

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

(4 March 2020)

These FAQs elaborate on how the mandatory clearing regime under the Securities and Futures (OTC Derivative Transactions –

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.....	7
Financial services providers	8
Transactions subject to mandatory clearing	9
Exemptions from clearing obligation.....	12
Exempt affiliate exemption	13
Exempt jurisdiction exemption	15
Exemption for transactions resulting from multilateral portfolio compression cycle	17
Substituted compliance.....	18
Exit from clearing obligation.....	19
How to comply with clearing obligation	20
Time allowed to clear	

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:

- **“HKMA”** refers to the Hong Kong Monetary Authority;
- **“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);
- **“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

	Calculation period	Prescribed day
1.	1 September 2016 to 30 November 2016	1 July 2017
2.	1 March 2017 to 31 May 2017	1 January 2018
3.	1 September 2017 to 30 November 2017	1 July 2018
4.	1 March 2018 to 31 May 2018	1 January 2019
5.	1 March 2019 to 31 May 2019	1 January 2020
6.	1 September 2019 to 30 November 2019	1 July 2020
7.	1 March 2020 to 31 May 2020	1 January 2021
8.	1 September 2020 to 30 November 2020	1 July 2021
9.	1 March 2021 to 31 May 2021	1 January 2022
10.	1 September 2021 to 30 November 2021	1 July 2022
11.	1 March 2022 to 31 May 2022	1 January 2023
12.	1 September 2022 to 30 November 2022	1 July 2023

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

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:

<https://www.sfc.hk/web/EN/files/SOM/OTC/List%20of%20Institutions%20that>

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.

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

Whilst only certain types of plain vanilla Interest Rate Swap (**IRS**) transactions are subject to mandatory clearing, for the purposes of calculation of the total position, **all** outstanding OTC derivative transactions are to be counted, **except for** transactions in deliverable FX forwards and deliverable FX swaps which the Clearing Rules have specifically excluded. Outstanding OTC derivative transactions refer to transaction which have not been matured or early terminated and to which the person is a counterparty.

Accordingly, this means that outstanding transactions –

1. that are entered into before and during the calculation period;
2. that are exempted; or
3. that are outside the scope of the first phase of clearing mandate

must also be included in the calculation of total position or local total position, as applicable.

For avoidance of doubt, any OTC derivative transactions not required to be cleared (whether by reason that the person has not yet reached the clearing threshold, the transactions are not specified OTC derivative transactions, or by any other reason) will still have to be included in the calculation.

However, intra-company transactions between (i) two trading desks or (ii) branches/offices of the same entity do not have to be included in the calculation.

Financial services providers

Q11. Who are financial services providers?

A financial services provider refers to a person that is designated by the SFC with the HKMA's consent pursuant to Rule 3(1) of the Clearing Rules. The current list of designated financial services providers has been published in the Government gazette and is reproduced in Annex 1 to this FAQ for ease of reference.

As we intend to cover only dealer-to-dealer transactions for now, only persons that meet the following criteria are included in the current gazette list of financial services providers –

- 1.

Point to note:

If the clearing obligation is applicable to a transaction between an AI/AMB/LC and a financial services provider, the responsibility for ensuring compliance with clearing obligation rests with the AI/AMB/LC and not with the financial services provider.

Transactions subject to mandatory clearing

Q12. What OTC derivative transactions are subject to the clearing obligation?

Only specified OTC derivative transactions which are set out in Schedule 1 to the Clearing Rules are subject to clearing obligation under the Clearing Rules (reproduced below for ease of reference) –

(a) a basis swap that has all

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

Item

Q16. Will an IRS become subject to mandatory clearing as a result of an

transaction was subject to clearing, the new transaction will be subject to clearing also.

Additionally, the new IRS transaction may be subject to clearing even if the old transaction was not. This can happen when the old transaction is a historical transaction executed prior to the prescribed day for a calculation period and the novation may happen after the relevant prescribed day.

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 features specified in Schedule 1 to the Clearing Rules.

Q20. What are the applicable floating rate indexes for IRS?

The applicable floating rate indexes are set out in Schedule 1 to the Clearing Rules. References to floating rate indexes include all valid quoting sources.

However, certain indexes may not be relevant if they are no longer maintained. For example, we do not expect HIBOR-ISDC will be used as it is no longer maintained by the International Swap and Derivatives Association.

The list of indexes may evolve over time but changes will be subject to consultation and the industry will be given time to make necessary arrangements before changes are implemented.

Q21. Are intra-company transactions subject to mandatory clearing?

Intra-company transactions between (i) two trading desks or (ii) branches/offices of the same entity are not subject to mandatory clearing.

Exemptions from clearing obligation

Q22. Are there any exemptions from the clearing obligation?

Yes. There are three exemptions available and they are -

- (a) transactions with an exempt affiliate – Rule 8 of the Clearing Rules (see Q23 to Q25 below);
- (b) transactions recorded in the books of an exempt jurisdiction – Rule 9 of the Clearing Rules (see Q26 to Q29 below); and
- (c) transactions resulting from multilateral portfolio compression cycle – Rule 10 of the Clearing Rules (see Q30 below).

The three exemptions are subject to certain requirements being fulfilled as set out in the Clearing Rules.

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 -

1. the accounts of the person and the exempt affiliate are consolidated in full by the holding company; and
2. 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 H0(om)-2 (pu491 (al)-6 (l)-26

- (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 –

1. the identity of the affiliate(s) that will no longer be regarded as an exempt affiliate; and
2. the date 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 the requirements under Rule 8(2) of the Clearing Rules, if a cessation notice has not been sent to the relevant regulator, any new transaction between the person and that affiliate cannot benefit from the exempt affiliate exemption.

Point to note:

Only transactions after the affiliate stops meeting the requirements under Rule 8(2) of the Clearing Rules are not exempted from clearing. Historical transactions prior to that date are not affected.

Exempt jurisdiction exemption

Q26. How does an exempt jurisdiction exemption under Rule 9 operate, and what are the procedures to follow if a person wishes to benefit from the exemption?

An exempt jurisdiction exemption is available to an LC or a local AI/AMB. This exemption applies to the transactions of such an institution that are booked in its branch in certain overseas jurisdictions provided that the conditions in Rule 9(2) are met. (PWF 61/s (uc)4.n

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 , the 0.048 c 0 T tpt 1 (on)]j 0 T ti, t d36 0 Tc 0 T that et, s [(, s)-1 (ob)

2. the date from which the jurisdiction is no longer regarded as an exempt jurisdiction

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

1. 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);
2. For a person that is an overseas AI/AMB/LC,

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 for clearing by the designated CCP, and if not, it must have taken all reasonable steps to ensure that the transaction is cleared as soon as possible within the timeline, including through another designated CCP if necessary.

Point to note:

The list of designated CCPs is set out in Annex 3.

Time allowed to clear

Q38. What is the time allowed to comply with clearing obligation?

A transaction has to be cleared with a designated CCP within one business day after the transaction has been entered into, i.e. on a T+1 business day basis. The term “business day” refers to a business day in Hong Kong.

Q39. What happens if a person is not able to clear the specified OTC derivative transaction in time?

If the transaction remains uncleared due to factors outside the person’s control, the person may have to terminate >>B deu1S h clte1e4. (>>i c Tc 0 Tw 8n)-14 (eo21 (t)+B de)3e

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) a

Annex 1

List of designated financial services providers (effective on 1 January 2020)

1. Abbey National Treasury Services plc
2. Agricultural Bank of China Limited
3. Banco Santander S.A.
4. Bank of America, N.A.
5. Bank of America Merrill Lynch International Designated Activity Company
6. Banque Palatine S.A.
7. Barclays Bank Ireland Plc
8. Barclays Bank PLC
9. Barclays Bank UK PLC
10. Barclays Capital Inc.
11. BNP Paribas Fortis SA/NV
12. BNP Paribas SA
13. BNP Paribas Securities Corp.
14. BofA Securities Europe SA
15. CACEIS Bank SA
16. Citibank, N.A.
17. Citigroup Global Markets Europe AG
18. Citigroup Global Markets Inc.
19. Citigroup Global Markets Japan Inc.
20. Citigroup Global Markets Limited
21. Credit Agricole Corporate and Investment Bank
22. Credit Foncier de France
23. Credit Suisse (Schweiz) AG
24. Credit Suisse AG
25. Credit Suisse International
26. Credit Suisse Securities (Japan) Limited
27. Credit Suisse Securities Sociedad de Valores, S.A.
28. Credit Suisse Securities (USA) LLC
29. Deutsche Bank AG

30. Deutsche Bank Securities Inc.
31. DB Privat- und Firmenkundenbank AG
32. Goldman Sachs & Co. LLC
33. Goldman Sachs Bank Europe SE
34. Goldman Sachs Bank USA
35. Goldman Sachs Financial Markets Pty Ltd
36. Goldman Sachs International
37. Goldman Sachs Japan Co., Ltd.
38. HSBC Bank plc
39. HSBC Bank USA, N.A.
40. HSBC France
41. HSBC Securities (USA) Inc.
42. HSBC UK Bank plc
43. ING Bank N.V.
44. ING Bank Sla(a)4 4 (44.)Tj (.)TJ 6.2 0 Td ()Tj EMC /LBody .45 0 Td ()Tj El (a)4
6145 Td 200 1 Tf 1.d (38.T1 1 Tf ()Tj /TT0 1 [(G)-e (N)-0 >>u/

65. MUFG Securities EMEA plc
66. NATIXIS
67. National Westminster Bank Plc
68. NatWest Markets N.V.
69. NatWest Markets plc
70. Nomura Financial Products & Services, Inc.
71. Nomura Global Financial Products, Inc.
72. Nomura International plc
73. Nomura Securities Co., Ltd.
74. Nomura Securities International, Inc.
75. Nordea Bank Abp
76. RBC Capital Markets, LLC
77. RBC Europe Limited
78. Royal Bank of Canada
79. Santander Investment Securities Inc.
80. SG Americas Securities LLC
81. SMBC Capital Markets Inc.
82. SMBC Nikko 04 Tc 0.014 Tw 1.5 0 Td [(S)-8 (an)-4 (t)-6 (an)-4 (d)6 (o)1.65 Td (620 Tw 11.2

Annex 2

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

Annex 3

List of designated CCPs

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