

CB(1)1502/11-12(02)

*Legislative Council*  
*Panel on Financial Affairs*

**Progress in the Regulation of  
Over-the-counter Derivatives Market**

*2 April 2012*



**1**

**Progress Update – Consultation feedback**

**2**

**Interim measure to facilitate voluntary clearing**



# ***1. Progress Update - Consultation feedback***



# Summary of Developments

## G20 COMMITMENTS

2009

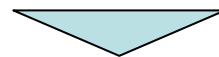
- In the wake of the financial crisis, the G20 leaders committed to reforms that would require certain Over-the-counter (OTC) derivatives transactions to be:
  - i. reported to trade repositories (TRs);
  - ii. centrally cleared through central counterparties (CCPs);
  - iii. traded on exchanges or electronic trading platforms (ETPs) where appropriate; and
  - iv. subject to higher capital requirements if not centrally cleared



## REGIME DEVELOPMENT

2010

- In line with the G20 commitment, the HKMA and SFC have been developing a regulatory regime for the OTC derivatives market in Hong Kong (Note: this is primarily an institutional market, **NOT** a market for retail investors)



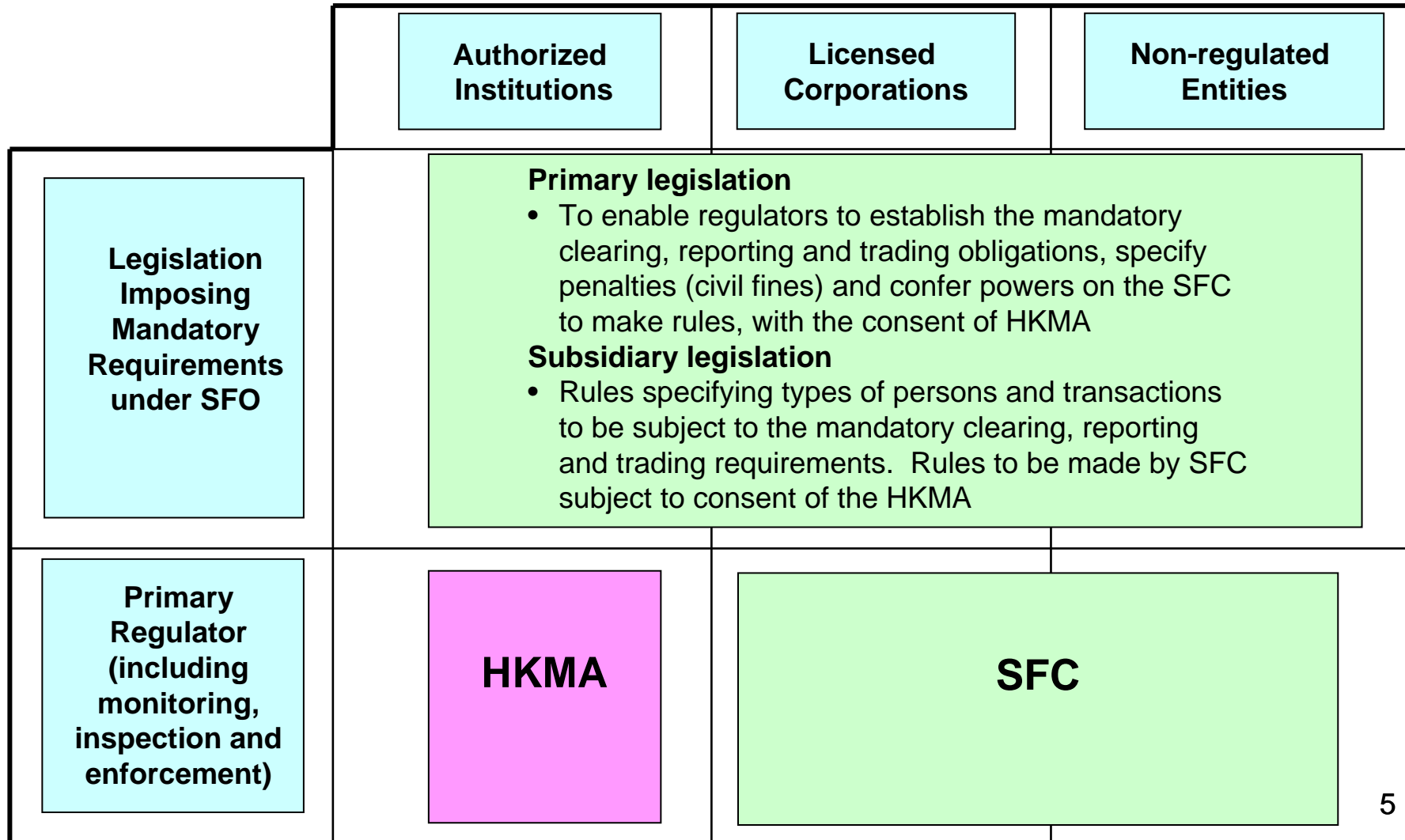
## CONSULTATION PAPER

October  
2011

- The HKMA/SFC issued a joint consultation paper outlining our thinking on how the regime might be cast and inviting industry feedback on specific issues to help finalise key aspects of the local regime
- 33 submissions were received from financial institutions and industry bodies, including the Hong Kong Association of Banks and International Swaps and Derivatives Association



# Proposed Regulatory Framework





# Key Responses from Consultation

## General Feedback

Respondents:

- Generally supportive of the proposed regulatory regime
- Recognise the need for Hong Kong to develop and implement measures in line with G20 objectives to regulate the OTC derivatives market

## Areas of Support



Proposed **division of regulatory responsibilities** between the HKMA and SFC as lead regulators of AIs and non-AIs in respect of their OTC derivatives market activities respectively



Proposed **“two-tiered” legislative framework**, with high-level requirements in primary legislation and subsidiary legislation, in the form of rules, providing details for implementation



**Not imposing the mandatory trading requirements at the outset** and prioritising efforts on clearing and reporting obligations at the initial stage



# Key Responses from Consultation

## Key Concerns

### Scope of Regime

1

Ambit of the term “OTC derivatives transactions”, which inappropriately captures securitized products and embedded derivatives

2

The extent to which the OTC derivatives transactions of foreign AIs might be caught and the requirement for local AIs to comply on a group basis

3

Absence of exemptions for end-users using OTC derivatives solely for commercial hedging purposes

### Mandatory Obligations

4

Application of mandatory requirements to AIs/LCs that only “originate/execute” trades

5

Method for determination of the reporting and clearing thresholds

6

Potential conflict of law regarding client confidentiality for overseas AIs and overseas branches of a local AI complying with the reporting obligation

### Regulated Activities

7

Need for clearer delineation of the new regulated activities and their overlap with existing regulated activities



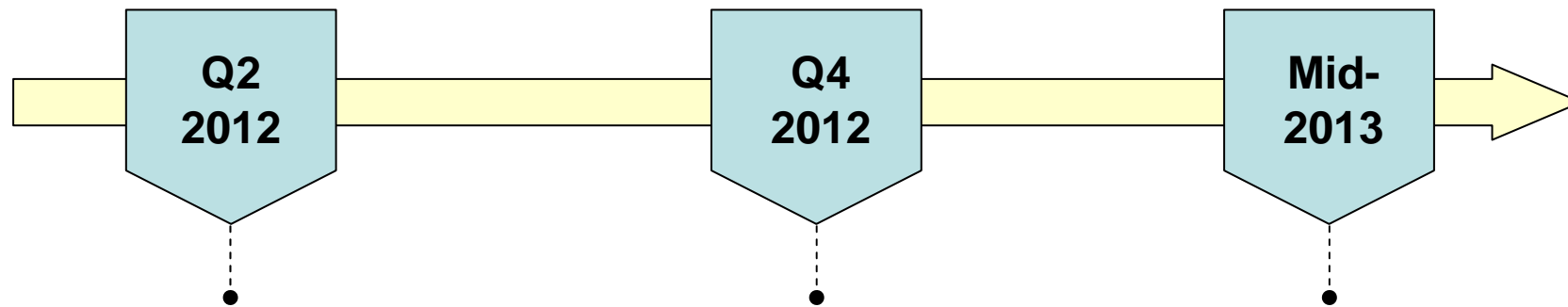
## Development of Infrastructure

	Local Initiatives	Planned Launch Date
CCP	<ul style="list-style-type: none"><li>Local CCP developed by Hong Kong Exchanges and Clearing Limited (HKEx)</li></ul>	End-2012
TR	<ul style="list-style-type: none"><li>Local TR developed by the HKMA</li><li>Built upon existing Central Moneymarkets Unit (CMU) infrastructure</li></ul>	<i>Matching Services:</i> End-2012  <i>Receive Reports:</i> Q2 2013





## Timeline: Regulatory Developments



- Issue **Consultation Conclusions Paper**  
  
The Paper will summarise the key concerns raised by market participants as well as communicate the HKMA/SFC's corresponding response
- **Introduce Amendment Bill** to establish the regulatory framework for the OTC derivatives market to the LegCo
- **Public consultation** on draft subsidiary legislation
- **Implement the new regulations** for the OTC derivatives market subject to passage of relevant legislation by LegCo



## ***2. Interim measure to facilitate voluntary clearing***



## Voluntary clearing of OTC derivatives transactions

- **Although mandatory clearing has yet to be implemented, market participants are already moving towards clearing their OTC derivatives transactions through a CCP on a voluntary basis**
  - Early preparation for mandatory clearing
  - Benefits of central clearing
- **CCPs in the US, Europe and Singapore have provided voluntary clearing services to market participants**



## Proposed interim legislative measure to support voluntary clearing

- **Make use of the Financial Secretary's power under section 392 of the SFO to prescribe, by way of a notice published in the Gazette ("section 392 Notice") –**
  - Prescribe certain OTC derivatives transactions as "futures contracts" for the purposes of particular provisions under the SFO
  - Regulate CCPs offering OTC derivatives clearing services based on the existing regulatory framework
  - Extend insolvency override protection to cover OTC derivatives transactions cleared by a local CCP



## **Proposed interim legislative measure to support voluntary clearing**

- **Establish track record of the local CCP to facilitate its recognition by overseas authorities**
- **The interim legislative measure will be repealed upon implementation of the full-fledged regulatory regime for the OTC derivatives market**
- **We aim to table the relevant Gazette Notice on the interim measure (i.e. the section 392 Notice) before the LegCo for negative vetting in May 2012**

**Thank You**