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VIA EMAIL AND FAX SUBMISSION

Legislative Council Secretariat  
Legislative Council Complex  
1 Legislative Council Road  
Central  
Hong Kong

**Attn: Clerk to the Bills Committee on the Securities and Futures (Amendment) Bill 2013**

**Re: The Securities and Futures (Amendment) Bill 2013 ("Bill")**

Dear Sirs:

CME Group Inc. ("**CME Group**") would like to express appreciation to the Bills Committee on the Securities and Futures (Amendment) Bill 2013 for its invitation to comment on the Bill. CME Group generally supports the Bill but takes the opportunity to set out a number of concerns in respect of the absence of transitional provisions for new regulatory measures, the absence of any explicit recognition of international standards and the fragmented extension of statutory insolvency protection.

**1. CME GROUP**

CME Group is a global provider of risk management and investment solutions. Founded in 1898, it has a long history and deep experience in the management of trading and clearing risks for both exchange traded products and over-the-counter ("**OTC**") derivatives, including in respect of interest rates, equities, foreign exchange, agricultural commodities, energy and metals. In the United States, its subsidiaries include the Chicago Mercantile Exchange Inc. ("**CME**"), the Board of Trade of the City of Chicago, Inc. ("**CBOT**"), the New York Mercantile Exchange, Inc. ("**NYMEX**"), the Commodity Exchange ("**COMEX**"), and the Kansas City Board of Trade ("**KCBT**"). In Europe, its subsidiaries include CME Clearing Europe Ltd. As at the date of this letter, the open interest in OTC transactions cleared through the CME Group's subsidiaries exceeds US\$6 trillion.

**2. THE BILL**

CME Group supports the commitment made in September, 2009 by the leaders of the G-20 nations to improve OTC derivatives markets by mandating that *"All standardized OTC derivative contracts should be traded on exchanges on electronic trading platforms, where appropriate, and cleared through central counterparties"* and that *"OTC derivative contracts should be reported to trade repositories"*. CME Group further supports the commitment made in June, 2010 by the leaders of the G-20 nations to achieve this mandate in an internationally consistent and non-discriminatory way. We believe that in general the Bill is a positive step towards meeting these commitments but should be amended to ensure that the competitive landscape in Hong Kong remains level between all market participants, including local and overseas clearing houses as well as local and overseas clearing brokers.

## 2.1. Transitional Provisions for ATS

The Bill expands the definition of an “**automated trading service**” at clause 53 so that automated trading services (“**ATS**”) will include electronic services for trading and clearing of OTC derivatives. The Bill contains no transitional provisions in respect of this expanded definition.

- (a) Absence of Transitional Provisions Prejudicial - The absence of transitional provisions is likely to prejudice the local Hong Kong financial industry and may increase systemic risk in the short to medium term and possibly the long term, contrary to the G-20 commitment.
- (i) *Bill Limits Availability of ATS Ahead of Coming into Force* - When the Bill comes into operation, any person offering electronic trading and clearing services in respect of OTC derivatives must stop. This is because when the Bill comes into operation, a person offering such services must be authorized to provide ATS for those activities. No person will have been authorized before the Bill comes into operation and thus, on the Bill coming into operation, no person will be in a position to offer electronic trading and clearing services in respect of OTC derivatives.
- (ii) *Bill Limits Availability of ATS After Coming into Force* - Equally, to the extent that it will take time for the Securities and Futures Commission (“**SFC**”) to process applications for authorization after the Bill comes into operation, operators of trading and clearing services will still be unable to offer their services in Hong Kong in the interim time period until the SFC approves their application.

The absence of transitional provisions in the Bill at this time is a deterrent to any operator of any system for trading and clearing OTC derivatives to offering its systems in Hong Kong.

We understand the importance of ensuring that operators of trading and clearing services are properly regulated in Hong Kong. However, it is equally important that market participants have the opportunity to avail themselves of credible trading and clearing services to reduce overall systemic risk. It seems inconsistent on the one hand to mandate the use of trading and clearing systems to reduce systemic risk and on the other hand, to deny market participants local access to trading and clearing systems on the basis that such systems have no credibility until thoroughly vetted by the SFC. The reality is that market participants may already access such systems through clearing brokers outside of Hong Kong. Refusing to allow market participants to access such systems through clearing brokers in Hong Kong only hurts the local Hong Kong finance industry and, to the extent that market participants do not use such systems (whether because of absence of local awareness or additional transactional costs in using overseas clearing brokers), increases systemic risk.

- (b) Transitional Equivalency - A better balance seems to lie in giving operators of trading and clearing systems which meet minimum standards the ability to offer in Hong Kong the same trading and clearing services offered outside of Hong Kong under transitional arrangements which require an application for authorization to be made within a specified time (e.g. the European Securities and Markets Authority has set a 6 month period in which to make an application), which require an applicant to submit to SFC jurisdiction on terms specified in the Bill and which give continued ability to offer such services until the SFC rejects such application or until a long-stop date.

The minimum standards required should provide a reasonable assurance of credibility and should include requirements as to (i) track record, including a minimum number of years of experience operating trading or clearing systems, (ii) capitalization, (iii) regulation under a

regulatory framework which, at a high level, seeks outcomes similar to those sought by the SFC, and (iv) regulatory oversight by a home regulator that is specified by the SFC as an acceptable regulator and that has existing information sharing arrangements in place with the SFC for investigation and enforcement purposes. In respect of (iii) and (iv), it may be desirable to specify certain jurisdictions in the Bill.

## 2.2. Transitional Provisions for Designation of Clearing and Trading Systems

The Bill establishes at clause 9 a bare framework for mandatory reporting, clearing and trading through persons designated by the SFC. The Bill establishes basic criteria for designation. For example, the Bill provides that a designated central clearing counterparty (“CCP”) must be either a recognized clearing house or an authorized ATS in Hong Kong. However, the Bill contains no transitional provisions in respect of the designation of CCPs and trading platforms.

Whilst we support requirements contemplated in the Bill for a designated CCP to be a recognized clearing house or an authorized ATS and a designated trading platform to be a recognized exchange company or an authorized ATS, we believe that transitional arrangements similar to the one proposed above in respect of the authorization of ATS should apply to the designation of CCPs and trading platforms. In other words, an operator of a trading or clearing system should be able to achieve (i) deemed authorization as an ATS on the basis of the transitional criteria proposed above, and (ii) deemed designation as a CCP or trading platform, as the case may be, on the basis that it is deemed to be authorized as an ATS and offers facilities to clear or trade in its home jurisdiction in the same OTC derivatives for which it will be deemed to be designated. The deeming provisions would apply where the operator applied for designation within a specified time of the introduction of a requirement to clear or trade a particular class of OTC derivatives through a designated CPP or trading platform and would cease to have effect on the rejection by the SFC of the application for designation or at a long-stop date.

We believe that these transitional provisions offer a number of benefits:

- (a) Reduction of Systemic Risk – The transitional provisions would support the overall reduction of systemic risk by facilitating the designation of overseas operators of trading and clearing systems, thereby diversifying risk across borders, reducing concentration of risk in Hong Kong and giving Hong Kong greater exposure to international risk management techniques.
- (b) Improved Access to Risk Management by Local Intermediaries - At the same time, there is a risk that overseas operators of trading and clearing systems may be deterred from making their systems available to local Hong Kong intermediaries in respect of OTC derivatives not presently subject to mandatory trading or clearing obligations out of concern that such a business could abruptly come to an end if such OTC derivatives became subject to mandatory obligations to trade or clear through designated persons. The result would be to discriminate against local Hong Kong intermediaries, effectively requiring them to assume greater risk or to increase their transaction costs by accessing such systems indirectly through an overseas clearing broker.

As noted in the CPSS-IOSCO (Committee on Payment and Settlement Systems and International Organization of Securities Commissions) report entitled “Guidance on the Application of the 2004 CPSS-IOSCO Recommendations for Central Counterparties to OTC Derivatives” dated 2010 at section 3, para. (f):

*As the international regulatory community promotes greater use of CCPs for OTC derivatives markets, a growing number of market participants are likely*

*to seek access to OTC derivatives CCPs abroad especially if there are no feasible domestic alternatives.*

- (c) Reduction of Conflicts - The Bill contemplates a requirement that certain trades by prescribed persons be subjected to mandatory trading and clearing. In the absence of subsidiary legislation, the extent, if any, to which these requirements may conflict with requirements in other jurisdictions is unclear. It is possible that, in some cases, an irreconcilable conflict may arise. For example, counterparties to a trade subject to different requirements for mandatory clearing of the trade in both Hong Kong and another jurisdiction cannot physically clear that trade through different CCPs if there is no single CCP designated to clear in both Hong Kong and the other jurisdiction. Similarly, counterparties to a trade, one of which is subject to a requirement to execute the trade on a designated trading platform in Hong Kong and the other of which is subject to a different requirement to execute that same trade on a designated trading in another jurisdiction cannot physically execute that trade through 2 different platforms.

The G-20 commitment to centralized trading and clearing of OTC derivatives may be frustrated if market participants and operators of trading and clearing systems face conflicting requirements in different jurisdictions.

The transitional provisions limit the risk of conflicts by facilitating the designation of overseas trading and clearing system operators as designated CCPs and trading platforms. Where global operators of trading and clearing systems are designated in Hong Kong, it is more likely that a market participant faced with competing requirements to trade or clear through a designated system in Hong Kong and a designated system in another jurisdiction may comply by trading or clearing through a global operator that is designated by both jurisdictions.

### **2.3. Equivalency for ATS and Designated Trading and Clearing Systems**

The Bill gives the SFC broad discretion to authorize ATS and to designate CCPs and trading platforms. The Bill is silent as to the extent to which the SFC should have regard to international developments though we understand that the SFC is sensitive to such developments. Given the international character of OTC derivatives trading, we believe that it is desirable for the Bill to recognize some degree of equivalency in any determination by the SFC as to whether or not to authorize an ATS or to designate a CCP or trading platform. In particular, it seems desirable to enunciate desired regulatory outcomes in making a determination, such outcomes to be consistent with international standards, and to give considerable weight in favour of granting authorization or designation where the SFC is satisfied that an applicant for authorization or designation is subject to a credible regulator overseas whose regulations and oversight result in regulatory outcomes similar to those sought by the SFC.

Whilst Hong Kong should regulate in accordance with its own circumstances, to the extent that it aspires to play a major and growing role as a centre for OTC derivatives trading, it is important that it adhere to international conventions and that it be open to international participants. Indeed, as noted above, the G-20 commitment refers to mandatory trading, clearing and trade reporting in an internationally consistent and non-discriminatory way. Similarly, the CPSS-IOSCO report entitled "Recommendations for Central Counterparties" dated 2004 and co-chaired by Hong Kong's Andrew Sheng notes at para. 1.6 the need for international standards for CCP risk management. Finally, the CPSS-IOSCO report entitled "Guidance on the Application of the 2004 CPSS-IOSCO Recommendations for Central Counterparties to OTC Derivatives" dated 2010 provides at Annex 2 as follows:

*As participants in the market, CCPs are expected to adhere to market protocols or act in a manner that does not conflict with such terms. Divergent practices by CCPs and individual market participants would undermine the market efforts to develop processes to govern and reduce uncertainty in the OTC derivatives markets... Supervisors of CCPs should encourage the use of reliable market conventions by CCPs where appropriate.*

#### **2.4. SIP Extra-Territoriality**

The Bill contemplates imposing registration and regulatory obligations consequent to registration upon persons who hold positions meeting criteria to be established by the SFC and who, accordingly, are regarded as systemically important participants (“SIPs”). It is not clear under the Bill whether or not operators of trading and clearing systems may be regarded as systemically important.

If such operators may be regarded as systemically important and the overall regulatory regime in Hong Kong is not favourable to such operators, who may be based overseas, achieving appropriate regulatory recognition in Hong Kong, it is unclear how the SIP regulations will apply since such operators will not be subject to the territorial jurisdiction of Hong Kong.

#### **2.5. Statutory Insolvency Protection**

The Bill provides at Clause 52 for the SFC to specify CCPs which are authorized as ATS as CCPs to whom statutory insolvency protection will be extended. It is not clear why SFC specification is necessary and why protection should only be given to designated CCPs. It seems that the Bill should extend statutory insolvency protection to all ATS which provide clearing services, whether or not they are specified by the SFC and whether or not they are designated as CCPs.

Any ATS which provides clearing services, whether or not designated as a CCP or specified by the SFC, poses systemic risks which are only magnified by uncertainty as to the application of insolvency laws in the event of the insolvency of a Hong Kong participant in that ATS. On the basis that a fundamental objective is to reduce systemic risk, there seems to be no basis to discriminate amongst ATS.

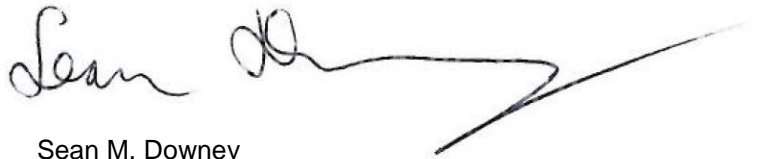
It is notable that recognized clearing houses are not subject to any specification or designation requirement and would therefore be entitled to statutory insolvency protection in the absence of any specification by the SFC or designation as a CCP. Given that both recognized clearing houses and ATS offering clearing services are systemically important in the overall clearing infrastructure, there seems to be no basis to discriminate between recognized clearing houses and ATS.

### **3. CONCLUSION**

We wish to thank the Bills Committee on the Securities and Futures (Amendment) Bill 2013 for the opportunity to comment on this important piece of legislation. We re-iterate that we support the aims of the legislation and we hope that the concerns that we have raised will be addressed.

Should you have any comments or questions with respect to our comments, please feel free to contact us.

Sincerely,

A handwritten signature in black ink, appearing to read "Sean M. Downey", followed by a long, sweeping horizontal line that extends to the right.

Sean M. Downey  
Senior Director and Associate General Counsel

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