

**Bills Committee on Securities and Futures (Amendment) Bill 2013**

**The Administration's responses to comments given by deputations  
to the Bills Committee on Securities and Futures (Amendment) Bill 2013**

Comments	The Administration's responses
<p><b>Grace periods and transitional arrangements</b></p> <p><i>Organisations: Clifford Chance (“CC”), CME Group Hong Kong Limited (“CME”), The Hong Kong Association of Banks (“HKAB”), The Hong Kong Society of Financial Analysts (“HKSFA”), The Law Society of Hong Kong (“LSHK”)</i></p>	
<p>1. Since compliance with the mandatory reporting and clearing obligations require a due process for setting up access and system linkages with trade repository (“TR”) and central counterparties (“CCPs”), sufficient grace period should be provided for effective implementation. Similarly, sufficient transitional period for deeming existing regulated activities for expanded regulated activities should also be allowed.</p>	<p>Agreed. The rules will provide for proposed grace periods for the clearing (three months) and the reporting (up to six months to cover backloading) requirements to allow affected entities to establish system connection and necessary documentation work. In fact, the interim reporting requirement is already effective on banks from August 2013 with a four-month grace period ending in December 2013. Subject to local regulatory approval, OTC Clear plans to offer clearing services on a voluntary basis by the end of the year. There would therefore be sufficient lead time before the implementation of the regime takes effect.</p> <p>Pursuant to the public consultation on the proposed scope of new/expanded regulated activities (“RAs”), we have taken on board the feedback from the public on the need to have a longer transitional period for new and expanded</p>

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	regulated activities. We have therefore proposed a longer application period of three months and a longer transitional period of six months to facilitate market players to ease into the new licensing regime with minimum disruption to their existing business.
2. It is not clear if there is any transitional arrangement for overseas CCPs or trading platforms which are currently operating and providing services to market participants when the clearing and trading obligations commence.	We note that there was no request for such transitional arrangements during public consultation. We are open to considering transitional arrangements for CCPs and trading platforms if it is indeed necessary.
<p><b>Cross-border transactions</b></p> <p><i>Organisations: CC, CME, HKAB, HKSFA, LSHK</i></p>	
3. Given that OTC derivative transactions are cross-border by nature, and the two counterparties to the transactions are often from two different jurisdictions where each has its own regulatory framework and rules, it is possible that some rules may have extraterritorial effect and the counterparties may face two sets of rules which are conflicting or overlapping, especially when a transaction involving two counterparties is required to be cleared at separate	We will endeavour to align our regulatory regime with international standards and those of the major markets while recognising the local circumstances. Our regime provides room for deeming certain cross-border transactions, if faced with conflicting rules, as compliant as long as these transactions already comply with the regulations under recognised regimes. Moreover, there is no location requirement on CCPs. Overseas CCPs can be authorised to provide services to prescribed persons and

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<p>CCPs designated by two jurisdictions. As a result, the transaction cannot take place. This may bring about undesirable market fragmentation and liquidity problems. It is suggested that mutual recognition of CCPs is desirable.</p>	<p>designated as a CCP for the purpose of meeting the mandatory clearing obligation under our regime. Effectively, the two counterparties to an OTC derivative transaction will have a choice to use a CCP as long as the CCP is authorised and designated by the Securities and Futures Commission (“SFC”).</p>
<p>4. Similarly, OTC derivative transactions are required to be reported to TRs across the borders. It is considered that the burden for multiple reporting should be reduced. In Hong Kong, the reporting obligation requires reports to be made to the Hong Kong Monetary Authority (“HKMA”) although it is allowed that reports can be made through third parties or agents, such as global TRs. Since the use of an agent or outsourcing of such function by banks require approval under the HKMA's Supervisory Manual, the flexibility of recognizing global TRs should be allowed to mitigate the burden.</p>	<p>For effective surveillance and monitoring, it is necessary to ensure that our regulators have effective and efficient access to transaction information. The local TR will facilitate the management of adequate amount of trade reports, instead of relying primarily on data sharing by overseas TRs or regulators. To address the concerns of reporting entities, there are linkages with major global TRs and regular dialogue with the industry so that they can readily entrust global TRs to file reports to the HKMA on their behalf. To enhance efficiency in processing the outsourcing applications in relation to reporting, the HKMA has been in close contact with reporting agents that are global TRs advising them the essential information and contributions required from them to support the outsourcing applications.</p>

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<p>5. It is necessary to provide exemption from compliance with the reporting obligation in situations where such reporting may be prohibited by conflicting laws, especially in relation to confidentiality.</p>	<p>We will take note of the development of relevant industry protocol as well as the development in other major jurisdictions in dealing with trade reporting issues such as conflicting laws and confidentiality issue so as to ensure that our regulations are in line with international standard and practice.</p>
<p><b>Better certainty and clarity of the requirements</b>  <i>Organisations: CC, HKAB, LSHK</i></p>	
<p>6. The Bill provides the regulatory framework for the OTC derivative market while the detailed rules will set out the implementation requirements. It is necessary to have the details as soon as possible for market participants to get the necessary preparation.</p>	<p>Agreed. The preparation of the detailed rules is in progress and there will be a public consultation in early 2014.</p>
<p>7. It is necessary to clarify how cross-border transactions, when facing conflicting rules as mentioned above, should be treated.</p>	<p>Agreed. The regime already provides for the treatment of cross-border transactions, and the rules being drafted will set out conditions under which certain cross-border transactions may be taken to have complied with certain requirements.</p>

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<p>8. It is important that the rules will take into consideration international alignment and negotiation for international equivalence and substituted compliance with the EU and the US.</p>	<p>Agreed. In the preparation of the detailed rules, we will take into account the regulations and rules in other major jurisdictions. We are also discussing equivalence assessment with the EU and comparability analysis with the US.</p>
<p><b>Proportionate scope of requirements and regulations and appropriate exemptions</b>  <i>Organisations: CME, HKAB, TriOptima Group</i></p>	
<p>9. <b>The scope of the new RA11</b></p> <p>Certain institutions based overseas, whose services involve facilitating portfolio compression and portfolio reconciliation (which are important processes for risk management of OTC derivatives) may be caught by the new RA11 (which covers activities in dealing in and advising on OTC derivative transactions). Clarification is sought on the scope of RA11 and whether exemption for such services will be granted.</p>	<p>Agree that portfolio compression and portfolio reconciliation are important processes for risk management of OTC derivatives. We are looking into the detailed processes.</p>

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<p><b>10. The scope of Systemically Important Participants (“SIP”)</b></p> <p>(a) The scope of SIP may be too broad and it is not certain if the scope also covers overseas entities, such as foreign CCPs and trading platforms.</p> <p>(b) There are concerns about the potential information collected and disclosed.</p>	<p>(a) Only entities with presence in Hong Kong will be regarded as Hong Kong entities. Hong Kong entities with significant positions in OTC derivatives may become SIP. The intention is to allow regulators in Hong Kong to have a sufficient level of oversight if these entities' activities pose a risk of systemic concern to our financial system. We take note of the comment and will further consider.</p> <p>(b) The information collected must be sufficient to ensure effective oversight. Public disclosure would be limited to the name of the SIP and the specific class of OTC derivative transactions in respect of which the notification level has been reached.</p>
<p><b>Trading obligation</b></p> <p><i>Organisations: HKAB, HKIDBA</i></p>	
<p>11. Since it has been stated that the trading obligation will not be imposed at the outset, it should be removed from the primary legislation as this may create uncertainty about the timing of imposition.</p>	<p>It is an international consensus that the trading obligation should be introduced, where appropriate, to enhance transparency which will help protect the market from abuse. We will conduct feasibility study and consult the market and make the relevant subsidiary legislation before the imposition of the trading obligation.</p>

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<p><b>Penalties for non-compliance</b> <i>Organisation: HKAB</i></p>	
<p>12. It would be difficult to quantify the profit gained, or loss avoided, in the context of determining the penalties for non-compliance with the mandatory obligations.</p>	<p>The current proposed pecuniary penalty applicable to authorised financial institutions or approved money brokers is an amount not exceeding the greater of (a) \$10,000,000 and (b) three times the amount of the profit gained, or loss avoided. This is to be consistent with pecuniary penalty that the SFC may impose on licensed corporations or registered institutions under sections 194 and 196 of the Securities and Futures Ordinance (“SFO”).</p>
<p><b>Definition issues</b> <i>Organisation: HKAB</i></p>	
<p>13. Some definitions, such as OTC derivatives and subsidiaries, may benefit from more clarifications.</p>	<p>It is necessary to have a wide definition of OTC derivative product in the primary legislation to ensure that we do not inadvertently omit any product which should be caught. The types of OTC derivative products which are subject to the mandatory obligations will be specified in the subsidiary legislation.</p> <p>For subsidiaries which will be specified by the HKMA for the purpose of compliance with the mandatory obligations,</p>

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	the HKMA will provide more details and information in the form of guidelines as necessary.
<p><b>Coverage of insolvency protection and CCP rules</b>  <i>Organisation: CME</i></p>	
<p>14. It is suggested to extend statutory insolvency protection to all CCPs instead of just designated CCPs.</p>	<p>It is not advisable to extend the statutory insolvency protection to all CCPs since it has a wide implication beyond just OTC derivatives and this requires careful consideration. CCPs should have adequate insolvency protection under the law of the jurisdiction that they are located in. Market participants using such CCPs should do their own due diligence to assess their risks beforehand. However, designated CCPs will have to be used by prescribed persons to meet their mandatory clearing requirements. It is therefore necessary to extend our insolvency protection to such designated CCPs in order to provide legal certainty on Hong Kong insolvency protection.</p>



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<p><b>Issues relating to recognised clearing house (“RCH”) and related provisions under the SFO</b>  <i>Organisation: Hong Kong Exchanges and Clearing Limited (“HKEx”)</i></p>	
<p>15. Whilst acknowledging that amendments have been made in respect of the following matters set out below, further amendments were suggested to the Bill -</p> <ul style="list-style-type: none"> <li>(a) provisions to allow RCH to make rules on taking of proceedings and other matters;</li> <li>(b) provisions on segregation and portability of client positions and collateral;</li> <li>(c) references to set-off and netting;</li> <li>(d) insolvency protection on rules relating to default of a RCH;</li> <li>(e) inclusion of reference to market collateral; and</li> <li>(f) exemption from RAs for the entering into of a market contract.</li> </ul>	<p>HKEx's submission is of a more technical nature. We are studying the comments raised by the HKEx and, where appropriate and relevant, will consider making the suggested changes.</p>