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SECURITIES AND FUTURES (CLIENT SECURITIES) RULES

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SECURITIES AND FUTURES (CLIENT SECURITIES) RULES

(Made by the Securities and Futures Commission under
section 144(1) of the Securities and Futures
Ordinance (of 2001))

PART I

PRELIMINARY

1. Commencement

These Rules shall come into operation on the day appointed for the commencement of Part VI of the Ordinance.

2. Interpretation

In these Rules, unless the context otherwise requires -

“approved institution” (核准機構) means an institution approved by the Commission by written notice as providing satisfactory facilities for the safe custody of client securities and securities collateral;

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"client contract" (客戶合約) includes any contract or arrangement between -

- (a) an intermediary to which these Rules apply and its client, containing terms on which the intermediary is to provide services the provision of which constitutes a regulated activity;
- (b) an associated entity to which these Rules apply and the client of an intermediary with which the associated entity is in a controlling entity relationship, which contains terms regarding the treatment of client securities or securities collateral;

"client's agreement" (客戶協議) means a written client contract in which a client is notified of the right of an intermediary, or an associated entity of the intermediary, to which these Rules apply, to dispose of client securities or securities collateral in accordance with section 6;

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"client's authority" (客戶授權) means the authority given in writing by a client to an intermediary, or an associated entity of the intermediary, to which these Rules apply, concerning the treatment of client securities or securities collateral and such authority -

- (a) is effective only if it specifies the period for which it is current;
- (b) remains in force for the period so specified or 12 months, whichever is the shorter; and
- (c) may be renewed in writing or otherwise for one or more further periods not exceeding 12 months at any one time;

"segregated account" (獨立帳戶) means an account designated as a trust account or a client account.

3. Application

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These Rules apply to client securities and securities collateral that are -

(a) either -

(i) listed on a recognized stock market; or

(ii) collective investment schemes authorized by the Commission under section 103 of the Ordinance; and

(b) received or held in Hong Kong by or on behalf of -

(i) an intermediary; or

(ii) an associated entity of the intermediary.

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PART II

TREATMENT OF CLIENT SECURITIES

Division 1 - General rules

4. Requirement for registration or deposit of client securities and securities collateral

(1) Subject to sections 5 and 6, and Division 2 as applicable, as soon as practicable after any client securities are received, an intermediary or an associated entity of the intermediary must ensure that they are -

(a) deposited in safe custody in a segregated account with -

- (i) an authorized financial institution;
 - (ii) an approved institution; or
 - (iii) another intermediary that is licensed for dealing in securities;
- or

(b) registered in the name of -

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- (i) the client from whom or on whose behalf the client securities have been received; or
- (ii) the associated entity.

(2) Subject to sections 5 and 6, and Division 2 as applicable, as soon as practicable after any securities collateral is received, an intermediary or an associated entity of the intermediary must ensure that it is -

- (a) deposited in safe custody in a segregated account with -

- (i) an authorized financial institution;
- (ii) an approved institution; or
- (iii) another intermediary that is licensed for dealing in securities;

- (b) deposited in an account in its own name with -

- (i) an authorized financial institution;
 - (ii) an approved institution; or
 - (iii) another intermediary that is licensed for dealing in securities;
- or

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(c) registered in the name of -

- (i) the client from whom or on whose behalf the securities collateral has been received;
- (ii) the intermediary; or
- (iii) the associated entity.

5. Withdrawal of client securities and securities collateral

Subject to section 6, and Division 2 as applicable, an intermediary or an associated entity of the intermediary may withdraw client securities or securities collateral in accordance with -

(a) an oral or written direction from the client from whom or on whose behalf the client securities or securities collateral have been received -

- (i) to sell specified client securities or securities collateral; or

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(ii) to settle such a sale order;

(b) an oral or written direction from the client from whom or on whose behalf the client securities or securities collateral have been received to withdraw specified client securities or securities collateral;
or

(c) the client's authority of the client from whom or on whose behalf the client securities or securities collateral have been received, except where this would -

(i) result in a transfer of the client securities or securities collateral to the account of any officer or employee of the intermediary or the associated entity, unless that officer or employee is the client; or

(ii) be unconscionable in the sense used in the Unconscionable Contracts Ordinance (Cap. 458), as if the client's authority

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were a contract under that
Ordinance.

6. Right of disposal of client securities and securities collateral

With the client's agreement of the client from whom
or on whose behalf client securities or securities
collateral have been received, an intermediary may -

(a) dispose; or

(b) initiate a disposal by an associated entity
of the intermediary,

of any of the client securities or securities collateral
in settlement of any liability owed by or on behalf of the
client to -

(c) the intermediary;

(d) the associated entity; or

(e) a third person.

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Division 2 - Particular rules

7. Treatment of client securities and securities collateral by intermediaries licensed or exempt for dealing in securities and their associated entities

(1) This section applies to -

(a) an intermediary licensed or exempt for dealing in securities; and

(b) an associated entity of the intermediary.

(2) With ~~the client's authority of the client from~~ whom or on whose behalf client securities or securities collateral have been received, an intermediary or an associated entity referred to in subsection (1) may -

(a) apply any of the client securities or securities collateral pursuant to a securities borrowing and lending agreement;

(b) deposit any of the securities collateral with an authorized financial institution as

Comment [SU1]: Based on ss. 81(5) and 81A(5) SO.

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collateral for financial accommodation
provided to the intermediary; or

(c) deposit any of the securities collateral
with -

- (i) a recognized clearing house; or
- (ii) a different intermediary
licensed for dealing in
securities,

Comment [SU2]: Based on
s.81A(6)(c) and (d) SO.

as collateral for the discharge and
satisfaction of the intermediary's
settlement obligations and liabilities.

(3) Where an intermediary referred to in subsection (1)
provides financial accommodation to a client in the course
of -

(a) dealing in securities; and

(b) any other regulated activity for which the
intermediary is licensed or exempt,

the intermediary or an associated entity of the
intermediary may apply or deposit any securities

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collateral in accordance with subsection (2) with the client's authority of the client from whom or on whose behalf the securities collateral has been received.

8. Treatment of securities collateral by intermediaries licensed for securities margin financing and their associated entities

(1) This section applies to -

(a) an intermediary licensed for securities margin financing; and

(b) an associated entity of the intermediary.

(2) With the client's authority of the client from whom or on whose behalf securities collateral has been received, an intermediary or an associated entity referred to in subsection (1) may deposit any of the securities collateral with -

(a) an authorized financial institution; or

(b) an intermediary licensed for dealing in securities,

Comment [SU3]: Based on s.121AB(4) SO.

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as collateral for financial accommodation provided to the intermediary.

9. Treatment of securities collateral by intermediaries licensed or exempt for dealing in futures contracts and their associated entities

(1) This section applies to -

(a) an intermediary licensed or exempt for dealing in futures contracts; and

(b) an associated entity of the intermediary.

(2) Subject to section 7(3), with the client's authority of the client from whom or on whose behalf securities collateral has been received, an intermediary or an associated entity referred to in subsection (1) may deposit any of the securities collateral with -

Comment [SU4]: Based on s. 81A(6)(a) SO.

(a) a recognized clearing house; or

Comment [SU5]: Based on s.81A(6)(c) and (d) SO.

(b) another intermediary licensed for dealing in futures contracts,

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as collateral for the discharge and satisfaction of the intermediary's settlement obligations and liabilities.

PART III

MISCELLANEOUS

10. Limitations on the treatment of client securities and securities collateral

(1) An intermediary or an associated entity to which these Rules apply must take reasonable steps to ensure that client securities and securities collateral are not -

Comment [SU6]: Based on s. 121AB(3), 81(4) and 81A(4) SO.

- (a) deposited;
- (b) transferred;
- (c) lent;
- (d) pledged;
- (e) repledged; or
- (f) otherwise dealt with,

except as provided in Part II.

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Comment [SU7]: Based on s.121AB(9), 81(11), 81A(10).

(2) For the avoidance of doubt, subsection (1) does not require the intermediary or associated entity to ensure that the client securities or securities collateral are not -

- (a) redeposited;
- (b) transferred;
- (c) relent;
- (d) pledged;
- (e) repledged; or
- (f) otherwise dealt with,

by a person to whom the intermediary or associated entity has lent or deposited any of the client securities or securities collateral in accordance with Part II.

11. Reporting of non-compliance with Rules

An intermediary or an associated entity which becomes aware that it is not in compliance with any of the provisions in Part II or section 10(1) must notify the Commission within one business day.

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12. Penalties

(1) An intermediary or an associated entity that contravenes section 4 or 11 -

(a) without reasonable excuse commits an offence and is liable on conviction to a fine at level 3;

(b) with intent to defraud commits an offence and is liable on conviction to a fine at level 6.

(2) An intermediary or an associated entity that contravenes section 10(1) -

(a) without reasonable excuse commits an offence and is liable -

(i) on conviction on indictment to a fine of \$200,000 and to imprisonment for 2 years; or

(ii) on summary conviction to a fine at level 6 and to imprisonment for 6 months;

Comment [SU8]: The vires for a fine at level 5 will be increased to level 6 as in current legislation.

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(b) with intent to defraud commits an offence
and is liable -

- (i) on conviction on indictment to a
fine of \$1,000,000 and to
imprisonment for 7 years; or
- (ii) on summary conviction to a fine
of \$500,000 and to imprisonment
for 1 year.

Chairman,
Securities and Futures
Commission

2001

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Explanatory Note

These Rules are made by the Securities and Futures Commission under section 144(1) of the Securities and Futures Ordinance (of 2001). They prescribe the manner in which intermediaries and their associated entities must treat client securities and securities collateral received or held in Hong Kong. Different requirements are prescribed for different intermediaries, and their respective associated entities, depending upon the type of regulated activity for which an intermediary is licensed.