Joint Consultation Conclusions on Proposed Amendments to the Clearing Rules for Over-the-Counter Derivative Transactions Pursuant to Global Interest Rate Benchmark Reform

August 2023



HONG KONG MONETARY AUTHORITY
香港金融管理局



SECURITIES AND FUTURES COMMISSION
證券及期貨事務監察委員會

TABLE OF CONTENTS

Introduction **1**

Comments and Conclusions to Consultation **1**

Concluding Remarks and Way Forward **4**

Annex 1 – List of Respondents **5**

Annex 2 – Securities and Futures (OTC Derivative Transactions—Clearing and Record Keeping Obligations and Designation of Central Counterparties) (Amendment) Rules 2023 ..... **6**

Introduction

1. Since September 2016, the Hong Kong Monetary Authority (HKMA) and Securities and Futures Commission (SFC) have implemented mandatory clearing for specified standardised interest rate swaps (IRS) between major dealers. Details are specified under the Securities and Futures (OTC Derivative Transactions – Clearing and Record Keeping Obligations and Designation of Central Counterparties) Rules (Clearing Rules). Over the years, the HKMA and the SFC have been monitoring global developments that impact the over-the-counter (OTC) derivatives market in Hong Kong and the regime implemented.

2. In March 2023, the HKMA and the SFC issued a joint consultation paper on proposed changes to the mandatory clearing regime. In the consultation paper, we proposed to remove the requirement to clear certain OTC derivative transactions referencing interbank offered rates (IBORs) that have ceased or will cease to be published or considered representative by the relevant regulators and administrators. Instead, we proposed to require clearing of those transactions that reference alternative reference rates (ARRs) as identified by the relevant regulators in the jurisdictions concerned.

3. This paper sets out our consultation conclusions and the way forward for implementation. During the consultation, we received 10 submissions (see Annex 1 for a list of the respondents) and their comments can be viewed on the websites of the HKMA and the SFC.

Comments and Conclusions to Consultation

Support for proposed changes

4. We received overwhelming support for our proposals set out in the consultation paper. Some respondents also sought clarifications on a few issues. A summary of the respondents' comments and our responses are set out below in paragraphs 5 to 14. A final version of the proposed amendments to Schedule 1 to the Clearing Rules (**Product Tables**) is set out in the Securities and Futures (OTC Derivative Transactions—Clearing and Record Keeping Obligations and Designation of Central Counterparties) (Amendment) Rules 2023 attached in Annex 2.

Availability of designated CCPs for providing clearing services of IRS transactions subject to clearing obligation

5. In the consultation paper, we provided an overview of the availability of designated central counterparties (CCPs) to provide clearing services for the revised Product Tables. One respondent that is a designated CCP stated that it currently does not provide clearing services for the full range of the specified tenors in respect of one of the proposed new IRS types. However, we understand that at least two designated CCPs are available for each of

the new or amended IRS types referencing ARRs covering all tenors as set out in the revised Product Tables. We therefore do not expect significant difficulties for prescribed persons to access the necessary clearing services in respect of the revised Product Tables.

Conventions for ARR OIS supported by designated CCPs

6. One respondent indicated that there are multiple overnight rate conventions for ARR overnight index swaps (OIS) (eg, payment delay, lookback, observation shift, lockout) and would like to know whether the related trade still falls under mandatory clearing requirements if a convention is not supported by CCPs.

7. Multiple conventions exist to support ARR OIS. Based on our understanding, designated CCPs generally support the standard overnight rate conventions commonly used by market participants as well as selected non-standard conventions. Understandably, a CCP may not support all the non-standard bespoke conventions given the cost and risk as well as the complexity of default management processes involved. That said, our understanding is that whilst differentiation in usage of conventions existed initially, market has converged largely to using market agreed standard conventions. We believe that un-supported conventions do not by itself present an obstacle to clearing. We further understand that market participants have not voiced any real concern on this issue. On that premise, we believe that designated CCPs can adequately support the clearing of the prescribed products.

8. The OTC derivative markets are vibrant and continuously evolve to cater to the changing needs of market participants. If a designated CCP usually engaged by a prescribed person is unable to clear a prescribed product on the grounds that the CCP does not support a particular non-standard overnight rate convention for OIS (eg, lookback), the prescribed person is expected to make reasonable efforts to ensure that the IRS is cleared if and as required by the Clearing Rules[1]. For instance, the prescribed person may seek to clear the IRS with other designated CCPs.

9. The Clearing Rules do not stipulate what happens if a trade is not cleared, as this is fact-dependent and it is unlikely to account for all possibilities under the Clearing Rules. That said, if a prescribed person fails to clear an in-scope OIS

[1] Question 37 of the Frequently Asked Questions on the Implementation and Operation of the Mandatory Clearing Regime (Clearing FAQs) provides that 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 actions -

(a) 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) follow 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.

as required by the Clearing Rules after taking reasonable steps (as mentioned in Question 37 of the Clearing FAQs) because the associated convention is not supported by any of the designated CCPs, we believe proper records of the reasonable steps taken by the prescribed person to comply with its clearing obligation should serve as a reasonable excuse.

10. Nonetheless, if there is market concern that CCP support may be unavailable for certain non-standard overnight rate conventions for OIS, consequently impacting the clearing obligation, we would take such concern into account, having due regard to harmonising international standards, during the next review of the Clearing Rules.

Proposed inclusion of HKD HONIA

11. One respondent questioned the proposal to add HKD OIS referencing Hong Kong Overnight Index Average (HONIA) and requested explanations for the specific calculation methods under the "multi-rate approach" adopted in respect of OIS referencing HKD HIBOR and HKD HONIA.

12. As stated in our consultation paper, while HONIA has been identified as an ARR to HIBOR, there is no plan to discontinue HIBOR. In light that HONIA is a type of overnight index, the proposal to add a new HKD OIS referencing HONIA is fair and also consistent with IBOR reforms in other major jurisdictions[2]. Further, the "multi-rate approach" mentioned in paragraph 10(d) of the consultation paper suggests the co-existence of HKD HIBOR and HKD HONIA going forward rather than a calculation mechanism.

Implementation timeline

13. One respondent requested to align the implementation timeline for the proposed rules with the CCP's conversion processes, or with the USD LIBOR cessation on 30 June 2023, which has been overtaken by events at this stage. Two other respondents requested a longer transition period before implementation, and specifically –

    (a) that a transition period of six months be allowed from the finalisation of legislative amendments, on the basis that a shorter period would bring to the industry additional costs, higher implementation risk and no identified benefit; and

    (b) that the changes be implemented by the first quarter of 2024 instead of the fourth quarter of 2023 (vs. the target implementation date between the fourth quarter 2023 and the first quarter of 2024 mentioned in the consultation paper) given the year-end technology change freeze practised by financial institutions.

[2] For example, various jurisdictions have already (among other things) removed basis swaps referencing USD/GBP/JPY LIBOR and added OIS referencing SOFR/SONIA/TONA respectively under their clearing regulations. Australia has also mandated (i) Basis Swaps and Fixed-to-Float Swaps denominated in AUD with Australian Bank Bill Swap Rate (BBSW), and (ii) OIS denominated in AUD with referencing RBA Interbank Overnight Cash rate (IBOC).

14. Having considered the responses, and balancing the need to align with international standards on IBOR reforms as soon as practicable as well as industry request and a need for operational efficiency, we are inclined a) to implement the changes at a later rather than an earlier date, noting that the industry prefers having more time to get ready for the proposed clearing obligation changes, and b) to align the implementation date with a Prescribed Day[3] under the Clearing Rules to reduce undue operational complexity for any prescribed person that has become newly subject to the clearing obligation after the end of a Calculation Period[4]. In this regard, we propose to implement the revised Product Tables no earlier than 1 July 2024, which is the Prescribed Day after the Calculation Period of 1 September 2023 to 31 November 2023.

Concluding Remarks and Way Forward

15. We take this opportunity to thank all respondents for the time and efforts to comment and assist us in finalising our proposals. The Clearing FAQs will accordingly be updated where appropriate to reflect the legislative amendments.

16. To implement our proposals, we will engage with designated CCPs to work on the designation of the revised products subject to clearing requirements We will also work with the Government on the legislative process and target to implement the amendments no earlier than 1 July 2024. We will continue to maintain close dialogue with the industry as we consult on other proposals regarding the OTC derivatives regulatory regime in the future.

[3] A Prescribed Day is seven months after the end of the corresponding Calculation Period.

[4] A Calculation Period is a specified period for calculating a person's average total position in OTC derivatives for the purpose of determining whether the person will be subject to the mandatory clearing obligation. Each Calculation Period is three months, and there are two Calculation Periods in each calendar year. For more details, please see Q5 of the Clearing FAQs.

Annex 1 – List of Respondents

(in alphabetical order)

Respondents whose comments are published on the websites of the HKMA and SFC

1. Asia Securities Industry & Financial Markets Association
2. Dr Chi Zhang
3. Hong Kong Bar Association
4. International Swaps and Derivatives Association
5. Japan Securities Clearing Corporation
6. The DTC Association
7. The Hong Kong Association of Banks
8. Treasury Markets Association

Respondents who requested their names and comments to be withheld

9. Anonymous
10. Anonymous

Annex 2 – Securities and Futures (OTC Derivative Transactions—Clearing and Record Keeping Obligations and Designation of Central Counterparties) (Amendment) Rules 2023

(Made by the Securities and Futures Commission under sections 101N and 101P of the Securities and Futures Ordinance (Cap. 571) with the consent of the Monetary Authority and after consultation with the Financial Secretary)

1. Commencement

These Rules come into operation on 1 July 2024.

2. Securities and Futures (OTC Derivative Transactions—Clearing and Record Keeping Obligations and Designation of Central Counterparties) Rules amended

The Securities and Futures (OTC Derivative Transactions—Clearing and Record Keeping Obligations and Designation of Central Counterparties) Rules (Cap. 571 sub. leg. AN) are amended as set out in rule 3.

3. Schedule 1 amended (specified OTC derivative transactions for the purposes of clearing obligation and record keeping obligation)

(1) Schedule 1, Table 1—

Repeal items 1, 3 and 4.

(2) Schedule 1, Table 2—

Repeal items 1, 3 and 4.

(3) Schedule 1, Table 3—

Repeal item 2

Substitute

" 2.	EUR	€STR	7 days to 3 years	No	Yes".	

(4) Schedule 1, Table 3, item 3—

Repeal

"2 years"

Substitute

"50 years".

(5) Schedule 1, Table 3, after item 3—

Add

"4.	JPY	TONA	7 days to 30 years	No	Yes
5.	USD	SOFR	7 days to 50 years	No	Yes
6.	HKD	HONIA	7 days to 10 years	No	Yes".