Frequently Asked Questions

on the Implementation and Operation of the Mandatory Clearing Regime

(March 2023)

*These FAQs elaborate on how the mandatory clearing regime under the Securities and Futures (OTC Derivative Transactions – Clearing and Record Keeping Obligations and Designation of Central Counterparties) Rules (**Clearing Rules**) will operate and are intended to help market participants better understand their obligations and responsibilities under the Clearing Rules so that they are better able to prepare for implementation of the new regime and ensure compliance going forward.*

transaction is 1 July 2017, i.e. there is a gap of 10 months from the date the Clearing Rules come into operation on 1 September 2016. This is explained in Q6 below.

Persons subject to clearing and record keeping obligations

Q4. Who would be subject to the mandatory clearing and related record keeping requirements?

The Clearing Rules at present are intended to cover specified OTC derivative transactions entered into between major dealers. The clearing and record-keeping obligations apply to the following persons:

(a) an authorized institution (**AI**);

(b) an approved money broker (**AMB**); or

(c) a licensed corporation (**LC**).

In respect of an AI and AMB that is incorporated overseas, the obligations apply only to the transactions that are recorded in the Hong Kong books of that AI and AMB, and transactions that are not recorded in the Hong Kong books are not subject to the obligations.

AIs, AMBs and LCs will need to ensure that their specified OTC derivative transactions are cleared in accordance with the Clearing Rules if circumstances for triggering mandatory clearing are met.

Circumstances clearing obligation is triggered

Q5. Under what circumstances are specified OTC derivative transactions subject to clearing obligation?

An AI, AMB or LC must centrally clear a specified OTC derivative transaction if the following circumstances are all met –

(a) The AI, AMB or LC has reached the clearing threshold. (Please see Q6 to Q10 on clearing threshold, calculation of average total position and average local total position, and types of transactions to be included in the calculation.)

(b) The transaction is entered into on or after the prescribed day for the calculation period in respect of which the AI, AMB or LC reached the clearing threshold for the first time (or for the first time agaw -15.()Tj 0.0l met

The clearing threshold is set out in Schedule 2 to the Clearing Rules. It is currently set at US$ 20 billion for all calculation periods specified in the rules. We may lower the threshold in future as appropriate.

Q8. When is a person regarded as having reached the clearing threshold?

A person has reached the clearing threshold if its applicable position for a calculation period equals or exceeds the clearing threshold for that calculation period. (Please see Q9 below for the calculation of the applicable position)

The person is regarded as having reached the clearing threshold at all times thereafter, even if the person's applicable position falls below the threshold for a subsequent calculation period, until an exit notice is given. (Please see Q35 and Q36 in relation to exit notice.)

The HKMA and the SFC jointly published the list of prescribed persons that have reached the clearing threshold on the SFC website – please see the latest update under the section "List of prescribed persons that have reached the clearing threshold for the purposes of Mandatory Clearing":

https://www.sfc.hk/en/Rules-and-standards/OTC-derivatives-regulatory-regime

Average total position and average local total position

Q9. How should a person calculate its applicable position in relation to its clearing threshold?

For a person that is a local AI/AMB/LC, its applicable position is its average total position which is calculated by taking a simple arithmetic average of the three month-end snapshots of the total position of the person over the 3-month calculation period.

For a person that is an overseas AI/AMB/LC, its applicable position is its average local total position which is calculated by taking a simple arithmetic average of the three month-end snapshots of the person's local total position over the 3-month calculation period. In other words, this calculation only takes into account the position that is booked in the person's Hong Kong branch.

Total position and total local position are the aggregate of notional amounts of applicable trades, calculated on a gross basis, i.e. without netting. Please see further elaboration in Q10.

2. persons that belong to a group of companies appearing on the list of global systemically important banks published by the Financial Stability Board, and/or on the list of dealer groups which undertook to the OTC Derivatives Supervisors Group to work collaboratively with CCPs, infrastructure providers and global supervisors to continue to make structural improvement to the global OTC derivatives markets.

The factors that are relevant to determining the list of financial services providers may also change when we expand our clearing obligation in the future to cover a wider range of entities. We will review the list of financial services providers from this perspective.

We perform an annual update of the list of financial services provider

Item	Currency	Floating rate index	Tenor	Optionality	Constant notional
3.	GBP	LIBOR	28 days to 10 years	No	Yes
4.	JPY	LIBOR	28 days to 10 years	No	Yes
5.	HKD	HIBOR	28 days to 10 years	No	Yes

(b) a fixed-to-floating swap (except an overnight index swap) that has all of the features specified for an item in a row of the table below –

Item	Currency	Floating rate index	Tenor	Optionality	Constant notional
1.	USD	LIBOR	28 days to 10 years	No	Yes
2.	EUR	EURIBOR	28 days to 10 years	No	Yes
3.	GBP	LIBOR	28 days to 10 years	No	Yes
4.	JPY	LIBOR	28 days to 10 years	No	Yes
5.	HKD	HIBOR	28 days to 10 years	No	Yes

(c) an overnight index swap that has all of the features specified for an item in a row of the table below -

Item	Currency	Floating rate index	Tenor	Optionality	Constant notional
1.	USD	Fed Funds	7 days to 2 years	No	Yes
2.	EUR	EONIA	7 days to 2 years	No	Yes
3.	GBP	SONIA	7 days to 2 years	No	Yes

Q13. Are historical transactions subject to clearing obligation?

No, historical transactions are not subject to clearing obligation under the Clearing Rules. Only specified OTC derivative transactions which the person entered into on or after the prescribed day that corresponds to the calculation period with respect to which the person reached the clearing threshold for the first time (or for the first time again after giving an exit notice) will be subject to the clearing obligation when other criteria are satisfied (see Q5 above). Please see Q6 above for the different calculation periods and their corresponding prescribed days.

Q14. Is a swaption subject to clearing obligation?

A swaption is an option to enter into a swap transaction, and is not itself a swap transaction. As it does not fall within the definition of IRS in the Clearing Rules, it is not subject to clearing.

Q15. Is an IRS entered into pursuant to the physical exercise of a swaption subject to clearing obligation?

An IRS entered into on or after the relevant prescribed day pursuant to the physical exercise of a swaption may be subject to clearing if:

(a) it falls within the definition of IRS under the Clearing Rules and its features meet the specified criteria set out in Schedule 1 to the Clearing Rules, and

(b) the corresponding swaption is e3 (nt)-2 (e)4 (r)-7 (e)4 i1-1 (is)Tj 0 Tcn107 0 T4 (y b

swap. It falls within the definition of fixed-to-

(b) the date from which the exemption is to take effect and the date must not be backdated, i.e. it must not be earlier than the day the notice is received by the HKMA or the SFC.

Point to note:

There is no need to provide a similar exemption for overseas incorporated AI/AMB because OTC derivative transactions that are booked overseas for an overseas incorporated AI/AMB are not subject to the Clearing Rules.

The exemption will only apply to transactions that are entered into on or after the effective date(s) specified in the exemption notice.

Q27. Can a person change the list of exempt jurisdictions in its previously submitted exemption notice?

A person may change its list of exempt jurisdictions from time to time. However, when an exempt jurisdiction is removed from the list, it may only be reinstated into the exempt jurisdiction list ***one more time***.

In other words, if an exempt jurisdiction is removed from the list the second time, it can never be added back to the list and new transactions booked in that jurisdiction after the second removal will not be able to benefit from the exemption under Rule 9. This is set out in Rule 9(5) of the Clearing Rules.

Q28. What are the conditions under Rule 9(2) of the Clearing Rules that must be satisfied in respect of the exempt jurisdiction exemption?

Rule 9(2) requires that the total position of the person for ***each*** exemption jurisdiction does not exceed 5% of the total position of the person and the total position for all exemption jurisdictions added together does not exceed 10% of the total position of the person.

If the total position of the person for any ***one*** exempt jurisdiction on the list specified in the exemption notice exceeds the 5% threshold, then the requirement under Rule 9(2)(a) is not met, and consequently, the exemption for not only that exempt jurisdiction but also ***all other*** exempt jurisdictions on the list will cease. Therefore, a person should remove any exempt jurisdiction that will not be able to comply with the 5% threshold in advance, so that the exemption in respect of the other exempt jurisdictions on the list will not be affected.

Similarly, if any increase of the total position of one exempt jurisdiction on the list is going to bring the total position of all exempt jurisdictions above the 10% threshold, the person should take action (e.g. remove that particular exempt jurisdiction) in advance to bring the total position down, so that the person can continue to utilise the exemption.

It is therefore critical that the list of exempt jurisdictions is kept up-to-date at all times and the person that is relying on the exemption closely monitors the level of activity in each exempt jurisdiction.

Q29. How can a person remove an exempt jurisdiction from the list?

When a person becomes aware that total position of an exempt jurisdiction will not be able to meet the requirements in the near future, it should give a cessation notice in respect of that jurisdiction as soon as possible to the HKMA or the SFC, as applicable. The cessation notice must specify the following –

(a) the jurisdiction(s) that will no longer be regarded as exempt jurisdiction(s); and

(b) the date from which the jurisdiction is no longer regarded as an exempt jurisdiction and the date must not be backdated, i.e. it must not be earlier than the day the n

Exemption for transactions resulting from multilateral portfolio compression exercise

Q30. What are the requirements in order for transactions resulting from multilateral portfolio compression exercise to benefit from the exemption?

According to Rule 10(1) of the Clearing Rules, (a) the transaction must be entered into by a person as a result of a multilateral portfolio compression exercise and with a participant in the exercise that was a counterparty to one or more of the compressed transactions; and (b) Rule 6(1) of the Clearing Rules did not apply to the person to any of the compressed transactions, under the multilateral portfolio compression exercise.

The meaning of a multilateral compression exercise is set out in Rule 10(3) of the Clearing Rules.

Substituted compliance

Q31. Relief in the form of substituted compliance is available. What does this mean and how does it provide relief to a person subject to clearing obligation?

When a cross-border transaction is entered into by a person, the transaction may be subject to more than one set of clearing requirements (from Hong Kong or the jurisdiction in which one of the counterparties to the transaction is based or incorporated) and the different sets of requirements may be duplicative or conflicting. Substituted compliance addresses such potential duplication or conflict by confirming that compliance with the overseas clearing requirements will suffice.

Rule 11 of the Clearing Rules essentially provides that clearing obligation is taken to have been complied with if the transaction has been cleared under the laws of a comparable jurisdiction through a designated CCP. Specifically, a transaction is taken to have complied with the Clearing Rules if –

(a) under the laws of the comparable jurisdiction, that transaction is required to be cleared with a CCP;

(b) the transaction has been cleared with a CCP in accordance with the laws of the comparable jurisdiction; and

(c) that CCP is a CCP that has been designated by the SFC under section 101J of the SFO.

Q32. What does the "stricter rule" approach under the substituted compliance framework mean and how does it work?

How to comply with clearing obligation

Q37. What are the steps a person needs to take to comply with clearing obligation under the Clearing Rules?

When a person has determined that the transaction it has entered into is subject to clearing obligation, it should ensure that the transaction is submitted to a designated CCP for central clearing, and that the transaction has been accepted for clearing by that CCP within the allowed timeframe. This includes taking the following steps-

(a) The person must have taken all reasonable steps to ensure that the transaction will be cleared by the designated CCP. For example, it must at least have complied with all the relevant requirements of the CCP's rules so that the CCP is not entitled to reject the transaction on account of anything that the person has done or failed to do.

(b) The person must have followed up on whether the transaction has been accepted

Record keeping requirements

Q40. What records do I need to keep in relation to the clearing obligation?

The list of records to be kept is set out in Part 3 of the Clearing Rules, and in particular, Rule 14 sets out the types of records to be kept.

Q41. For how long must the records be kept?

Records required to be kept in relation to a specified OTC derivative transaction must be kept for at least 5 years after maturity or termination of the transaction.

Q42. Are transactions of an overseas AI or overseas AMB that are booked outside of Hong Kong subject to the record keeping requirements?

Rule 6(1)(a)(ii) of the Clearing Rules excludes a transaction of an overseas AI or overseas AMB that is booked outside of Hong Kong from clearing obligation. Accordingly, there is also no record keeping obligation for such a transaction.

Consequences of breaches

Q43. What are the consequences of breaching the clearing or record keeping obligation?

Compliance with the clearing and record keeping obligations is a legal requirement. In the event of a breach, the HKMA (in the case of a breach by an AI or AMB) or the SFC (in the case of a breach by any other person) may apply to the Court of First Instance, which may then inquire into the case. If satisfied that there is no reasonable excuse for the breach, the Court may impose a financial penalty of up to HKD 5 million. Additionally, the HKMA (in the case of a breach by an AI or AMB) and the SFC (in the case of a breach by an LC) may take disciplinary action against the person in respect of the breach.

Q44. What is the consequence when a person has obtained confirmation from a counterparty that it has not reached the clearing threshold, and subsequently it comes to light that the counterparty has in fact reached the clearing threshold at the relevant time?

Where the person has received the confirmation in good faith, the confirmation should provide a reasonable excuse (in the case of any action under section 101F or 101G of

the SFO) and a mitigating factor (in any disciplinary proceedings against the person) for not having centrally cleared the transaction in question.

Hong Kong Monetary Authority
Securities and Futures Commission

Annex 1

List of comparable jurisdictions

1. Australia
2. Austria
3. Belgium
4. Brazil
5. Bulgaria
6. Canada
7. Croatia
8. Czech Republic
9. Denmark
10. Estonia
11. Finland
12. France
13. Germany
14. Greece
15. Hungary
16. Ireland
17. Italy
18. Japanitaly

10. 1]TJ EMC

Annex 2

List of designated CCPs

1. Chicago Mercantile Exchange Inc
2. Japan Securities Clearing Corporation
3. LCH Limited
4. OTC Clearing Hong Kong Limited