

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

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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) Rule (Chapter 571A, 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

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

- (b) The transaction is entered into on or after the prescribed day for the calculation period in respect of which the, AMB or LC reached the clearing threshold for the first time(

	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 Q35 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>

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, intracompany transactions between (i) 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. persons that are clearing members of the largest IRS central counterparties (CCPs) in the US, Europe, Japan and Hong Kong; and
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 based on a snapshot of the entities that would fall within the criteria at the end of each calendar year, and consult the market within Q1 of the following year. The effective date for the revised list of financial services providers will be the Prescribed Day that corresponds to the Calculation Period that is nearest to when the consultation conclusion is published.

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 amendment to its original terms or the occurrence of certain life cycle events?

defined in the SFO, the structure itself falls outside the scope of “OTC derivative product” (as defined in the SFO). The IRS, being only an embedded feature of the structure, will not be subject to mandatory clearing.

Q18. Is an IRS created as a result of novation subject to clearing obligation?

An IRS transaction that results from a novation will be subject to clearing if its features meet the specified criteria set out in Schedule 1 to the Clearing Rules. As these features are likely to be the same for both the original transaction and the new transaction resulting from the novation, it follows that if the original 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 and 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 or BCD 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 (see Q31 to Q34 below).

In respect of (b), we would expect that, for instance, there a centralised

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

When a person becomes aware that the 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:

1. the jurisdiction(s) that will no longer be regarded as exempt jurisdiction(s); and
2. 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 notice is received by the HKMA or the SFC as applicable.

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 the total position of an exempt jurisdiction or the total position of all exempt jurisdictions (as the case may be) ceases to meet the requirements under Rule 9(2) of the Clearing Rules, even if a cessation notice has not been sent to the relevant regulator, any new transaction in respect of an exempt jurisdiction on this date cannot benefit from the exempt jurisdiction exemption.

Point to note:

Only new transactions after the total position of an exempt jurisdiction stops meeting the requirements under Rule 9(2) of the Clearing Rules are exempted from clearing. Historical transactions prior to that date are not exempted from clearing. Historical transactions prior to that date are not exempted from clearing. Historical transactions prior to that date are not exempted from clearing.

2. involves more than 2 participants and the operator cannot be a participant (i.e. a bilateral compression will not be able to benefit from the exemption) and
3. is conducted in compliance with the risk tolerance levels set by the participants in the cycle

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 and the jurisdiction in which one of the counterparties to [()]-2 (ur)3 (l)-10 ()-6 (ear2 (ga)-2 (ur)

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 2.

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 in this area

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 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 the transaction with its counterparty within the T + 1 business day timeframe in order to avoid breaching the Clearing Rules.

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 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?

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Hong Kong Monetary Authority
Securities and Futures Commission

Annex 1

List of designated financial services providers effective on 1 January 2021

34. Goldman Sachs & Co. LLC
35. Goldman Sachs Bank Europe SE
36. Goldman Sachs Bank USA
37. Goldman Sachs Financial Markets Pty Ltd
38. GoldmanSachs International
39. Goldman Sachs Japan Co., Ltd.
40. HSBC Bank plc
41. HSBC Bank USA, N.A.
42. HSBC France
43. HSBC Securities (USA) Inc.
44. HSBC UK Bank plc
45. ING Bank N.V.
46. ING Bank Śląski S.A.
47. ING-DiBa AG
48. J.P. Morgan AG
49. J.P. Morgan Securities LLC
50. J.P. Morgan Securities plc
51. JPMorgan Chase Bank, N.A.
52. JPMorgan Securities Japan Co., Ltd.
53. Merrill Lynch Capital Services Inc.
54. Merrill Lynch International
55. Merrill Lynch Japan Securities Co., Ltd.
56. Mitsubishi UFJ Morgan Stanley Securities Co., Ltd.
57. Mizuho Bank, Ltd.
58. Mizuho Capital Markets LLC
59. Mizuho International plc
60. Mizuho Securities USA LLC
61. Morgan Stanley & Co. International plc
62. Morgan Stanley & Co. LLC
63. Morgan Stanley Capital Services LLC
64. Morgan Stanley Europe SE
65. Morgan Stanley MUFG Securities Co., Ltd.
66. MUFG Bank, Ltd.
67. MUFG Securities EMEA plc
68. National Westminster Bank Plc
69. NATIXIS
70. NatWest Markets N.V.
71. NatWest Markets plc

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
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 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