

HKEx Clearing House Risk Management Reform Measures

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Press Conference

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Chief Executive

Why Are the Clearing House Reforms Needed?



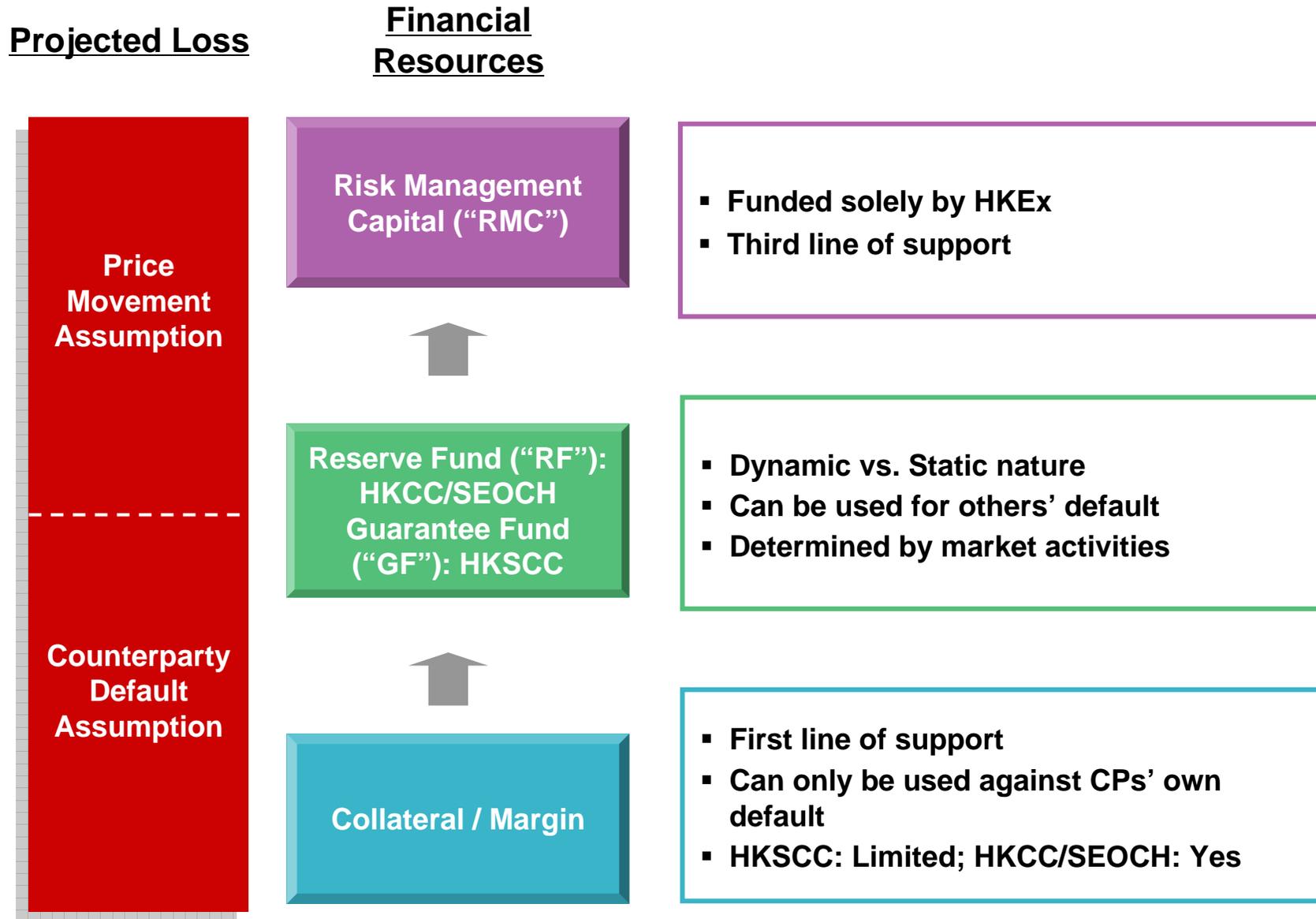
2008 global financial crisis and collapse of Lehman Brothers

Robustness of clearing houses crucial to stability and competitiveness of Hong Kong financial market

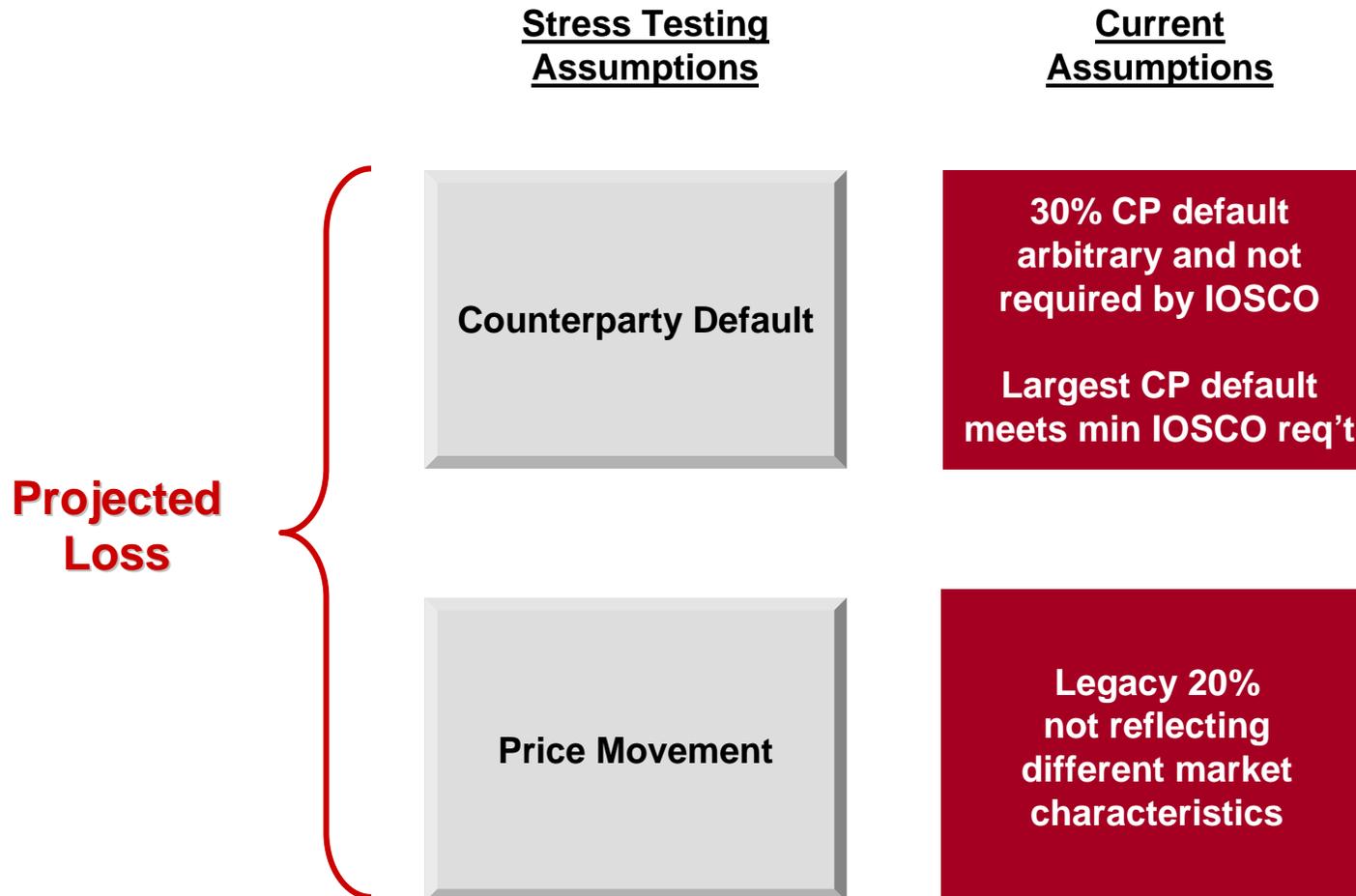
A global trend to review and tighten risk management standards

Enhancing IOSCO compliance and meeting evolving market conditions

Conceptual Framework – Projected Loss Supported by Financial Resources



Current Risk Management Issues – Projected Loss



HKSCC

ISSUES:

- Selective and static margining post-Lehman
- Insufficient and not scalable GF of \$245mn

RESULT: Insufficient funding 70% of the time

HKCC

ISSUES:

- Give credit to collateral not yet received¹
- Use only 30% default assumption to calculate Dynamic RF

RESULT: Undercharging CPs on Dynamic RF

SEOCH

ISSUES:

- No credit given to risk margin deposit already received²

RESULT: Overcharging CPs on Dynamic RF

1. HKCC currently counts collateral not yet received after an intraday margin call in daily RF calculation
 2. SEOCH currently does not give credit to risk margin deposit and surplus funds in daily RF calculation

The reform is overdue and has to be done

It must be fair and equitable: CPs and HKEx both share the burden

“User pays”: contributions should be commensurate with risks created

Minimise financial and administrative impact on segment creating smallest exposure

LOCAL REGULATOR'S REQUIREMENT

CPSS-IOSCO RECOMMENDATIONS

BENCHMARKING WITH MAJOR GLOBAL CCPs

Key Proposed Changes

Counterparty Default

- Adopt largest + 5th largest CPs & drop 30% for 3 clearing houses

Price Movement

- HKSCC/SEOCH: 22%
- HKCC HSI F/O: 20%*
- HKCC HHI F/O: 20%

* A review to be conducted three years after implementation

RMC for 3 Clearing Houses

Risk Management Fund (“RMF”)

- Discuss with regulator and Gov’t to establish RMF

Risk Management Capital

- Increase from \$3.1bn to \$4bn

HKSCC

- Introduce Dynamic GF

HKCC

- Exclude intraday margin call credit from RF calculation

SEOCH

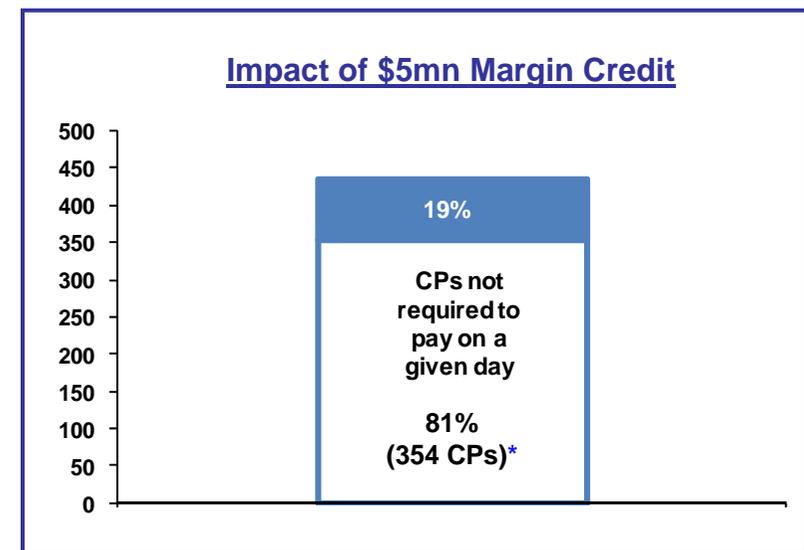
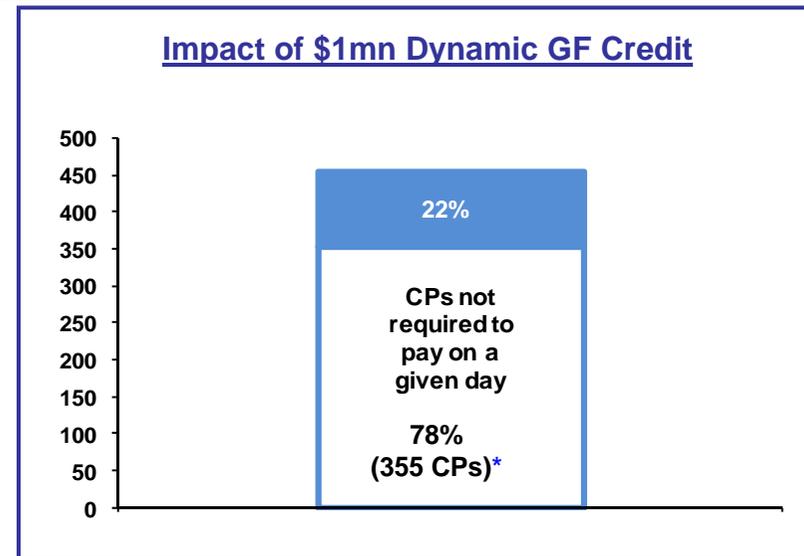
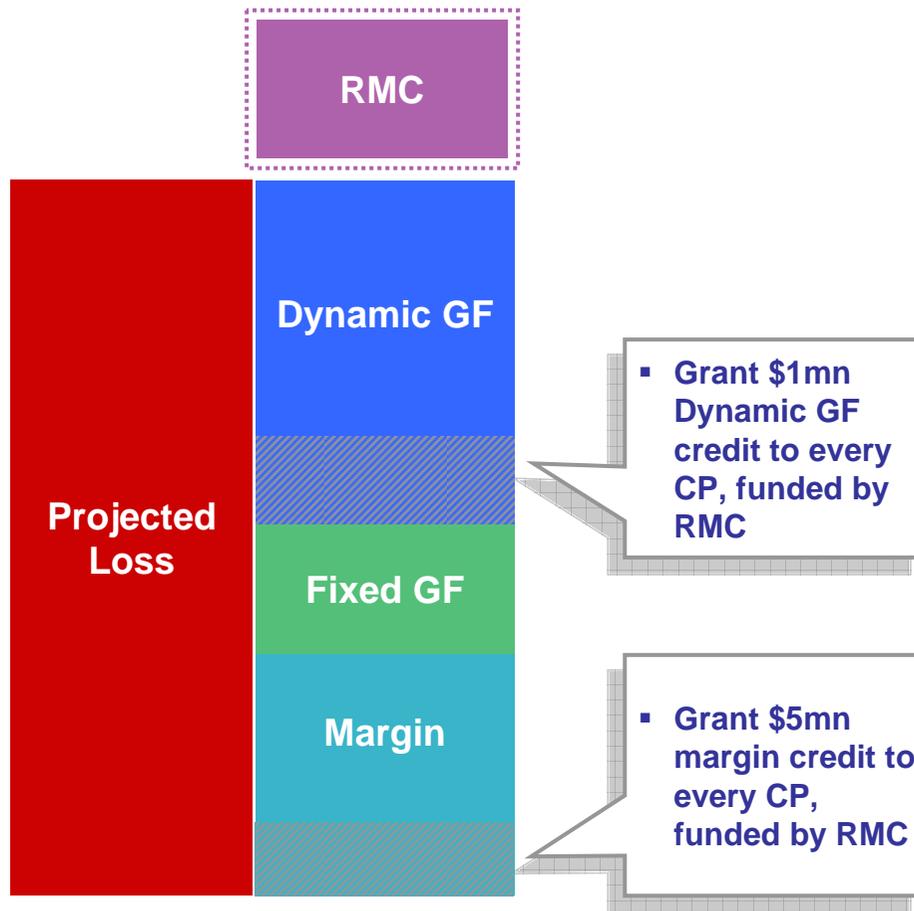
- Give credit to risk margin deposit in RF calculation

HKSCC

- Adopt volatility-based margin methodology, min at 5%



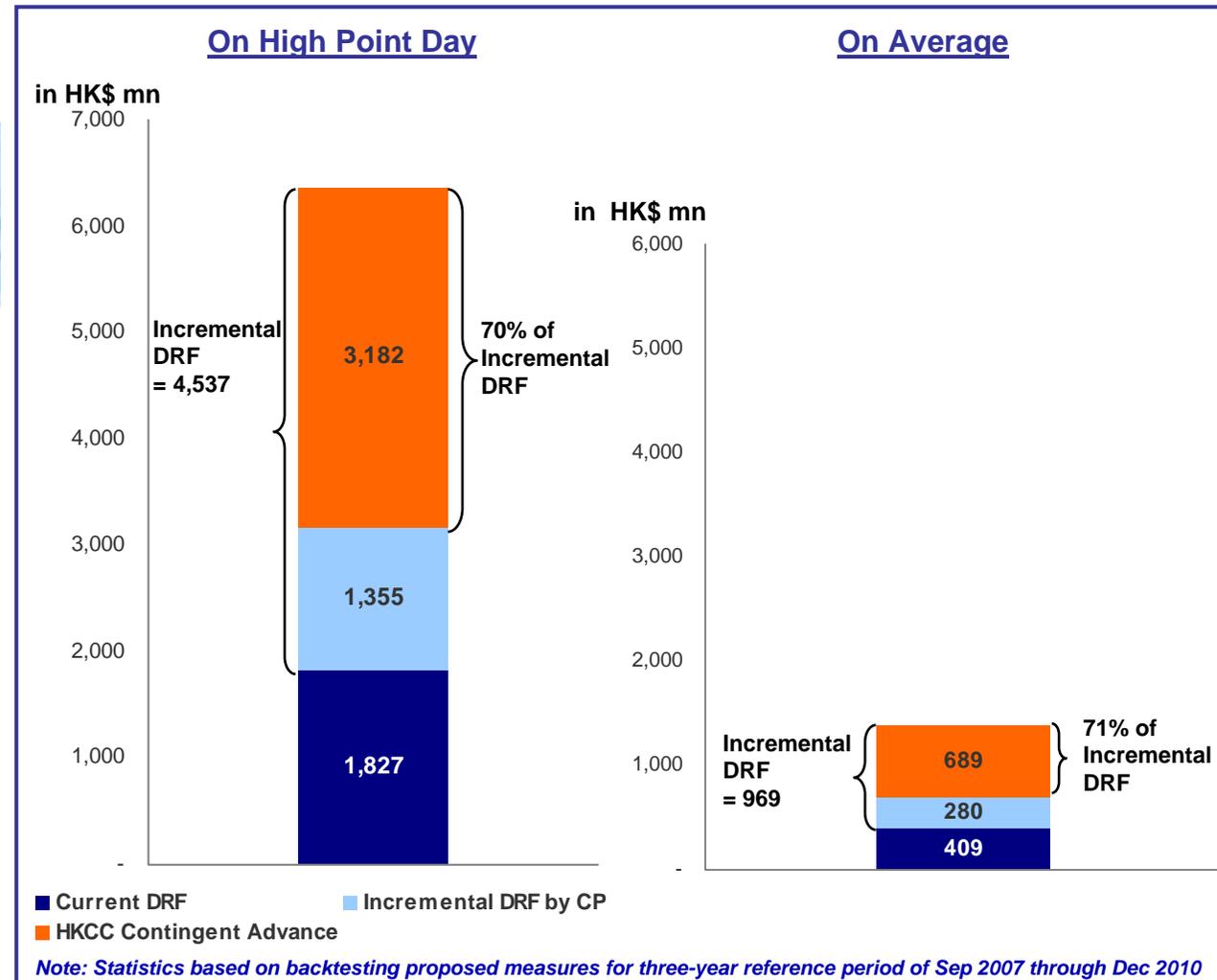
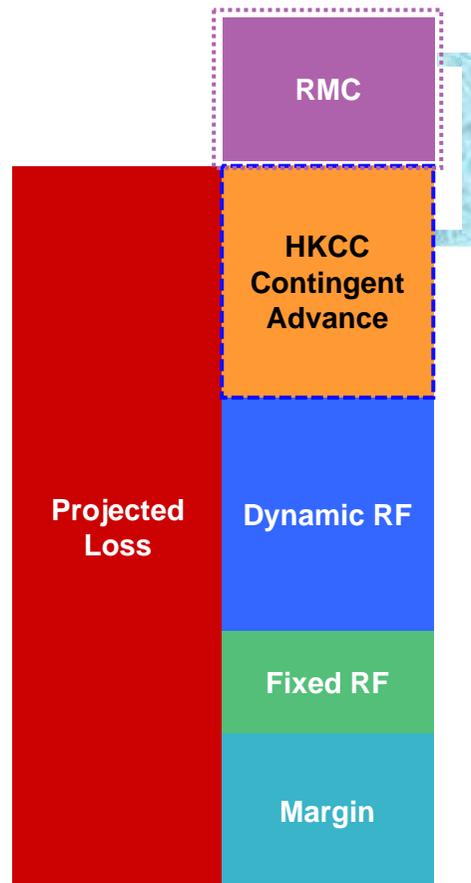
HKEx Funding Support – HKSCC Credits



*Based on backtesting proposed measures for three-year reference period of September 2007 through December 2010

~80% of the HKSCC CPs on average would not have been required to pay margin or Dynamic GF on a given day

Impact of HKCC Contingent Advance

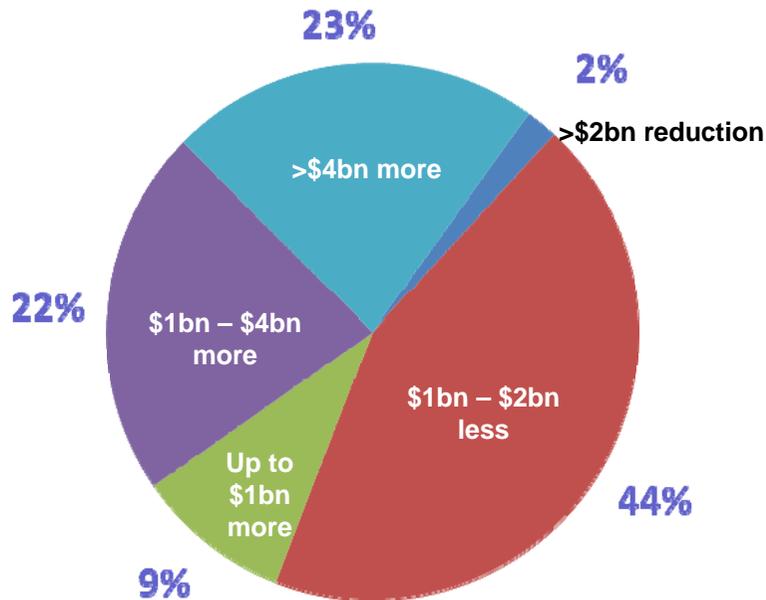


- HKCC Contingent Advance shares ~70% of CPs' incremental Dynamic RF requirement
- Any loss sustained by HKCC Contingent Advance will be recoverable from CP

Impact on HKSCC CPs – Margin and Dynamic GF (Backtesting Results)

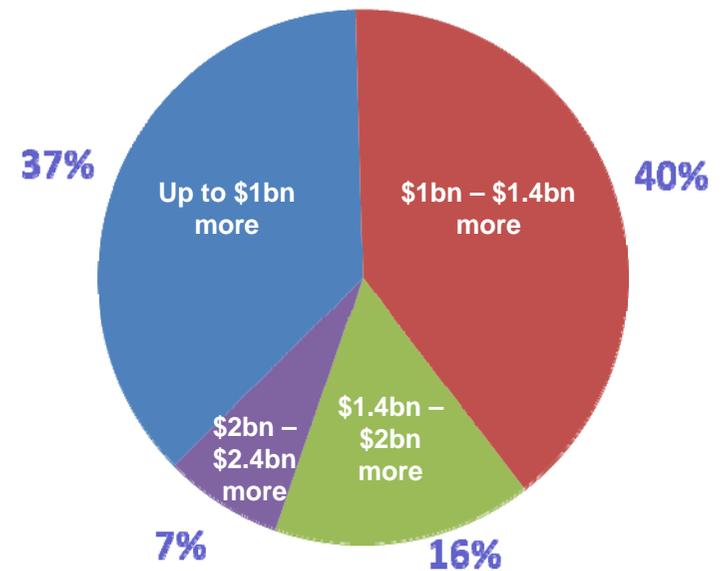


Distribution of Incremental Margin Collectible by % of Time



Margin Collectible	Current (in HK\$ mn)	Proposed (in HK\$ mn)
Market average daily	2,389	3,769

Distribution of Incremental Dynamic GF Collectible by % of Time



Dynamic GF Collectible	Current (in HK\$ mn)	Proposed (in HK\$ mn)
Market average daily	0	1,129

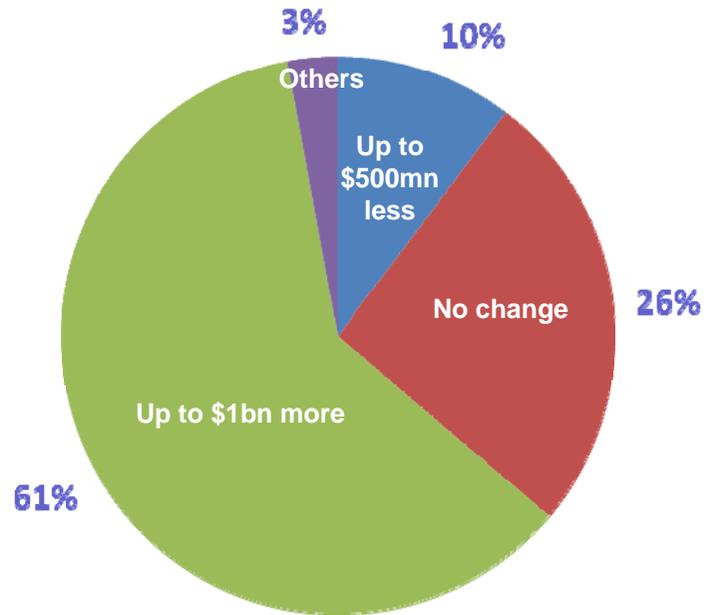
Note: Statistics based on backtesting proposed measures for three-year reference period of Sep 2007 through Dec 2010

**HKSCC Margin: 46% of time pay less; 31% of time pay up to \$4bn more
HKSCC Dynamic GF: 77% of time pay up to \$1.4bn more**

Impact on Derivatives Market CPs – Dynamic RF (Backtesting Results)

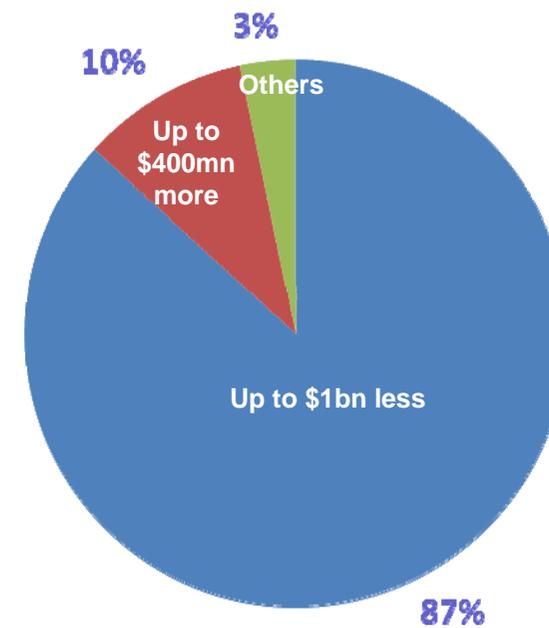


**Distribution of Incremental Dynamic RF
Collectible by % of Time – HKCC**



Dynamic RF Collectible	Current (in HK\$ mn)	Proposed (in HK\$ mn)
Market average daily	409	689

**Distribution of Incremental Dynamic RF
Collectible by % of time – SEOCH**

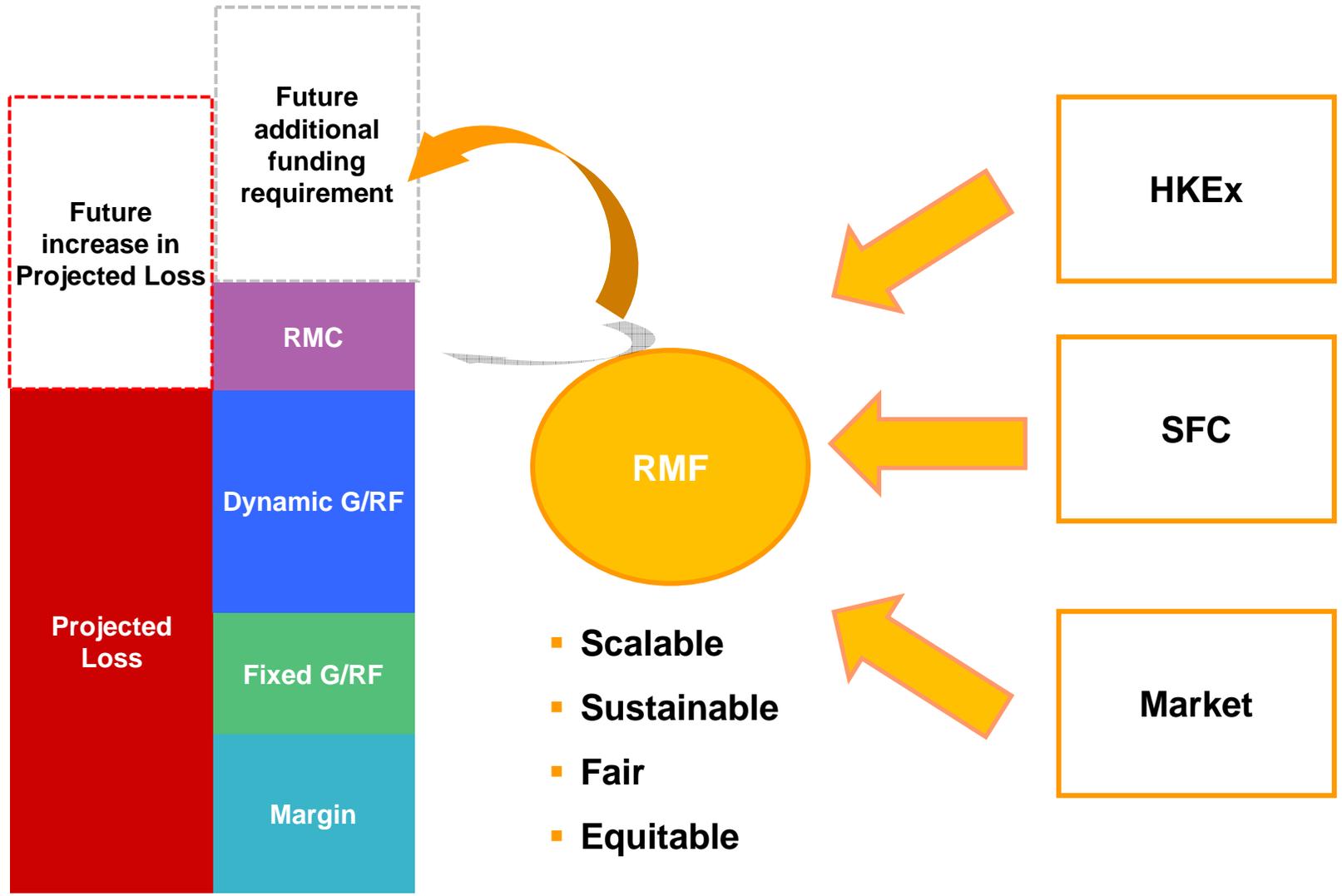


Dynamic RF Collectible	Current (in HK\$ mn)	Proposed (in HK\$ mn)
Market average daily	560	358

Note: Statistics based on backtesting proposed measures for three-year reference period of Sep 2007 through Dec 2010

HKCC: 39% of time, no change or pay less; 61% of time, pay up to \$1bn more
SEOCH: 87% of the time, pay less

Risk Management Fund: A Longer Term Consideration



RMF provides scalable funding resource and a buffer for future regulatory changes

Public release 8 Jul 2011

Seminars and one-on-one meetings Jul – Oct 2011

Consultation period closing 28 Oct 2011

Consultation conclusion target to release in early 2012

Thank You