Re: Comments to Proposed Revisions to the Code of Conduct

Dear Sir/Madam,

Attached are comments that we make in response to your "Consultation Document on the Proposed Revisions to the Code of Conduct for Persons Registered with the Securities and Futures Commission"

Incidentally, we have noticed that only 3 of the 11 proposals that you studied in the " Response of the Securities and Futures Commission to the Public Consultation on the Review of the Leveraged Foreign Exchange Trading Regulatory System ' on April 1997 are either discussed here or reviewed in other consultation related to FFR. We were just wondering why the rest of the 8 proposals have not been followed up after all these years. In particular, proposal (d) which you supported in the April 1997 Review dealing with "No Over Loss Rule" has caught our attention.

We are taking the liberty to reopen this issue again for discussion, details of which are discussed in the attachment. Hopefully, you would take this opportunity to entertain it further. We are interested to know your most current position on this.

Should you have any further inquiries, please do not hesitation to contact me.

Yours truly,

Schedule 6

Proposal 19 & 20

Your proposals may give the benefit of doubt to the client involved in respect of disputed order when the trader in questions fails to provide neither verbal or written evidences to support his own argument. However, you may have also unwittingly put us traders in a no win situation at the same time. To better illustrate my point, please consider the following scenario once the proposed Code 19 and 20 are implemented.

Process
Client A called Trader B for a market price to execute a short order to stop loss her prior established long position. Both parties agreed with the price and other details. The order was confirmed and executed accordingly. As usual, Trader B hand written all the details of the transaction including among others, client account number, executed price, number of hands, direction of trade on the order form.

On the following day, Trader B discovered that the voice of Client A was too low to be recorded clearly. He then invited her to sign the respective order form, so as to confirm that the order in question was indeed transacted properly.

Knowing that Code 19 and 20 allow her to void the stop loss order if she refused to sign the order form regardless of its truthfulness, Client A began to dispute the order. Final judgement was of course on her side in accordance with the spirit of Code 20. She then proceeded to execute a new order to turn a position from loss to gain because price had reversed direction by the time she disputed the order.

Other Trader B's customers who called in recently for stop loss order executions followed the example of Client A as well. A long queue was formed in all Trader B's branches. As expected, their first request was to hear recording, hoping that they could always void the order in question if their voices could not be recorded properly provided that they also declined to sign the order form.

To stop this scenario from repeating, Trader B considered the following options:
(1) Decline all orders by phone resulting in a contraction of business volume, risking his business and his staff employment.
(2) Invest more money to buy a state of the art recording device. But there is no guarantee that any one of the following factors, such as the background noise of the caller, the quality of transmission, or the type of mobile phone the caller is using would not impact the quality of the recording. The problem may have nothing to do with the trader or the recorder itself. Rather, it comes from the caller but ironically, the trader is made to take the fall.
(3) Follow code 19 by *requiring* client to sign his order form if the tape is unable to pick up his voice. But the question is how could a trader FORCE his client

to sign the order form to confirm his losing position when he knows that he could always abuse the system and find a way out.

Without a doubt, Trader B is trapped regardless of what actions he is willing to take. Perhaps the only time that a client is willing to substantiate the contents of the missing tape by signing the order form is when he is winning, or when he could be losing more money.

Evidently, proposed code 19 and 20 are biased and unworkable. What would be the integrity of these 2 codes if they are so lopsided, and so prejudicial that the interests of traders who are willing to play by the rules are left unprotected, while customers who know how to abuse your best intentions are rewarded.

Suggestion:

What we suggest is to scrap these two proposals from your code and conduct guideline once and for all, since there is no fair, quick and "one for all" solution to deal with this kind of problem which could be very simple, complex or unexpected. Sometimes it may be better to "muddle through" by taking a step by step approach to mediate this kind of disputes in response to the circumstances as it happens.

Proposal 23

We support the idea that client be given more freedom to make his trading decision and the use of his margin deposit. However, we fail to see why margin deposit is still required to cover the risk of a locked position.

Our understanding is that when a client chooses to lock his open position, he would not need to face the position risk that comes with such a decision, and has no reason to show his net worth to maintain a locked position.. In reality, margin deposit has completely lost its purpose in a locked transaction. Accordingly, client should be allowed to withdraw all his money because we are unable to rationalize why such a deposit is required when there is no open position, and the corresponding risk involved is in fact nil. We fail to see the useful functions of Margin Deposit, which is to serve as good faith deposit from client and reduce counterparty risks of trader could still be applicable under this circumstance. Perhaps the only time that we require deposit back is when the client involved wants to re-open his position.

No Over Loss Rule

Because you have made quite a comprehensive assessment regarding the pros and cons of lower margin requirement related to the "No Over Loss Rule" in your "Response of the Securities and Futures Commission to the Public Consultation on the Review of the Leveraged Foreign Exchange Trading Regulatory System' on April 1997, we see no need to repeat the whole exercise again. Rather, we want to bring to your attention that our company has been practicing this rule since we were licensed about 7 years ago. We have even formalized it as part of the terms and conditions in our client agreement. In fact, the respective term even allows our client to keep 10% of his margin loss, meaning that the client involved will be able to retain a small part of his loss at the end of the day.

We also agree with you that only experienced client be allowed to enter this No Over loss agreement with us. We surely do not want to be accused of using this feature to attract potential client who has no trading experience. Perhaps the concept of "Professional Investor" that you introduced lately could be used in the retail market as well.

All in all, we believe SFC should allow trader to set its own margin level for its client as long as the No Over Loss Rule is observed. We have accumulated a lot of experience in this area. Should you be interested and want to investigate the issue further, we are more than happy to share it with you.

Proposed Amendment

We suggest that proposed code 23 be amended as follows:

" Except for licensed person who observes No Over Loss Rule in the LFET market is allowed to set its own initial and maintenance margin level, all other licensed persons should set the respective two margin levels for its clients at not less than 5% and 3% respectively of the gross principal value of the contact offered by the licensed person. For cross currency trades, only one set of margin is required while locked positions (i.e. situation where a client simultaneously holds an equal long and short positions of the same currency) require none."