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Newsletter

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What's inside?

HKMA releases a technical whitepaper on Retail Central Bank Digital Currency ("**CBDC**")

Simon Deane and Crystal Choi

The Hong Kong Monetary Authority ("**HKMA**") released a technical whitepaper on CBDC on 4th October 2021 "e-HKD: A technical perspective" ("**Whitepaper**").

The HKMA announced its "Fintech 2025" strategy in June this year, one part of which is to strengthen research work into CBDC with a view to future-proofing Hong Kong in terms of CBDC readiness. Apart from the continued and expanded collaborative effort with peer central banks on the cross-border application of wholesale CBDC, the HKMA has commenced a study into the prospects of issuing retail CBDC in Hong Kong, i.e. e-HKD, covering both technical and policy considerations, and aims to come up with an initial view by the middle of next year. The publication of the Whitepaper constitutes part of the HKMA's research effort on the technical front.

The Whitepaper explores potential technical design options for issuing and distributing retail CBDCs. This is the first among similar papers published by central banks to unveil a technical architecture that includes a ground breaking privacy preservation arrangement that allows transaction traceability in a privacy-amicable manner. In the course of this research, the HKMA has also identified a number of issues for further exploration which are summarised in the problem statements in the Whitepaper. The HKMA is seeking feedback and suggestions on its proposed design from academia and the industry by 31 December 2021.

The report can be found here.

The Office of the Privacy Commissioner for Personal Data ("PCPD") publishes FAQ on "Understanding the European Commission's New Standard Contractual Clauses for Transfer of Personal Data from EU to Non-EU Regions"

Simon Deane and Bonnie Wong

The European Commission adopted a new set of Standard Contractual Clauses ("**New SCCs**"), effective 27 June 2021, for the transfer of personal data to non-EU regions. From 27 September 2021 onwards, data exporters and data importers can only conclude contracts which incorporate the New SCCs for the transfer of personal data out of the European Union. The PCPD has published an FAQ on the practical implications of the New SCCs for cross-border data transfer agreements using the New SCCs.

Key takeaways include:

- The New SCCs apply where a data exporter is subject to the General Data Protection Regulation but the data importer is not. Therefore businesses in Hong Kong may be required to accept the New SCCs where they act as data importers receiving European Union/European Economic Area personal data.

- Organisations have been given a transitional period of 18 months from 27 June 2021 (i.e. the date when the New SCCs became effective) to 27 December 2022 to replace all existing contracts containing the old Standard Contractual Clauses with the New SCCs.

The New SCCS provide for engagement of sub-processors of personal data by a data importer.

For the full version of the FAQ, please visit the PCPD's website.

Board of the International Organisation of Securities Commissions (IOSCO) publishes final guidance report for artificial intelligence and machine learning

Simon Deane and Ruby Hui

Subsequent to the consultation report published by IOSCO in June 2021, the final guidance report ("**IOSCO** Report") for artificial intelligence ("**AI**") and machine learning ("**ML**") entitled "The use of artificial intelligence and machine learning by market intermediaries and asset managers" was released on 7 September 2021.

Per the IOSCO Report, market intermediaries and asset managers tend to achieve cost reductions and improve efficiency through the use of AL and ML. While market intermediaries, asset managers and investors receive benefits including efficiency enhancement, cost reduction and resource sparing, a concern is amplification of risk that affects the interests of consumers and other market participants.

In the light of the above, the IOSCO Report sets out some recommended measures to ensure that the interests of investors and other relevant stakeholders are protected. Further, Annex I and Annex 2 to the IOSCO Report outline the regulators' responses to the challenges arising from AI and ML, and the guidance issued by supranational bodies respectively.

Recent update on Term SOFR and ARRC's best practice recommendations

Simon Deane and Natalie Chan

On 27 August 2021, the Alternative Reference Rates Committee ("**ARRC**"), a group of private-market participants convened by the Federal Reserve Board and the Federal Reserve Bank of New York in 2014 to lead the LIBOR transition in the United States, issued FAQs and Best Practice Recommendations on, among other things, the use of the Secured Overnight Financing Rate ("**SOFR**") and its term rates ("**Term SOFR**"), following the ARRC's formal recommendation to use Term SOFR on 29 July 2021.

The ARRC supports using Term SOFR in business loan activities, in particular in syndicated loans, middle market loans and trade finance loans, where the use of forward-looking term rates is likely better to address difficulties transitioning from LIBOR (which is a forward-looking rate) than other alternative reference rates (where a number of options are backward-looking, prior to Term SOFR being made available to the market).

For derivatives, the ARRC's general position is that Term SOFR should not be used for the majority of derivative products, except that limited use of Term SOFR in end-user facing derivatives that intend to hedge cash products is recommended. For these purposes, an end-user is classified by the ARRC as (a) a direct party or guarantor in respect of a new SOFR term rate loan, (b) a securitization linked to SOFR term rate assets or (c) a legacy LIBOR product that has converted to Term SOFR.

For more details on the FAQs, please see here.

For more details on the Best Practice Recommendations, please see here.

Information note on the end of LIBOR by the APLMA and the TMA

Simon Deane and Natalie Chan

On 14 September 2021, the Asia Pacific Loan Market Association ("**APLMA**") and the Treasury Markets Association ("**TMA**") jointly published a note ("**Note**") that sets out a summary of options available in the loan market for replacing USD LIBOR with the Secured Overnight Financing Rate ("**SOFR**").

The Note is supported and endorsed by the Hong Kong Monetary Authority ("**HKMA**"). Market surveys revealed that moving away from LIBOR is often hindered by, among other factors, market participants' lack of knowledge of the relevant alternative reference rates. In the light of the deadline set by the HKMA for financial institutions to cease entering into new LIBOR contracts after 31 December 2021, it is hoped that the Note, which sets out the characteristics and pros and cons of each SOFR option, can help drive market forces to work towards this deadline.

For more information on the Note, please click here.

Synthetic LIBOR available for certain currencies to facilitate wind-down of LIBOR

Simon Deane and James Tong

The UK's Financial Conduct Authority ("**FCA**") announced on 5 March 2021 that Sterling, Japanese yen, Swiss franc and euro LIBOR panels will cease on 31 December 2021.

Following up on that announcement, on 29 September 2021, the FCA published an important note which confirmed that it would require the LIBOR benchmark administrator, The Intercontinental Exchange Benchmark Administration, to publish certain sterling and Japanese yen LIBOR settings using a "synthetic' methodology, based on term risk-free rates and the ISDA fixed spread adjustment, after end-2021 for a limited period. The purpose of these arrangements is to try to avoid disruption to legacy LIBOR based contracts that reference the 1-, 3- and 6-month sterling and Japanese LIBOR settings.

Two points however should be noted. First, these synthetic settings will be published on a non-representative basis. Secondly, the synthetic settings will only be permitted to be used in certain types of legacy contracts and the publication of synthetic LIBOR is not intended to delay or discourage active transition from the use of LIBOR to risk-free rates in contracts.

For more details on FCA's note on synthetic settings, please click here.

HKMA's Fintech Supervisory Sandbox links up with the PBOC's Fintech Innovation Regulatory Facility

Simon Deane and Crystal Choi

The Hong Kong Monetary Authority ("**HKMA**") and the People's Bank of China ("**PBOC**") jointly announced on 21 October 2021 that the two authorities have signed a "Memorandum of Understanding on Fintech Innovation Supervisory Cooperation in the Guangdong-Hong Kong-Macao Greater Bay Area".

By signing the Memorandum of Understanding, the two authorities have agreed to link up the PBOC's Fintech Innovation Regulatory Facility with the HKMA's Fintech Supervisory Sandbox in the form of a "network". The "network link-up" aims to provide a "one-stop platform" to allow eligible financial institutions ("FIs") and technology firms to conduct pilot trials of cross-boundary fintech initiatives, concurrently in Hong Kong and Mainland Greater Bay Area cities. The arrangement will enable FIs and tech firms to obtain early supervisory feedback and user opinions, expediting the launch of Fintech products and reducing development costs.

Further details can be found in the joint announcement (Chinese version only) issued by the HKMA and the PBOC.

Want to know more?

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