

Frequently Asked Questions
on the Implementation and Operation of the Mandatory Clearing Regime

(July 2024)

*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.*

Table of Contents

Definitions and interpretation.....	3
Legislation and technical guidance	3
Commencement date	3
Transitional arrangement.....	3
Persons subject to clearing and record keeping obligations	4
Circumstances clearing obligation is triggered	4
Calculation period, prescribed day and clearing threshold.....	5
Average total position and average local total position.....	6
Financial services providers	7

Definitions and interpretation

Unless the context otherwise requires, terms defined in Schedule 1 to the SFO or in the Clearing Rules bear the same meaning when used in the questions and answers below, and the following terms bear the following meanings:

- **“Clearing Rules”** means the Securities and Futures (OTC Derivative Transactions – Clearing and Record Keeping Obligations and Designation of Central Counterparties) Rules (Chapter 571AN, Laws of Hong Kong);
- **“HKMA”** refers to the Hong Kong Monetary Authority;
- **“SFC”** refers to the Securities and Futures Commission;
- **“SFO”** refers to the Securities and Futures Ordinance (Chapter 571, Laws of Hong Kong);
- **“specified OTC derivative transaction”** means an OTC derivative transaction that is specified in section 2 of Schedule 1 to the Clearing Rules, which will be subject to mandatory clearing if certain criteria are satisfied.

Legislation and technical guidance

Q1. Where are the clearing and record keeping requirements set out?

The broad framework for clearing and record keeping obligations is contained in Part IIIA of the SFO, and the detailed requirements are set out in the Clearing Rules.

These documents are accessible at the Hong Kong e-Legislation database website: www.elegislation.gov.hk.

Commencement date

Q2. When did the clearing and record keeping obligations start to operate?

The requirements for clearing and record keeping obligations came into operation on 1 September 2016.

Transitional arrangement

Q3. Is there any transitional arrangement for complying with the mandatory clearing requirements?

No, there is no provision for transitional arrangement under the Clearing Rules. That said, the first date a person may be required to clear a specified OTC derivative

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 again after giving an exit notice). (Please see Q6 on calculation period and prescribed day and Q35 and Q36 on exit notice.)

- (c) The counterparty is an AI/AMB/LC and is also required to clear the transaction concerned (i.e. circumstances (a) and (b) above are applicable to that counterparty), or the counterparty is a financial services provider. (Please see Q11 below for the definition of a financial services provider.)

Calculation period, prescribed day and clearing threshold

Q6. What is a calculation period and what is a prescribed day in relation to a calculation period?

A calculation period is the period in which a person's applicable position in OTC derivatives is calculated to determine whether it has reached the clearing threshold. Please see Q8 to Q10 for further information. There are multiple calculation periods. Each calculation period is three months in duration and there is in general a six-month interval between the start of one calculation period and the start of the next one. We may extend this six-month gap in future as appropriate.

A prescribed day in relation to a calculation period is the day which is seven months after the end of the calculation period. For a person who has reached the clearing threshold for the first time in a calculation period, the clearing obligation will only apply to future transactions entered into on or after the prescribed day for that calculation period. This is to allow one month for the calculation of the applicable position and six months for setting up the infrastructure and completing the documentation and on-boarding exercise for central clearing.

When mandatory clearing was implemented, there were four calculation periods specified in Schedule 2 to the Clearing Rules, each with its corresponding prescribed day. The first calculation period ran from 1 September 2016 to 30 November 2016. The first prescribed day was 1 July 2017, seven months after 30 November 2016. This explains the 10-month gap between the commencement of the Clearing Rules and the first date a person may be required to clear a specified OTC derivative transaction. Over time, we have since added new calculation periods to Schedule 2 to ensure that the Clearing Rules continue to operate effectively.

The current list of the calculation periods and their corresponding prescribed days, as set out in Schedule 2 to the Clearing Rules, can be found at this link: <https://www.elegislation.gov.hk/hk/cap571AN>.

Q7. What is the clearing threshold for an AI/AMB/LC?

Q10. What transactions are included in the calculation of the total position?

Q19. Is a zero coupon swap subject to mandatory clearing?

A zero coupon swap is an exchange of income streams in which the stream of floating rate interest payments is made periodically, but the stream of fixed rate payments is made as one lump-sum payment at maturity instead of periodically over the life of the swap. It falls within the definition of fixed-to-floating swap in Schedule 1 to the Clearing Rules. It will be subject to mandatory clearing if it has the

Exempt affiliate exemption

Q23. How does an exempt affiliate exemption under Rule 8 operate and what are the requirements?

Transactions with an exempt affiliate do not have to be subject to mandatory clearing if -

- (a) the accounts of the person and the exempt affiliate are consolidated in full by the holding company; and
- (b) the risk evaluation, measurement and control procedures applicable to the person and the exempt affiliate are centrally overseen and managed within the group.

In respect of (a), the consolidated accounts of the holding company must be prepared in compliance with the accounting standards issued by the Hong Kong Institute of Certified Public Accountants or the International Accounting Standards Board, or the standards of accounting practices applicable to the holding company in its place of incorporation.

In respect of (b), we would expect that, for instance, there is a centralised evaluation, measurement and control function to oversee the risks relating to OTC derivative transactions of the person and its exempt affiliates for which the exemption is being sought.

Q24. What does a person have to do in order for an affiliate to become an exempt affiliate under Rule 8 of the Clearing Rules?

The person must send an exemption notice to either the HKMA or the SFC. The exemption notice should specify –

- (a) the identity of the affiliate(s) to be regarded as an exempt affiliate and more than one affiliate may be included in the exemption notice; and
- (b) the date from which the exemption is to take effect and that date must not be backdated, i.e. it must not be earlier than the day the notice is received by the HKMA or SFC.

The exemption will only apply to transactions that are entered into by the person with the relevant exempt affiliate(s) on or after the effective date(s) as specified in the exemption notice.

Point to note:

An **affiliate** of a person is a corporation that is in the same group of companies as the person, except a corporation that is a collective investment scheme.

Q25. What should a person do if it becomes aware that an affiliate will no longer meet the requirements set out in Rule 8(2) of the Clearing Rules after an exemption notice has been sent in respect of that affiliate to the HKMA or the SFC?

When a person becomes aware that an affiliate will no longer meet the requirements, it should give a cessation notice to the HKMA or the SFC. A cessation notice must specify the following –

- (a) the identity of the affiliate(s) that will no longer be regarded as an exempt affiliate; and
- (b) the date ^{anha} from which the affiliate is no longer an exempt affiliate 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.

It is the responsibility of the person (that otherwise has the clearing obligation) to ensure that it is entitled to benefit from the exemption. As and when an exempt affiliate ceases to meet

To benefit from the exemption, a person must send an exemption notice to the relevant regulator (if it is an LC, to the SFC, and if it is a locally incorporated AI or AMB, to the HKMA). The exemption notice should specify –

- (a) the jurisdiction(s) that is to be regarded as exempt jurisdiction(s) and more than one jurisdiction may be included in the

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 believes that an exempt jurisdiction on the list will no longer be able to comply with the 5% threshold, the person should remove that jurisdiction from the list in advance to ensure that the exemption is not lost.

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?

The substituted compliance framework operates on a stricter rule approach. By that, it means if a transaction is exempted from clearing in a comparable jurisdiction, substituted compliance is not applicable. That transaction will have to be cleared under the Clearing Rules.

This can happen, for example, when a comparable jurisdiction has in place a clearing obligation, but that particular transaction is exempted from mandatory clearing, for example, due to exemption on the types of persons or particular products that we do not provide similar exemption or relief for. In such a situation, under our stricter rule approach, we will then require the transaction to be cleared under the Clearing Rules.

Q33. Which jurisdictions are on the list of comparable jurisdictions?

The list of comparable jurisdictions has been gazetted and the initial list comprises of member jurisdictions of the OTC Derivatives Regulators Group (ODRG). They are set out in Annex 1.

Q34. Will more jurisdictions be added to the list of comparable jurisdictions?

We have used member jurisdictions of ODRG as a starting point for the list of comparable jurisdictions. We anticipate that more jurisdictions will be added to the list as the global regulatory reform in respect of OTC derivative markets makes further progress. We will continue to monitor international developments in this area and consider whether new jurisdictions should be added to the list. The market will be consulted before the list is expanded.

Exit from clearing obligation

Q35. What is an exit threshold and how does it work?

An exit threshold serves to determine how a person can exit from its clearing obligation when, for instance, there is a permanent change in the person’s trading profile or business model. An exit notice may be given by a person under Rule 6(3) when its applicable position (on a gross basis) as at the last day of each month falls below the exit threshold of US\$14 billion (70% of the clearing threshold of US\$20 billion) for a *period of 12 consecutive months*.

A person that has reached the exit threshold may give an exit notice to the HKMA or the SFC (as applicable) confirming that its applicable position is below US\$14 billion for 12 consecutive months and specifying the 12-month period and its applicable position on the last day of each month during the 12-month period. It must also confirm that its applicable position has not equalled or exceeded the exit threshold between the last day of the last month included in the 12-month period and the day on which the exit notice is given.

Once an exit notice is given, the person will no longer be regarded as having reached the clearing threshold and thus released from the clearing obligation.

Points to note:

For the purposes of determining whether a person has reached the exit threshold, the applicable position refers to: -

- (a) For a person that is a local AI/AMB/LC, the “total position” as defined in the Clearing Rules, being the aggregate notional amounts of all outstanding OTC derivative transactions (other than deliverable FX forwards and deliverable FX swaps);
- (b) For a person that is an overseas AI/AMB/LC, the “local total position” as defined in the Clearing Rules, being the aggregate notional amounts of all outstanding OTC derivative transactions (other than deliverable FX forwards and deliverable FX swaps), excluding every outstanding trade that is recorded in the person’s overseas books. In other words, this calculation only counts the position that is booked at the person’s Hong Kong branch.

Calculation of the applicable position is on a “gross” notional basis, without any netting.

Q36. What happens when the person subsequently reaches the clearing threshold again, after it has given an exit notice to the relevant regulator?

If the person subsequently reaches the clearing threshold after giving an exit notice, it

Tw 15.42 0 atyor()JTJ -0c 0.17r()JTc (ha)4 (t)-t cleriliatia aie-2 (he)4 ()JTJ -0.004 Tc 0.004

How to comply with clearing obligation

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 a breach of the clearing obligation?

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. Japan
19. Latvia
20. Lithuania
21. Luxembourg
22. Malta
23. Netherlands
24. Poland
25. Portugal
26. Republic of Cyprus
27. Romania
28. Singapore
29. Slovakia
30. Slovenia
31. Spain
32. Sweden
33. Switzerland
34. United Kingdom
35. United States

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