

# **Development of CCP and Trade Repository for OTC Derivatives in Hong Kong**

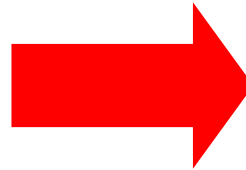
**3 January 2011**



## Background

Recent financial crisis revealed the risk embedded in the OTC derivative market

To minimize  
systemic risk



International bodies have called for improvement in financial market infrastructure and regulatory framework (e.g. strengthening the use of CCP and trade repository)

At the Pittsburgh meeting in Sep 09, G-20 leaders agreed that :

“All standardized OTC derivative contracts should be traded on exchanges or electronic trading platforms, where appropriate, and cleared through central counterparties by end-2012 at the latest. OTC derivative contracts should be reported to trade repositories. Non-centrally cleared contracts should be subject to higher capital requirements.”



## International Efforts – (1)

- The Financial Stability Board (FSB) has formed a working group involving a number of national authorities to produce a report on Implementing OTC Derivatives Market Reforms
- CPSS and IOSCO are jointly revising their recommendations for Central Counterparties (CCP) and proposing recommendations for Trade Repositories (TR)
- The BCBS is revising its capital requirements in relation to bank's exposures to CCPs



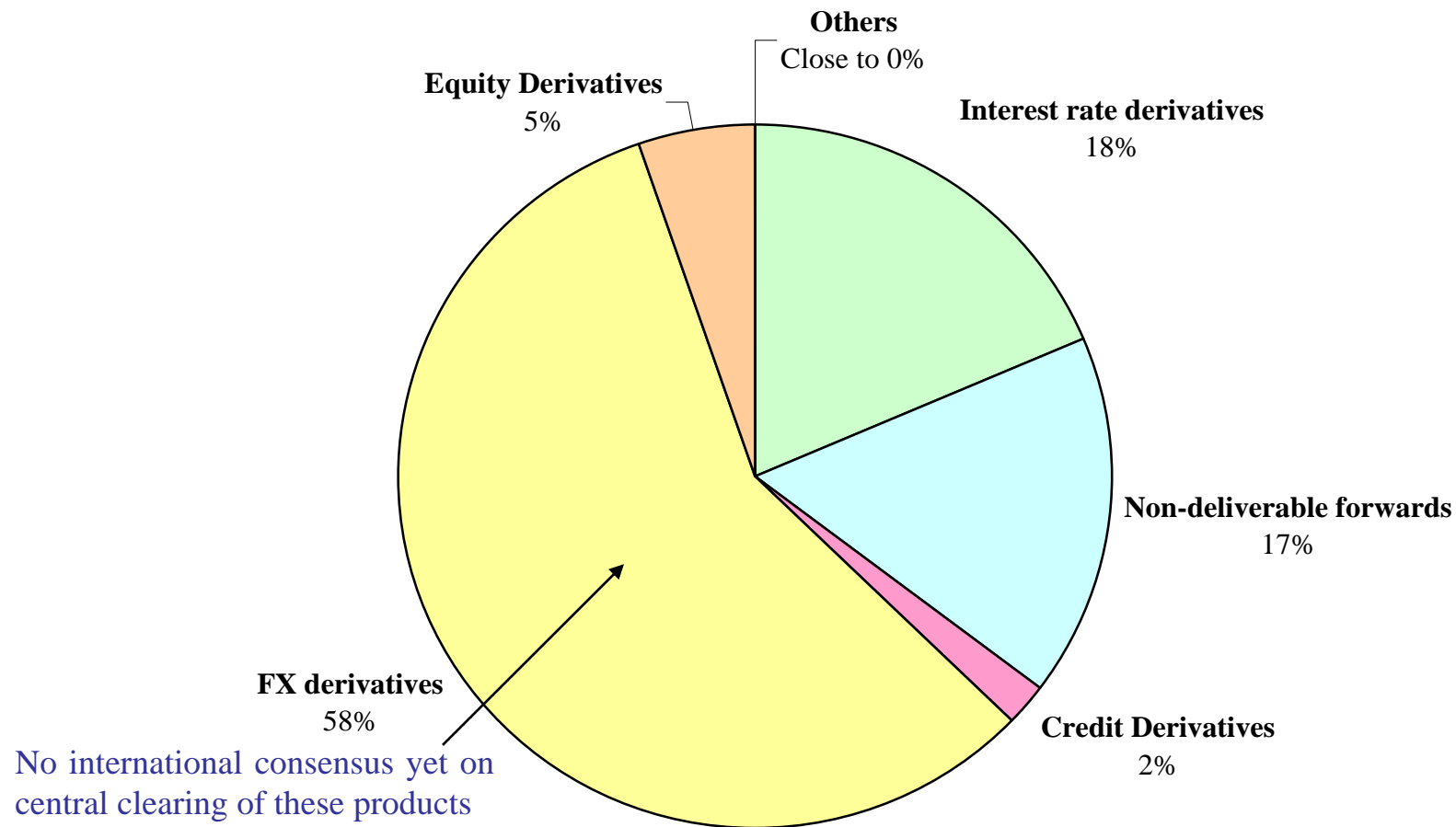
## International Efforts – (2)

The FSB has recently approved a report containing recommendations to promote consistent implementation of the G20's commitments concerning –

- Increasing the proportion of the market that is standardised
- Moving to central clearing of standardised OTC derivatives by end 2012
  - implementing mandatory clearing requirements
  - strengthening oversight and regulation of CCPs
  - introducing robust risk management requirements for the remaining non-centrally cleared trades
- Ensuring that OTC derivatives transactions are reported to TRs by end 2012



## Breakdown of OTC derivative trades generated in Hong Kong during 2009 (by nominal amount)

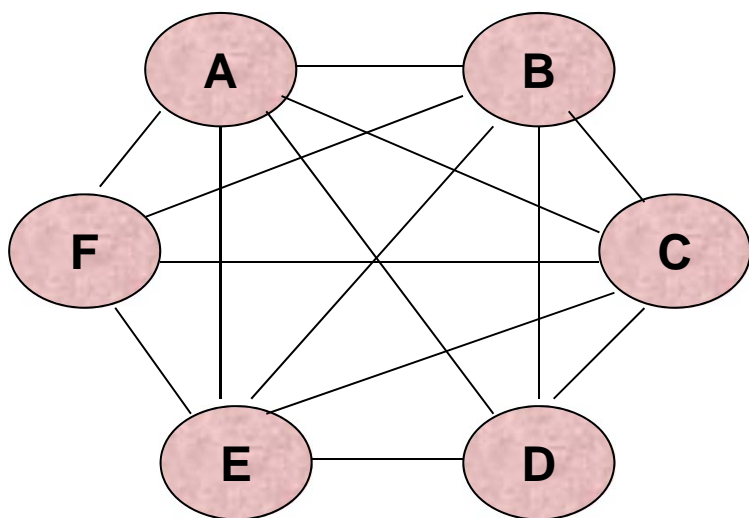


Data obtained from a survey conducted with a list of major market participants

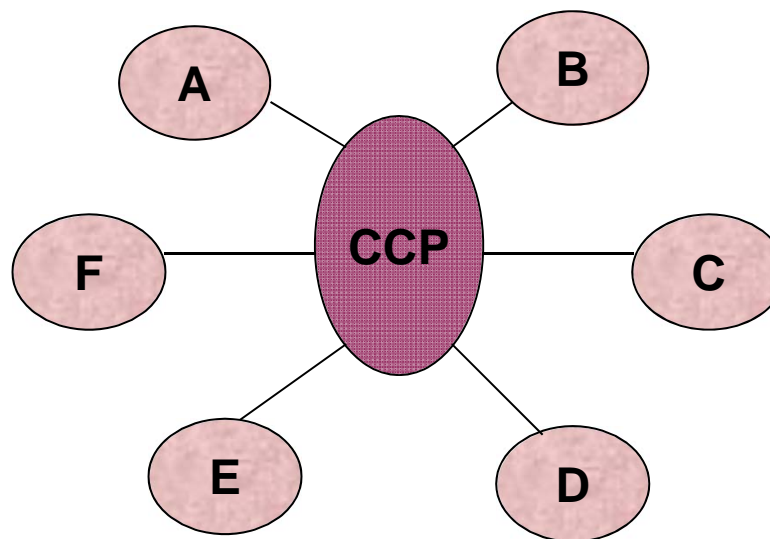


## Benefits of CCP

In the bilateral OTC market



Clearing through a CCP



HKEx will develop a local CCP for OTC derivatives (initially covering interest rate swaps and non-deliverable forwards)

CCP stands between two counterparties, acting as buyer for the seller and seller for the buyer  
It will be able to perform multilateral netting and facilitates the reduction of counterparty risks



## Benefits of TR

TR : A centralised registry that maintains an electronic database of OTC derivative transaction records



Improves market transparency for better systemic risk assessment

Enhances market surveillance role of regulators given that TR enables relevant regulatory data access



Enhances financial market stability

HKMA's Central Moneymarkets Unit (CMU) will develop a local TR for OTC derivatives (initially capturing transactions of interest rate swaps and non-deliverable forwards)



## Hong Kong's Position – International Commitments

- As a member of the FSB, Basel Committee and IOSCO and to fulfil the role of an international financial centre, we have the responsibility to comply with international standards
- Under the current regulatory framework, we will take the necessary steps to implement G20's commitments in practice
- The relevant regulatory authorities will work together to develop the regulatory framework and ensure a level playing field for financial institutions (FIs) in HK





## Building a regulatory regime for OTC derivatives markets

- Regulatory regime is required to support the TR and CCP
  - introduce mandatory trading, clearing and reporting requirements
    - entities subject to the requirements
    - types of contracts to be reported and/or cleared
- The SFC, the HKMA and the Government will work together in building the regime and consult the market on the detailed regulatory requirements by Q3 2011
- Level playing field for all FIs in Hong Kong



## Legislative amendments

- Proposals will require amendment to primary legislation (SFO) and introduction of new subsidiary legislation
- Primary legislation
  - introduce new rule-making power to enable SFC to
    - impose mandatory trading, clearing and reporting obligations,
    - provide for related and ancillary matters (e.g. additional requirements, penalties for breach, etc.)
- Subsidiary legislation
  - to be made under the new rule-making power
  - will set out the detailed regulation of the OTC derivatives market



## Legislative amendments

- Plan to submit the proposed SFO amendments to Legislative Council later in 2011
- SFC will conduct public consultation on new subsidiary legislation by Q3 2011

# OTC Clearing – Rationale

## Global Regulatory Mandate

- **G-20 Initiatives**
- **Comply with international standards**
- **HKEx – proven record in central clearing**



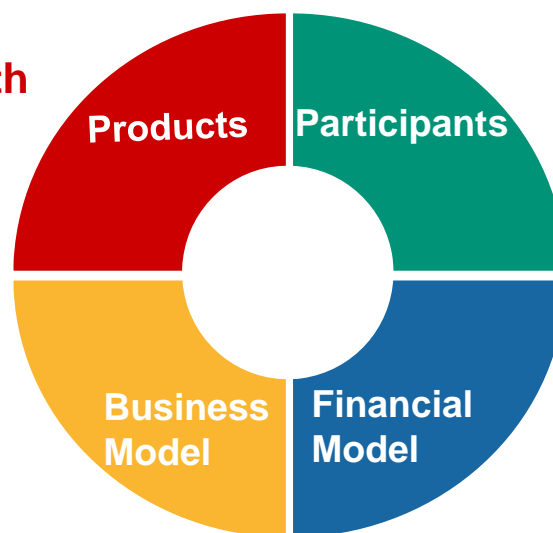
## Strategic Value to HKEx

- **New business and revenue**
- **New customers and products**
- **Capture RMB related opportunity**

# OTC Clearing – Overview

- **Current HK market size: Small**
- **Start up: IRS and NDF**
- **Future expansion: FX and equity derivatives**
- **RMB: the potential growth driver**

- **Potential participants: International banks, Mainland banks in HK and local banks**

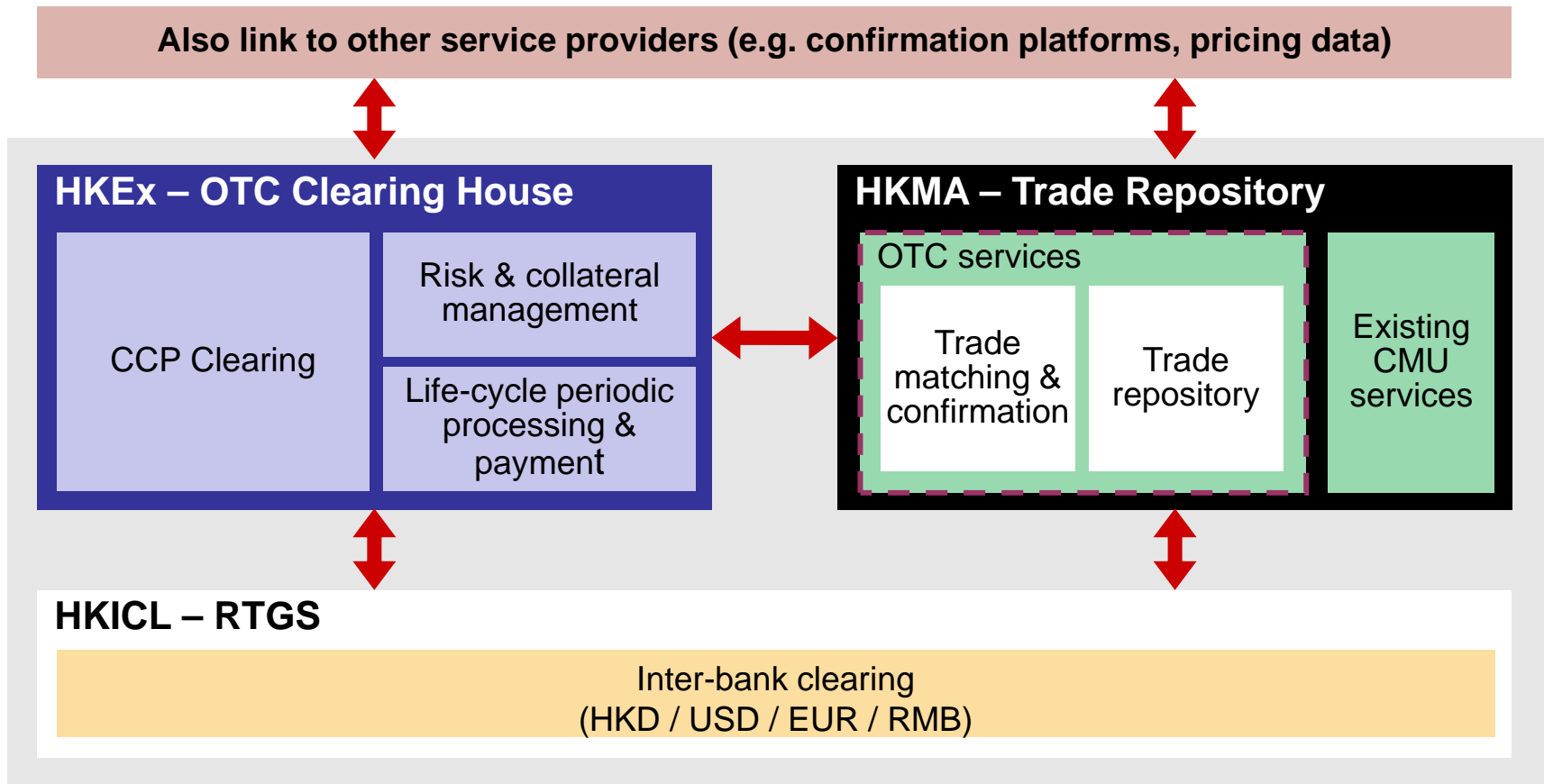


**Set up by HKEx**  
**Flexible shareholding structure**  
**May invite partners**

- **Initial Guarantee Fund seeded by HKEx and contribution by participants**

***HKEx Board approved in Nov 2010; Target to launch before end 2012***

# OTC Clearing – Interface with the Trade Repository



*HKMA to develop these functions in its existing CMU system to support OTC Clearing*

**Thank You**