposing the customer to FX risk, while exposing the bank to certain operational risks, and changing – and disrupting – the long-standing and well-functioning settlement processing for the systemically relevant securities markets that exists today.

OTC derivatives regulation simply should not be applied to the types of incidental transactions at issue here and will not provide any meaningful protection to participants (in the form of disclosures) or meaningful information to the regulatory authorities (in the form of regulatory reporting). Inconsistent treatment of these transactions globally should be avoided to ensure that the lack of an exclusion for FX Security Conversions from OTC derivatives regulation in some jurisdictions (e.g. Hong Kong) doesn't create unnecessary disincentives from transacting in securities in those jurisdictions by raising their transactional costs relative to other jurisdictions which have excluded them (e.g. in the United States and Canada).

Scope of reporting products

Under the existing reporting rules, a reporting entity is required to report all specified OTC derivative transactions (i.e. FX NDFs in certain currencies) that are conducted in Hong Kong, regardless of who their counterpart to that trade is. This means that in some cases, banks' transactions with retail clients are reportable, though the retail client's identity is masked. The trade repository therefore receives an 'incomplete' report which is of little informational value to the regulators.

Given the expanded product scope proposed in this Consultation Paper, the GFXD are extremely concerned about the potential increase in reporting burden for retail banks under this regime. The GFXD would suggest that relief be provided for the reporting of these trades until such time as there is an obligation for Hong Kong persons (retail or corporate clients) to report trades.

The GFXD welcomes the HKMA/SFC's very measured approach in implementing key derivatives reforms thus far, for example, beginning trade reporting with a very limited product scope. This has allowed both regulators and market participants to test the new requirements and address problems at an early stage. The GFXD would therefore encourage the regulators to take a similarly phased approach with the additional reporting requirements proposed. We note, for example, that in the US and Europe, where trade reporting for all eligible products went live simultaneously, a huge volume of data has been produced from the start, which the regulators have had difficulty understanding and analysing. A similar scenario could be avoided with phased implementation of the new products brought in scope.

Q35. Do you have any comments or concerns about our proposal that the "exempt person" relief should be extended to cover all OTC derivative products, but that it should no longer apply on a product class basis? If you do, please provide specific details.

The GFXD supports the joint response submitted by ISDA/FIA/ASIFMA on 5th November, 2015.

Q36. With respect to the criteria for triggering the "exempt person" relief, do you have any comments or concerns about our proposal that the limit on the aggregate notional amount should stay at US$30 million? If you do, please provide specific details.

The GFXD supports the joint response submitted by ISDA/FIA/ASIFMA on 5th November, 2015.

Q37. Do you have any comments or concerns about our proposal to do away with the concession period and defer commencement of phase 2 reporting until 6 months after the rules are enacted? If you do, please provide specific details.

In principle, a 6 month deferral of implementation would be sufficient for GFXD members, if the scope of the reporting requirements was being expanded only to cover all FX OTC Derivatives. However, given that all OTC Derivatives across multiple asset classes will be reportable under the new rules, with additional fields, we are concerned by the delivery concentration, especially when other global deliverables are considered, e.g. MiFID in Europe. As outlined in our response to Q34, the GFXD welcomes the HKMA/SFC's very measured approach in implementing key derivatives reforms thus far. We would therefore recommend that a phased implementation approach is adopted, with a timeframe longer than 6 months, to allow all market participants, including the trade repositories, enough time to build, test and implement the reporting requirements.

In addition, the GFXD notes that the field specifications will be published in the Gazette, rather than in the final rules. We therefore seek clarification from the HKMA/SFC that the implementation period will begin after both the final rules and the final detailed field information have been published. We also request that the industry is given an opportunity to comment on the detailed field information in the Gazette before it is finalised.

Q38. Do you have any comments or concerns about our proposal to only set out the information categories in the subsidiary legislation, and separately publish, by way of a (non-statutory) Gazette notice, the specific data fields to be completed when reporting transaction information to the HKTR? If you do, please provide specific details.

In order for market participants, including trade repositories, to adequately prepare for the implementation of the new trade reporting requirements, explicit guidance on field specifications is required to enable consistent interpretation and compliance. The publication of the specific data fields in a non-statutory publication could result in misinterpretation or incorrect application, which would impact the quality of the data received by regulators. This is of particular concern in the FX market, where the number of participants and volume of transactions are both particularly high.

As explained in our response to Q37 above, we also recommend that the implementation period begins at the publication of the detailed field specifications, rather than the general rules.

Q39. Do you have any comments or concerns about the specific data fields set out in the tables at Appendix D? If you do, please provide specific details, including suggestions for alternative ways to capture the relevant information.

The GFXD understands from this Consultation Paper that comments on the data fields set out in Appendix D are requested by 30 November. We will therefore submit our response to this question separately by 30 November, in accordance with the directions set out in this Consultation Paper.

Q40. Do you have any comments or concerns about our revised proposal on the reporting of valuation transaction information? If you do, please provide specific details.

The GFXD supports the joint response submitted by ISDA/FIA/ASIFMA on 5th November, 2015.

Q41. In what circumstances do you envisage it will be necessary to submit the previous day's valuation figures, and why? Please provide specific details including the practices adopted and the particular difficulty encountered in view of such practices.

The GFXD supports the joint response submitted by ISDA/FIA/ASIFMA on 5th November, 2015.

Q42. Do you have any comments or concerns about our proposal to expand the mandatory record keeping obligation so that it applies in respect of the expanded product scope, but to leave the obligation otherwise unchanged? If you do, please provide specific details.

The GFXD supports the joint response submitted by ISDA/FIA/ASIFMA on 5th November, 2015.

Q43. Do you have any comments or concerns about our proposal to have a single grace period under phase 2 that applies across all products and product types? If you do, please provide specific details.

The GFXD supports the joint response submitted by ISDA/FIA/ASIFMA on 5th November, 2015.

Q44. Do you have any comments or concerns about our proposals for how the single grace period under phase 2 will apply in respect of persons who are already reporting under phase 1? If you do, please provide specific details.

The GFXD supports the joint response submitted by ISDA/FIA/ASIFMA on 5th November, 2015.

Q45. Do you have any comments or concerns about our proposals for how the single grace period under phase 2 will apply in respect of persons who became subject to mandatory reporting under phase 1 but whose grace period under phase 1 is still running when phase 2 reporting takes effect? If you do, please provide specific details.

The GFXD has no response in respect of this question.

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We appreciate the opportunity to share our views on this consultation paper issued by the HKMA and SFC. Please do not hesitate to contact John Ball on +852 2531 6512, email jball@gfma.org should you wish to discuss any of the above.

Yours faithfully,

James Kemp
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