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Hong Kong Monetary Authority
Banking Policy
55/F Two International Finance Centre
8 Finance Street
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Hong Kong

Email to: Ms Theresa Kwan tyykwan@hkma.gov.hk

Dear Sirs/Madams

Consultation on implementation of Basel III Leverage Ratio Framework (Consultation)

FIA welcomes the opportunity to respond to the Consultation published by the Hong Kong Monetary Authority **(MA)** on 13 April 2017.

FIA is the leading global trade organisation for the futures, options and centrally cleared derivatives markets, with offices in London, Singapore and Washington, D.C. FIA's membership includes clearing firms, exchanges, clearinghouses, trading firms and commodities specialists from more than 48 countries as well as technology vendors, lawyers and other professionals serving the industry. FIA's mission is to support open, transparent and competitive markets, protect and enhance the integrity of the financial system, and promote high standards of professional conduct. As the principal members of derivatives clearinghouses worldwide, FIA's member firms play a critical role in the reduction of systemic risk in global financial markets. Further information is available at www.fia.org.

Our responses to some of the questions raised in the Consultation are set out below. We have not responded to all questions but focused on those primarily impacting cleared derivatives transactions and clearing services. We wish to highlight that if there is a failure to recognise the exposure-reducing effect of initial segregated margin in cleared derivatives transactions under the current proposed Leverage Ratio Framework, this will lead to negative effects on the ability of bank or bank-affiliated clearing members to provide client clearing services.

<u>FIA comments</u>

We support the MA's proposal to adopt a 'two-phase' approach to implement the Leverage Ratio Framework in Hong Kong from 1 January 2018 for Authorised Institutions (**AIs**). We fully support the MA's intention to consult with the industry again for the second phase of implementation when the final Leverage Ratio Framework is published.

We do not object to the proposed legislative approach which will introduce the required changes through amendments to the Banking (Capital) Rules (**BCR**). However, we would like to highlight our concerns relevant to the calculation of bank exposure under the Leverage Ratio Framework.

In response to question 4 of the Consultation, we understand that the changes in the BCR (as noted on pages 5-6 of the Consultation) are expected to include provisions dealing with:

> *"exposure measure" calculated as sum of an AI's exposure to each of the following 4 components (subject to refinements):*

(a) on-balance sheet items (other than derivative contracts and securities financing transactions ("SFTs"));
(b) derivative contracts;
(c) SFTs; and
(d) Off-balance sheet items (other than derivative contracts and SFTs)"

As set out in our previous submissions to the Basel Committee[1] and discussed with the MA, FIA and other market participants strongly believe that in the context of a bank exposure created by a cleared derivatives transaction, the Leverage Ratio Framework should recognise the exposure-reducing effect of margin that is segregated, because segregated margin[2] cannot be used to increase the bank's leverage.

FIA has previously collected data submitted to the Basel Committee which supports the conclusion that if uncorrected, the current proposed Leverage Ratio Framework would significantly reduce clearing members' incentives to continue to offer clearing services for clients. Our members believe that this in turn could result in significantly reduced clearing services; higher fees for cleared derivative clients; increased concentration among clearing members; and reduced portability of client accounts in times of systemic stress – all of which would conflict with the G20 mandate to increase the use of central counterparty clearing for derivatives transactions. These concerns are also shared by various regulators around the world and most recently expressed by U.S Commodity Futures and Trading Commission Acting Chairman J. Christopher Giancarlo in remarks made on 10 May 2017[3].

We note that the European Commission has proposed to offset client initial margin for cleared derivatives in its Capital Markets Requirement Directive IV (**CRD IV**) which is an EU legislative package covering prudential rules for banks, building societies and investment firms.

We would urge the MA to further consider the concerns set out in this letter and our previous submissions prior to implementation of the Leverage Ratio Framework. We encourage the MA to discuss this issue further with other global prudential regulators and consider an offset for client initial margin for cleared derivatives to harmonise rules as much as possible and to minimise any potential disadvantage for Hong Kong AIs.

Thank you for considering the issues raised in this letter. We would be happy to discuss this in further detail with you if it is helpful. In the meantime, if you have any questions, please contact Phuong Trinh, Vice President Legal & Policy Asia – Pacific at +65 6549 7335 or ptrinh@fia.org

Yours faithfully

Bill Herder
Head of Asia-Pacific

[1] https://fia.org/sites/default/files/2016-07-06_FIA_Comment_Letter_Basel_Committee_Leverage_Ratio.pdf
[2] "Segregated margin" refers to margin (usually consisting of initial margin) that is provided to a clearing member but cannot be used by that member to leverage itself due to national laws, regulatory/client money rules or clearinghouse requirements that prevent clearing members from using posted collateral for purposes other than collateralising client exposure.
[3] Full transcript available at http://www.cftc.gov/PressRoom/SpeechesTestimony/opagiancarlo-22