

# **LEGISLATIVE COUNCIL BRIEF**

## **Securities and Futures Ordinance (Cap. 571)**

### **SECURITIES AND FUTURES (LEVERAGED FOREIGN EXCHANGE TRADING - EXEMPTION) 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 (Leveraged Foreign Exchange Trading - Exemption) 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 the 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 sets of draft subsidiary legislation, including the vires to make them.

#### **THE PROPOSALS**

##### **Major policy considerations**

4. The Rules supplement the regulatory regime in Part V of the SFO in

respect of persons carrying on the business of leveraged foreign exchange trading. The term “leveraged foreign exchange trading” in Part 2 of Schedule 5 of the SFO is described in broad terms but a range of acts and transactions are excluded from the definition. The acts excluded include, under paragraph (xiii) of the definition, acts performed for or in connection with any contract or arrangement by any person belonging to a class of persons, or carrying on a type of business, as prescribed by rules made by the SFC under section 397 of the SFO. Persons excluded by such rules do not have to be licensed under Part V to carry on a leveraged foreign exchange trading business.

5. The Rules set out the three classes of persons that are excluded. The first class replicates that in the Leveraged Foreign Exchange Trading (Exemption) Rules (Cap. 451 Sub. Leg. E) prescribed under the Leveraged Foreign Exchange Trading Ordinance, as set out in paragraph 8 below. The corporations concerned generally target the non-retail market and therefore excluding them from the licensing regime would not compromise investor protection.

6. The second and third classes (see paragraphs 9 and 10 below) have been included to facilitate the development of the listed currency warrant market by removing unnecessary technical obstacles without compromising investor protection.

## **THE RULES**

7. Section 3 of the Rules prescribes that the three classes of persons to be excluded from the definition of “leveraged foreign exchange trading” are those set out in sections 4, 5 and 6 respectively.

8. Section 4 prescribes that a corporation is to be excluded if it has, or whose parent company has, a qualifying credit rating, provided that either (a) the principal business of the corporation is not in leveraged foreign exchange spot transactions; or (b) the average principal amount in each leveraged foreign exchange spot transaction entered into by the corporation is not less than \$7.8 million. It also requires the corporation in question to notify the SFC within 4 months after the end of its financial year that it satisfied the condition for exclusion and provide the SFC with necessary information for verification. The corporation also needs to notify the SFC within 7 days of its ceasing to satisfy the conditions.

9. Section 5 prescribes that a person is to be excluded if it is a licensed corporation or a client of such a licensed corporation performing an

act in connection with the sale, purchase or transfer of a listed currency warrant.

10. Section 6 prescribes that a person is to be excluded if it is an issuer, or a corporation in the same group of companies as the issuer, of a listed currency warrant performing an act in connection with the sale, purchase or transfer of the listed currency warrant within the same group or with a licensed corporation.

## **PUBLIC CONSULTATION**

11. The SFC released a consultation document and an exposure draft of the Rules on 5 June 2002 for comment by the public. Two submissions were received. The Rules were refined to better reflect the policy intention and to improve drafting

12. A draft of the Rules was considered by the Subcommittee at its meeting on 15 July 2002. The SFC provided further clarification to the Subcommittee after the meeting. No further concerns were expressed by members of the Subcommittee.

## **FINANCIAL AND STAFFING IMPLICATIONS**

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

## **COMMENCEMENT DATE**

14. 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**

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

## **ENQUIRIES**

16. For any enquiries on this brief, please contact Mr. Alvin Lok of the Licensing Department of the SFC at 28427695 or Mr. Anthony Wood of the Legal Services Division of the SFC at 2840 9276.

The Securities and Futures Commission  
25 November 2002

**SECURITIES AND FUTURES (LEVERAGED FOREIGN EXCHANGE  
TRADING - EXEMPTION) 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, "listed currency warrant" (上市貨幣權證) means a warrant -

- (a) that gives the holder of the warrant a right to receive from the issuer of the warrant a cash payment, on exercise, in the event that one specified currency is worth more or less (as the case may be) in relation to another specified currency on a specified date; and
- (b) that -
  - (i) is listed; or
  - (ii) is not listed, but it is reasonably foreseeable will be listed within 14 days after the day on which the warrant is first offered for sale.

**3. Persons prescribed for purposes of paragraph (xiii) of definition of "leveraged foreign exchange trading"**

For the purposes of paragraph (xiii) of the definition of "leveraged foreign exchange trading" in Part 2 of Schedule 5 to the Ordinance, a person described in -

- (a) section 4(1);
- (b) section 5; or
- (c) section 6,

is prescribed as a person referred to in that paragraph for the purposes of any provision of the Ordinance.

**4. Person referred to in section 3(a)**

(1) The person referred to in section 3(a) is a corporation that -

- (a) satisfies the conditions set out in subsection (2);  
and
- (b) complies with the requirement in subsection (3).

(2) The conditions referred to in subsection (1)(a) are that -

- (a)
  - (i) the corporation has a qualifying credit rating or has such a rating for any of its debt instruments; or
  - (ii) the shares of the corporation are wholly owned, directly or indirectly, by another corporation, or by a partnership, which has a qualifying credit rating or has such a rating for any of its debt instruments; and

- (b)
  - (i) the principal business of the corporation is not in leveraged foreign exchange spot transactions; or
  - (ii) the average principal amount of each leveraged foreign exchange spot transaction entered into by the corporation, calculated for each financial year of the corporation, is not less than \$7.8 million.

(3) The corporation shall, annually, within 4 months after the end of its financial year -

- (a) notify the Commission in writing that it satisfies the conditions set out in subsection (2); and
- (b) provide the Commission with such information as the Commission may reasonably require to enable the Commission to verify that the corporation does satisfy the conditions set out in subsection (2).

(4) If a corporation ceases to satisfy the conditions set out in subsection (2)(a), it shall within 7 days thereof notify the Commission in writing of the cessation.

(5) For the purposes of this section, the average principal amount of each leveraged foreign exchange spot transaction entered into by a corporation shall be computed by dividing the aggregate of all principal amounts of leveraged foreign exchange spot transactions entered into by the corporation during the relevant financial year by the total number of such transactions entered into by the corporation during that financial year.

**5. Person referred to in section 3(b)**

The person referred to in section 3(b) is -

- (a) a licensed person in so far as the licensed person performs an act for or in connection with a contract or arrangement or a proposed contract or arrangement for the sale, purchase or transfer of a listed currency warrant; or
- (b) a client of a licensed corporation in so far as the client performs an act for or in connection with a contract or arrangement or a proposed contract or arrangement between the licensed corporation and the client for the sale, purchase or transfer of a listed currency warrant.

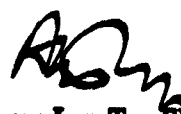
**6. Person referred to in section 3(c)**

The person referred to in section 3(c) is a corporation which is the issuer of any listed currency warrant or a corporation in the same group of companies as the issuer of any listed currency warrant in so far as the corporation performs an act for or in connection with a contract or arrangement or a proposed contract or arrangement for the sale, purchase or transfer of the listed currency warrant -

- (a) between a corporation (whether or not it is the corporation first referred to in this section) which is the issuer of the listed currency warrant or a corporation in the same group of companies as the issuer of the listed currency warrant, and a licensed corporation;



- (b) between a corporation (whether or not it is the corporation first referred to in this section) which is the issuer of the listed currency warrant and a corporation in the same group of companies as the issuer of the listed currency warrant; or
- (c) between corporations which are both in the same group of companies as the issuer of the listed currency warrant but are not themselves the issuer.



**Andrew Len Tao SHENG**

Chairman

Securities and Futures Commission

*25<sup>th</sup> 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 persons as belonging to a class of persons for the purposes of paragraph (xiii) of the definition of "leveraged foreign exchange trading" in Part 2 of Schedule 5 to the Ordinance. This means that any act performed by such persons for or in connection with any contract or arrangement or a proposed contract or arrangement is excluded from that definition.

A consequence is that the prescribed persons need not be licensed for such activities.