



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

A Consultation Paper on the Securities and Futures (Financial Resources) Rules

《證券及期貨（財政資源）規則》諮詢文件

Hong Kong
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Consultation Document

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

Introduction

1. As is the position under the Securities and Futures Commission Ordinance and the Leveraged Foreign Exchange Trading Ordinance, the Securities and Futures Ordinance (the “SFO”) does not contain detailed requirements in relation to the financial resources that are to be maintained by licensed corporations; it merely gives the Commission the necessary power under section 145(1) to prescribe requirements in the subsidiary legislation. Rules made by the SFC will be subject to negative vetting by the Legislative Council.
2. The Commission now releases the draft Rules (see Attachment A) for public consultation.
3. For those registered persons who have established connection with the FinNet, the SFC has used the FinNet to send copies of the draft Rules and the consultation document to them. The SFC has also advised all registered persons and exempt persons of this consultation and invited them to collect a copy free of charge at the SFC’s office or access the SFC’s Internet web site at <http://www.hksfc.org.hk>.
4. The public is invited to submit comments before close of business on 12 July 2002. Comments should be submitted by the following means:
 - (a) by fax: Fax number: (852) 2523-4598
 - (b) by mail: SFC (Financial Resources Rules)
12/F, Edinburgh Tower
The Landmark
15 Queen’s Road Central
Hong Kong
 - (c) by email: financial_resources_rules@hksfc.org.hk
 - (d) by online submission: <http://www.hksfc.org.hk>
5. The draft Rules should be read in conjunction with the SFO.
6. Please note that the names of the commentators and their submissions received will 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 (see Attachment B).

7. You may not wish your name to be published by the SFC. If this is the case, please state that you wish your name to be withheld from publication when you make your submission.
8. To ensure that an appropriate balance is struck between investor protection and general market practice, the SFC has formulated the draft Rules after considering submissions from the market and discussions with selected firms and representatives from selected industry groups. We wish to acknowledge and thank them for their invaluable input.

Background

9. During March 2002, the SFC released for public consultation a consultative document proposing two amendments to the current Financial Resources Rules made under section 28 of the Securities and Futures Commission Ordinance (the "FRR") designed to address risks arising from aggressive margin lending and funding practices noted amongst firms conducting securities margin financing. Besides commenting on the proposed amendments, some of the respondents recognized the need to address various structural and financial risk issues in the longer-term and suggested possible alternative approaches. These issues, such as the pooling of clients' securities and the required capital level for firms conducting different business activities, are fundamental issues that Hong Kong should address in the context of the overall framework for intermediaries and market participants.
10. As considerable time is required for the necessary review, discussion, consultation and consensus building on these structural issues, and any proposals are likely to be far-reaching, they cannot realistically be implemented before the SFO comes into effect.
11. Given the need to manage down the risks inherent in some of the more aggressive lending and funding practices in the margin financing area, especially against the current economic climate and market downturn, the SFC has revised the two proposed amendments (i.e. the "illiquid collateral haircut" and the "gearing adjustment"), taking into account market comments received. The plan is for these revised amendments to come into effect on 1 October 2002, thus amending the current FRR. For details of these two revised amendments, please refer to the relevant consultation conclusion report (see Attachment C).
12. For purposes of formulating the draft Rules to be made under the SFO, the SFC now proposes that Rules should basically follow the current FRR (as amended by the two revised amendments). Only minimal policy changes should be introduced in order to meet the following objectives:
 - (a) *to facilitate market development and reduce compliance cost*
 - (i) acknowledging that many brokers nowadays allow their cash clients to settle on a rolling balance basis;

- (ii) recognizing overseas futures/options exchanges or clearing houses in Korea and Malaysia;
 - (iii) excluding liabilities corresponding to client money held overseas (subject to conditions) from the calculation of total liabilities;
 - (iv) applying lower discount rates (i.e. haircut percentages) to constituent stocks of the Hang Seng Hong Kong LargeCap Index and the Hang Seng Hong Kong MidCap Index;
 - (v) disapplying the grouping of related securities in the calculation of the concentration discounting factor;
 - (vi) allowing licensed corporations to use their own fiscal reporting dates rather than calendar month-ends; and
 - (vii) requiring quarterly submission instead of monthly submission for part of the financial returns.
- (b) *to support the new single licensing regime under the SFO*
- (i) consolidating the FRR and the Leveraged Foreign Exchange Trading (Financial Resources) Rules (the “LFET-FRR”), streamlining and rationalising the requirements as appropriate;
 - (ii) introducing one standard set of capital rules for universal application to all types of licensed corporations; and
 - (iii) accommodating the conduct of multiple regulated activities by licensed corporations.

These minimal changes are designed as part of the SFC’s ongoing effort to de-regulate, recognizing the industry’s desire for a more streamlined regulatory approach, and the market’s need for a facilitative regime.

Summary of the New Proposals

Overall regime

13. We propose to have a uniform financial resource regime applicable to all licensed corporations. The changes from the existing regime have been summarised as follows:

- (a) “Paid-up share capital” is defined in the LFET(FR)R but not in the FRR.

For consistency of treatment, we propose not to define “paid-up share capital” so that it will bear its ordinary meaning in the draft Rules.

- (b) All licensed corporations should be subject to the liquid capital requirement, and there should not be different capital calculation bases for different corporations.

Under the current FRR, certain types of registered persons are subject to a net tangible assets requirement, not a liquid capital requirement. The former is not effective as a regulatory capital requirement for it is a basic solvency test. It does not attempt to assess the quality of assets. For the purposes of net tangible assets calculation, assets such as fixtures and fittings, computer equipment, unlisted securities, unsecured amounts receivable from directors and group companies can all be included in the computation. Assets of such nature may not give sufficient comfort that a firm can continue as a going concern.

In view of the above, we propose to replace the net tangible assets requirement by the liquid capital requirement for all licensed corporations.

- (c) Where a corporation is licensed for more than one regulated activity, the highest of all the monetary requirements (for establishing the required liquid capital) and the highest of the paid-up share capital requirements which are applicable to the different regulated activities should apply.

This is consistent with the existing FRR. It is not appropriate nor necessary to raise the overall monetary requirement by adding together all the different monetary requirements for the different regulated activities just because a licensed corporation conducts more than one regulated activity. As the total liabilities test takes into account the aggregate of a licensed corporation's on balance sheet liabilities as well as various off balance sheet positions, the total liabilities test would capture all the liabilities and margin requirements incurred as a result of the regulated activities. As a result, requiring the firm to maintain the highest of the required liquid capital and paid-up share capital that are applicable to the regulated activities would be sufficient for financial resources purposes.

Take, for example, a licensed corporation that is licensed for 5 regulated activities: dealing in securities, dealing in futures contracts, advising on securities, advising on futures contracts and leveraged foreign exchange trading. Under the draft Rules, this licensed corporation is only required to maintain minimum liquid capital of \$15 million (subject to any increase made necessary by the total liabilities test) and paid-up share capital of \$30 million, being the highest of the requirements as applicable to leveraged foreign exchange trading.

If these different regulated activities were to be conducted by 5 different licensed corporations, in aggregate terms, these corporations

would need to maintain minimum liquid capital of \$27 million and paid-up share capital of \$50 million.

We believe that the draft Rules with these capital savings can prove most useful to the market for raising their return on capital and improving the quality of services provided to clients.

This also marks a very important first step taken by the SFC in the direction of de-regulation.

- (d) For those advisers and asset managers that are subject to a licensing condition that they shall not hold client assets, they should maintain liquid capital with the monetary requirement set at \$100,000. In other cases, the monetary requirement would be raised to \$3 million and in addition, they should maintain paid up share capital of not less than \$5 million.

For those advisers and asset managers that are not in a position to hold client assets, when it is important that they should still have reasonably sufficient liquid funds to ensure they remain a going concern, their failure should not have a direct financial impact on their clients save for inconvenience brought about by disruption of services rendered. As a consequence, the liquid capital that they should be required to maintain should be significantly less.

- (e) Leveraged foreign exchange traders should maintain minimum liquid capital set at the higher of
 - (i) \$15 million; and
 - (ii) the sum of 5% of total liabilities and 1.5% of aggregate gross positions (“AGP”) for all foreign currencies excluding positions with a recognized counterparty.

The \$15 million liquid capital requirement has been reduced from the existing \$25 million requirement in accordance with the recommendation made by the 1996 Review of the Leveraged Foreign Exchange Trading Regulatory System (the “LFET Review”).

As part of the rationalisation process, the total liabilities test (being the cornerstone of the liquid capital requirement) should be applied also to leveraged foreign exchange traders.

The 1.5% AGP requirement is derived from the existing requirement in the LFET(FR)R which limits AGP to 60 times the liquid capital of a leveraged foreign exchange trader.

- (f) Providers of automated trading services should be treated on the same basis as securities and futures dealers.

Paragraph 15 of the Guidelines for the Regulation of Automated Trading Services (issued by the Commission in February 2002) concludes that the FRR requirement applicable to ATS providers should generally be commensurate with that applicable to licensed dealers. An exception should be made where an ATS involves the novation of settlement obligations and provision of settlement guarantees. In this case, the SFC would seek to apply international best practices. Instead of proposing a monetary requirement for this activity now, we believe that this should be stipulated on a case-by-case basis, probably by way of licensing conditions.

- (g) Apart from excluding liabilities corresponding to client money held in accordance with the Securities and Futures (Client Money) Rules, the total liabilities test should also exclude liabilities corresponding to client money held overseas provided that such money is maintained in separate accounts with any authorized financial institution or approved bank outside Hong Kong.

The exclusion in the existing FRR is limited to money held in accordance with the Securities Ordinance and the Commodities Trading Ordinance. Given that the Securities and Futures (Client Money) Rules would not apply to client money held overseas, we would need an extension in order to avoid any undue burden for licensed corporations that provide dealing services in overseas markets and in particular, asset managers that hold client money in trust/segregated accounts outside Hong Kong.

Haircut deduction applicable to local stocks

- 14. We propose to change the existing haircut deduction structure so that
 - (a) a 15% haircut would be applied to Constituent stocks of the Hang Seng Hong Kong LargeCap Index; and

Constituent stocks of the Hang Seng Hong Kong LargeCap Index are considered to be of the same standing as constituent stocks of the Hang Seng Index. Hence, they should attract the same haircut.

- (b) a 20% haircut would be applied to Constituent stocks of the Hang Seng Hong Kong MidCap Index.

Hang Seng Hong Kong MidCap Index can be used to identify the middle ranking stocks now that the old Hang Seng 100 Index has been abolished.

Treatment of cash clients

- 15. More and more cash clients are now permitted to roll their balance provided that any net trade receivable is adequately covered by the securities held in safe custody by the securities dealer.

16. Whereas we maintain that receivables from and payables to the same cash client should generally be treated on a gross basis, we propose to give securities dealers an option to set off receivables from and payables to the same cash client and include any net receivable in liquid assets provided that the amount for each client so included shall not exceed the market value less applicable haircut (hereafter referred to as “admissible value”) of all securities held by the licensed corporation for or on behalf of that client.
17. Both account balance and stock balance should be computed on the trade date basis and this option is only available where the dealer has obtained the authority of the client -
 - (a) to set off transactions; and
 - (b) to dispose of the client's securities which are held in its custody when the client fails to meet any liability he owes.

Treatment of margin accounts

18. We propose to retain the newly added “illiquid collateral haircut” and “gearing adjustment” in the draft Rules. In addition, we also propose to drop the grouping of related securities in the calculation of the concentration discounting factor; this should simplify the calculation and reduce compliance work.

Leveraged foreign exchange trading

19. We propose that -
 - (a) for cross-currency transactions¹, leveraged foreign exchange traders need only collect 1 set of margin;

This is in accordance with recommendation made in the LFET Review.

and

- (b) locked positions² held by the same client (except omnibus account) in the same currency should be counted as one position for the purpose of margin requirements and AGP calculations.

The 1996 LFET Review concluded that allowance should be given for locked positions as they do not pose any risk until the client decides to unlock the position by closing out either leg of the position, in which case the exposure will still be on one side of the position.

¹ A cross trade is one in which the client takes a position between two currencies other than the US\$.

² where the client simultaneously holds an equal long and short position in the same currency

List of overseas markets

20. We propose to add Malaysian Derivatives Exchange Berhad and Korea Futures Exchange to our list of specified exchanges (so that amounts receivable from, or cash deposited with their clearing houses, or clearing members of these clearing houses can be included as liquid assets) as we recognize that they are subject to comparable regulatory controls.

Introduction of transactions

21. The existing FRR acknowledge that there are dealers that do not book amounts receivable and payable on their balance sheet when they introduce transactions even though they may be subject to the recourse of clients or other dealers to whom they have introduced the transactions. In these circumstances, the dealers are required to make an adjustment to the extent that the aggregate of their total liabilities and the consideration of unsettled trades exceeds \$60 million. An express agreement or a clear market practice is currently required to establish whether there is recourse or not.
22. We understand that there may not be express agreement where the Hong Kong entity introduces transactions to an overseas affiliate. We accordingly propose an exception be made where the licensed corporation introduces transactions to another dealer for execution or clearing where that other dealer
 - (a) is in the same group of companies as the licensed corporation; and
 - (b) has a direct broker-client relationship with the clients whose transactions have been introduced thereto by the licensed corporation and the licensed corporation is not legally liable to the client for settlement of such transactions or fault of that other dealer.

Financial return

23. We propose to consolidate the FRR Return and the LFET(FR)R Returns and rationalise them where appropriate. Under section 402 of the SFO, the SFC can specify the form in respect of these returns by notice published in the Gazette. On this basis, we have not included the draft returns in the draft Rules. However, the main proposals will still be covered in this Consultative Document in the usual manner.
24. Our major proposals include:
 - (a) electronic filing of financial return, with a digital signature attached, should become mandatory;

Automatic uploading of data into the SFC databases is essential for timely assessment of the solvency of firms and accurate assessment of the risks involved in any firm's regulated activities. This, in turn, can ensure more effective regulation of the industry and management of its risks in the interests of investor protection and systemic stability.

Moreover, the firms should also be able to benefit from the built-in validation checks to reduce input errors.

- (b) 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; those that are not subject to such a condition should submit financial return on a monthly basis;
- (c) there should be segmental reporting for client assets, number of active clients, turnover, income and expenses arising from different regulated activities;
- (d) licensed corporations should be able to elect to use their own fiscal month-ends as their FRR return reporting date. Such election should be notified to the Commission in writing, setting out the basis of how such fiscal month-ends are set and any subsequent change should require prior written approval from the Commission;
- (e) the report on proprietary derivative positions which is required to be submitted at monthly intervals by the FRR should only be submitted on a quarterly basis as regard March, June, September and December;
- (f) a number of additional disclosures should be made, such as management fee receivable from or payable to group companies or related parties of the licensed corporation.

Transitional arrangement

- 25. We propose to allow a period of 3 months before exempt dealers and exempt investment advisers that are not authorized institutions, are required to comply with the new Rules. This should give them sufficient time to institute the necessary capital and system changes.
- 26. Since sole proprietors and partnerships shall be grandfathered into the new regime by being deemed to be licensed corporations, they cannot comply with the paid-up share capital requirement until such time as they have completed the process of incorporating and obtaining their new licence as such.

The draft Rules will contain transitional provisions so that "paid-up share capital" can be taken to mean capital accounts until such time as these sole proprietors and partnerships have completed the process of incorporating and obtaining their new licence as such and require them to account for amounts receivable from, and payable to, themselves as amounts receivable from, and payable to, third party clients. This, in fact, is no different from the prevailing requirement in the existing FRR.

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SECURITIES AND FUTURES (FINANCIAL RESOURCES) RULES

(Made by the Securities and Futures Commission under section 145(1) of the Securities and Futures Ordinance (Ord. No. 5 of 2002) after consultation with the Financial Secretary)

PART 1

PRELIMINARY

1. Commencement

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

2. Interpretation

In these Rules, unless the context otherwise requires -

"adjusted liabilities" (經調整負債) for the purpose of calculating the variable required liquid capital of a licensed corporation, means the sum of its on-balance sheet liabilities including provisions, 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, made by the Commission under section 149 of the Ordinance;
 - (ii) client money held by it in a segregated account with an approved bank incorporated outside Hong Kong and, to the extent not covered in subparagraph (i) above, with an authorized financial institution;
 - (iii) in relation to futures contracts or options contracts traded on behalf of its clients, cash balances held by it in a segregated account maintained with a futures or options clearing house; and
 - (iv) in relation to futures contracts or options contracts traded on behalf of its clients, cash balances held as margin with a futures dealer, a clearing participant or a clearing member of a futures or options clearing house; and

(b) approved subordinated loans;

[cf. s.2 FRR "total liabilities"]

"advising on corporate finance" (就機構融資提供意見) has the meaning assigned to it in Part 2 of Schedule 5 to the Ordinance;

[new]

"advising on futures contracts" (就期貨合約提供意見) has the meaning assigned to it in Part 2 of Schedule 5 to the Ordinance;

[new]

"advising on securities" (就證券提供意見) has the meaning assigned to it in Part 2 of Schedule 5 to the Ordinance;

[new]

"aggregate gross foreign currency position" (合計外幣總持倉量) means the aggregate of the gross foreign currency positions in all foreign currencies of a licensed corporation licensed for leveraged foreign exchange trading, excluding positions 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 sum of money or other form of security required to be deposited as margin upon opening a position or for maintaining an existing

position in a futures contract or an options contract, including all subsequent or maintenance margin deposits required from time to time until that position is closed out, calculated as the highest prevailing margin amount set by -

- (a) the exchange company operating the relevant market in which the futures contract or options contract is traded;
- (b) the futures or options 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]

"approved bank incorporated outside Hong Kong" (核准在香港以外地方成立為法團的銀行) means a bank incorporated outside Hong Kong which is incorporated under the law or other authority of -

- (a) a prescribed country; or
- (b) any jurisdiction outside Hong Kong which is approved by the Commission under section 60(1),

including its branches and wholly owned subsidiaries which are banks, within the meaning of Part 1 of Schedule 1 to the Ordinance;

[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 by the Commission under section 60(1)(b);

[new]

"approved redeemable shares" (核准可贖回股份) means shares in the share capital of a licensed corporation which are redeemable at the option of the holder of the shares or the licensed corporation and approved by the Commission under section 60(5)(a);

[cf. s.2 FRR]

"approved securities borrowing and lending counterparty" (核准證券借貸對手方) means -

- (a) a recognized clearing house; or
- (b) a person approved as such by the Commission under section 60(1)(c);

[cf. s.2 FRR]

"approved stand-by subordinated loan facility" (核准備用後償貸款融通) means a loan facility provided to a licensed corporation licensed for dealing in securities, dealing in futures contracts, leveraged foreign exchange trading or securities margin

financing, which is approved by the Commission under section 60(5)(c), 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 subordinated loan" (核准後償貸款) means a loan provided to a licensed corporation, which is approved by the Commission under section 60(5)(b), under which the lender's claim 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]

"asset management" (資產管理) has the meaning assigned to it in Part 2 of Schedule 5 to the Ordinance;

[new]

"authorized financial institution" (認可財務機構) has the meaning assigned to it in Part 1 of Schedule 1 to the Ordinance, and in relation to -

(a) a bank, includes -

(i) any local branch, within the meaning of section 2(1) of the Banking Ordinance (Cap. 155); and

- (ii) any wholly owned subsidiary that is a bank;
- (b) 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), means -
 - (i) its principal place of business in Hong Kong; and
 - (ii) any local branch, within the meaning of that section;

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

"automated trading services" (自動化交易服務) has the meaning assigned to it in Part 2 of Schedule 5 to the Ordinance;

[new]

"clearing participant" (結算所參與者), in relation to a futures or options clearing house, means -

- (a) a clearing participant, within the meaning of Part 1 of Schedule 1 to the Ordinance; and
- (b) a person who, in accordance with the rules of a futures or options clearing house outside Hong Kong, 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) means the shares specified in column 2 of Table 1, 2 or 3 in Schedule 1, other securities specified in column 1 of Table 7 in Schedule 1, qualifying debt securities specified in column 1 of Table 4 in Schedule 1 and special debt securities specified in column 1 of Table 6 in Schedule 1, which are deposited as security -

(a) by a licensed corporation with another person; or

(b) with a licensed corporation by a client, and which -

(i) are unencumbered, in its possession and readily realizable by it;

(ii) if held in Hong Kong, 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, made by the

Commission under section 148 of the Ordinance; or

(iii) if held outside Hong Kong, are encumbered only by virtue of being deposited with or pledged to -

(A) an authorized financial institution or 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 a regulated activity which, if it were carried on in Hong Kong would constitute dealing in securities or dealing in futures contracts; or

(C) a futures or options clearing house or its clearing member or clearing participant 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 clients" (共同客戶) means clients of a licensed corporation licensed for dealing in securities who are also clients of a licensed corporation licensed for securities margin financing and whose dealings in securities through the first mentioned corporation are settled on their behalf by the second mentioned corporation;

[cf. s.2 FRR]

"concentration discounting factor" (集中折扣系數) in relation to securities received as collateral by a corporation licensed for dealing in securities or securities margin financing from margin clients, means -

- (a) where the securities are 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 those securities which are so received as collateral;
- (b) to the extent not already covered in paragraph (a) above, where the securities are 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 those securities which are so received as collateral;
- (c) to the extent not already covered in paragraph (a) or (b) above, where the securities are 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 those securities which are so received as collateral; and
- (d) where the securities are 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 those warrants which are so received as collateral;

[cf. s.2 FRR]

"dealing in futures contracts" (期貨合約交易) has the meaning assigned to it in Part 2 of Schedule 5 to the Ordinance;

[new]

"dealing in securities" (證券交易) has the meaning assigned to it in Part 2 of Schedule 5 to the Ordinance;

[new]

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

[new]

"exchange participant" (交易所參與者) in relation to a specified exchange, means -

- (a) an exchange participant within the meaning of Part 1 of Schedule 1 to the Ordinance; and
- (b) 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" (豁免負債) 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, made by the Commission under section 149 of the Ordinance;

- (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) above, with an authorized financial institution; and
- (c) in relation to futures contracts or options contracts traded on behalf of its clients, cash balances held by it in a segregated account maintained with a recognized clearing house;

[new]

"FinNet" (金融服務網絡) means the secure private network operated by FinNet Limited for interconnecting, among others, licensed corporations and the Commission;

[new]

"floating losses" (浮動虧損) means unrealized losses calculated by marking to market open positions in -

- (a) foreign currency contracts; and
- (b) futures contracts or options contracts;

[cf. s.2 LFET FRR]

"floating profits" (浮動利潤) means unrealized profits calculated by marking to market open positions in -

- (a) foreign currency contracts; and
- (b) futures contracts or options contracts;

[cf. s.2 LFET FRR]

"foreign currency" (外幣) in relation to a licensed corporation, means any currency other than -

- (a) the currency used, or intended to be used, by it in its annual accounts; and
- (b) any currency which has an exchange rate which is linked to the currency referred to in paragraph (a);

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

"foreign exchange agreement" (外匯協議) means an agreement other than a futures contract or an options contract, whereby 2 parties agree to exchange different currencies at a future time;

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

"free delivery" (信用交付) means -

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

[cf. s.2 FRR]

"futures contract" (期貨合約) other than for the purposes of the definition of dealing in futures contracts,

has the meaning assigned to it in Part 1 of Schedule 1 to the Ordinance except that it does not include an options contract;

[new]

"futures dealer" (期貨交易商) means -

- (a) a licensed corporation licensed for dealing in futures contracts; and
- (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 dealing in futures contracts;

[new]

"futures non-clearing dealer" (期貨非結算交易商) means a licensed corporation licensed for dealing in futures contracts which is an exchange participant, but is not a clearing participant;

[cf. s.2 FRR]

"futures or options clearing house" (期貨或期權結算所) means

-

- (a) a recognized clearing house, within the meaning of Part 1 of Schedule 1 to the Ordinance; and
- (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 contract; and

- (b) the aggregate 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 contract,

except that each pair of outstanding contracts that the licensed corporation holds with a client (other than a client whose account with the licensed corporation is an omnibus account), where -

- (i) one contract of the pair is intended to exchange an amount in a currency ("A") for an amount in another currency ("B"); and

- (ii) the other contract of the pair is intended to exchange the same amount in the other currency ("B") for an amount of the first-mentioned currency ("A"),

shall, notwithstanding section 12, be treated as one contract.

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

“group of related margin clients” (一組關連保證金客戶) means any two or more margin clients of a licensed corporation licensed for dealing in securities or securities margin financing -

(a) of whom one is the spouse of another margin client;

(b) of whom 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 those other margin clients; or

(c) which are members of the same group of companies;

[*cf. s.2 FRR*]

“haircut amount” (扣減數額) in relation to any shares specified in column 2 of Table 1, 2 or 3 in Schedule 1, other investments specified in column 1 of Table 8 in Schedule 1, other securities specified in column 1 of Table 7 in Schedule 1, qualifying debt securities specified in column 1 of Table 4 in Schedule 1 and special debt securities specified in column 1 of Table 6 of Schedule 1, means an amount equal to its market value multiplied by the applicable haircut percentage;

[*cf. s.2 FRR*]

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

- (a) any shares specified in column 2 of Table 1, 2 or 3 in Schedule 1, means the applicable percentage specified in column 3 of the relevant Table;
- (b) other investments specified in column 1 of Table 8 in Schedule 1, means the applicable percentage specified in column 2 of the Table;
- (c) other securities specified in column 1 of Table 7 in Schedule 1, means the applicable percentage specified in column 2 of the Table;
- (d) qualifying debt securities specified in column 1 of Table 4 in Schedule 1, having regard to the term to maturity specified in column 1 of Table 5, means the aggregate of the applicable percentages specified in column 2 of Table 4 and in column 2 or 3 (as the case may be) of Table 5 in Schedule 1; and
- (e) special debt securities specified in column 1 of Table 6 in Schedule 1, means the applicable percentage specified in column 2 of the Table;

[cf. s.2 FRR]

"initial margin requirement" (規定開倉保證金) means the sum of money or other form of security required to be deposited as margin upon opening a position in a futures contract or an options contract, calculated as the highest prevailing margin amount set by -

- (a) the exchange company operating the relevant market in which the futures contract or options contract is traded;
- (b) the futures or options 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 2 parties 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 stock options contract, $N \times (M - S)$
- (b) a put stock options contract, $N \times (S - M)$
- (c) a call warrant on shares, $N \times (M - S)$
- (d) a call options contract on an asset other than shares, $M - S$

(e) a put options contract on an asset other than shares, $S - M$,

where -

"N" equals the number of shares underlying the options contract or warrant;

"M" equals the market value of the share or asset underlying the options contract or warrant; and

"S" equals the strike price of the options contract or the exercise price of the warrant, and "in-the-money", in relation to an options contract or warrant, shall be construed accordingly;

[cf. s.2 FRR]

"introducing agent" (介紹代理人) means a licensed corporation which has been approved by the Commission as an introducing agent under section 60(4);

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

"leveraged foreign exchange trading" (槓桿式外匯交易) has the meaning assigned to it in Part 2 of Schedule 5 to the Ordinance;

[new]

"liquid assets" (速動資產), in relation to a licensed corporation, means such assets as are prescribed in Division 2 of Part 3;

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

"liquid capital" (速動資金) means the amount by which liquid assets exceeds 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 dealing in securities, a client to whom the licensed corporation provides securities margin financing; or
- (b) a client of a licensed corporation licensed for securities margin financing;

[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 open positions to reflect current market values;

[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 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 1]

“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 contract; and

(b) the aggregate 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 contract;

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

“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]

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

- (a) buy, whether by way of issue or transfer, or sell a specified quantity of securities or other property; or
- (b) be paid an amount of money calculated by reference to the value of such securities, futures contracts or other property or index, as may be specified in the contract;

[new]

"other investments" (其他投資項目) means the items specified in column 1 of Table 8 in Schedule 1;

[cf. s.2 FRR]

"other securities" (其他證券) means the securities specified in column 1 of Table 7 in Schedule 1;

[cf. s.2 FRR]

"out-of-the-money amount" (價外值) means, in relation to -

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

where -

"N" equals the number of shares underlying the options contract or warrant;

"M" equals the market value of the share underlying the options contract or warrant;

"S" equals the strike price of the options contract or the exercise price of the warrant, and "out-of-the-money", in relation to an options contract or warrant, shall be construed accordingly;

[cf. s.2 FRR]

"prescribed country" (訂明國家) means -

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

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

"qualifying debt securities" (合資格債務證券) means debenture stock, loan stock, debentures, bonds, notes and any securities or other instruments acknowledging, evidencing or creating indebtedness -

- (a) which are issued or guaranteed by -
 - (i) the central government or central bank of the People's Republic 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 Investor 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; or
- (e) the guarantor of which has at least one issue currently rated by -
 - (i) Moody's Investor 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,

but does not include special debt securities, IOUs and securities or instruments acknowledging, evidencing or creating subordinated debts or debts due from one corporation within a group of companies

to another corporation within that group, if the holder is a member of that group;

[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 liabilities and financial adjustments prescribed in Division 3 of Part 3;

[cf. s.2 FRR]

"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;

[new]

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

[new]

"repurchase transaction" (回購交易) means a sale of securities whereby the seller is obliged to repurchase from the purchaser, or the purchaser is obliged to resell to the seller, securities of the same description at a pre-determined price and date;

[cf. s.2 FRR]

"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 the liquid capital it is required under section 6 to maintain exceeds the amount of liquid capital it maintains;

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

"securities dealer" (證券交易商) means -

- (a) a licensed corporation licensed for dealing in securities; and
- (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 dealing in securities;

[cf. S.2 FRR]

"securities margin financing" (證券保證金融資) -

- (a) in relation to an activity carried on by a licensed corporation means providing a financial accommodation in order to facilitate -
 - (i) the acquisition of securities listed or traded on any stock market, whether a recognized stock market or any other stock market outside Hong Kong; and

- (ii) (where applicable) the continued holding of those securities; and
- (b) in relation to a regulated activity for which a licensed corporation is licensed, has the meaning assigned to it in Part 2 of Schedule 5 to the Ordinance;

[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, made by the Commission under section 149 of the Ordinance; or
- (b) an account for holding client money which is separate from a licensed corporation's house account;

[new]

"settlement date" (交收日期) in relation to any dealing in securities, means -

- (a) in relation to transactions effected on a stock market, the date on which payment for the securities is first due in accordance with the rules of the exchange company that operates the stock market; or
- (b) in relation to any other transactions, the date on which payment for the securities

is first due as agreed between the parties
to the transaction,
but in either case, 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 government or central
bank of the People’s Republic 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 Investor 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; or
- (e) the guarantor of which has at least one issue currently rated by -
 - (i) Moody's Investor 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,

but does not include IOUs and securities or instruments acknowledging, evidencing or creating subordinated debt or debt due from one corporation

within a group of companies to another corporation within the group, if the holder is a member of that group;

[cf. s.2 FRR]

"specified licensing condition" (指明發牌條件), in relation to a licensed corporation licensed for advising on securities, advising on futures contracts, advising on corporate finance or asset management, means the licensing condition that the licensed corporation shall not hold client assets;

[new]

"specified exchange" (指明交易所) means an exchange specified in Schedule 2 and, where appropriate, includes a stock or futures market operated by such an exchange;

[new]

"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 agrees to deliver to the other party at an agreed future time an agreed quantity of a specific share at an agreed price; or

(b) the parties will make an adjustment between themselves at an agreed future time according to whether at that time an

agreed quantity of a specific 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 agrees to provide to the other party the right to purchase or sell at an agreed price an agreed quantity of a specific share at or before an agreed future time;

[cf. s.2 FRR]

"trade date" (交易日) in relation to any dealing in securities, futures contracts, options contracts and leveraged foreign exchange contracts, means -

- (a) in the case of transactions on any stock market, the date on which the transaction was effected; and
- (b) in any other case, the date on which the agreement between the parties was made;

[new]

"trader" (買賣商) means a licensed corporation licensed for dealing in securities or dealing in futures contracts which does not hold client assets or handle clients' orders and, in respect of 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 1]

3. Accounting practices

(1) A licensed corporation -

(a) shall account for all assets and liabilities in accordance with generally accepted accounting practices, unless otherwise specified in these Rules;

(b) shall account for all assets and liabilities in a way that recognizes the substance of a transaction, arrangement or position including, for example, accounting for a structured bond as a derivative product and not as a debt security; and

(c) shall not, without the Commission's prior written approval, adopt an accounting practice that is inconsistent with this section.

[s.4 FRR, s. 3 LFET FRR ((a) only)]

(2) Subject to subsection (3), a licensed corporation shall not without the Commission's prior written approval change any of its accounting practices in a way that may materially effect the amount of liquid capital or paid-up share capital that it maintains or is required under Part 2 to maintain.

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

[s.32 FRR, s.9 LFET FRR]

PART 2

FINANCIAL RESOURCES REQUIREMENTS

4. Licensed corporations to maintain financial resources

A licensed corporation shall have and at all times maintain financial resources in the amount calculated in

accordance with the requirements specified in this Part.

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

5. Paid-up share capital requirement for licensed corporations

A licensed corporation other than -

- (a) an introducing agent approved by the Commission under section 60(4), except a licensed corporation licensed for leveraged foreign exchange trading;
- (b) a trader;
- (c) a futures non-clearing dealer; and
- (d) in the case of a licensed corporation licensed for advising on corporate finance, advising on futures contracts, advising on securities or asset management, where it is subject to the specified licensing condition,

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

- (i) where it is licensed for only one regulated activity specified in column 1 of Table A, below, the corresponding amount specified in column 2 of the Table; or

(ii) where it is licensed for more than one regulated activity, the higher or highest corresponding amount for all such regulated activities specified in column 2 of the Table.

TABLE A

Regulated activity	Required paid-up share capital
Dealing in securities - (a) Where it provides securities margin financing; (b) Others	\$10,000,000 \$5,000,000
Dealing in futures contracts	\$5,000,000
Leveraged foreign exchange trading - (a) Where it is an introducing agent; (b) Others	\$5,000,000 \$30,000,000
Advising on securities and not subject to the specified licensing condition	\$5,000,000
Advising on futures contracts and not subject to the specified licensing condition	\$5,000,000
Advising on corporate finance and not subject to the specified licensing condition	\$5,000,000

Providing automated trading services	\$5,000,000
Securities margin financing	\$10,000,000
Asset management and not subject to the specified licensing condition	\$5,000,000

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

6. Required liquid capital for licensed corporations

(1) A licensed corporation shall have and at all times maintain liquid capital of not less than the required liquid capital which is applicable to it.

(2) In this section -

“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 licensed for only one regulated activity specified in column 1 of Table B, below, the corresponding amount specified in column 2 of the Table; or

(b) where it is licensed for more than one regulated activity specified in column 1 of Table B, below, the higher or highest corresponding amount for all such regulated activities specified in column 2 of the Table; and

(c) its variable required liquid capital; and

TABLE B

Regulated activity	Liquid capital
Dealing in securities - (a) Where it is an introducing agent or trader; (b) Others	 \$500,000 \$3,000,000
Dealing in futures contracts - (a) Where it is an introducing agent, futures non-clearing dealer or trader; (b) Others	 \$500,000 \$3,000,000
Leveraged foreign exchange trading - (a) Where it is an introducing agent; (b) Others	 \$3,000,000 \$15,000,000
Advising on securities - (a) Where it is subject to the specified licensing condition; (b) Others	 \$100,000 \$3,000,000
Advising on futures contracts - (a) Where it is subject to the specified licensing condition; (b) Others	 \$100,000 3,000,000
Advising on corporate finance - (a) Where it is subject to the specified licensing condition; (b) Others	 \$100,000 \$3,000,000

Providing automated trading services	\$3,000,000
Securities margin financing	\$3,000,000
Asset management -	
(a) Where it is subject to the specified licensing condition;	\$100,000
(b) Others	\$3,000,000

“variable required liquid capital” (可變的規定速動資金) in relation to a licensed corporation, means the sum of

-

- (a) 5% of the aggregate of -
 - (i) its adjusted liabilities; and
 - (ii) the initial margin requirement in respect of open positions in futures contracts and options contracts held by it on behalf of clients; and
 - (iii) the amount of margin required to be deposited in respect of open positions in futures contracts and options contracts held by it on behalf of clients, to the extent that the futures contracts and options contracts have not been subject to the initial margin requirement described in subparagraph (a)(ii); and

- (b) where the licensed corporation is licensed for leveraged foreign exchange trading, 1.5% of its aggregate gross foreign currency position.

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

7. Reliance upon approved stand-by subordinated loan facility to relieve temporary liquid capital deficit

(1) This section applies to a licensed corporation licensed for one or more of the following regulated activities -

- (a) dealing in securities, unless it is an introducing agent or a trader in respect of that activity;
- (b) dealing in futures contracts, unless it is an introducing agent, a trader or a futures non-clearing dealer in respect of that activity;
- (c) leveraged foreign exchange trading, unless it is an introducing agent in respect of that activity; and
- (d) securities margin financing.

(2) Subject to subsection (3), a licensed corporation which on a particular business day maintains less than the required liquid capital that it is required

under section 6(1) to maintain will not have breached that requirement on that day provided -

(a) it is entitled to draw down at least the amount of the required liquid capital deficit under an approved stand-by subordinated loan facility; and

(b) the required liquid capital that it is required to maintain on that day is at least 20% more than the required liquid capital that it was required to maintain at the close of business on the previous business day, as a result of -

(i) in respect of dealing in securities, an increase in the gross value of its dealings in securities on behalf of clients or aggregate amounts receivable from margin clients or both;

(ii) in respect of dealing in futures contracts, an increase in open positions in futures contracts or options contracts held by it on behalf of clients;

(iii) in respect of leveraged foreign exchange trading, an increase in

aggregate gross foreign currency
position;

(iv) in respect of any two or more of
dealing in securities, dealing in
futures contracts and leveraged
foreign exchange trading, one or more
of the circumstances described in
subparagraphs (i) to (iii) that apply
to it; or

(v) in respect of securities margin
financing, an increase in aggregate
amounts receivable from margin
clients.

(3) Subsection (2) only applies to required liquid
capital deficits occurring on 5 or less business days
during any period of 2 consecutive months.

[cf. s.7 FRR]

PART 3

COMPUTATION OF LIQUID CAPITAL

Division 1 - General

8. Calculation of liquid capital

When calculating liquid capital, a licensed corporation shall account for all assets, liabilities and transactions in accordance with this Part.

[cf. s.11(1) FRR]

9. Calculations to be on trade date basis

A licensed corporation shall calculate all assets and liabilities and transactions arising from any regulated activity carried on by it, and from any dealing in futures contracts, dealing in securities or trading in leveraged foreign contracts, whether as principal or not, on a trade date basis.

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

10. Determining quantities of securities and collateral on a trade date basis

(1) A licensed corporation shall determine the quantity of securities and collateral which it holds for or on behalf of any of its clients on a trade date basis by means of the formula $(A + B) - C$.

(2) For the purposes of the formula in subsection
(1) -

"A" equals the quantity of the securities and collateral held by the licensed corporation for or on behalf of any of its clients;

"B" equals the quantity of the securities which is receivable by the licensed corporation in settlement of a purchase of securities by or on behalf of any of its clients, where the purchase consideration has been debited to the client's account with the licensed corporation; and

"C" equals the quantity of securities which is deliverable by the licensed corporation in settlement of a sale of securities by or on behalf of any of its clients, where the sale consideration has been credited to the client's account with the licensed corporation.

(3) A licensed corporation shall determine the quantity of securities and collateral held by it for its own account by means of the formula $(X + Y) - Z$.

(4) For the purposes of the formula in subsection
(3) -

"X" equals the quantity of the securities held by the licensed corporation to its own account;

"Y" equals the quantity of securities which is receivable by the licensed corporation in settlement

of a purchase of securities by it for its own account; and

"Z" equals the quantity of securities which is deliverable by the licensed corporation in settlement of a sale of securities by it for its own account.

[new, cf. s.5(1)(b)FRR]

11. Valuations

Unless otherwise provided in these Rules, all investments, trading positions and collateral held by a licensed corporation shall be valued at market value, except that -

(a) debt securities, in respect of which there is no market price, shall be valued -

(i) at the average value of quotations obtained from at least 2 market makers or, where in relation to any debt securities there are less than 2 market makers, 2 third party banks, licensed corporations or dealers outside Hong Kong, who customarily deal in such debt securities, or any combination of 2 of such persons; or

(ii) if quotations from at least 2 of the persons specified in subparagraph (i) are not available -

(A) at nil, in the case of long positions; and

(B) at the face value of the debt securities, in the case of short positions; and

(b) securities which have been suspended from trading for at least 3 business days or ceased trading on the exchange on which the securities were listed, shall be valued -

(i) at nil, in the case of long positions; and

(ii) at the last closing price before the suspension or cessation of trading, in the case of short positions,

and any reference in these Rules to the market value of the securities referred to in paragraphs (a) and (b) shall be construed accordingly.

[cf. s.5(2)FRR]

12. Pairs of transactions

A licensed corporation which enters into a pair of transactions in which its roles are opposite, but which

otherwise have identical or similar terms, shall account for the transactions as separate transactions.

[cf. s.5(3)]

13. No set off

Unless otherwise provided in these Rules, 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 except -

(a) balances held by it with a recognised clearing house which may be set off under the rules of the clearing house for settlement purposes;

(b) amounts receivable by it from, and payable by it to, the same person, which -

(i) do not arise from any regulated activity carried on by it; and

(ii) in respect of which it has a legally enforceable right to set off;

(c) amounts receivable by it from, and payable by it to, the same client, which arise from -

(i) dealings in securities which are due to be settled on a cash-against-delivery basis, which relate to the same securities, provided it is

authorized by the client to set off those amounts;

(ii) dealings in securities in relation to which it is authorized by its client to set off those amounts, provided it has opted for the set off of balances due to and from the client under section 23(2); or

(iii) the provision by it to that client of securities margin financing; or

(d) in respect of dealings in securities by the common clients of a licensed corporation licensed for securities margin financing and a licensed corporation licensed for dealing in securities, amounts receivable from and payable to one another.

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

14. Transactions in margined accounts

(1) Unless otherwise provided in these Rules, a licensed corporation shall not set off amounts receivable by it from, and payable by it to, the same client which arise from transactions in different margined accounts maintained with it by the client and in respect of which the client has authorized it to set off such amounts, but

it may instead apply any surplus cash, collateral and bank guarantee which remains in any one of those margined accounts (after all deductions from liquid assets and financial adjustments required by this Part have been made in respect of that account), to reduce or avoid in relation to another margined account of the client the deductions from liquid assets and financial adjustments that would otherwise be required under this Part.

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

(2) In this section, "margined account" (保證金帳戶), in relation to a client of a licensed corporation, means

-

- (a) a securities margin account, being an account of a client to whom a licensed corporation licensed for dealing in securities provides securities margin financing;
- (b) a short selling account;
- (c) a futures contract dealing account;
- (d) an options contract dealing account;
- (e) a securities borrowing and lending account;
- (f) a leveraged foreign exchange trading account; or
- (g) an account held for the purposes of effecting repurchase transactions,

maintained by the client with the licensed corporation.

[cf. s.2 FRR "margined account"]

15. Treatment of exercised options contracts

(1) A licensed corporation shall, immediately upon the exercise of an options contract written by it or purchased on its own account -

(a) treat the options contract as having ceased to exist; and

(b) account for all assets and liabilities arising from the exercise of the options contract.

(2) A licensed corporation shall, immediately upon the exercise of an options contract purchased, written or cleared by it on behalf of another person -

(a) treat the options contract as having ceased to exist; and

(b) account for all assets and liabilities arising from the exercise of the options contract.

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

16. Assignments

(1) A licensed corporation shall not include in its liquid assets amounts receivable by it from clients if such amounts have been assigned by it to others.

(2) A licensed corporation shall not include in its collateral, collateral or other types of security deposited with it by clients if such collateral or other types of security has been assigned by it to others.

[cf. s.5(8) FRR]

17. Treatment of securities borrowing and lending agreements

(1) A licensed corporation which, in a securities borrowing and lending agreement, is the lender of securities, is deemed for the purposes of these Rules -

(a) where the securities so lent are accounted for under section 29 as its house position, to remain the owner of the securities;

(b) not to own any collateral deposited with it as security by the borrower of the securities and so shall not include these in its liquid assets; and

(c) to be liable to the borrower of the securities for an amount equal to any cash deposited with it as security by the borrower of the securities, except where the cash has -

(i) not been included in its liquid assets under section 22; and

(ii) been segregated in a segregated account .

(2) A licensed corporation which, in a securities borrowing and lending agreement, is the borrower of 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;
- (b) to have an amount receivable from the lender of the securities in the amount of cash provided by it as security to the lender of the securities; and
- (c) not to own the securities borrowed and so shall not include these in its liquid assets.

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

18. Treatment of repurchase transactions

(1) Where a licensed corporation is the first seller of securities beneficially owned by it in a repurchase transaction, it is deemed for the purposes of these Rules -

- (a) to remain the owner of the securities so sold; and

(b) to be liable to the purchaser of the securities for an amount equal to the price at which it sold the securities.

(2) Where a licensed corporation is the first purchaser of securities in a repurchase transaction, it is deemed for the purposes of these Rules -

(a) to have an amount receivable from the seller of the securities in the amount of the price at which it purchased the securities; and

(b) not to own the securities purchased and so shall not include these in its liquid assets.

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

Division 2 - Liquid Assets

19. Liquid assets

Subject to sections 9 to 18, 20 and 21, only the assets described in, and required to be calculated in accordance with, this Division constitute the liquid assets of the licensed corporation for the purposes of these Rules.

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

20. Exclusions from liquid assets

(1) Subject to section 21, a licensed corporation shall not include in its liquid assets any assets which it beneficially owns but which it has provided to others as security for its liabilities or obligations.

[cf. s.11(3) FRR]

(2) A licensed corporation which operates a branch outside Hong Kong shall not include in its liquid assets any assets which it is required by an authority or regulatory organization, or under the law of any jurisdiction, outside Hong Kong to maintain 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]

(3) All assets held in a foreign currency that is subject to exchange control, or the proceeds of which upon realization or liquidation are not freely remittable to Hong Kong, shall be excluded from liquid assets unless the licensed corporation reasonably believes that remittance approval can be obtained within 1 week of application for approval to make such remittance to Hong Kong.

[cf. s.11(4) FRR]

21. Assets provided as security

A licensed corporation shall, after complying with all applicable requirements under this Part, include in its liquid assets all assets 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 such person;

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

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

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

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

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

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

[new]

(f) to obtain a bank guarantee for the purpose of enabling it to participate in any fidelity fund established under the rules of a recognized exchange company; or

[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 a guarantee or reserve fund, by whatever name called).

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

22. Cash in hand and at bank

(1) A licensed corporation shall include in its liquid assets -

(a) cash which it beneficially owns and holds;

[cf. s.12(a)]

(b) money which it beneficially owns and -

(i) holds in its own name on account; or

- (ii) holds in a segregated account, with an authorized financial institution or an approved bank incorporated outside Hong Kong in -
 - (A) demand deposits; or
 - (B) time deposits which will mature in 6 months or less; and

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

- (c) interest accrued on time deposits which will mature in 3 months or less which it beneficially owns and holds in its own name on account with an authorized financial institution or approved bank incorporated outside Hong Kong.

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

23. Amounts receivable from clients arising from purchases etc. of securities

(1) Except where an election has been made under subsection (2), a licensed corporation shall, subject to subsection (7), include in its liquid assets, in respect of amounts receivable from clients which arise from purchases of securities on a cash-against-delivery basis

-

- (a) amounts receivable which have been outstanding for 5 business days or less after the settlement date; and
- (b) where an 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) the amount receivable less any specific provision made for bad or doubtful debts; and
 - (ii) the market value of the securities purchased.

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

(2) Subject to subsection (7), a licensed corporation may elect to set off amounts receivable from and amounts payable to the same client which arise from purchases and sales of securities on a cash-against-delivery basis, provided that it has obtained from the client an authorization to -

- (a) set off amounts receivable from and amounts payable to the client; and
- (b) dispose of securities held for or on behalf of the client for the purpose of

settling any liability owed by the person 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 from and the amount payable to a client which arises from purchases and sales 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 positive value that remains after deducting from the amount receivable, the amount payable and any specific provision made for bad or doubtful debts; and
- (b) the market value of the securities held for or on behalf of the client less the applicable haircut amounts.

(4) Subject to subsection (7), a licensed corporation shall include in its liquid assets, in respect of amounts receivable from clients which arise from purchases and sales of securities on a free delivery basis, the amounts receivable calculated on a transaction-by-transaction basis which -

- (a) where the clearing system of the stock market on which the securities are traded settles only on a free delivery basis,

have been outstanding for 2 weeks or less after the settlement date; or

(b) in all other cases, are not yet due for settlement in accordance with the rules of the exchange company that operates the stock market on which the securities are traded.

[cf. s.13(3) FRR]

(5) Subject to subsection (7), in respect of securities subscribed for on behalf of clients, a licensed corporation shall, prior to the commencement of trading of the securities on the stock market on which they are listed, include 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 of subscribing for the securities; and

(b) the amounts receivable from the respective clients for subscribing for the securities.

[cf. s.13(9) FRR]

(6) In respect of securities subscribed for on behalf of clients, a licensed corporation shall, after the commencement of trading of the securities on the stock market on which they are listed, include the amount receivable from the clients for subscribing for the

securities in its liquid assets in accordance with subsection (1), (2), (3) or (4) (as the case may be).

[new]

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

[new]

24. Amounts receivable arising from providing securities margin financing

(1) Subject to subsections (2) and (3), a licensed corporation licensed for dealing in securities or for securities margin financing shall, in respect of the provision by it of securities margin financing, include in its liquid assets the amount receivable from a margin client less the higher of -

(a) any specific provision for bad or doubtful debts; and

(b) the margin shortfall amount, calculated as the amount by which the amount receivable exceeds the aggregate of -

(i) the market value of collateral other than illiquid collateral provided by

the client less the applicable haircut amount and multiplied by the applicable concentration discounting factor;

(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 dealing in securities, the maximum amount that can be drawn by it under a bank guarantee provided to it by the client and which is issued by an authorized financial institution or an approved bank incorporated outside Hong Kong.

[cf. s.13(4) FRR]

(2) Notwithstanding sections 9 and 10, a licensed corporation to which subsection (1) applies may, in calculating the margin shortfall in relation to a margin client, elect to exclude from the amount receivable from the client, amounts receivable from the client in respect of dealings in securities which are not yet due for settlement according to the settlement date and, if the licensed corporation so elects the quantity of collateral

referred to in subsection (1)(b)(i) and (ii) shall be equal to the quantity actually received from or on account of the client.

[cf. s.13(5) FRR]

(3) The aggregated amounts that a licensed corporation includes in its liquid assets under subsection (1) in respect of amounts receivable from its margin clients shall not exceed the aggregated amounts receivable from the clients less the aggregated amounts of specific and general provisions for bad or doubtful debts in respect of such amounts receivable.

[new]

(4) In this section -

"average monthly turnover" (平均每月成交額) in relation to a listed share or 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);

"illiquid collateral" (非速動抵押品) in relation to collateral provided to a licensed corporation by a

margin client, means any listed share or warrant which is of the same description as that identified as top 3 collateral 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 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 warrant which has been
so 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;

"market capitalization" (市場資本值) in relation to a
share, means the total number of shares of the same
class as that share issued by the issuer of that
share, as 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
dealing in securities or for securities margin

financing, means any of the 3 highest listed shares or warrants in terms of market value among all shares and warrants provided by him to the licensed corporation as collateral; and

"top margin client (佔首位的保證金客戶) in relation to a licensed corporation licensed for dealing in securities or for securities margin financing, means -

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

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

25. Amounts receivable from counterparties arising from dealings in securities

(1) Subject to subsection (2), a licensed corporation shall include in its liquid assets, in respect of all sales by it of securities to a securities dealer -

- (a) where the securities are sold on a cash-against-delivery basis -
 - (i) amounts receivable from the securities dealer which have been

outstanding for 2 weeks or less after the settlement date; and

- (ii) where an amount receivable from the securities dealer 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) the amount receivable less any specific provision made for bad or doubtful debts; and
 - (B) the market value of the securities sold to the securities dealer;

[cf. s.14(1) FRR]

- (b) where the securities are sold on a free delivery basis, amounts receivable from the securities dealer calculated on a transaction-by-transaction basis, which -

- (i) where the clearing system of the stock market on which the securities are traded settles only on a free delivery basis, have been outstanding for 2 weeks or less after the settlement date; or

(ii) in all other cases, are not yet due for settlement in accordance with the rules of the exchange company that operates the stock market on which the securities are traded.

[cf. s.14(2) FRR]

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

[new]

26. Amounts receivable from dealings in securities by common clients

(1) A licensed corporation licensed for securities margin financing shall include in its liquid assets the net amount receivable from each licensed corporation licensed for dealing in securities with which it has common clients, in respect of dealings in securities through the second mentioned licensed corporation by their common clients which are not yet due for settlement according to the settlement date.

[cf. s.14(5) FRR]

(2) A licensed corporation licensed for dealing in securities shall include in its liquid assets the net amount receivable from each licensed corporation licensed for securities margin financing with which it has common clients, in respect of dealings by those clients in securities which are not yet due for settlement according to the settlement date.

[cf. s.13(8) FRR]

27. Amounts receivable from securities margin financier

(1) Subject to subsection (2), a licensed corporation licensed for dealing in securities shall include in its liquid assets, in respect of amounts receivable from licensed corporations licensed for securities margin financing (other than amounts receivable referred to in section 26(2)), the amounts which, in respect of each such licensed corporation, is the lower of -

(a) the amount receivable less any specific provision for bad or doubtful debts; and

(b) the sum of -

(i) cash deposited with it by such licensed corporation as security; and

(ii) the market value of collateral deposited with it by that licensed

corporation, less the applicable haircut amount.

[cf. s.13(7) FRR]

(2) The aggregated amounts in respect of amounts receivable from licensed corporations licensed for securities margin financing that a licensed corporation licensed for dealing in securities includes in its liquid assets under subsection (1) shall not exceed the aggregated amounts receivable from such licensed corporations less the aggregated amounts of specific and general provisions for bad or doubtful debts in respect of such amounts receivable.

[new]

28. Cash provided as security for short selling

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

- (a) a securities dealer;
- (b) a specified exchange;
- (c) a clearing house of a specified exchange;

or

- (d) a clearing member or clearing participant of a clearing house referred to in paragraph (c).

[cf. s.14(6) FRR]

29. House positions

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

- (a) subject to subsections (2), (3), (4), (6) and (7) , shares specified in column 2 of Table 1, 2 or 3 in Schedule 1 (as the case may be) at market value less the applicable haircut amounts, provided that for shares which are specified in both Table 1 and Table 2 in Schedule 1, it may elect to calculate the haircut amounts by reference to the applicable haircut percentages specified in column 3 of either Table 1 or Table 2 in Schedule 1 (as the case may be);
- (b) qualifying debt securities specified in column 1 of Table 4 in Schedule 1 at market value less the applicable haircut amounts;
- (c) special debt securities specified in column 1 of Table 6 in Schedule 1 at

market value less the applicable haircut amounts;

(d) other securities specified in column 1 of Table 7 in Schedule 1 at market value less the applicable haircut amounts; and

(e) other investments specified in column 1 of Table 8 in Schedule 1, at market value less the applicable haircut amounts.

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

(2) Subject to subsection (5), where a licensed corporation beneficially owns shares and writes a call stock options contract on the same shares, to the extent that the number of shares underlying the options contract is equal to the number of shares it owns, subsection (1)(a) and section 42(3) and (4) do not apply to such shares and the options contract and it shall instead include such shares in its liquid assets at the lower of

-

(a) their market value less the applicable haircut amount; and

(b) the number of such shares multiplied by the strike price of the options contract.

[cf. s.5(13) FRR]

(3) Subject to subsection (5), where a licensed corporation beneficially owns shares and holds a short position in a stock futures contract in respect of the

same shares, to the extent that the number of shares underlying the futures contract is equal to the number of shares it owns, subsection (1)(a) and section 42(4) do not apply to such shares and the futures contract and it shall instead include such shares in its liquid assets at market value.

[cf. s.5(14) FRR]

(4) Subject to subsection (5), where a licensed corporation beneficially owns shares and holds a put stock options contract in respect of the same shares which has been paid in full and is therefore not subject to any margin requirement, to the extent that the number of shares underlying the options contract is equal to the number of shares it owns, it may elect not to apply subsection (1)(a) and section 33(1) to such shares and the options contract and if it so elects, it shall instead include such shares in its liquid assets at the higher of -

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

[cf. s.5(15) FRR]

(5) Subsections (2), (3) and (4) do not apply to 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.

[cf. s.5(12) FRR]

(6) Where a licensed corporation beneficially owns shares and issues call non-collateralized warrants on the same shares, to the extent that the number of shares it owns is equal to the number of shares underlying the warrants which are outstanding, subsection (1)(a) and section 45(1), (2) and (3) do not apply to those shares and warrants and it shall include such shares in its liquid assets at the lower of -

- (a) the market value less the applicable haircut amount; and
- (b) the number of shares multiplied by the exercise price of the warrants.

[cf. s.5(10) FRR]

(7) Where a licensed corporation beneficially owns shares which are charged for the purpose of issuing call collateralized warrants on those shares, subsection (1)(a) and section 45(1), (2) and (3) do not apply to those shares and warrants and it shall include those shares in its liquid assets at the lower of -

- (a) the market value less the applicable haircut amount; and

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

[cf. s.5(11) FRR]

30. Amounts receivable from clearing houses

(1) A licensed corporation shall include in its liquid assets -

- (a) amounts receivable from; and
- (b) cash deposited with,

a recognized clearing house, other than -

- (i) admission fees it has paid to;
- (ii) contributions it has made to the guarantee fund or reserve fund (as the case may be) of; and
- (iii) client money maintained in a segregated account with,

the clearing house.

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

(2) A licensed corporation shall include in its liquid assets -

- (a) amounts receivable from; and
- (b) cash deposited with,

Euroclear or Clearstream, other than -

- (i) admission fees it has paid to; and

(ii) cash it has deposited as security
against its general obligations with,
Euroclear or Clearstream.

[cf. s.14(4) FRR]

(3) A licensed corporation shall include in its
liquid assets, in respect of dealing by it in futures
contracts or options contracts -

(a) amounts receivable from; and

(b) cash deposited with,

a futures or options clearing house other than a
recognized clearing house, other than -

(i) admission fees it has paid to; and

(ii) cash it has deposited as security
against its general obligations with,

such clearing house.

[new; cf. s.16(c) FRR]

**31. Amounts receivable from other dealers arising from
dealings in futures contracts and options contracts**

A licensed corporation shall include in its liquid
assets, in respect of dealing by it in futures contracts
or options contracts amounts receivable from and cash
deposited with -

(a) a licensed corporation licensed for
dealing in futures contracts; or

- (b) a clearing member or clearing participant of a futures or options clearing house.

[cf. s.16(c)FRR]

32. Amounts receivable from clients arising from purchases of exchange-traded options contracts

A licensed corporation shall include in its liquid assets, amounts receivable from clients, calculated on a transaction-by-transaction basis, which arise from purchases of options contracts traded on a specified exchange which have been outstanding for 5 business days or less after the settlement date.

[cf. s.16(d)FRR]

33. Exchange-traded options contracts trading on house account

(1) Subject to subsections (2) and (3) and sections 29(4), 42(7) and (8) and 45(6), a licensed corporation which purchases on its own account options contracts traded on a specified exchange shall include in its liquid assets -

- (a) 60% of the market value of the options contracts, other than options contracts referred to in paragraph (b); or
- (b) for options contracts which are included in the calculation of the net amount of

margin required to be deposited in respect of the options contracts and any other futures contracts or options contracts positions, any net credit balance arising from the calculation that is maintained with -

- (i) a licensed corporation licensed for dealing in futures contracts;
- (ii) a futures or options clearing house ;
or
- (iii) a clearing member or clearing participant of a futures or options clearing house,

provided that the net credit balance has not already been included in liquid assets under sections 30(1) or (3) or 31.

[cf. s.16(e)FRR]

(2) Subject to subsection (4), where a licensed corporation holds a long position in a stock futures contract and holds a put stock options contract in respect of the same underlying shares which has been paid in full and is therefore not subject to any margin requirement, to the extent that the numbers of shares underlying both positions is equal, subsection (1) and section 42(4) do not apply to the options contract and

the futures contract and it shall instead include in its liquid assets the market value of the options contract.

[cf. s.5(21) FRR]

(3) Subject to subsection (4), where a licensed corporation holds a short position in a stock futures contract and holds a call stock options contract in respect of the same underlying shares which has been paid in full and is therefore not subject to any margin requirement, to the extent that the numbers of shares underlying both positions is equal, subsection (1) and section 42(4) do not apply to the options contract and the futures contract and it shall instead include in its liquid assets the market value of the options contract.

[cf. s.5(22) FRR]

(4) Subsections (2) and (3) do not apply to 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.

[cf. s.5(12) FRR]

34. 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 an amount

receivable from the lender of the securities in respect of any cash provided by it as security to the lender.

[cf. s.17(1) FRR]

35. Amounts receivable under repurchase transactions

A licensed corporation which is the first purchaser of securities in a repurchase transaction, shall include in its liquid assets an amount receivable from the seller of the securities in the amount of the price at which it purchased the securities.

[cf. s.17(2) FRR]

36. Amounts receivable arising from leveraged foreign exchange trading

A licensed corporation licensed for leveraged foreign exchange trading shall include in its liquid assets -

- (a) amounts receivable from and cash deposited with a recognized counterparty; and

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

- (b) floating profits in respect of its foreign currency positions.

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

37. Miscellaneous

A licensed corporation shall include in its liquid assets any of the following items that it beneficially

owns and, where appropriate having regard to the nature of the item, holds in its name -

(a) if they arise from carrying on a regulated activity, fees, commissions, commission rebates and interest charges -

(i) which have accrued and will first be due for billing or payment within 3 months; or

(ii) which have been billed or fallen due for payment and remain outstanding for 2 weeks or less after the date on which they were billed or fell due;

(b) deposits maintained with and in accordance with the rules or requirements of a recognized exchange company as security for its liabilities to the recognized exchange company for stamp duty chargeable under the Stamp Duty Ordinance (Cap. 117) on contract notes specified in an agreement made under section 5A of that Ordinance;

(c) prepaid operating expenses which will be incurred within 3 months;

(d) tax reserve certificates issued by the Commissioner of Inland Revenue in

accordance with the Tax Reserve Certificates Ordinance (Cap. 289);

(e) interest accrued under an interest rate swap agreement to which it is a party, other than an amount which remains outstanding after it is first due for payment;

(f) amounts paid by it on its own account for subscribing for -

(i) shares specified in column 2 of Table 1, 2 or 3 (as the case may be);

(ii) other securities specified in column 1 of Table 7;

(iii) qualifying debt securities specified in column 1 of Table 4; or

(iv) special debt securities specified in column 1 of Table 6,

in Schedule 1, less those amounts multiplied by 50% of the applicable haircut percentages;

(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

(h) interest accrued on qualifying debt securities or special debt securities that are traded on an ex-interest basis.

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

Division 3 - Ranking Liabilities

38. Application

Subject to sections 9 to 18, the liabilities and financial adjustments described in and calculated in accordance with this Division constitute the ranking liabilities of a licensed corporation for the purposes of these Rules, save to the extent that it has otherwise made specific provision for such adjustments.

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

39. Amounts payable to clients etc.

A licensed corporation shall include in its ranking liabilities, in respect of regulated activities carried on by it, amounts payable to -

(a) clients, except-

(i) amounts payable in respect of client money held by it in a segregated account with an authorized financial institution, an approved bank incorporated outside Hong Kong or a recognized clearing house; and

- (ii) amounts payable to clients which are set off against amounts receivable from clients under section 23(3) or 24; and

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

- (b) counterparties and clearing houses.

[cf. s.20(1)(c), s.22(1)FRR]

40. Amounts payable arising from dealings in securities

A licensed corporation, in respect of each sale of securities -

- (a) by it on behalf of a client who is in default of his obligation to deliver the securities; and
- (b) which it has not settled with securities purchased at its own expense,

shall include in its ranking liabilities the amount by which the market value of the securities exceeds the price at which they were sold, provided the client has been in default for more than -

- (i) 2 weeks after the settlement date; or
- (ii) 5 business days but not more than 2 weeks after the settlement date, and the market value of the securities is

more than 200% of the price at which they were sold.

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

41. Amounts payable from dealings in securities by common clients

(1) A licensed corporation licensed for dealing in securities shall include in its ranking liabilities the net amount payable to each licensed corporation licensed for securities margin financing with which it has common clients, in respect of dealings in securities by those clients.

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

(2) A licensed corporation licensed for securities margin financing shall include in its ranking liabilities the net amount payable to each licensed corporation licensed for dealing in securities with which it has common clients, in respect of dealings in securities by those clients.

[s.21(b)FRR]

42. Futures contracts and options contracts trading

(1) Subject to subsection (2), a licensed corporation which, on behalf of another person, deals in futures contracts, writes options contracts or clears futures contracts or options contracts, shall include in its ranking liabilities in respect of every such person

the amount, calculated on an account-by-account basis, by which the amount of -

(a) margin required to be deposited with it;

and

(b) any floating losses incurred; less

(c) any floating profits made, by the person,

exceeds the sum of -

(i) cash deposited with it by the person as security;

(ii) the market value of collateral, less the applicable haircut amounts, deposited with it by the person;

(iii) the market value of other investments, less the applicable haircut amounts, deposited with it by the person as security; and

(iv) the maximum amount that can be drawn by the licensed corporation under a bank guarantee which is provided by the person and which is issued by an authorized financial institution or an approved bank incorporated outside Hong Kong.

[cf. s.22(2) FRR]

(2) Subsection (1) shall not apply to any futures contract or options contract during any period in respect

of which the licensed corporation is allowed under the rules of the exchange company that operates the market on which the futures contract or options contract is traded not to collect from the client the margin required to be deposited by the client.

[cf. ss.22(6)FRR]

(3) Subject to subsections (5), (6) and (9) and sections 29(2) and 45(5), a licensed corporation shall include in its ranking liabilities, the market value of options contracts written by it on its own account which are traded on a specified exchange, to the extent that the market value has not been included in the calculation of the amount of margin required to be deposited by it in respect of such options contracts.

[cf. s.22(3)FRR]

(4) Subject to subsections (5), (6), (7), (8) and (9) and sections 29(2) and (3), 33(2) and (3) and 45(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) futures contracts traded by it on its own account; and
- (b) options contracts purchased or written by it on its own account which are traded on a specified exchange.

[cf. s.22(4)FRR]

(5) Subject to subsection (10), where a licensed corporation borrows 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 shares borrowed, it may elect not to apply subsections (3) and (4) and section 47(1) to the options contract and the securities borrowing and lending agreement and, if it so elects, shall instead include in its ranking liabilities the sum of the in-the-money amount of the options contract and the higher of -

- (a) the haircut amount applicable to such shares, as if it beneficially owned the shares; and
- (b) the financial adjustment that would, but for this subsection, arise under section 47(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 shares, to the extent that the numbers of shares underlying both positions is equal, subsections (3) and (4) do not apply to the options

contract and the futures contract and it shall instead include in its ranking liabilities the higher of -

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

[cf. s.5(20)FRR]

(7) Subject to subsection (10), where a licensed corporation holds a long position in a stock futures contract and holds a put stock options contract in respect of the same underlying shares which has been paid in full and is therefore not subject to any margin requirement, to the extent that the numbers of shares underlying both positions is equal, subsection (4) and section 33(1) do not apply to the options contract and the futures contract and, if the options contract is out-of-the-money, it shall include in its ranking liabilities the lower of -

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

[cf. s.5(21)FRR]

(8) Subject to subsection (10), where a licensed corporation holds a short position in a stock futures contract and holds a call stock options contract in respect of the same underlying shares which has been paid in full and is therefore not subject to any margin requirement, to the extent that the numbers of shares underlying both positions is equal, subsection (4) and section 33(1) do not apply to the options contract and the futures contract and, if the options contract is out of the money, it shall instead include in its ranking liabilities the lower of -

- (a) the out-of-the-money amount of the options contract; and
- (b) the amount of margin required to be deposited in respect of the futures 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 shares, to the extent that the numbers of shares underlying both positions is equal, subsections (3) and (4) do not apply to the options contract and the futures contract and it shall instead include in its ranking liabilities the higher of -

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

[cf. s.5(23)FRR]

(10) Subsections (5), (6), (7), (8) and (9) do not apply to 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.

[cf. s.5(12)FRR]

(11) A licensed corporation must include in its ranking liabilities, in respect of each options contract written by it on its own account which is not traded on a specified exchange, the highest of -

- (a) twice the market value of the options contract;
- (b) twice the in-the-money amount of the options contract; and
- (c) twice the amount of margin required to be deposited by it with the holder of the options contract or the agent who executes the trade for it,

provided that in respect of a put options contract, the amount included in ranking liabilities under this

subsection shall not exceed the value of the underlying assets stated at the strike price of the options contract.

[cf. s.22(5)FRR]

43. Leveraged foreign exchange trading

(1) A licensed corporation licensed for leveraged foreign exchange trading shall include in its ranking liabilities -

(a) subject to subsection (2), in respect of all outstanding leveraged foreign exchange contracts in all foreign currencies which it has with clients, the excess, calculated on a client-by-client basis, of the amount by which the sum of -

(i) subject to subsection (3), 3% of the aggregate gross principal value of the outstanding contracts with the client; and

(ii) floating losses incurred by the client on the contracts,

exceeds the sum of -

(A) 100% of cash in Hong Kong currency (or currency linked to Hong Kong currency);

- (B) 95% of cash in such foreign currency as may be approved under section 60(5)(h);
- (C) 95% of any time deposits in Hong Kong currency (or currency linked to Hong Kong currency) which are placed with a local branch or the principal place of business in Hong Kong of an authorized financial institution and which will become payable within 6 months and which have been assigned to the licensed corporation;
- (D) the market value of collateral, less the applicable haircut amounts, deposited with it by the client;
- (E) floating profits made by the client on the contracts;
- (F) 90% of the maximum amount that can be drawn under a letter of credit issued by an authorized financial institution or an approved bank incorporated

outside Hong Kong, in favour of the licensed corporation; and

(G) accrued interest, fees and commissions receivable from the client in respect of the contracts; and

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

(b) floating losses in respect of its foreign currency positions.

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

(2) For the purposes of subsection (1)(a), a contract referred to therein, whether involving the exchange of -

(a) two foreign currencies; or

(b) the reporting currency of the licensed corporation and a foreign currency,

shall be treated as one contract.

[new]

(3) For the purposes of calculating the aggregate gross principal value of outstanding contracts referred to in subsection (1)(a)(i), each pair of outstanding contracts that a licensed corporation holds with a client, other than a client whose account with the licensed corporation is an omnibus account, where -

(a) one contract of the pair is intended to exchange an amount in a currency against another currency; and

(b) the other contract of the pair is intended to exchange the same amount in the same currency against that other currency, but in the opposite direction,

shall be treated as one contract.

[new]

(4) In this section, "gross principal value" (本金合計總額) in relation to a contract referred to in subsection (1)(a)(i), means the higher of the equivalent amounts in the reporting currency of the licensed corporation of the two amounts of currencies that the contract is intended to exchange.

[new]

44. Provision of securities margin financing

(1) Subject to subsection (2), a licensed corporation shall include in its ranking liabilities the amount, in respect of the provision by it of securities margin financing, calculated on a client-by-client basis, by which -

(a) any amount receivable from a margin client; or

(b) in the case of a group of related margin clients, the aggregate of amounts receivable from the group, exceeds 10% of the aggregate of amounts receivable from its margin clients, provided that all such amounts receivable are as calculated under section 24(1).

[cf. s.23 FRR]

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

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

45. Short positions in securities and other investments

(1) Subject to subsections (2), (3), (6), (8) and (9) and section 29(6) and (7), a licensed corporation which holds on its own account a short position in securities or other investments, whether by short selling or otherwise, shall include in its ranking liabilities the market value of those securities or other investments.

[cf. s.24(1) FRR]

(2) Subject to subsection (3), a licensed corporation which holds on its own account a short position in -

- (a) subject to subsections (4), (5) and (6) and section 47(5), shares specified in column 2 of Table 1, 2 or 3 (as the case may be);
- (b) qualifying debt securities specified in column 1 of Table 4;
- (c) special debt securities specified in column 1 of Table 6;
- (d) subject to subsections (8) and (9) and section 29(6) and (7), other securities specified in column 1 of Table 7; or
- (e) other investments specified in column 1 of Table 8,

in Schedule 1, whether by short selling or otherwise, shall increase the amount included in its ranking liabilities under subsection (1) by the applicable haircut amounts.

[cf. s.24(2) FRR]

(3) Subject to subsections (4), (5), (6) and (8) and sections 29(6) and (7) and 47(5), a licensed corporation which holds on its own account a short position in securities or other investments, whether by short selling or otherwise, which -

- (a) are not of a type specified in Schedule 1;
- (b) constitute more than 5% by market value of all securities, or of any class of securities, issued by a particular corporation; or
- (c) are shares or warrants which have been suspended from trading for 3 business days or more,

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

[cf. s.24(3) FRR]

(4) Subject to subsection (7), where a licensed corporation short sells shares and holds a long position in a stock futures contract in respect of the same 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) and section 42(4) do not apply to the shares short sold and the futures contract.

[cf. s.5(17) FRR]

(5) Subject to subsection (7), if a licensed corporation short sells shares and writes a put stock options contract in respect of the same 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) and section 42(3) and (4) do not apply to the shares short sold and the options contract and it shall instead include in its ranking liabilities the higher of -

- (a) the financial adjustment that would, but for this subsection, arise under subsections (2) and (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 shares and holds a call stock options contract in respect of the same shares which has been paid in full and is therefore not subject to any margin requirement, 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) and section 33(1) to the shares short sold and the options contract and if it so elects, it shall instead include in its ranking liabilities the lower of -

- (a) the sum of the market value of the shares sold short and the financial adjustment that, but for this subsection, would arise under subsections (2) and (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 to a futures contract or a stock options contract which has been grouped with other positions for the purpose of calculating a net amount of margin to be deposited.

[cf. s.5(12) FRR]

(8) A licensed corporation shall increase the amount included in its ranking liabilities under subsection (1) in respect of any outstanding call non-collateralized warrants issued by it on shares, to the extent that it does not cover such warrants by holding the underlying shares, by the amount by which the haircut amount which would be applicable to the underlying shares exceeds the aggregate 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 short selling of

securities on behalf of a client, other than where those securities have been delivered to it by the client or are not yet due for settlement, the amount by which the sum of -

- (a) the market value of those securities; and
- (b) the haircut amount applicable to those securities,

exceeds the aggregate of -

- (i) the amount of cash deposited with it by the client and sale proceeds withheld by it as security;
- (ii) the maximum amount that can be drawn by it under a bank guarantee, issued by an authorized financial institution or an approved bank incorporated outside Hong Kong, which is provided to it by the client; and
- (iii) the market value of any collateral, less the applicable haircut amounts, deposited with it by that client.

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

46. Concentrated house positions

A licensed corporation which holds on its own account -

- (a) shares specified in column 2 of Table 1, 2 and 3;
- (b) qualifying debt securities specified in column 1 of Table 4;
- (c) special debt securities specified in column 1 of Table 6;
- (d) other securities specified in column 1 of Table 7; or
- (e) other investments specified in column 1 of Table 8,

in Schedule 1, the net market value of which, calculated by netting item-by-item the long and short positions in such securities or other investments, equals 25% or more of its required liquid capital, shall include in its ranking liabilities -

- (i) where the value is 25% or more but less than 51% of its required liquid capital, 5% of such net market value; or
- (ii) where the value is 51% or more of its required liquid capital, 10% of such net market value.

[cf. s.25 FRR]

47. Securities borrowing and lending transactions

(1) Subject to subsections (5) and (6) and section 42(5) , a licensed corporation which is the borrower of securities in a securities borrowing and lending agreement shall include in its ranking liabilities the amount by which the sum of -

(a) cash deposited by it with the lender as security; and

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

exceeds -

(i) where the securities are shares listed on a specified exchange, qualifying debt securities or special debt securities, 110% of their market value; or

(ii) in any other case, 50% of their market value.

[cf. s.26(1) FRR]

(2) Subject to subsection (6), a licensed corporation which, in a securities borrowing and lending agreement, is the lender of securities which are accounted for under section 29 as its house position, shall include in its ranking liabilities the amount by

which the market value of the securities less the applicable haircut amount exceeds the sum of -

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

[cf. s.26(2) FRR]

(3) Subject to subsection (6), a licensed corporation which, in a securities borrowing and lending agreement, is the lender of securities, which are not accounted for under section 29 as its house position,

shall include in its ranking liabilities the amount by which either -

- (a) where the securities are listed shares, qualifying debt securities, special debt securities or other securities, the sum of the market value of the securities and the applicable haircut amount; or
- (b) in any other case, twice the market value of the securities,

exceeds the sum of -

- (i) the maximum amount that can be drawn by the licensed corporation under a bank guarantee, provided by the borrower, which is issued by an authorized financial institution or an approved bank incorporated outside Hong Kong;
- (ii) cash deposited with it by the borrower as security;
- (iii) the market value of shares listed on a specified exchange, qualifying debt securities and special debt securities, less the applicable haircut amount, deposited with it by the borrower as collateral; and

(iv) other than securities referred to in subparagraph (iii), 50% of the market value of any collateral deposited with it by the borrower.

[s.26(3) FRR]

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

(a) been segregated in a segregated account;

and

(b) not been included in its liquid assets under section 22.

[new]

(5) If a licensed corporation borrows shares under a securities borrowing and lending agreement for the purpose of short selling on 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) and section 45(2) and (3) do not apply to these transactions and it shall include in its ranking liabilities the amount which is the higher of the financial adjustments that, but for this subsection, would arise under -

- (a) subsection (1); and
- (b) section 45(2) and (3).

[cf. s.5(9) FRR]

(6) This section does not apply to 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]

48. Repurchase transactions

(1) A licensed corporation which is the first purchaser of securities in a repurchase transaction shall include in its ranking liabilities the amount by which the amount receivable by it from the seller of the securities (that is, the amount included in its liquid assets under section 35), exceeds -

- (a) where the securities are shares listed on a specified exchange, qualifying debt securities or special debt securities, 110% of the market value of the securities; 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 first seller of securities in a repurchase transaction shall include in its ranking liabilities the amount by which the market value of the securities less the applicable haircut amount exceeds the sum of -

- (a) the maximum amount that can be drawn by the licensed corporation under a bank guarantee, provided by the purchaser, which is issued by an authorized financial institution or an approved bank incorporated outside Hong Kong
- (b) the amount of sale proceeds received by it from the purchaser;
- (c) where the securities deposited with it by the purchaser as collateral are shares listed on a specified exchange, qualifying debt securities and special debt securities, their market value less the applicable haircut amount; and
- (d) other than securities referred to in paragraph (c), 50% of the market value of any collateral deposited with it by the purchaser.

[s.26(2) FRR]

(3) A licensed corporation which is the first seller of securities in a repurchase transaction shall

include in its ranking liabilities an amount payable to the purchaser of the securities in the amount of the price at which it sold the securities.

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

49. Underwriting and sub-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 respect of a rights issue where the market price of the securities for which the rights may be subscribed -

(i) is less than or equal to their subscription price, the aggregate of

-

(A) 50% of the haircut percentage applicable 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) is greater than their subscription price, 5% of the haircut percentage

applicable to the securities multiplied by the net underwriting commitment; or

(b) in any other case, 50% of the haircut percentage applicable 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 sub-underwriting commitment 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 the time -

(a) when it commits itself to underwrite or sub-underwrite the securities; and

(b) when the lead underwriter or co-lead underwriter signs the underwriting agreement with the issuer or the seller (as the case may be).

[cf. s.28(2) FRR]

(4) In this section, "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 securities which are sub-underwritten or subscribed for in writing through or from that licensed corporation by another person.

[cf. s.2 FRR]

50. Non-specified exchange traded derivative contracts

(1) Subject to subsection (2), a licensed corporation shall include in its ranking liabilities, floating losses incurred by it in respect of positions in non-specified exchange traded derivative contracts.

[cf. s.29(1) FRR]

(2) A licensed corporation which, in respect of two or more non-specified exchange traded derivative contracts has entered into a bilateral netting agreement with the counterparty with whom it maintains the positions, shall include in its ranking liabilities any floating losses less any floating profits in respect of those positions.

[cf. s.29(1) FRR]

(3) In this section, "bilateral netting agreement" means an agreement between the licensed corporation and the counterparty which creates a single legal obligation for all individual products covered by the agreement and which provides that, in the event that the counterparty fails to comply with any obligation under the agreement,

the licensed corporation would have a single claim or obligation either to receive or pay only the net amount of the sum of the positive and negative values of those products covered by the agreement.

[new]

51. Interest rate swap agreements

A licensed corporation which is a party to an interest rate swap agreement shall include in its ranking liabilities the notional principal amount on which any interest payment to be made by it under the agreement is calculated, multiplied by the percentage specified in column 2 of Table A which applies according to the remaining term to maturity of the agreement.

TABLE A

Remaining term to maturity -	Percentage
(a) less than 3 months	0%
(b) 3 months or more but less than 1 year	0.05%
(c) 1 year or more but less than 2 years	0.1%
(d) Each additional year	0.1%

[cf. s.29(2) & Part 1 of Schedule 4 FRR]

52. 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 2 of Table B which applies according to the identity of the counterparty to, and remaining term to maturity of, the agreement.

TABLE B

Description	Percentage
1. where the counterparty 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%, plus 0.3% for each additional full year after 1 year, subject to a maximum of 5%

2. where the counterparty is any other person and the remaining term to maturity is -	
(a) less than 3 business days	0%
(b) 3 business days or more	5%

[cf. s.29(3) & Part 2 of Schedule 4 FRR]

53. Introduction of transactions

(1) Subject to subsection (2), where a licensed corporation introduces transactions to another person for execution or clearing on behalf of its clients and -

(a) it does not include the amounts receivable or payable in respect of such transactions in the calculation of its liquid capital in accordance with these Rules; and

(b) there is no express agreement or a clear market practice that it will not be subject to the recourse of the clients or the other person (as the case may be),

it shall include in its ranking liabilities the amount by which its required liquid capital would be increased if the following amounts were included in the calculation of its adjusted liabilities (as if the transactions had been executed or cleared directly by the licensed corporation instead of the other person) -

- (i) where the transactions introduced are dealings in securities, the total value of the consideration, computed on a gross basis, of purchases and sales of securities entered into as a result of the introduction which have not been fully settled by the clients or the other person (as the case may be);
- (ii) where the transactions introduced are dealings in futures contracts or options contracts, the aggregate of the amounts of margin required to be deposited in respect of futures or options contracts entered into as a result of the introduction which remain outstanding; and
- (iii) where the transactions introduced are trades in leveraged foreign exchange contracts, the aggregate gross foreign currency position arising from leveraged foreign exchange contracts entered into as a result of the introduction which remain outstanding.

[cf. s.27 FRR]

(2) Subsection (1) shall not apply to transactions introduced by a licensed corporation to another person for execution or clearing on behalf of its clients where

-

(a) the other person is a member of the same group of companies as the licensed corporation;

(b) the clients have a direct broker client contractual relationship with the other person; and

(c) the licensed corporation is not legally liable to the client for clearing or settlement of such transactions or default by the other person.

[cf. S.27 FRR]

54. Other liabilities

(1) Subject to subsection (2), a licensed corporation shall include in its ranking liabilities, all liabilities not specifically required to be included in ranking liabilities elsewhere in this Division, including

-

(a) any overdraft;

(b) any loan;

(c) accrued interest;

- (d) accrued expenses;
- (e) the amount by which any tax payable exceeds prepaid tax, if the tax payable and the tax prepaid are of the same kind and levied by the same taxation authority;
- (f) other tax payable;
- (g) provisions made for contingent liabilities which have not been included in ranking liabilities under other sections of this Division;
- (h) provisions made for floating losses in respect of trading positions held on its own account which have not been included in ranking liabilities under other sections of this Division; and
- (i) all other liabilities provided for in accordance with generally accepted accounting practices.

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

(2) A licensed corporation shall not include in its ranking liabilities -

- (a) any approved subordinated loan; or
- (b) any liability that it is not required to settle within 1 year which is secured by a first legal charge on real estate property beneficially owned by it and used in the

business for which it is licensed, to the extent of the net realizable value of that property.

[cf. s.30(2) FRR]

55. Miscellaneous financial adjustments

(1) A licensed corporation shall include in its ranking liabilities -

(a) 10% of the amount of any guarantee, indemnity or other similar financial commitment given by it, directly or indirectly (including the pledging of assets for the purpose of obtaining a bank guarantee), other than -

(i) any guarantee provided to a recognized clearing house for the purpose of enabling it to fulfil its obligations under the rules of that clearing house (other than rules which relate to a guarantee fund or reserve fund, by whatever name called); and

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

(ii) any guarantee, indemnity or other financial commitment provided in

respect of its own liabilities and obligations;

[s.31(1)(a)(iv) FRR]

(b) the amount by which the liabilities of any subsidiary of the licensed corporation (excluding any amounts due from the subsidiary to the licensed corporation), exceed the assets of that subsidiary;

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

(c) the consideration at which redeemable shares, other than approved redeemable shares, have been issued by it but not redeemed;

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

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

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

(e) where it is a guarantor to a note issuance facility, the total costs of purchasing short term notes which it undertakes to purchase if unsold, multiplied by the percentage specified in column 2 of Table C, below, which applies according to the remaining term to maturity of the note issuance facility.

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

TABLE C

Remaining term to maturity of the note issuance facility -	Percentage
(a) less than 1 year	1%
(b) 1 year or more but less than 5 years	2.5%
(c) 5 years or more	5%

[cf. s.31(1) FRR]

(2) In calculating the net position in a foreign currency, as required under subsection (1)(d) a licensed corporation may elect, to deduct from the aggregate of assets and commitment to purchase the foreign currency an amount not exceeding the value of any assets which are denominated in that foreign currency and not included in its liquid assets.

[cf. s.31(2) FRR]

(3) In this section, "note issuance facility" (票據發行融通) means an arrangement whereby a borrower is able to issue short-term notes which a guarantor undertakes to purchase if unsold.

[s.2 FRR]

PART 4

MISCELLANEOUS

56. Notification of failure to comply with financial resources 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 the applicable specified amount requirements; or

(b) under section 146(3) of the Ordinance that it is unable to comply, or to ascertain whether it complies, with the applicable requirements other than the specified amount requirements,

it shall include in the notice -

(i) the reasons therefor; and

(ii) the details of any steps it is taking, has taken or proposes to take to comply with the requirements.

[new]

(2) Without prejudice to section 146(1) and (3) of the Ordinance and subsection (1), where a licensed corporation notifies the Commission of any matter referred to in subsection (1), it shall in addition

provide in such form and within such time as the Commission may reasonably require such additional information and document as the Commission may require.

[new]

(3) In this section, "specified amount requirements" (指明數額規定) in relation to a licensed corporation, means the applicable requirements specified in sections 4, 5 and 6.

[new]

57. Licensed corporations to notify Commission of circumstances relating to financial resources and trading activities

(1) Subject to subsection (3), a licensed corporation shall notify the Commission in writing within 1 business day of becoming aware of any of the following matters -

(a) its liquid capital falls below 120% of its required liquid capital under section 6(1);

[cf. s.33(1)(a) FRR, s.10(b) LFET FRR]

(b) its liquid capital falls below its required liquid capital under section 6(1);

[cf. s33(1)(b) FRR]

(c) if not for the approved stand-by subordinated loan facility, it would have breached the requirement under section 6(1);

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

(d) its liquid capital falls below 50% of the liquid capital stated in its last return lodged with the Commission;

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

(e) its paid-up share capital falls below the amount required under section 5;

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

(f) the information contained in any of its previous returns lodged with the Commission pursuant to these Rules has become misleading in a material particular;

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

(g) the aggregate of the amounts it has drawn down on bank loans, advances, credit facilities or other financial accommodation exceeds the total limits of those facilities;

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

(h) it has been or will be unable, for 3 consecutive business days, to meet in

whole or in part calls or demands for payment or repayment (as the case may be), by any of its lenders or credit or financial accommodation providers;

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

- (i) any of its lenders or credit or financial accommodation providers has exercised, or has informed it that it will exercise, its right to liquidate security provided by the licensed corporation to it in order to reduce an outstanding loan, advance, credit facility balance or other financial accommodation; or

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

- (j) in relation to the provision by it of securities margin financing -

- (i) a financial adjustment has been made under section 44; or

- (ii) the concentration discounting factor of any stock or warrant received from its margin clients as collateral -

- (A) has fallen below 1; or

- (B) has dropped by 0.1 or more compared to the concentration discounting factor on that stock or warrant previously reported

to the Commission under this section.

[cf. s.33(2) FRR]

(2) Subject to subsection (3), a licensed corporation shall notify the Commission in writing within 1 business day of becoming aware of any of the following matters -

(a) the aggregate of the maximum amounts that can be drawn down against it under guarantees, indemnities and similar financial commitments provided by it, if that aggregate -

(i) exceeds \$5,000,000; or

(ii) would, if deducted from the liquid capital it maintains, cause that liquid capital to be less than 120% of the liquid capital it is required to maintain;

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

(b) the outstanding claims made in writing by or against it (whether disputed or not), if the total amount of those claims exceeds or is likely to exceed \$5,000,000;

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

(c) the outstanding claims made in writing against it (whether disputed or not), if

the total amount of those claims would, if deducted from the liquid capital it maintains, cause its liquid capital to be less than 120% of the liquid capital it is required to maintain;

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

(d) any claim made by it under any professional indemnity or other insurance policy that it is required under the Securities and Futures (Insurance) Rules, made under section 116(5) of the Ordinance, or the rules of any exchange company or clearing house to effect;

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

(e) any financial commitment, including a guarantee, that has been provided for or on behalf of it in favour of a stock exchange, futures exchange or clearing house, by a corporation within the same group of companies as the licensed corporation.

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

(3) Where a licensed corporation gives notice of any matter to the Commission under subsection (1) or (2), it shall include in the notice -

- (a) full details of the matter and the reasons for the occurrence;
- (b) in the case of a notification under subsection (1), the details of any steps it is taking, has taken or proposes to take to prevent a liquid capital deficit or to improve its liquidity; and
- (c) in the case of a notification under subsection (1)(j), submit the returns specified in section 58(1)(iii), (iv) and (v).

[cf. s.33(1) FRR]

(4) Where a licensed corporation has, prior to the commencement of these Rules -

- (a) taken on any off-balance sheet exposure which is not captured by Part 3; or
- (b) entered into any position in non-specified exchange traded derivative contract which is not captured by Part 3, save for section 50,

shall within 1 business day of the commencement of these Rules notify the Commission in writing of the details of such exposure or position.

[cf. s.33(3) FRR]

(5) Where a licensed corporation wishes to -

- (a) take on any off-balance sheet exposure which is not captured by Part 3; or
- (b) enter into any position in non-specified exchange traded derivative contract which is not captured by Part 3, save for section 50,

shall notify the Commission in writing of the details of the intended exposure or position at least 10 business days in advance of his taking on or entering into such exposure or position.

[cf. s.33(4) FRR]

58. Licensed corporations to submit declaration document and returns to the Commission

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

- (a) dealing in securities;
- (b) dealing in futures contracts;
- (c) leveraged foreign exchange trading;
- (d) advising on securities, where it is not subject to the specified licensing condition;
- (e) advising on futures contracts, where it is not subject to the specified licensing condition;

- (f) advising on corporate finance, where it is not subject to the specified licensing condition;
- (g) providing automated trading services;
- (h) securities margin financing; or
- (i) asset management, where it is not subject to the specified licensing condition,

shall, in respect of the end of each month during which it carries on any regulated activity, prepare and submit to the Commission in the manner specified in subsection (6), no later than 3 weeks after the end of the month to which it relates, a declaration document and the following returns -

- (i) a liquid capital computation;
- (ii) a required liquid capital computation;
- (iii) a summary of bank loans, advances, credit facilities and other financial accommodation available to it;
- (iv) an analysis of margin clients;
- (v) an analysis of collateral received from margin clients;
- (vi) a rolling balance cash client analysis;
- (vii) a profit and loss account;

- (viii) an analysis of client assets; and
- (ix) in the case of a licensed corporation licensed for leveraged foreign exchange trading, an analysis of its foreign currency positions.

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

(2) A licensed corporation to which subsection (1) applies, shall, in respect of each 3 month period during which it carries on any regulated activity, concluding at the end of the months of March, June, September and December, respectively, prepare and submit to the Commission in the manner specified in subsection (6), no later than 3 weeks after the end of the period to which it relates, a declaration document and the following returns -

- (a) a report on number of active clients; and
- (b) a report on proprietary derivative positions,

and in the case of -

- (i) a licensed corporation licensed for leveraged foreign exchange trading, a list of its recognized counterparties; and

- (ii) a licensed corporation licensed for asset management, an analysis of the assets under its management.

[new]

(3) A licensed corporation licensed for one or more of the following regulated activities -

- (a) advising on securities;
- (b) advising on futures contracts;
- (c) advising on corporate finance; or
- (d) asset management,

where it is subject to the specified licensing condition shall, in respect of each 6 month period during which it carries on any regulated activity, concluding at the end of the months of June and December, respectively, prepare and submit to the Commission in the manner specified in subsection (6), no later than 3 weeks after the end of the period to which it relates, a declaration document and the following returns -

- (i) a liquid capital computation;
- (ii) a required liquid capital computation;
- (iii) a profit and loss account;
- (iv) a report on number of active clients;
and
- (v) in the case of a licensed corporation licensed for asset management, an

analysis of the assets under its management.

(4) If in respect of any return required to be submitted under this section, a licensed corporation would, upon completing the applicable computation and analysis required under these Rules, make a nil return or, having regard to its activities, an analysis would not be applicable, it may so indicate in the declaration document submitted to the Commission with the return.

(5) A licensed corporation may elect to prepare the declaration document and returns required under -

- (a) subsection (1), by reference to a period of not less than 28, nor more than 35, days ending not more than 7 days before or after the end of the relevant month;
- (b) subsection (2), by reference to a 3 month period ending not more than 7 days before or after the end of the relevant third month;
- (c) subsection (3), by reference to a 6 month period ending not more than 7 days before or after the end of the relevant sixth month,

provided that, once the election is made the basis for determining the period shall apply to the preparation of all future declaration documents and returns unless the

Commission approves the withdrawal of the election under section 61.

[new]

(6) A declaration document and return referred to in this section shall -

- (a) be prepared in Hong Kong dollars;
- (b) be in the form specified under section 402 of the Ordinance, compiled in accordance with any directions or instructions contained therein and, if applicable, accompanied by such documents as may be specified therein;
- (c) bear the digital signature of the licensed corporation, attached by a responsible officer or another officer of the licensed corporation approved by the Commission under section 60(5)(g) for the purposes of this section, supported by a recognized certificate; and
- (d) be submitted electronically by means of FinNet.

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

(7) In this section, "rolling balance cash client" (滾存結餘現金客戶) means a client of a licensed corporation other than a margin client whose amounts payable to the licensed corporation in respect of dealing in securities

by the licensed corporation for him or on his behalf may be set-off against amounts payable to the client by the licensed corporation in accordance with section 23(2).

[new]

59. Licensed corporations to provide information

(1) The Commission may at any time, by notice in writing require 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 its financial position, trading activities or other matter related to these Rules.

(2) The Commission shall not require a licensed corporation to provide it with information under subsection (1) unless it considers that the information sought might assist in assessing the financial resources of the licensed corporation.

[cf. s.36 FRR]

60. Approvals

(1) The Commission may, for the purposes of these Rules, approve a person as -

- (a) an approved bank incorporated outside Hong Kong;
- (b) an approved credit rating agency; and

(c) an approved securities borrowing and lending counterparty.

(2) The Commission may, in relation to an approval under subsection (1)(b), specify the appropriate tier in column 1 of Table 4 in Schedule 1 into which debt securities rated at or above a specified grade by such approved credit rating agency shall fall.

[cf. s.37(2) FRR]

(3) The Commission may approve under subsection (1)(c) a person whose activities or objects include the provision of services for interposing itself in a securities borrowing and lending agreement as the counterparty to both the borrower and the lender, including administering the security deposited 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 prescribed fee approve a licensed corporation for the purposes of these Rules as an introducing agent if the licensed corporation satisfies the Commission that -

(a) where it is licensed for dealing in securities or dealing in futures

contracts, it conducts no business other than -

(i) communicating offers to effect dealings in securities, futures contracts or options contracts to exchange participants, in the names of the persons from whom those offers are received; or

(ii) introducing persons to exchange participants, in order that they may

-
(A) effect dealings in securities, futures contracts or options contracts; or

(B) make offers to deal in securities, futures contracts or options contracts;

(b) where it is licensed for leveraged foreign exchange trading, it conducts no business other than -

(i) communicating offers to effect leveraged foreign exchange trading to recognized counterparties in the names of the persons from whom those offers are received; or

- (ii) introducing persons to recognized counterparties;
- (c) it does not hold client assets; and
- (d) in connection with the offers communicated or the persons so introduced, it incurs no legal liability to any person except for its own negligence, wilful default or fraud.

[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 prescribed fee approve -

- (a) as approved redeemable shares, redeemable shares issued by the licensed corporation;
- (b) as an approved subordinated loan, a subordinated loan obtained by the licensed corporation;
- (c) as an approved stand-by subordinated loan facility a stand-by subordinated loan facility obtained by the licensed corporation;
- (d) a change in calculation of the licensed corporation's liquid capital;

- (e) the adoption by the licensed corporation of an inconsistent accounting practice, referred to in section 3(1)(c);
- (f) the change by the licensed corporation of any of its accounting practices, referred to in section 3(2);
- (g) an officer of the licensed corporation to attach a digital signature to returns;
- (h) the inclusion in ranking liabilities of the licensed corporation 95% of cash in such foreign currency, for the purposes of section 43(1)(a)(ii)(B); and

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

- (i) the withdrawal of an election under section 61.

(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) An approval granted under subsection (1), (4) or (5) remains in force -

- (a) if a period is specified in the approval notice, until the end of the period; or

(b) if no such period is specified, until revoked by the Commission by notice in writing.

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

61. Withdrawal of elections made under the 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 60.

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

62. Transitional

(1) Notwithstanding the commencement provision in section 1, these Rules shall not apply to a person who, at the date of commencement of these Rules, 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 [31 March] 2003.

[new]

(3) Notwithstanding section 1, section 5 shall not apply to -

(a) a partnership deemed under section 27; and

(b) an individual deemed under section 30,

of Part 1 of Schedule 10 to the Ordinance to be a licensed corporation, until such time as the specified

decision referred to in section 53(1) (b) or (c) of Part 1 of Schedule 10 to the Ordinance, respectively, takes effect in relation to the partnership or individual (as the case may be), provided that -

- (i) in the case of a partnership, it maintains an aggregate of partners' capital accounts; and
- (ii) in the case of an individual, he maintains a capital account, in the like sum as that required under section 5.

[new]

(4) For the purpose of calculating adjusted liabilities, liquid assets and ranking liabilities of a person to whom subsection (3) applies, amounts receivable from, or payable to -

- (a) a partner of the partnership; or
- (b) an individual operating a sole-proprietorship,

which arise from -

- (i) dealing in futures contracts;
- (ii) dealing in options contracts;
- (iii) dealing in securities; or
- (iv) the provision of securities margin financing,

shall be treated as amounts receivable from, or payable to (as the case may be) third party clients and shall be subject to the same deductions or financial adjustments as are required under these Rules.

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

[ss.2, 29 & 60]

SCHEDULE 1

Haircut Percentages

TABLE 1

HAIRCUT PERCENTAGES FOR HK, UK,

US AND JAPANESE SHARES (WITH DIFFERENTIATION)

Item	Description	Haircut %
1.	Shares which are listed on a recognized stock exchange - (a) being a constituent of the Hang Seng Index or the Hang Seng Hong Kong LargeCap Index (b) being a constituent of the Hang Seng Hong Kong MidCap Index (c) being any other share	 15 20 30
2.	Shares which are listed on a specified exchange in the UK, US or Japan -	

	(a) being a constituent of the FTSE-100 Index, Nikkei 500 Index or Standard & Poor's 500 Index	15
	(b) being any other share	20

[cf. Part 1 of Schedule 1 FRR]

TABLE 2

HAIRCUT PERCENTAGES FOR HK, UK, US AND JAPANESE SHARES

(WITHOUT DIFFERENTIATION)

Item	Description	Haircut %
1.	Shares which are listed on a recognized stock exchange	30
2.	Shares which are listed on a specified exchange in the UK, US or Japan	20

[cf. Part 1 of Schedule 1 FRR]

TABLE 3

HAIRCUT PERCENTAGES FOR OTHER SHARES

Item	Description	Haircut %
1.	Shares listed on a specified exchange other than a specified exchange in the UK, US or Japan	20

2.	Shares listed on a specified exchange mentioned in Part 2 of Schedule 2	30
3.	Shares traded on the National Association of Securities Dealers Automatic Quotations - National Market System, the Japanese Association of Securities Dealers Automated Quotations or Stock Exchange Automated Quotations International (SEAQ International)	30
4.	Shares listed on any other stock exchange which is an FIBV member	50
5.	All other listed shares	75

[cf. Part III of Schedule 1 FRR]

TABLE 4
HAIRCUT PERCENTAGES FOR QUALIFYING DEBT
SECURITIES, BY ISSUER

Tiers & Description	Haircut %
Tier 1 Where the issuer or guarantor - (a) is the central government or central bank in the People's Republic of China;	0

<p>(b) is the Government of the Hong Kong Special Administrative Region;</p> <p>(c) is the Hong Kong Exchange Fund;</p> <p>(d) has an issue or issues currently rated by -</p> <p style="padding-left: 40px;">(i) Moody's Investors Services at Aaa or Prime-1; or</p> <p style="padding-left: 40px;">(ii) Standard & Poor's Corporation at AAA or A-1</p>	
<p>Tier 2</p> <p>To the extent not already covered in Tier 1 -</p> <p>(a) where the issuer or guarantor has an issue or issues currently rated by -</p> <p style="padding-left: 40px;">(i) Moody's Investors Services at Aa, A or Prime-2; or</p> <p style="padding-left: 40px;">(ii) Standard and Poor's Corporation at AA, A or A-2; or</p> <p>(b) where the issuer is the Hong Kong Mortgage Corporation; or</p> <p>(c) where the debt securities are listed on a recognized stock market</p>	2

<p>Tier 3</p> <p>To the extent not already covered in Tier 1 or Tier 2, where the issuer has an issue or issues currently rated by -</p> <p>(a) Moody's Investors Services as Baa or Prime-3; or</p> <p>(b) Standard and Poor's Corporation at BBB or A-3</p>	<p>5</p>
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[cf. Table 1, Part I of Schedule 2 FRR]

TABLE 5
HAIRCUT PERCENTAGES FOR QUALIFYING DEBT
SECURITIES, BY MATURITY

Remaining term to maturity	(I) Fixed coupon bonds/ normal floating rate bonds	(II) Any bonds other than those set out in (I)
	Haircut %	Haircut %
(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

Description	Haircut %
(a) indexed bonds	same as that applicable to the underlying assets
(b) convertible debt securities or bonds with non-detachable warrants - (i) where their market value is more than their par or nominal value (ii) where their market value is equal to, or less than, their par or nominal value	same as that applicable to the underlying assets same as would be applicable to the qualifying debt securities with the same issuer and remaining term to maturity

(c) non-interest bearing debt securities	105% of haircut percentage which would be applicable to the qualifying debt securities of the same issuer and remaining term to maturity
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[cf. Part II of Schedule 2 FRR]

TABLE 7

HAIRCUT PERCENTAGES FOR OTHER SECURITIES

Description	Haircut %
(a) warrants that are listed on a specified exchange mentioned in Part 1 of Schedule 2	40
(b) units in any unit trust, and shares in any mutual fund, which is authorized by the Commission under section 104 of the Ordinance or a Recognized Jurisdiction Schemes specified in Appendix A to the Code on Unit Trusts and Mutual Funds published by the Commission, where its nature is - (i) the same as that of a warrant funds, futures or options funds,	

leveraged funds or hedge funds referred to in that Code	40
(ii) not the same as any of the funds mentioned in (i) above	20

[cf. Schedule 3 FRR]

TABLE 8

HAIRCUT PERCENTAGES FOR OTHER INVESTMENTS

Types of investments	Haircut %
Other investments - (a) gold coin and gold bullion or investments in gold which are specified in Schedule 1 to the Securities and Futures (Collective Investments Schemes) Notice under section 393 of the Ordinance and are authorized by the Commission under section 104 of the Ordinance	10
(b) physical commodities of a quantity, quality and condition suitable for delivery under a futures contract or options contract traded on a specified exchange	40

[cf. Schedule 3 FRR]

[ss.2, 28, 30, 32, 33,
37, 42, 48 & Sch.1]

SCHEDULE 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

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]

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 (Financial Resources) 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.

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

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 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,
The 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.



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

Consultation Conclusions on the Proposed Amendments to the Financial Resources Rules made under section 28 of the Securities and Futures Commission Ordinance (Cap. 24)

**根據《證券及期貨事務監察委員會條例》
(第 24 章) 第 28 條訂立的
《財政資源規則》的建議修訂的
諮詢總結**

Hong Kong
May 2002

香港
2002 年 5 月

INTRODUCTION

1. On 4 March 2002, the Securities and Futures Commission (“SFC”) released a Consultation Document (the “Consultation Document”) on the proposed amendments (“Proposed Amendments”) to the Financial Resources Rules made under section 28 of the Securities and Futures Commission Ordinance (Cap. 24) (“FRR”).
2. The Proposed Amendments require brokers providing securities margin financing and securities margin financiers:
 - (a) to apply a discount rate of 90% to collateral for margin loans that, because of its size compared to average monthly turnover and market capitalization, may be difficult to liquidate quickly (referred to in the Consultation Document and this Consultation Conclusion Report as the “illiquid collateral haircut”); and
 - (b) where a firm’s total borrowings, which are secured by repledging margin clients’ securities, exceed 50% (referred to in the Consultation Document as the “firm borrowings to margin loan ratio trigger”) of total amounts lent to its margin clients, the amount that exceeds 50% will be included in the firm’s ranking liabilities (referred to in this Consultation Conclusion Report as the “gearing adjustment”).
3. The consultation closed on 26 March 2002.
4. The Proposed Amendments, as modified after market consultation, have been adopted by the SFC and effected in the Amendment Rules, which are attached as Appendix 1.
5. 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 SFC’s conclusions. This report should be read in conjunction with the Consultation Document, the Amendment Rules and the summary of comments (the “Summary of Comments”) received on the Proposed Amendments, which are attached as Appendix 2.

PUBLIC CONSULTATION

A. Background

6. Hong Kong currently has 8 securities margin financiers and 258 securities dealers that conduct securities margin financing. In the competition for business, the SFC has observed a tendency among some firms for more aggressive lending practices, even though the size of the market-wide margin loans has declined.
7. The SFC has reviewed the business practices of the firms and has identified two practices that are considered particularly risky and imprudent:

- (a) accepting as collateral for margin loans a large quantity of stocks that may be difficult to liquidate quickly; and
 - (b) pooling securities belonging to margin clients, including “non-borrowing or low-borrowing” margin clients (i.e., those clients who borrow very little or not at all, but have a relatively large amount of securities in their margin accounts), and repledging the more liquid of such securities to banks in order to obtain bank loans. These borrowed funds are then used by the firms to finance their business operations and loans to other margin clients against collateral that may not be acceptable as collateral to banks.
8. The Proposed Amendments were formulated with a view to minimize the risks posed to a firm’s clients as a result of the firm’s own aggressive lending and funding practices. This type of risk should not be borne by the firm’s clients, especially those non-borrowing or low-borrowing margin clients with securities held by the firm and possibly repledged by the firm to a bank. Instead, the firm should be using its own capital as a buffer against this risk to minimize the exposure of its non-borrowing or low-borrowing margin clients and to enhance the firm's financial soundness.
9. The Proposed Amendments sought to enhance a firm’s capital buffer by two means:
- (a) by introducing the illiquid collateral haircut, a firm that aggressively grants margin loans against securities which may be difficult to liquidate or sell (because of the size of the holdings relative to the market demand) would be required to maintain more liquid capital. This was to be achieved by applying a steep discount to the value of such securities in assessing the amount of credit risk adjustment necessary on the relevant margin loan secured by such securities. Specifically, firms that want to provide margin loans collateralised by those securities to which a bank would apply a high discount (or might not be willing to lend against at all) should be funding much of those margin loans with their own capital, rather than with bank loans obtained through repledging their clients’ securities. Accordingly, we originally proposed a 90% discount for such identified securities¹; and

¹ Specifically, the discount would apply to those stocks and warrants pledged as margin collateral where such stocks or warrants would:

- (a) likely take more than one month to liquidate based on their respective trading volume during the previous six months; or
- (b) constitute 5% or more of the market capitalization of the shares or the issue size of the warrants.

This analysis would be applied only to those shares and warrants identified as the three largest collateral holdings (based on the securities’ respective market value) of each firm’s top 20 margin clients (those with the largest outstanding margin loan balances). However, once any shares or warrants meet either of these tests, the 90% discount would apply to all such shares or warrants held by the firm as collateral.

- (b) by introducing the gearing adjustment, where a firm's borrowings secured by clients' securities exceed 50% of aggregate margin loans made to all its clients, the firm must include the excess in its ranking liabilities for FRR calculation purposes (the gearing adjustment). The net result is that firms that rely heavily on borrowings secured by their clients' securities for their operational funding must bring in additional liquid capital, the better to manage the financial risks brought on by pooling and repledging clients' securities.
10. We believed that the combination of these two requirements would effectively require firms that adopt the practices described in paragraph 7, above, to increase their capital to cushion themselves and their clients against credit, liquidity and other financial business risks. In the process, these firms would be more financially sound and their clients would have a reduced risk of loss arising from the firms' defaulting on their borrowings.

B. Consultation Process and Comments

11. In addition to the public announcement inviting comments, the Consultation Document was sent to all registered securities dealers and securities margin financiers via the FinNet communication network, distributed to the Financial Services Bureau, various industry representative bodies and professional associations. The Consultation Document was also published on the SFC website.
12. 23 responses were received from the public as well as market practitioners including securities dealers, legal firms, industry representative bodies and professional associations. One of the submissions consisted of a survey of its members conducted by the Hong Kong Securities Institute.
13. Comments varied considerably in range and depth, with some focusing on broad principles and others on points of detail and clarification. On the whole, the market generally supported introducing measures to reduce financial and credit risks. Some commentators supported the Proposed Amendments. Others focused primarily on the practical effects of the Proposed Amendments on the market overall. Different commentators suggested varying levels of discount as well as changing the gearing adjustment. Others expressed concern over the possible effect on market liquidity generally as well as on specific 3rd and 4th liner stocks and on the proposal not differentiating between the perceived "quality" of the securities that may be discounted. Concerns were also expressed as to the impact on the IPO market and ensuring a level playing field with banks.
14. We have considered all market comments expressing concern over the proposal as well as those that have offered alternative suggestions. After the public consultation closed, we met with different commentators to discuss possible amendments and solutions that would be acceptable to the market generally. After much discussion and weighing all comments and investor considerations, we have made the Amendment Rules to balance the concerns (please see paragraphs 17 to 23).

15. There were also comments recognizing the need to address various financial risk issues in the long-term and possible alternative approaches. These issues, such as the pooling of clients' securities and the required capital level for firms conducting different business activities, are fundamental issues that Hong Kong should address in the context of the overall framework for intermediaries and market participants. As these will require considerable time for the necessary review, discussion, consultation and consensus building, they will be addressed separately in due course.
16. In the meantime, we believe it is imperative to introduce some interim measures to address the identified risks posed to firms, their clients and potentially to the systemic stability of the market. This we mean to achieve by making the Amendment Rules effective as soon as practicable.

AMENDMENT RULES

17. Taking into account the submissions received and following discussions with commentators, several revisions to the Proposed Amendments were considered appropriate.
18. First, we have reduced the "illiquid collateral haircut" percentage from 90% to 80%. This is in keeping with the percentage discount level broadly applied by banks to similar stocks. The "illiquid collateral haircut" would also override the current discount and concentration discounting factors in the FRR that would otherwise apply to the stock or warrant, so that there will not be any "double discounting" on the same stocks or warrants.
19. Second, in response to market comments, we have relaxed the gearing adjustment from 50% to 35%. This effectively means that if a firm's total borrowings secured by margin clients' securities exceed 65% of the total margin loans it lends to clients, the firm will be required to maintain an additional liquid capital buffer in the amount of such excess. This liquid capital buffer should, to a large extent, manage down both insolvency risks as well as liquidity risks.
20. Third, we note the concerns over practicality of applying the Proposed Amendments in the situation of IPO and newly listed shares without a 6 month trading period, as well as practical difficulties in tracking average monthly turnover and market capitalization.
21. To address these concerns, we have now revised the Proposed Amendments so that effectively the illiquid collateral haircut would not apply to shares or warrants that have been listed or traded for less than 7 consecutive calendar months (including any period during which the share or warrant is suspended from trading) immediately preceding the month in which the calculation is made. We have also allowed more lag time for firms to calculate the average monthly turnover of stocks and warrants.

22. Fourth, it has been brought to our attention that the definition of “illiquid collateral” would inadvertently affect shares that have been subject to a recent stock split. To overcome such technical problem, we have now changed the reference point from “number of shares or warrants” to “value”.
23. As revised, we believe that the Proposed Amendments are sound and offer the most reasonable means of reducing currently identified credit risk. While the Amendment Rules do not necessarily address all of the concerns expressed by the industry, we believe that they strike an acceptable balance between the interests of the industry and the protection of investors.

EFFECTIVE DATE

24. The effective date of the Amendment Rules will be 1 October 2002.

FINANCIAL RESOURCES (AMENDMENT) RULES 2002

(Made by the Securities and Futures Commission under section 28 of the Securities and Futures Commission Ordinance (Cap. 24) after consultation with the Financial Secretary)

1. Commencement

These Rules shall come into operation on 1 October 2002.

2. Amounts receivable from clients and securities margin financiers arising from dealings in securities or the provision of securities margin financing

Section 13 of the Financial Resources Rules (Cap. 24 sub. leg.) is amended -

(a) in subsection (4)(b) -

(i) in subparagraph (i), by adding ", other than illiquid collateral," after "collateral";

(ii) by adding -

"(ia) the market value of all illiquid collateral provided by the client, multiplied by 20%";

(b) by adding -

"(10) In this section, "illiquid collateral" (非速動抵押品), in relation to collateral provided to a dealer or securities margin financier by a margin client, means any listed or traded share or warrant which is of the same description as that identified as the top 3 collateral where -

(a) if it is a share, the aggregate market value of all shares of the same description as that share provided to the dealer or securities margin financier by his margin clients as collateral is equal to or greater than -

(i) the average monthly turnover of that share; or

(ii) 5% of the total 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 dealer or
securities margin financier by
his margin clients as
collateral is equal to or
greater than -

(i) the average monthly
turnover of that
warrant; or

(ii) 5% of the 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 or traded share or
warrant which has been listed
or traded 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.

(11) In this subsection and subsection (10) -

"average monthly turnover" (平均每月成交額), in relation to a listed or traded share or warrant, means one sixth of the aggregate value of transactions in that share or warrant on any stock market on which it is listed or traded 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 (4);

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

"top 3 collateral" (首3位抵押品), in relation to a top margin client of a dealer or securities margin financier, means any of the 3 highest listed or traded shares or warrants in terms of market value among all shares or warrants provided by him to the dealer or securities margin financier as collateral;

"top margin client" (佔首位的保證金客戶), in relation to a dealer or securities margin financier, means -

- (a) where he has less than 20 margin clients, each of his margin clients; or
- (b) where he has 20 or more margin clients, each of the 20 margin clients with the largest outstanding margin loan balances;

"traded" (買賣), in relation to any share or warrant, means traded on a stock market."

3. Provision of securities margin financing

Section 21 is amended -

- (a) By renumbering it as section 21(1);
- (b) by adding -

"(2) Where a dealer or securities margin financier obtains financial accommodation wholly or partly secured by collateral provided by his margin clients, he shall include in his ranking liabilities the amount by which such financial accommodation exceeds 65% of the aggregate amount receivable from his margin clients arising from the provision of securities margin financing."

4. Liquid capital computation

Schedule 7 is amended -

(a) in item 21, in column 3, by repealing "21(a)" and substituting "21(1)(a)";

(b) in item 22, in column 3, by repealing "21(b)" and substituting "21(1)(b)";

(c) in item 29, in columns 2 and 3, by adding -

" gearing adjustment		21(2)"
before -		
" short selling of		24(6)".
securities on behalf		
of clients		

Andrew Len Tao SHENG
Chairman,
Securities and Futures Commission

29 May 2002

Explanatory Note

The purpose of these Rules is to amend the Financial Resources Rules (Cap. 24 sub. leg.) ("the principal Rules") to limit the main financial and credit risks arising from the

provision of margin loans by securities dealers and securities margin financiers.

2. Section 2 amends section 13 of the principal Rules to require the application of a steep discount to the market value of certain securities held by the securities dealers and securities margin financiers as collateral, for the purpose of calculating their liquid assets.

3. Section 3 amends section 21 of the principal Rules to require securities dealers and securities margin financiers to compare the total value of their margin loans to clients with the total value of borrowings they have obtained by re-pledging securities received from their margin clients. If the borrowings obtained by any securities dealer or securities margin financier exceed 65% of the total margin loans extended by him, the excess must be included in his ranking liabilities.

4. Section 4 amends Schedule 7 to the principal Rules by introducing consequential renumbering of references to section 21 of the principal Rules, and adding a new item relating to the gearing adjustment required under the new section 21(2).

Summary of comments received on Proposed Amendments to the Financial Resources Rules

	Section reference	Details of the Rules/ Areas of concern	Respondent's comments	SFC's response
1.	-	General comments	<ul style="list-style-type: none"> Comments generally support the proposal to manage down the financial risks of margin financing intermediaries, and increase protection to investors. Some commentators have proposed that we should look at more fundamental issues such as capital requirements and pooling. 	<ul style="list-style-type: none"> We thank the market for their support and valuable comments. We will examine these structural issues as part of an overall review later in the year.
<i>Specific Comments</i>				
2.	S13(4)(b) & (10)	"Illiquid collateral" – general comments	<ul style="list-style-type: none"> The haircut % should be reduced from 90% to 80% as applied by the authorized institutions. 	<ul style="list-style-type: none"> We agree and have amended the proposal to reduce the haircut to 80%.
3.	S13(4)(b) & (10)	"Illiquid collateral" - concern over reducing liquidity	<ul style="list-style-type: none"> Some commentators were concerned that the proposal would affect market liquidity and brokers' ability to meet on-going liquidity requirements. 	<ul style="list-style-type: none"> The objective is to ensure that firms have adequate capital buffer in case they cannot liquidate their clients' securities collateral within a reasonable timeframe.
4.	S13(10)	"Illiquid collateral" - definition	<ul style="list-style-type: none"> The definition of 'illiquid collateral' cannot address the problem because there are stocks of sound fundamentals but not frequently traded. There are also stocks of dubious quality but being traded actively, this haircut may encourage "manufactured" liquidity (liquidity does not define the quality of a stock). <p>There are technical difficulties in applying the definition to IPO with less than 6 months track records.</p>	<ul style="list-style-type: none"> We have already excluded from "illiquid collateral" all HSI index or HSI HK LargeCap and MidCap stocks. 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 to detect incidents involving the ramping of share prices. In relation to all such malpractices the Commission will take decisive action, including the prosecution of offences and disciplining persons guilty of misconduct. <p>We agree that the illiquid collateral haircut should only apply to any share or warrant which has been listed or traded for 7 consecutive months or more immediately preceding the month in which the calculation is made.</p>

	Section reference	Details of the Rules/ Areas of concern	Respondent's comments	SFC's response
5.	S21(2)	Ranking liabilities on repledging margin client securities – general comments	<ul style="list-style-type: none"> 50% loan to bank borrowing ratio appears high. 	<ul style="list-style-type: none"> In response to market comments, we agree that the firm loan to bank borrowing adjustment should only be triggered when bank borrowings, secured by clients' securities collateral, exceed 65% of aggregate margin loans (<u>i.e.</u>, two-thirds). <p>Our major concern is over pooling where one client's collateral can be used to secure the firm's borrowings. If a firm's own practice is not to allow pooling and the bank is willing to regard each sub-account under the umbrella margin financing account on a stand-alone basis (<u>e.g.</u>, it agrees not to combine these accounts or to effect any netting), we would be prepared to consider granting an FRR modification in these circumstances.</p> <p>We will work with the industry and where appropriate, be prepared to grant modifications of the FRR provided that the risks are adequately addressed by compensating controls and investor protection is not undermined.</p>
6.		Other Comments	<ul style="list-style-type: none"> Given the increasing pressure on consumers to plan for their long term financial needs, and the role that the stock market plays in this regard, every endeavour should be undertaken to ensure that investors' funds are adequately protected. The proposals are therefore a step in the right direction for HK as an international financial center. It was suggested that the proposals be examined in light of other regulatory capital requirements in other international markets. The concern expressed was that the regulators should be addressing concerns that are unique to Hong Kong but also being mindful of established systemic approaches in other international regimes so that the competitiveness of Hong Kong brokerage firms is not otherwise negatively impacted as compared to their counterparts in other countries. 	<ul style="list-style-type: none"> We thank the market for their support and valuable comments. We thank the market for the suggestions and will consider these concerns in the White Paper.

List of Respondents

Date Received	Respondent
7 March 2002	Fidelity Investments Ltd
11 March 2002	Albert Pun
14 March 2002	Anne Ng (Retail Investor)
14 March 2002	- (Retail Investor without name)
20 March 2002	POP Electronic Product Ltd
21 March 2002	Consumer Council
21 March 2002	Hong Kong Stockbrokers Association
21 March 2002	City University of Hong Kong
23 March 2002	Cho Man Sang
25 March 2002	Tai Fook Securities Group Ltd
25 March 2002	Institute of Securities Dealers Ltd
26 March 2002	- (no name)
26 March 2002	- (commentator reserved anonymity and contents of submission)
26 March 2002	Sun Hung Kai & Co Ltd
26 March 2002	OSK Asia Corporation Ltd
26 March 2002	South China Securities Ltd
26 March 2002	Albert T. da Rosa, Jr.
27 March 2002	- (commentator reserved anonymity and contents of submission)
27 March 2002	Hong Kong Society of Accountants
28 March 2002	Hong Kong Institute of Directors
28 March 2002	Survey conducted by Hong Kong Securities Institute on its members
9 April 2002	Shengyin Wanguo Group
12 April 2002	Hong Kong Securities Professionals Association