

Consultation Document

The Draft Securities and Futures (Recognized Counterparty) Rules (the “draft Rules”)

Introduction

1. Under section 2 of the Leveraged Foreign Exchange Trading Ordinance (“LFETO”), a recognized counterparty is defined to mean an authorized institution, another licensed leveraged foreign exchange trader (“trader”) or an institution designated in writing by the Securities and Futures Commission (the “SFC”) as a recognized counterparty. As part of our effort to enhance transparency, the last limb of the definition has been amended under Schedule 1 of the Securities and Futures Bill (“Bill”) to read “an institution prescribed by rules made under clause 384 of the Bill for the purposes of this definition as a recognized counterparty”.
2. The qualifying criteria are to be prescribed in the subsidiary and not the primary legislation. Effective regulation depends upon the regulator having the flexibility quickly to address changing market practices and global conditions, by amending the rules rather than the primary legislation.
3. There are controls built into the legislative system, whereby any rules made by the SFC must be subject to negative vetting by the Legislative Council. In addition, the SFC now releases the draft Rules for public consultation.
4. Copies of the consultation document have been sent to all existing traders by post. The public may obtain copies of the consultation document free of charge at the SFC’s office and on the SFC web site at <http://www.hksfc.org.hk>.
5. The SFC invites market participants and interested parties to submit written comments on the draft Rules or to comment on related matters that might have a significant impact upon the draft Rules no later than 29 December 2001. Any person wishing to comment on the draft Rules should, where applicable, provide details of any organisation whose views they represent. In addition, persons suggesting alternative approaches are encouraged to submit proposed text to amend the draft Rules.

The Importance of Recognized Counterparty Status

6. Treatment of an institution as a recognized counterparty has two implications under the existing LFETO:
 - (a) the requirements imposed on the trader in relation to its clients (such as, issuance of contract notes and statements of accounts to clients, segregation of client monies into trust accounts, etc.) are not applicable to an institution that is designated as a recognized counterparty; and
 - (b) under the Leveraged Foreign Exchange Trading (Financial Resources) Rules (“LFET(FR)R”),
 - (i) the positions with a recognized counterparty are excluded in calculating the aggregate gross position for all foreign currencies of a trader; and
 - (ii) a trader is not required to collect 3% margin from its recognized counterparties.

The SFC intends to apply the same concept in the Securities and Futures (Financial Resources) Rules.

7. It is important that only high quality institutions are accepted as recognized counterparties in order not to undermine the effectiveness of the LFET(FR)R.
8. SFC has formulated the draft Rules after informally consulting selected traders. We wish to acknowledge and thank them for their invaluable input.

Background

9. A copy of the draft Rules is attached for reference. The draft Rules are generally based on the major criteria used by the SFC in considering past applications. They take into account the following pertinent factors:
 - (a) regulatory oversight, placing reliance on overseas regulatory systems that are well established with recognizable international standards;

- (b) relevant experience in trading in exchange-traded currency futures contracts, which are the products commonly used for hedging purposes;
 - (c) financial standing (capital base to be compatible with that of a trader); and
 - (d) qualifying credit rating.
10. Besides recognising institutions that meet these characteristics, it is necessary to allow for exceptional cases from time to time. At present, 2 out of the 8 existing recognized counterparties would not automatically qualify under the draft Rules (see Schedule 2 to the draft Rules).

Policy Initiatives

11. In addition to authorised institutions and traders that would automatically qualify as recognized counterparties under the Bill, four other types of institutions will also qualify automatically in the draft Rules:
- (a) a corporation licensed for dealing in futures contracts that deals in currency futures contracts on any specified futures exchange (as defined in Part 2 of Schedule 1 of the Bill, which is attached for ease of reference);

[Note: Exchange participants of Hong Kong Futures Exchange Limited will fall under this category.]
 - (b) a futures dealer regulated in any specified jurisdiction (excluding any dealer which the relevant authority has ordered to cease operation) that deals in currency futures contracts on any specified futures exchange and has shareholders' funds of not less than Hong Kong dollars \$30,000,000 or its equivalent. The specified jurisdictions consist of Australia, Canada, Germany, France, Japan, Switzerland, UK and US (see Schedule 1 to the draft Rules);
 - (c) a bank carrying on deposit taking business other than a merchant bank or an investment bank (excluding any bank which the relevant authority has ordered to cease operation) which is incorporated and regulated in any specified jurisdiction; and

- (d) a corporation that has issued debt instruments which continue to attract a qualifying credit rating (as defined in Part 4 of Schedule 1 of the Bill, being a Moody's Investors Service rating of A3 or above for long term debt or Prime-3 or above for short term debt or a Standard & Poor's Corporation rating of A or above for long term debt or A-3 or above for short term debt).
12. In addition, there is the fifth category of institutions which the SFC believes should qualify as recognized counterparties but which do not fit into any of the four prescribed categories mentioned above. Such institutions will be listed in Schedule 2 to the Rules. In the event that the list needs to be changed by way of addition or deletion over time, the Schedule can be amended accordingly. An example will be an unrated central bank that is not in a specified jurisdiction.
13. **Please note that the names of the commentators and the contents of their submissions may be published on the SFC web site and in other documents to be published by the SFC. In this connection, please read the Personal Information Collection Statement attached to this consultation document.**
14. **You may not wish your name and/or submission to be published by the SFC. If this is the case, please state that you wish your name and/or submission to be withheld from publication when you make your submission.**
15. Written comments may be sent

By mail to: SFC Recognized Counterparty Rules
12/F, Edinburgh Tower
The Landmark
15 Queen's Road, Central
Hong Kong

By fax to: (852) 2523 4598

By on-line submission: <http://www.hksfc.org.hk>

By e-mail to: recognized_counterparty_rules@hksfc.org.hk

Personal Information Collection Statement

1. This Personal Information Collection Statement (“PICS”) is made in accordance with the guidelines issued by the Privacy Commissioner for Personal Data. The PICS sets out the purposes for which your Personal Data¹ will be used following collection by the Securities and Futures Commission (“SFC”), what you are agreeing to with respect to the SFC’s use of your Personal Data and your rights under the PDPO.

Purpose of Collection

2. The Personal Data provided in your submission to the SFC in response to the Consultation Document on The Draft Securities and Futures (Recognized Counterparty) Rules (“the Consultation Document”) may be used by the SFC for one or more of the following purposes:
 - to administer the relevant Ordinances, rules, regulations, codes and guidelines made or promulgated pursuant to the powers vested in the SFC
 - for the purposes of performing the SFC’s statutory functions under the relevant Ordinances
 - for research and statistical purposes
 - other purposes permitted by law

Transfer of Personal Data

3. Personal Data may be disclosed by the SFC to the members of the public in Hong Kong and elsewhere, as part of the public consultation on the Consultation Document. The names of persons who submit comments on the Consultation Document together with the whole or part of their submission may be disclosed to members of the public. This will be done by publishing this information on the SFC web site and in documents to be published by the SFC throughout and at the conclusion of the consultation period.

Access to Data

4. You have the right to request access to and correction of your Personal Data in accordance with the provisions of the PDPO. Your right of access includes the right to obtain a copy of your Personal Data

¹ Personal Data means personal data as defined in the Personal Data (Privacy) Ordinance, Cap 486 (“PDPO”)

provided in your submission on the Consultation Document. The SFC has the right to charge a reasonable fee for processing any data access request.

Enquiries

5. Any enquiries regarding the Personal Data provided in your submission on the Consultation Document, or requests for access to Personal Data or correction of Personal Data, should be addressed in writing to:

The Data Privacy Officer,
Securities and Futures Commission
12/F, Edinburgh Tower, The Landmark
15 Queen's Road Central Hong Kong

A copy of the Privacy Policy Statement adopted by the SFC is available upon request.

PART 2

SPECIFIED FUTURES EXCHANGES

1. Amsterdam Exchange NV
2. Australian Stock Exchange
3. Chicago Board of Trade
4. Chicago Board Options Exchange
5. Chicago Mercantile Exchange Inc.
6. Commodity Exchange, Inc. (New York)
7. Eurex
8. Hong Kong Futures Exchange Limited
9. Korea Stock Exchange
10. London International Financial Futures and Options Exchange
11. London Metal Exchange
12. Marche a Terme International de France
13. Marche des Options Negociables de Paris
14. New York Cotton Exchange, Inc.
15. New York Futures Exchange
16. New York Mercantile Exchange
17. New Zealand Futures and Options Exchange
18. OM Stockholm Exchange
19. Osaka Securities Exchange
20. Pacific Stock Exchange
21. Philadelphia Stock Exchange
22. Singapore Exchange Derivatives Trading Limited
23. Sydney Futures Exchange, Ltd.
24. Tokyo Grain Exchange
25. Tokyo International Financial Futures Exchange
26. Tokyo Stock Exchange
27. Toronto Futures Exchange
28. Winnipeg Commodities Exchange

SECURITIES AND FUTURES (RECOGNIZED COUNTERPARTY) RULES

SECURITIES AND FUTURES (RECOGNIZED COUNTERPARTY) RULES

(Made by the Securities and Futures Commission
under section 384(1) of the Securities and
Futures Ordinance (of 2002)

1. Commencement

These Rules shall come into operation on the day
appointed for the commencement of Part XVI of the Securities
and Futures Ordinance (of 2002).

2. Interpretation

In these Rules, unless the context otherwise requires -

“currency futures contract” (貨幣期貨合約) means a futures
contract in respect of any currency;

“equivalent corporation” (等同法團) means a corporation that -

- (a) is incorporated and regulated in a specified
jurisdiction;

(b) is the equivalent in the specified jurisdiction of a corporation licensed for dealing in futures contracts; and

(c) has and maintains issued and paid up share capital of not less than \$30,000,000 or its equivalent in any other currency as calculated by -

(i) adding together the corporation's -

(A) issued and paid up share capital;

and

(B) retained profits and reserves

with aggregate net credit

balances; and

(ii) subtracting the corporation's

accumulated losses and reserves with

aggregate net debit balances;

"specified jurisdiction" (指明司法管轄區) means a jurisdiction specified in Schedule 1.

3. Institutions that are recognized counterparties

For the purposes of paragraph (c) of the definition of "recognized counterparty" in Part 1 of Schedule 1 to the Ordinance, the following institutions are recognized counterparties -

- (a) a corporation licensed for dealing in futures contracts that deals in currency futures contracts on any specified futures exchange;
- (b) an equivalent corporation that deals in currency futures contracts on any specified futures exchange, except where such corporation ceases to be permitted to carry out such dealing as a result of the action of the authority that regulates it in the specified jurisdiction in which it is incorporated and regulated;
- (c) a bank carrying on deposit-taking business that is incorporated and regulated in a specified jurisdiction, except where the bank -
 - (i) is a merchant bank;
 - (ii) is an investment bank; or

(iii) ceases to be permitted to operate as a bank as a result of the action of the authority that regulates it in the specified jurisdiction;

(d) a corporation that has issued debt instruments which continue to attract a qualifying credit rating; and

(e) an institution -

(i) in respect of which the Commission is satisfied that recognition as a counterparty -

(A) is appropriate; and

(B) would not prejudice the interests of the investing public; and

(ii) which is specified in Schedule 2.

SCHEDULE 1

[ss.2, 3(b), (c)]

SPECIFIED JURISDICTIONS

Australia

Canada

The Federal Republic of Germany

The French Republic

Japan

The Swiss Confederation

The United Kingdom of Great Britain and Northern Ireland

The United States of America

SCHEDULE 2

[s.3(e)]

SPECIFIED INSTITUTIONS THAT ARE RECOGNIZED COUNTERPARTIES

1. Bear Stearns Forex Inc.
2. HSBC Broking Securities (Asia) Ltd.

Chairman,
Securities and Futures
Commission

2002

Explanatory Note

These Rules are made by the Securities and Futures Commission under section 384(1) of the Securities and Futures Ordinance (of 2002). They prescribe certain institutions as recognized counterparties for the purposes of paragraph (c) of the definition of "recognized counterparty" in Part 1 of Schedule 1 to the Ordinance. This means that such institutions fall within paragraph (b) of the definition of "client" in Part 1 of Schedule 1 to the Ordinance. As a consequence, in connection with trading in leveraged foreign exchange contracts by a corporation licensed for such trading with or on behalf of any such institution, the institution is not considered to be a client of the licensed corporation.