

SECTION 2: QUESTIONS FOR RESPONSE

Please indicate your views by providing comments as appropriate. Where there is insufficient space, please use additional sheets of paper as necessary.

HKEx's Proposal 1: Revise HKEx Stress Testing Assumptions

We are in principle favorable to raising the stringency on the conditions to be a clearing participant, as it fosters the resiliency of the market infrastructure against credit risk.

But we would like to raise one point - the current consultation proposed to implement the CPSS IOSCO 2004 standards for CCPs while the CPSS IOSCO 2011 Principles for Market Infrastructures are under the final stage of their adoption; despite the fact that the 2011 Principles are not fully endorsed, they will in any case remain a non-binding instrument and their content is already know, thus HKEx could consider implement them. This would definitely avoid a change of rules again in a near future.

Questions

1. Do you support the proposed revision of the Price Movement assumptions in stress testing?

Yes

No

Please provide reasons for your response and include any other suggestions or comments you may have on this question:

Yes, we fully support the revision of the Price Movements which is in line with the most volatile historical price movements.

We therefore consider these scenarios as extreme scenarios but possible ones.

Moreover, a positive effect is related to the approach applied in establishing the Net CNS positions which will no longer integrate cross-stocks netting. This proposed modification should contribute to a more realistic assessment of the risk, avoiding taking into account too much diversification across stocks.

Nevertheless, we would like to raise the issue on the time horizon that is not detailed in the consultation paper. Our understanding is that HKSCC will consider 1 day as the period required to liquidate positions of the defaulting CP. Such a period could appear not conservative enough to reflect stressed conditions of liquidation.

2. Do you support the proposed revision of the Counterparty Default assumption in stress testing?

Yes

No

Please provide reasons for your response and include any other suggestions or comments you may have on this question:

Yes. Our view is that removing the 30% of loss-making positions from the current assumption and adopting a scenario where assuming the single largest as well as the fifth largest CP would default is in line with IOSCO Recommendations and is more in line with industry standards (Other major CCPs)

HKEx's Proposal 2: Introduce Margining and Dynamic Guarantee Fund in HKSCC

Questions

3. Do you agree with the proposed margining arrangements at HKSCC?

Yes

No

Please provide reasons for your response and include any other suggestions or comments you may have on this question:

Yes, we agree with the proposed margining arrangements introducing a volatility based margin measure.

The introduction of a Value at Risk approach designed to estimate the worst expected losses over a given time interval under normal market conditions at a given confidence level would allow the HKSCC to be in line with the practices of major international CCP. We are favorable to it.

Regarding the approach applicable to the Margin Rate, we have several remarks:

- The choice of a volatility based on the HSI Index could lead to underestimation of the potential future variations of the positions. As mentioned in the document, the volatility of the index is not the same as the Stocks belonging to the index, and actually it is lower due to some diversification effects within the Index. It could be more appropriate to estimate historical volatility of the different stocks and to compare them to the volatility of the index and then to establish some multiplier to be used to rescale the parameter.
- The choice of the parameter used in the EWMA Method is not discussed. It has a significant impact on the reactivity of the model and could lead to very unstable Margin Rate that would be not easily manageable.
- As for the Question 1, the time horizon is not discussed. In our opinion, the 1-day assumption could be revisited.

From a treasury and operation perspective, we have concerns about the Collection Frequency and the Timing of this Collection. It should be noted that other major international CCP do not collect margin at night based on positions opened on the same day.

Other major International CCP only collect margin on the next morning.

Currently the broadcast report which is made available to CP and to GCP is an estimated amount only. There could be differences between this estimated amount and the real amount collected by the CCP. Also, the request for the additional collateral is communicated too late in the evening for CP or GCP to be able to react.

We therefore recommend that:

- HKSCC performs one single Margin Call based on end of day figures.
- The Margin Collection should be performed on next morning only (and not on the same day at night) which is in line with other major CCP.

- The Report to be communicated to CP should be definitive and not an estimate only (should include option exercised).
- This definitive report should be produced early enough to allow CP to take appropriate actions.
- The report provided by the HKSCC to GCP should include the break down per NCP.

It should be noted as well that the proposition is not very clear on whether the Marks, the Concentration collateral and the Additional collateral will remain in place or will be replaced.

4. Do you agree with the proposed Dynamic GF model at HKSCC?

Yes

No

Please provide reasons for your response and include any other suggestions or comments you may have on this question:

Yes, we fully support the introduction of a Dynamic GF, its calculation method, its frequency review, and its collection / refund method. However we are of the view that for GCP, GF notification issued by the CCP should show the breakdown by NCP.

In addition, we consider that it would be fair that all participants contribute to the Guarantee Fund.

HKEx's Proposal 3: Revise HKCC Reserve Fund Calculation

Questions

5. Do you support the proposed revisions to the HKCC Collateral assumption?

Yes

No

Please provide reasons for your response and include any other suggestions or comments you may have on this question:

As stated previously in question 1 and question 2, we fully support the revision of the Price Movements and the stress test scenario where assuming the single largest as well as the fifth largest CP would default. We also support the exclusion of IDM from daily RF calculation based on the fact that IDM may not be collected in case of CP default

6. Do you support the use of HKCC Contingent Advance in relieving burden of CPs?

Yes

No

Please provide reasons for your response and include any other suggestions or comments you may have on this question:

We welcome the HKCC Contingent Advance.

We understand the principle to increase the Dynamic RF but also appreciate that a significant part of this increase is covered by the HKCC Contingent Advance mechanism on a daily basis. We note that the loss sustained by the HKCC contingent Advance will be recoverable from CP's.

7. What is your view on allowing RF contribution to be counted as liquid capital? Will this help your company in terms of reducing liquid capital funding burden?

Allowing RF contribution to be counted as liquid capital will reduce financial resources needed to comply with the FRR rule. We confirm our interest in this proposal.

HKEx's Proposal 4: Revise SEOCH Reserve Fund Calculation

Questions

8. Do you support the proposed revisions to the SEOCH Collateral assumption?

Yes

No

Please provide reasons for your response and include any other suggestions or comments you may have on this question:

We agree with HKCC enhancement proposal and therefore support a collateral assumption consistency between HKEx clearing houses.