

LEGISLATIVE COUNCIL BRIEF

Securities and Futures Ordinance (Cap. 571)

SECURITIES AND FUTURES (RECOGNIZED COUNTERPARTY) RULES

INTRODUCTION

Pursuant to section 397(1) of the Securities and Futures Ordinance (Cap. 571) (SFO), the Securities and Futures Commission (SFC) has made the Securities and Futures (Recognized Counterparty) Rules (the Rules) at the **Annex**.

BACKGROUND

The SFO

2. The SFO was enacted in March 2002. It consolidates and modernizes ten existing ordinances governing the securities and futures markets into a composite piece of legislation to keep the regulatory regime on a par with international standards and practices. For effective regulation, the SFO provides flexibility in addressing changing market practices and global conditions by empowering the Chief Executive in Council, the Financial Secretary, the Chief Justice and the SFC to prescribe detailed and technical requirements as necessary by way of subsidiary legislation, to supplement the regulatory framework laid down under the primary legislation.

3. On 22 February 2002, the House Committee of the Legislative Council established a Subcommittee on Draft Subsidiary Legislation to be made under the SFO (the Subcommittee) to study the subsidiary legislation necessary for commencing the SFO. From March 2002 to October 2002, the Subcommittee held 12 meetings and considered a total of 37 items of draft subsidiary legislation, including the *vires* to make them.

THE PROPOSALS

Major policy considerations

4. The term “recognized counterparty” is defined in Part 1 of Schedule 1 to the SFO in the following terms -

“ "recognized counterparty" (認可對手方) means -

- (a) an authorized financial institution;
- (b) in relation to a particular transaction conducted by a corporation licensed for Type 3 regulated activity,¹ another corporation which is also so licensed; or
- (c) an institution prescribed by rules made under section 397 of this Ordinance for the purposes of this definition as a recognized counterparty.”

5. Pursuant to paragraph (c) of the definition, the SFC has prescribed in the Rules other institutions which qualify as recognized counterparties.

6. The Rules basically preserve the criteria adopted by the SFC in considering past applications for designation as a “recognized counterparty” under section 2 of the Leveraged Foreign Exchange Trading Ordinance (Cap. 451). An institution prescribed as a “recognized counterparty” under the Rules would not be considered a client of a corporation licensed in Hong Kong for leveraged foreign exchange trading. Also, regulatory requirements in relation to the clients of such a corporation (e.g. issuance of contract notes and statements of account) would not be applicable. In addition, certain requirements under the Financial Resources Rules to be made under the SFO would not be applicable to dealings of a licensed leveraged foreign exchange trader with such recognized counterparties. The SFC considers that enabling leveraged foreign exchange traders to treat as recognized counterparties a reasonable range of institutions will facilitate the conduct of their business. The types of institutions specified in the Rules are drawn up by the SFC in a rigorous manner to ensure that only those institutions that are appropriate will qualify.

THE RULES

¹ Leveraged foreign exchange trading.

7. The Rules prescribe five more types of institutions as recognized counterparties -

- (a) a corporation licensed for dealing in futures contracts that deals in currency futures contracts on any specified futures exchange, as defined in Part 2 of Schedule 1 to the SFO (section 3(a));
- (b) a futures contracts dealer that is regulated in any specified jurisdiction as set out in Schedule 1 to the Rules and that deals in currency futures contracts on a specified futures exchange (except where such dealer ceases to be authorized to carry out such dealing as a result of the action of the authority or regulatory organization that regulates it in its home jurisdiction) (section 3(b));
- (c) a bank that is incorporated in any specified jurisdiction and regulated by a specified bank regulator in that jurisdiction, as set out in Schedule 1 to the Rules, (except where the bank ceases to be authorized to operate as a bank as a result of the action of the specified bank regulator) (section 3(c));
- (d) a corporation that has issued debt instruments which continue to attract a qualifying credit rating (as defined in Part 5 of Schedule 1 to the SFO) (section 3(d) and Schedule 1); and
- (e) an institution in respect of which the SFC is satisfied that the recognition is appropriate because it would not prejudice the interests of the investing public and which is specified in Schedule 2 to the Rules (section 3(e) and Schedule 2). The list of specified institutions in Schedule 2 is drawn up by the SFC with reference to the existing list of “recognized counterparties” not otherwise belonging to any of the above types of institutions.

PUBLIC CONSULTATION

8. The SFC released a consultation document and an exposure draft

of the Rules on 30 November 2001 for comment by the public. Six submissions were received. The SFC considered all the comments received and revised the draft Rules as appropriate.

9. A draft of the Rules was considered by the Subcommittee at its meeting held on 29 April 2002. No major concerns were expressed by members of the Subcommittee at the meeting.

FINANCIAL AND STAFFING IMPLICATIONS

10. There are no financial or staffing implications for the Government.

COMMENCEMENT DATE

11. The Rules will come into operation on the day appointed for the commencement of the SFO, together with other subsidiary legislation necessary for the commencement. We expect this to take place shortly, after completion of the negative vetting procedure through the Legislative Council and allowing the industry a reasonable period of time for making necessary adjustments with reference to the subsidiary legislation. We aim to announce the commencement date by the end of 2002.

PUBLICITY

12. The Rules will be published in the Gazette on 29 November 2002. The SFC will issue a press release on the same day.

ENQUIRIES

13. For any enquiries on this brief, please contact Mr. Johnny Shih of the Intermediaries Supervision Department of the SFC at 2842 7601.

The Securities and Futures Commission
25 November 2002

SECURITIES AND FUTURES (RECOGNIZED COUNTERPARTY) RULES

(Made by the Securities and Futures Commission
under section 397(1) of the Securities and
Futures Ordinance (Cap. 571))

1. Commencement

These Rules shall come into operation on the day appointed for the commencement of the Securities and Futures Ordinance (Cap. 571).

2. Interpretation

In these Rules, unless the context otherwise requires -

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

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

"equivalent corporation" (等同法團) means a corporation that -

- (a) carries on a business in a specified jurisdiction in an activity which, if carried on in Hong Kong, would constitute dealing in futures contracts, under an authorization (however described) by an authority or regulatory organization in that jurisdiction; and
- (b) has and maintains shareholders' funds of not less than \$30,000,000 or its equivalent in any foreign currency as calculated by -

- (i) adding together the corporation's -
 - (A) issued and paid-up share capital;
and
 - (B) retained profits and reserves with
aggregate net credit balances; and
- (ii) subtracting from the sum calculated under
subparagraph (i) the corporation's
accumulated losses and reserves with
aggregate net debit balances;

"specified bank regulator" (指明銀行規管當局) means -

- (a) an authority specified in column 3 of Schedule 1 as
an authority in a specified jurisdiction set out
opposite to it in column 2 of Schedule 1 with
responsibility for regulating banks in that
jurisdiction; or
- (b) any successor of such authority;

"specified jurisdiction" (指明司法管轄區) means a jurisdiction
specified in column 2 of Schedule 1.

3. Institutions that are recognized counterparties

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

- (a) a corporation licensed for dealing in futures contracts that deals in currency futures contracts on any specified futures exchange;
- (b) an equivalent corporation that deals in currency futures contracts on any specified futures exchange, except where such corporation ceases to be authorized to carry out such dealing as a result of the action of the authority or regulatory organization that regulates it in the specified jurisdiction in which it is incorporated and regulated;
- (c) a bank that is incorporated in a specified jurisdiction and regulated by a specified bank regulator in that jurisdiction, except where the bank ceases to be authorized to operate as a bank as a result of the action of the specified bank regulator;
- (d) a corporation that has issued debt instruments which continue to attract a qualifying credit rating; and
- (e) an institution -
 - (i) in respect of which the Commission is satisfied that recognition as a counterparty -
 - (A) is appropriate; and

- (B) would not prejudice the interest of
the investing public; and
- (ii) which is specified in Schedule 2.

SCHEDULE 1

[s. 2]

SPECIFIED JURISDICTIONS AND SPECIFIED BANK REGULATORS

| Item | Specified jurisdiction | Specified bank regulator |
|------|--|---|
| 1. | Australia | Australian Prudential Regulation Authority |
| 2. | Canada | Office of the Superintendent of Financial Institutions |
| 3. | The Federal Republic of Germany | Bundesaufsichtsamt für das Kreditwesen |
| 4. | The French Republic | La Commission Bancaire |
| 5. | Japan | Financial Services Agency |
| 6. | The Swiss Confederation | Eidgenössische Bankenkommission |
| 7. | The United Kingdom of Great Britain and Northern Ireland | Financial Services Authority |
| 8. | The United States of America | Board of Governors of the Federal Reserve System The Office of the Comptroller of the Currency |

SCHEDULE 2

[s. 3]

SPECIFIED INSTITUTIONS THAT ARE RECOGNIZED COUNTERPARTIES

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



Andrew Leo Tao SHENG

Chairman,
Securities and Futures Commission

25th November, 2002

Explanatory Note

These Rules are made by the Securities and Futures Commission under section 397(1) of the Securities and Futures Ordinance (Cap. 571). They prescribe certain institutions as recognized counterparties for the purposes of paragraph (c) of the definition of "recognized counterparty" in section 1 of Part 1 of Schedule 1 to the Ordinance. This means that such an institution would not be a client of a corporation licensed in Hong Kong for leveraged foreign exchange trading.