



3 December 2021

To: Hong Kong Exchanges and Clearing Limited

Dear Sirs/Madams

### **Consultation on Holiday Trading in the Derivatives Market**

FIA<sup>1</sup> appreciates the opportunity to respond to the proposals set out in the “Derivatives Holiday Trading” consultation paper issued by Hong Kong Exchanges and Clearing Limited (**HKEX**) in November 2021.

Please find below our comments. These follow HKEX’s questionnaire format for gathering feedback.

#### **QUESTION 1:**

#### **DO YOU HAVE ANY COMMENTS OR CONCERNS ON:**

##### **I. THE PROPOSED TRADING ARRANGEMENTS**

1. The consultation paper states that participants will be classified as either Holiday Trading Participants or non-Holiday Trading Participants. Will there also a separate classification for Clearing Members (i.e Holiday Clearing Participants / non-Holiday Clearing Participants)? If so, will there be any document that covers those arrangements?
2. Will all non-HKD denominated Holiday Trading Products be included for trading and clearing at the same time or will they be gradually introduced?
3. Will a non-HKD contract be tradeable if the underlying holiday also falls on a HK Holiday (e.g. Christmas)? If so, the lack of liquidity will lead to an increase of exaggerated price movements.

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<sup>1</sup> FIA is the leading global trade organization 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](http://www.fia.org).



4. What challenges could arise for trading platforms to be configured such that only a subset of an exchange's contracts are tradable on certain days?
5. With participation in Holiday Trading being optional, there are concerns that end-clients would be left without access if their brokers aren't H participants.

## II. THE PROPOSED CLEARING ARRANGEMENTS

### General Concerns / Questions

1. Margin settlement on shared holidays - USD liquidity concerns
  - a. HKEC suggests that members pre-fund USD when USD / HKD are bank holidays on same day. Moreover, members have to make margin calls on T for T+1 settlement per local regulations but are not permitted to withdraw excess funds. This has led to member concerns about the funding needs being generated and the resultant liquidity stress. Some members are also concerned about the potential contravention of client money rules in Hong Kong if Clearing Participants leave excess collateral onshore.
    - i. The current structure of some members restricts them from withdrawing any excess on H+1. As a result, all the excess sitting with HKEx will be used to cover any intraday margin call as no bank settlement will take place on H due to HKEx not supporting excess withdrawal on H. However, any deficit will be auto debited from a member's nostro account. Under this situation, all the excess placed with HKEx will be used for intraday margin call coverage (including, for example, the JPY currently placed at HKEx which belongs to member entity A, not member entity B. (Corresponding regulatory reference - [Section 16\(a\) of Schedule 4 to SFC Code of Conduct](#)).
    - ii. Can members transfer P&L on H+1 as the SFC rules mention that P&L needs to be transferred from client to house account on next 'business' day. HK Client Money Rules exclude HK public holidays like Christmas. As HKEX consultation seems to also suggest H day is NOT a business day, this may mean that licensed corporations don't need to count H day as 1 business day for purpose of proper segregation within 1 business day as per HK Client Money Rules but we will need explicit confirmation from SFC on the definition of Business Day. Can HKEX clarify whether H day is considered "business day" under HK client money rules?

- b. Can HKEX advise if there will be any margin calls in CNH on HK holidays? The consultation paper doesn't make much mention of CNH (where it explicitly says no calls in HKD which will be replaced by USD on the Holiday) but since CNH is predominantly a HK based currency, would there be calls issued in CNH? And if yes, why is this different from HKD? Or will HKCC call SGD and JPY similar to the USD process on a HK holiday?
      - c. Is there a requirement to perform Client Money calculations on the HK holiday with the introduction of holiday trading? Members expect any margin calls (for HKD and USD) on the Holiday to be issued and called in USD (and subject to the settlement question above, maybe CNH, SGD and JPY as well). Members also understand that HKEX's proposal is to ask members to work on a USD credit line with their settlement banks. However, as members have no ability to cover USD from their clients on a HK Holiday, does the HKEX expect members to carry a USD overdraft in our client account? Likewise for any currencies which can be called by HKCC.
      - d. One alternative would be for H CPs to engage with overseas settlement banks which could provide fund transfer services during HK holidays. However, there would be timing issues for meeting margin payment during HK hours if H CPs engage with overseas settlement banks. Are there any other alternatives to address the issue? Would HKCC consider accepting settlement currencies other than USD?
    2. There needs to be a good uptake from the local brokers/clearing members, else there is a risk of liquidity being compromised for the eligible contracts. It is important for HKEx to demonstrate that a large part of the clearing members (% of the total risk in these contracts) are able to support Holiday trading. Members have been given to understand that since most members bank with HSBC, USD funding on a holiday will not be an issue but that is yet to be demonstrated.
    3. The USD funding model is very focused (or creates concentration) at one Settlement bank i.e HSBC. The CCP will need to create a robust diligence model to monitor the health of this bank and set appropriate counterparty limits. Given there are not as many alternatives to HSBC, in the medium terms as activity ramps up on the holiday trading eligible contracts, the CCP should identify and on-board more of USD settlement banks. Each of these banks should be governed by their counterparty limits.
    4. Does the HKEx know which of their panel settlement banks can offer holiday settlement of non-HKD or is this up to each member to approach their settlement bank?



5. Potential margining imbalance between H participants and non-H participants - This is due to the double margin charge (VM and holiday margin) for Non-H products of H participants during H days, payable on H day. However, Non-H participants are only charged holiday margins, payable after the H days. We await confirmation from HKEX on this point through the provision of real-life examples.
6. Potential Funding/Liquidity Stress for H CPs - It is expected that margin calls issued to clients (who are not H EPs) on H days can only be met after the holidays while the margin calls from HKCC have to be met on H days by H CPs. Therefore, there may be potential financing/funding issue arising from H CPs using their house account funds to fulfil EOD margin requirements for H trading clients during the holiday season (e.g. CNY holidays). The situation could be aggravated when market becomes more volatile.
7. Will HKEX release a CCP/balance report on HK holidays? For the additional concentration margin, will HKEX send an email notification as they do a normal business day?
8. H day margin methodologies: Can more details about the basis/methodology with which holiday margin is calculated by the HKEX/HKCC so that we could better predict the potential margin calls on H days?
9. HKD and USD margin requirements could be collateralized by non-cash collateral of up to 50% and the remaining 50% in any other currency (proposal 28.4). There could be operational challenges to convert large amounts of securities into HKD after a holiday (Note, this proposal excludes VM) and could it cause an undesirable FX move.

#### **COB H Day-1 (e.g. CNY eve)**

1. For H EPs trading HKD products on COB H Day-1 (e.g. CNY eve), will HKEX calculate IM and VM in HKD and debit HKD from CP's HKCC balance to meet IM and VM? If there is insufficient HKD excess to cover all HKD IM and VM, will the remaining HKD IM and VM be translated into USD equivalent amount and HKCC will issue a direct debit instruction (DDI) to CP's agent bank and debit CP's USD bank account? If so, which reports will show how much USD is used in to cover i) HKD IM, ii) HKD VM, iii) USD IM and iv) USD VM?
2. For H EPs, will IM and VM of CNH, JPY and SGD products for COB H Day-1 (e.g. CNY eve) settle in a) respective contract currency or b) USD on H Day? Which reports should CP use to check margin requirements?



3. If IM and VM of CNH, JPY and SGD products for COB H Day-1 (e.g. CNY eve) are to settle in respective contract currency on H Day, are local HK banks able to support CP in cross-border settlement to receive and pay CNH, JPY and SGD on H Day against offshore banks? If this is not possible, local HK banks must be required by HKEX to provide overnight unsecured credit line to CP to cover the DDI amount. This partnership is fundamental in enabling CPs to meet the money settlement on H Days requirement.

#### **H-Day (e.g. CNY Day 1, 2 and 3)**

1. On H Day, HKEX will follow regular business day's intraday margin cycles and settlement time for non-HKD products (CNH, JPY, SGD and USD products): a) 10am HKT mandatory margin call for T+1 night session trading; and b) 10.30am to 4pm HKT intraday margin calls for day session trading? c) Which reports should CP use to check margin requirements?
2. Currency for settlement are in respective contract currencies i.e. CNH, JPY, SGD and USD?
3. For HKD products, will HKEX not issue intraday and EOD margin call as products are not traded and cleared during H Days?

#### **Day after H-Day (e.g. CNY Day 4)**

1. How will HKEX calculate margin requirement for HKD products assuming EOD margin for COB H Day-1 (e.g. CNY eve), some of HKD IM and VM was covered by USD that was DDI from CP's agent bank on H Day (e.g. CNY Day 1)? Will HKEX call HKD to replace the USD collected from CP on H Day? If so, will the HKD margin call be issued during 10am HKT mandatory call or during the intraday margin call cycle (10.30am to 4pm HKT)? Which reports should CP use to check margin requirements?

#### **Currency settlement on H-Day**

1. Will FX currency futures delivery fall on a H-Day? Please describe the settlement details if settlement should take on H-Day? Are there any exceptions to take note?

#### **H Day & USD shared holiday**

1. Do you have a list of days which are shared HKD and USD bank holidays? Please clarify settlement arrangement on HKD and USD shared holidays (e.g. Christmas Day, Mon



after Christmas Day). Can HKEX send early notification (at least 2 weeks before shared holiday) to remind CPs of such exceptional days and the settlement approach?

#### **HKEX and SFC Regulatory Rules**

1. Do HKEX and SFC allow CP to issue and collect margin of an alternative currency (e.g. USD) to its end client, which is different from the contract denominated currency (CNH, JPY and SGD) that its end client has traded? If allowed, do HKEX and SFC have any expectation on the FX rate used for CP to issue and collect margin of an alternative currency from the end client? Do HKEX and SFC have any expectation on the margin requirement rate (e.g. minimum 1.33x margin requirement) used by CP to issue and collect margin of an alternative currency from its end client?
2. What are the relevant HKEX and SFC rules that CP should take note of and are required to comply with?

### **III. THE PROPOSED RISK MANAGEMENT ARRANGEMENTS**

1. Default management arrangement: Some members have expressed concerns around the default management process during H days in case of member default, especially regarding the Non-H products within the defaulter's portfolio.
2. In the event of a default during a HK Holiday, it is understood that the CCP cannot convene its DM process and that is fair given the close out will happen at the portfolio level and that can only be done on a HK working day. However, the CCP should set its margins for contracts (traded during a holiday) at the appropriate levels such that they take into account the extended periods of close out.
3. What is the rationale for proposing to suspend the 50-50 rule on collateral for USD and HKD margins but not for the other currencies?

### **IV. THE PROPOSED MARKET DATA ARRANGEMENTS**

N.A.

### **V. THE PROPOSED LARGE OPEN POSITION REPORTING ARRANGEMENTS**

N.A.



**QUESTION 2:**

**ARE THERE ANY OTHER ISSUES REGARDING THE PROPOSAL THAT HKEX SHOULD CONSIDER?**

Globally, there are other CCP initiatives that are currently being worked on and being launched at around the same time, which international brokers involved in. As the timeline to launch holiday trading is extremely tight (Q1 testing and April go live), members would like to know if HKEX will consider a delay?

We welcome the opportunity to work with HKEX to address these comments before the implementation of the proposals for holiday trading.

Please feel free to contact me at [bherder@fia.org](mailto:bherder@fia.org), Stella Gan, Head of Operations, Asia Pacific at [sgan@fia.org](mailto:sgan@fia.org) or TzeMin Yeo, Head of Legal & Policy, Asia Pacific at [tmyeo@fia.org](mailto:tmyeo@fia.org) should you wish to further discuss.

Yours faithfully

A handwritten signature in black ink, appearing to read 'Bill Herder', is written in a cursive style.

Bill Herder  
Head of Asia-Pacific