

[For Consultation]

**CODE OF CONDUCT
FOR PERSONS REGISTERED WITH
THE SECURITIES AND FUTURES COMMISSION**

Securities and Futures Commission
Hong Kong
September 2000

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Explanatory notes: -

The Commission will be guided by this Code of Conduct (the "Code") in considering whether a registered person satisfies the fit and proper test to remain registered. The Code has been published in the Gazette.

Where the Commission has information which suggests that a registered person is not a fit and proper person to remain registered, it may initiate an inquiry under section 56(1), or section 121S of the Securities Ordinance (Cap. 333), or section 36(1) of the Commodities Trading Ordinance (Cap. 250). This information may refer to how the registered person conducts the business for which it is registered, or it may refer to other matters. The conduct of business is discussed in this Code. The Commission places great importance on registered persons being fit and proper. It will review cases of registered persons not being fit and proper most stringently.

A registered person should have regard to the general principles, as well as the letter, of the Code. The Commission takes a breach of the general principles of the Code as seriously as a breach of the letter of the Code.

Registered persons should note the various Schedules to the Code. These are part of the Code and provide, among other things, supplemental materials such as risk disclosure statements. There are also specific Schedules of provisions that apply to registered persons which transact in securities and/or futures contracts of The Stock Exchange of Hong Kong Limited and/or Hong Kong Futures Exchange Ltd. These are derived primarily from former rules of the Exchanges. Registered persons are expected under paragraph 12.1 of the Code to comply with the rules of exchanges and clearing houses of which they are members or participants.

To reflect the realities of today's markets, the Commission recognizes that conduct of business principles should be flexible enough to differentiate between professional and non-professional investors.¹

This Code does not have the force of law and should not be interpreted in a way that would override the provision of any law.

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¹ See Report of the International Organization of Securities Commissions (IOSCO) Technical Committee, July 9, 1990: International Conduct of Business Principles.

General principles

The Commission has modelled the Code on principles developed and recognized by the International Organization of Securities Commissions and other principles the Commission believes to be fundamental to the undertaking of a registered person's business.

Deleted: In considering whether a registered person is conducting his business satisfactorily and whether the way in which he conducts his business reflects on his ability to satisfy the fit and proper test to remain registered,

GP1. Honesty and fairness

In conducting its business activities, a registered person should act honestly, fairly, and in the best interests of its clients and the integrity of the market.

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GP2. Diligence

In conducting its business activities, a registered person should act with due skill, care and diligence, in the best interests of its clients and the integrity of the market.

GP3. Capabilities

A registered person should have and employ effectively the resources and procedures which are needed for the proper performance of its business activities.

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GP4. Information about clients

A registered person should seek from its clients information about their financial situation, investment experience and investment objectives relevant to the services to be provided.

GP5. Information for clients

A registered person should make adequate disclosure of relevant material information in its dealings with its clients.

GP6. Conflicts of interest

A registered person should try to avoid conflicts of interest, and when they cannot be avoided, should ensure that its clients are fairly treated.

GP7. Compliance

A registered person should comply with all regulatory requirements applicable to the conduct of its business activities so as to promote the best interests of clients and the integrity of the market.

GP8. Client assets

A registered person should ensure that client assets are promptly and properly accounted for and adequately safeguarded.

GP9. Responsibility of senior management

The senior management of a registered person should bear primary responsibility for ensuring the maintenance of appropriate standards of conduct and adherence to proper procedures by the whole firm.²

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CODE OF CONDUCT

Interpretation and application

Deleted: The Commission has referred to these principles in compiling the Code of Conduct set out below.¹
~~~~Section Break (Next Page)~~~~

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#### **1.1 Definition: registered person, person**

(a) A reference in the Code to a "registered person" has the same meaning as under section 2 of the Securities and Futures Commission Ordinance (Cap. 24). These are persons registered under the Securities Ordinance (Cap. 333) or the Commodities Trading Ordinance (Cap. 250) as a dealer, dealing partnership, dealer's representative, investment adviser, commodity trading adviser, investment advisers' partnership, investment representative, commodity trading adviser's representative, securities margin financier, and securities margin financier's representative.<sup>3</sup>

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(b) A reference in the Code to a "person" includes any public body and any body of persons, corporate or unincorporate.

#### **1.2 Definitions: securities, securities margin financing, futures contracts**

A reference in the Code to "securities", "securities margin financing" or "futures contracts" has the same meaning as under the Securities Ordinance (Cap. 333) or Commodities Trading Ordinance (Cap. 250).

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#### **1.3 Persons to which the Code applies**

Although the Code applies to all registered persons, the Commission recognizes that some aspects of compliance with the Code may not be within the control of a representative. In considering the conduct of representatives under the Code, the Commission will consider their levels

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<sup>2</sup> See Section 12.5 of the IOSCO report entitled "Objectives and Principles of Securities Regulation" released in September 1998.

<sup>3</sup> See Securities (Margin Financing)(Amendment) Ordinance (Ord. No. 20 of 2000), Schedule 1: Consequential amendment of Securities Ordinance.

of responsibility within the firm, any supervisory duties they may perform, and the levels of control or knowledge they may have concerning any failure by their firms or persons under their supervision to follow the Code.

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#### 1.4 Persons to which the Code does not apply

The Code does not apply to a registered person to the extent such person is acting in the capacity of a management company in relation to an authorized unit trust or mutual fund under the Commission's Code on Unit Trusts and Mutual Funds. These registered persons are subject to the Fund Manager Code of Conduct issued by the Commission.

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#### 1.5 Effect of breach of the Code

When the Commission makes inquiry in respect of registered persons under section 56(1) or section 121S(1) of the Securities Ordinance (Cap. 333), or section 36(1) of the Commodities Trading Ordinance (Cap. 250), the Commission will be guided by this Code in considering whether any person is or has been guilty of misconduct or is a fit and proper person to remain registered.

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#### 1.6 Paragraph headings

A paragraph or section heading to any provision of the Code should not in any way vary, limit or extend the interpretation of the Code.

## Honesty and fairness

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note on page 29

### 2.1 Accurate representations

Where a registered person advises or acts on behalf of a client, it should ensure that any representations made and information provided to the client are accurate and not misleading.

CTO s63-64  
PIO s3-5  
SO s72, 78  
FMC 7.1

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### 2.2 Fair and reasonable charges

The general course of dealing or advising concerning a client, the conduct of securities margin financing, and the charges, mark-ups, or fees affecting a client should be fair and reasonable under the circumstances, and be characterized by good faith.

FMC 8.2

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### 2.3 Advertising

A registered person should ensure that invitations and advertisements do not contain information that is false, biased, misleading or deceptive.<sup>4</sup>

PIO s4-5 &  
FMC 7.1

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### 2.4 Anti-bribery guidelines<sup>5</sup>

A registered person should be familiar with the Prevention of Bribery Ordinance (Cap. 201) (PBO) and follow related guidance issued by the Independent Commission Against Corruption. The PBO provides that an agent (normally an employee) cannot solicit or accept an advantage without the permission of the principal (normally the employer) when conducting the principal's business. A person who offers the advantage may also commit an offence.

PBO  
FMC 2.2

<sup>4</sup> Provisions derived, in part, from Code of Unit Trusts and Mutual Funds, The Stock Exchange of Hong Kong Limited Rule 361, The Stock Exchange of Hong Kong Limited Rules: Twelfth Schedule (section 1)) and Hong Kong Futures Exchange Ltd. Rule 523.

<sup>5</sup> Provisions derived, in part, from The Stock Exchange of Hong Kong Limited Rules: Seventh Schedule (section 7b) and Hong Kong Futures Exchange Ltd. Rules: Schedule 3, section 1(b).

## Diligence

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### 3.1 Prompt execution

A registered person should take all reasonable steps to execute promptly client orders in accordance with clients' instructions. GIR 6.2.2

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### 3.2 Best execution

A registered person when acting for or with clients should execute client orders on the best available terms. FMC 3.2

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### 3.3 Prompt and fair allocation

A registered person should ensure that transactions executed on behalf of clients are promptly and fairly allocated to the accounts of the clients on whose behalf the transactions were executed. FMC 3.4 ICG VII & App A

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### 3.4 Advice to clients: due skill, care and diligence

When providing advice to a client, a registered person should act diligently, disclose material facts and ensure that its advice and recommendations to clients are based on thorough analysis and take into account available alternatives.

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### 3.5 No withholding of orders for convenience<sup>6</sup>

A registered person should not withdraw or withhold orders for its own convenience or for the convenience of any other person.

### 3.6 Collection of margins<sup>7</sup>

In dealing for its clients in securities and futures contracts that require the provision of margin (including collateral), a registered person should collect promptly from clients any amounts due as margin.

### 3.7 Separate accounts<sup>8</sup>

A registered person should keep separate accounts for each client for dealings in securities and futures contracts, and where relevant, for transactions concluded on a cash basis and a margin basis.

### 3.8 Derivative position and reporting limits<sup>9</sup>

<sup>6</sup> Provisions derived, in part, from Hong Kong Futures Exchange Ltd. Rule 813.

<sup>7</sup> Provisions derived, in part, from Hong Kong Futures Exchange Ltd. Rule 617(f).

<sup>8</sup> Provisions derived, in part, from The Stock Exchange of Hong Kong Limited Rule 424(1).

A registered person should bring applicable derivatives position and reporting limits to the attention of clients who may be affected by the limits.

CTO s59  
SO

### **3.9 Order recording**<sup>10</sup>

Except as otherwise provided in Schedule 3 to the Code, a registered person should record and immediately time stamp records of the particulars of the instructions for agency orders and internally generated orders (such as proprietary accounts and staff accounts). Where order instructions are received from clients through the telephone, a registered person should use a telephone recording system to record such instructions and maintain telephone recordings as part of its records for at least 6 months.

CTO s45SO Deleted: ¶  
s67& 83  
ICG

#### Note

*The Commission realises that some registered persons may not currently have telephone recording systems to record clients' order instructions received by telephone. The Commission generally expects such registered persons to arrange to put a recording system in place within six months of the effective date of the new provision. The Commission notes that mobile telephones are widely used in Hong Kong. In this regard, the Commission expects registered persons to arrange for the use of a telephone recording system in their offices. Although use of mobile phones for receiving client order instructions is discouraged, where orders are accepted by mobile phones outside of the office, the time of receipt and the order details should be recorded immediately (e.g. by a call to the office system or in writing by hand).*

### **3.10 Best interests of clients**<sup>11</sup>

A registered person should act in the best interests of its clients in providing services or recommending the services of another person to its clients.

FMC 3 & 8

<sup>9</sup> Provisions derived, in part, from Hong Kong Futures Exchange Ltd. Rule 633 and The Stock Exchange of Hong Kong Limited Operational Trading Procedures (sections 5.9-5.10).

<sup>10</sup> Provisions derived, in part, from Hong Kong Futures Exchange Ltd. Rules 531 and 531A, and The Stock Exchange of Hong Kong Limited Options Trading Rule 410.

<sup>11</sup> Provisions derived, in part, from The Stock Exchange of Hong Kong Limited Rule 604, Hong Kong Futures Exchange Ltd. Rule 516 and Code 4.1.

## Capabilities

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### 4.1 Fit and proper staff

A registered person ~~should~~ ensure that any person ~~it~~ employs or appoints to conduct business with clients or other registered persons is fit and proper and otherwise qualified to act in the capacity so employed or appointed ~~(including having relevant professional training or experience).~~

CTO Pt IV  
SO Pt VI &  
VIA  
FMC 1.1-1.2  
FPC  
GIR

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### 4.2 Staff supervision

A registered person ~~should~~ ensure that ~~it~~ has adequate resources to supervise diligently and ~~supervises~~ diligently ~~persons employed or appointed~~ by ~~it~~ to conduct business with clients or other registered persons.

FMC 1.2 & 1.3  
FPC  
ICG I & III

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### 4.3 Internal control, financial and operational resources

A registered person ~~should have~~ satisfactory internal control procedures and financial and operational capabilities which can be reasonably expected to protect ~~its~~ operations, ~~its~~ clients and other registered persons from financial loss arising from theft, fraud, and other dishonest acts, professional misconduct or omissions.

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FMC 1.2 & 1.3  
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## Information about clients

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### 5.1 Know your client: in general

A registered person should take all reasonable steps to establish the true and full identity of each of its clients, and of each client's financial situation, investment experience, and investment objectives. Where an account opening procedure other than a face-to-face approach is used, it should be one that satisfactorily ensures the identity of the client. Where the account opening documents are not executed in the presence of an employee of the registered person, the Client Agreement (as defined in paragraph 6.1) and related identity documents should be certified by a professional person such as a banker, certified public accountant, solicitor or notary public.

FMC 6.3  
GIR 6.2.1  
MLG 4

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### 5.2 Know your client: reasonable advice

Having regard to information disclosed by a client and other circumstances relating to the client which the registered person is or should be aware of through the exercise of due diligence, the registered person should, when making a recommendation or solicitation, ensure the suitability of such recommendation or solicitation for that client as is reasonable in all the circumstances.

FMC 3.1 & 6.3

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### 5.3 Know your client: derivative products

A registered person providing services to a client in derivative products, including futures contracts or options, or any leveraged transaction should assure itself that the client understands the nature and risks of the products and has sufficient net worth to be able to assume the risks and bear the potential losses of trading in such products.

CC 3.6  
FMC 6.3

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### 5.4 Client identity: origination of instructions and beneficiaries

- (a) Subject to paragraph 5.4(e)<sup>12</sup>, a registered person should be satisfied on reasonable grounds about:
- (i) the identity, address and contact details of:
    - (A) the person or entity (legal or otherwise) ultimately responsible for originating the instruction in relation to a transaction; and
    - (B) except in the case of 5.4(d) below, the person or entity (legal or otherwise) that stands to gain the commercial or economic benefit of the transaction and/or bear its commercial or economic risk; and

CIRP  
MLG

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<sup>12</sup> Revisions approved by the Commission on 17 July 2000, effective on 28 July 2000.

- (ii) the instruction given by the person or entity referred to in paragraph 5.4(a)(i)(A). Formatted
- (b) A registered person ~~should~~ keep in Hong Kong a record of the details referred to in paragraph 5.4(a) and give the Commission access to that record upon request. Deleted: must  
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- (c) A registered person ~~should~~ not do anything to effect a transaction unless ~~it has~~ first complied with paragraphs 5.4(a) and (b). Deleted: must  
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- (d) In relation to an investment fund (e.g., a mutual fund, unit trust, pooled retirement scheme, European CIS company, etc) or discretionary account the "entity" referred to in paragraph 5.4(a) is the investment fund or account, and the manager of that investment fund or account, not those who hold a beneficial interest in that investment fund or account (e.g., the unitholders of a unit trust). Formatted
- (e) Paragraph 5.4(a) applies only where the transaction involves securities or futures contracts that are listed or traded on an exchange in Hong Kong or an over the counter derivative written over such securities or futures contracts.<sup>13</sup>

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<sup>13</sup> Revisions approved by the Commission on 17 July 2000, effective on 28 July 2000.

## Client agreement

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### 6.1 Client agreement in writing

Registered persons should enter into a written agreement (Client Agreement) with each client before services are provided to the client. The Client Agreement should be in Chinese or English according to the language preference of the client, as should any other agreement, authority, risk disclosure, or supporting document. Registered persons should explain to the client the purpose and terms of each document referred to above and provide a copy of each of them to the client. Where an account opening procedure other than a face-to-face approach is used, explanation of such documents should be conducted in a manner that reasonably ensures that the client is properly advised and informed. As explained below, the type of Client Agreement may vary depending on the services provided.

CC Sch 1  
FMC 6.4  
GIR 6.2.6 &

Deleted: A registered person shall ensure that a written agreement (Client Agreement) is entered into with a client before any services are provided to that client. The registered person shall ensure that the Client Agreement is in a language understood by the client and shall explain to the client the contents of the Client Agreement.¶

### 6.2 Minimum content of client agreement

Subject to Schedules 1, 3 and 4 to the Code, a Client Agreement should contain at least provisions to the following effect:

CC Sch 3 &  
FMC 6.4, 8.1  
& App1

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- (a) the full name and address of the client as verified by a retained copy of the identity card, relevant sections of the passport, business registration certificate, corporation documents, or any other official document which uniquely identifies the client;
- (b) the full name and address of the registered person's business, including the registered person's registration status with the Commission and the CE number (being the unique identifier assigned by the Commission);
- (c) undertakings by the registered person and the client to notify the other in the event of any material change to the information (as specified in paragraphs 6.2(a), (b), (d), (e) and (i)) provided in the agreement;
- (d) a description of the nature of services to be provided to or available to the client, such as securities cash account, securities margin account, discretionary account, portfolio management, investment advice, unit trusts, or futures/options account;
- (e) a description of any remuneration (and the basis for payment) that is to be paid by the client to the registered person, such as commission, brokerage, and any other fees and charges;

- (f) if the registered person is acting as a dealer in relation to securities and it holds client's securities for safe custody in Hong Kong, a statement explaining section 81 of the Securities Ordinance (Cap. 333) and that if the client specifically authorizes the dealer to lend

CC Sch 1

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~~or deposit the client's securities to a person under section 81(6) of the Securities Ordinance (Cap. 333), the client faces a risk of loss of such securities;~~

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~~(g) if the registered person is acting as a dealer in relation to securities and it holds client's securities as collateral, a statement explaining section 81A of the Securities Ordinance (Cap. 333) and that if the client specifically authorizes the dealer to pledge, deposit or lend the client's securities to a person under section 81A(6) of the Securities Ordinance (Cap. 333), the client faces a risk of loss of such securities;~~

~~(h) if the registered person is acting as a securities margin financier and it holds client's securities as collateral, a statement explaining section 121AB of the Securities Ordinance (Cap. 333) and that if the client specifically authorizes the securities margin financier to deposit the client's securities with a person under section 121AB(4) of the Securities Ordinance (Cap. 333), the client faces a risk of loss of such securities;~~

~~(i) if margin or short selling facilities are to be provided to the client, details of margin requirements, interest charges, margin calls, and the circumstances under which a client's positions may be closed without the client's consent;~~

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~~(j) if services are to be provided to the client in relation to derivative products, including futures contracts or options, (1) a statement that the registered person should provide to the client upon request product specifications and any prospectus or other offering document covering such products and (2) a full explanation of margin procedures and the circumstances under which a client's positions may be closed without the client's consent; and~~ CC 3.6 & 5.3

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~~(k) the risk disclosure statements as specified in Schedule 1 to the CC Sch 1 Code.~~

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### 6.3 No circumvention of legal requirements

A registered person ~~should~~ ensure that it complies with its obligations ~~FMC 3.1~~ under a Client Agreement and that a Client Agreement does not operate to remove, exclude or restrict any rights of a client or obligations of the registered person under the law.

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**Discretionary accounts**

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**7.1 Authorization and operation of a discretionary account**

(a) A registered person should not effect a transaction for a client unless before the transaction is effected (i) the client, or a person designated by the client, has specifically authorized the transaction; or (ii) the client has authorized in writing the registered person or any person employed by the registered person to effect transactions for the client without the client's specific authorization. (b) the client at least on an annual basis whether the client wishes to revoke such authority.(c)

- ICG VII.2 **Deleted:** shall
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(d) Senior management should approve the opening of discretionary accounts.

(e) A registered person should implement internal control procedures to ensure proper supervision of the operation of discretionary accounts.

ICG VII.2

Where  
If a reg

## Information for clients

### 8.1 Information about the firm: in general

(a) A registered person should provide clients with adequate and appropriate information about its business, contact details, services available to clients, and the identity and status of employees and others acting on its behalf with whom the client may have contact.

(b) A registered person should ensure that its employees clearly identify the company for which they are acting. This is particularly important where employees act for more than one company, or in more than one capacity, in which case they should make clear on behalf of which company and in which capacity they are acting.

### 8.2 Prompt confirmation

(a) Unless specifically agreed otherwise in writing by the client, after a registered person has effected a transaction for a client, it should endeavour to confirm promptly with the client the essential features of the transaction.

(b) Where a registered person trades in options contracts for its clients, it should provide each client with a trade confirmation within 1 business day after effecting such trading that includes:<sup>14</sup>

(i) the number of contracts purchased or sold, the underlying asset, expiry month, strike price, option type (put or call), version number (if not 0) and whether they were closing contracts or opening contracts; and

(ii) the price and the unit of the asset comprised in each lot the subject of such contract.

### 8.3 Timely and accurate reporting

(a) A registered person should provide each client with a regular statement of account, which should be at least monthly, in relation to the client's transactions and related dealings, unless during the relevant period, there is no transaction or any revenue or expense item in the account and the account does not have any outstanding balance or holding of positions or collateral.

(b) The statement of account should include the client's transactions and other account movements during the period, and details of closing balances and positions; and quote the CE number (being the unique identifier assigned by the Commission).

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FMC 6.1 Deleted: shall

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CTO s45A  
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FMC 6.5

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SO s75  
FMC 6.5

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<sup>14</sup> The Stock Exchange of Hong Kong Limited Options Trading Rule 414.

(c) A registered person should indicate on the contract note if a transaction is a short selling transaction or is a securities borrowing and lending transaction.

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(d) If a registered person is a dealer in relation to securities and its client operates a cash account, the registered person should state on the statement of account that the account is a cash account.

#### 8.4 Information about the firm: financials

A registered person should disclose the financial condition of its business to a client upon request by providing a copy of the latest audited balance sheet and profit and loss account required to be filed with the Commission.

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Deleted: under the Financial Resources Rules and disclose any material changes which adversely affect the registered person's financial condition after the date of the accounts

#### 8.5 Information on corporate actions

A registered person that has control of a client's assets should respond promptly to such client's requests for information on corporate actions.

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## Client priority

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### 9.1 Priority for client orders: order handling and recording

A registered person should handle orders of clients fairly and in the order in which they are received. Orders of clients or transactions to be undertaken on behalf of clients should have in all cases priority over orders for the account of the registered person, or any account in which the registered person has an interest or the account of any employee or agent of the registered person.

FMC 2 & 3.1  
GIR 6.2.2  
ICG VII

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### 9.2 Priority for client orders: order allocation

A registered person should, where it has aggregated an order for a client with an order for another client, or with an order for its own account, give priority to satisfying orders of clients in any subsequent allocation if all orders cannot be filled.

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ICG VII

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### 9.3 Nonpublic, material information

A registered person should not deal in any securities or futures contracts for itself for any account in which it has an interest, or for any client based upon knowledge it possesses of pending transactions for or with clients or on any other non-public information (including research and analysis)<sup>15</sup> the disclosure of which would be expected to affect prices of such securities or futures contracts.

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FMC 1-2  
ICG VII

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### 9.4 Withdrawal from business

A registered person that withdraws in whole or in part from providing any investment or related services should ensure that affected clients are promptly notified of such action and that any such business which remains outstanding is promptly completed or transferred to another registered person in accordance with any instructions of the affected clients.

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## Conflicts of interest

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C10.

10.1 Disclosure and fair treatment

Where a registered person has a material interest in a transaction with or for a client or a relationship which gives rise to an actual or potential conflict of interest in relation to such transaction, it should neither advise, nor deal in relation to the transaction unless it has disclosed that material interest or conflict to the client and has taken all reasonable steps to ensure fair treatment of the client.

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ICG VII

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¹⁵ Provisions derived, in part, from The Stock Exchange of Hong Kong Limited Rules: Seventh Schedule (section 12c.i).

Client assets

11.1 Handling of client assets

A registered person should, in the handling of client transactions and assets, act to ensure that client assets are accounted for properly and promptly. Where the registered person or a third party on behalf of the registered person is in possession or control of client positions or assets, the registered person should ensure that client positions or assets are adequately safeguarded.

CTO s45-46
SO s67, 81, 83
& 84
FMC 4
ICG VII

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Compliance

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12.1 Compliance: in general

A registered person should comply with, and implement and maintain measures appropriate to ensuring compliance with the law, rules, regulations and codes issued by the Commission, the rules of any exchange or clearing house of which it is a member or participant, and the requirements of any regulatory authority which apply to the registered person.

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ICG V

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12.2 Employee dealings

(a) A registered person should have a policy which has been communicated to employees in writing on whether employees are permitted to deal for their own accounts in securities or futures contracts. For purposes of paragraph 12.2, the term “employees” includes directors of a registered person.

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ICG App A

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Deleted: If employees are permitted to deal, the conditions on which they may do so shall be set out in writing and communicated to each employee. A registered person shall not knowingly deal in securities or futures contracts for another registered person's employee unless he has written to that registered person and received his written consent.

(b) In the event that employees of a registered person are permitted to deal for their own accounts in securities or futures contracts:¹⁶

(i) the written policy should specify the conditions on which employees may deal for their own accounts;

(ii) such employees should be required to identify all related accounts and report them to senior management. For purposes of this paragraph 12.2, the term “related accounts” includes accounts of their minor children and accounts in which the employees hold beneficial interests;

(iii) such employees should generally be required to deal through the registered person or its affiliates;

(iv) if employees are permitted to deal through another dealer, the registered person and employee should arrange for duplicate trade confirmations and statements of account to be provided to senior management of the registered person;

(v) any transactions for such employees' related accounts should be separately recorded and clearly identified in the accounting records of the registered person; and

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¹⁶ Provisions derived, in part, from Hong Kong Futures Exchange Ltd. Rule 607 and Hong Kong Futures Exchange Ltd. Rules: Schedule 3 (section 9(a)).

(vi) transactions of such employees' related accounts should be reported to and actively monitored by senior management of the registered person who should not have any beneficial or other interest in such transactions and who should maintain procedures to detect irregularities and ensure that the handling by the registered person of the transactions or orders of such employees is not prejudicial to the interests of the registered person's other clients.

(c) A registered person should not knowingly deal in securities or futures contracts for another registered person's employee unless it has received written consent from that registered person.

12.3 Complaints

A registered person should ensure that:

- (a) complaints from clients relating to jts business are handled in a timely and appropriate manner;
- (b) steps are taken to investigate and respond promptly to such complaints; and
- (c) where a complaint is not remedied promptly, the client is advised of any further steps which may be available to the client under the regulatory system.

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12.4 Responsibility for acts of employees

A registered person should be responsible for the acts or omissions of jts employees and agents in respect to the conduct of jts business. **FMC 1.5 ICGI**

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12.5 Notifications to the Commission

A registered person should report in writing to the Commission immediately upon the happening of any one or more of the following:

- (a) any breach, infringement of or non-compliance with any law, rules, regulations, and codes issued by the Commission¹⁷, the rules of any exchange or clearing house of which it is a member or participant, and the requirements of any regulatory authority which apply to the registered person¹⁸, or where it has reason to suspect any such breach, infringement or non-compliance¹⁹ whether by:

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- (i) itself;

¹⁷ Provisions derived, in part, from Code 12.1.

¹⁸ Provisions derived, in part, from Code 12.1.

¹⁹ Provisions derived, in part, from The Stock Exchange of Hong Kong Limited Rule 606.

(ii) persons it employs or appoints to conduct business for or with clients or other registered persons²⁰; or

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(iii) any other registered persons;

giving particulars of and/or the reasons for suspecting such breach, infringement or non-compliance and all other relevant information and documents;²¹

(b) the passing of any resolutions, the initiation of any proceedings, or the making of any order which may result in the appointment of a receiver, provisional liquidator, liquidator or administrator or the winding-up, re-organisation, reconstruction, amalgamation, dissolution or bankruptcy of the registered person or any of its shareholders or the making of any receiving order or arrangement or composition with creditors;²²

(c) the bankruptcy of any of its directors;

(d) the exercise of any disciplinary measure against it by any regulatory or other professional or trade body or the refusal, suspension or revocation of any regulatory licence, consent or approval required in connection with its business; and

(e) any material failure, error or defect in the operation or functioning of its trading, accounting, clearing or settlement systems or equipment.

²⁰ Provisions derived, in part, from Code 4.1.

²¹ Provisions derived, in part, from The Stock Exchange of Hong Kong Limited Rule 606.

²² Provisions (b) - (e) derived, in part, from Hong Kong Futures Exchange Ltd. Rule 506.

Rebates, soft dollars, and connected transactions

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Retention of rebates, soft dollars and connected transactions

13.1 A registered person that acts for a client in the exercise of investment discretion may receive goods or services (i.e. soft dollars) from a broker in consideration of directing transaction business on behalf of such client to the broker only if:

FMC 8.2-8.3

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- (a) the goods or services are of demonstrable benefit to the registered person's clients;
- (b) transaction execution is consistent with best execution standards and brokerage rates are not in excess of customary full-service brokerage rates;
- (c) the client has consented in writing to the receipt of such goods and services; and
- (d)

Goods and services may include: research and advisory services; economic and political analysis; portfolio analysis, including valuation and performance measurement; market analysis, data and quotation services; computer hardware and software incidental to the above goods and services; clearing and custodian services and investment-related publications. Such goods and services may not include travel, accommodation, entertainment, general administrative goods or services, general office equipment or premises, membership fees, employee salaries, or direct money payments. This note is not exhaustive and may be amended from time to time.

Disclosure and consent may be made or given in the Client Agreement or other investment management agreement (or an addendum thereto). Whichever form of document is used, it must include a specific statement describing the registered person's soft dollar practices. In addition, at least annually the client must be given a statement describing the registered person's soft dollar practices, including a description of the goods and services received by the manager.

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13.2 A registered person described in paragraph 13.1 that intends to receive and retain cash or money rebates in relation to client transactions may retain such rebates only if:

FMC 8.3

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- (a) the client has consented in writing to such retention of rebates;
- (b) brokerage rates are not in excess of customary full-service brokerage rates; and
- (c) disclosure of such rebates and their approximate value is made to the client.

Note

Disclosure and consent may be made or given in the Client Agreement or other investment management agreement (or an addendum thereto). Whichever form of document is used it must include a specific statement that the manager may receive and retain brokerage commission rebates and describe the registered person's practices in regard to such rebates. In addition, at least twice annually the client must be provided with a quantification of the value of rebates received in relation to the client's account. Alternatively, this may be done in each contract note provided to the client. Quantification of rebates may involve estimates taken from aggregate commission and rebate data provided such estimates are reasonably accurate in relation to the client's account.

13.3 A registered person described in paragraph 13.1 ~~should~~ ensure and be able to demonstrate that any transactions undertaken or services acquired in relation to a client's account that involve payments from client assets directly or indirectly to a person connected with the registered person are undertaken at arm's length terms and in the best interests of the client. Essentially, this requires that such terms not be less favourable than those generally available in the market.

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13.4 A registered dealer ~~that~~ provides a portfolio manager with goods, services, or cash rebates has a responsibility to satisfy ~~itself~~ that the portfolio manager is mindful of the requirements of this section and the registered dealer takes reasonable steps to ensure that the type of goods and services listed in the invoices presented for payment by the portfolio manager are those goods and services described in paragraph 13.1. This is in addition to any legal duties that the dealer and the manager may have, including those imposed by the Prevention of Bribery Ordinance.

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Responsibility of senior management

14.1 Responsibility of senior management

Senior management of a registered person should properly manage the risks associated with the business of the registered person, including performing periodic evaluation of its risk management processes. Senior management should understand the nature of the business of the registered person, its internal control procedures and its policies on the assumption of risk. They should clearly understand the extent of their own authority and responsibilities and have access to all relevant information about the business on a timely basis and have available to them all necessary advice on that business and on their own responsibilities.

Professional investors²³ *[Pending outcome of public consultation]*

15.1 Professional investors: in general

Where a client belongs to a group described in paragraph 15.3 and has given its consent to a registered person to be treated as a professional investor, the registered person may treat the client as such with respect to provisions described in paragraph 15.4.

15.2 Definition of professional investors

Professional investors should be limited to the following group of entities:

- (a) persons registered with or declared exempt by the Commission or persons whose regular business is the provision of investment services and which are licensed or regulated in another jurisdiction;
- (b) entities authorized by the Commission (exchanges, clearing houses);
- (c) authorized institutions under the Banking Ordinance or other credit institutions that are licensed or regulated in another jurisdiction;
- (d) insurance companies authorized by the Insurance Authority or which are licensed or regulated in another jurisdiction;
- (e) trustee companies under the Trustee Ordinance;
- (f) collective investment schemes and the management companies of such schemes;
- (g) pension funds and the management companies of such funds;
- (h) investors (private individuals or corporations) having a portfolio of at least US\$ 5 million (or equivalent) in securities and having declared themselves as professional investors; and
- (i) national governments and international and supranational institutions such as the World Bank, IMF and regional development banks.

²³ Provisions derived from Consultation Paper on Code of Conduct for Regulated Persons Serving the Professional or Sophisticated Market.

15.3 Clients' consent

- (a) Clients who meet the criteria described in paragraph 15.2 must consent to be treated as professional investors before a registered person can treat them as such.
- (b) In the case of clients as referred to under paragraph 15.2(h), a registered person should:
- (i) explain to the clients concerned the consequences of being treated as a professional investor, in particular, to identify the information that will not be provided and make an initial assessment of the client's financial situation, investment experience and investment objectives as required under paragraph 5.1;
 - (ii) sign a statement indicating that it has provided such explanation to its clients;
 - (iii) receive from the clients a statement that the consequences have been explained to them, and that they have understood the explanation; and
 - (iv) receive a declaration from the clients that they wish to be treated as professional investors.
- (c) In the event a client consents to be treated as a professional investor, then such a consent should also state whether the client wishes to be so treated with respect to all or just some of the provisions described in paragraph 15.4. If the consent is only for certain provisions, then it must state clearly with regards to which provisions the client is to be treated as a professional investor.
- (d) After giving the consent, it is the responsibility of the professional investor to look after its own interests with respect to these specific provisions. However, the client may always revert back to the higher level of protection afforded by the Code generally by revoking the consent. Revocation of the consent should be accompanied by appropriate notice period.

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15.4 Provisions with regard to which clients may be treated as professional investors

A client of a registered person who meets the criteria described in paragraph 15.2 and who has given consent to be treated as a professional investor may be treated as such with respect to the following provisions of the Code:

- (a) Information about clients

(i) the need to establish a client's financial situation, investment experience and investment objectives except where the registered person is providing advice on corporate finance work (paragraph 5.1);

(ii) the need to ensure the suitability of a recommendation or solicitation (paragraph 5.2);

(b) Client agreement

the need to enter into a written agreement with the client (paragraph 6.1 of the Code, paragraph 2 of Schedule 3 to the Code and paragraph 2 of Schedule 4 to the Code);

(c) Information for clients

(i) the need to inform the client about the registered person and the identity and status of its employees and others acting on its behalf (paragraph 8.1);

(ii) the need to confirm promptly with the client the essential features of a transaction after effecting a transaction for a client and the need to provide the client with an options trade confirmation (paragraph 8.2 of the Code and paragraph 4 of Schedule 3 to the Code);

(iii) the need to provide the client with regular statements of account (paragraph 8.3);

(iv) the need to provide the client with documentation on the Nasdaq-Amex Pilot Program (paragraph 1 of Schedule 3 to the Code);

(d) Rebates, soft dollars, and connected transactions

(i) the need to obtain prior consent from a client before a registered person (that acts for the client in the exercise of investment decision) can receive goods and services from a broker in consideration of directing transaction business on behalf of such client to the broker (paragraph 13.1(c)); and

(ii) the need to obtain prior consent from a client before a registered person (that acts for the client in the exercise of investment decision) can retain cash or money rebates in relation to client transactions (paragraph 13.2(a)).

Note

The derivative column and references to specific codes, guidelines and legislation are provided solely for the assistance of registered persons and do not form part of the Code. These references are not intended to be exhaustive.

Key

| | |
|------|---|
| CTO | Commodities Trading Ordinance |
| PBO | Prevention of Bribery Ordinance |
| PIO | Protection of Investors Ordinance |
| SIDO | Securities (Insider Dealing) Ordinance |
| SO | Securities Ordinance |
| CC | Code of Conduct for Persons Registered with the Securities and Futures Commission |
| CIRP | Client Identity Rule Policy |
| FMC | Fund Manager Code of Conduct |
| FPC | Fit and Proper Criteria |
| FRR | Financial Resources Rules |
| GIR | Guidance Note on Internet Regulation |
| ICG | Management, Supervision and Internal Control Guidelines |
| MLG | Guidance Notes on Money Laundering |

SCHEDULE 1 RISK DISCLOSURE STATEMENTS

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A Client Agreement under paragraph 6 of the Code should include applicable risk disclosures, declaration by staff and acknowledgement by client in substantially the following form and should be in print at least as large as other text in the Client Agreement.

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The substance contained in the following risk disclosure statements is considered to be the minimum required. A registered person may elect to provide additional risk disclosure information as appropriate.

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Where any of the following risk disclosure statements is applicable, a declaration by staff and acknowledgement by client should be executed. The substance contained in the following declaration by staff and acknowledgement by client is considered to be the minimum required.

A. DECLARATION BY STAFF

A member of staff, who should be a registered person, should sign and date a declaration confirming that such staff has fully and properly explained to the client this risk disclosure statement in Chinese or English according to the language preference of the client. The name and CE number of that staff member should be stated in block letters in the risk disclosure statement.

B. ACKNOWLEDGEMENT BY CLIENT

The client shall sign and date an acknowledgement that this risk disclosure statement has been fully explained to the client and the client has read and fully understands the contents thereof.

C. RISK DISCLOSURE STATEMENTS

1. **If the Client Agreement involves transactions in securities a statement as follows-**

RISK DISCLOSURE STATEMENT

The price of securities can and does fluctuate, and any individual security may experience upward or downward movements, and may even become valueless. There is an inherent risk that losses may be incurred rather than profit made as a result of buying and selling securities.

2. **If the Client Agreement involves transactions in futures contracts or options a statement as follows-**

RISK DISCLOSURE STATEMENT

The risk of loss in trading futures contracts or options can be substantial. In some circumstances, you may sustain losses in excess of your initial margin funds. Placing contingent orders, such as "stop-loss" or "stop-limit" orders, will not necessarily achieve the desired results. Market conditions may make it impossible to execute such orders. You may be called upon at short notice to deposit additional margin funds. If the required funds are not provided within the prescribed time, your position may be liquidated. You will remain liable for any resulting deficit in your account. You should therefore study and understand futures contracts and options before you trade and carefully consider whether such trading is suitable in the light of your own financial position and investment objectives.

3. If the Client Agreement involves transactions in the Growth Enterprise Market of The Stock Exchange of Hong Kong Limited, statements as follows-

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RISK DISCLOSURE STATEMENT

1. The Growth Enterprise Market has been established as a market designed to accommodate companies to which a high investment risk may be attached. In particular, companies may list on the Growth Enterprise Market with neither a track record of profitability nor any obligation to forecast future profitability. There may be risks arising out of the emerging nature of companies listed on the Growth Enterprise Market and the business sectors or countries in which the companies operate.
2. There are potential risks of investing in such companies and you should make the decision to invest only after due and careful consideration. The greater risk profile and other characteristics of the Growth Enterprise Market mean that it is a market more suited to professional and other sophisticated investors.
3. Given the emerging nature of companies listed on the Growth Enterprise Market, there is a risk that securities traded on the Growth Enterprise Market may be susceptible to higher market volatility compared to securities traded on the Main Board and no assurance is given that there will be a liquid market in the securities traded on the Growth Enterprise Market.
4. The principal means of information dissemination on the Growth Enterprise Market is publication on the internet website operated by the Exchange. Companies listed on the Growth Enterprise Market are not generally required to issue paid announcements in gazetted newspapers. Accordingly, you need to have access to up-to-date information on the Growth Enterprise Market-listed companies as published on the Growth Enterprise Market website.
5. This risk disclosure statement does not purport to disclose all the risks and other significant aspects of the Growth Enterprise Market. You should

undertake your own research and study on the trading of securities on the Growth Enterprise Market before commencing any trading activities.

6. You should seek independent professional advice if you are uncertain of or have not understood any aspect of this risk disclosure statement or the nature and risks involved in trading of securities on the Growth Enterprise Market.

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4. **If the Client Agreement involves transactions in Options Contracts of The Stock Exchange of Hong Kong Limited, a statement in block letters as follows-**²⁴

RISK DISCLOSURE STATEMENT

I/WE ACKNOWLEDGE THAT DUE TO THE VOLATILE NATURE OF SECURITIES MARKETS, THE PURCHASE AND WRITING OF OPTIONS OVER SECURITIES INVOLVES A HIGH DEGREE OF RISK.

WARNING TO OPTION HOLDERS

SOME OPTIONS MAY ONLY BE EXERCISED ON AN EXPIRY DAY (EUROPEAN-STYLE EXERCISE) AND OTHER OPTIONS MAY BE EXERCISED AT ANY TIME BEFORE EXPIRATION (AMERICAN-STYLE EXERCISE). I/WE UNDERSTAND THAT UPON EXERCISE SOME OPTIONS REQUIRE DELIVERY AND RECEIPT OF THE UNDERLYING SECURITY AND THAT OTHER OPTIONS REQUIRE A CASH PAYMENT.

AN OPTION IS A WASTING ASSET AND THERE IS A POSSIBILITY THAT AS AN OPTION HOLDER I/WE MAY SUFFER THE LOSS OF THE TOTAL PREMIUM PAID FOR THE OPTION. I/WE ACKNOWLEDGE THAT, AS AN OPTION HOLDER, IN ORDER TO REALISE A PROFIT IT WILL BE NECESSARY TO EITHER EXERCISE THE OPTION OR CLOSE THE LONG OPTION POSITION IN THE MARKET. UNDER SOME CIRCUMSTANCES IT MAY BE DIFFICULT TO TRADE THE OPTION DUE TO LACK OF LIQUIDITY IN THE MARKET. I/WE ACKNOWLEDGE THAT YOU HAVE NO OBLIGATION EITHER TO EXERCISE A VALUABLE OPTION IN THE ABSENCE OF MY/OUR INSTRUCTION OR TO GIVE TO ME/US PRIOR NOTICE OF THE EXPIRATION DATE OF THE OPTION.

WARNING TO OPTION WRITERS

AS A WRITER OF AN OPTION I/WE MAY BE REQUIRED TO PAY ADDITIONAL MARGIN AT ANY TIME. I/WE ACKNOWLEDGE THAT AS AN OPTION WRITER, UNLIKE AN OPTION HOLDER, I/WE MAY BE LIABLE FOR UNLIMITED LOSSES BASED ON THE RISE OR FALL OF THE PRICE OF THE UNDERLYING SECURITY AND MY/OUR GAINS ARE LIMITED TO THE OPTION PREMIUM.

²⁴ Provisions derived, in part, from The Stock Exchange of Hong Kong Limited Options Trading Rules: First Schedule (Item A1).

ADDITIONALLY, WRITERS OF AMERICAN-STYLE CALL (PUT) OPTIONS MAY BE REQUIRED AT ANY TIME BEFORE EXPIRY TO DELIVER (PAY FOR) THE UNDERLYING SECURITIES TO THE FULL VALUE OF THE STRIKE PRICE MULTIPLIED BY THE NUMBER OF UNDERLYING SECURITIES. I/WE RECOGNIZE THAT THIS OBLIGATION MAY BE WHOLLY DISPROPORTIONATE TO THE VALUE OF PREMIUM RECEIVED AT THE TIME THE OPTIONS WERE WRITTEN AND MAY BE REQUIRED AT SHORT NOTICE.

5. **If the Client Agreement involves transactions in Futures Contracts and/or Options Contracts of the Hong Kong Futures Exchange Ltd., a statement as follows-**

RISK DISCLOSURE STATEMENT FOR FUTURES AND OPTIONS

This brief statement does not disclose all of the risks and other significant aspects of trading in futures and options. In light of the risks, you should undertake such transactions only if you understand the nature of the contracts (and contractual relationships) into which you are entering and the extent of your exposure to risk. Trading in futures and options is not suitable for many members of the public. You should carefully consider whether trading is appropriate for you in light of your experience, objectives, financial resources and other relevant circumstances.

FUTURES

1. Effect of “Leverage” or “Gearing”

Transactions in futures carry a high degree of risk. The amount of initial margin is small relative to the value of the futures contract so that transactions are “leveraged” or “geared”. A relatively small market movement will have a proportionately larger impact on the funds you have deposited or will have to deposit: this may work against you as well as for you. You may sustain a total loss of initial margin funds and any additional funds deposited with the firm to maintain your position. If the market moves against your position or margin levels are increased, you may be called upon to pay substantial additional funds on short notice to maintain your position. If you fail to comply with a request for additional funds within the time prescribed, your position may be liquidated at a loss and you will be liable for any resulting deficit.

2. Risk-reducing orders or strategies

The placing of certain orders (e.g. “stop-loss” orders, or “stop-limit” orders) which are intended to limit losses to certain amounts may not be effective because market conditions may make it impossible to execute such orders. Strategies using combinations of positions, such as “spread” and “straddle” positions may be as risky as taking simple “long” or “short” positions.

3. Risks underlying the One Day Rolling Currency Futures Contract (“ODRCF” Contract)

The ODRCF Contract, similar to other exchanged-traded futures contracts, provides a versatile and well-leveraged investment vehicle to investors. However, increases in both the volatility of the relative currency value and the volume of world trade have resulted in an exposure to dramatically higher foreign exchange risk in recent years. It has not been uncommon for major currencies to fluctuate in value by twenty or thirty percent vis-à-vis the US dollar in a period of less than one year.

In addition, a variety of other factors including interest rate movements, macro and micro economic condition and political stability may also affect the value of currencies. Investors should only participate in the ODRCF Market if they fully appreciate the risks inherent in the foreign exchange market and employ strategies consistent with their currency value expectations, investment objectives and tolerance for risk.

Investors should also be aware of the potential risks associated with possible exchange rate fluctuations where foreign exchange investments are priced and/or settled in a currency other than their home currency.

OPTIONS

4. Variable degree of risk

Transactions in options carry a high degree of risk. Purchasers and sellers of options should familiarise themselves with the type of option (i.e. put or call) which they contemplate trading and the associated risks. You should calculate the extent to which the value of the options must increase for your position to become profitable, taking into account the premium and all transaction costs.

The purchaser of options may offset or exercise the options or allow the options to expire. The exercise of an option results either in a cash settlement or in the purchaser acquiring or delivering the underlying interest. If the option is on a future, the purchaser will acquire a futures position with associated liabilities for margin (see the section on Futures above). If the purchased options expire worthless, you will suffer a total loss of your investment which will consist of the option premium plus transaction costs. If you are contemplating purchasing deep-out-of-the-money options, you should be aware that the chance of such options becoming profitable ordinarily is remote.

Selling (“writing” or “granting”) an option generally entails considerably greater risk than purchasing options. Although the premium received by the seller is fixed, the seller may sustain a loss well in excess of that amount. The seller will be liable for additional margin to maintain the position if the market moves unfavourably. The seller will also be

exposed to the risk of the purchaser exercising the option and the seller will be obligated to either settle the option in cash or to acquire or deliver the underlying interest. If the option is on a future, the seller will acquire a position in a future with associated liabilities for margin (see the section on Futures above). If the option is “covered” by the seller holding a corresponding position in the underlying interest or a future or another option, the risk may be reduced. If the option is not covered, the risk of loss can be unlimited.

Certain exchanges in some jurisdictions permit deferred payment of the option premium, exposing the purchaser to liability for margin payments not exceeding the amount of the premium. The purchaser is still subject to the risk of losing the premium and transaction costs. When the option is exercised or expires, the purchaser is responsible for any unpaid premium outstanding at that time.

ADDITIONAL RISKS COMMON TO FUTURES AND OPTIONS

5. Terms and conditions of contracts

You should ask the firm with which you deal about the terms and conditions of the specific futures or options which you are trading and associated obligations (e.g. the circumstances under which you may become obliged to make or take delivery of the underlying interest of a futures contract and, in respect of options, expiration dates and restrictions on the time for exercise). Under certain circumstances the specifications of outstanding contracts (including the exercise price of an option) may be modified by the exchange or clearing house to reflect changes in the underlying interest.

6. Suspension or restriction of trading and pricing relationships

Market conditions (e.g. illiquidity) and/or the operation of the rules of certain markets (e.g. the suspension of trading in any contract or contract month because of price limits or “circuit breakers”) may increase the risk of loss by making it difficult or impossible to effect transactions or liquidate/offset positions. If you have sold options, this may increase the risk of loss.

Further, normal pricing relationships between the underlying interest and the future, and the underlying interest and the option may not exist. This can occur when, for example, the futures contract underlying the option is subject to price limits while the option is not. The absence of an underlying reference price may make it difficult to judge “fair” value.

7. Deposited cash and property

You should familiarise yourself with the protections accorded money or other property you deposit for domestic and foreign transactions, particularly in the event of a firm insolvency or bankruptcy. The extent to which you may recover your money or property may be governed by specific legislation or local rules. In some jurisdictions, property which had been specifically identifiable as your own will be pro-rated in the same manner as cash for purposes of distribution in the event of a shortfall.

8. Commission and other charges

Before you begin to trade, you should obtain a clear explanation of all commission, fees and other charges for which you will be liable. These charges will affect your net profit (if any) or increase your loss.

9. Transactions in other jurisdictions

Transactions on markets in other jurisdictions, including markets formally linked to a domestic market, may expose you to additional risk. Such markets may be subject to regulation which may offer different or diminished investor protection. Before you trade you should enquire about any rules relevant to your particular transactions. Your local regulatory authority will be unable to compel the enforcement of the rules of regulatory authorities or markets in other jurisdictions where your transactions have been effected. You should ask the firm with which you deal for details about the types of redress available in both your home jurisdiction and other relevant jurisdictions before you start to trade.

10. Currency risks

The profit or loss in transactions in foreign currency-denominated contracts (whether they are traded in your own or another jurisdiction) will be affected by fluctuations in currency rates where there is a need to convert from the currency denomination of the contract to another currency.

11. Trading facilities

Electronic trading facilities are supported by computer-based component systems for the order-routing, execution, matching, registration or clearing of trades. As with all facilities and systems, they are vulnerable to temporary disruption or failure. Your ability to recover certain losses may be subject to limits on liability imposed by the system provider, the market, the clearing house and/or participant firms. Such limits may vary: you should ask the firm with which you deal for details in this respect.

12. Electronic trading

Trading on an electronic trading system may differ from trading on other electronic trading systems. If you undertake transactions on an electronic trading system, you will be exposed to risks associated with the system including the failure of hardware and software. The result of any system failure may be that your order is either not executed according to your instructions or is not executed at all.

13. Off-exchange transactions

In some jurisdictions, and only then in restricted circumstances, firms are permitted to effect off-exchange transactions. The firm with which you deal may be acting as your counterparty to the transaction. It may be difficult or impossible to liquidate an existing position, to assess the value, to determine a fair price or to assess the exposure to risk. For these reasons, these transactions may involve increased risks. Off-exchange transactions may be less regulated or subject to a separate regulatory regime. Before you undertake such transactions, you should familiarise yourself with applicable rules and attendant risks.

6. **Where a registered person obtains an authority from a client under section 81, 81A, or 121AB of the Securities Ordinance (Cap. 333), it should include within the body of the authority the following risk disclosure statement in block letters-**

RISK DISCLOSURE STATEMENT

THIS AUTHORITY ALLOWS (NAME OF THE DEALER**) TO LEND YOUR SECURITIES TO OR DEPOSIT THEM WITH CERTAIN THIRD PARTIES UNDER SECTION 81, 81A OR 121AB OF THE SECURITIES ORDINANCE AND RELATED RULES. THIS IS ALLOWED ONLY IF YOU CONSENT IN WRITING. THE CONSENT MUST SPECIFY THE PERIOD FOR WHICH IT IS CURRENT, WHICH CANNOT EXCEED 12 MONTHS.

YOU ARE NOT REQUIRED BY ANY LAW TO SIGN THIS AUTHORITY. BUT THE AUTHORITY MAY BE REQUIRED BY DEALERS, FOR EXAMPLE, TO FACILITATE MARGIN LENDING TO THE CLIENT OR TO ALLOW THE CLIENT'S SECURITIES TO BE LOANED TO OR DEPOSITED AS COLLATERAL WITH THIRD PARTIES. (NAME OF DEALER) SHOULD EXPLAIN TO YOU THE PURPOSES FOR WHICH THIS AUTHORITY IS TO BE USED.

IF YOU SIGN THIS AUTHORITY AND YOUR SECURITIES ARE LENT TO OR DEPOSITED WITH THIRD PARTIES THOSE THIRD PARTIES WILL HAVE A LIEN OR CHARGE ON YOUR SECURITIES. ALTHOUGH (NAME OF DEALER) IS RESPONSIBLE TO YOU FOR YOUR SECURITIES LENT OR DEPOSITED UNDER THIS AUTHORITY, A DEFAULT BY IT COULD RESULT IN THE LOSS OF YOUR SECURITIES.

A CASH ACCOUNT NOT INVOLVING SECURITIES BORROWING AND LENDING IS AVAILABLE FROM MOST DEALERS. IF YOU DO NOT REQUIRE MARGIN FACILITIES OR DO NOT WISH YOUR SECURITIES TO BE LENT OR PLEDGED, DO NOT SIGN THIS AUTHORITY AND ASK TO OPEN THIS TYPE OF CASH ACCOUNT.

** References to the term "DEALER" should be replaced with references to "SECURITIES MARGIN FINANCIER", as appropriate.

Notes for registered persons

The declaration by staff and acknowledgement by the client are needed when the client signs the first authority and not for any later renewal. The staff member should explain to the client the purposes for which the authority is to be used.

The authority should state the date it takes effect and the date it expires. The authority should only remain in force for the period so specified or 12 months, whichever is shorter.

7. **If a registered person enters into a hold-mail arrangement with a client or an arrangement where mail is directed to a third person, a statement as follows-**

RISK DISCLOSURE STATEMENT

It is important for you to promptly collect in person all contract notes and statements of your account and review them in detail to ensure that any anomalies or mistakes can be detected in a timely fashion.

Notes for registered persons

The declaration by staff and acknowledgement by the client are needed when the client signs the first authority and not for any later renewal. The staff member should explain to the client the purposes for which the authority is to be used.

The authority should specify the date it takes effect and the date it expires. The authority should only remain in force for the period so specified or 12 months, whichever is shorter.

8. **If the Client Agreement involves securities margin financing, a statement as follows-**

RISK DISCLOSURE STATEMENT

The risk of loss in financing a transaction by deposit of collateral can be significant. In some circumstances, you may sustain losses in excess of your cash and any other assets deposited as collateral with the dealer or securities margin financier. Market conditions may make it impossible to execute contingent orders, such as "stop-loss" or "stop-limit" orders. You may be called upon at short notice to make additional margin deposits or interest payments. If the required margin deposits or interest payments are not made within the prescribed time, your collateral may be liquidated without your consent. Moreover, you will remain

liable for any resulting deficit in your account and interest charged on your account. You should therefore carefully consider whether such financing arrangement is suitable in light of your own financial position and investment objectives.

9. **Where the Client Agreement involves trading of securities of The Stock Exchange of Hong Kong Limited under the Nasdaq-Amex Pilot Program, a statement as follows-**

RISK DISCLOSURE STATEMENT

The securities under the Nasdaq-Amex Pilot Program (PP) are aimed at sophisticated investors. You should consult your broker and become familiarised with the PP before trading in the PP securities.

You should be aware that the PP securities are not regulated as a primary or secondary listing on the Main Board or the Growth Enterprise Market of The Stock Exchange of Hong Kong Limited.

SCHEDULE 2 CLIENT IDENTITY GUIDANCE NOTE

Paragraph 5.4 of the Code requires that registered persons:

- satisfy themselves about information that identifies those who are ultimately responsible for originating instructions about a transaction and those who will ultimately benefit from a transaction or bear its risk and
- record that information in Hong Kong,

before doing anything to effect such a transaction.

This note supplements the existing "know your client" in paragraph 5.1 of the Code.

The note is intended to improve the transparency of trading in securities listed or futures contracts traded on one of the Hong Kong Exchanges or in over the counter derivatives written over such securities or futures contracts, wherever such trading occurs,²⁵ by improving the information that is available to the Commission about the identity of those interested in transactions on those markets.

Like the rest of the Code, the note uses simple language. Registered persons should interpret the note sensibly in accordance with its spirit and not interpret the note technically or literally. That is, registered persons must satisfy themselves about and record information that identifies those who are really behind a transaction: those who ultimately originate instructions in relation to a transaction and those who ultimately benefit from, or bear the risk of, that transaction. The Commission is concerned about the substance of what is going on with a transaction and not the technicalities.

For example, if a registered person's client was a company incorporated in the British Virgin Islands, the registered person would have to satisfy itself whether or not a shareholder or director of that company had originated the instructions in relation to the transaction and would receive the ultimate benefit from, or bear the risk of, the transaction. The registered person would also have to satisfy itself whether or not the company was being used as a nominee to conceal that person's identity. If it was the shareholder who turned out to be relevant and not the company, and the relevant shares turned out to be held on trust, the registered person would have to be satisfied about who was giving instructions in relation to the trust and who would benefit from, or bear the risk of, the transaction.

In relation to an investment fund or discretionary account, the Commission does not intend that registered persons concern themselves with those who have a beneficial interest in that investment fund or discretionary account, unless they are ultimately responsible for originating instructions in relation to a specific transaction.

For example, in relation to an investment fund or discretionary account, registered persons must only satisfy themselves about and record information about the fund or account and the manager of that fund or account if they are the person giving instructions. However, registered persons must record information about a beneficiary of the fund or

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²⁵ Revisions approved by Commission on 17 July 2000, effective on 28 July 2000.

account rather than the investment manager if that beneficiary has overridden the manager's discretion and originated the instructions in relation to a transaction.

SCHEDULE 3 ADDITIONAL REQUIREMENTS FOR REGISTERED PERSONS TRANSACTING IN SECURITIES OF THE STOCK EXCHANGE OF HONG KONG LIMITED

The provisions in this Schedule 3 to the Code apply to all registered persons which transact in securities of The Stock Exchange of Hong Kong Limited (“SEHK”), except as otherwise specified in certain paragraphs which do not apply to registered persons which are not exchange participants (as defined in the Securities and Futures Commission Ordinance (Cap. 24)) of SEHK.

For purposes of Schedule 3 to the Code, unless otherwise specified, the defined terms and expressions set out below have the meanings assigned to them under the rules (including the Options Trading Rules and Operational Trading Procedures for Options Trading Exchange Participants) of SEHK. Where such defined terms and expressions are applied to exchange participants of SEHK, they are deemed to apply with the same meaning to registered persons which are not exchange participants wherever the context so permits.

Nasdaq-Amex pilot program

1. Before accepting or operating a securities trading account for any person in relation to securities admitted to trading under the Nasdaq-Amex Pilot Program, a registered person which is an exchange participant of SEHK should provide the person with documentation on the Nasdaq-Amex Pilot Program as prescribed by SEHK in either the Chinese or English language according to the language preference of the person.²⁶

Options client agreement

2. Without prejudice to paragraphs 6.1 to 6.3 of the Code, before any services are provided to a person (the client) in relation to the Options Contracts, a registered person which is an Options Exchange Participant or engages in Exchange Traded Options Business should ensure that the Client Agreement (“Options Client Agreement”) contains at least statements to the effect that:²⁷
 - (a) the registered person will keep information relating to the client’s options account confidential, but may provide any such information to the Commission and, where the registered person is an Options Exchange Participant, also to the SEHK to comply with their requirements or requests for information;
 - (b) the client will confirm that:
 - (i) the options account is operated solely for the client’s account and benefit, and not for the benefit of any other person; or

²⁶ Provisions derived, in part, from The Stock Exchange of Hong Kong Limited Rule 532B.

²⁷ Provisions derived, in part, from The Stock Exchange of Hong Kong Limited Rule 532 and The Stock Exchange of Hong Kong Limited Options Trading Rules: Rule 401 and First Schedule (Item A1).

- (ii) the client has disclosed to the registered person in writing the name of the person(s) for whose benefit the options account is being operated; or
 - (iii) the client has requested the registered person to operate the options account as an Omnibus Account, and will immediately notify the registered person, on request, of the identity of any person(s) ultimately beneficially interested in Client Contracts;
- (c) where the registered person is an Options Exchange Participant, all Exchange Traded Options Business shall be effected in accordance with all laws, rules and regulatory directions (the “Rules”) applying to the registered person, which include the Options Trading Rules of SEHK, the Clearing Rules of The SEHK Options Clearing House Limited (“SEOCH”) and the rules of the Hong Kong Securities Clearing Company Limited (“HKSCC”); and in particular, SEOCH has authority under the Rules to make adjustments to the terms of Contracts, the registered person should notify the client of any such adjustments which affect Client Contracts to which the client is a party, and all actions taken by the registered person, by SEHK, by SEOCH or by HKSCC in accordance with such Rules shall be binding on the client;
- (d) where the registered person is not an Options Exchange Participant, the registered person will collect margin requirements and premium in accordance with the Rules;
- (e) the client agrees that the terms of the Standard Contract for the relevant options series shall apply to each Client Contract between the registered person and the client, and that all Client Contracts shall be created, exercised, settled and discharged in accordance with the Rules;
- (f) the client agrees to provide the registered person with cash and/or securities and/or other assets (“Margin”) as may be agreed from time to time, as security for the client’s obligations to the registered person under the Options Client Agreement; such Margin should be paid or delivered as demanded by the registered person from time to time; and the amounts required by way of Margin should not be less than, but may exceed, the amounts as may be required by the Rules in respect of the client’s open positions and delivery obligations, and further Margin may be required to reflect changes in market value;
- (g) if the registered person accepts securities by way of Margin, the client will on request provide the registered person with such authority as the registered person may require under the Rules to authorize the registered person to deliver such securities, directly or through an Options Exchange Participant, to SEOCH as SEOCH Collateral in respect of Exchange Traded Options Business resulting from the client’s instructions to the registered person; and the registered person does not have any further authority from the client to borrow or lend the client’s securities or

otherwise part with possession (except to the client or on the client's instructions) of any of the client's securities for any other purpose;

- (h) the client agrees to indemnify the registered person, and the registered person's employees and agents, against all losses and expenses resulting from breach of the client's obligation under the Options Client Agreement, including costs reasonably incurred in collecting debts from the client, and in closing the options account;
- (i) if the client fails to comply with any of the client's obligations and/or to meet the client's liabilities under the Options Client Agreement, including failure to provide Margin, the registered person may:
 - (i) decline to accept further instructions from the client in respect of Exchange Traded Options Business;
 - (ii) close out some or all of the client's Client Contracts with the registered person;
 - (iii) enter into Contracts, or into transactions in securities, futures or commodities, in order to settle obligations arising or to hedge the risks to which the registered person is exposed in relation to the client's failure;
 - (iv) dispose of Margin, and apply the proceeds thereof to discharge the client's liabilities to the registered person;

and any proceeds remaining after discharge of all the client's liabilities to the registered person should be paid to the client;

- (j) the client agrees to pay interest on all overdue balances (including interest arising after a judgement debt is obtained against the client) at such rates and on such other terms as the registered person has notified to the client from time to time;
- (k) in respect of all Contracts effected on the client's instructions, the client will pay the registered person, within the time period notified by the registered person, Premium, the registered person's commission and any other charges, and applicable levies imposed by SEHK, as have been notified to the client; and the registered person may deduct such premium, commissions, charges and levies from the options account;
- (l) the registered person may place limits on the open positions or delivery obligations that the client may have at any time;
- (m) where the registered person is an Options Exchange Participant, an acknowledgement by the client that:
 - (i) the registered person may be required to close out Client Contracts to comply with position limits imposed by SEHK; and

- (ii) if the registered person goes into default, the default procedures of SEHK may result in Client Contracts being closed out, or replaced by Client Contracts between the client and another Options Exchange Participant;
- (n) where the registered person is an Options Exchange Participant, at the client's request, it may agree to the Client Contracts between itself and the client being replaced, in accordance with the Rules, by Client Contracts between the client and another Options Exchange Participant;
- (o) on exercise of a Client Contract by or against the client, the client will perform the client's delivery obligations under the relevant contract, in accordance with the Standard Contract and as the client has been notified by the registered person;
- (p) where the registered person is an Options Exchange Participant, the client acknowledges that, although all Options Contracts are to be executed on SEHK, the client and the registered person shall contract as principals under Client Contracts;
- (q) the registered person agrees to provide the client, upon request, with the product specifications for Options Contracts;
- (r) where the registered person is an Options Exchange Participant, if the registered person fails to meet its obligations to the client pursuant to the Options Client Agreement, the client shall have a right to claim under the Compensation Fund established under the Securities Ordinance (Cap. 333), subject to the terms of the Compensation Fund from time to time;
- (s) the registered person will notify the client of material changes in respect of the registered person's business which may affect the services the registered person provide to the client;
- (t) the client confirms that the client has read and agrees to the terms of the Options Client Agreement, which have been explained to the client in a language that the client prefers;
- (u) the Options Client Agreement is governed by, and may be enforced in accordance with, the laws of the Special Administrative Region of Hong Kong;
- (v) where the registered person is an Options Exchange Participant, the category of Options Exchange participation under which it is registered and the full name and contact details of the Options Officer or Options Representative who will be primarily responsible for the client's affairs should also be provided. A registered person which is subject to the Long-Only Restriction in accordance with Options Trading Rule 207 should also deliver to such client a written statement to the effect that: (i) the registered person is registered by SEHK as an Options Broker Exchange

Participant, and not as an Options Trading Exchange Participant; (ii) as a condition of such registration, the only Exchange Traded Options Business which the registered person may conduct for clients is the purchase, closing, exercise, settlement and discharge of long options transactions; and (iii) therefore a client cannot write options through the client's options account with the registered person, or otherwise create any short open position;²⁸

- (w) where the registered person is an Options Exchange Participant, on the expiry day but only on the expiry day, the Options System will automatically generate exercise instructions in respect of all open long positions which are in-the-money by or above the percentage prescribed by SEOCH from time to time²⁹;
- (x) where the registered person is an Options Exchange Participant, the client may instruct the registered person to override an "automatically generated exercise instruction" referred to in subparagraph (w) above before the System Closure on the expiry day in accordance with the Operational Clearing Procedures of SEOCH³⁰; and
- (y) risk disclosure statements as specified in Schedule 1 to the Code will be attached.

Time stamping³¹

3. Without prejudice to paragraph 3.9 of the Code:

- (a) a registered person should maintain a record of the date and time at which it receives each instruction from a client in respect of the purchase, sale or exercise of Client Contracts. It must also maintain a record of the date and time at which it originates a purchase or sale of the Options Contracts for its House Account. A registered person should immediately time stamp the records of instructions received from clients and the origination of orders for its House Account;
- (b) notwithstanding paragraph 3(a) of Schedule 3 to the Code, a registered person which is a Market Maker, when fulfilling its Market Maker obligations, may choose not to time stamp the records of its quotes entered into the Options System, but it should continue to abide by all other conditions of paragraph 3(a) of Schedule 3 to the Code; and

²⁸ Provisions derived, in part, from The Stock Exchange of Hong Kong Limited Options Trading Rules: First Schedule (Item A2).

²⁹ Provisions derived, in part, from The Stock Exchange of Hong Kong Limited Options Trading Rule 415A.

³⁰ Provisions derived, in part, from The Stock Exchange of Hong Kong Limited Options Trading Rule 415A.

³¹ Provisions derived, in part, from The Stock Exchange of Hong Kong Limited Options Trading Rule 410.

- (c) notwithstanding paragraph 3(b) of Schedule 3 to the Code, where an Authorized User, in the course of the same day, enters orders in respect of both market making activity and client business, all orders, including quotes, so entered that day by that Authorized User should be time stamped in the manner described above.

Options trade confirmations

4. Where the registered person is an Options Exchange Participant, it should provide an Options Trade Confirmation that includes:³²
- (a) the number of Client Contracts or Options Broker Client Contracts purchased or sold, the underlying security, expiry month, strike price, option type (put or call), version number (if not 0) and whether they were closing contracts or opening contracts;
 - (b) the price and the number of securities comprised in each lot the subject of such Client Contract or Options Broker Client Contract;
 - (c) a risk disclosure statement to the following effect: “Options can involve a high degree of risk and may not be suitable for every investor. Investors should ensure they understand those risks before participating in the options market”;
 - (d) a statement that one or more Options Contracts on the same terms as the Client Contracts or Options Broker Client Contracts were executed by the registered person which is an Options Exchange Participant (or, if applicable, by an Options Trading Exchange Participant on its behalf) on SEHK;
 - (e) a statement that, in the event of a default committed by the registered person resulting in the client suffering pecuniary loss, the client shall have a right to claim under the Compensation Fund established under the Securities Ordinance, subject to the terms of the Compensation Fund from time to time; and
 - (f) a statement that all Exchange Traded Options Business made for or on behalf of a client shall be subject to the relevant provisions of the constitution, SEHK Rules, regulations, the Articles, customs and usages of SEHK, the Options Trading Rules, the Clearing Rules of SEOCH, the CCASS Rules and of the laws of Hong Kong, which shall be binding on both the registered person and the client.

³² The Stock Exchange of Hong Kong Limited Options Trading Rule 414.

Exercise of client contracts

5. (a) Following notification of exercise pursuant to Clearing Rule 505 of SEOCH in respect of an OCH Contract or an NCP Contract comprised in a short open position of a registered person which is an Options Trading Exchange Participant allocated to its Client Account, that registered person should, by a random selection process, select a Client Contract from among all Client Contracts comprised in short open positions of clients in the same option series as that Contract. The Client Contract so selected should, by operation of the Options Client Agreement and Options Trading Rule 416, for all purposes be treated as having been validly exercised at the time of such selection. The registered person should notify its client of the details of such exercise as soon as possible.³³
- (b) Where a registered person which is an Options Broker Exchange Participant receives notification pursuant to Options Trading Rule 416A in respect of the exercise of an Options Broker Client Contract, the registered person should, by a random selection process, select a Client Contract from among all Client Contracts comprised in short open positions of clients in the same option series as that Options Broker Client Contract. The Client Contract so selected shall also be treated for all purposes as having been validly exercised. The registered person should notify its client of the details of such exercise as soon as possible.³⁴
6. Where a registered person which is not an Options Exchange Participant receives notification from another registered person for the exercise of a Client Contract, the first-mentioned registered person should, by a random selection process, select a Client Contract from among all Client Contracts comprised in short open positions of clients in the same option series as that Client Contract. The Client Contract so selected shall also be treated for all purposes as having been validly exercised. The first-mentioned registered person should notify its client of the details of such exercise as soon as possible.

Adjustments to contracts (“capital adjustments”)

7. Where SEOCH makes adjustments to the terms of the Contracts of an option series in accordance with the Clearing Rules, a registered person which is an Options Exchange Participant, should:
 - (a) by no later than the next Business Day after such adjustments have been announced, notify all its clients affected by such adjustments of the details of the adjustments.³⁵
 - (b) as soon as possible but in any event no later than 1 Business Day after the adjustment takes effect, notify all its clients of any changes to the terms of any Contracts in the client’s account resulting from such adjustments.³⁶

³³ Provisions derived, in part, from The Stock Exchange of Hong Kong Limited Options Trading Rule 416.

³⁴ Provisions derived, in part, from The Stock Exchange of Hong Kong Limited Options Trading Rule 416B.

³⁵ Provisions derived, in part, from The Stock Exchange of Hong Kong Limited Options Trading Rule 507.

8. Where a registered person which is not an Options Exchange Participant receives an notification about capital adjustments from an Options Exchange Participant, it should promptly inform its clients of the same.

Omnibus Accounts³⁷

9. Where a registered person which is an Options Exchange Participant accepts as a client a person whom the registered person knows to be engaging in Exchange Traded Options Business on behalf of other persons, the registered person should open one or more Omnibus Account(s) in the name of the client and should ensure that the client, to the fullest extent possible, calculates and collects appropriate amounts of margin and Premium from such other persons.

Client's Money in relation to Exchange Traded Options Business

10. A registered person which is an Options Exchange Participant should pay into and maintain in a trust account all amount received from or on account of a client in relation to Exchange Traded Options Business (less amounts lawfully payable by the client to the registered person, such as brokerage, fees, levies and amounts required to be deposited by the client as margin or SEOCH Collateral) as soon as possible and in any event not later than 2 Business Days³⁸ after receipt, except amounts paid to the client or in accordance with the client's directions³⁹.
11. Without prejudice to paragraph 3.7 of the Code, each registered person should maintain a separate ledger account for each of its clients into which should be entered sufficient particulars to identify uniquely and unambiguously all Exchange Traded Options Business in relation to each client. Each such ledger account must contain information which is sufficient, at any given time, to enable all collateral and money received from each client to be separately identified and allocated to each aspect of Exchange Traded Options Business conducted on behalf of that client⁴⁰.

Other requirements

12. A registered person which is an exchange participant of SEHK should also comply with the following rules (including the rules, regulations, guidelines, procedures and circulars) of the SEHK:

³⁶ Provisions derived, in part, from The Stock Exchange of Hong Kong Limited Options Trading Rule 508.

³⁷ Provisions derived, in part, from The Stock Exchange of Hong Kong Limited Options Trading Rule 421.

³⁸ It should be noted that where the registered person is not an Options Exchange Participant, it is required under section 84 of the Securities Ordinance to deposit such money into a trust account within 4 business days.

³⁹ Provisions derived, in part, from The Stock Exchange of Hong Kong Limited Options Trading Rule 432.

⁴⁰ Provisions derived, in part, from The Stock Exchange of Hong Kong Limited Options Trading Rule 433.

- (a) Schedule 6 of SEHK Rules on securities borrowing and lending regulations;
- (b) Schedule 11 of SEHK Rules on short selling regulations;
- (c) Options Trading Rules 423 to 426A and Operational Trading Procedures paragraphs 5.4 to 5.6 and Appendix H on client margin requirements; and
- (d) Options Trading Rules 435 to 441 and Operational Trading Procedures paragraphs 5.9 to 5.12 of SEHK on position limits.

SCHEDULE 4 ADDITIONAL REQUIREMENTS FOR REGISTERED PERSONS TRANSACTING IN FUTURES CONTRACTS AND/OR OPTIONS CONTRACTS OF HONG KONG FUTURES EXCHANGE LTD.

The provisions in this Schedule 4 to the Code apply to all registered persons which transact in Futures Contracts and/or Options Contracts of Hong Kong Futures Exchange Ltd (“HKFE”) except as otherwise specified in certain paragraphs which do not apply to registered persons which are not exchange participants (as defined in the Securities and Futures Commission Ordinance (Cap. 24)) of HKFE.

For purposes of Schedule 4 to the Code, unless otherwise specified, the defined terms and expressions set out below have the meanings assigned to them under the rules of HKFE. Where such defined terms and expressions are applied to exchange participants of HKFE, they are deemed to apply with the same meaning to registered persons which are not exchange participants wherever the context so permits.

Books and accounts

1. A registered person which is an exchange participant of HKFE should maintain proper books and records which, inter alia, correctly and clearly record⁴¹:
 - (a) the financial position of each client's trading account;
 - (b) the time, date and complete particulars of instructions received from and trades executed for clients;
 - (c) the time, date and complete particulars of the registered person's own orders and trades;
 - (d) particulars of all the open positions of the registered person and of each of its clients (that is, not simply the net open positions);
 - (e) the amount of margin deposited from time to time by the registered person with
 - (i) the Clearing House (where applicable); and
 - (ii) executing agents,identifying each such agent and the amount of margin deposited with each;
 - (f) the amount of variation adjustment and Interest Rate Cash Adjustment paid by the registered person to
 - (i) the Clearing House (where applicable); and
 - (ii) executing agents,

⁴¹ Provisions derived, in part, from Hong Kong Futures Exchange Ltd. Rule 531.

identifying each such agent and the amount of variation adjustment and Interest Rate Cash Adjustment paid to each;

- (g) the amount of margin deposited or required to be deposited by each client;
- (h) the amount of variation adjustment and Interest Rate Cash Adjustment collected or required to be collected from clients;
- (i) all payments received or held by the registered person to satisfy margin requirements;
- (j) particulars of all margin calls and demands for variation adjustment and Interest Rate Cash Adjustment made;
- (k) particulars required to be kept pursuant to HKFE Rule 1411 (NYMEX ACCESSSM); and
- (l) any other particulars from time to time required by the Exchange to be kept in the books and records of the registered person.

Client agreement

2. Without prejudice to paragraphs 6.1 to 6.3 of the Code, before any services are provided to a client in relation to the transaction of any Futures Contracts and/or Options Contracts, a registered person should ensure that the Client Agreement contains at least provisions to the following effect that⁴²:
 - (a) (where a registered person is an exchange participant of HKFE) the category of exchange participant (as defined in the Securities and Futures Commission Ordinance (Cap. 24)) under which the registered person is registered. The particulars of every registration (including the CE number) maintained by the registered person (for both exchange participants and non-exchange participants) pursuant to the relevant Ordinances (as defined in the Securities and Futures Commission Ordinance (Cap. 24)) or any other regulatory provisions, and the full name of the employee primarily responsible for the client's affairs and particulars of the registration maintained by that employee (including the CE number) pursuant to the relevant Ordinances (as defined in the Securities and Futures Commission Ordinance (Cap. 24)) or any other regulatory provisions⁴³;
 - (b) (where a registered person is an exchange participant of HKFE) every Exchange Contract shall be subject to the charge of a Compensation Fund levy and a levy pursuant to the Securities and Futures Commission Ordinance (Cap. 24), the cost of both of which shall be borne by the client;

⁴² Provisions derived, in part, from Hong Kong Futures Exchange Ltd. Rule 602.

⁴³ Provisions derived, in part, from Hong Kong Futures Exchange Ltd. Rule 601(c).

- (c) (where a registered person is an exchange participant of HKFE) if the client suffers pecuniary loss by reason of the registered person's default, the liability of the Compensation Fund will be restricted to valid claims as provided for in the relevant Ordinances (as defined in the Securities and Futures Commission Ordinance (Cap. 24)) and will be subject to the monetary limits specified in the Ordinances and accordingly there can be no assurance that any pecuniary loss sustained by reason of such a default will necessarily be recouped from the Compensation Fund in full, in part or at all;
- (d) transactions related to exchange traded futures and options contracts shall be subject to the rules of the relevant markets and exchanges. A statement that the registered person is required, upon the request of the Exchange (in the case where the registered person is an exchange participant) or the Commission, to disclose the name, beneficial identity and such other information concerning the client as the Exchange or the Commission may require and that the client agrees to provide such information concerning the client as the registered person may require in order for the registered person to comply with this requirement;
- (e) the client may have varying level and type of protection in relation to transactions on different markets and exchanges;
- (f) the registered person enters into a transaction for NYMEX Contracts on NYMEX ACCESSSM for the account of the client:
 - (i) the transactions are subject to the NYMEX Rules; and
 - (ii) if the client is dealing in NYMEX Contracts for the benefit of another person, the client should ensure that in its agreement with that other person there should be a provision to the effect of sub-paragraph (i) and this sub-paragraph (ii);
- (g) (if appropriate, then prominently displayed and in bold type) the registered person may, subject to the provisions of the relevant Ordinances (as defined in the Securities and Futures Commission Ordinance (Cap. 24)) and any applicable law, take the opposite position to the client's order in relation to any exchange traded futures and options contracts, whether on the registered person's own account or for the account of its associated company or other clients of the registered person, provided that such trade is executed competitively on or through the facilities of the Exchange in accordance with the rules or the facilities of any other commodity, futures or options exchange in accordance with the rules and regulations of such other exchange;
- (h) (where a registered person is an exchange participant of HKFE) the client acknowledges that the Clearing House may do all things necessary to transfer any open positions held by the registered person on the client's behalf and any money and security standing to the credit of its account with the registered person to another exchange participant of HKFE in the event

the rights of the registered person as an exchange participant of HKFE are suspended or revoked;

- (i) all money, approved debt securities and other property received by the registered person from the client or from any other person (including the Clearing House) for the account of the client shall be held by the registered person as trustee, segregated from the registered person own assets and paid into a segregated bank account or a segregated debt securities account, and that all money, approved debt securities or other property so held by the registered person shall not form part of the assets of the registered person for insolvency or winding up purposes but shall be returned to the client promptly upon the appointment of a provisional liquidator, liquidator or similar officer over all or any part of the registered person's business or assets;
- (j) (where a registered person is an exchange participant of HKFE) the client authorises the registered person to apply any monies or approved debt securities which the client may pay to the registered person in the manner specified under HKFE Rule 622 or Rule 622A and, in particular, that the registered person may apply such monies or approved debt securities in or towards meeting the registered person's obligations to any party insofar as such obligations arise in connection with or incidental to F.O. Business transacted on that client's behalf;
- (k) (where a registered person is an exchange participant of HKFE) the client acknowledges that in respect of any account of the registered person maintained with the Clearing House, whether or not such account is maintained wholly or partly in respect of F.O. Business transacted on behalf of that client and whether or not money or approved debt securities paid by that client has been paid to the Clearing House, as between the registered person and the Clearing House, the registered person deals as principal and accordingly no such account is impressed with any trust or other equitable interest in favour of the client and monies and approved debt securities paid to the Clearing House are thereby freed from the trust referred to in paragraph 2(i) of Schedule 4 to the Code;
- (l) (where a registered person is an exchange participant of HKFE) the period within which margin calls, demands for variation adjustments and Interest Rate Cash Adjustments must be met, the registered person may be required to report to the Exchange and the Commission particulars of all open positions in respect of which two successive margin calls, demands for variation adjustments and Interest Rate Cash Adjustments are not met within the period specified by the registered person and the registered person may require more margin, variation adjustments or Interest Rate Cash Adjustments than that specified by the Exchange and/or the Clearing House and may close out open positions in respect of which any margin calls, demands for variation adjustments and Interest Rate Cash

Adjustments are not met within the period specified by the registered person or at the time of making such call(s) or demand(s)⁴⁴;

- (m) (where a registered person is an exchange participant of HKFE) the client acknowledges that the registered person is bound by the Exchange Rules which permit the Exchange to take steps to limit the positions or require the closing out of contracts on behalf of such clients who in the opinion of the Exchange are accumulating positions which are or may be detrimental to any particular Market or Markets or which are or may be capable of adversely affecting the fair and orderly operation of any Market or Markets as the case may be; and
- (n) risk disclosure statements as specified in Schedule 1 to the Code will be attached.

Discretionary accounts

- 3. (a) In the event that the net equity in a discretionary account falls below such sum as is specified by the client in writing to the registered person from time to time or if, in any period of three or fewer consecutive trading days, it falls by more than 50 per cent from the level at which it stood at the beginning of that period, a registered person should forthwith notify the client in writing of the level of net equity and, except with the prior written consent of the client to every subsequent transaction, should not initiate any new trades in respect of that discretionary account (except in order to close out existing open positions) until such time as the net equity in the discretionary account exceeds the specified amount or (as the case may be) is restored to the level at which it stood at the beginning of the period.
- (b) For the purpose of paragraph 3 (a) of Schedule 4 to the Code, "net equity" at any time means the balance at that time shown in the ledger account relating to the discretionary account plus any floating profit or less any floating loss in respect of the discretionary account, and after adjusting for any levies or commission due from the client.⁴⁵
- 4. (a) A registered person should not accept, carry or initiate on behalf of a discretionary account more than two day trades in any Market unless it has obtained from the client on whose instructions the discretionary account was opened prior written approval specifically authorising such transactions.
- (b) For the purpose of paragraph 4 (a) of Schedule 4 to the Code, a "day trade" is a transaction whereby a registered person executes in the same day an order to buy and an order to sell Exchange Contracts on the same Market in the same futures contract month, option series, or Currency Contract Type for the same client.⁴⁶

⁴⁴ Provisions derived, in part, from Hong Kong Futures Exchange Ltd. Rule 617.

⁴⁵ Provisions derived, in part, from Hong Kong Futures Exchange Ltd. Rule 610.

⁴⁶ Provisions derived, in part, from Hong Kong Futures Exchange Ltd. Rule 611.

Omnibus Accounts⁴⁷

5. A registered person which is an exchange participant of HKFE should maintain the following information of all omnibus accounts carried by it:
- (i) the name of the client on whose instructions the account is operated and an indication as to whether or not it is an exchange participant of HKFE;
 - (ii) the title of the account in the books of the registered person;
 - (iii) the address of the client;
 - (iv) whether the business transacted in respect of the account is HKFE Trade or Non-HKFE Trade;
 - (v) whether the client is authorised under the Ordinances or the laws of its jurisdiction to operate an omnibus account and whether the client is a dealer registered under the Ordinances or under the laws of its relevant jurisdiction; and
 - (vi) any other information which the Commission and HKFE may from time to time require.
6. A registered person which is an exchange participant of HKFE should ensure that a client who operates an omnibus account and who is not an exchange participant of the HKFE shall:
- (a) in the client's dealings with the person(s) from whom it receives instructions with respect to the omnibus account, comply with and enforce the margin, variation adjustment and Interest Rate Cash Adjustment requirements and procedures as stipulated in the rules as though the client were an exchange participant of HKFE and as though the person(s) for whose account or benefit such instructions are given were clients;
 - (b) cause Exchange Contracts to be entered into in fulfillment of such instructions, so that there shall in no circumstances be any dealing with the instructions in a manner which constitutes unlawful dealing in differences in market quotations of commodities under the laws of Hong Kong or any other applicable jurisdiction or in a manner which constitutes or involves betting, wagering, gaming or gambling with respect to such items in contravention of Hong Kong law or any other applicable laws; and
 - (c) ensure that the persons from whom the client receives instructions comply with the margin, variation adjustment and Interest Rate Cash Adjustment requirements as stipulated in the rules, with the result that, as between HKFE

⁴⁷ Provisions derived, in part, from Hong Kong Futures Exchange Ltd. Rules 612 and 614.

and the registered person, the registered person should be responsible for ensuring that such requirements are complied with by all persons through whom instructions pass with respect to the omnibus account as if each in turn was the client for whom such omnibus account was operated.

A registered person should not operate an omnibus account unless it is able, whether by virtue of the contractual terms applying between it and its client or otherwise, to comply strictly with paragraph 6 of Schedule 4 to the Code.

Client's money and approved debt securities of clients

7. (a) Every registered person which is an exchange participant of HKFE transacts business for clients should establish and keep with an authorised institution within the meaning of Section 2 of the Banking Ordinance or with an organisation approved by the Commission pursuant to Section 46 of the Commodities Trading Ordinance (Cap. 250), at least one current or deposit bank account in the name of the registered person and in the title of which the word "client", "segregated", "Non-House" or other similar word or phrase appears and which constitutes a Segregated Bank Account of the registered person⁴⁸.
- (b) Every registered person which is an exchange participant of HKFE transacts on behalf of its clients both HKFE Trade and Non-HKFE Trade should maintain at least two Segregated Bank Accounts and should ensure that client's money relating to HKFE Trade is paid into one Segregated Bank Account designated as an "HKFE Trade" account whilst client's money relating to Non-HKFE Trade is paid into another Segregated Bank Account designated as a "Non-HKFE Trade" account, and should procure that client's money received and paid by the registered person in respect of HKFE Trade and Non-HKFE Trade is always kept separately and accounted for separately⁴⁹.
8. (a) Every registered person which is an exchange participant of HKFE receives from clients collateral for margin requirements in the form of approved debt securities should establish and keep with a recognized dealer registered with the Hong Kong Monetary Authority (in the case of Exchange Fund Bills or Notes) or any bank, depository or institution approved by the Exchange or the Clearing House from time to time (in the case of other approved debt securities) at least one debt securities account in the name of the registered person and in the title of which the word "client", "segregated", "Non-House" or other similar word or phrase appears and which constitutes a Segregated Debt Securities Account.
- (b) Every registered person which is an exchange participant of HKFE receives from clients collateral for margin requirements in the form of approved debt securities and which transacts on behalf of clients both HKFE Trade and Non-HKFE Trade should maintain at least two Segregated Debt Securities

⁴⁸ Provisions derived, in part, from Hong Kong Futures Exchange Ltd. Rule 620(a).

⁴⁹ Provisions derived, in part, from Hong Kong Futures Exchange Ltd. Rule 620(b).

Accounts and should ensure that clients' approved debt securities relating to HKFE Trade are deposited into one Segregated Debt Securities Account designated as an "HKFE Trade" account whilst clients' approved debt securities relating to Non-HKFE Trade are deposited into another Segregated Debt Securities Account designated as a "Non-HKFE Trade" account, and should procure that clients' approved debt securities received and deposited by the registered person in respect of HKFE Trade and Non-HKFE Trade are always kept separately and accounted for separately⁵⁰.

9. (a) All money received by a registered person which is an exchange participant of HKFE from a client or from any other person (including the Clearing House) for the account of the client should be held by the registered person as trustee, segregated from the registered person's own assets and paid into a Segregated Bank Account of the registered person.
 - (b) Every registered person which is an exchange participant of HKFE holds or receives client's money should as soon as practicable and in any event within the next business day after its receipts pay client's money into a Segregated Bank Account of the registered person.
 - (c) No client's money may be paid by a registered person which is an exchange participant of HKFE into any bank account other than a Segregated Bank Account maintained by that registered person.
 - (d) No money other than client's money may be paid by a registered person which is an exchange participant of HKFE into a Segregated Bank Account.
 - (e) Each registered person, whether an exchange participant of HKFE or not, should ensure that client's money maintained in segregated bank accounts is at all times sufficiently liquid to satisfy readily all margin requirements or other trading related liabilities in respect of F.O. Business conducted on behalf of clients. In this connection, each registered person should ensure that prudent cash flow management procedures are employed⁵¹.
10. (a) All approved debt securities received by a registered person which is an exchange participant of HKFE from a client or from any other person (including the Clearing House) for the account of the client should be held by the registered person as trustee, segregated from the registered person's own assets and deposited into a Segregated Debt Securities Account of the registered person.
 - (b) Unless clients' approved debt securities are deposited directly into the registered person's Segregated Debt Securities Account, every registered person which is an exchange participant of HKFE holds or receives clients' approved debt securities should as soon as practicable and in any event within the next business day after its receipt deposit clients' approved debt securities into the registered person's Segregated Debt Securities Account.

⁵⁰ Provisions derived, in part, from Hong Kong Futures Exchange Ltd. Rule 620A.

⁵¹ Provisions derived, in part, from Hong Kong Futures Exchange Ltd. Rule 621.

- (c) No clients' approved debt securities may be deposited by a registered person which is an exchange participant of HKFE into any debt securities or other account of the registered person or any holding company or any subsidiary of such holding company other than a Segregated Debt Securities Account maintained by that registered person.
 - (d) No approved debt securities or other debt securities other than clients' approved debt securities may be deposited by a registered person which is an exchange participant of HKFE into a Segregated Debt Securities Account⁵².
11. Client's money may only be withdrawn by a registered person which is an exchange participant of HKFE from a Segregated Bank Account for the following purposes⁵³:
- (a) money properly required to meet obligations of registered persons to the Clearing House or an executing agent arising in connection with F.O. Business transacted by a registered person on the instructions of one or more clients provided that no withdrawal may be made which would have the effect that Clearing House margin, variation adjustment, Interest Rate Cash Adjustment requirements or other trading related liabilities in respect of F.O. Business conducted on behalf of any client are thereby financed by other client's money;
 - (b) money properly required to meet commission, brokerage, levies and other proper charges directly relating to F.O. Business transacted by a registered person on the instructions of one or more clients (whether or not payable to the registered person);
 - (c) money which is transferred to another Segregated Bank Account of the registered person;
 - (d) money paid to or in accordance with the directions of a client, but in such a case notwithstanding the client's directions, no money may be paid into another account of the registered person unless that account is a Segregated Bank Account; and
 - (e) money representing interest on client's money, which may be retained by the registered person if the terms of the registered person's Client Account Agreement with the client in question permit the registered person to do so.
12. Where a registered person is an exchange participant of HKFE, there may be withdrawn from a Segregated Debt Securities Account⁵⁴:
- (a) approved debt securities required to meet obligations of registered persons to the Clearing House or an executing agent arising in connection with F.O. Business transacted by a registered person on the instructions of one or more clients provided that no withdrawal may be made which would

⁵² Provisions derived, in part, from Hong Kong Futures Exchange Ltd. Rule 621A.

⁵³ Provisions derived, in part, from Hong Kong Futures Exchange Ltd. Rule 622.

⁵⁴ Provisions derived, in part, from Hong Kong Futures Exchange Ltd. Rule 622A.

have the effect that Clearing House margin, variation adjustment, Interest Rate Cash Adjustment requirements or other trading related liabilities in respect of F.O. Business conducted on behalf of any client are thereby financed by other clients' approved debt securities;

- (b) approved debt securities which are transferred to another Segregated Debt Securities Account; and
- (c) approved debt securities paid to or in accordance with the directions of a client, but in such a case notwithstanding the client's directions, no approved debt securities may be paid into another account of the registered person unless that account is a Segregated Debt Securities Account.

No set-off between registered person's accounts and client's accounts⁵⁵

- 13. (a) No registered person should apply, permit or suffer any monies, approved debt securities or other non-cash collateral standing to the credit of any client's ledger account to be applied for the benefit of its own trading accounts, accounts of its directors or employees or for the benefit of trading accounts of any other clients.
- (b) No registered person should apply, permit or suffer any monies or any other forms of collateral received from clients to be applied against debts of its own trading account or accounts of its directors or employees.

Client's ledgers⁵⁶

- 14. Every registered person which is an exchange participant of HKFE should maintain in its books and records separate ledger accounts for every client in respect of:
 - (a) all HKFE Trade;
 - (b) all Non-HKFE Trade;
 - (c) all trade which is neither HKFE Trade nor Non-HKFE Trade and is consequently not F.O Business, of that client.
- 15. (a) Every registered person which is an exchange participant of HKFE receives from clients collateral for margin requirements in the form of approved debt securities (or which arranges for approved debt securities of clients to be deposited directly with the Clearing House) should maintain proper books and records which correctly and clearly record, inter alia, the following details of all approved debt securities received from each client:
 - (i) a complete description of each type of approved debt securities; and

⁵⁵ Provisions derived, in part, from Hong Kong Futures Exchange Ltd. Rule 623.

⁵⁶ Provisions derived, in part, from Hong Kong Futures Exchange Ltd. Rule 624.

- (ii) the quantity and face value of approved debt securities deposited with or withdrawn from the Clearing House or each depository with which the Segregated Debt Securities Account is maintained and the date of any such deposit or withdrawal.
 - (b) Every registered person which is an exchange participant of HKFE should ensure that all regular statements of account to clients contain the details listed in paragraph 15 (a) above⁵⁷.
16. Every registered person which is an exchange participant of HKFE should segregate its clients' HKFE Trade ledger accounts and Non-HKFE Trade ledger accounts and any other ledger accounts so that, except by actual cash payments or approved debt securities transfers, credit balances on any given type of trade account may not be used to offset debit balances, or to meet margin requirements, demands for variation adjustment or Interest Rate Cash Adjustment on any other type of trade account⁵⁸.

Other requirements

17. A registered person which is an exchange participant of HKFE should also comply with the following rules (including the rules, regulations, guidelines, procedures and circulars) of HKFE:
- (a) Circular dated 12/9/1994 (Ref. No. MEM/CIR/9409002/002) on immediate time-stamping procedures;
 - (b) HKFE Rule 531A on telephone recording and its related Circular dated 24/9/99 (Ref. No. CIR/CMP/990378);
 - (c) Circular dated 31/7/1998 (Ref. No. CIR/LEGAL/980274) on disclaimer and Circular dated 8/5/1998 (Ref. No. CIR/LEGAL/980141) on HKFE disclaimer;
 - (d) HKFE Rule 617 on minimum margin requirements, including Circular dated 7/12/1993 (Ref. No. MEM/CIR/9312050/017) on the requirements governing omnibus accounts; Circular dated 27/8/1998 (Ref. No. CIR/CMP/980310) on day trade margin requirements; and Circular dated 3/3/1997 (Ref. No. AUD/9703001) on Guidelines on Margin Procedures;
 - (e) Circular dated 12/9/1994 (Ref. No. MEM/CIR/9409005/005) on spread trade procedures;
 - (f) Circular dated 30/1/1997 (Ref. No. CMP/CIR/9701010) and 13/6/1997 (Ref. No. MEM/CIR/9706036) on large open position (reporting) procedures (including HSI Futures, HSI Options and NYMEX contracts) and Circular dated 14/7/1999 (Ref. No. CIR/CMP/990271) on delta position limits; and

⁵⁷ Provisions derived, in part, from Hong Kong Futures Exchange Ltd. Rule 624A.

⁵⁸ Provisions derived, in part, from Hong Kong Futures Exchange Ltd. Rule 625.

- (g) Circular dated 10/3/1995 (Ref. No. MEM/CIR/9503029/023) on stock futures (client margining, large open positions and position limits, client account documentation and general).

**SCHEDULE 5 ADDITIONAL REQUIREMENTS FOR REGISTERED
PERSONS CONDUCTING SECURITIES MARGIN
FINANCING**

General

1. This schedule applies to persons registered under the Securities Ordinance (Cap. 333) that are:
 - (a) securities margin financiers;
 - (b) dealers that conduct securities margin financing; and
 - (c) where applicable, their representatives,except as otherwise specified.

Securities margin financing policy

2. A registered person should have a prudent margin lending and margin call policy set out in writing and properly communicated to its staff.
3. A registered person should assure itself that the margin client has the financial capacity to meet obligations arising from instructions the margin client gives and in the absence of such assurance, it shall not accept instructions from such margin client.

Differentiation between cash and margin accounts

4. Where a client operates both a cash and a margin account, the registered person should have adequate systems and resources to ensure that transactions and assets booked under one account are not commingled with those booked under the other.

Prudent bank borrowing

5. To avoid potential over-borrowing, a registered person should ensure that the aggregate of all outstanding bank borrowings, overdrafts, advances etc. secured by the pledging or deposit of securities collateral belonging to margin clients remains prudent when compared to the aggregate of all outstanding margin loans made to margin clients. As a general guide, the amount of such bank borrowings, overdrafts and advances should not exceed 120% of the value of outstanding margin loans.

Client agreement

6. A registered person should ensure that a written Margin Client Agreement is entered into with a client before securities margin financing is provided to that client. The Margin Client Agreement shall specify that the account is a “margin account”.
7. In the case of a securities margin financier registered under the Securities Ordinance (Cap. 333), the Margin Client Agreement should, in addition to the requirements set out in paragraph 6 of the Code, contain a statement that:
 - (a) the financier is subject to the sole business requirement and it can only provide financial accommodation to facilitate the acquisition of listed securities and, where applicable, for the continued holding of those securities. The client will not be able to withdraw funds under the facility unless they are for such purposes; and
 - (b) the financier cannot effect dealing in securities for or on behalf of clients, except for the liquidation of their securities collateral in order to collect margin calls or outstanding debts.

Information for clients

8. A registered person should clearly inform margin clients in writing of its margin lending and margin call policy as it affects them.
9. A registered person should ensure that margin clients are fully informed as to the circumstances of their accounts and should provide them with a regular statement of account, stating that
 - (a) that the account is a margin account;
 - (b) that the securities are held as collateral; and
 - (c) whether the margin client has given an authority under section 81A or 121AB of the Securities Ordinance (Cap. 333), and if yes, the expiry date of such authority.

Internal controls

10. A registered person should, where possible, assign the responsibility for securities margin financing to a senior officer or committee that is independent of the sales or trading function. A clear securities margin financing policy should be developed, documented and communicated to all relevant staff for strict enforcement. Such policy should include at least the following objectives:
 - (a) to provide a basis for protecting the capital of the registered person;

- (b) to ensure adequate procedures are in place for identification of risks, effective monitoring and corrective action; and
 - (c) to ensure there is a consistent risk management policy.
11. In particular, this policy should:
- (a) ensure exposure to individual margin clients or groups of related margin clients (as defined in the Financial Resources Rules made under the Securities and Futures Commission Ordinance (Cap. 24)) (FRR) is adequately secured;
 - (b) avoid building up excessive exposure to individual margin clients or groups of related margin clients; and
 - (c) avoid building up excessive exposure to individual item of securities or items of related securities (as defined in the FRR) deposited as collateral.
12. The securities margin financing policy framework should address, amongst other things, the following:
- (a) the form of objective proof of net income or net worth such as: tax returns, salaries advice and bank statements. This should be used as a reference for setting credit limits and should be subject to strict enforcement and regular review;
 - (b) the list of securities acceptable as collateral, and the different haircuts applicable to collateral, bearing in mind their liquidity and volatility in prevailing market conditions;
 - (c) the procedures to identify groups of related margin clients;
 - (d) the monitoring of changes in concentrated collateral positions (including related securities), and consider the need to amend the list of securities acceptable as collateral for additional advances;
 - (e) the monitoring of changes in concentrated securities margin loans and consider whether additional advances would be prudent where there is such concentration;
 - (f) the triggering level for making the first and successive margin calls, including intra-day calls;
 - (g) the giving of warnings to clients with outstanding margin calls specifying the steps the firm plans to take and when;
 - (h) the maintenance of appropriate detailed records to ensure that the case history of margin calls for each individual client can be readily established;

- (i) the triggering level for stopping further advances to clients, for example where there are outstanding margin calls yet to be met;
- (j) the triggering level for forced liquidation of a client's collateral;
- (k) a procedure in the case of a forced liquidation of a client's collateral to ensure the best available terms to the client and reduction of the firm's exposure to that client to an acceptable level;
- (l) the circumstances in which deviation from the policy, supported by written explanations, may be approved by management, specifying the limits applicable to each level of the management; and where such deviation has an adverse effect on the firm's liquid capital position, the steps taken to ensure that the firm will not, as a result, be in breach of the FRR; and
- (m) the management reports (especially exception reports) necessary to ensure efficient monitoring over securities margin financing on an ongoing basis, readily showing
 - (i) outstanding margin loan balance per account;
 - (ii) margin call status of each margin client;
 - (iii) analysis of collateral received;
 - (iv) margin ratios for different collateral items; and
 - (v) concentration of exposure to securities collateral or clients.

13. In the case of a securities margin financier registered under the Securities Ordinance (Cap. 333), the financier should make appropriate enquiries of a margin client when that margin client wishes to draw against the client's account. Generally, any advance in excess of the realisable value of the securities collateral would indicate lending outside the scope of providing financial accommodation for facilitating the acquisition or any continued holding of listed securities.