# Cleared Up.

**Linklaters**

Your Asia OTC Derivatives Clearing and Reporting Update

**Volume 1, 2016**

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Hong Kong regulators publish proposed rules for mandatory clearing and expanded mandatory reporting

On 30 September 2015, the Hong Kong Monetary Authority ("HKMA") and the Securities and Futures Commission ("SFC") published their proposed next steps in the regulation of over-the-counter ("OTC") derivative transactions, being:

> phase 1 clearing: mandatory clearing of certain derivative trades, and
> phase 2 reporting: a broader mandatory reporting requirement.

The "Consultation Paper on introducing mandatory clearing and expanding mandatory reporting" sets out new rules relating to clearing, and revisions to the existing set of rules relating to reporting.
Please see here for the detailed client alert published by Linklaters on this consultation.

**SFC enters into MoUs with ESMA and CFTC**

The SFC has entered into a Memorandum of Understanding ("MoU") with the European Securities and Markets Authority ("ESMA") to facilitate exchange of information on derivatives contracts held in trade repositories in Hong Kong and the EU. In addition, a MoU has been entered into between the SFC and the U.S. Commodity Futures Trading Commission ("CFTC") in connection with cooperation and exchange of information in the supervision and oversight of regulated entities that operate on a cross-border basis in Hong Kong and in the United States.

**HKMA issues consultation paper on margining and other risk mitigation standards for non-centrally cleared OTC derivatives transactions**

On 3 December 2015, the HKMA issued a consultation paper on the proposed margin and risk mitigation rules for non-centrally cleared OTC derivatives, together with the draft chapter of the Supervisory Policy Manual implementing such proposals. The HKMA is seeking public feedback and the deadline for comments is 15 January 2016. The rules are expected to be in place by 1 September 2016, subject to phase-in arrangements.

Please see here for the detailed client alert published by Linklaters on this consultation.

**Financial Institutions (Resolution) Bill gazetted**

The Financial Institutions (Resolution) Bill was gazetted on 20 November 2015. The proposed cross-sector resolution regime will cover global systemically important financial institutions in the banking, insurance, and securities and futures sectors, as well as certain financial market infrastructures and exchanges. The HKMA, the Insurance Authority and the SFC will be given powers as resolution authorities, including the power to impose a write off or conversion of capital instruments issued by authorised institutions, the power to resolve a holding company or group company of an in-scope entity, and the power to give effect to a resolution action taken by an overseas counterpart.

**OTC Clear granted DCO registration exemption**

On 22 December 2015, the CFTC has granted OTC Clearing Hong Kong Limited an exemption from registration as a Derivatives Clearing Organization ("DCO").

**MAS consultation on margin requirements for non-centrally cleared OTC derivatives**

The Monetary Authority of Singapore ("MAS") commenced a policy consultation on 1 October 2015 on proposals to impose margin requirements on non-centrally cleared OTC derivative trades ("uncleared derivatives"), excluding physically-settled foreign exchange forwards and swaps. Such requirements complement the MAS’s proposal in July 2015 to introduce a mandatory central clearing regime for specified OTC derivative contracts in 2016. Any margining requirements would only apply from 1 September 2016 at the earliest. The policy consultation covers items such as scope of the margin requirements, nexus and threshold limits, calculation methodologies, eligible collateral and valuation and treatment of collateral.
The margin requirements will be implemented in phases over the next few years. To begin with, the margin requirements will be applied to certain MAS-licensed entities (e.g. banks and merchant banks), subject to a limited exemption for certain entities whose exposures to uncleared derivative transactions booked in Singapore fall below a certain threshold. Cross-border transactions will be subject to a substituted compliance regime. An MAS-licensed entity would be deemed to have complied with Singapore’s margin rules where: (i) it is established under the laws of, or has a place of business in, a foreign jurisdiction with comparable margin requirements and it has complied with such comparable margin requirements; or (ii) it trades with a foreign counterparty and has complied with comparable home or host margin requirements imposed on the foreign counterparty.

Please see here for the detailed client alert published by Linklaters on this consultation.

Revisions to OTC derivatives reporting regime

The MAS has amended the principal reporting regulations for OTC derivatives under the Singapore Securities and Futures Act (the Securities and Futures (Reporting of Derivatives Contracts) Regulations 2013, the “Reporting Regulations”) with effect from 1 November 2015.

Pursuant to these amendments, the MAS has extended masking relief (which was granted in the light of banking secrecy laws in certain jurisdictions which may conflict with the obligation to report counterparty information) by nearly two years, to 1 July 2017. A specified party to a specified derivatives contract which previously benefitted from masking relief will therefore continue to benefit from such relief and shall not be required to report counterparty information until 1 July 2017, provided that it meets the same conditions (which have not been amended) to qualify for such masking relief. The time period in which to unmask historical transactions after the relief expires has been extended from two months to six months. Counterparty information will therefore be reportable from 1 January 2018.

The conditions to qualify for masking relief are as follows: (i) the party who would otherwise have been subject to the reporting obligations in respect of counterparty information is prohibited from reporting such counterparty information under the laws of certain specified jurisdictions (as specified in the fifth schedule to the Reporting Regulations) or by any requirements imposed on it by any authority of any such jurisdictions; or (ii) where the laws of any jurisdiction, or the requirements imposed on it by any authority of any jurisdiction, allow such party to report the counterparty information only with the consent of the counterparty and/or such counterparty’s principal (in the case where such counterparty entered into the specified derivatives contract as an agent), it has made reasonable efforts, but was unable, to obtain such consent(s).

In addition, the MAS has removed the reporting obligations (which were previously due to commence from 1 February 2016) for interest rate derivatives and credit derivatives contracts “traded in Singapore” for certain financial institutions (e.g. capital markets services licence holders and insurers) and “significant derivatives holders” – with the effect that the only reporting obligations that will apply to such persons are in respect of (i) interest rate derivatives contracts “booked in Singapore” and (ii) credit derivatives contracts “booked in Singapore”.

The MAS also expanded the scope of excluded contracts for the purpose of calculating whether the reporting threshold of S$8bn (in gross notional amount of specified derivatives contracts) for becoming a “significant derivatives holder” has been exceeded: interest rate derivatives contracts “traded in Singapore” and credit derivatives contracts “traded in Singapore” no longer count towards the threshold calculation (previously, only foreign exchange derivatives contracts “traded in Singapore” and/or “booked in Singapore” were excluded).

Please see here for the regulations amending the Reporting Regulations and here for the full text of the Reporting Regulations as amended.
CME and CFETS sign MoU to strengthen collaborations

On 5 August 2015, a MoU was signed between Chicago Mercantile Exchange Inc. (“CME”) and China Foreign Exchange Trading System & National Interbank Funding Centre (“CFETS”) as an action to give effect to the outcome from the 7th U.S. and China Strategic Economic Dialogue. Both parties express the plan to set up a joint venture in the United States, hoping to speed up the construction of market infrastructures and trading of the products on the two markets. They pledged to develop the offshore FX and interest rate spot products and derivatives products denominated in Renminbi.

CFETS, as the only foreign exchange and interbank money market in China, provides trading, information and facilities to the interbank lending, bond and FX market, and publishes market benchmarks such as Shanghai Interbank Offered Rate. The MoU enables CFETS to have access to international expertise and CME to obtain a better understanding of Chinese market.

INE publishes draft clearing rules for consultation

The Shanghai International Energy Exchange (“INE”) published a set of draft rules on trading, clearing, settlement and risk control on 21 August 2015. Key features of the draft clearing rules are as follows:

> Client clearing: A client (onshore or offshore) will clear with a clearing member of INE (“CM”), who will in turn settle back-to-back with INE. The CM acts as a principal vis-a-vis both its client and INE. A CM will be required to settle all client trades with INE, even if a client has defaulted in settling with the CM.

> Segregation of client assets: INE intends to hold the assets of CMs’ clients based on the LSOC model (legally segregated but operationally com mingled). Under the draft rules, an CM will not be required to open individual cash accounts with INE for each of its clients, but the trades entered into by a CM for each client will need to be recorded under the unique trading code of that client on INE’s books and records. In addition, it appears that sub-accounts may be opened under a CM’s client account for each “overseas special participant” who clears through such CM.

> Eligible collateral: Collaterals acceptable to INE include cash, standard warehouse receipts and any other assets as specified by INE.
September 2015:

> USD, EUR and AUD denominated transactions have been added to the list of transactions eligible to be cleared. Previously, JSCC cleared only JPY denominated transactions. Under the new rules, variation margin is calculated with respect to each currency, and separate default process may be taken for different currencies.

> JSCC also introduced cross-service margining between interest rate swaps (“IRS”) and Japanese Government Bonds (“JGB”) futures. If a clearing member uses cross-service margining, effectively, initial margin for IRS is calculated based on the net positions of IRS and cross-margined JGB futures, and initial margin for JGB futures is calculated in respect of non-cross-margined JGB futures. If a cross-service margining user defaults, cross-margined JGB futures will be settled under the IRS clearing service.

JSCC granted DCO registration exemption

On 26 October 2015, the CFTC has granted JSCC an exemption from registration as a DCO.

Publication of the second consultation draft of non-cleared derivatives margin rules

On 11 December 2015, the second proposal for non-cleared derivatives margin rules was published by the Financial Services Agency to the Cabinet Ordinance and Supervisory Guidelines. The rules will become effective on 1 September 2016.

Further steps toward a central clearing mandate

> The Corporations (Derivatives) Amendment Determination 2015 (No. 1) came into effect on 23 August 2015. It allows central clearing requirements to be imposed with respect to certain types of OTC interest rate swaps denominated in Australian dollars, U.S. dollars, Euros, British pounds or Japanese yen.

> It is also supported by a set of amendments in the Corporations Amendment (Central Clearing and Single-Sided Reporting) Regulation 2015, which sets out the key parameters of the clearing mandate.

> Under the amendments, clearing requirements may only be imposed on an ‘Australian clearing entity’ or a ‘foreign clearing entity’ in relation to a transaction. This includes Authorised Deposit-taking Institutions, Australian Financial Services Licensees and Exempt Foreign Licensees where the relevant entity holds total gross notional outstanding positions of at least A$100 billion at the end of each of two consecutive calendar quarters across all OTC derivatives subject to the clearing mandate.

> On 28 October 2015, the Reserve Bank of Australia released its consultation conclusions on central clearing of repurchase transactions (repos) in Australia.

> On 14 December 2015, the Australian Securities and Investments Commission (“ASIC”) released rules implementing Australia’s mandatory central clearing regime for OTC derivatives of financial institutions. The rules will apply to transactions in OTC interest rate derivatives denominated in Australian dollars, and in U.S. dollars, Euros, British pounds and Japanese yen between OTC derivatives dealers. The clearing obligations will commence in April 2016. For a copy of the ASIC Derivative Transaction Rules (Clearing) 2015, click here.
Introduction of single-sided reporting for certain OTC derivative transactions

> Following on from the consultation package released by the Department of Treasury on 28 May 2015, the Corporations Amendment (Central Clearing and Single-Sided Reporting) Regulation 2015 amended the Corporations Regulations to allow for ‘single-sided’ reporting from 1 October 2015.

> Single-sided reporting is permitted for Phase 3B entities (entities with less than A$5 billion gross notional OTC derivative positions outstanding). The relief is available to these entities subject to the condition that the counterparty to the transaction makes certain representations about its own reporting obligations and the Phase 3B entity makes regular enquiries reasonably designed to determine whether its counterparty is complying with those representations.

Limited application of Derivative Transaction Rules to Australian Financial Services Licensees

> The Corporations Amendment (Central Clearing and Single-Sided Reporting) Regulation 2015 also provides that the ASIC Derivative Transaction Rules can only impose requirements relating to a particular class of derivatives on Australian Financial Services Licensees who are specifically authorised to provide financial services in relation to that class of derivatives.

CCIL publishes consultation paper on Central Counterparty (“CCP”) recovery and resolution mechanism

On 31 July 2015, the Clearing Corporation of India Limited (“CCIL”) released a consultation paper that outlines broadly the recovery and resolution plan and actions that CCIL would undertake in case of stress events such as insolvency of CCIL. This consultation paper is a preliminary step taken by CCIL to ensure that its regulatory framework is in compliance with Principles for Financial Market Infrastructure which stipulate that all CCPs must develop and maintain a viable recovery or orderly wind-down plan. A copy of the consultation paper is available here.

CCIL proposes integration of the Forex Forward Segment and Forex Settlement Segments

On 24 July 2015, CCIL released a consultation paper which envisages the integration of the Forex Forward Segment and the Forex Settlement Segment of CCIL. The rationale for the proposed integration as explained by CCIL is: (a) the similar settlement and clearing mechanism followed on these two segments; (ii) presence of same clearing members; and (iii) improved operational efficiency in the system if these two segments are merged as the forex market is expected to expand significantly in the next few years. A copy of the consultation paper is available here.
KRX amends membership regulation

The Korea Exchange ("KRX") amended its membership regulation on 2 September 2015 (effective 3 September 2015) in response to a Financial Services Commission ("FSC") decision to allow banks to obtain a licence to engage in the trading of exchange-traded derivatives based on currency or interest rate. Key elements include:

> The definition of “currency/interest rate derivatives member” has been amended to mean a member that is entitled to take part in trading of exchange-traded derivatives based on currency or interest rate in the derivatives market.

> The amount that a currency/interest rate derivatives member contributes to the joint compensation fund is now equal to the basic contribution (KRW 0.5 billion) plus intermittent contribution. The intermittent contribution is calculated by multiplying the ratio of a clearing member’s average daily margin relative to that of all clearing members obliged to contribute to the fund for a retroactive one-year period from the end of the previous quarter, by the difference obtained by subtracting the total basic contribution from the total amount of the joint compensation fund.

> The rules for postponement or cancellation of the measures imposed due to unsatisfactory financial conditions will be stipulated in the enforcement rules.

KRX expands the scope of mandatory clearing

> KRX has amended OTC Derivatives Clearing and Settlement Business Regulation and Enforcement Rules in order to expand the range of clearing eligible transactions for KRW Interest Rate Swap. From 23 November 2015, financial investment companies are required to clear KRW-denominated interest rate swaps subject to extended range of clearing eligible transactions through the KRX in accordance with the Financial Investment Services and Capital Markets Act.

FSC designates KRX as trade repository

> On 17 August 2015, the FSC announced that KRX had been designated as a trade repository ("TR").

> The FSC expects the TR to centrally collect and efficiently manage large amounts of data and information regarding OTC derivatives trades, improving derivatives market monitoring and transparency. Specific action plans will be set out by KRX.

KRX granted DCO registration exemption

> On 26 October 2015, the CFTC has granted KRX an exemption from registration as a DCO.
For the latest developments in the EU, U.S. and other jurisdictions, please visit our Client Knowledge Portal.

Please contact Karen Lam, I-Ping Soong or Derek Chua for more information, or click here to get in touch with a member of our Asia Clearing team.

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Previous Issues - 2014: Volume 1, Volume 2 and Volume 3