



SECURITIES AND  
FUTURES COMMISSION  
證券及期貨事務監察委員會

Consultation Conclusions on the  
Draft Securities and Futures  
(Financial Resources) Rules

《證券及期貨(財政資源)規則》草擬本  
諮詢總結

Hong Kong  
October 2002

香港  
2002年10月

## **INTRODUCTION**

1. On 14 June 2002, the Securities and Futures Commission released ‘the “Consultation Document on the draft Securities and Futures (Financial Resources) Rules (“Consultation Document”)’.
2. The Consultation Document contained proposed draft rules (the “Draft Rules”) to be made under section 145(1) of the Securities and Futures Ordinance (the “SFO”) in relation to the financial resources that are to be maintained by licensed corporations.
3. The consultation period lasted until 12 July 2002.
4. Taking into account the submissions received and following discussions with commentators, several revisions to the Draft Rules were considered appropriate.
5. A summary of comments received on the Draft Rules (“Summary of Comments”) is attached as Appendix A and the Revised Draft Securities and Futures (Financial Resources) Rules (“Revised Draft Rules”) are attached as Appendix B.
6. The purpose of this report is to provide interested persons with an analysis of the main comments raised during the consultation process and the rationale for the Commissions conclusions. This report should be read in conjunction with the SFO, the Consultation Document, the Summary of Comments and the Revised Draft Rules.

## **PUBLIC CONSULTATION**

### **A. Background**

7. Essentially, the Draft Rules were prepared to follow the current Financial Resources Rules made under section 28 of the Securities and Futures Commission Ordinance (the “FRR”) applicable to securities and futures dealers and advisers, as amended by the two new amendments relating to securities margin financing and the Leveraged Foreign Exchange Trading (Financial Resources) Rules. There were only minimal policy changes.

### **B. Consultation Process**

8. In addition to the public announcement inviting comments, the Consultation Document was distributed to all registered persons, exempt persons, various professional bodies and the Financial Services and The Treasury Bureau. The Consultation Document was also published on the SFC website.

9. 13 submissions were received from practitioners including fund management firms, international brokerage firms and their legal adviser, industry representative bodies and professional associations.
10. The overall tone of the comments was positive. Commentators generally welcomed the Draft Rules. Comments varied considerably in range and depth, with some focusing on broad principles and others on points of detail and clarification.

## **CONSULTATION CONCLUSIONS**

11. In addition to the drafting changes that have been suggested by the Department of Justice and a few minor amendments, the following policy changes have been reflected in the Revised Draft Rules:

### Grace period for advisers

12. In the Consultation Document, we proposed to replace the net tangible asset requirement (which is not effective for purposes of assessing the quality of assets) by the liquid capital requirement.
13. One commentator has suggested that advisers not holding client assets should not be subject to the Draft Rules at all. One other has suggested a transitional period of 3 months when another has suggested a transitional period of 12 months for advisers and fund managers.
14. In view of the market comment, we have amended the Draft Rules to provide for a transitional period of 6 months. During this transitional period, existing advisers will only need to comply with the net tangible asset requirement.
15. Some have pointed out that fees receivable from rendering fund management services are generally not collected within 2 weeks and suggested extension to 2 months.
16. We have amended the Draft Rules to include fees in liquid assets provided that they have not been outstanding for more than a month.

### Inclusion of new HKEx products in liquid assets

17. It has been submitted that all securities listed or traded on any market operated by HKEx should be included in liquid assets, subject to a specified haircut<sup>1</sup>. These would include the equity linked instruments (“ELIs”) as well as other structured products that might be launched later whose underlying assets could be a security, currency, commodity or other asset or combination of assets.

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<sup>1</sup> securities are included in liquid assets at market value less a specified percentage (i.e. haircut) to provide for adverse price movements.

18. While we do not believe it is appropriate to include all future listed structured products in liquid assets as they may pose very different risks and require very different haircut treatment, we have considered the nature of the recently SEHK-listed ELIs and propose to include them in liquid assets, subject to the same haircut as is applicable to the underlying securities. We will regularly review the need to amend the Rules in view of new products being launched onto the market.

Certificates of deposit issued by banks

19. Further to our discussions with other market participants, we recognize a growing interest in certificates of deposit issued by banks. These certificates, to the extent that they are not issued by banks with investment grade credit rating, cannot be presently included in liquid assets as qualifying debt securities. We propose to relax this by including certificates of deposit which are issued by authorized financial institutions or approved banks incorporated in specified countries/areas outside Hong Kong (i.e. banks incorporated under the law or other authority of a country belonging to the OECD or Singapore) in qualifying debt securities. These shall be stated at market value and subject to a haircut for the purposes of capturing the interest rate risk.

Financial return

20. In the Consultation Document, we proposed to make mandatory electronic filing of financial returns, with a digital signature attached. This would allow automatic uploading of data into the SFC databases for timely assessment of the solvency of firms and accurate assessment of the risks involved in any firm's regulated activities. The licensed corporations should also be able to benefit from the built-in validation checks to reduce input errors, and from the more flexible delivery time.
21. Several market responses have argued that
- (a) small and medium brokers may have resource problems in automation, which include both financial resources and manpower;
  - (b) a grace period is needed for licensed corporations to amend and test their systems; and
  - (c) there should be added flexibility to allow submission without attaching digital signature (e.g. by allowing submission of hard copy duly signed by the relevant person).
22. We are sympathetic to the concerns raised by the industry. While we believe that electronic filing is desirable as it can help firms reduce input errors and facilitate the Commission's data uploading, we agree not to make it mandatory at this stage, given the concerns of the industry. Longer term, however, electronic filing is in the right direction. We propose to revisit this issue in two years' time.

### Transitional arrangement for exempt persons

23. A grace period of 3 months was originally proposed for exempt dealers and exempt investment advisers. In view of market response, this has been extended to 6 months in the Revised Draft Rules.

### Miscellaneous

24. A commentator has reiterated its concern over the two new amendments made to the existing FRR and enacted in May 2002, namely the illiquid collateral haircut<sup>2</sup> and the gearing adjustment<sup>3</sup>. Both has become effective on 1 October 2002. The view it has taken is that some fundamentally sound stocks may fall within the definition of illiquid collateral whereas many speculative stocks without fundamentals are often heavily traded. Also, the commentator pointed out that the gearing adjustment will also make brokers less competitive than banks.
25. These two measures are interim measures to address the identified risk in the securities margin financing business, pending a longer term solution to be recommended by the working group<sup>4</sup> on the review of financial regulatory framework for intermediaries. Once an alternate solution is identified and accepted, the two measures can be modified or replaced accordingly. The industry and the public will be fully consulted before policy decisions are made. In the meantime, we are actively stress testing the two amendments on our brokers and will engage any brokers with potential compliance problems in early discussions to ensure that the transition can be as smooth as possible. We will apply the rules flexibly and in the case where a broker has genuine difficulty complying with the new amendments, we will consider granting modification or relief as appropriate, so long as there is no investor protection concern.
26. We also take this opportunity to clarify that the illiquid collateral haircut does not prohibit lending by a firm against any stock. It only requires the firm to effectively put in extra liquid capital to buffer against the risk of the firm not being able to liquidate the stock in time to resolve any temporary cash flow problems.

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<sup>2</sup> In essence, where a particular security or warrant held by a firm as clients' securities collateral cannot be liquidated within one month or represents more than 5% of its market capitalization, the security or warrant will be subject to a 80% haircut.

<sup>3</sup> Where a firm obtains funding secured by clients' securities collateral, and such funding exceeds 65% of aggregate margin loans, then the excess should be included in ranking liabilities. This in effect requires a firm to fund 35% of aggregate margin loans by its shareholders' funds or loans secured by some other means.

<sup>4</sup> Members of the group include local and international brokers, representatives of brokers and fund managers associations, members from the academia and media, and the Consumer Council.

27. We are mindful that a stock that is illiquid is not necessarily a poor quality stock. The objective of the illiquid collateral haircut is not to focus on quality – that is a matter for the broker and its client. Rather, the haircut aims to address liquidity problems. In addition, the illiquid collateral haircut should not have a “labelling effect” on stocks. A stock subject to the 80% haircut in the liquid capital calculation of one firm may not be so subject in the case of another firm - what matters is the actual holding of illiquid collateral by the firm. The 80% haircut would apply only when the firm's collateral holding in a stock is greater than 5 % of the stock's market capitalization or the average monthly turnover of that stock over a 6-month historical period.

#### **EFFECTIVE DATE**

28. The Securities and Futures (Financial Resources) Rules will become effective on the day appointed for the commencement of Part VI of the SFO.

## Draft Securities and Futures (Financial Resources) Rules

### Summary of comments received and SFC's response

Item no.	Clause no.	Respondent	Respondent's comments	SFC's response
<b>General Comments</b>				
1.	-	Linklaters & Alliance	Whilst the draft Rules do substantially follow the requirements of the existing Financial Resources Rules and the LFET (Financial Resources) Rules, the commentator expressed an interest in seeing changes towards a more risk-based capital framework, which corresponds closely to the risk associated with the activities undertaken by the intermediaries.	<p>The FRR are risk-based in that they levy capital charges against different risks underlying risk assets or exposures and require a capital buffer to be maintained for the different types of regulated activities conducted.</p> <p>As explained in the Consultation Paper, we have formed a working group to critically review the overall regulatory framework for intermediaries and will in due course release a White Paper setting out our proposals.</p>
2.	-	Law Society of Hong Kong	<p>The Securities Law Committee of the Law Society supports the initiative to:</p> <ul style="list-style-type: none"> <li>(i) harmonise the financial resources rules applying to persons carrying on more than one regulated activity;</li> <li>(ii) streamline and reduce the administrative burden associated with compliance with the financial resources rules;</li> <li>(iii) better reflect the level of risk associated with various asset liabilities.</li> </ul>	We appreciate the support.
3.	-	Hong Kong Securities Institute	<p>Some responses to a survey conducted by the Hong Kong Securities Institute commented that:</p> <ul style="list-style-type: none"> <li>(a) The consistency of applying the concept of liquid capital requirements to all licensed corporations is lacking the consideration of the nature of different corporations.</li> <li>(b) Investment advisers who do not hold clients' monies or assets should not be subject to the Rules</li> </ul>	<p>We have proposed to replace the net tangible asset requirement by the liquid capital requirement because the net tangible asset requirement has been found to be deficient for not being able to ensure basic quality of assets.</p> <p>The liquid capital requirement for investment advisers who do not hold client assets is the lowest amongst all classes of licensed corporations. It is important for investor protection and market integrity purposes that all licensed corporations should have sufficient liquidity and capital to operate their business.</p>

Item no.	Clause no.	Respondent	Respondent's comments	SFC's response
<i>Specific Comments</i>				
4.	5	Anonymous	Please advise whether paid-up share capital covers paid-up redeemable shares and share premium.	“Paid up share capital” does not include the items mentioned.
5.	5 & 6	JF Asset Management	Asset managers that are not subject to the specified licensing condition are required to maintain a minimum liquid capital at HK\$3 million and paid up share capital of not less than HK\$5 million. The commentator wishes that the Commission would clarify the circumstances under which the licensing condition would be granted for the deemed licence when the Securities and Futures Ordinance becomes effective.	Under section 55 of Part V of Schedule 10 of the Ordinance, any licensing condition that has been attached or imposed to the registration of an adviser immediately before the commencement of the Ordinance will be deemed to be imposed in respect of the licence it is deemed to be licensed under the Ordinance when the Ordinance comes into effect. Advisers who are not subject to a licensing condition of not holding client assets immediately before the commencement of the Ordinance would not automatically have that condition attached under the Ordinance and therefore will be required to comply with the relevant requirements under the Rules upon expiry of the 6 month transitional period. Asset managers and advisers who do not need to hold client assets and wish to enjoy the lower capital requirement may contact us for such licensing condition.
6.	11(a)	Linklaters & Alliance	The Draft Rules indicated an average quote should be obtained from parties such as market makers, third party banks, licensed corporations or dealers outside Hong Kong. Otherwise, the securities will be valued at nil and face value for long and short positions respectively. In respect of debt securities with no market value, valuations per a discounted cash flow model can be used for the purpose of calculating amount to be included as liquid assets and ranking liabilities.	Although the discounted cash flow method is suitable for determining the theoretical value of debt securities, the Rules do not accept such method for calculating the value of debt securities because in the absence of independent market quotes, the debt securities may not be readily marketable and thus it may be difficult to realize.  Nevertheless, the SFC will keep an open mind on alternative valuation methods and grant modification where appropriate.  In view of general market interest to purchase certificates of deposit issued by banks, which currently are subject to the same qualifying requirements as other debt securities, we have amended the Draft Rules to specifically include them in qualifying debt securities at the price quoted by the issuing bank where no published price is available.



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7.	Division 2 Liquid Assets	Linklaters & Alliance	In determining the relevant treatment for balances held with overseas bodies (e.g. an authorized financial institution, an approved bank incorporated outside Hong Kong or a recognized clearing house), reference should be made to the local market regulation and requirements. For example, deposits held at Korea Securities Finance Corporation ("KSFC") should be considered a liquid asset since the Korean Securities and Exchange Law requires securities companies to deposit with KSFC all cash deposits received from customers in excess of 15% margin.	The Draft Rules have been revised to include deposits with KSFC in liquid assets. The SFC will also keep an open mind on specific circumstances of individual firms and grant modification where appropriate.
8.	23(2)	Linklaters & Alliance	The commentator wished to clarify whether a formal legal agreement is required in order to set off amounts receivable from and amounts payable to a client, or whether an implied agreement is sufficient, and whether any agreement must be in writing. If netting off is allowed, they also wanted to clarify whether this can be done on a security-by-security basis and whether the securities need to be the same value date.	The Draft Rules have been revised to require <u>written</u> client authorization for set-off and disposal of securities held for the client. The netting treatment under section 21(2) of the revised Draft Rules can be applied to all amounts receivable and payable to the client in respect of purchases and sales of securities on a cash-against-delivery basis, irrespective of their trade date and can be applied on transactions in different securities.
9.	24	HK Stockbrokers Association Ltd	Although the SFC has gone some ways to reduce the concerns regarding the definition of what is an "illiquid stock", the commentator believes that the approach taken still does not address the issue of a stock that is fundamentally sound but thinly traded. For example, a stock can be trading at a deep discount to NAV, with a low p/e ratio and paying a good dividend rate. To classify this as "illiquid" for the purpose of the FRR and to apply a deep discount of 80% is overkill. As good investment advisers, the commentator would recommend exactly this kind of "bargain" stocks to clients to accumulate. Fundamentally sound stocks should not be penalized merely because the general investing public has not discovered it. A "by the numbers" approach to defining "illiquid" stocks may not necessarily be appropriate as many speculative stocks without fundamentals are often heavily traded. Turnover can be easily "manufactured" and can just as easily dry up.	<p>We have already excluded from "illiquid collateral" all HSI index, HSI HK LargeCap and HSI HK MidCap stocks. The objective of applying a heavier haircut to "illiquid collateral" is to ensure that firms have adequate capital buffer in case they cannot liquidate their clients' securities collateral within a reasonable timeframe. Market liquidity and the fundamental quality of the stock are important matters for consideration in exercising good credit management and achieving the above objective.</p> <p>Regarding the worry about "manufactured turnover", we reiterate that entering into wash sales (which involve the sale and purchase of stocks without any change in their beneficial ownership) is a criminal offence, as is the creation of a false market. The SFC will be vigilant in its monitoring of share movements. In relation to such malpractices the SFC will take action, including the prosecution of offences and disciplining persons guilty of misconduct.</p>

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10.	29	Anonymous	Equity linked instruments should be regarded as liquid asset as it is a listed product which can be traded freely on a recognized exchange. In addition, there is liquidity providing facility to provide liquidity of the product. The SFC may consider adding a provision to the effect that all products listed or traded on the market operated by the HKEx be considered as liquid assets for the purpose of calculating liquid capital, which are subject to specified haircut of the Rules.	<p>The Draft Rules have been revised to prescribe the treatment of equity linked instruments listed on the Stock Exchange of Hong Kong.</p> <p>Given the diversity of products that may be launched in the market and the variation in their risks, the SFC will regularly review the need of amending the Rules for new products.</p>
11.	37(a)(ii)	Anonymous	For asset management service billed on a quarterly basis, client may take a longer time to check and settle a bill. A bill overdue for 2 weeks ceasing to be a liquid asset is relatively short for asset manager. It is suggested to extend the time from 2 weeks to 2 months.	We have revised the Draft Rules to accept fees receivable which have not been outstanding for more than one month as liquid assets.
12.	Division 3 Ranking liabilities	Anonymous	<p>Division 3 does not have any provision for client assets (equities, bonds, unit trusts and others) held by an asset manager in segregated accounts with local or overseas custodians on clients' behalf. Based on this, it is interpreted that such client assets do not fall within Division 2 – Liquid Assets and Division 3 – Ranking Liabilities of the Rules. The same interpretation applies to client assets held by an asset manager on client's behalf in a capacity outside the regulated activities (e.g. being a trustee of a particular trust).</p> <p>Further, it is also interpreted that money due to/from clients/trustees in respect of redemption/subsorption of unit trusts do not fall within Division 2 – Liquid Assets and Division 3 – Ranking Liabilities of the Rules in computing liquid capital of a dealer dealing in unit trusts.</p> <p>Please advise whether the above interpretations are correct.</p>	<p>Client securities held by licensed corporations are not assets of the licensed corporation and under general accounting principles no corresponding liabilities in respect of the holding of client securities will be booked on the balance sheet of the licensed corporations.</p> <p>The treatment of amounts receivable and payable to clients/ trustees in respect of subscription/redemption of funds will depend on the role of the licensed corporation in the settlement process. In case payment is made directly between the clients and the trustees and the licensed corporation is not liable to default risk of both parties, there should be no liquid assets and ranking liabilities effect on the book of the licensed corporation.</p>

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13.	39	Law Society of Hong Kong	<p>In addition to excluding liabilities corresponding to client money held overseas in separate accounts with authorized institutions and other approved banks outside Hong Kong, client money held with a suitable trustee or in a segregated client account of any financial intermediary (e.g. offshore brokerage firm) should also be excluded and for the same reason (subject to compliance with the Securities and Futures (Client Money) Rules). Where client money is held by a third party, the customer's account terms and conditions will typically provide that risk of loss lies with the clients and not with the licensed entity. In effect, such arrangements usually do not place the licensed entity at risk. The legal position is similar to the investment of a client's cash balance into a money market fund – the liability ceases to be that of the licensed entity once the investment is made.</p>	<p>The exclusion in respect of client money kept in separate bank account is in recognition of the lower risk faced by licensed corporations in satisfying their obligation to pay the money back to clients, as the banks holding the client money are subject to regulatory supervision in Hong Kong or other jurisdictions.</p> <p>With respect to the terms and conditions in client agreement, the SFC is unable to comment on the exact nature and enforceability of legal agreements entered into by the licensed corporation and its clients as such agreements vary on a case by case basis. Given the varying set of facts and circumstances that can be present in each case, we see no reason to amend the Draft Rules to extend the exclusion to client money held with non-bank intermediaries. Nevertheless, the SFC will keep an open mind on special situations of individual firms and grant modification where appropriate.</p> <p>For the avoidance of doubt, client money invested in money market funds would have become client securities held for the client and should fall outside the balance sheet of the licensed corporation.</p>
14.	43 & 52	Linklaters & Alliance	<p>There is potential inconsistency in how ranking liabilities are to be calculated under section 43 (LFET) and section 52 (foreign exchange agreement). The commentator wishes to clarify the correct treatment of foreign exchange transactions under this circumstance, i.e. would section 43 only apply to corporations licensed to undertake leveraged foreign exchange trading, whilst section 52 would apply to corporations exempt from being licensed. If not, would one section prevail over the other, or would the highest-ranking liability amount calculated under the respective section apply.</p>	<p>There is no inconsistency or overlap between sections 43 and 52 (now sections 41 and 50 of the revised Draft Rules). Section 43 applies to licensed corporations which are licensed to carry out leveraged foreign exchange trading, whereas section 52 applies to all licensed corporations, including licensed corporations which are licensed to carry out leveraged foreign exchange trading. Licensed leveraged foreign exchange traders are currently subject to similar requirements under sections 6(1)(b), (c) &amp; (e) of the Leveraged Foreign Exchange Trading (Financial Resources) Rules, the sections from which sections 43 and 52 of the Draft Rules are derived, whereas dealers and securities margin financiers are currently subject to section 29(3) of the existing Financial Resources Rules, the section from which section 52 of the Draft Rules is derived.</p>

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15.	44(2)	HK Stockbrokers Association Ltd	<p>The proposed gearing adjustment is too high and would have the effect of making brokers not competitive with banks in terms of financing their clients. Also, the proposed gearing adjustment will have the effect of limiting the overall liquidity of the market as it effectively caps the amount of lending that can be made to clients to roughly 3 times capital. Based on the analysis of 10 listed banks in HK, they are lending 5.55 times capital which translates to an 18% ratio. This is half of the ratio proposed for brokers. The commentator also submits that the security used for bank lending on the whole is not as liquid as those used for brokers lending.</p> <p>The commentator (commenting generally on both the gearing adjustment and the illiquid collateral haircut) agrees with the SFC that measures need to be taken but pointed out that drastic measures will only destabilize the market. The assumption that brokers will be able to immediately fund any shortfalls in capital requirements is overly optimistic. In practice, a combination of margin calls on clients and additional capitalization will be required. Finally, the commentator points out that the current situation is the result of the financial crisis of 1997 and sudden moves should not be made as this would destabilize the market by forcing brokers to liquidate client assets.</p>	<p>It is inappropriate to compare brokers with banks in selected areas. One needs to bear in mind that banks, besides being subject to the capital adequacy ratio (CAR) requirement, are also governed by other regulatory requirements such as the liquidity ratio and limits on individual exposures. The degrees of diversification of clientele, loan types and collateral in banks are very different from the margin lending business carried out by brokers. The resources available to banks for instituting a tight control structure are also not comparable with that of brokers as most brokers are in general not as well-capitalized as banks (the smallest of the 10 listed banks quoted has an equity of \$3.7 Billion).</p> <p>Both the gearing adjustment and the illiquid collateral haircut under the existing Financial Resources Rules were enacted in May 2002 and will only come into operation in October 2002. Brokers should have sufficient time to evaluate the implication of the new requirement and make appropriate arrangements. We understand that firms are already taking steps to prepare for the two amendments in an orderly manner. Hence, we do not propose to lower the gearing adjustment or modify the illiquid collateral haircut at this time but undertake to review the need for their retention or modification with the working group on the review of financial regulatory framework for intermediaries. At the same time, we are actively stress testing the two amendments on our brokers and will engage any brokers with potential compliance problems in early discussions to ensure that the transition can be as smooth as possible. In the case where a broker has genuine problem complying with these two amendments, we may consider granting modification or relief as appropriate.</p>
16.	49	Law Society of Hong Kong	<p>The definition of "underwriting commitment" in section 49(4) should be amended as follows so as to better reflect current market practice:</p> <p>"(4) In this section "net underwriting commitment" means the total costs of subscribing for or purchasing securities</p>	<p>The Draft Rules have been revised to reflect the market practice.</p>

Item no.	Clause no.	Respondent	Respondent's comments	SFC's response
			<p>underwritten or sub-underwritten by a licensed corporation other than securities which</p> <ul style="list-style-type: none"> <li>(i) are sub-underwritten,</li> <li>(ii) are subscribed for in writing or</li> <li>(ii) which have been the subject of a legally binding contract either entered into in writing or recorded in writing,</li> </ul> <p>in each case for the subscription or purchase through or from the licensed corporation by another person.”</p>	
17.	50	Linklaters & Alliance	<p>Section 50 refers to “non specified exchange traded derivative contracts” whereas the existing financial resources rules Rule 29(1) refers to “off-exchange derivative products”. It is not clear these two terms refer to the same types of products.</p>	<p>The intended scope of application is the same and we have revised the description in the Revised Draft Rules.</p>
18.	52	Anonymous	<p>Being an asset manager, it does enter into foreign exchange agreements with counterparties to hedge portfolio of assets held on behalf of clients. If such client assets fall outside the liquid assets and ranking liabilities under the Rules, the foreign exchange agreements to hedge such assets should also fall outside this section. Please advise whether the above interpretation is correct.</p>	<p>Generally, asset managers would arrange execution of foreign exchange agreements <u>for their clients</u> to hedge the clients’ foreign exchange exposures and such foreign exchange agreements are held directly by the clients. Where asset managers enter into foreign exchange agreements in their own capacity, whether as counterparty of the client, they should account for the foreign exchange agreements in accordance with the requirements of the Rules.</p>
19.	53	Linklaters & Alliance	<p>The Rules specify three scenarios where the capital charge on introductory transactions will not apply:</p> <ul style="list-style-type: none"> <li>(a) the other person is a member of the same group of companies as the licensed corporation;</li> <li>(b) the clients have a direct broker client contractual relationship with the other person ; and</li> <li>(c) the licensed corporation is not legally liable to the client for clearing or settlement of such transactions or default by the other person.</li> </ul> <p>Based on the understanding of the commentator, in the majority of instances, Section 53 will not apply due to market practice, i.e. the licensed corporation will not be subject to the recourse of clients. However, since in some</p>	<p>Section 53 (now section 51 of the revised Draft Rules) of the Draft Rules refers to introduction by licensed corporations of client transactions to a third party for dealing or clearing of the transactions. The relationship between the third party and the client would be one of the dealing or clearing of the transactions described in that section, i.e. transactions in securities, futures contracts or options contracts, or leveraged foreign exchange contracts. The Draft Rules have been revised to clarify the need of existence of either a broking relationship or a clearing relationship.</p>

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			cases direct client-broker relationships do not exist (under Section 53(2)(ii)), we feel a more reasonable approach would be if this sub-section is reworded to read "the clients have a direct broker client <u>or other relationship</u> with the other person".	
20.	55(1)(c)	Anonymous	Please advise whether share premium (redeemable) paid on issuance of redeemable shares falls within the ranking liabilities.	The intention of this section is to require the licensed corporation to include in its ranking liabilities the amount it would be required to pay upon redemption of its redeemable shares. If the licensed corporation remains liable to the shareholders to repay the share premium upon redemption of the shares, the share premium should be included as ranking liabilities of the licensed corporation. The Draft Rules have been revised to make this clear.
21.	57(2)(a)	Anonymous	(a) Please advise whether a licensed corporation needs to report the financial commitments even if there is no sign that the beneficiary is going to draw down such commitment.  (b) Please advise whether a back-to-back financial commitment given to a third party at the client's request and secured by client's asset in the portfolio held by an asset manager subject to disclosure under section 57(2)(a).	The notification is required for the purpose of SFC's monitoring of the risk of licensed corporations and is required regardless of the intention of the beneficiary of the commitment.  Notification is required in the scenario described.
22.	57(4)(a) & (5)(b)	Anonymous	If client assets are held by an asset manager in a capacity falling outside the regulated activities (e.g. trustee of a particular trust), please clarify whether the assets due to clients subject to disclosure under subsection 57(4)(a) and (5)(a) as both assets and liabilities are off-balance sheet.	In the scenario described, the assets are those of the clients' and not the licensed corporation's and therefore would not be subject to the notification requirement.
23.	58(2)	Linklaters & Alliance	The commentator would like to clarify whether section 58(2) will require any change to the report on proprietary derivative positions as is currently provided under Form 7 of the existing financial resources rules.	We do not intend to introduce any substantial change to the information required by the current Form 7 (Report on proprietary derivative positions).

<b>Item no.</b>	<b>Clause no.</b>	<b>Respondent</b>	<b>Respondent's comments</b>	<b>SFC's response</b>
24.	58(2)	Linklaters & Alliance	The commentator welcomes the change in the reporting cycle on proprietary derivatives positions from a monthly basis to a quarterly basis.	We appreciate the support.
25.	58(2)(b)(ii)	JF Asset Management	The commentator would request that further information on the format of the required analysis be provided as the extent of the analysis and information required may affect system requirements.	The SFC has started to work with industry representatives in designing the new returns. As the analysis of assets under management is only required to be submitted on a quarterly basis (in the case of asset managers holding client assets) or semi-annually (in the case of asset managers not holding client assets) and advisers and asset managers will be given a 6 month transitional period, we believe that the industry should have sufficient time for making necessary system changes for reporting purposes.
26.	58(3)	Hong Kong Securities Institute	Advisers and asset managers that are subject to the licensing condition that they shall not hold client assets should submit financial return on semi-annually as regard June and December only. Some of the members of the Institute commented that this would create unnecessary compliance work.	The reporting requirements on advisers and asset managers who are not holding client assets are minimal and such reporting is important for the SFC's monitoring of these firms' financial position and compliance with the Rules.
27.	58(6)(d)	Linklaters & Alliance	Both the declaration document and the FRR return to "be submitted electronically by means of FinNet". The commentator would like to confirm that as an alternative it would be possible to file the required information electronically via FinNet, and subsequently provide the SFC with a hard copy signed by the relevant person of the licensed corporation.  There also should be a fallback position if there is a system failure, which means it is not possible to submit the return electronically.	Please see item 28.  Same as above.
28.		Institute of Securities Dealers Ltd	Some of the members of the commentator have expressed concern on the issue of the immediate transition from manual to electronic filing of declaration and return on 1 October 2002. A transitional or grace period should be given to licensed corporations in complying with the	In response to market comments, we shall not make electronic filing mandatory in the Revised Draft Rules but we will revisit the issue in two years' time.

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			proposed provision to allow for more time to amend and assess their systems.	
29.		Hong Kong Securities Institute	Please consider the automation costs to be borne by small and medium brokers. The SFC seems to put everything automated and never considers small brokers' resources, which include both financial and manpower. Submissions of FRR in paper and diskette seem to pose no problems.	Please see item 28.
30.	60(4) & (5)	Linklaters & Alliance	<p>There is no indication in the Rules or Consultation Paper how much this fee will be, and whether it will be a once only or annual fee. The commentator also would like some guidance on how long the SFC will take to grant such approval, and what procedures will need to be followed to obtain such approval.</p> <p>The commentator would like details of what fees are to be paid, whether these are once only or annual fees, and details of the procedures to be followed in order to obtain such approval.</p>	<p>The fees for application for approval under the Draft Rules are specified in the Securities and Futures (Fees) Rules, which has been submitted to the Legislative Council Subcommittee on Draft Subsidiary Legislation for consideration. As consistent with current practice, application fees will be on-off and a renewal fee may be levied upon application for renewal of any approval which is granted for a limited period of time.</p> <p>The application can be made in writing to the Commission. The time needed for processing an application will vary with the circumstances on a case by case basis but the Commission will process all applications as soon as practicable.</p>
31.	60(5)(e)	Linklaters & Alliance	Under s60(5)(e), the SFC may approve a "change in the licensed corporation's accounting practice that <u>materially</u> affects the amount of liquid capital or paid-up capital it maintains or is required to maintain under Part 2." The commentator would like the SFC to issue guidance on what it regards as material.	<p>The materiality of the effect of a change of accounting practices to a licensed corporation's liquid capital, required liquid capital or paid-up capital will vary with the circumstances on a case by case basis. In general, any change that will</p> <ul style="list-style-type: none"> <li>(a) increase or decrease the licensed corporation's liquid capital, required liquid capital or paid-up capital by 10% or more, or</li> <li>(b) save the licensed corporation from having to make a notification in respect of its liquid capital or paid-up capital as required under the Rules, would be regarded as material.</li> </ul> <p>Licensed corporations are urged to discuss with the SFC in advance their plan to change their accounting practices and the likely impact on their capital.</p>



<b>Item no.</b>	<b>Clause no.</b>	<b>Respondent</b>	<b>Respondent's comments</b>	<b>SFC's response</b>
32.	60(5)(g)	Linklaters & Alliance	The commentator would like further guidance on who the SFC would consider as being suitable to be regarded as "another officer...approved by the Commission" under section 58(6)(c). They would also like further information on the approval procedures and the fees to be paid for such approval.	As is the current procedure, application can be made in writing to the Commission for approval of a non-dealing director to make declaration on the financial returns.  Please see item 30.
33.	62	Hong Kong Securities Institute	The grace period of 3 months is proposed for the exempt dealers and exempt investment advisers. Some members of the Institute commented that the grace period should be at least 6 months.	We have amended the Draft Rules so that exempt persons will only need to comply with the Rules 6 months from the commencement date of the Rules.
34.		JF Asset Management	The transitional arrangement on the grace period should also be extended to investment advisers who are not exempt dealers. They also need sufficient time to institute the capital and system changes.	We recognize that some advisers may not have the systems in place to calculate and monitor their liquid capital and accordingly have revised the Draft Rules to allow existing investment advisers a 6-month grace period during which they will only need to comply with the net tangible asset requirement.
35.		Anonymous	The commentator would like to clarify whether investment advisers are required to comply with the Rules on the commencement date of the Rules or upon the date the investment adviser being registered as a licensed corporation. A grace period of 12 months is suggested for investment adviser and fund manager.	The Rules will come into operation at the same time as the Ordinance. Pursuant to section 22 of Part 1 of Schedule 10 of the Ordinance, all existing investment advisers will be deemed to have been licensed under the Ordinance and will be subject to the Rules pursuant to section 53(4) of Part 1 of Schedule 10 of the Ordinance.  A 6-month grace period will be granted to existing advisers. Please see item 34.
36.	Schedule 2	Linklaters & Alliance	SFC should consider the inclusion of other exchanges, such as Taiwan Stock Exchange, Bombay Stock Exchange and Jakarta Stock Exchange in the list in Schedule 2.	The SFC will regularly review the need to update the list of specified exchanges. For the avoidance of doubts, shares listed on exchanges other than specified exchanges can be included in liquid assets subject to the applicable haircut specified in Table 3 of Schedule 1 of the Draft Rules.
<b>Others</b>				
37.	Consultation Paper para.13(f)	Law Society of Hong Kong	If the SFC proposes to stipulate mandatory requirements for ATS involving the novation of settlement obligations and the provision of settlement guarantees on a case-by-case	We appreciate the support.  Whilst the details of the capital requirements imposed on an

Item no.	Clause no.	Respondent	Respondent's comments	SFC's response
			basis, it would be helpful if the SFC would publish some guidelines on what it regards as “international best practices”. The commentator supports use of licensing conditions to achieve this objective.	ATS in question may vary with the circumstances on a case by case basis, the SFC would in the process be guided by the general principles of investors and market protection, taking into consideration applicable contemporary practices in leading financial markets and the risks of the operations of the ATS in question. Please also refer to the Guidelines for the Regulation of Automated Trading Services published by the SFC for the principles and standards for the regulation of ATS.
38.	Consultation Paper para. 24	Hong Kong Securities Institute	Some members of the Institute asked why the SFC needs to know so much information of a limited company and not the listing company. The SFC should put more effort in monitoring those listed companies instead of licensed companies.	The disclosure requirements on listed companies are subject to other requirements such as the Companies Ordinance and the Listing Rules. The disclosures required under the Draft Rules are important for enhancing the SFC's monitoring of licensed corporations' financial positions and the risk implications to investors and the market.
39.	Consultation Paper para. 24 (c)	Hong Kong Securities Institute	The FRR return requires segmental reporting for client assets, number of active clients, turnover, income and expenses arising from different regulated activities. Some members of the Institute commented that this would create unnecessary compliance work.	The reporting requirements are important for the SFC's monitoring of licensed corporations' financial position and compliance with these Rules.  Please see item 25.
40.	Consultation Paper para. 24(f)	Linklaters & Alliance	The Consultation Paper states that a number of additional disclosures are to be required under the Rules, including management fees receivable from or payable to group companies or related parties of the licensed corporation. However, it is not clear from the Rules where those disclosures are required.	Licensed corporations will be required to report additional disclosures in various returns, such as details of their management fees income and expenses in the profit and loss account to be submitted under section 58.  Please see item 25.

Item no.	Clause no.	Respondent	Respondent's comments	SFC's response
41.		Law Society of Hong Kong	The Securities Law Committee of the Society queries the new requirement to disclose management fees receivable and payable to group companies or related parties of the licensed entity. Given that the FRR is balance sheet based liquidity/solvency test, not a test of cash flow, it is difficult to see what bearing this will have on a licensed person's suitability to remain licensed.	<p>The FRR returns will require reporting of management fee income and expense in the profit and loss account. Management fee is a major component of income and expense of many licensed firms, especially for those sharing common resources (such as office and administration functions) with other companies within the same group of companies. Reporting of such items would facilitate monitoring of licensed corporations' financial position and compliance with these Rules.</p> <p>Please see item 25.</p>

**List of Respondents**

	<b>Date Received</b>	<b>Respondent</b>
1	9 July 2002	Anonymous
2	12 July 2002	Institute of Securities Dealers Ltd
3	12 July 2002	JF Asset Management Ltd
4	12 July 2002	Anonymous
5	12 July 2002	Law Society of Hong Kong
6	12 July 2002	Linklaters & Alliance representing (Linklaters & Alliance) - Goldman Sachs (Asia) L.L.C. - J.P. Morgan - Merrill Lynch (Asia Pacific) Ltd - Morgan Stanley Dean Witter Asia Ltd - Salmon Smith Barney Hong Kong Ltd
7	15 July 2002	Hong Kong Securities Institute
8	18 July 2002	Hong Kong Stockbrokers Association Ltd
		<i>Respondent with no specific comments on the Draft Rules</i>
9	3 July 2002	Consumer Council
10	20 June 2002	Hong Kong Bar Association
11	24 July 2002	Hong Kong Institute of Directors, The
12	12 July 2002	Hong Kong Monetary Authority
13	16 July 2002	Hong Kong Society of Accountants

Draft Securities and Futures  
(Financial Resources) Rules (the “draft Rules”)

Derivation Table

This Table compares the version of the draft Rules that was exposed for public consultation with the version of the draft Rules submitted to the Sub-committee of the Legislative Council

Clause of exposure draft Rules	Heading in exposure draft Rules	Remarks	Clause of draft Rules before Sub-committee/
	Part 1 – Preliminary		
1.	Commencement		1.
2.	Interpretation		2.
		<i>Deleted definitions -</i>	
		"advising on corporate finance"	
		"advising on futures contracts"	
		"advising on securities"	
		"asset management"	
		"automated trading services"	
		"dealing in futures contracts"	
		"dealing in securities"	
		" FinNet "	
		"introducing agent"	
		"leveraged foreign exchange trading"	
		<i>Relocated definitions -</i>	
		"digital signature" relocated to section 56(7)	
		"group of related margin clients" relocated to section 42(3)	
		"net positions" relocated to section 52(3)	
		"recognized certificate" relocated to section 56(7)	
		"recognized certification authority" relocated to section 56(7)	
		"required liquid capital" relocated from section 6(2)	
		"variable required liquid capital" relocated from	

Clause of exposure draft Rules	Heading in exposure draft Rules	Remarks	Clause of draft Rules before Subcommittee/
		section 6(2)	
		<i>New definitions</i>	
		"approved introducing agent"	
		"basic amount"	
		"clearing house"	
		"derivative contract"	
		"equity linked instruments"	
		"Hong Kong Exchange Fund"	
		"off-exchange traded derivative contracts"	
		"omnibus account"	
		"redeemable shares"	
		"reporting currency"	
		"rules"	
		"standby subordinated loan facility"	
		"subordinated loan"	
		<i>Renamed definitions -</i>	
		"free delivery" renamed as "free delivery basis"	
		"note issuance facility " renamed as "note issuance and revolving underwriting facility" and relocated from section 55(3)	
		"other investments" renamed as "specified investments"	
		"other securities" renamed as "specified securities"	
3.	Accounting practices	Renamed: "Accounting Treatment" and moved to Part 2	3.
	Part 2 - Financial Resources Requirements	Renumbered as Part 3	
4.	Licensed corporations to maintain financial resources		4.
5.	Paid-up share capital requirement for licensed corporations	Table A relocated to Table 1 of Schedule 1	5.
6.	Required liquid capital for licensed corporations	- Renamed: "Liquid capital requirement for licensed corporations" - Table B relocated to Table	6.

Clause of exposure draft Rules	Heading in exposure draft Rules	Remarks	Clause of draft Rules before Subcommittee/
		2 of Schedule 1	
7.	Reliance upon approved stand by subordinated loan facility to relieve temporary liquid capital deficit	Merged with section 6	6(2), (3) and (4)
	Part 3 – Computation of Liquid Capital	Renumbered and renamed: “Part 4 -Liquid Capital”	
	Division 1 – General		
8.	Calculations of liquid capital	Renamed: “Calculation of liquid capital and required liquid capital”	7.
9.	Calculations to be on trade date basis	- Renamed: “Accounting for transactions on trade date basis” - Sections 8 – 16 are new Division 2.	8.
10.	Determining quantities of securities and collateral on a trade date basis	Deleted	
11.	Valuations	Renamed: “Valuation of proprietary positions, etc.”	9.
12.	Pairs of transactions		10.
13.	No set-off		11.
14.	Transactions in margined accounts		12.
15.	Treatment of exercised options contracts		13.
16.	Assignments		14.
17.	Treatment of securities borrowing and lending agreements	Subclauses (1) and (2) changed places.	15.
18.	Treatment of repurchase transactions	Subclauses (1) and (2) changed places.	16.
	Division 2 – Liquid Assets	Renumbered as Division 3	
19.	Liquid assets	Renamed: “Computation basis”	17.
20.	Exclusions from liquid assets	Subclause (1) relocated to next clause as 19(1).	18.
21.	Assets provided as security	- Renamed: “Assets provided to others as security” - Subclause (1) was relocated from previous clause 20(1)	19.
22.	Cash in hand and at bank		20.
23.	Amounts receivable from clients arising from purchases, etc. of	Renamed: “Amounts receivable from clients in	21.

<b>Clause of exposure draft Rules</b>	<b>Heading in exposure draft Rules</b>	<b>Remarks</b>	<b>Clause of draft Rules before Subcommittee/</b>
	securities	respect of purchases of and subscription for securities”	
24.	Amounts receivable arising from providing securities margin financing	- Renamed: “Amounts receivable in respect of providing securities margin financing” - New subclause (5) = old (4), save that definition of "illiquid collateral" remains in (4).	22.
25.	Amounts receivable from counterparties arising from dealings in securities	Renamed: “Amounts receivable from counterparties in respect of dealings in securities”	23.
26.	Amounts receivable from dealings in securities by common clients	Renamed: “Amounts receivable in respect of dealings in securities by common clients”	24.
27.	Amounts receivable from securities margin financier	Renamed: “Amounts receivable from licensed corporations licensed for Type 8 regulated activity”	25.
28.	Cash provided as security for short selling		26.
29.	House positions	Renamed: “Proprietary positions of licensed corporations”	27.
30.	Amounts receivable from clearing houses	Renamed: “Amounts receivable from clearing houses, etc.”	28.
31.	Amounts receivable from other dealers arising from dealings in futures contracts and options contracts	Renamed: “Amounts receivable from other dealers in respect of dealings in futures contracts and options contracts”	29.
32.	Amounts receivable from clients arising from purchases of exchange-traded options contracts	Renamed: “Amounts receivable from clients in respect of the purchase of exchange-traded options contracts”	30.
33.	Exchange-traded options contracts trading on house account	Renamed: “Exchange-traded options contracts trading for own account”	31.
34.	Amounts receivable under securities borrowing and lending agreements		32.
35.	Amounts receivable under repurchase transactions		33.



<b>Clause of exposure draft Rules</b>	<b>Heading in exposure draft Rules</b>	<b>Remarks</b>	<b>Clause of draft Rules before Subcommittee/</b>
36.	Amounts receivable arising from leveraged foreign exchange trading	Renamed: "Amounts receivable in respect of leveraged foreign exchange trading"	34.
37.	Miscellaneous	Renamed: "Miscellaneous assets"	35.
	Division 3 – Ranking Liabilities	Renumbered as Division 4	
38.	Application	Renamed: "Computation basis"	36.
39.	Amounts payable to clients, etc		37.
40.	Amounts payable arising from dealings in securities	Renamed: "Amounts payable in respect of dealings in securities"	38.
41.	Amounts payable from dealings in securities by common clients	Renamed: "Amounts payable in respect of dealings in securities by common clients"	39.
42.	Futures contracts and options contracts trading	Renamed: "Futures contracts and options contracts dealing, etc."	40.
43.	Leveraged foreign exchange trading	Old subclause (2) deleted. Remaining subclauses renumbered.	41.
44.	Provision of securities margin financing		42.
45.	Short positions in securities and other investments	Renamed: "Short positions in securities (other than options contracts) and specified investments"	43.
46.	Concentrated house positions	Renamed: "Concentrated proprietary positions"	44.
47.	Securities borrowing and lending transactions	Renamed: "Securities borrowing and lending agreements"	45.
48.	Repurchase transactions		46.
49.	Underwriting and sub underwriting commitments	Renamed: "Net underwriting commitments"	47.
50.	Non specified exchange traded derivative contracts	Renamed: "Off-exchange traded derivative contracts"	48.
51.	Interest rate swap agreements	Table A relocated to Table 1 of Schedule 4	49.
52.	Foreign exchange agreements	Table B relocated to Table 2 of Schedule 4	50.
53.	Introduction of transactions		51.
54.	Other liabilities		53.
55.	Miscellaneous financial	- Renamed: "Miscellaneous"	52.

<b>Clause of exposure draft Rules</b>	<b>Heading in exposure draft Rules</b>	<b>Remarks</b>	<b>Clause of draft Rules before Subcommittee/</b>
	adjustments	- Table C relocated to Schedule 5	
	Part 4 - Miscellaneous	Renumbered as Part 5	
56.	Notification of failure to comply with financial resources rules	Renamed: "Licensed corporations to notify Commission of failure to comply with these Rules"	54.
57.	Licensed corporations to notify Commission of circumstances relating to financial resources and trading activities	Renamed: "Licensed corporations to notify Commission of circumstances relating to financial resources and trading activities and to submit returns in certain cases"	55.
58.	Licensed corporations to submit declaration document and returns to the Commission	- Renamed: "Licensed corporations to submit returns to Commission" - New definition in subclause (7): "within the validity of that certificate"	56.
59.	Licensed corporations to provide information		57.
60.	Approvals		58.
61.	Withdrawal of elections made under the rules	Renamed: "Withdrawal of elections made under these Rules"	59.
62.	Transitional		60.
	Schedule 1 – Haircut Percentages	Renumbered as Schedule 2	
Table 1.			Table 1.
Table 2.			Table 2.
Table 3.			Table 3.
Table 4.			Table 4.
Table 5.			Table 5.
Table 6.			Table 6.
Table 7.			Table 7.
Table 8.			Table 8.
	Schedule 2 – Specified Exchanges	Renumbered as Schedule 3	
Part 1.			Part 1.
Part 2.			Part 2.

**DRAFT****SECURITIES AND FUTURES (FINANCIAL RESOURCES)  
RULES****CONTENTS**

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## SECURITIES AND FUTURES (FINANCIAL RESOURCES) RULES

(Made the Securities and Futures Commission under sections 145, 397 and 398 of the Securities and Futures Ordinance (Cap. 571) after consultation with the Financial Secretary)

### PART 1

#### PRELIMINARY

#### 1. Commencement

These Rules shall come into operation on the day on which Part VI of the Securities and Futures Ordinance (Cap. 571) comes into operation.

#### 2. Interpretation

In these Rules, unless the context otherwise requires –

“adjusted liabilities” (經調整負債), for the purpose of calculating the variable required liquid capital in relation to a licensed corporation, means the sum of its on-balance sheet liabilities including provisions made for liabilities already incurred or for contingent liabilities, but excluding –

- (a) amounts payable to clients in respect of –
  - (i) client money held by it in a segregated account in accordance with the Securities and Futures (Client Money) Rules (L.N. \_\_\_\_\_ of 2002);
  - (ii) to the extent not covered in subparagraph (i), client money held by it in a segregated account with an authorized financial institution;
  - (iii) client money held by it in a segregated account with an approved bank incorporated outside Hong Kong;

- (iv) client money held by it in a segregated account maintained with a futures or options clearing house; or
- (v) client money held as margin by –
  - (A) a clearing house other than a futures or options clearing house;
  - (B) a clearing participant;
  - (C) a futures dealer; or
  - (D) a securities dealer; and
- (b) an approved subordinated loan provided to it;

*[cf. s.2 FRR “total liabilities”]*

“aggregate gross foreign currency position” (合計外幣總持倉量) means the aggregate of all the gross foreign currency positions held by a licensed corporation licensed for Type 3 regulated activity, excluding positions held with a recognized counterparty;

*[cf. s.2 LFET FRR]*

“amount of margin required to be deposited” (規定存放的保證金數額) means the amount of money required to be deposited (whether the requirement is met by depositing the amount of money or by the provision of security instead of making such deposit) –

- (a) upon opening a position; or
- (b) for maintaining an existing position,

in a futures contract or an options contract, calculated as the highest of the prevailing margin amounts set by –

- (c) the exchange operating the market on which the futures contract or options contract is traded;
- (d) the clearing house who registers such trade;
- (e) the agent who executes such trade for the licensed corporation;



(f) the counterparty who executes such trade with the licensed corporation; and

(g) the licensed corporation itself;

*[cf. s.2 FRR]*

“approved bank incorporated outside Hong Kong” (核准的在香港以外地方成立為法團的銀行) means –

(a) a bank incorporated under the law or other authority of a prescribed country, and includes any of its branches or wholly owned subsidiaries which is a bank; or

(b) any other bank approved as such under section 58(1)(a), and includes any of its branches or wholly owned subsidiaries which is a bank;

*[cf. s.2 FRR and "bank incorporated outside HK" in Part 1 of Schedule 1 to the Ordinance]*

“approved credit rating agency” (核准信貸評級機構) means a person approved as such under section 58(1)(b);

*[new]*

“approved introducing agent” (核准介紹代理人) means a licensed corporation approved as such under section 58(4);

*[cf. "introducing broker", s.2 FRR and "leveraged foreign exchange trading introducing agent", s.2 LFET FRR]*

“approved redeemable shares” (核准可贖回股份) means redeemable shares in the share capital of a licensed corporation approved as such under section 58(5)(a);

*[cf. s.2 FRR]*

“approved securities borrowing and lending counterparty” (核准證券借貸對方) means –

(a) a recognized clearing house; or

(b) a person approved as such under section 58(1)(c);

*[cf. s.2 FRR]*

“approved standby subordinated loan facility” (核准備用後償貸款融通) means a standby subordinated loan facility obtained by a licensed corporation licensed for Type 1, Type 2, Type 3 or Type 8 regulated activity, which is approved as such under section 58(5)(c);

*[cf. s.2 FRR]*

“approved subordinated loan” (核准後償貸款) means a subordinated loan obtained by a licensed corporation approved as such under section 58(5)(b);

*[cf. s.2 FRR]*

“authorized financial institution” (認可財務機構) means -

- (a) a bank and includes any of its branches;
- (b) any wholly owned subsidiary of a bank referred to in paragraph (a) which is a bank; or
- (c) the principal place of business in Hong Kong of and any local branch of a restricted licence bank or a deposit-taking company, in each case within the meaning of section 2(1) of the Banking Ordinance (Cap. 155);

*[cf. s.2 FRR and definition of "bank" in Part 1 of schedule 1 to the Ordinance]*

“basic amount” (基本數額), in relation to a licensed corporation, means 5% of the aggregate of –

- (a) its adjusted liabilities;
- (b) the aggregate of the initial margin requirements in respect of outstanding futures contracts and outstanding options contracts held by it on behalf of its clients; and
- (c) the aggregate of the amounts of margin required to be deposited in respect of outstanding futures contracts and outstanding options contracts held by it on behalf of its

clients, to the extent that such contracts are not subject to payment of initial margin requirements;

*[new cf. s.6 FRR]*

“clearing house” (結算所) means a person –

- (a) whose activities or objects include the provision of services for the clearing and settlement of transactions in, or the day-to-day adjustment of the financial position of, futures contracts or options contracts effected on a futures market;
- (b) whose activities or objects include the provision of services for the clearing and settlement of transactions in securities effected on a stock market; or
- (c) who guarantees the settlement of any such transactions as are referred to in paragraph (a) or (b),

but does not include a corporation operated by or on behalf of the Government;

*[new]*

“clearing participant” (結算所參與者) –

- (a) in relation to a recognized clearing house, means a clearing participant within the meaning of section 1 of Part 1 of Schedule 1 to the Ordinance; or
- (b) in relation to a clearing house other than a recognized clearing house, means a person who, in accordance with the rules of the clearing house, may participate in one or more of the services provided by the clearing house in its capacity as a clearing house, and whose name is entered in a list, roll or register kept by the clearing house as a person who may participate in one or more of the services provided by the clearing house;

[new]

“collateral” (抵押品), in relation to a licensed corporation, means -

- (a) any listed shares;
- (b) any specified securities;
- (c) any qualifying debt securities; or
- (d) any special debt securities,

which –

- (e) are deposited as security by the licensed corporation with another person; or
- (f) are deposited as security with the licensed corporation by another person, and –
  - (i) are unencumbered, in its possession and readily realizable by it;
  - (ii) are encumbered only by virtue of being lent, deposited or pledged by it in accordance with the requirements of the Securities and Futures (Client Securities) Rules (L.N. \_\_\_\_\_ of 2002); or
  - (iii) if not covered under the Securities and Futures (Client Securities) Rules (L.N. \_\_\_\_\_ of 2002), are encumbered only by virtue of being deposited with or pledged to –
    - (A) an authorized financial institution or an approved bank incorporated outside Hong Kong;
    - (B) a person who is licensed, registered or authorized by an authority or regulatory organization outside Hong Kong, for an activity which, if carried on in Hong Kong, would constitute Type 1, Type 2, Type 3 or Type 8 regulated activity; or

- (C) a clearing house of a specified exchange or any of its clearing participants to secure its obligation to meet its clearing obligations or liabilities;

*[cf. s.2 FRR]*

“collateralized warrants” (有抵押權證) means derivative warrants listed on a recognized stock market in respect of which the issuer owns all of the underlying securities or other assets to which the warrants relate and grants a charge over those securities or assets in favour of an independent trustee which acts for the benefit of the warrant holders;

*[cf. s.2 FRR]*

“common client” (共同客戶) means a client of a securities dealer who is also a client of a licensed corporation licensed for Type 8 regulated activity and whose dealings in securities through the securities dealer are settled on his behalf by the licensed corporation;

*[cf. s.2 FRR]*

“concentration discounting factor” (集中折扣系數), in relation to listed shares or listed warrants received as collateral by a licensed corporation licensed for Type 1 or Type 8 regulated activity from any of its margin clients, means –

- (a) in the case of listed shares issued by a corporation which is the issuer of a constituent stock of the Hang Seng Index or the Hang Seng Hong Kong LargeCap Index, the lower of –
- (i) 1; and
  - (ii) the factor derived by dividing 20% of the total market value of all collateral received from all margin clients by the total market value of shares of the same description as those shares which are so received as collateral;

- (b) to the extent that the shares are not already covered in paragraph (a), in the case of listed shares issued by a corporation which is the issuer of a constituent stock of the Hang Seng Hong Kong MidCap Index, the lower of –
  - (i) 1; and
  - (ii) the factor derived by dividing 15% of the total market value of all collateral received from all margin clients by the total market value of shares of the same description as those shares which are so received as collateral;
- (c) to the extent that the shares are not already covered in paragraph (a) or (b), in the case of listed shares issued by a corporation incorporated in Hong Kong or elsewhere, the lower of –
  - (i) 1; and
  - (ii) the factor derived by dividing 10% of the total market value of all collateral received from all margin clients by the total market value of shares of the same description as those shares which are so received as collateral; or
- (d) in the case of listed warrants issued by a corporation incorporated in Hong Kong or elsewhere, the lower of –
  - (i) 1; and
  - (ii) the factor derived by dividing 10% of the total market value of all collateral received from all margin clients by the total market value of warrants of the same description as those warrants which are so received as collateral;

*[cf. s.2 FRR]*

“derivative contract” (衍生工具合約) means an agreement the purpose or effect of which is to obtain a profit or avoid a loss by reference to fluctuations in the value or price of property of any description or in an index or other factor designated for that purpose in the agreement, and includes a futures contract or an options contract;

[new]

“equity linked instruments” (股票掛鈎票據) means securities described as such which are listed on a recognized stock market;

[new]

“exchange participant” (交易所參與者) –

- (a) in relation to a recognized exchange company, means an exchange participant within the meaning of section 1 of Part 1 of Schedule 1 to the Ordinance; or
- (b) in relation to an exchange outside Hong Kong, means a person who, in accordance with the rules of the exchange, may trade through that exchange or on any market operated by that exchange, and whose name is entered in a list, roll or register kept by the exchange as a person who may trade through that exchange or on any market operated by that exchange;

[new]

“excluded liabilities” (豁除負債), in relation to the on-balance sheet liabilities of a licensed corporation, means amounts payable to clients in respect of –

- (a) client money held by it in a segregated account in accordance with the Securities and Futures (Client Money) Rules (L.N. of 2002);
- (b) client money held by it in a segregated account with an approved bank incorporated outside Hong Kong and, to

the extent not covered in paragraph (a), with an authorized financial institution; and

- (c) client money held by it in a segregated account maintained with a recognized clearing house;

*[new]*

“floating losses” (浮動虧損) means unrealized losses calculated by marking to market an open position in –

- (a) a futures contract;
- (b) any securities;
- (c) an options contract;
- (d) a derivative contract;
- (e) a leveraged foreign exchange contract;
- (f) a foreign exchange agreement;
- (g) an interest rate swap agreement; or
- (h) a specified investment;

*[cf. s.2 LFET FRR]*

“floating profits” (浮動利潤) means unrealized profits calculated by marking to market an open position in –

- (a) a futures contract;
- (b) any securities;
- (c) an options contract;
- (d) a derivative contract;
- (e) a leveraged foreign exchange contract;
- (f) a foreign exchange agreement;
- (g) an interest rate swap agreement; or
- (h) a specified investment;

*[cf. s.2 LFET FRR]*

“foreign currency” (外幣), in relation to a licensed corporation, means any currency other than –



- (a) the reporting currency; and
- (b) any currency which has an exchange rate which is linked to the reporting currency;

*[cf. s.2 FRR, s.2 LFETO]*

“foreign exchange agreement” (外匯協議) means an agreement other than a futures contract and an options contract, whereby the parties to the agreement agree to exchange different currencies at a future time;

*[cf. s.2 FRR, s.2 LFET FRR]*

“free delivery basis” (信用交付形式) means the basis on which a sale or purchase of securities is effected, under which –

- (a) delivery of the securities by the seller takes place irrespective of whether the seller has received payment in settlement of a liability arising from the sale of the securities; or
- (b) payment is made by the purchaser of the securities in settlement of a liability arising from the purchase of the securities, irrespective of whether the securities have been delivered;

*[cf. s.2 FRR]*

“futures contract” (期貨合約) has the meaning assigned to it by section 1 of Part 1 of Schedule 1 to the Ordinance save that it does not include an options contract;

*[new]*

“futures dealer” (期貨交易商) means -

- (a) a licensed corporation licensed for Type 2 regulated activity; or
- (b) a person licensed, registered or authorized by an authority or regulatory organization outside Hong Kong for an

activity which, if carried on in Hong Kong, would constitute Type 2 regulated activity;

*[new]*

“futures non-clearing dealer” (期貨非結算交易商) means a licensed corporation licensed for Type 2 regulated activity which is an exchange participant of a recognized futures market, but is not a clearing participant of a recognized clearing house;

*[cf. s.2 FRR]*

“futures or options clearing house” (期貨或期權結算所) means -

- (a) a recognized clearing house other than a recognized clearing house whose activities or objects include the provision of services for the clearing and settlement of transactions in securities (other than options contracts); or
- (b) a person –
  - (i) whose activities or objects include the provision of services for –
    - (A) the clearing and settlement of transactions in futures contracts or options contracts; or
    - (B) the day-to-day adjustment of the financial position of futures contracts or options contracts, effected on a specified exchange, or subject to the rules of a specified exchange; or
  - (ii) who guarantees the settlement of any such transactions as are referred to in subparagraph (i), but does not include a corporation operated by or on behalf of the Government;

*[cf. s.2 FRR]*

“gross foreign currency position” (外幣總持倉量), in relation to a foreign currency, means the total of –

- (a) the aggregate of the value of assets, other than fixed assets, beneficially owned by a licensed corporation which are denominated in the foreign currency together with the amount of the foreign currency which it is obliged to purchase under any outstanding contract; and
- (b) the aggregate of the amount of the on-balance sheet liabilities of the licensed corporation, other than excluded liabilities, which are denominated in such foreign currency together with the amount of that foreign currency which it is obliged to sell under any outstanding contract,

save that where the licensed corporation holds with a client (other than a client whose account with the licensed corporation is an omnibus account) 2 outstanding contracts and -

- (c) under one of the contracts it is obliged to purchase an amount in a currency (“A”) and sell an amount (“X”) in another currency (“B”); and
- (d) under the other contract it is obliged to purchase the same amount (“X”) in the other currency (“B”) and sell an amount of the first-mentioned currency (“A”),

it shall, in relation to the contracts described in paragraphs (c) and (d), include in the total –

- (e) the amount “X” of currency “B” that it is obliged to sell under the contract referred to in paragraph (c); and
- (f) the amount of currency “A” at the higher of –
  - (i) the amount of that currency which it is obliged to purchase under the contract referred to in paragraph (c); and

- (ii) the amount of that currency which it is obliged to sell under the contract referred to in paragraph (d);

[cf. "gross position" s.2 LFET FRR]

“haircut amount” (扣減數額), in relation to –

- (a) any shares -
  - (i) that are listed in Hong Kong, the United Kingdom, the United States of America or Japan (stratified according to stock indices), specified in column 2 of Table 1 in Schedule 2;
  - (ii) that are listed in Hong Kong, the United Kingdom, the United States of America or Japan (not stratified according to stock indices), specified in column 2 of Table 2 in Schedule 2; or
  - (iii) that are listed (other than those referred to in subparagraph (i) or (ii)), specified in column 2 of Table 3 in Schedule 2,

means an amount derived by multiplying the market value of the shares by the haircut percentage in relation to such shares;

- (b) specified investments, means an amount derived by multiplying the market value of the specified investments by the haircut percentage in relation to such specified investments;
- (c) specified securities, means an amount derived by multiplying the market value of the specified securities by the haircut percentage in relation to such specified securities;
- (d) qualifying debt securities, means an amount derived by multiplying the market value of the qualifying debt

securities by the haircut percentage in relation to such qualifying debt securities;

- (e) special debt securities, means an amount derived by multiplying the market value of the special debt securities by the haircut percentage in relation to such special debt securities;

*[cf. s.2 FRR]*

“haircut percentage” (扣減百分率), in relation to –

- (a) any shares –
  - (i) that are listed in Hong Kong, the United Kingdom, the United States of America or Japan (stratified according to stock indices), specified in column 2 of Table 1 in Schedule 2;
  - (ii) that are listed in Hong Kong, the United Kingdom, the United States of America or Japan (not stratified according to stock indices), specified in column 2 of Table 2 in Schedule 2; or
  - (iii) that are listed (other than those referred to in subparagraph (i) or (ii)), specified in column 2 of Table 3 in Schedule 2,

means –

- (iv) in the case where the shares are described in column 2 of Table 1 or Table 2 in Schedule 2 and in column 2 of Table 3 in that Schedule, such percentage specified in column 3 of the Table concerned opposite the applicable description set out in column 2 of the Table as may be elected by a licensed corporation; or
- (v) in any other case, the percentage specified in column 3 of the Table concerned opposite the

applicable description set out in column 2 of the Table;

- (b) any specified investments, means the percentage specified in column 3 of Table 8 in Schedule 2 opposite the applicable description set out in column 2 of the Table;
- (c) any specified securities, means the percentage specified in column 3 of Table 7 in Schedule 2 opposite the applicable description set out in column 2 of the Table;
- (d) any qualifying debt securities, means the aggregate of –
  - (i) the percentage specified in column 3 of Table 4 in Schedule 2 opposite the applicable description set out in column 2 of the Table; and
  - (ii) the percentage specified in column 2 or 3 (as the case may be) of Table 5 in Schedule 2 opposite the applicable description set out in column 1 of the Table;
- (e) any special debt securities specified in column 2 of Table 6 in Schedule 2, means the percentage specified in column 3 of Table 6 in Schedule 2 opposite the applicable description set out in column 2 of the Table;

*[cf. s.2 FRR]*

“Hong Kong Exchange Fund” (香港外匯基金) means the Exchange Fund established under the Exchange Fund Ordinance (Cap. 66);

*[new]*

“initial margin requirement” (規定開倉保證金) means the amount of money required to be deposited (whether the requirement is met by depositing the amount of money or by the provision of security instead of making such deposit) upon opening a position in a futures contract or an options contract, calculated as the highest of the prevailing margin amounts set by -

- (a) the exchange operating the market on which the futures contract or options contract is traded;
- (b) the clearing house who registers such trade;
- (c) the agent who executes such trade for the licensed corporation;
- (d) the counterparty who executes such trade with the licensed corporation; and
- (e) the licensed corporation itself;

*[cf. s.2 FRR]*

“interest rate swap agreement” (掉期息率協議) means an agreement whereby the parties to the agreement agree to exchange a series of interest payments over time;

*[s.2 FRR]*

“in-the-money amount” (價內值) means, in relation to –

- (a) a call options contract,  $N \times (M - S)$ ;
- (b) a put options contract,  $N \times (S - M)$ ; or
- (c) a call warrant on listed shares,  $N \times (M - S)$ ,

where –

“N” represents –

- (i) where the asset underlying the options contract or warrant is shares, the number of such shares; or
- (ii) where the asset underlying the options contract is an asset other than shares, the number of units of such asset;

“M” represents the market value of –

- (i) where the asset underlying the options contract or warrant is shares, one such share; or

- (ii) where the asset underlying the options contract is an asset other than shares, one unit of such asset; and

“S” represents the strike price of the options contract or the exercise price of the warrant –

- (i) where the asset underlying the options contract or warrant is shares, for one such share; or
- (ii) where the asset underlying the options contract is an asset other than shares, for one unit of such asset;

*[cf. s.2 FRR]*

“liquid assets” (速動資産), in relation to a licensed corporation, means the aggregate of the amounts required to be included in its liquid assets under the provisions of Division 3 of Part 4;

*[cf. s.2 FRR & s.2 LFET FRR]*

“liquid capital” (速動資金), in relation to a licensed corporation, means the amount by which its liquid assets exceeds its ranking liabilities;

*[s.2 FRR & s.2 LFET FRR]*

“listed” (上市), in relation to securities, means listed or traded on any stock market;

*[new]*

“margin client” (保證金客戶) means -

- (a) in relation to a licensed corporation licensed for Type 1 regulated activity, a client to whom the licensed corporation provides securities margin financing; or
- (b) in relation to a licensed corporation licensed for Type 8 regulated activity, any of its clients;

*[cf. s.2 FRR]*



“marking to market” (按照市值計算差額) means the method or procedure of adjusting the valuation of an open position in –

- (a) a futures contract;
- (b) any securities;
- (c) an options contract;
- (d) a derivative contract;
- (e) a leveraged foreign exchange contract;
- (f) a foreign exchange agreement;
- (g) an interest rate swap agreement; or
- (h) a specified investment,

to reflect its current market value;

*[s.2 LFET FRR]*

“mutual fund” (互惠基金) means any arrangement made for the purpose, or having the effect, of providing facilities for investment in shares in a corporation which is or holds itself out as being engaged primarily in the business of investing, reinvesting or trading in securities or any other property whatsoever and which is offering for sale or has outstanding any redeemable shares of which it is the issuer;

*[new, for the purposes of paragraph (b), Table 7 of Schedule 2]*

“non-collateralized warrants” (非抵押權證) means derivative warrants listed on a recognized stock market in respect of which the performance of the issuer’s obligations is secured other than by a charge over the underlying securities or other assets to which the warrants relate;

*[cf. s.2 FRR]*

“note issuance and revolving underwriting facility” (票據的發行及循環式包銷融通) means an arrangement under which a borrower may draw down funds up to an agreed limit over an agreed period of time (the term to maturity of the facility) by making repeated note issues to the market, and where, should an issue prove unable to be placed in the market, the

unplaced amount is to be taken up or funds made available by the underwriter of the facility;

[cf. "note issuance facility" s.2 FRR]

“off-exchange traded derivative contracts” (場外買賣衍生工具合約) means derivative contracts which are traded other than on an exchange;

[new]

“omnibus account” (客戶匯集綜合帳戶) means an account opened with a licensed corporation by a client of the licensed corporation, and the client has notified it that the account is to be operated by him as agent for the benefit of 2 or more other persons;

[new]

“options contract” (期權合約) means a contract which gives the holder of the contract the option or right, exercisable at or before a time specified in the contract to –

- (a) buy or sell –
  - (i) at an agreed consideration an agreed quantity of a specified futures contract, share or other property;  
or
  - (ii) an agreed value of a specified futures contract, share or other property; or
- (b) be paid an amount of money calculated by reference to the value of such securities, futures contract or other property or by reference to the level of an index, as may be specified in the contract;

[new]

“out-of-the-money amount” (價外值) means, in relation to –

- (a) a call options contract,  $N \times (S - M)$ ;
- (b) a put options contract,  $N \times (M - S)$ ; or
- (c) a call warrant on listed shares,  $N \times (S - M)$ ,

where –

“N” represents –

- (i) where the asset underlying the options contract or warrant is shares, the number of such shares; or
- (ii) where the asset underlying the options contract is an asset other than shares, the number of units of such asset;

“M” represents the market value of –

- (i) where the asset underlying the options contract or warrant is shares, one such share; or
  - (ii) where the asset underlying the options contract is an asset other than shares, one unit of such asset;
- and

“S” represents the strike price of the options contract or the exercise price of the warrant -

- (i) where the asset underlying the options contract or warrant is shares, for one such share; or
- (ii) where the asset underlying the options contract is an asset other than shares, for one unit of such asset;

*[cf. s.2 FRR]*

“prescribed country” (訂明國家) means -

- (a) a country belonging to the Organization for Economic Co-operation and Development; or
- (b) Singapore;

*[new, cf. "OECD countries" s.2 FRR]*

“qualifying debt securities” (合資格債務證券) means -

- (a) debenture stock, loan stock, debentures, bonds, notes and any securities or other instruments acknowledging, evidencing or creating indebtedness –
  - (i) which are issued or guaranteed by –
    - (A) the Central People's Government of the People's Republic of China or the People's Bank of China;
    - (B) the Government; or
    - (C) the Hong Kong Exchange Fund;
  - (ii) which are issued by the Hong Kong Mortgage Corporation;
  - (iii) which are listed on a recognized stock market;
  - (iv) the issuer of which has at least one issue currently rated by –
    - (A) Moody's Investors Services at either Baa or Prime-3 or above;
    - (B) Standard & Poor's Corporation at either BBB or A-3 or above; or
    - (C) an approved credit rating agency at or above a grade specified by the Commission under section 58(2); or
  - (v) the guarantor of which has at least one issue currently rated by –
    - (A) Moody's Investors Services at either A or Prime-2 or above;
    - (B) Standard & Poor's Corporation at either A or A-2 or above; or
    - (C) an approved credit rating agency at or above a grade specified by the Commission under section 58(2),

but does not include –

- (vi) any special debt securities;
  - (vii) any I-owe-you; and
  - (viii) any securities or any instrument acknowledging, evidencing or creating a subordinated loan or a debt due from a corporation within a group of companies of which the holder of the securities or instrument is a member; or
- (b) certificates of deposit issued by an authorized financial institution or an approved bank incorporated outside Hong Kong;

*[cf. s.2 FRR & s.2 LFET FRR "recognized debt securities"]*

“ranking liabilities” (認可負債), in relation to a licensed corporation, means the aggregate of the amounts required to be included in its ranking liabilities under the provisions of Division 4 of Part 4;

*[cf. s.2 FRR]*

“redeemable shares” (可贖回股份) means shares in the share capital of a corporation which are redeemable at the option of the holder of the shares or the corporation;

*[cf. s.2 FRR "approved redeemable shares"]*

“reporting currency” (申報貨幣), in relation to a licensed corporation, means the currency in which its financial statements, required under section 156 of the Ordinance to be submitted to the Commission, are denominated, or intended to be denominated;

*[new]*

“repurchase transaction” (回購交易) means a transaction under which there is a sale of securities and a further arrangement obliging the seller of the securities to repurchase from the purchaser, or obliging the purchaser to

resell to the seller, securities of the same description as the securities first sold, at a pre-determined consideration and date;

*[cf. s.2 FRR]*

“required liquid capital” (規定速動資金), in relation to a licensed corporation, means an amount equal to the higher of –

- (a) where it is –
  - (i) licensed for only one regulated activity specified in column 1 of Table 2 in Schedule 1, the amount specified in column 2 of the Table opposite the regulated activity or, where any further description is set out for the regulated activity in column 1 of the Table, opposite the applicable description; or
  - (ii) licensed for 2 or more regulated activities specified in column 1 of the Table, the amount which is the higher or highest upon comparing each amount specified in column 2 of the Table opposite any of such regulated activities or, where any further description is set out for any of such activities in column 1 of the Table, opposite any of such activities or any of the applicable descriptions; and
- (b) its variable required liquid capital;

*[new]*

“required liquid capital deficit” (規定速動資金短欠數額), in relation to a licensed corporation, means the amount by which its required liquid capital exceeds its liquid capital;

*[cf. "liquid capital deficiency" s.2 FRR]*

“rules” (規章) –

- (a) in relation to an exchange other than a recognized exchange company, includes its constitution and any rules, regulations, guidelines or directions, by whatever name they may be called and wherever contained, governing –
  - (i) its exchange participants;
  - (ii) the persons who may participate in any of the services it provides or trade on any futures market or stock market that it operates;
  - (iii) the setting and levying of fees;
  - (iv) the listing of securities;
  - (v) the trading of securities, futures contracts or leveraged foreign exchange contracts through it or on any futures market or stock market that it operates;
  - (vi) the provision of other services; or
  - (vii) generally, its management, operations or procedures and those of any futures market or stock market that it operates; or
- (b) in relation to a clearing house other than a recognized clearing house, includes its constitution and any rules, regulations, guidelines or directions, by whatever name they may be called and wherever contained, governing –
  - (i) its clearing participants;
  - (ii) the persons who may participate in any of the services it provides;
  - (iii) the setting and levying of fees;
  - (iv) the clearing and settlement of transactions, whether or not executed on an exchange, or any

futures market or stock market operated by the exchange, of which it is the clearing house;

- (v) the imposition of margin requirements and matters pertaining to the deposit or collection of margin;
- (vi) the manner of making and receiving payment of monies in respect of the provision by it of any service, including the setting-off of such amounts receivable and amounts payable to it;
- (vii) the provision of other services; or
- (viii) generally, its management, operations or procedures;

[new]

“securities dealer” (證券交易商) means -

- (a) a licensed corporation licensed for Type 1 regulated activity; or
- (b) a person licensed, registered or authorized by an authority or regulatory organization outside Hong Kong for an activity which, if carried on in Hong Kong, would constitute Type 1 regulated activity;

[*cf. S.2 FRR*]

“securities margin financing” (證券保證金融資) has the meaning assigned to it by Part 2 of Schedule 5 to the Ordinance, save that notwithstanding paragraph (iii) of that definition, it includes the provision of financial accommodation by a licensed corporation licensed for Type 1 regulated activity to a client of the licensed corporation to facilitate –

- (a) the acquisition of securities listed on any stock market, whether a recognized stock market or any other stock market outside Hong Kong; or



- (b) (where applicable) the continued holding of those securities;

*[cf. s.2 FRR]*

“segregated account” (獨立帳戶) means -

- (a) a segregated account within the meaning of section 2 of the Securities and Futures (Client Money) Rules (L.N. of 2002); or
- (b) an account for holding client money which is separate from a licensed corporation's own account;

*[new]*

“settlement date” (交收日期), in relation to any dealing in securities, means –

- (a) in the case of a transaction effected on a stock market, the date on which payment for the securities is first due in accordance with the rules or conventions of the exchange that operates the stock market on which the securities are traded; or
- (b) in any other case, the date on which payment for the securities is first due as agreed between the parties to the transaction,

but in either case, the date not exceeding 20 business days after the trade date;

*[cf. s.2 FRR]*

“short selling” (賣空) means a sale of securities where at the time of the sale –

- (a) the seller does not have a presently exercisable and unconditional right to vest the securities in the purchaser of them; or
- (b) the seller has a presently exercisable and unconditional right to vest the securities in the purchaser of them by

virtue of having entered into a securities borrowing and lending agreement;

[*cf. s. 2 FRR*]

“special debt securities” (特別債務證券) means indexed bonds, convertible debt securities, bonds with non-detachable warrants and non-interest bearing debt securities –

- (a) which are issued or guaranteed by –
  - (i) the Central People's Government of the People's Republic of China or the People's Bank of China;
  - (ii) the Government; or
  - (iii) the Hong Kong Exchange Fund;
- (b) which are issued by the Hong Kong Mortgage Corporation;
- (c) which are listed on a recognized stock market;
- (d) the issuer of which has at least one issue currently rated by –
  - (i) Moody's Investors Services at either Baa or Prime-3 or above;
  - (ii) Standard & Poor's Corporation at either BBB or A-3 or above; or
  - (iii) an approved credit rating agency at or above a grade specified by the Commission under section 58(2); or
- (e) the guarantor of which has at least one issue currently rated by –
  - (i) Moody's Investors Services at either A or Prime-2 or above;
  - (ii) Standard & Poor's Corporation at either A or A-2 or above; or

- (iii) an approved credit rating agency at or above a grade specified by the Commission under section 58(2),

but does not include –

- (f) any I-owe-you; and
- (g) any securities or any instrument acknowledging, evidencing or creating a subordinated loan or a debt due from a corporation within a group of companies of which the holder of the securities or instrument is a member;

*[cf. s.2 FRR]*

“specified exchange” (指明交易所) means an exchange specified in Schedule 3 and, where appropriate, includes a stock market or futures market operated by such an exchange;

*[new]*

“specified investments” (指明投資項目) means the investments specified in column 2 of Table 8 in Schedule 2;

*[cf. s.2 FRR]*

“specified licensing condition” (指明發牌條件), in relation to a licensed corporation licensed for Type 4, Type 5, Type 6 or Type 9 regulated activity, means a licensing condition that the licensed corporation shall not hold client assets;

*[new]*

“specified securities” (指明證券) means the securities specified in column 2 of Table 7 in Schedule 2;

*[cf. s.2 FRR]*

“standby subordinated loan facility” (備用後償貸款融通) means a loan facility provided to a licensed corporation licensed for Type 1, Type 2, Type 3 or Type 8 regulated activity under which the lender’s claim in respect of any drawdown by the licensed corporation is subordinated to the prior

payment, or provision for payment, in full of all claims of all other present and future creditors of the licensed corporation;

*[cf. s. 2 FRR "approved stand-by subordinated stand-by loan facility"]*

“stock futures contract” (股票期貨合約) means a contract which is traded on a specified exchange, the effect of which is that –

- (a) one party to the contract agrees to deliver to the other party to the contract at an agreed future time an agreed quantity of a specific listed share at an agreed consideration; or
- (b) the parties to the contract will make an adjustment between themselves at an agreed future time according to whether at that time an agreed quantity of a specific listed share is worth more or less than a value agreed at the time the contract is made;

*[cf. s.2 FRR]*

“stock options contract” (股票期權合約) means a contract which is traded on a specified exchange, the effect of which is that one party to the contract agrees to provide to the other party to the contract the right to sell or purchase at an agreed consideration an agreed quantity of a specific listed share at or before an agreed future time;

*[cf. s.2 FRR]*

“subordinated loan” (後償貸款) means a loan provided to a person under which the lender's claim in respect of the loan is subordinated to the prior payment, or provision for payment, in full of all claims of all other present and future creditors of the person;

*[cf. s.2 FRR "approved subordinated loan"]*

“trade date” (交易日期), in relation to a transaction in –

- (a) a futures contract;
- (b) any securities;

- (c) an options contract;
- (d) a derivative contract;
- (e) a leveraged foreign exchange contract;
- (f) a foreign exchange agreement;
- (g) an interest rate swap agreement; or
- (h) a specified investment,

means –

- (i) in the case of a transaction on any exchange, the date on which the transaction is executed; or
- (j) in any other case, the date on which the agreement between the parties is made;

*[new]*

“trader” (買賣商) means a licensed corporation licensed for Type 1 or Type 2 regulated activity which does not hold client assets or handle clients’ orders and, in carrying on the regulated activity for which it is licensed, conducts no business other than effecting, or offering to effect, dealings in securities, futures contracts or options contracts for its own account;

*[cf. s.2 FRR]*

“unit trust” (單位信託) means any arrangement made for the purpose, or having the effect, of providing facilities for the participation by persons as beneficiaries under a trust, in profits or income arising from the acquisition, holding, management or disposal of securities or any other property whatsoever;

*[new, for the purposes of paragraph (b) of Table 7 in Schedule 2]*

“variable required liquid capital” (可變動規定速動資金) –

- (a) in relation to a licensed corporation licensed for Type 3 regulated activity (whether or not it is also licensed for any other regulated activity), means the sum of the basic

amount and 1.5% of its aggregate gross foreign currency position; or

- (b) in relation to a licensed corporation licensed for any regulated activity other than Type 3 regulated activity, means the basic amount.

*[new cf. s.6 FRR s.4 LFET FRR]*

## PART 2

### ACCOUNTING TREATMENT

#### **3. Accounting treatment**

(1) For the purposes of these Rules and subject to subsection (4), a licensed corporation shall account for all assets and liabilities –

- (a) in accordance with generally accepted accounting principles, unless otherwise specified in these Rules; and
- (b) in a way that recognizes the substance of a transaction, arrangement or position including accounting for a structured bond as a derivative product and not as a debt security.

*[s.4(2) FRR, s. 3 LFET FRR]*

(2) Subject to subsections (3) and (4), a licensed corporation shall not without notifying the Commission under section 55(5), change any of its accounting principles in a way that may materially affect the liquid capital or paid-up share capital that it maintains or is required to maintain under Part 3.

*[cf. s.32(1) FRR]*

(3) Subsection (2) does not apply in respect of any change of the generally accepted accounting principles in accordance with which its assets and liabilities are accounted for as required under subsection (1).

*[s.32 FRR, s.9(2) LFET FRR]*

(4) A licensed corporation may, with the Commission's prior written approval under section 58(5)(d), adopt an accounting principle that is inconsistent with subsection (1).

*[cf. s.4(3) FRR]*

PART 3

FINANCIAL RESOURCES REQUIREMENTS

**4. Licensed corporations to maintain financial resources**

A licensed corporation shall at all times maintain financial resources in the amount required of it under this Part.

*[cf. s.6 FRR & s.4 LFET FRR]*

**5. Paid-up share capital requirement for licensed corporations**

For the purposes of section 4, a licensed corporation other than one which carries on a regulated activity solely as one or more of the following –

- (a) an approved introducing agent who is not a licensed corporation licensed for Type 3 regulated activity;
- (b) a trader;
- (c) a futures non-clearing dealer;
- (d) a licensed corporation licensed for Type 4, Type 5, Type 6 or Type 9 regulated activity, where it is subject to the specified licensing condition,

shall at all times maintain paid-up share capital of not less than –

- (e) where it is licensed for only one regulated activity specified in column 1 of Table 1 in Schedule 1, the amount specified in column 2 of the Table opposite the regulated activity or, where any further description is set out for the

regulated activity in column 1 of the Table, opposite the applicable description; or

- (f) where it is licensed for 2 or more regulated activities specified in column 1 of the Table, the amount which is the higher or highest upon comparing each amount specified in column 2 of the Table opposite any of such regulated activities or, where any further description is set out for any of such activities in column 1 of the Table, opposite any of such activities or any of the applicable descriptions.

*[cf. ss.9 & 10 FRR; s.4(1)(a) and (2)(a) LFET FRR]*

**6. Liquid capital requirement for licensed corporations**

(1) For the purposes of section 4, a licensed corporation shall at all times maintain liquid capital which is not less than its required liquid capital.

*[cf. ss.6 & 10 FRR & s.4(1)(b)& (2)(b) LFET FRR]*

(2) Subsections (3) and (4) apply in respect of a licensed corporation licensed for one or more of the following –

- (a) Type 1 regulated activity;
- (b) Type 2 regulated activity;
- (c) Type 3 regulated activity; and
- (d) Type 8 regulated activity,

unless it is –

- (e) in the case of paragraph (a), an approved introducing agent or a trader;
- (f) in the case of paragraph (b), an approved introducing agent, a trader or a futures non-clearing dealer; or
- (g) in the case of paragraph (c), an approved introducing agent.



(3) Subject to subsection (4), where on any particular business day a licensed corporation's required liquid capital rises above its liquid capital and on any subsequent business days there is a required liquid capital deficit, the licensed corporation will be regarded as having complied with subsection (1) if –

- (a) it is entitled to draw down an amount not less than the required liquid capital deficit under an approved standby subordinated loan facility; and
- (b) its required liquid capital on the day that its required liquid capital rises above its liquid capital is at least 20% more than its required liquid capital at the close of business on the previous business day, as a result of –
  - (i) an increase in its adjusted liabilities which is attributable to an increase in its dealings in securities for its clients;
  - (ii) an increase in the aggregate of the initial margin requirements, or of the amounts of margin required to be deposited, which is attributable to outstanding futures contracts or outstanding options contracts held by it on behalf of its clients;
  - (iii) an increase in its aggregate gross foreign currency position;
  - (iv) an increase in its adjusted liabilities which is attributable to an increase in the aggregate of the amounts receivable from its margin clients; or
  - (v) where applicable, the aggregate of the increases described in 2 or more of subparagraph (i), (ii), (iii) or (iv).

(4) Subsection (3) only applies where the required liquid capital of a licensed corporation has exceeded its liquid capital on 4 or less business days

during the 60 days immediately preceding the day on which the required liquid capital deficit occurs.

*[cf. s.7 FRR]*

## PART 4

### LIQUID CAPITAL

#### **Division 1 – General**

#### **7. Calculation of liquid capital and required liquid capital**

A licensed corporation, for the purposes of calculating its liquid capital and required liquid capital, shall account for all its assets, liabilities and transactions in accordance with this Part.

*[cf. s.11(1) FRR]*

#### **Division 2 – Computation basis**

#### **8. Accounting for transactions on trade date basis**

A licensed corporation, for the purposes of calculating its liquid capital and required liquid capital, shall account on a trade date basis for all transactions effected by it, whether as principal or agent, in relation to –

- (a) any dealing in –
  - (i) a futures contract;
  - (ii) any securities;
  - (iii) an options contract;
  - (iv) a derivative contract; or
  - (v) a specified investment;
- (b) trading in a leveraged foreign exchange contract; or
- (c) entering into any –

- (i) foreign exchange agreement; or
- (ii) interest rate swap agreement.

*[cf. s.5(1) FRR]*

**9. Valuation of proprietary positions, etc.**

(1) A licensed corporation, for the purposes of calculating its liquid capital and required liquid capital, shall, subject to subsection (2), value any open position in –

- (a) a futures contract;
- (b) any securities;
- (c) an options contract;
- (d) a derivative contract;
- (e) a leveraged foreign exchange contract;
- (f) a foreign exchange agreement;
- (g) an interest rate swap agreement; or
- (h) a specified investment,

entered into for its own account at market value.

(2) Notwithstanding subsection (1), for the purposes of calculating the liquid capital and required liquid capital of a licensed corporation, any reference in these Rules to the market value of the securities referred to in this subsection shall be construed as referring to the value (including any nil value) at which they are required to be valued under this subsection, namely -

- (a) debt securities other than a certificate of deposit, in respect of which there is no published market price, shall be valued –
  - (i) at the average value of quotations obtained in respect of those debt securities from –
    - (A) at least 2 market makers; or
    - (B) where in relation to any debt securities there are less than 2 market makers, at

- least 2 banks, licensed corporations or securities dealers outside Hong Kong, who customarily deal in such debt securities, or at least 2 of the persons referred to in this sub-subparagraph; or
- (ii) if the quotations referred to in subparagraph (i) are not available –
    - (A) in the case of long positions, at nil; or
    - (B) in the case of short positions, at the face value of the debt securities;
  - (b) listed securities which have been suspended from trading for at least 3 business days or ceased trading on any exchange on which the securities were listed, shall, unless the securities can continue to be traded on any other exchange on which the securities are listed, be valued –
    - (i) in the case of long positions, at nil; or
    - (ii) in the case of short positions, at the last closing price before the suspension or cessation of trading;
  - (c) certificates of deposit issued by an authorized financial institution or an approved bank incorporated outside Hong Kong, in respect of which there is no published market price, shall be valued at the value quoted by the issuer.

*[cf. s.5(2)FRR]*

**10. Pairs of transactions**

A licensed corporation which enters into a pair of transactions in which its respective roles are opposite, but which otherwise have identical or similar terms, shall account for the transactions as separate transactions.

*[cf. s.5(3)]*

## 11. No set-off

(1) Subject to subsections (2), (3), (4), (5) and (6) and section 48(2), the assets and liabilities of a licensed corporation shall be treated separately on a gross basis and shall not be set-off against each other.

(2) Subsection (1) does not apply in respect of any amounts receivable by a licensed corporation from, and any amounts payable by it to, a recognized clearing house, where the rules of the clearing house permit the setting-off of such amounts against each other for settlement purposes.

(3) Subsection (1) does not apply in respect of any amounts receivable by a licensed corporation from, and any amounts payable by it to, a person, where –

- (a) such amounts do not arise from the carrying on of any regulated activity for which it is licensed; and
- (b) it has a legally enforceable right to set-off such amounts against each other.

(4) Subsection (1) does not apply in respect of any amounts receivable by a licensed corporation from, and any amounts payable by it to, a client of the licensed corporation, where such amounts arise from –

- (a) the purchase and sale by the client of securities of the same description due to be settled on a cash against delivery basis and the client has authorized the licensed corporation to set-off such amounts;
- (b) the sale and purchase by the client of securities in relation to which the licensed corporation has elected to set-off such amounts against each other under section 21(2); or
- (c) the provision by it to the client of securities margin financing.

(5) Subsection (1) does not apply in respect of any amounts receivable by a licensed corporation licensed for Type 8 regulated activity from, and any amounts payable by it to, each securities dealer with which it has common

clients, where such amounts arise from dealings in securities through the securities dealer for those clients.

(6) Subsection (1) does not apply in respect of any amounts receivable by a licensed corporation licensed for Type 1 regulated activity from, and any amounts payable by it to, each licensed corporation licensed for Type 8 regulated activity with which it has common clients, where such amounts arise from dealings in securities through it for those clients.

*[cf. s.5(5)(a)(b)(c)(d)(e)(i)(ii)(f)(g)FRR]*

**12. Transactions in margined accounts**

(1) A licensed corporation shall not set-off amounts receivable by it from, and amounts payable by it to, a client of the licensed corporation arising from transactions in different margined accounts maintained with it by the client.

(2) Where a licensed corporation has a client who –

- (a) maintains with it more than one margined account;
- (b) has deposited with it security against his liabilities to it in the form of –
  - (i) cash;
  - (ii) collateral; or
  - (iii) a bank guarantee; and
- (c) has authorized it to apply such security to satisfy any liabilities to it arising from the execution by it of any transaction in relation to any of his margined accounts,

the licensed corporation may, subject to subsections (3) and (4) –

- (d) for the purpose of calculating –
  - (i) a specified shortfall amount in relation to a margined account of the client; or
  - (ii) a margin shortfall amount under section 22(1)(b) in relation to the client,

- deem all or part of such security to be deposited by the client as security to the margined account in relation to which such shortfall amount is calculated; or
- (e) for the purposes of calculating any amount to be included in its ranking liabilities under section 45(1) or 46(1) in relation to a margined account of the client, reduce any such amount by –
- (i) where the client has deposited cash referred to in paragraph (b)(i), the amount of such cash;
  - (ii) where the client has deposited collateral referred to in paragraph (b)(ii), the amount of the market value of such collateral, less the haircut amount in relation to the collateral; or
  - (iii) where the client has deposited a bank guarantee referred to in paragraph (b)(iii), the amount that it can draw down under such bank guarantee.
- (3) A licensed corporation shall not –
- (a) under subsection (2)(d), deem –
    - (i) any amount of cash;
    - (ii) any collateral; or
    - (iii) any amount that it can draw down under a bank guarantee,to be security to the margined account concerned; or
  - (b) effect any reduction under subsection (2)(e) in respect of such security,
- if –
- (c) such security has been deemed under subsection (2)(d) to be deposited as security to another margined account of the client; or

- (d) by reference to such security a reduction under subsection (2)(e) has been effected in relation to another margined account of the client.

(4) For the purposes of these Rules, a licensed corporation shall cease to treat –

- (a) any cash referred to in subsection (2)(b)(i);
- (b) any collateral referred to in subsection (2)(b)(ii); or
- (c) any bank guarantee referred to in subsection (2)(b)(iii),

as security in relation to the margined account of the client into which it was deposited, to the extent that such security –

- (d) has been deemed under subsection (2)(d) to be deposited as security to another margined account of the client; or
- (e) has been utilized to effect a reduction under subsection (2)(e).

(5) For the purposes of subsection (2), “specified shortfall amount” (指明短欠數額) means an amount to be included in the licensed corporation's ranking liabilities under –

- (a) section 40(1);
- (b) section 41(1);
- (c) section 43(10);
- (d) section 45(2); or
- (e) section 46(2).

*[cf. s.5(5)(e)(iii)FRR]*

(6) In this section, “margined account” (以保證金形式操作的帳戶), in relation to a client of a licensed corporation, means –

- (a) an account maintained with a licensed corporation licensed for Type 1 regulated activity by the client for the provision to him by the licensed corporation of securities margin financing; or



- (b) an account maintained with the licensed corporation by the client for –
  - (i) short selling;
  - (ii) dealings in futures contracts;
  - (iii) dealings in options contracts;
  - (iv) securities borrowing and lending;
  - (v) trading in leveraged foreign exchange contracts;
  - or
  - (vi) entering into repurchase transactions.

*[cf. s.2 FRR “margined account”]*

### **13. Treatment of exercised options contracts**

A licensed corporation shall, immediately upon the exercise of an options contract purchased, written or cleared by it, treat the options contract as having ceased to exist and account for –

- (a) all its assets; and
- (b) all its liabilities,

arising from such exercise.

*[cf. s.5(6) and (7) FRR]*

### **14. Assignments**

(1) A licensed corporation shall not include in its liquid assets any amount receivable by it from any of its clients if such amount has been assigned by it to another person.

(2) A licensed corporation shall not treat any collateral or any other type of security deposited with it by any of its clients as so deposited where such collateral or other type of security has been assigned by it to another person.

*[cf. s.5(8) FRR]*

**15. Treatment of securities borrowing  
and lending agreements**

(1) A licensed corporation which, under a securities borrowing and lending agreement, is the borrower of any securities, is deemed for the purposes of these Rules –

- (a) to remain the owner of any collateral beneficially owned by it and provided by it as security to the lender of the securities under the agreement;
- (b) to have an amount receivable from that lender equal to the amount of cash provided by it as security to that lender; and
- (c) not to own the securities borrowed under the agreement.

(2) A licensed corporation which, under a securities borrowing and lending agreement, is the lender of any securities, is deemed for the purposes of these Rules –

- (a) where the securities lent under the agreement are beneficially owned by it, to remain the beneficial owner of the securities for the purposes of section 27;
- (b) not to own any collateral deposited with it as security by the borrower of the securities under the agreement; and
- (c) to have an amount payable to that borrower equal to the amount of cash deposited with it as security by that borrower, unless the cash –
  - (i) is not included in its liquid assets under section 20; and
  - (ii) is held in a segregated account.

*[cf. s.5(24) and (25) FRR]*

## 16. Treatment of repurchase transactions

(1) Where a licensed corporation is the purchaser in the first instance of any securities under a repurchase transaction, it is deemed for the purposes of these Rules –

- (a) to have an amount receivable from the seller of the securities equal to the consideration for which it purchased the securities; and
- (b) not to own the securities purchased and so shall not include them in its liquid assets under section 27.

(2) Where a licensed corporation is the seller in the first instance of any securities beneficially owned by it under a repurchase transaction, it is deemed for the purposes of these Rules –

- (a) to remain the owner of the securities sold by it; and
- (b) to be liable to the purchaser of the securities for an amount equal to the consideration for which it sold the securities.

*[cf. s.5(26) and (27) FRR]*

## Division 3 – Liquid assets

### 17. Computation basis

A licensed corporation shall, for the purposes of calculating its liquid assets under the provisions of this Division, apply the computation basis prescribed in Division 2.

*[cf. s.11(1) FRR]*.

### 18. Exclusions from liquid assets

(1) A licensed corporation which operates a branch in a place outside Hong Kong shall not include in its liquid assets any asset which it is required by an authority or regulatory organization in, or under the law of, that place, to maintain in that place in order for the branch to obtain or maintain a licence,

registration, membership or authorization to carry on an activity which, if carried on in Hong Kong, would constitute a regulated activity.

*[cf. s.11(2) FRR]*

- (2) A licensed corporation shall not include in its liquid assets –
  - (a) any asset that is an amount of a currency that is subject to exchange control; or
  - (b) any assets the proceeds of which upon realization are not freely remittable to Hong Kong,

unless the licensed corporation reasonably believes that approval for the remittance of such currency or proceeds to Hong Kong can be obtained from the relevant authority within one week of application by it for such approval.

*[cf. s.11(4) FRR]*

## **19. Assets provided to others as security**

(1) A licensed corporation, for the purposes of calculating its liquid capital, subject to subsection (2), is deemed not to own any asset which it beneficially owns and has provided to another person as security for any liabilities or obligations.

*[cf. s.11(3) FRR]*

(2) A licensed corporation is deemed to remain the owner of any asset which it beneficially owns and has provided as security –

- (a) to –
  - (i) an authorized financial institution;
  - (ii) an approved bank incorporated outside Hong Kong; or
  - (iii) another licensed corporation,  
for credit facilities provided to it by the institution, bank or corporation (as the case may be);

*[cf. s.11(3)(a) FRR]*

- (b) under a securities borrowing and lending agreement under which it is the borrower of securities;

*[cf. s.11(3)(b) FRR]*

- (c) in the form of margin deposited in respect of any short selling by it;

*[cf. s.11(3)(c) FRR]*

- (d) in the form of margin deposited in respect of any dealing in futures contracts or options contracts by it;

*[cf. s.11(3)(d) FRR]*

- (e) in the form of margin deposited in respect of any trading in leveraged foreign exchange contracts by it;

*[new]*

- (f) to obtain a bank guarantee for the purpose of fulfilling its obligations under the rules of a recognized exchange company to furnish the exchange company with a guarantee as an alternative to participating in the Fidelity Fund established under the rules;

*[cf. s.11(3)(e) FRR]*

- (g) to, or to obtain a bank guarantee in favour of, a recognized clearing house for the purpose of enabling it to fulfil its obligations under the rules of the clearing house (other than rules which relate to the Guarantee Fund or the Reserve Fund); or

*[cf. s.11(3)(f)-(h) FRR]*

- (h) in relation to collateralized warrants of which it is the issuer, in the form of a charge over the underlying securities or other assets to which the warrants relate in favour of an independent trustee.

*[new]*

**20. Cash in hand and at bank**

A licensed corporation shall include in its liquid assets -

- (a) cash in hand which it beneficially owns;

*[cf. s.12(a)]*

- (b) money which it beneficially owns and holds in its name, or in a segregated account, with an authorized financial institution or an approved bank incorporated outside Hong Kong in the form of –

- (i) a demand deposit; or
- (ii) a time deposit which will mature in 6 months or less; and

*[cf. s.12(b)(i)(ii) FRR]*

- (c) interest accrued on any deposit referred to in paragraph (b)(ii).

*[cf. s.12(b)(iii) FRR & s.5(a) – (c) LFET FRR]*

**21. Amounts receivable from clients in respect of purchase of and subscription for securities**

(1) Subject to subsections (3) and (7), a licensed corporation shall include in its liquid assets the following amount receivable from any of its clients arising from purchase by the client of securities on a cash-against-delivery basis –

- (a) any such amount receivable which –
  - (i) is not yet due for settlement according to the settlement date; or
  - (ii) has been outstanding for 5 business days or less after the settlement date; and
- (b) where any such amount receivable has been outstanding for more than 5 business days but less than one month

after the settlement date, the amount which is the lower, when calculated on a transaction-by-transaction basis, of –

- (i) such outstanding amount receivable less any specific provision for bad or doubtful debts made in respect thereof; and
- (ii) the market value of the securities to which such outstanding amount relates.

*[cf. s.13(1) and (2) FRR]*

(2) A licensed corporation may elect to set-off, on a client-by-client basis, any amount receivable from, and amount payable to, a client where such amounts arise from the purchase and sale of securities on a cash-against-delivery basis, and the licensed corporation has obtained from the client a written authorization to –

- (a) set-off such amounts against each other; and
- (b) dispose of securities held for the client for the purpose of settling any of the amounts payable by the client to the licensed corporation.

(3) Subject to subsection (7), where a licensed corporation makes an election under subsection (2), it shall include in its liquid assets in respect of the amount receivable by it from and the amount payable by it to a client which arises from the purchase and sale of securities on a cash-against-delivery basis the amount which is the lower, when calculated on a client-by-client basis, of –

- (a) any amount receivable that remains after the set-off referred to in subsection (2) less any specific provision for bad or doubtful debts made in respect of such amount receivable; and
- (b) the market value of the securities held for the client, less the haircut amounts relating to the securities.

(4) Subject to subsection (7), a licensed corporation shall include in its liquid assets the following amount receivable from any of its clients in respect of the purchase of securities by the client on a free delivery basis –

- (a) in the case where the clearing system of the stock market on which the securities are traded effects settlement only on a free delivery basis, such amount receivable which, when calculated on a transaction-by-transaction basis, has been outstanding for 2 weeks or less after the settlement date; or
- (b) in any other case, such amount receivable which, when calculated on a transaction-by-transaction basis, is not yet due for settlement according to the settlement date.

*[cf. s.13(3) FRR]*

(5) Subject to subsection (7), a licensed corporation shall, in respect of securities subscribed for on behalf of any of its clients, include, prior to the commencement of trading of the securities on any stock market on which they are listed, in its liquid assets the amount which is the lower, when calculated on a transaction-by-transaction basis, of –

- (a) 90% of the total costs to the client of subscribing for the securities; and
- (b) the amount receivable from the client for subscribing for the securities.

*[cf. s.13(9) FRR]*

(6) Subject to subsection (7), a licensed corporation shall, in respect of securities subscribed for on behalf of any of its clients, include, after the commencement of trading of the securities on any stock market on which they are listed, in its liquid assets the amount receivable from the clients arising from subscribing for the securities in accordance with subsection (1) or (3) as if the securities had been purchased on a cash-against-delivery basis.

*[new]*



(7) The aggregate of amounts that a licensed corporation includes in its liquid assets under subsections (1), (3), (4), (5) and (6) shall not exceed the aggregate of amounts receivable from its clients referred to in those subsections less the aggregate of amounts of specific and general provisions for bad or doubtful debts made in respect of such aggregate of amounts receivable.

*[new]*

(8) In subsection (2), “written authorization” (書面授權) includes an agreement in writing within the meaning of the Securities and Futures (Client Securities) Rules (L.N. of 2002).

*[new]*

**22. Amounts receivable in respect of providing securities margin financing**

(1) Subject to subsections (2) and (3), a licensed corporation licensed for Type 1 or Type 8 regulated activity shall include in its liquid assets any net amount receivable from any of its margin clients, calculated as the amount by which the amount receivable from the margin client exceeds the amount payable by it to the margin client arising from the provision by it of securities margin financing, after deducting the higher of –

- (a) any specific provision for bad or doubtful debts made in respect of such net amount receivable; and
- (b) the margin shortfall amount, calculated as the amount by which the net amount receivable exceeds the aggregate of –
  - (i) the market value of collateral, other than illiquid collateral, provided by the client, less the haircut amount in relation to such collateral and multiplied by the concentration discounting factor in relation to such collateral;

- (ii) the market value of all illiquid collateral provided by the client, multiplied by 20%;
- (iii) the amount of cash deposited as security by the client; and
- (iv) in the case of a licensed corporation licensed for Type 1 regulated activity, the maximum amount that it can draw under a bank guarantee provided to it by the client and issued by an authorized financial institution or an approved bank incorporated outside Hong Kong.

*[cf. s.13(4) FRR]*

(2) Notwithstanding section 8, a licensed corporation licensed for Type 1 or Type 8 regulated activity may, in calculating the margin shortfall amount referred to in subsection (1)(b) in relation to any of its margin clients, elect to exclude, for all its clients and on a client-by-client basis, from the calculation of the net amount receivable from the client, any –

- (a) amount receivable from the client; and
- (b) amount payable by it to the client,

arising from dealings in securities which are not yet due for settlement according to the settlement date, whereupon subsection (1)(b) shall apply to it as if such dealings in securities –

- (c) had not given rise to any amount receivable from, or any amount payable by it to, the client; and
- (d) had not given rise to any change in the amount of collateral provided to it by the client.

*[cf. s.13(5) FRR]*

(3) The aggregate of amounts that a licensed corporation includes in its liquid assets under subsection (1) shall not exceed the aggregate of net amounts receivable from its margin clients referred to under that subsection less

the aggregate of amounts of specific and general provisions for bad or doubtful debts made in respect of such aggregate of net amounts receivable.

*[new]*

(4) In subsection (1)(b)(i) and (ii), “illiquid collateral” (非速動抵押品), in relation to any collateral provided to a licensed corporation licensed for Type 1 or Type 8 regulated activity by its margin clients, means any listed share or listed warrant which is of the same description as that identified as top 3 collateral provided by any top margin client of the licensed corporation, where –

- (a) if it is a share, the aggregate market value of all shares of the same description as that share provided to the licensed corporation by its margin clients as collateral is equal to or greater than –
  - (i) the average monthly turnover of that share; or
  - (ii) 5% of the market capitalization of that share as at the end of the month immediately preceding the month prior to the month in which the calculation is made; or
- (b) if it is a warrant, the aggregate market value of all warrants of the same description as that warrant provided to the licensed corporation by its margin clients as collateral is equal to or greater than –
  - (i) the average monthly turnover of that warrant; or
  - (ii) 5% of the value of the relevant warrant issue as at the end of the month immediately preceding the month prior to the month in which the calculation is made,

but does not include –

- (c) any listed share or listed warrant which has been listed for less than 6 consecutive months (including any period

during which the share or warrant is suspended from trading) immediately preceding the month prior to the month in which the calculation is made; and

- (d) any listed share which is a constituent stock of any of the following indices –
- (i) Hang Seng Index;
  - (ii) Hang Seng Hong Kong LargeCap Index;
  - (iii) Hang Seng Hong Kong MidCap Index;
  - (iv) FTSE-100 Index;
  - (v) Nikkei 225 Index; or
  - (vi) Standard & Poor's 500 Index.

(5) In subsection (4) –

“average monthly turnover” (平均每月成交額), in relation to a listed share or listed warrant, means one sixth of the aggregate value of transactions in that share or warrant on any stock market on which it is listed for a period of 6 consecutive months (including any period during which the share or warrant is suspended from trading) immediately preceding the month prior to the month in which the calculation is made;

“calculation” (有關計算) means a calculation made for the purposes of subsection (1);

“market capitalization” (市場資本值), in relation to a listed share, means the amount of the total number of shares of the same description as that share issued by the issuer of that share multiplied by their market price;

“top 3 collateral” (首 3 位抵押品), in relation to a top margin client of a licensed corporation licensed for Type 1 or Type 8 regulated activity, means any of the 3 highest listed shares or listed warrants in terms of market value among all listed shares and listed warrants provided by him to the licensed corporation as collateral;

“top margin client” (佔首位的保證金客戶), in relation to a licensed corporation licensed for Type 1 or Type 8 regulated activity, means –

- (a) where it has less than 20 margin clients, all its margin clients; or
- (b) where it has 20 or more margin clients, the 20 margin clients with the largest outstanding margin loan balance.

*[new, cf. s.2 Financial Resources (Amendment) Rules 2002]*

**23. Amounts receivable from counterparties in respect of dealings in securities**

(1) Subject to subsection (2), a licensed corporation shall include in its liquid assets the following amounts receivable from any securities dealer which arise from the sale of securities by it to the securities dealer –

- (a) where the securities are sold on a cash-against-delivery basis –
  - (i) any such amount receivable which has been outstanding for 2 weeks or less after the settlement date; and
  - (ii) where any such amount receivable has been outstanding for more than 2 weeks but less than one month after the settlement date, the amount which is the lower, when calculated on a transaction-by-transaction basis, of –
    - (A) such amount receivable less any specific provision for bad or doubtful debts made in respect of the outstanding amount; and
    - (B) the market value of the securities to which the outstanding amount relates;

*[cf. s.14(1) FRR]*

- (b) where the securities are sold on a free delivery basis, such amount receivable calculated on a transaction-by-transaction basis, which –
  - (i) in the case where the clearing system of the stock market on which the securities are traded effects settlement only on a free delivery basis, has been outstanding for 2 weeks or less after the settlement date; or
  - (ii) in any other case, is not yet due for settlement according to the settlement date.

*[cf. s.14(2) FRR]*

(2) The aggregate of amounts that a licensed corporation includes in its liquid assets under subsection (1) shall not exceed the aggregate of amounts receivable from securities dealers referred to in that subsection less the aggregate of amounts of specific and general provisions for bad or doubtful debts made in respect of such aggregate of amounts receivable.

*[new]*

**24. Amounts receivable in respect of dealings in securities by common clients**

(1) A licensed corporation licensed for Type 8 regulated activity shall include in its liquid assets the net amount receivable from each securities dealer with which it has common clients, calculated as the amount by which the amount receivable from such securities dealer exceeds the amount payable by it to the securities dealer, where such amounts arise from any dealing in securities through such securities dealer for those clients, to the extent that such amount does not exceed the total amount receivable from such securities dealer arising from any such dealing in securities which is not yet due for settlement according to the settlement date.

*[cf. s.14(5) FRR]*

(2) A licensed corporation licensed for Type 1 regulated activity shall include in its liquid assets the net amount receivable from each licensed corporation licensed for Type 8 regulated activity with which it has common clients, calculated as the amount by which the amount receivable from such second-mentioned licensed corporation exceeds the amount payable by it to such second-mentioned licensed corporation, where such amounts arise from any dealing in securities by it for those clients, to the extent that such amount does not exceed the total amount receivable from such second-mentioned licensed corporation arising from any such dealing in securities which is not yet due for settlement according to the settlement date.

*[cf. s.13(8) FRR]*

**25. Amounts receivable from licensed corporations licensed for Type 8 regulated activity**

(1) Subject to subsection (2), a licensed corporation licensed for Type 1 regulated activity shall include in its liquid assets the aggregate of any amount receivable from each licensed corporation licensed for Type 8 regulated activity and any net amount receivable from such second-mentioned licensed corporation referred to in section 24(2) that has not been included in its liquid assets under that section, in the amount which, in relation to each such second-mentioned licensed corporation, is the lower of –

- (a) such aggregate amount less any specific provision for bad or doubtful debts made in respect of each such aggregate amount; and
- (b) the sum of –
  - (i) the amount of cash deposited as security with it by such second-mentioned licensed corporation;
  - (ii) the market value of collateral deposited with it by such second-mentioned licensed corporation, less

the haircut amount in relation to such collateral; and

- (iii) the maximum amount that it can draw under a bank guarantee provided to it by such second-mentioned licensed corporation and issued by an authorized financial institution or an approved bank incorporated outside Hong Kong.

*[cf. s.13(7) FRR]*

(2) The aggregate of amounts that a licensed corporation includes in its liquid assets under subsection (1) shall not exceed the aggregate of amounts receivable from other licensed corporations referred to in that subsection less the aggregate of amounts of specific and general provisions for bad or doubtful debts made in respect of such aggregate of amounts receivable.

*[new]*

**26. Cash provided as security for short selling**

A licensed corporation shall include in its liquid assets an amount receivable in the amount of any cash (including interest accrued on it) provided by it as security to the counterparty in respect of a short selling by it of securities where it has not yet delivered the securities to the counterparty for settlement, where the counterparty is –

- (a) a securities dealer;
- (b) a specified exchange;
- (c) a clearing house of a specified exchange; or
- (d) a clearing participant of a clearing house referred to in paragraph (c).

*[cf. s.14(6) FRR]*



**27. Proprietary positions of licensed corporations**

(1) A licensed corporation shall include in its liquid assets any of the following assets that it beneficially owns –

- (a) subject to subsections (2), (3), (4), (6) and (7), listed shares;
- (b) qualifying debt securities;
- (c) special debt securities;
- (d) specified securities;
- (e) specified investments,

at market value, less the haircut amounts related to the securities or specified investments concerned.

*[cf. s.15(a), (c), (d), (g) & (h) FRR]*

(2) Subject to subsection (5), where a licensed corporation beneficially owns any listed shares and writes a call stock options contract on such shares, to the extent that the number of shares underlying the options contract is equal to the number of such shares, subsection (1)(a) does not apply in respect of such shares and section 40(3) and (4) does not apply in respect of the options contract and it shall include in its liquid assets such shares in the amount which is the lower of –

- (a) their market value, less the haircut amount in relation to such shares; and
- (b) the number of such shares multiplied by the strike price of such options contract.

*[cf. s.5(13) FRR]*

(3) Subject to subsection (5), where a licensed corporation beneficially owns any listed shares and holds a short position in a stock futures contract in respect of such shares, to the extent that the number of shares underlying the futures contract is equal to the number of such shares, subsection (1)(a) does not apply in respect of such shares and section 40(4) does not apply in respect of the

futures contract and it shall include in its liquid assets such shares at market value.

*[cf. s.5(14) FRR]*

(4) Subject to subsection (5), where a licensed corporation beneficially owns any listed shares and holds a put stock options contract, which is not subject to any margin requirement, in respect of such shares, to the extent that the number of shares underlying the options contract is equal to the number of such shares, it may elect not to apply subsection (1)(a) in respect of such shares and section 31(1)(b) in respect of the options contract whereupon it shall include in its liquid assets such shares in the amount which is the higher of –

- (a) their market value, less the haircut amount in relation to such shares; and
- (b) the number of such shares multiplied by the strike price of such options contract.

*[cf. s.5(15) FRR]*

(5) Subsections (2), (3) and (4) do not apply in respect of a stock futures contract or a stock options contract which has been grouped with other positions for the purpose of calculating a net amount of margin required to be deposited by the licensed corporation.

*[cf. s.5(12) FRR]*

(6) Where a licensed corporation beneficially owns any listed shares and issues any call non-collateralized warrants on such shares, to the extent that the number of shares underlying the warrants which are outstanding is equal to the number of such shares, subsection (1)(a) does not apply in respect of such shares and section 43(1), (2)(d) and (3) does not apply in respect of such warrants and it shall include in its liquid assets such shares in the amount which is the lower of –

- (a) the market value of such shares, less the haircut amount in relation to such shares; and

- (b) the number of such shares multiplied by the exercise price of such warrants.

*[cf. s.5(10) FRR]*

(7) Where a licensed corporation beneficially owns any listed shares which are charged for the purpose of issuing any call collateralized warrants on such shares, subsection (1)(a) does not apply in respect of such shares and section 43(1),(2)(d) and (3) does not apply in respect of such warrants and it shall include in its liquid assets such shares in the amount which is the lower of –

- (a) the market value of such shares, less the haircut amount in relation to such shares; and
- (b) the number of such shares multiplied by the exercise price of such warrants.

*[cf. s.5(11) FRR]*

**28. Amounts receivable from clearing houses, etc.**

- (1) A licensed corporation shall include in its liquid assets –
  - (a) amounts receivable from a recognized clearing house; and
  - (b) cash deposited with such clearing house,other than –
  - (c) admission fees it has paid to such clearing house;
  - (d) contributions it has made to the Guarantee Fund or Reserve Fund of such clearing house; and
  - (e) client money held in a segregated account maintained with such clearing house.

*[cf. s.14(3)and 16(a) and (b) FRR]*

- (2) A licensed corporation shall, in respect of –
  - (a) any dealing by it in –
    - (i) a futures contract;
    - (ii) any securities;
    - (iii) an options contract;

- (iv) a derivative contract; or
- (v) a specified investment;
- (b) any trading by it in a leveraged foreign exchange contract;  
or
- (c) its entering into any –
  - (i) foreign exchange agreement; or
  - (ii) interest rate swap agreement,

include in its liquid assets –

- (d) amounts receivable from Euroclear, Clearstream or Korea Securities Finance Corporation; and
- (e) cash deposited with Euroclear, Clearstream or Korea Securities Finance Corporation,

other than –

- (f) admission fees it has paid to Euroclear, Clearstream or Korea Securities Finance Corporation; and
- (g) cash it has deposited with Euroclear, Clearstream or Korea Securities Finance Corporation as security against its general obligations.

*[cf. s.14(4) FRR]*

(3) A licensed corporation shall include in its liquid assets, in respect of any dealing by it in futures contracts or options contracts or any trading by it in leveraged foreign exchange contracts –

- (a) amounts receivable from a futures or options clearing house other than a recognized clearing house; and
- (b) cash deposited with such clearing house,

other than –

- (c) admission fees it has paid to such clearing house; and
- (d) cash it has deposited with such clearing house as security against its general obligations.

*[new; cf. s.16(c)FRR & s.5(h) LFET FRR]*

**29. Amounts receivable from other dealers in respect of dealings in futures contracts and options contracts**

A licensed corporation shall include in its liquid assets, in respect of any dealing by it in futures contracts or options contracts or any trading by it in leveraged foreign exchange contracts –

- (a) amounts receivable from a licensed corporation licensed for Type 1 or Type 2 regulated activity or a clearing participant of a futures or options clearing house; and
- (b) cash deposited with that licensed corporation or that clearing participant,

other than –

- (c) admission fees it has paid to such licensed corporation or clearing participant; and
- (d) cash it has deposited with such licensed corporation or clearing participant as security against its general obligations.

*[cf. s.16(c)FRR & s.5(h) LFET FRR]*

**30. Amounts receivable from clients in respect of purchase of exchange-traded options contracts**

A licensed corporation shall include in its liquid assets any amount receivable from any of its clients, calculated on a transaction-by-transaction basis, where such amount receivable arises from the purchase of any options contract traded on a specified exchange and has been outstanding for 5 business days or less after the settlement date.

*[cf. s.16(d)FRR]*

**31. Exchange-traded options contracts trading  
for own account**

(1) Where a licensed corporation purchases for its own account any options contract traded on a specified exchange, it shall include in its liquid assets –

- (a) in the case where the options contract has been grouped with any other position held by the licensed corporation in –
  - (i) a futures contract; or
  - (ii) any other options contract,for the purpose of calculating a net amount of margin required to be deposited by it in respect of such positions, any amount receivable by it (other than any such amount receivable which has already been included in its liquid assets under section 28(1), (2) or (3) or 29) from –
  - (iii) a licensed corporation licensed for Type 1 or Type 2 regulated activity;
  - (iv) a futures or options clearing house; or
  - (v) a clearing participant of a futures or options clearing house,arising from such calculation; or
- (b) in any other case, subject to subsections (2) and (3) and sections 27(4), 40(7) and (8) and 43(6), an amount which equals 60% of the market value of such options contract.

*[cf. s.16(e)FRR]*

(2) Subject to subsection (4) and without prejudice to section 40(7), where a licensed corporation holds a long position in a stock futures contract and holds a put stock options contract, which is not subject to any margin requirement, in respect of the same underlying listed shares, to the extent that the number of shares underlying the futures contract is equal to the number of shares

underlying the options contract, subsection (1)(b) does not apply in respect of the options contract and section 40(4) does not apply in respect of the futures contract and it shall include in its liquid assets the options contract at market value.

*[cf. s.5(21) FRR]*

(3) Subject to subsection (4) and without prejudice to section 40(8), where a licensed corporation holds a short position in a stock futures contract and holds a call stock options contract, which is not subject to any margin requirement, in respect of the same underlying listed shares, to the extent that the number of shares underlying the futures contract is equal to the number of shares underlying the options contract, subsection (1)(b) does not apply in respect of the options contract and section 40(4) does not apply in respect of the futures contract and it shall include in its liquid assets the options contract at market value.

*[cf. s.5(22) FRR]*

(4) Subsections (2) and (3) do not apply in respect of a stock futures contract or a stock options contract which has been grouped with other positions for the purpose of calculating a net amount of margin required to be deposited by the licensed corporation.

*[cf. s.5(12)FRR]*

### **32. Amounts receivable under securities borrowing and lending agreements**

A licensed corporation which is the borrower of securities under a securities borrowing and lending agreement shall include in its liquid assets any amount receivable from the lender of the securities that it is deemed under section 15(1)(b) to have in respect of any cash provided by it as security to the lender.

*[cf. s.17(1)FRR]*

**33. Amounts receivable under repurchase transactions**

A licensed corporation which is the purchaser in the first instance of any securities under a repurchase transaction shall include in its liquid assets any amount receivable from the seller of the securities that it is deemed under section 16(1)(a) to have in respect of the consideration for which it purchased the securities.

*[cf. s.17(2)FRR]*

**34. Amounts receivable in respect of leveraged foreign exchange trading**

(1) A licensed corporation licensed for Type 3 regulated activity shall include in its liquid assets, in respect of any trading by it in leveraged foreign exchange contracts –

- (a) any amount receivable from a recognized counterparty;  
and
- (b) the amount of any cash deposited by it with the recognized counterparty.

*[cf. s.5(h) LFET FRR]*

(2) A licensed corporation licensed for Type 3 regulated activity shall include in its liquid assets the amount of any floating profits in respect of outstanding foreign exchange agreements and leveraged foreign exchange contracts to which it is a party.

*[cf. s.5(i) LFET FRR]*

**35. Miscellaneous assets**

A licensed corporation shall include in its liquid assets any of the following assets –

- (a) the amount of any fees, commissions, commission rebates and interest charges to which it is beneficially entitled



which arise from the carrying on by it of any regulated activity for which it is licensed and –

- (i) which have accrued and will first be due for billing or payment within the next 3 months; or
  - (ii) which have been billed or fallen due for payment and remain outstanding for one month or less after the date on which they were billed or fell due;
- (b) deposits which it beneficially owns and maintained with, and in accordance with the rules or requirements of, a recognized exchange company as security for its obligations or liabilities owed to the recognized exchange company for stamp duty chargeable under the Stamp Duty Ordinance (Cap. 117) on contract notes specified in an agreement under section 5A of that Ordinance;
- (c) prepaid operating expenses which will be incurred within the next 3 months;
- (d) tax reserve certificates issued by the Commissioner of Inland Revenue in accordance with the Tax Reserve Certificates Ordinance (Cap. 289) which it beneficially owns;
- (e) interest accrued to it under an interest rate swap agreement to which it is a party, other than interest which remains outstanding after it is first due for payment;
- (f) amounts paid by it for its own account for subscribing for –
- (i) listed shares or shares pending their being listed;
  - (ii) qualifying debt securities;
  - (iii) special debt securities;
  - (iv) specified securities,

less an amount equal to such amounts as multiplied by 50% of the haircut percentages in relation to such shares or securities;

- (g) dividends receivable on shares listed on a recognized stock market or on a specified exchange that are traded on an ex-dividend basis and which it beneficially owns;
- (h) interest accrued on qualifying debt securities or special debt securities that are traded on an ex-interest basis and which it beneficially owns.

*[cf. ss.15(b), (e), (f) & 18(a) & (c) – (f)FRR]*

## **Division 4 – Ranking liabilities**

### **36. Computation basis**

A licensed corporation shall, for the purposes of calculating its ranking liabilities under the provisions of this Division, apply the computation basis prescribed in Division 2.

*[cf. s.19 FRR & s.6(1) LFET FRR]*

### **37. Amounts payable to clients, etc.**

A licensed corporation shall include in its ranking liabilities any amount payable to any of its clients or any counterparty or clearing house which arises from the carrying on of any regulated activity for which it is licensed, other than

—

- (a) an amount payable to any of its clients in respect of client money held by it in a segregated account maintained with an authorized financial institution, an approved bank incorporated outside Hong Kong or a recognized clearing house; and

- (b) an amount payable to any of its clients which is set-off against an amount receivable from the client under section 21(3).

*[cf. s.20(1)(a) &(c), 21(a) &22(1)FRR and s.6(1)(a) LFET FRR]*

**38. Amounts payable in respect of dealing in securities**

A licensed corporation shall include in its ranking liabilities, in respect of a sale of securities –

- (a) by it for a client who is in default of his obligation to deliver the securities for –
  - (i) more than 2 weeks after the settlement date; or
  - (ii) (A) more than 5 business days but not more than 2 weeks after the settlement date; and
  - (B) the market value of the securities is more than 200% of the consideration for which they were sold; and
- (b) which it has not settled with securities purchased at its own expense,

the amount by which the market value of the securities exceeds the consideration for which they were sold.

*[cf. s.20(2)(3)FRR]*

**39. Amounts payable in respect of dealing in securities by common clients**

(1) A licensed corporation licensed for Type 1 regulated activity shall include in its ranking liabilities the net amount payable to each licensed corporation licensed for Type 8 regulated activity with which it has common clients, calculated as the amount by which the amount payable to each such second-mentioned licensed corporation exceeds the amount receivable by it from

such second-mentioned licensed corporation, where such amounts arise from any dealing in securities by it for any of those clients.

*[cf. s.20(1)(b)FRR]*

(2) A licensed corporation licensed for Type 8 regulated activity shall include in its ranking liabilities the net amount payable to each securities dealer with which it has common clients, calculated as the amount by which the amount payable to each such securities dealer exceeds the amount receivable by it from such securities dealer, where such amounts arise from any dealing in securities by such securities dealer for any of those clients.

*[s.21(b)FRR]*

**40. Futures contracts and options contracts dealing, etc.**

(1) Subject to subsection (2), a licensed corporation shall include in its ranking liabilities, in respect of –

- (a) any dealing by it in any futures contract;
- (b) any options contract written by it; or
- (c) any futures contract or options contract cleared by it,

for another person, the amount, when calculated on an account-by-account basis, by which the aggregate of the amount of margin required to be deposited with it by the person and the amount of any floating losses incurred by the person on the contract less the amount of any floating profits made by the person on the contract exceeds the aggregate of –

- (d) the amount of cash deposited with it by the person as security;
- (e) the market value of collateral, less the haircut amounts in relation to the collateral, deposited with it by the person;
- (f) the market value of specified investments, less the haircut amounts in relation to such investments, deposited with it by the person as security; and

- (g) the maximum amount that it can draw under a bank guarantee provided to it by the person as security and issued by an authorized financial institution or an approved bank incorporated outside Hong Kong.

*[cf. s.22(2) FRR]*

(2) Subsection (1) does not apply to a licensed corporation on the day or days on which it is allowed, under the rules or conventions of the exchange that operates the market on which the futures contract or options contract is traded, not to collect from the other person the margin required to be deposited by the other person in respect of the futures contract or options contract.

*[cf. ss.22(6)FRR]*

(3) Subject to subsections (5), (6) and (9) and sections 27(2) and 43(5), a licensed corporation shall include in its ranking liabilities the market value of any options contract written by it for its own account and traded on a specified exchange, to the extent that the market value of the options contract exceeds the amount of margin required to be deposited by it in respect of the options contract.

*[cf. s.22(3)FRR]*

(4) Subject to subsections (5), (6), (7), (8) and (9) and sections 27(2) and (3), 31(2) and (3) and 43(4) and (5), a licensed corporation shall include in its ranking liabilities the amount of margin required to be deposited by it in respect of –

- (a) any futures contract which is traded by it for its own account; and
- (b) any options contract which is purchased or written by it for its own account and traded on a specified exchange.

*[cf. s.22(4)FRR]*

(5) Subject to subsection (10), where a licensed corporation borrows any listed shares under a securities borrowing and lending agreement for the purpose of depositing them to cover a call stock options contract written by it, to

the extent that the number of shares underlying the options contract is equal to the number of such shares, it may elect not to apply subsections (3) and (4) in respect of the options contract and not to apply section 45(1) in respect of the securities borrowing and lending agreement, whereupon it shall include in its ranking liabilities an amount in the aggregate of the in-the-money amount of the options contract and the higher of –

- (a) the haircut amount in relation to such shares; and
- (b) the amount that would, but for this subsection, be required to be included in its ranking liabilities under section 45(1).

*[cf. s.5(16)FRR]*

(6) Subject to subsection (10), where a licensed corporation holds a long position in a stock futures contract and writes a call stock options contract in respect of the same underlying listed shares, to the extent that the number of shares underlying the futures contract is equal to the number of shares underlying the options contract, subsections (3) and (4) do not apply in respect of the futures contract and the options contract and it shall include in its ranking liabilities an amount which is the higher of –

- (a) the amount of margin required to be deposited by it in respect of the futures contract; and
- (b) the in-the-money amount of the options contract.

*[cf. s.5(20)FRR]*

(7) Subject to subsection (10) and without prejudice to section 31(2), where a licensed corporation holds a long position in a stock futures contract and holds a put stock options contract, which is not subject to any margin requirement, in respect of the same underlying listed shares, to the extent that the number of shares underlying the futures contract is equal to the number of shares underlying the options contract, subsection (4) does not apply in respect of the futures contract and section 31(1)(b) does not apply in respect of the options contract and, if the options contract is out-of-the-money, it shall include in its ranking liabilities the lower of –

- (a) the amount of margin required to be deposited by it in respect of the futures contract; and
- (b) the out-of-the-money amount of the options contract.

*[cf. s.5(21)FRR]*

(8) Subject to subsection (10) and without prejudice to section 31(3), where a licensed corporation holds a short position in a stock futures contract and holds a call stock options contract, which is not subject to any margin requirement, in respect of the same underlying listed shares, to the extent that the number of shares underlying the futures contract is equal to the number of shares underlying the options contract, subsection (4) does not apply in respect of the futures contract and section 31(1)(b) does not apply in respect of the options contract and, if the options contract is out-of-the-money, it shall include in its ranking liabilities the lower of –

- (a) the amount of margin required to be deposited by it in respect of the futures contract; and
- (b) the out-of-the-money amount of the options contract.

*[cf. s.5(22) FRR]*

(9) Subject to subsection (10), where a licensed corporation holds a short position in a stock futures contract and writes a put stock options contract in respect of the same underlying listed shares, to the extent that the number of shares underlying the futures contract is equal to the number of shares underlying the options contract, subsections (3) and (4) do not apply in respect of the futures contract and the options contract and it shall include in its ranking liabilities an amount which is the higher of –

- (a) the amount of margin required to be deposited by it in respect of the futures contract; and
- (b) the in-the-money amount of the options contract.

*[cf. s.5(23)FRR]*

(10) Subsections (5), (6), (7), (8) and (9) do not apply in respect of a stock futures contract or a stock options contract which has been grouped with

other positions for the purpose of calculating a net amount of margin required to be deposited by the licensed corporation.

*[cf. s.5(12)FRR]*

(11) A licensed corporation shall include in its ranking liabilities, in respect of any options contract (other than a put options contract) which is written by it for its own account and traded other than on a specified exchange or not exchange traded, an amount which is the highest of –

- (a) 200% of the market value of the options contract;
- (b) 200% of the in-the-money amount of the options contract;  
and
- (c) 200% of the amount of margin required to be deposited by it.

(12) A licensed corporation shall include in its ranking liabilities, in respect of any put options contract which is written by it for its own account and traded other than on a specified exchange or not exchange traded, an amount, not exceeding the value of the assets underlying the options contract stated at the strike price of the options contract, which is the highest of –

- (a) 200% of the market value of the options contract;
- (b) 200% of the in-the-money amount of the options contract;  
and
- (c) 200% of the amount of margin required to be deposited by it.

*[cf. s.22(5)FRR]*

**41. Leveraged foreign exchange trading**

(1) A licensed corporation licensed for Type 3 regulated activity shall include in its ranking liabilities –

- (a) in respect of all outstanding leveraged foreign exchange contracts which it has with any of its clients, the excess,



when calculated on a client-by-client basis, of the amount by which the aggregate of –

- (i) 3% of the aggregate of the amount of the gross principal values of the contracts;
- (ii) the amount of any floating losses incurred by, and due from, the client on the contracts; and
- (iii) the amount of any accrued interest, fees and commissions receivable from the client in respect of any such contracts,

exceeds the aggregate of –

- (iv) 100% of the amount of cash in the Hong Kong currency (or any currency linked to the Hong Kong currency) deposited with it as security by the client;
- (v) 95% of the amount of cash in such foreign currency as may be approved under section 58(5)(f) deposited with it as security by the client;
- (vi) 95% of the amount of any time deposit in the Hong Kong currency (or currency linked to the Hong Kong currency) which –
  - (A) is placed with a local branch or the principal place of business in Hong Kong of an authorized financial institution;
  - (B) will become payable within 6 months; and
  - (C) has been assigned to it by the client;
- (vii) the market value of collateral, less the haircut amounts in relation to such collateral, deposited with it by the client;
- (viii) the amount of any floating profits made by, and due to, the client on the contracts;

- (ix) 90% of the maximum amount that it can draw under a letter of credit issued in favour of it as security by an authorized financial institution or an approved bank incorporated outside Hong Kong; and
- (x) the amount of any accrued interest payable to the client in respect of any such contracts; and

*[cf. LFET FRR s.6(1)(b)& (2)]*

- (b) the amount of any floating losses incurred by it on any outstanding foreign exchange agreements and outstanding leveraged foreign exchange contracts to which it is a party.

*[cf. s.6(1)(c) LFET FRR]*

(2) Where a licensed corporation holds with any of its clients (other than a client whose account with the licensed corporation is an omnibus account) any outstanding leveraged foreign exchange contracts, for the purposes of calculating the aggregate of the amount of the gross principal values of the outstanding contracts, it may elect not to include in such aggregate the gross principal values of any 2 outstanding contracts where –

- (a) under one of the contracts it is obliged to purchase an amount in a currency (“A”) and sell an amount (“X”) in another currency (“B”); and
- (b) under the other contract it is obliged to purchase the same amount (“X”) in the other currency (“B”) and sell an amount of the first-mentioned currency (“A”),

whereupon it shall include in the aggregate the highest of the equivalent amount in its reporting currency of –

- (c) the amount “X” of currency “B”;
- (d) the amount of currency “A” which it is obliged to purchase under the contract referred to in paragraph (a); and

- (e) the amount of currency “A” which it is obliged to sell under the contract referred to in paragraph (b).

*[new]*

(3) In this section, “gross principal value” (本金總額), in relation to an outstanding leveraged foreign exchange contract, means the higher of the equivalent amounts in the reporting currency of the licensed corporation of the 2 amounts of currencies that the contract is intended to exchange.

*[new]*

#### **42. Provision of securities margin financing**

(1) A licensed corporation licensed for Type 1 or Type 8 regulated activity shall include in its ranking liabilities the amount, when calculated on a client-by-client basis, by which –

- (a) any amount receivable from any of its margin clients; or  
(b) in the case of a group of related margin clients, the aggregate of amounts receivable from the group,

included in its liquid assets under section 22(1), exceeds 10% of the aggregate of amounts receivable from its margin clients included in its liquid assets in accordance with that section.

*[cf. s.23 FRR]*

(2) Where a licensed corporation licensed for Type 1 or Type 8 regulated activity obtains any financial accommodation wholly or partly secured by collateral provided by any of its margin clients, it shall include in its ranking liabilities the amount by which such financial accommodation exceeds 65% of the aggregate of amounts receivable from its margin clients arising from the provision of securities margin financing.

*[new, cf. s.3(b) Financial Resources (Amendment) Rules 2002]*

(3) In subsection (1), “group of related margin clients” (一組關連保證金客戶) means any 2 or more margin clients of a licensed corporation licensed for Type 1 or Type 8 regulated activity and –

- (a) where it is a group of 2 margin clients, one is the spouse of the other;
- (b) where one or more of the margin clients are corporations, one is in control, either alone or with his spouse, of 35% or more of the voting rights of that other margin client or each of the other margin clients (as the case may be); or
- (c) where the margin clients are corporations, they are members of the same group of companies.

*[cf. s.2 FRR]*

**43. Short positions in securities (other than options contracts) and specified investments**

(1) Subject to subsections (2), (3), (6), (8) and (9) and section 27(6) and (7), a licensed corporation which holds for its own account a short position in securities (other than options contracts) or specified investments, whether by short selling or otherwise, shall include in its ranking liabilities the market value of those securities or specified investments.

*[cf. s.24(1) FRR]*

(2) Subject to subsection (3), a licensed corporation which holds for its own account a short position, whether by short selling or otherwise, in –

- (a) subject to subsections (4), (5) and (6) and section 45(5), listed shares;
- (b) qualifying debt securities;
- (c) special debt securities;
- (d) subject to subsections (8) and (9) and section 27(6) and (7), specified securities; or
- (e) specified investments,

shall increase the amount required to be included in its ranking liabilities under subsection (1) by the haircut amounts in relation thereto.

*[cf. s.24(2) FRR]*

(3) Subject to subsections (4), (5), (6), (8) and (9) and sections 27(6) and (7) and 45(5), a licensed corporation which holds for its own account a short position in securities or specified investments, whether by short selling or otherwise, which –

- (a) are not of a type specified in Schedule 2;
- (b) constitute more than 5% by market value of all securities of the same description issued by a particular corporation;  
or
- (c) are listed shares or listed warrants which have been suspended from trading for at least 3 business days or ceased trading on any exchange on which the securities were listed, unless the securities can continue to be traded on any other exchange on which the securities are listed,

shall increase the amount required to be included in its ranking liabilities under subsection (1) by the market value of such securities or specified investments.

*[cf. s.24(3) FRR]*

(4) Subject to subsection (7), where a licensed corporation short sells any listed shares and holds a long position in a stock futures contract in respect of such shares, to the extent that the number of shares underlying the futures contract is equal to the number of shares short sold by it, subsections (2) and (3) do not apply in respect of the shares short sold and section 40(4) does not apply in respect of the futures contract.

*[cf. s.5(17) FRR]*

(5) Subject to subsection (7), where a licensed corporation short sells any listed shares and writes a put stock options contract in respect of such shares, to the extent that the number of shares underlying the options contract is equal to the number of shares short sold by it, subsections (2) and (3) do not apply in respect of the shares short sold and section 40(3) and (4) does not apply in respect of the options contract and it shall include in its ranking liabilities the higher of –

- (a) the increased amount that would, but for this subsection, arise under subsection (2) or (3); and
- (b) the in-the-money amount of the options contract.

*[cf. s.5(18) FRR]*

(6) Subject to subsection (7), where a licensed corporation short sells any listed shares and holds a call stock options contract, which is not subject to any margin requirement, in respect of such shares, to the extent that the number of shares underlying the options contract is equal to the number of shares short sold by it, it may elect not to apply subsections (1), (2) and (3) in respect of the shares short sold and not to apply section 31(1)(b) in respect of the options contract, whereupon it shall include in its ranking liabilities the lower of –

- (a) the aggregate of the market value of such shares sold short and the increased amount that would, but for this subsection, arise under subsection (2) or (3); and
- (b) the number of shares short sold multiplied by the strike price of the options contract.

*[cf. s.5(19) FRR]*

(7) Subsections (4), (5) and (6) do not apply in respect of a stock futures contract or a stock options contract which has been grouped with other positions for the purpose of calculating a net amount of margin required to be deposited by the licensed corporation.

*[cf. s.5(12) FRR]*

(8) A licensed corporation which is the issuer of any call non-collateralized warrants issued on listed shares shall increase the amount included in its ranking liabilities under subsection (1) in respect of any outstanding call non-collateralized warrants so issued which it does not cover by holding the underlying shares, by the amount by which the haircut amount in relation to the underlying shares which are not so held exceeds the aggregate of the out-of-the-money amounts of the warrants.

*[cf. s.24(4) FRR]*

(9) A licensed corporation shall increase the amount included in its ranking liabilities under subsection (1) in respect of any outstanding non-collateralized warrants issued by it on any assets other than shares, by 30% of the market value of the assets underlying such warrants.

*[cf. s.24(5) FRR]*

(10) A licensed corporation shall include in its ranking liabilities, in respect of the short selling of securities for any of its clients, save where such securities have been delivered to it by the client or are not yet due for settlement according to the settlement date, the amount by which the aggregate of –

- (a) the market value of such securities; and
- (b) the haircut amount in relation to such securities,

exceeds the aggregate of –

- (c) the amount of cash deposited with it by the client and the amount of proceeds of sale of such securities withheld by it as security for delivery of securities by the client to the licensed corporation;
- (d) the maximum amount that it can draw under a bank guarantee provided to it by the client as security and issued by an authorized financial institution or an approved bank incorporated outside Hong Kong; and
- (e) the market value of any collateral deposited with it by the client, less the haircut amount in relation to such collateral.

*[cf. ss.24(6) and (7) FRR]*

#### **44. Concentrated proprietary positions**

- (1) Where a licensed corporation holds for its own account –
  - (a) listed shares;
  - (b) qualifying debt securities;
  - (c) special debt securities;
  - (d) specified securities; or

(e) specified investments,

and the net market value of any such securities or specified investments (as the case may be) which are of the same description equals 25% or more of its required liquid capital, it shall include in its ranking liabilities –

(f) where the net market value is 25% or more but less than 51% of its required liquid capital, 5% of such net market value; or

(g) where the net market value is 51% or more of its required liquid capital, 10% of such net market value.

*[cf. s.25 FRR]*

(2) In subsection (1), “net market value” (淨市值), in relation to any securities and any specified investments referred to in that subsection, means the market value that remains after netting each long and short position in securities and specified investments (as the case may be) of the same description.

*[new]*

#### **45. Securities borrowing and lending agreements**

(1) Subject to subsections (5) and (6) and section 40(5), a licensed corporation which is the borrower of securities under a securities borrowing and lending agreement shall include in its ranking liabilities the amount by which the aggregate of –

(a) the amount of cash deposited by it with the lender under the agreement as security; and

(b) the market value of collateral provided by it to the lender, less the haircut amount in relation to such collateral,

exceeds –

(c) in the case where the securities are –

(i) shares listed on a specified exchange;

(ii) qualifying debt securities; or



- (iii) special debt securities,  
110% of their market value; or
- (d) in any other case, 50% of the market value of the securities.

*[cf. s.26(1) FRR]*

(2) Subject to subsection (6), a licensed corporation which, under a securities borrowing and lending agreement, is the lender of securities which are included in its liquid assets under section 27, shall include in its ranking liabilities the amount by which the market value of the securities, less the haircut amount in relation to such securities, exceeds the aggregate of –

- (a) the maximum amount that it can draw under a bank guarantee provided to it as security by the borrower under the agreement and issued by an authorized financial institution or an approved bank incorporated outside Hong Kong;
- (b) the amount of cash deposited with it by the borrower as security;
- (c) the market value of –
  - (i) any shares listed on a specified exchange;
  - (ii) any qualifying debt securities; and
  - (iii) any special debt securities,  
deposited with it by the borrower as collateral, less the haircut amount in relation to such collateral; and
- (d) 50% of the market value of any collateral, other than collateral referred to in paragraph (c), deposited with it by the borrower.

*[cf. s.26(2) FRR]*

(3) Subject to subsection (6), a licensed corporation which, under a securities borrowing and lending agreement, is the lender of any securities as agent for another person, or where the securities are borrowed by it under

another securities borrowing and lending agreement, shall include in its ranking liabilities the amount by which the market value of the securities exceeds the aggregate of –

- (a) the maximum amount that it can draw under a bank guarantee provided to it as security by the borrower under the agreement and issued by an authorized financial institution or an approved bank incorporated outside Hong Kong;
- (b) the amount of cash deposited with it by the borrower as security;
- (c) the market value of –
  - (i) any shares listed on a specified exchange;
  - (ii) any qualifying debt securities; and
  - (iii) any special debt securities, deposited with it by the borrower as collateral, less the haircut amount in relation to such collateral; and
- (d) 50% of the market value of any collateral, other than collateral referred to in paragraph (c), deposited with it by the borrower.

*[s.26(3) FRR]*

(4) A licensed corporation which is the lender of securities under a securities borrowing and lending agreement shall include in its ranking liabilities the amount payable to the borrower under the agreement in respect of any cash deposited with it by the borrower as security, save where the cash –

- (a) is held in a segregated account; and
- (b) is not included in its liquid assets under section 20.

*[new]*

(5) Where a licensed corporation borrows listed shares under a securities borrowing and lending agreement for the purpose of short selling for its own account, to the extent that the number of shares borrowed is equal to the

number of shares short sold by it, subsection (1) does not apply in respect of the agreement and section 43(2) and (3) does not apply in respect of the shares short sold and it shall include in its ranking liabilities the amount which is the higher of –

- (a) the amount that would arise under subsection (1); and
- (b) the increased amount that would arise under section 43(2) or (3),

but for this subsection.

*[cf. s.5(9) FRR]*

(6) Subsections (1), (2) and (3) do not apply in respect of a securities borrowing and lending agreement to which a licensed corporation is a party, where the other party to the agreement is an approved securities borrowing and lending counterparty.

*[cf. s.26(1)& (2) FRR]*

#### **46. Repurchase transactions**

(1) A licensed corporation which is the purchaser in the first instance of any securities in a repurchase transaction shall include in its ranking liabilities the amount by which the amount included in its liquid assets under section 33 exceeds –

- (a) in the case where the securities are –
  - (i) shares listed on a specified exchange;
  - (ii) qualifying debt securities; or
  - (iii) special debt securities,  
110% of their market value; or
- (b) in any other case, 50% of the market value of the securities.

*[cf. s.26(1) FRR]*

(2) A licensed corporation which is the seller in the first instance of any securities in a repurchase transaction shall include in its ranking liabilities

the amount by which the market value of the securities, less the haircut amount in relation to the securities, exceeds the aggregate of –

- (a) the maximum amount that it can draw under a bank guarantee provided to it as security by the purchaser of the securities and issued by an authorized financial institution or an approved bank incorporated outside Hong Kong;
- (b) the amount of proceeds of sale of such securities received by it from the purchaser;
- (c) the market value of –
  - (i) any shares listed on a specified exchange;
  - (ii) any qualifying debt securities; and
  - (iii) any special debt securities, deposited with it by the purchaser as collateral, less the haircut amount in relation to such collateral; and
- (d) 50% of the market value of any collateral, other than collateral referred to in paragraph (c), deposited with it by the purchaser.

*[s.26(2) FRR]*

(3) A licensed corporation which is the seller in the first instance of any securities in a repurchase transaction shall include in its ranking liabilities the amount of the consideration for which it sold the securities.

*[cf. s.30(1)(e) FRR]*

#### **47. Net underwriting commitments**

(1) Subject to subsection (2), a licensed corporation which underwrites or sub-underwrites an issue or a sale of securities shall include in its ranking liabilities –

- (a) in the case of a rights issue –

- (i) where the market price of the securities is less than or equal to their subscription price, the aggregate of –
  - (A) 50% of the haircut percentage in relation to the securities multiplied by the net underwriting commitment; and
  - (B) the amount by which the net underwriting commitment exceeds the market value of the securities; or
- (ii) where the market price of the securities is greater than their subscription price, 5% of the haircut percentage in relation to the securities multiplied by the net underwriting commitment; or
- (b) in any other case, 50% of the haircut percentage in relation to the securities multiplied by the net underwriting commitment.

*[cf. s.28(1) FRR]*

(2) This section does not apply to a licensed corporation on the day on which it acquires an underwriting or a sub-underwriting commitment in respect of an issue or a sale of securities and the business day following that day.

*[cf. s.28(3) FRR]*

(3) For the purposes of subsection (2), a licensed corporation acquires an underwriting or a sub-underwriting commitment in respect of an issue or a sale of securities at the later of –

- (a) the time when it commits itself to underwrite or sub-underwrite the securities; and
- (b) the time when the lead underwriter or co-lead underwriter signs the underwriting agreement with the issuer or the seller (as the case may be) of the securities.

*[cf. s.28(2) FRR]*

(4) In subsection (1), “net underwriting commitment” (包銷承擔淨額) means the total costs of subscribing for or purchasing securities underwritten or sub-underwritten by a licensed corporation other than –

- (a) securities which are sub-underwritten; and
- (b) securities which are the subject of a legally binding contract for the subscription for or purchase of such securities,

through or from that licensed corporation by another person.

*[cf. s.2 FRR]*

#### **48. Off-exchange traded derivative contracts**

(1) Subject to subsection (2), a licensed corporation shall include in its ranking liabilities the amount of any floating losses incurred by it in respect of any position in any off-exchange traded derivative contract.

*[cf. s.29(1) FRR]*

(2) Where a licensed corporation has entered into a bilateral netting agreement in respect of 2 or more off-exchange traded derivative contracts with the counterparty with whom it maintains the positions, it shall include in its ranking liabilities the amount by which the amount of any floating losses incurred by it exceeds the amount of any floating profits made by it in respect of the contracts.

*[cf. s.29(1) FRR]*

(3) In subsection (2), “bilateral netting agreement” (雙邊淨額結算協議) means an agreement between the licensed corporation and the counterparty with whom it maintains positions in off-exchange traded derivative contracts under which each party has a single obligation to the other in respect of all such contracts covered by the agreement and which provides that, in the event that the counterparty fails to comply with its obligation under the agreement, the licensed corporation will have –

- (a) a single claim to receive only the net amount of the aggregate positive mark-to-market value of any contract covered by the agreement, calculated by deducting from the aggregate positive mark-to-market value of any contract covered by the agreement the aggregate negative mark-to-market value of any other contract covered by the agreement; or
- (b) a single obligation to pay only the net amount of the aggregate negative mark-to-market value of any contract covered by the agreement, calculated by deducting from the aggregate negative mark-to-market value of any contract covered by the agreement the aggregate positive mark-to-market value of any other contract covered by the agreement.

*[new]*

#### **49. Interest rate swap agreements**

(1) A licensed corporation which is a party to an interest rate swap agreement shall include in its ranking liabilities the notional principal amount multiplied by the percentage specified in column 3 of Table 1 in Schedule 4 opposite the description of the remaining term to maturity in column 2 of the Table which is applicable to the agreement.

*[cf. s.29(2) FRR]*

(2) In subsection (1), “notional principal amount” (名義本金額) means the theoretical amount agreed upon by the parties to an interest rate swap agreement on the basis of which any interest payment to be made under the agreement is calculated.

*[new]*

## 50. Foreign exchange agreements

A licensed corporation which is a party to a foreign exchange agreement shall include in its ranking liabilities the amount of currency to be delivered by it under the agreement multiplied by the percentage specified in column 3 of Table 2 in Schedule 4 opposite the description of the counterparty and the remaining term to maturity in column 2 of the Table which is applicable to the agreement.

*[cf. s.29(3) FRR]*

## 51. Introduction of transactions

(1) Subject to subsection (2), where a licensed corporation introduces transactions which involve –

- (a) a dealing in any securities;
- (b) a dealing in a futures contract or an options contract; or
- (c) a trading in a leveraged foreign exchange contract,

to another person for execution or clearing on behalf of any of its clients and –

- (d) it does not include the amount receivable by it or payable to it in respect of any such transaction in the calculation of its liquid capital under this Part; and
- (e) there is neither express agreement nor a clear market practice that exempts it from any liability to the client or the other person in relation to such transaction,

it shall include in its ranking liabilities the amount by which its required liquid capital would have been increased had one or more of the following amounts been included in the calculation of its variable required liquid capital (as if the transaction had been executed or cleared by it) –

- (f) (where the transaction introduced is a dealing in securities and the transaction has not been fully settled by the client or the other person (as the case may be)) the total value of the transaction entered into as a result of the introduction;



- (g) (where the transaction introduced is a dealing in a futures contract or an options contract) the total amount of margin required to be deposited in respect of the futures contract or the options contract entered into as a result of the introduction which remains outstanding;
- (h) (where the transaction introduced is a trading in a leveraged foreign exchange contract) the aggregate gross foreign currency position arising from the leveraged foreign exchange contract entered into as a result of the introduction which remains outstanding.

*[cf. s.27 FRR]*

- (2) Subsection (1) does not apply where –
  - (a) the person to whom the transaction is introduced is a member of a group of companies of which the licensed corporation is a member;
  - (b) the person to whom the transaction is introduced has entered into an agreement with the client for providing the execution or clearing service to the client and is contractually liable to the client for any default in the execution or clearing of the transaction; and
  - (c) the licensed corporation is not liable to the client for execution or clearing of such transactions or default by the person to whom the transaction is introduced.

*[cf. S.27 FRR]*

## **52. Miscellaneous**

- (1) A licensed corporation shall include in its ranking liabilities –
  - (a) 10% of the amount of any guarantee, indemnity or other similar financial commitment provided by it, directly or indirectly (including the pledging of assets for the purpose

of obtaining a bank guarantee), other than a guarantee, an indemnity and other financial commitment provided by it in respect of its own liabilities and obligations;

*[cf. s.31(1)(a)(i) - (iv) FRR]*

- (b) the amount by which the liabilities of any subsidiary of it (excluding any amounts due to it from the subsidiary) exceed the assets of the subsidiary;

*[cf. s.31(1)(b) FRR]*

- (c) the consideration it is obliged to pay for the redemption of redeemable shares, other than approved redeemable shares, which have not yet been redeemed;

*[cf. s.31(1)(c) FRR]*

- (d) subject to subsection (2), 5% of its net position in each foreign currency; and

*[cf. s.31(1)(d) FRR]*

- (e) where it is the underwriter of a note issuance and revolving underwriting facility, the maximum amount that can be drawn down by the issuer under the facility by issuing notes less the amount that has been drawn down by the issuer by issuing and placing notes multiplied by the percentage specified in column 3 of Schedule 5 opposite the description of the remaining term to maturity in column 2 of the Schedule which is applicable to the facility.

*[cf. s.31(1)(e) FRR]*

(2) In calculating the net position in a foreign currency for the purposes of subsection (1)(d), a licensed corporation may elect to exclude from the calculation the value of any asset which is denominated in that foreign currency and not included in its liquid assets under any provision in Division 3.

*[cf. s.31(2) FRR]*

(3) In this section, “net position” (淨持倉量), in relation to a foreign currency, means the difference between –

- (a) the aggregate of the value of assets, other than fixed assets, beneficially owned by a licensed corporation which are denominated in the foreign currency together with the amount of the foreign currency which it is obliged to purchase under any outstanding contract; and
- (b) the aggregate of the amount of the on-balance sheet liabilities of the licensed corporation, other than excluded liabilities, which are denominated in such foreign currency together with the amount of such foreign currency which it is obliged to sell under any outstanding contract.

*[cf. s.6(3)(a) LFET FRR]*

**53. Other liabilities**

(1) Subject to subsection (2), a licensed corporation shall include in its ranking liabilities all its liabilities not otherwise required to be included in its ranking liabilities under any other provision of this Division, including –

- (a) any amount payable by it in relation to any overdraft obtained by it;
- (b) any amount payable by it in relation to any loan obtained by it;
- (c) any accrued interest payable by it to any other person;
- (d) any accrued expenses incurred by it;
- (e) any tax payable by it, less any tax prepaid by it, to the extent that the tax payable and the tax prepaid are of the same description and levied by the same taxation authority;
- (f) any provision made by it for contingent liabilities;

- (g) any provision made by it for floating losses in respect of open positions held for its own account; and
- (h) any other liabilities provided for in accordance with generally accepted accounting principles.

*[cf. s.30(1)(a)- (d) & (f) FRR].*

- (2) A licensed corporation shall not include in its ranking liabilities –
  - (a) any approved subordinated loan provided to it; or
  - (b) any liability that it is not required to settle within the next 12 months and is secured by a first legal charge on immovable property beneficially owned by it and used in carrying on the regulated activity for which it is licensed, to the extent that the net realizable value of that property equals such liability.

*[cf. s.30(2) FRR]*

PART 5

MISCELLANEOUS

**54. Licensed corporations to notify Commission of failure to comply with these Rules**

- (1) Where a licensed corporation notifies the Commission –
  - (a) under section 146(1) of the Ordinance that it is unable to maintain, or to ascertain whether it maintains, financial resources in accordance with the specified amount requirements that apply to it; or
  - (b) under section 146(3) of the Ordinance that it is unable to comply with, or to ascertain whether it complies with, all or any of the requirements of these Rules, other than the specified amount requirements,

it shall include in the notice –

- (c) full details of the matter and the reason therefor; and
- (d) full details of any steps it is taking, has taken or proposes to take to redress the inability.

*[new; cf. s.33(1)(a) & (d) FRR, s.10(a)& (c) LFET FRR]*

(2) The Commission may, where a licensed corporation gives notice to the Commission under section 146(1) and (3) of the Ordinance, request the licensed corporation to provide, in such form and within such time as the Commission may specify, such additional information and document as the Commission may require in connection with the matter, whereupon the licensed corporation shall comply with the request accordingly.

*[new]*

(3) For the purposes of this section and section 144 of the Ordinance, “specified amount requirements” (指明數額規定), in relation to a licensed corporation, means the applicable requirements specified in section 4 and –

- (a) the requirement to maintain paid-up share capital in the amount required under section 5; and
- (b) the requirement to maintain liquid capital not less than its required liquid capital under section 6.

*[new]*

**55. Licensed corporations to notify Commission of circumstances relating to financial resources and trading activities and to submit returns in certain cases**

(1) A licensed corporation shall notify the Commission in writing as soon as reasonably practicable and in any event within one business day of becoming aware of any of the following matters –

- (a) its liquid capital falls below 120% of its required liquid capital;

*[cf. s33(1)(b) FRR & s.10(b) LFET FRR]*

- (b) a required liquid capital deficit occurs, but the licensed corporation is regarded as having complied with section 6(1) by virtue of section 6(3);

*[cf. s.33(1)(c) FRR]*

- (c) its liquid capital falls below 50% of the liquid capital stated in its last return submitted to the Commission under section 56(1) or (3);

*[cf. s.33(1)(e) FRR & s.10(d) LFET FRR]*

- (d) any information contained in any of its previous returns submitted to the Commission pursuant to these Rules has become false or misleading in a material particular;

*[cf. s.33(1)(f) FRR, s.10(g) LFET FRR]*

- (e) the aggregate of the amounts it has drawn down on any loan, advance, credit facility or other financial accommodation provided to it by banks exceeds the aggregate of the credit limits thereof;

*[cf. s.33(1)(g) FRR]*

- (f) it has been or will be unable, for 3 consecutive business days, to meet in whole or in part any calls or demands for payment or repayment (as the case may be), from any of its lenders, credit providers or financial accommodation providers;

*[cf. s.33(1)(h) FRR]*

- (g) any of its lenders or any person who has provided credit or financial accommodation to it has exercised, or has informed it that he will exercise, the right to liquidate security provided by it to him in order to reduce its liability or indebtedness to him under any outstanding loan, advance, credit facility balance or other financial accommodation provided to it by him;

*[cf. s.33(1)(i) FRR]*

- (h) where it provides securities margin financing –
  - (i) it is required to include an amount in its ranking liabilities under section 42(1); or
  - (ii) the concentration discounting factor of any listed share or listed warrant received from its margin clients as collateral –
    - (A) falls below one;
    - (B) has dropped by 0.1 or more compared to the concentration discounting factor on that share or warrant as previously reported to the Commission; or
    - (C) is less than one in respect of that share or warrant if this is the first time a concentration discounting factor less than one arises in relation to that share or warrant;

*[cf. s.33(2)FRR]*

- (i) the aggregate of the maximum amounts that can be drawn down against it under any guarantee, indemnity or any other similar financial commitment provided by it –
  - (i) exceeds \$5,000,000; or
  - (ii) would, if deducted from its liquid capital, cause its liquid capital to fall below 120% of its required liquid capital;

*[cf. s.33(5)(a) FRR]*

- (j) the aggregate of amounts of any outstanding claim made in writing by it or against it (whether disputed or not) exceeds or is likely to exceed \$5,000,000;

*[cf. s.33(5)(b) FRR]*

- (k) the aggregate of amounts of any outstanding claim made in writing by it or against it (whether disputed or not) would, if deducted from its liquid capital, cause its liquid capital to fall below 120% of its required liquid capital;

*[cf. s.33(5)(b) FRR]*

- (l) any claim is made by it under any professional indemnity or other insurance policy that it is required to maintain under the Securities and Futures (Insurance) Rules (L.N. \_\_\_\_\_ of 2002) or the rules or conventions of any exchange or clearing house;

*[cf. s.33(5)(c) FRR]*

- (m) any financial commitment, including a guarantee, is provided for it in favour of an exchange or a clearing house, by a corporation which is a member of a group of companies of which it is a member.

*[cf. s.33(5)(d) FRR]*

(2) Where a licensed corporation notifies the Commission of any matter under subsection (1), it shall –

- (a) include in the notice full details of the matter and the reason therefor;
- (b) in the case of a notification under subsection (1)(a), (b), (c), (d), (e), (f) or (g), include in the notice full details of any steps it is taking, has taken or proposes to take to prevent its liquid capital from falling below its required liquid capital or to improve its liquidity;
- (c) in the case of a notification under subsection (1)(h)(i), submit the returns specified in section 56(1)(m), stated as at the date the matter notified arose; and



- (d) in the case of a notification under subsection (1)(h)(ii), submit the returns specified in section 56(1)(n), stated as at the date the matter notified arose.

*[cf. s.33(1) FRR]*

(3) Where a licensed corporation has, prior to the commencement of these Rules entered into any position in an off-exchange traded derivative contract other than –

- (a) an options contract written by it on its own account;
- (b) an interest rate swap agreement; and
- (c) a foreign exchange agreement,

of which it has not notified the Commission prior to the commencement of these Rules, it shall within one business day of the commencement of these Rules notify the Commission in writing of the details of such position.

*[cf. s.33(3) FRR]*

(4) Where a licensed corporation intends to enter into any position in an off-exchange traded derivative contract other than –

- (a) an options contract written by it on its own account;
- (b) an interest rate swap agreement; and
- (c) a foreign exchange agreement,

it shall notify the Commission in writing of the details of the position it intends to enter into at least 10 business days before entering into the position.

*[cf. s.33(4) FRR]*

(5) Where a licensed corporation intends to change any of its accounting principles in a way that may materially affect the liquid capital or paid-up share capital that it maintains or is required to maintain under Part 3, for the purposes of section 3(2), it shall notify the Commission in writing of the details of, and the reasons for, the intended change not less than 5 business days prior to effecting the change.

*[cf. s. 32(1) FRR]*

**56. Licensed corporations to submit returns to Commission**

(1) Subject to subsection (4), a licensed corporation licensed for one or more of the following –

- (a) Type 1 regulated activity;
- (b) Type 2 regulated activity;
- (c) Type 3 regulated activity;
- (d) Type 4 regulated activity, and it is not subject to the specified licensing condition;
- (e) Type 5 regulated activity, and it is not subject to the specified licensing condition;
- (f) Type 6 regulated activity, and it is not subject to the specified licensing condition;
- (g) Type 7 regulated activity;
- (h) Type 8 regulated activity;
- (i) Type 9 regulated activity, and it is not subject to the specified licensing condition,

shall, in respect of each month at the end of which it remains licensed, submit to the Commission in the manner specified in subsections (5) and (6)(d), (e) or (f) (as the case may be), no later than 3 weeks after the end of the month concerned, a return, in the form specified by the Commission under section 402 of the Ordinance, which includes –

- (j) its liquid capital computation, as at the end of the month;
- (k) its required liquid capital computation, as at the end of the month;
- (l) a summary of bank loans, advances, credit facilities and other financial accommodation available to it, as at the end of the month;
- (m) an analysis of its margin clients, as at the end of the month;

- (n) an analysis of collateral received from its margin clients, as at the end of the month;
- (o) an analysis of its rolling balance cash clients, as at the end of the month;
- (p) an analysis of its profit and loss account;
- (q) an analysis of its client assets, as at the end of the month; and
- (r) where it is licensed for Type 3 regulated activity, an analysis of its foreign currency positions, as at the end of the month.

*[cf. s.35(1) FRR & s.11 LFET FRR]*

(2) Subject to subsection (4), a licensed corporation to which subsection (1) applies shall, in respect of each period of 3 months at the end of which it remains licensed, being such period in a year ending at the end of the month of March, June, September or December, respectively, submit to the Commission in the manner specified in subsections (5) and (6)(d), (e) or (f) (as the case may be), no later than 3 weeks after the end of the period concerned, a return, in the form specified by the Commission under section 402 of the Ordinance, which includes –

- (a) an analysis of its clientele, as at the end of the 3 month period;
- (b) an analysis of its proprietary derivative positions, as at the end of the 3 month period;
- (c) where it is licensed for Type 3 regulated activity, an analysis of its recognized counterparties, as at the end of the 3 month period; and
- (d) where it is licensed for Type 9 regulated activity, an analysis of the assets under its management, as at the end of the 3 month period.

[new]

(3) Subject to subsection (4), a licensed corporation which is licensed solely for one or more of the following –

- (a) Type 4 regulated activity;
- (b) Type 5 regulated activity;
- (c) Type 6 regulated activity;
- (d) Type 9 regulated activity,

and subject to the specified licensing condition, shall, in respect of each period of 6 months at the end of which it remains licensed, being such period in a year ending at the end of the month of June or December, respectively, submit to the Commission in the manner specified in subsections (5) and (6)(d), (e) or (f) (as the case may be), no later than 3 weeks after the end of the period concerned, a return, in the form specified by the Commission under section 402 of the Ordinance, which includes –

- (e) its liquid capital computation, as at the end of the 6 month period;
- (f) its required liquid capital computation, as at the end of the 6 month period;
- (g) an analysis of its profit and loss account;
- (h) an analysis of its clientele, as at the end of the 6 month period; and
- (i) where it is licensed for Type 9 regulated activity, an analysis of the assets under its management, as at the end of the 6 month period.

(4) A licensed corporation may elect to submit the return required under –

- (a) subsection (1), in respect of periods of not less than 28 days but not more than 35 days, each ending not more than 7 days before or after the end of a month;

- (b) subsection (2), in respect of periods of 3 months each ending not more than 7 days before or after the end of March, June, September or December in a year;
- (c) subsection (3), in respect of periods of 6 months each ending not more than 7 days before or after the end of June or December in a year,

determined by it on a basis according to which the ending date of each period so determined is predictable, and where it so elects and submits the return concerned, it shall be deemed to have submitted the return concerned in respect of the period required under subsection (1), (2) or (3) (as the case may be).

*[new]*

(5) A return referred to in this section or section 55(2)(c) or (d) shall be signed in the manner prescribed in subsection (6) by a responsible officer or another officer of the licensed corporation approved by the Commission under section 58(5)(e) for the purposes of this section.

(6) A licensed corporation may, in relation to a return referred to in this section or section 55(2)(c) or (d), elect to submit the return to the Commission –

- (a) electronically, by means of a secure online communication network approved by the Commission under section 58(7) for the purposes of this paragraph;
- (b) in electronic form on a floppy disk, delivered by hand or by post to the Commission; or
- (c) in paper form, delivered by hand or by post to the Commission,

and where –

- (d) it submits the return in accordance with paragraph (a) –
  - (i) the return shall be signed by way of attachment with the digital signature of the licensed corporation, supported by a recognized certificate

and generated within the validity of that certificate; or

- (ii) where the return is not signed by way of attachment with the digital signature referred to in subparagraph (i), it shall also submit a signed copy of the return in paper form, delivered by hand or by post to the Commission;
- (e) it submits the return in accordance with paragraph (b), the floppy disk shall be accompanied by a signed copy of the return in paper form; or
- (f) it submits the return in accordance with paragraph (c), the signed original of the return shall be submitted.

*[new cf. s.35 FRR, s.11 LFET FRR]*

(7) In this section –

“digital signature” (數碼簽署) has the meaning assigned to it by the Electronic Transactions Ordinance (Cap. 553);

*[new]*

“recognized certificate” (認可證書) means a certificate issued by a recognized certification authority, in each case within the meaning of the Electronic Transactions Ordinance (Cap. 553), to and in the name of a licensed corporation which is within the validity of that certificate within the meaning of section 6(2) of that Ordinance;

“recognized certification authority” (認可核證機關) has the meaning assigned to it by the Electronic Transactions Ordinance (Cap. 553);

“rolling balance cash client” (滾存結餘現金客戶) means a client of a licensed corporation in respect of whom the amounts receivable from, and amounts payable to, him by the licensed corporation arising from the purchase and sale of securities on a cash-against-delivery basis by the licensed

corporation for him may be set-off by the licensed corporation under section 21(2);

“within the validity of that certificate” (在該證書的有效期內) has the meaning assigned to it by section 6(2) of the Electronic Transactions Ordinance (Cap. 553).

[new]

#### **57. Licensed corporations to provide information**

The Commission may at any time, by notice in writing, request a licensed corporation to provide it within the time and in the manner specified in the notice with such information, including any record or document, as it may specify in the notice relating to the financial resources or trading activities of the licensed corporation, whereupon the licensed corporation shall comply with the request accordingly.

[cf. s.36 FRR]

#### **58. Approvals**

(1) For the purposes of these Rules, the Commission may, whether or not on application in writing and payment of the fee prescribed in the Securities and Futures (Fees) Rules (L.N. of 2002), approve a person as –

- (a) an approved bank incorporated outside Hong Kong, where the person is a bank which is incorporated under the law or other authority of any jurisdiction outside Hong Kong;
- (b) an approved credit rating agency; or
- (c) an approved securities borrowing and lending counterparty.

(2) Where the Commission approves a person under subsection (1), it shall as soon as reasonably practicable –

- (a) publish in such manner as it considers appropriate the name of the person approved; and

- (b) in the case of a person approved under subsection (1)(b), specify the ratings issued by the person as being equivalent to a specified rating issued by Moody's Investors Services or Standard & Poor's Corporation.

[cf. s.37(2) FRR]

(3) A person approved under subsection (1)(c) shall be a person whose activities or objects include the provision of services for interposing himself in a securities borrowing and lending agreement as the counterparty to both the borrower and the lender, including administering any security deposited with him in connection with the agreement and registration and settlement of the agreement.

[cf. "approved securities borrowing and lending counterparty" s.2 FRR]

(4) The Commission may, on application in writing and payment of the fee prescribed in the Securities and Futures (Fees) Rules (L.N. \_\_\_\_\_ of 2002), approve a licensed corporation for the purposes of these Rules as an approved introducing agent where the licensed corporation satisfies the Commission that –

- (a) where –
  - (i) it is licensed solely for Type 1 regulated activity, it conducts no business other than –
    - (A) communicating offers to effect dealings in securities to exchange participants of a recognized exchange company or a specified exchange, in the names of the persons from whom those offers are received; and
    - (B) introducing persons to exchange participants of a recognized exchange company or a specified exchange, in order that they may –
      - (I) effect dealings in securities; or



- (II) make offers to deal in securities;
- (ii) it is licensed solely for Type 2 regulated activity, it conducts no business other than –
  - (A) communicating offers to effect dealings in futures contracts or options contracts to exchange participants of a recognized exchange company or a specified exchange, in the names of the persons from whom those offers are received; and
  - (B) introducing persons to exchange participants of a recognized exchange company or a specified exchange, in order that they may –
    - (I) effect dealings in futures contracts or options contracts; or
    - (II) make offers to deal in futures contracts or options contracts;
- (iii) it is licensed solely for Type 3 regulated activity, it conducts no business other than –
  - (A) communicating offers to effect leveraged foreign exchange trading to recognized counterparties in the names of the persons from whom those offers are received; and
  - (B) introducing persons to recognized counterparties in order that they may –
    - (I) effect trading in leveraged foreign exchange contracts; or
    - (II) make offers to trade in leveraged foreign exchange contracts; or

- (iv) it is –
  - (A) licensed for one or more of the following –
    - (I) Type 1 regulated activity;
    - (II) Type 2 regulated activity;
    - (III) Type 3 regulated activity; or
  - (B) licensed for one or more of the regulated activities referred to in sub-subparagraph (A) and one or more of the following –
    - (I) Type 4 regulated activity, and it is subject to the specified licensing condition;
    - (II) Type 5 regulated activity, and it is subject to the specified licensing condition;
    - (III) Type 6 regulated activity, and it is subject to the specified licensing condition,

and not licensed for any regulated activity other than as described in sub-subparagraphs (A) and (B), in relation to any one or more of the regulated activities referred to in sub-subparagraph (A) for which it is licensed, it conducts no business other than that described in subparagraph (i), (ii) or (iii);

- (b) in connection with the offers communicated or the persons so introduced, it will not incur any liability to any person except for its own negligence, wilful default or fraud; and
- (c) it does not hold client assets.

*[cf. "introducing broker", s.2 FRR and "leveraged foreign exchange trading introducing agent", s.2 LFET FRR]*

(5) The Commission may, on application in writing by a licensed corporation and payment of the fee prescribed in the Securities and Futures (Fees) Rules (L.N. of 2002), approve –

- (a) as approved redeemable shares, any redeemable shares issued by the licensed corporation;
- (b) as an approved subordinated loan, any subordinated loan obtained by the licensed corporation;
- (c) as an approved standby subordinated loan facility, any standby subordinated loan facility obtained by the licensed corporation;
- (d) for the purposes of section 3(4), the adoption by the licensed corporation of an accounting principle inconsistent with subsection (1) of that section;
- (e) for the purposes of section 56(5), an officer of the licensed corporation to sign a return;
- (f) for the purposes of section 41(1)(a)(v), a foreign currency; and

*[cf. s.6(2)(b) LFET FRR]*

- (g) the withdrawal of an election made by the licensed corporation under any provision of these Rules.

(6) An approval granted under subsection (1), (4) or (5) shall be subject to such reasonable conditions as the Commission may impose, and the Commission may at any time amend or revoke any such condition or impose new conditions as may be reasonable in the circumstances.

*[cf. s.37(3) FRR]*

(7) The Commission may, for the purposes of section 56(6)(a), approve a secure online communication network.

(8) Where the Commission approves a communication network under subsection (7), it shall as soon as reasonably practicable publish details of the network in such manner as it considers appropriate.

*[new]*

(9) An approval granted under subsection (1), (4), (5) or (7) remains in force –

- (a) where a period of validity of the approval is specified in the notice of approval, until the expiry of the period; or
- (b) where no such period is specified, until revoked by the Commission by notice in writing.

*[new. Cf. s.134(5) of the Ordinance]*

**59. Withdrawal of elections made under these Rules**

A licensed corporation which makes an election under any provision of these Rules shall be bound by the election until such time as the Commission approves the withdrawal of the election under section 58(5)(g).

*[new, cf. e.g. s.13(5) & (6) FRR]*

**60. Transitional**

(1) Notwithstanding section 1 and subject to subsection (2), these Rules do not apply in respect of a person who is deemed under section 25(b) of Part 1 of Schedule 10 to the Ordinance to be a licensed corporation.

*[new]*

(2) Subsection (1) shall expire on [30 June] 2003.

*[new]*

(3) Notwithstanding section 1 and subject to subsection (5), section 5 does not apply in respect of –

- (a) a partnership deemed under section 27 of Part 1 of Schedule 10 to the Ordinance to be a licensed corporation; or
- (b) an individual deemed under section 30 of Part 1 of Schedule 10 to the Ordinance to be a licensed corporation,

provided that –

- (c) in the case of a partnership, the aggregate of amounts maintained in all partners' capital accounts; or
- (d) in the case of an individual, the amount maintained in his capital account,

is not less than the amount of paid-up share capital required of a licensed corporation under section 5, until such time as the specified decision referred to, in the case of a partnership, in section 53(1)(b) of Part 1 of Schedule 10 to the Ordinance or, in the case of an individual, in section 53(1)(c) of Part 1 of Schedule 10 to the Ordinance takes effect.

*[new]*

- (4) For the purposes of these Rules, a transaction executed by –
  - (a) a partnership deemed under section 27 of Part 1 of Schedule 10 to the Ordinance to be a licensed corporation, for the account of a partner of the partnership; and
  - (b) an individual deemed under section 30 of Part 1 of Schedule 10 to the Ordinance to be a licensed corporation, for his own account,

shall be treated as a transaction executed by it or him (as the case may be) for a client.

*[new, cf. s.5(4) FRR]*

(5) Notwithstanding section 1 and subject to subsection (6), these Rules do not apply in respect of –

- (a) a partnership deemed under section 27 of Part 1 of Schedule 10 to the Ordinance to be a licensed corporation;
- (b) an individual deemed under section 30 of Part 1 of Schedule 10 to the Ordinance to be a licensed corporation;
- or
- (c) a licensed corporation,

which is licensed solely for one or more of the following –

- (d) Type 4 regulated activity;

- (e) Type 5 regulated activity;
- (f) Type 6 regulated activity;
- (g) Type 9 regulated activity,

provided that it maintains net tangible assets in an amount of not less than \$500,000.

*[new, cf. s.8 FRR]*

- (6) Subsection (5) shall expire on [30 June] 2003.

*[new]*

- (7) In this section –

“capital account” (資本帳) means an account in which the amount of capital injected into the business of a partnership or sole-proprietorship is kept;

“net tangible assets” (有形資產淨值), in relation to a person referred to in subsection (5)(a), (b) or (c), means its total assets less –

- (a) its intangible assets, including goodwill, copyrights, patents and licences; and
- (b) its total liabilities (after excluding any approved subordinated loan provided to it).

*[cf. s.2 FRR "capital account" and "net tangible assets"]*

SCHEDULE 1 [ss. 2 & 5]  
 FINANCIAL RESOURCES REQUIREMENTS

TABLE 1  
 PAID-UP SHARE CAPITAL

Regulated activity	Minimum amount of paid-up share capital
Type 1 –	
(a) in the case where the licensed corporation in question provides securities margin financing	\$10,000,000
(b) in any other case	\$5,000,000
Type 2	\$5,000,000
Type 3 –	
(a) in the case where the licensed corporation in question is an approved introducing agent	\$5,000,000
(b) in any other case	\$30,000,000
Type 4	\$5,000,000
Type 5	\$5,000,000
Type 6	\$5,000,000
Type 7	\$5,000,000
Type 8	\$10,000,000
Type 9	\$5,000,000

[cf. ss.9 & 10 FRR; s.4(1)(a) and (2)(a) LFET FRR]

TABLE 2  
REQUIRED LIQUID CAPITAL

Regulated activity	Minimum amount of required liquid capital
Type 1 –	
(a) in the case where the licensed corporation in question is an approved introducing agent or trader	\$500,000
(b) in any other case	\$3,000,000
Type 2 –	
(a) in the case where the licensed corporation in question is an approved introducing agent, futures non-clearing dealer or trader	\$500,000
(b) in any other case	\$3,000,000
Type 3 –	
(a) in the case where the licensed corporation in question is an approved introducing agent	\$3,000,000
(b) in any other case	\$15,000,000
Type 4 –	
(a) in the case where the licensed corporation in question is subject to the specified licensing condition	\$100,000
(b) in any other case	\$3,000,000
Type 5 –	
(a) in the case where the licensed corporation in question is subject to the specified licensing condition	\$100,000
(b) in any other case	\$3,000,000
Type 6 –	
(a) in the case where the licensed corporation in question is subject to the specified licensing condition	\$100,000
(b) in any other case	\$3,000,000



Type 7	\$3,000,000
Type 8	\$3,000,000
Type 9 –	
(a) in the case where the licensed corporation in question is subject to the specified licensing condition	\$100,000
(b) in any other case	\$3,000,000

*[cf. ss. 6 & 10 FRR & s.4(1)(b) & (2)(b) LFET FRR]*

## SCHEDULE 2

[ss. 2, &amp; 43]

## HAIRCUT PERCENTAGES

TABLE 1

## HAIRCUT PERCENTAGES FOR SHARES LISTED IN HONG KONG, THE UNITED KINGDOM, THE UNITED STATES OF AMERICA AND JAPAN (SHARES STRATIFIED ACCORDING TO STOCK INDICES)

Item	Description	Haircut Percentage %
1.	Shares which are listed on a recognized stock market –	
	(a) being a constituent of the Hang Seng Index or the Hang Seng Hong Kong LargeCap Index	15
	(b) to the extent not already covered in paragraph (a), being a constituent of the Hang Seng Hong Kong MidCap Index	20
	(c) being any share not referred to in paragraph (a) or (b)	30
2.	Shares which are listed on a specified exchange in the United Kingdom (other than the Stock Exchange Automated Quotations International (SEAQ International)), the United States of America (other than the National Association of Securities Dealers Automated Quotations – National Market) or Japan (other than the Japanese Association of Securities Dealers Automated Quotations) –	
	(a) being a constituent of the FTSE-100 Index, Nikkei 500 Index or Standard & Poor's 500 Index	15
	(b) being any share not referred to in paragraph (a)	20

[cf. Part 1 of Schedule 1 FRR]

TABLE 2

HAIRCUT PERCENTAGES FOR SHARES LISTED IN HONG KONG, THE UNITED KINGDOM, THE UNITED STATES OF AMERICA AND JAPAN  
(SHARES NOT STRATIFIED ACCORDING TO STOCK INDICES)

Item	Description	Haircut Percentage %
1.	Shares which are listed on a recognized stock market	30
2.	Shares which are listed on a specified exchange in the United Kingdom (other than the Stock Exchange Automated Quotations International (SEAQ International)), the United States of America (other than the National Association of Securities Dealers Automated Quotations – National Market) or Japan (other than the Japanese Association of Securities Dealers Automated Quotations)	20

*[cf. Part 1 of Schedule 1 FRR]*

TABLE 3

HAIRCUT PERCENTAGES FOR OTHER SHARES

Item	Description	Haircut Percentage %
1.	Shares listed on a specified exchange specified in <u>Part 1 of Schedule 3</u> (other than the Stock Exchange Automated Quotations International (SEAQ International), the National Association of Securities Dealers Automated Quotations – National Market or the Japanese Association of Securities Dealers Automated Quotations)	20

2.	Shares listed on a specified exchange specified in <u>Part 2 of Schedule 3</u>	30
3.	Shares listed on the National Association of Securities Dealers Automated Quotations - National Market, the Japanese Association of Securities Dealers Automated Quotations or the Stock Exchange Automated Quotations International (SEAQ International)	30
4.	Shares listed on any other stock exchange which is a member of the Fédération Internationale des Bourses de Valeurs	50
5.	Shares not referred to in <u>item 1, 2, 3 or 4</u> or <u>Table 1 or 2</u> <i>[cf. Part III of Schedule 1 FRR]</i>	75

TABLE 4

HAIRCUT PERCENTAGES FOR QUALIFYING DEBT SECURITIES, BY  
ISSUER OR GUARANTOR, ETC.

Tier	Description	Haircut Percentage %
1.	Where the issuer or guarantor of the qualifying debt securities – (a) is the Central People's Government of the People's Republic of China or the People's Bank of China; (b) is the Government; (c) is the Hong Kong Exchange Fund; or (d) has an issue or issues currently rated by – (i) Moody's Investors Services at Aaa or Prime-1; or (ii) Standard & Poor's Corporation at AAA or A-1	0
2.	Where the qualifying debt securities are any certificate of deposit, the issuer of which is an	0

certificate of deposit, the issuer of which is an authorized financial institution or an approved bank incorporated outside Hong Kong

3. To the extent not already covered in Tier 1 or Tier 2 – 2
- (a) where the issuer or guarantor of the qualifying debt securities has an issue or issues currently rated by –
- (i) Moody's Investors Services at Aa, A or Prime-2; or
- (ii) Standard & Poor's Corporation at AA, A or A-2;
- (b) where the issuer of the qualifying debt securities is the Hong Kong Mortgage Corporation; or
- (c) where the qualifying debt securities are listed on a recognized stock market
4. To the extent not already covered in Tier 1, Tier 2 or Tier 3, where the issuer of the qualifying debt securities has an issue or issues currently rated by – 5
- (a) Moody's Investors Services as Baa or Prime-3; or
- (b) Standard & Poor's Corporation at BBB or A-3

*[cf. Table 1, Part I of Schedule 2 FRR]*

TABLE 5  
HAIRCUT PERCENTAGES FOR QUALIFYING DEBT SECURITIES, BY  
REMAINING TERM TO MATURITY

Remaining term to maturity	(I)	(II)
	Qualifying debt securities with a fixed coupon or with a floating rate coupon	Qualifying debt securities other than those with a fixed coupon or with a floating rate coupon
	Haircut Percentage %	Haircut Percentage %
(a) Less than 6 months	1	1
(b) 6 months to less than 3 years	3	3
(c) 3 years to less than 5 years	4	5
(d) 5 years to less than 10 years	7	10
(e) 10 years or more	10	22

*[cf. Table 2, Part I of Schedule 2 FRR]*

TABLE 6  
HAIRCUT PERCENTAGES FOR SPECIAL DEBT SECURITIES

Item	Description	Haircut Percentage
1.	Special debt securities being indexed bonds	same as that applicable to the underlying assets
2.	Special debt securities being – (a) convertible debt securities; or (b) bonds with non-detachable warrants, where – (c) their market value is more than their par value or nominal value; or (d) their market value is equal to, or less than, their par value or nominal value	same as that applicable to the assets underlying the securities or bonds concerned  same as that applicable to the qualifying debt securities referred to in <u>column 2 in relation to Tier 1, Tier 3 or Tier 4 in Table 4</u> and with the same remaining term to maturity
3.	Special debt securities being non-interest bearing debt securities	105% of the haircut percentage applicable to the qualifying debt securities referred to in <u>column 2 in relation to Tier 1, Tier 3 or Tier 4 in Table 4</u> and with the same remaining term to maturity

*[cf. Part II of Schedule 2 FRR]*

TABLE 7  
HAIRCUT PERCENTAGES FOR SPECIFIED SECURITIES

Item	Description	Haircut Percentage
1.	Specified securities being warrants listed on a specified exchange	40%
2.	Specified securities being equity linked instruments	same as that applicable to the underlying securities
3.	Specified securities being units in any unit trust or shares in any mutual fund –	
	(a) which is authorized under section 104 of the Ordinance; or	
	(b) under a Recognized Jurisdiction Scheme specified in an Appendix to the Code on Unit Trusts and Mutual Funds published by the Commission, where their nature is –	
	(c) the same as that of a warrant fund, futures and options fund, leveraged fund or hedge fund referred to in that Code; or	40%
	(d) not the same as any of the funds mentioned in paragraph (c)	20%

*[cf. Schedule 3 FRR]*



TABLE 8  
HAIRCUT PERCENTAGES FOR SPECIFIED INVESTMENTS

Item	Description	Haircut Percentage %
1.	Specified investments being – (a) gold coin or gold bullion; or (b) investments in gold which are prescribed in <u>Schedule 1 to the Securities and Futures (Collective Investments Schemes) Notice (L.N. _____ of 2002)</u> and authorized by the Commission under section 104 of the Ordinance	10
2.	Specified investments being physical commodities of a quantity, quality and condition suitable for delivery under a futures contract or options contract traded on a specified exchange <i>[cf. Schedule 3 FRR]</i>	40

SCHEDULE 3

[ss. 2 & Sch. 2]

SPECIFIED EXCHANGES

PART 1

American Stock Exchange

Australian Stock Exchange

Bolsa de Madrid

Borsa Italiana S.p.A.

Bourse de Montréal Inc.

Chicago Board of Trade  
Chicago Board Options Exchange  
Chicago Mercantile Exchange  
Commodity Exchange, Inc. (New York)  
Copenhagen Stock Exchange  
Deutsche Börse AG  
Eurex  
Euronext Amsterdam  
Euronext Brussels  
Euronext Paris  
Helsinki Exchanges  
Hong Kong Futures Exchange Limited  
Japanese Association of Securities Dealers Automated Quotations  
Korea Futures Exchange  
Korea Stock Exchange  
London International Financial Futures and Options Exchange  
London Metal Exchange  
London Stock Exchange  
Luxembourg Stock Exchange  
Nagoya Stock Exchange  
National Association of Securities Dealers Automated Quotations – National  
Market  
New York Cotton Exchange  
New York Futures Exchange  
New York Mercantile Exchange  
New York Stock Exchange  
New Zealand Futures and Options Exchange  
New Zealand Stock Exchange  
Osaka Securities Exchange  
Oslo Børs

Pacific Exchange

Philadelphia Stock Exchange

The Stock Exchange of Hong Kong Limited

Stockholmsbörsen

SWX Swiss Exchange

Sydney Futures Exchange Limited

Tokyo Grain Exchange

Tokyo International Financial Futures Exchange

Tokyo Stock Exchange

Toronto Stock Exchange

Wiener Börse AG

Winnipeg Commodities Exchange

**PART 2**

Kuala Lumpur Stock Exchange

Malaysian Derivatives Exchange Berhad

Philippine Stock Exchange Inc.

Singapore Exchange Derivatives Trading Limited

Singapore Exchange Securities Trading Limited

Stock Exchange of Thailand

*[cf. Schedules 5 & 6 FRR]*

## SCHEDULE 4

[ss. 49 &amp; 50]

## FINANCIAL COMMITMENTS

TABLE 1

## INTEREST RATE SWAP AGREEMENTS

Item	Remaining term to maturity	Percentage %
1.	Less than 3 months	0
2.	3 months or more but less than 1 year	0.05
3.	1 year or more but less than 2 years	0.1
4.	Each year in addition to the period referred to in <u>item 3</u>	0.1

TABLE 2

## FOREIGN EXCHANGE AGREEMENTS

Item	Description	Percentage
1.	The counterparty of the foreign exchange agreement is an authorized financial institution or an approved bank incorporated outside Hong Kong and the remaining term to maturity is –	
	(a) less than 3 business days	0%
	(b) 3 business days or more but less than 1 year	0.2%
	(c) 1 year or more	0.5% where the remaining term to maturity of the agreement is less than 2 years, plus 0.3% for each

additional full year  
after 1 year, subject  
to a maximum of 5%

2. The counterparty of the foreign exchange agreement is a person other than a person referred to in item 1 and the remaining term to maturity is –
- (a) less than 3 business days 0%
  - (b) 3 business days or more 5%

*[cf. Part 2 of Schedule 4 FRR]*

SCHEDULE 5

[s. 52]

NOTE ISSUANCE AND REVOLVING UNDERWRITING  
FACILITIES

Item	Remaining term to maturity	Percentage %
1.	Less than 1 year	1
2.	1 year or more but less than 5 years	2.5
3.	5 years or more	5

*[cf. s.31(1) FRR]*

Chairman,  
Securities and Futures Commission

## Explanatory Note

These Rules provide for the financial resources requirements of a licensed corporation. Under the Rules, a standardized set of requirements is to apply to all licensed corporations.

2. The Rules are divided into 5 Parts and 5 Schedules.
3. Part 1 provides for the commencement of, and the defined terms used in, the Rules.
4. Part 2 provides for the accounting treatment to be adopted by a licensed corporation in accounting for its assets and liabilities.
5. Part 3 provides for the specific financial resources requirements of a licensed corporation, namely the paid-up share capital requirement and the liquid capital requirement.
6. Part 4 provides for the calculation of a licensed corporation's financial resources. It prescribes the amounts or values of assets and the amounts of liabilities which are required to be included in the calculation of a licensed corporation's financial resources. They are referred to in the Rules as the liquid assets and ranking liabilities of a licensed corporation. This Part also provides for the methodology of calculations to be made under this Part, which includes the adjustments to be applied in the calculations to cater for such factors as illiquidity and credit risk in the case of liquid assets and other contingent risks in the case of ranking liabilities.
7. Part 5 provides for the obligation for a licensed corporation to notify the Securities and Futures Commission ("the Commission") of certain matters in certain circumstances, including its inability to comply with the Rules and some other matters relating to its financial resources. This Part also provides for the submission of financial resources returns to the Commission, the provision of certain information to the Commission on request and the granting of certain approvals by the Commission under the Rules. Provisions have also been made for transitional matters.

8. The 5 Schedules set out, among other things, details of the minimum amount of paid-up share capital and of liquid capital that a licensed corporation is required to maintain (Schedule 1), haircut percentages applicable in certain calculations required under Part 4 (Schedule 2) and lists of specified exchanges (Schedule 3). In addition, specific figures concerning the calculation of a licensed corporation's ranking liabilities in relation to interest rate swap agreements, foreign exchange agreements, and note issuance and revolving underwriting facilities are set out in Schedule 4 and Schedule 5 respectively.