



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

***Consultation Conclusions on the
Proposed Revisions to the Code of
Conduct for Persons Registered with
the Securities and Futures
Commission***

有關《證券及期貨事務監察委員會註冊人操守準則》的建議修訂的諮詢總結

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INTRODUCTION

1. On 21 November 2002, the Securities and Futures Commission (“Commission” or “SFC”) released a Consultation Document (“Consultation Document”) on the proposed revisions to the Code of Conduct for Persons Registered with the Securities and Futures Commission (the “Code”).
2. The consultation period lasted until 21 December 2002.
3. A summary of comments received on the proposed revisions (“Summary of Comments”) is attached as Attachment 1.
4. Taking into account the submissions received, several amendments to the original proposed revisions were considered appropriate.
5. These revisions have been adopted by the Commission and effected in the draft Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission (“Revised Code”) which is attached as Attachment 2.
6. The Commission would like to thank those who have provided their comments on the proposed revisions.
7. 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 Commission’s conclusions. This report should be read in conjunction with the Consultation Document, the Summary of Comments and the draft Revised Code.

PUBLIC CONSULTATION

A. Background

8. The Revised Code is to be made under section 169 of the Securities and Futures Ordinance (“SFO”). It basically follows the current Code (as last revised in June 2002) and changes introduced are primarily intended to meet the following objectives:
 - (a) to extend the application of the Revised Code to all intermediaries (including registered institutions and licensed leveraged foreign exchange traders) and their representatives to ensure a level playing field; and
 - (b) to rationalise the Revised Code with the SFO and the rules made thereunder.

B. Consultation Process

9. In addition to the public announcement inviting comments, the Consultation Document was distributed to all intermediaries and various professional bodies. The Consultation Document was also published on the SFC website.
10. 15 submissions were received from practitioners including leveraged foreign exchange traders, local and international brokerage firms, legal firms, industry representative bodies and professional associations.
11. The overall tone of the comments was positive. Commentators generally acknowledged the need for and welcomed the proposed revisions. Comments varied considerably in range and depth, with some focusing on broad principles and others on points of detail and clarification. In addition, some of the comments received are not related to the proposed revisions but are rather seeking clarification on interpretation of some of the existing provisions of the Code.

CONSULTATION CONCLUSIONS

Professional Investors (paragraph 15.2)

12. Paragraph 15.2 of the Code prescribes 2 categories of professional investors. Several commentators expressed concerns that the professional investor definition under paragraph 15.2B does not align that in the Securities and Futures (Professional Investor) Rules (the “PI Rules”). They commented that the PI Rules do not mention any element of investment experience nor are there any provisions to include any test on this matter. However, the existing investment experience tests remain in paragraph 15.3 of the Revised Code.
13. In the Revised Code, we have already aligned the definition of “professional investor” with that under the SFO. We would also like to point out that the expanded definition of “professional investor” under the PI Rules is only applicable to sections 103, 174 and 175 of the SFO. This is set out in the PI Rules and the rationale for this partial relaxation is that while these investors should be sufficiently sophisticated to merit a relaxation of the provisions specified, they may not be experienced enough to be regarded as “professional investor” for all other purposes.
14. Therefore, we maintain the view that before waiving the requirements as set out in paragraph 15.5 (including the need to establish clients’ financial situation and investment objectives, ensure the suitability of a recommendation and sign client agreements) for those professional investors as referred to under paragraph 15.2B (i.e. a person falling under the definition of the PI Rules), licensed or registered persons must ensure that these professional investors are knowledgeable and have sufficient expertise in relevant products and markets. We have fine-tuned the wordings in the Revised Code to better reflect our policy intention.

Provisions for Securities Borrowing and Lending and Short Selling (Paragraphs 12 to 15(a)&(b) of Schedule 3 and Schedules 3A and 3B)

15. A few market participants commented that some of the requirements in relation to securities borrowing and lending and short selling as set out under Schedule 3 are applicable to exchange participants only and thus created an unlevel playing field between exchange participants and non-exchange participants. For example, paragraph 12(d) requires an exchange participant to segregate any collateral received from the borrower in a separate bank account when paragraph 13(f) stipulates that an exchange participant must ensure that a written securities borrowing and lending agreement is in place and the agreement should include, inter alia, a provision that the value of collateral received from the borrower should not be less than 100% of the current market value of the borrowed securities or 105% if the securities borrowing is for the purposes of a short sale.
16. Other commentators pointed out that paragraph 13(p), which requires a securities borrowing and lending agreement to include a warranty by the borrower of a securities borrowing and lending transaction that it shall register the executed agreement with the Collector no later than 2 weeks (for Hong Kong borrower) after the execution, is inconsistent with the 30 days requirement as set out in section 19(12A) of the Stamp Duty Ordinance.
17. Having considered the comments received and also the fact that the specific provisions in relation to securities borrowing and lending and short selling under Schedule 3 of the Code are already covered by relevant subsidiary legislations made under the SFO (such as the Securities and Futures (Client Money) Rules and the Securities and Futures (Short Selling and Securities Borrowing and Lending (Miscellaneous)) Rules) and/or the Stamp Duty Ordinance, we have now deleted paragraphs 12 to 14, paragraph 15 (a) & (b) of Schedule 3 and also Schedules 3A and 3B.

Avoidance of duplication with the SFO

18. After careful consideration and taking into account of the market comments, we have also deleted paragraphs 7(a), 10(a) to (d) and paragraph 13 of Schedule 4 in order to avoid duplication, as the relevant requirements are already covered by the Securities and Futures (Client Money) Rules.

EFFECTIVE DATE

19. The Revised Code will become effective on 1 April 2003.

**Proposed revisions to the Code of Conduct for Persons Registered with the Securities and Futures Commission (“Code”)
Summary of comments received and the SFC’s response**

Item No.	Section No.	Details of the Requirements	Respondent’s Comments	SFC’s Response
<i>General Comments</i>				
1.	-	<u>General</u>	[Simmons] The commentator suggested that ad hoc guidelines and circulars issued by the Commission over the years should be incorporated into the Code for completeness.	<p>In general, the Code is intended to set out the business conduct principles which are fundamental to the undertaking of a licensed or registered person’s business but not the detailed operational procedures or guidelines. Therefore, it may not be appropriate to incorporate those ad hoc guidelines and circulars, which are usually more specific and operational in nature.</p> <p>However, to facilitate access to all codes, guidelines and important circulars issued by the SFC, the SFC launched its electronic Regulatory Handbook in May 2002. The handbook incorporates all the existing regulatory codes and guidelines and is regularly updated on our website at www.hksfc.org.hk.</p>
2.	-	<u>General</u>	<p>[LSHK] The commentator supported the Code being published pursuant to section 169 rather as “rules” pursuant to section 168 of the Securities and Futures Ordinance (“SFO”).</p> <p>[LSHK] & [CC] The commentators supported the Code being applicable to all intermediaries and their representatives.</p>	Comments noted and acknowledged.
3.	-	<u>General</u>	[CC] The commentator supported clarifying the extent of responsibility for compliance with the Code by providing that a “registered person” means not only a	Comments noted and acknowledged.

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			"registered institution" but also a "relevant individual".	
4.	-	<u>General</u>	[HKAOBr] The commentator appreciated that the main purposes of the proposed revisions are to rationalize the Code with the SFO and its rules and to have a uniform code of conduct applicable to all intermediaries (including authorized institutions and licensed leveraged foreign exchange traders) and their representatives.	Comments noted and acknowledged.
5.	-	<u>Cover page</u>	[LSHK] The commentator suggested retaining a publication date on the face of the Code to ensure that users do not inadvertently refer to outdated editions.	The publication date will be stated.
<i>Specific Comments</i>				
6.	1.5	<u>Effect of breach of the Code</u> A failure by any person to comply with any provision of the Code that applies to it – (a) shall not by itself render it liable to any judicial or other proceedings, but in any proceedings under the SFO before any court the Code shall be admissible in evidence, and if any provision set out in the Code appears to the court to be relevant to any question arising in the proceedings it shall be taken into account in determining the question;	[ISDL] The commentator believed that the Court would make its own judgment on whether any provisions set out in the Code would be of relevance to questions arising from proceedings. The Code therefore should not predetermine what the Court should or should not use in making its findings.	The Code cannot predetermine what the Court should or should not use. As explained in paragraph 1.5 of the revised Code, if any provision set out in the Code <u>appears to the court to be relevant</u> to any question arising in a proceeding under the SFO, it shall be taken into account in determining the question. It is therefore up to the Court to determine whether any provision in the revised Code is relevant.

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7.	3.9	<u>Order recording</u>	<p>[Linklaters] The commentator noted that in the SFC Enforcement Reporter (December 2002), the SFC stated that it had disciplined a licensed firm for, among other things, not having a procedure to review regularly the tape recordings of client-broker phone conversations. The SFC then stated: "Brokerages should review the recordings regularly on a sample basis to keep an eye on their staff."</p> <p>The commentator asked whether or not this is a requirement of the Code, and if it is, the commentator requested the SFC to set out clearly its expectations, i.e. whether this should be done monthly, and as to how many samples should be reviewed.</p>	<p>Except for paragraph 39(b) of Schedule 6 to the revised Code which requires a leveraged foreign exchange trader to carry out random checks at intervals of not less than once every week to ensure that all applicable laws, rules and regulations have been complied with, there is no specific requirement in respect of reviewing of tape recordings for other licensed or registered persons.</p> <p>However, paragraph 12.1 of the revised Code requires a licensed or registered person to implement and maintain adequate internal control procedures to ensure compliance with all relevant law, rules, regulations and codes applicable to it. Regular review of tape recordings no doubt forms part of the internal control procedures that are required under paragraph 12.1. Licensed or registered persons should take into consideration their circumstances (e.g. the nature & complexity of their business operations and other control procedures instituted) in deciding the frequency and the scope of their review.</p>
8.	5.1	<u>Know your client</u>	<p>[Simmons] The commentator considered the non face-to-face account opening procedures introduced in June 2002 is inadequate to fully address issues connected with account opening for overseas clients. In particular when these potential overseas clients do not have a bank account in Hong Kong. The commentator recommended the Commission to accept verifications or referrals from reputable overseas financial intermediaries (e.g. duly registered/supervised by their local regulators in jurisdictions recognized by the</p>	<p>The Code has already provided for a number of alternatives for verification of client identity overseas, such as certification by affiliated companies of a licensed or registered person and professionals, including a branch manager of a bank (i.e. not necessarily a bank in Hong Kong), certified public accountant, lawyer or notary public. We will however keep a close watch on the development of the market and consider the suggestion in our next revision.</p>

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			<p>Commission) whether or not the overseas entity is an affiliate of the registrant.</p> <p>[HKSbA] The commentator questioned the practicality of identifying a client by encashing a cheque of not less than \$10,000 and suggested that this method could be used for internet trading client only. The commentator recommended that face-to-face verification is a more direct and certain way.</p>	<p>Paragraph 5.1 (b) was introduced as an alternative client identification procedure. It was indeed designed to help licensed or registered persons to verify the identity of new clients who wish to open accounts in non-face-to-face situations, such as those internet trading clients.</p>
9.	5.4	<p><u>Client identity: origination of instructions and beneficiaries</u></p>	<p>[Simmons] The commentator questioned how the client identity provisions should be applied to corporate entities. For example, should identity cards or passports of directors/shareholders of corporate client be provided?</p>	<p>As clarified in paragraph 35 of the Client Identity Rule Policy, a licensed or registered person would usually be able to assume that a transaction for a corporate client is for the benefit of the corporation and record the required information about the corporation (e.g. business registration certification and other corporation documents) rather than information about all its shareholders. In addition, the person ultimately responsible for originating the instruction in relation to a transaction will usually be a director, executive officer or other person authorized by the board of directors. In such circumstances, the identity documents of the authorized person (e.g. copy of identity card or passport) should be obtained in order to comply with the "Know Your Client" requirements under paragraphs 5.1 to 5.3 of the Code.</p>

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10.	5.4 (b)	A licensed or registered person should keep in Hong Kong a record of the details referred to in paragraph 5.4(a) and give the Commission access to that record upon request.	[Simmons] The commentator noted that paragraph 5.4(b) required intermediaries to keep certain information in Hong Kong and give the Commission access to that record upon request. The commentator further noted that under s.130 of the SFO, the Commission might approve premises to be used for keeping records or documents. The commentator requested the Commission to make clear whether or not it might accept such records being maintained overseas.	The Client Identity Rule Policy says intermediaries do not have to keep records in Hong Kong where this is not practical. Premises at which records are kept need to be approved by the SFC under s.130, whether they are in or outside Hong Kong.
11.	5.4 (d)	In relation to an investment fund (e.g., a mutual fund, unit trust, pooled retirement scheme, European CIS company, etc) or discretionary account the "entity" referred to in paragraph 5.4(a) is the investment fund or account, and the manager of that investment fund or account, not those who hold a beneficial interest in that investment fund or account (e.g., the unitholders of a unit trust).	[Linklaters] The commentator believed that the reference to "investment fund" in subparagraph (d) should refer to "collective investment scheme", which is the new terminology used in the SFO.	We agree with the comment and have amended the revised Code accordingly.
12.	5.4(e) & Schedule 2	<p><u>5.4 (e)</u></p> <p>Paragraph 5.4(a) applies only where the transaction involves securities or futures contracts that are listed or traded on a recognized stock market or a recognized futures market or a derivative, including an over-the-counter derivative, written over such securities or futures contracts.</p> <p><u>Schedule 2</u></p> <p>"...Paragraph 5.4 of the Code is intended to improve the transparency of</p>	[Linklaters] [HSBC] & [HKSbA] The commentators noted that both paragraph 5(e) and Schedule 2 have been amended to refer to "a recognized stock market or a recognized futures market" rather than one of the Hong Kong exchanges. The commentators would like the Commission to confirm that the intention remains that the client identity rule only applies to transactions relating to securities and futures contracts listed or traded in Hong Kong and not a change of intention that this provision shall apply to markets outside Hong Kong.	Yes, our intention remains to apply the client identity rule to securities or futures contracts listed or traded in Hong Kong. The proposed amendment is only a technical change as "a recognized stock market or a recognized futures market" is the new terminology used in the SFO and is defined in Part 1 Schedule 1 of the SFO.

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		trading in securities or futures contracts listed or traded on a recognized stock market or a recognized futures market or in derivatives..."	[HSBC] The commentator further suggested the Commission to change the provision to "a recognized stock market or a recognized futures market <u>in Hong Kong</u> " to reflect the original intention of the Client Identity Rule Policy.	
13.	7.1	<u>Authorization and operation of a discretionary account</u>	[HKSbA] The commentator commented that the question of authorization and operation of discretionary account should be covered by the Client Money Rules and Client Securities Rules. It was suggested that a reference to the relevant parts of those rules would suffice.	The requirements as set out in paragraph 7.1 of the Code are totally different from those in the Client Money Rules and the Client Securities Rules. Paragraph 7.1 of the Code focuses on the authority given by a client to effect any transactions (including and not limiting to trading transactions) on behalf of the client whereas the authorizations described in the Client Money Rules and Client Securities Rules refer to written authority from clients to deal with their monies or securities.
14.	8.2	<u>Prompt confirmation</u>	[Simmons] The commentator questioned whether the requirement of confirming promptly the order executed on behalf of client exists independently of the requirement to provide contract note under the Contract Notes, Statements of Account and Receipts Rules.	Issuance of contract note and prompt confirmation of executed orders to clients are two different requirements. We expect licensed or registered person to confirm promptly the orders executed for clients (except for a discretionary account or as otherwise agreed with the client in writing) so that clients are fully informed of the status of their orders. Issuance of contract note is a separate requirement under the Contract Notes, Statements of Account and Receipts Rules.
15.	8.2(a)		[PSHKL] The commentator would like the Commission to clarify whether the "passive" order status service recommended in paragraph 79(h) of the Consultation Paper on the Regulation of On-line Trading	The "passive" order status service may not be appropriate for non-internet trading clients as these clients may not have ready access to the internet. In respect of on-line trading, the Commission will issue a consultation

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			Of Securities and Futures published by the SFC in December 2000 complies with the prompt confirmation requirement.	conclusion on the Regulation of On-line Trading of Securities and Futures in due course.
16.	8.4	<u>Information about the firm: financials</u>	[Simmons] The commentator questioned whether the disclosure of material adverse change only applies on request or whether there is a positive duty on the intermediary to make disclosure. If there is a positive duty to disclose, rather than merely upon request, the commentator suggested clarifying whether the disclosure is required to be made to the Commission or to clients generally, or both.	The disclosure of material adverse changes only applies on request and needs only be made to the clients making the request.
17.	9.3	<u>Non-public, material information</u> A licensed or registered person should have procedures in place to ensure that its employees do not deal (for the benefit of the licensed or registered person, the employee or a client) in securities or futures contracts where the employee concerned effects the dealing in order to "front-run" pending transactions for or with clients, or other non-public information which would be expected to materially affect prices of those securities or futures contracts and which is to be released to the market.	[Linklaters] The commentator suggested the words "or on the basis of" should be inserted before "other non-public information" in line 6 of this paragraph.	Agreed. The revised Code has been further amended accordingly.
18.	11.1(b)	<u>Handling of client assets</u>	[CC] The commentator is concerned that if a client who has relied on his broker's advice to purchase overseas assets without making specific instructions as to the shares or the locations, the client might not be in a position to gauge the extent of risk	Client's securities are normally held in the country where the securities are listed or traded. Given that the Contract Notes, Statements of Account and Receipts Rules already require licensed or registered persons to include the name of the market or exchange on which the

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			associated with having assets in a particular country. The commentator suggested requiring an intermediary to indicate in a client's statement the country where assets not located in Hong Kong are held.	relevant contracts (i.e. the transactions) have been executed, no additional disclosure in the statement of account is considered necessary.
19.	12.2	<u>Employee Dealings</u>	[HKAB] The commentator questioned whether the application of paragraph 12.2 was intended to be confined to securities dealing staff or to extend to include non-securities dealing staff in the context of registered institutions.	The purpose of paragraph 12.2 of the Code is to address the issue of potential conflict of interest between the employees and the clients of the intermediaries. Therefore the term "employees" shall include both securities dealing and non-securities dealing staff who are employed by the intermediaries to carry out the regulated activities. No differentiation should be made between registered institutions or licensed corporations.
20.	12.2(b)(ii)	employees should be required to identify all related accounts and report them to senior management. For purposes of paragraph 12.2, the term "related accounts" includes accounts of their minor children and accounts in which the employees hold beneficial interests;	[HKAB] The commentator suggested that the meaning of "related accounts" should be clearly defined. The commentator pointed out that according to sub-paragraph 12.2(b)(ii), "related accounts" includes accounts of the employees' minor children and accounts in which the employees hold beneficial interests. The commentator further suggested the SFC to make available an exhaustive list of related accounts, e.g. are spouse accounts regarded as related accounts.	A spouse account shall not be automatically deemed as a related account but it will be caught if the employee holds a beneficial interest in the account. Whether an account is a related account depends very much on the circumstances of each case and in particular whether the employee has a beneficial interest. Therefore, it is impossible to have an exhaustive list of related accounts to cover all possible scenarios.
21.	12.2(b)(iii), (v) & (vi)		[HKAB] The commentator is of the view that sub-paragraph 12.2(b)(iii), (v) and (vi) applied to the accounts of the dealing staff which opened with the employer who was a licensed or registered person. The commentator questioned how should these provisions be applied to registered	Paragraph 12.2(b) of the revised Code sets out the procedures expected from a licensed or registered person (including a registered institution) if its employees are permitted to deal for their own accounts. Generally, employees should be required to deal

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			<p>institution who only acts as intermediary between its dealing staff and the broker.</p>	<p>through the licensed or registered person or its affiliates. This will include the situation where a registered institution acts as an intermediary between its staff (this should not be limited to dealing staff) and the execution broker. Also, the transactions for employees' accounts and related accounts should be separately recorded and monitored by senior management to detect irregularities and ensure that those transactions are not prejudicial to the interests of the registered or licensed person's other clients as required under sub-paragraph 12(b)(v) and (vi).</p> <p>On the other hand, if employees are allowed to deal through another dealer, the licensed or registered person should then arrange for duplicate trade confirmations and statements of account to be provided to senior management as stipulated in paragraph 12.2(b)(iv) of the Code for review.</p>
22.	12.2(b)(iv)	<p>if the licensed or registered person provides services in securities or futures contracts listed or traded on a recognized stock market or a recognized futures market or in derivatives, including over-the-counter derivatives written over such securities or futures contracts, and its employees are permitted to deal through another dealer, in those securities or futures contracts, the licensed or registered person and employee should arrange for duplicate trade confirmations and statements of account to be provided to senior management of the licensed or registered person;</p>	<p>[HKAOBr] The commentator argued that as employees' transactions may be monitored electronically through automated systems and there is no need to arrange for duplicate trade confirmations and statements of account. Therefore the commentator suggested adding to the end of subsection (b)(iv) "unless the licensed or registered person has alternative means to monitor its employees' transactions".</p>	<p>It is important to obtain duplicate trade confirmations and statement of accounts from other licensed or registered person as independent confirmation of transactions done by the employee. Of course, such confirmation may be provided in electronic or any other means rather than in hard copies.</p>

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23.	12.2(b)(iv) & 12.2 (c)	<p><u>12.2(b)(iv)</u></p> <p>See item 22.</p> <p><u>12.2(c)</u></p> <p>A licensed or registered person should not knowingly deal in securities or futures contracts for another licensed or registered person's employee unless it has received written consent from that licensed or registered person.</p>	<p>[PSHKL] The commentator asked if a licensed or registered person should request for written consent and duplicated trade confirmation and statement of accounts for senior management review under the following cases:</p> <p>(i) if the employer is a leveraged foreign exchange trader and it permits its employees to trade through another dealer for their own accounts in leveraged foreign exchange, securities or futures contracts (listed or traded on a recognized stock market or a recognized futures market);</p> <p>(ii) if the employer provides trading services in securities or futures contracts, and it permits its employees to trade through another dealer for their own accounts in leveraged foreign exchange contracts.</p> <p>(iii) If an employee of a licensed or registered person is permitted to trade, through another overseas dealer or licensed or registered person, for their own accounts in overseas stocks and futures contracts.</p> <p>The commentator further queried that if the answers for the above cases are negative, by the same principle is it necessary for the licensed or registered persons dealing in securities to obtain duplicate trade confirmation of their employees dealing in futures contracts with other houses.</p>	<p>The principle underlying paragraphs 12.2(b)(iv) and 12.2(c) of the Code is to ensure that employees dealings through another broker are properly reported and monitored by the licensed or registered persons to avoid potential conflicts of interest between the employees and their clients. Therefore, the requirement of obtaining duplicate trade confirmations and statements of account from outside broker or written consents in order to deal for employees of another dealer should only be applicable where the products traded by the employees of a licensed or registered person are directly related to the services which are provided by that licensed or registered person. For example, a broker providing only securities dealing service is only expected to obtain duplicate trade confirmations and statements of account of its employees' trading in their securities dealing account opened with another broker but not their futures trading accounts. Likewise, a broker who provides securities dealing trading for employees of another broker should obtain written consents from that broker if it also provides securities dealing services.</p> <p>Notwithstanding the above, we would like to point out that paragraph 30 of Schedule 6 to the revised Code prohibits any representative or employee of a leveraged foreign exchange trader to be a client of another licensed person for trading in leveraged foreign exchange contracts.</p>

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24.	15	<u>Professional Investors</u>	<p>[Linklaters] The commentator asked what documentation is required to evidence a client is a “professional investor” within the categories set out in Schedule 1 to the SFO. The commentator pointed out that the Keeping of Records Rules required firms to keep “records showing particulars sufficient to establish that the client is a professional investor” (paragraph 4(a) of the Schedule). The commentator raised that where the client is a “professional investor” within the Professional Investor Rules (“PI Rules”), since only particular documentation can be relied upon, it is obvious that it is those documents that must be kept. For other professional investors, it should be sufficient for a firm to keep records showing that it has conducted checks to ascertain that a client falls within one of the categories (e.g. a record that it has checked that a client is, say, a bank regulated by the HKMA).</p>	<p>We agree that in case of a professional investor that is a bank, it will be sufficient to keep records showing that the licensed or registered person has checked that it is an authorized institution under the regulation of HKMA. These should detail the source document that has been checked against and where possible include a copy of such document.</p>
25.	15.2B		<p>[HKSbA], [Linklaters] & [HSBC] The commentators queried that the definition of “professional investor” does not align with the Professional Investor Rules (the “PI Rules”). The commentators noted that the PI Rules do not mention any element of experience nor is there any provision to include any test on this matter, but such tests are set out in paragraph 15.3 of the revised Code.</p> <p>[Linklaters] The commentator recalled that when discussing the PI Rules, the Commission accepted the tests in paragraph 15.3 of the existing code were difficult in</p>	<p>We have already aligned the definition of “professional investor” in the revised Code with that under the SFO.</p> <p>We would like to point out that the expanded definition of “professional investor” under the Professional Investor Rules only applies to sections 103, 174 and 175 of the SFO. The rationale for this partial relaxation is that while these investors should be sufficiently sophisticated to merit a relaxation of the provisions specified, they may not be experienced enough to be regarded as “professional investor” for all other purposes.</p>

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			<p>practice to comply with and that was one reason why such tests were not included in the PI Rules. The commentator demanded the Commission to clarify on this issue.</p> <p>[HSBC] The commentator further suggested that the Commission should standardize the criteria for this group of investor and argued that there is no reason that investors who are experienced enough to be exempted from signing account agreement and risk disclosures need to be of a higher standard of professional investors that included investment experience.</p>	<p>Therefore, we maintain the view that before waiving the requirements as set out in paragraph 15.5 (including the need to establish clients' financial and investment details and sign client agreements) for those professional investors as referred to under paragraph 15.2B (i.e. a person falling under the definition of the Professional Investor Rules), licensed or registered persons must ensure that these professional investors are knowledgeable and have sufficient expertise in relevant products and markets. We have fine-tuned the wordings in the revised Code to better reflect our policy intention.</p>
26.	15.3(b)/ 15.4(c)	<p><u>15.3(b)</u></p> <p>In assessing the investment experience of any of the persons in paragraph 15.2B above, the registered person should have regard to:</p> <p>(b) the frequency and size of trades (a Professional Investor would be expected to have traded not less than 40 transactions per annum);</p> <p><u>15.4(c)</u></p> <p>Prior to treating persons referred to in paragraph 15.2B as Professional Investors, the licensed or registered person should:</p> <p>(c) have in place procedures to enable it to carry out a confirmation exercise annually to enable it to ensure that clients falling within</p>	<p>[HKSbA] The commentator commented that it was difficult to ask a professional client to produce records of 40 previous transactions as evidence of experience. It was proposed that the declaration from client that the number of his previous transactions was over 40 should be sufficient.</p> <p>The commentator also suggested that professional investors needed not be assessed annually since experience gained in one year could not be lost.</p>	<p>A signed declaration may not be sufficient for the purpose. Licensed or registered person should endeavour to obtain further documentary evidence to reasonably satisfy itself that the client has sufficient investment experience.</p> <p>The annual confirmation is to ensure that clients continue to fulfill the requisite requirements under the Professional Investors Rules but not the investment experience requirement.</p>

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		<p>paragraph 15.2B and who have elected to be treated as Professional Investors continue to fulfil the requisite requirements under the Securities and Futures (Professional Investor) Rules.</p>		
27.	15.5	<p><u>Provisions that may be waived for Professional Investors</u></p>	<p>[Simmons] The commentator suggested extending the scope of the waiver to other requirements for documentation from professional investors. For example, intermediaries must comply with the client identity procedures regardless of whether the client is a professional investor. In addition, where the client is another intermediary, he should obtain an undertaking that the intermediary client will in turn require his underlying client to disclose the ultimate beneficiaries to the regulators. The commentator is of the view that to be consistent, if a registered or licensed person is satisfied that its client is a professional investor, whatever procedures it adopts should be a matter for the registered or licensed person. The commentator further proposed that alternatively, the Code of Conduct should require a client agreement for professional investors or there might be uncertainty as to whether the intermediary might be in breach of the requirements. Therefore, the commentator recommended either requiring client agreements to be kept for all clients but relax the content requirements for professional investors or abolish all documentary requirements for professional investors.</p>	<p>“Know Your Client” is a very fundamental principle which should be observed by all licensed or registered persons regardless of whether the client is a professional investor or not. In respect of the suggestion to require client agreement to be kept for professional investors, we would like to clarify that paragraph 15.5 of the revised Code does not ban a licensed or registered person from entering a client agreement with professional investors. The provision is merely intended to give flexibility in this area. Therefore, it is up to the licensed or registered person and its professional investor client to decide whether they would like to enter any client agreement.</p>

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28.	Schedules 5 & 6	<u>General</u>	[Commentator has reserved anonymity] The commentator questioned that given one of the objectives of introducing changes to the current Code is to ensure a level playing field, the commentator queried why Schedules 5 and 6 would not apply to registered persons.	Schedule 5 (on margin lending) should not apply to registered persons because they are expected to have already in place sound systems and controls for their core lending business. Schedule 6 (on leveraged foreign exchange trading) cannot apply to registered persons given that they do not need to be registered for this activity at all.
29.	Schedules 3 & 4	<u>General</u>	[Commentator has reserved anonymity] In view of changes which may take place in relation to the relevant circulars, rules and procedures from time to time, the commentator considered it inappropriate to list out particular circulars and provisions in the revised Code. The commentator proposed the SFC to set out the actual requirements or procedures expected for compliance by an exchange participant of SEHK or HKFE.	Given that the rules, guidelines or circulars as listed out in paragraph 15 of Schedule 3 and paragraph 20 of Schedule 4 are issued by SEHK/ HKFE and are subject to changes or updates from time to time, it may not be appropriate to incorporate them into the main body of the Code.
30.	Schedule 1	<u>Risk Disclosure Statements</u>	[MH] The commentator noted that there are new developments and innovations in financial products and trading system and suggested the following risk disclosure statements to be added to this schedule: <ul style="list-style-type: none"> • Risk of trading securities through Internet • Risk of trading futures and options through Internet • Risk of Collective Investment Schemes (i.e. Unit Trusts, Mutual Funds, etc.) • Risk of hedge funds • Risk of investment advising services 	It may not be appropriate for the Commission to set out detailed risk disclosure statement for each specific product or service as the Code only aims at providing general conduct of business principles.

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			<p>[Simmons] The commentator also suggested adding a mandatory warning statement about trading in equity-linked instruments where applicable.</p> <p>[Commentator has reserved anonymity] The commentator referred to the circular (No. IS/005/2002) issued by the Commission on 31 January 2002 and suggested the Commission to incorporate a risk disclosure statement regarding the dealing in derivative warrants into the Code.</p>	
31.	Schedule 1	<p><u>Declaration by staff</u></p> <p>A member of staff, who should be a licensed or registered person, should sign and date a declaration confirming that the licensed or registered person has:</p> <ul style="list-style-type: none"> • provided the risk disclosure statement in a language of the client's choice (English or Chinese); and • invited the client to read the risk disclosure statement, ask questions and take independent advice if the client wishes. 	<p>[Simmons] The commentator questioned that given the possibility of non face-to-face account opening procedures, the terms of the declaration by staff might not be applicable. The commentator suggested making this clear in the Code of Conduct.</p> <p>[PSHKL] The commentator noted that in the FAQ on Code of Conduct issued in July 2001, it stated that "where there is no face-to-face approach, the registered person should ensure that the covering correspondence should specifically draw the client's attention to the appropriate risk disclosure statements and client acknowledgement should be sought. It would not be necessary for the "declaration by staff" section to be signed." For the avoidance of doubt, the commentator suggested that the SFC incorporating the exemption to Schedule 1 of the Code of Conduct.</p>	<p>Paragraph 6.1 of the Code (which Schedule 1 also refers to) has already provided that where an account opening procedure other than a face-to-face approach is used, the covering correspondence should specifically direct the client's attention to the appropriate risk disclosure statement.</p>
32.	Schedule 1	<p><u>Risk of providing authority to repledge client's collateral</u></p>	<p>[HKSbA] The commentator questioned the necessity in explaining to client the</p>	<p>Given the risk involved in providing an authority to repledge clients' securities,</p>

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			<p>“purpose” of repledging clients’ collateral. The commentator argued that the right to repledge the client’s collateral for any financial accommodation should have been clearly defined in the client agreement and is self-explanatory. However, if “purposes” mean the reasons behind the pledging, the commentator considered it something beyond the interest of the client.</p> <p>[HKAOBr] The commentator noted that the SFC had prior discussions in considering alleviating the requirement under section 81A of the Securities Ordinance to have written authority of the client which might be renewed in writing for one or more further period not exceeding 12 months. The commentator would like the SFC’s advice on the status.</p>	<p>collateral etc., it is important that the purpose for which such authorities are to be used are clearly explained to clients before clients are required to sign the authorities.</p> <p>Under the new Client Securities Rules, such written authority shall be deemed to have been renewed if the licensed or registered person issues a reminder at least 14 days prior to the expiry of the authority, and clients do not object to such deemed renewal before the expiry date of the then existing authority. Please refer to section 4(3) of the Client Securities Rules for detailed requirements.</p>
33.	Schedule 1	<u>Additional risks common to futures and options</u>	[Simmons] The commentator viewed that paragraphs 7 to 13 under “Additional Risks Common to Futures and Options” might not be particular to trading in futures and options but could also apply to other investment activities. The commentator suggested moving these paragraphs to an earlier section of the Schedule.	The risk disclosure statements contained in Schedule 1 are considered to be the minimum required. Licensed or registered persons should provide additional risk disclosure information to client as appropriate.
34.	Schedule 2	<u>Client identity guidance note</u> “...Paragraph 5.4 of the Code is intended to improve the transparency of trading in securities or futures contracts listed or traded on a recognized stock market or a recognized futures market or in derivatives, including over-the-	[Simmons] The commentator questioned that given the over-the-counter derivatives over futures contracts which are not exchange traded are not caught by the Commodities Trading Ordinance, it would be inappropriate to request the client identity information from this client unless this client happens to be an SFC registrant	In our supervision of the licensed and registered intermediaries, the review of their trading on OTC derivatives written over securities or futures traded on recognised stock or futures markets are relevant to our surveillance of trading on securities or futures markets for market misconduct and the integrity of trading conducted through licensed or registered

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		counter derivatives, written over such securities or futures contracts, wherever such trading occurs, by improving the information that is available to the Commission about the identity of those interested in transactions on those markets....”	or licensee. The commentator suggested that the Commission to consider removing the reference to over-the-counter derivatives.	intermediaries. It is therefore necessary to request the intermediaries to keep identity information from these clients in respect of their trading on over-the-counter derivatives.
35.	Schedule 3 – paragraphs 12 (d), 13(f) & 13(p)	<p><u>Securities Borrowing and Lending</u></p> <p>Where the licensed or registered person is an exchange participant of SEHK and it borrows or lends securities:</p> <p>(d) it should, where applicable, place any collateral received by it as a lender pursuant to a securities borrowing in a separate bank account established exclusively for such purpose. If collateral from different borrowers pursuant to securities borrowing is maintained in a bank account whether or not established for such purpose, it should ensure that its books and records are sufficiently up-to-date and will enable proper and prompt accounting to a particular borrower as to which collateral maintained in that bank account relates to the particular borrower's securities borrowing. (This does not apply to the compulsory stock borrowing transaction effected pursuant to the CCASS Rules.)</p> <p><u>Securities Borrowing and Lending Agreement</u></p>	<p>[HKAObR] & [PSHKL] The commentators noted that the requirement under paragraph 12(d) on securities borrowing and lending is applicable to exchange participants only and thus putting exchange participants at a disadvantage.</p> <p>[PSHKL] In addition, one of the commentators further noted that if the collateral under a securities borrowing and lending agreement is considered as clients' money, it should be covered by the Client Money Rules and therefore the requirements under paragraph 12(d) to place collateral in a separate bank account is redundant.</p> <p>The commentator also remarked that the amount of collateral required under paragraph 13(f) on securities borrowing and lending should be a commercial decision and should be left to the market participants to decide. The commentator also commented that this provision, which applies to exchange participants only, has created an unlevel playing field.</p> <p>In general, the commentator is of the view that several requirements in the Code of Conduct that are only applicable to</p>	<p>Having considered the comments received and also the fact that the specific provisions in relation to securities borrowing and lending and short selling have already been covered by relevant subsidiary legislation made under the SFO (such as the Client Money Rules and the Short Selling and Securities Borrowing and Lending (Miscellaneous) Rules as well as the Stamp Duty Ordinance, we have deleted paragraphs 12 to 14 and paragraph 15 (a) & (b) of Schedule 3, Schedules 3A and also 3B from the revised Code.</p> <p>In respect of other requirements in the Schedules that are only applicable to exchange participants, they are mainly specific guidelines and operational procedures previously inherited from the rules of the Stock Exchange. The general principles underlying these provisions have all been included in the main body of the Code and are expected to be observed by both exchange participants and non-exchange participants. Therefore, no amendment is considered necessary in this revision.</p>

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		<p>Where the licensed or registered person is an exchange participant of SEHK The securities borrowing and lending agreement should include, but not be limited to the following provisions:</p> <p>(f) that the value of the collateral should at all times be not less than 100% (or such higher percentage as may be agreed between the parties) of the current market value of the borrowed securities, and that where the securities borrowing is for the purposes of a short sale (as defined in the Short Selling Regulations in the Eleventh Schedule to the SEHK Rules), the amount of collateral deposited by the borrower should at all times be not less than 105% of the current market value of the relevant uncovered securities borrowing position;</p> <p>(p) a warranty by the borrower, where the borrowing is in relation to Hong Kong stock, that it shall, as soon as practicable after, and in any event, no later than 2 weeks for Hong Kong borrowers and 1 month for non-Hong Kong borrowers as required by the Collector after the execution of the stock borrowing and lending agreement, register the stock borrowing and lending agreement with the Collector...</p>	<p>exchange participants have put the exchange participants at disadvantages.</p> <p>[HKSbA] & [Linklaters] Other commentators also noted an inconsistency between the Code and the Stamp Duty Ordinance. The commentators pointed out that paragraph 13(p) of Schedule 3 requires a warranty from the borrower to register the executed agreement with the Collector for no later than 2 weeks after the execution of the agreement for HK borrowers and 1 month for non-HK borrower. This requirement, however, is inconsistent with Section 19(12A) of the Stamp Duty Ordinance, which required a copy of the executed agreement to be provided by the borrower to the Collector no later than 30 days after the first stock borrowing is effected under that agreement.</p>	

Item No.	Section No.	Details of the Requirements	Respondent's Comments	SFC's Response
36.	Schedule 4	<u>Additional Requirements for Licensed or Registered Persons Dealing in Futures Contracts and/or Options Contracts Traded on Hong Kong Futures Exchange Ltd</u>	<p>[LSHK] The commentator pointed out that under the sole business requirement for HKFE exchange participants (unlike the SEHK which allows the sole business requirement to be waived in writing by the SFC), it would not be possible for a registered person (i.e. an authorized institution) to be subject to some of the provisions in Schedule 4 (although other provisions will clearly still be of potential relevance) unless it is proposed to also amend the requirements for being an exchange participant of the HKFE.</p> <p>[Simmons] The commentator stated that the provisions in Schedule 4 have some overlap with the Keeping of Records Rules, Client Money Rules and Client Securities Rules. To avoid confusion, the commentator suggested removing specific requirements from the Code and making appropriate reference to the subsidiary legislation for greater simplicity.</p>	<p>Please note that both the SEHK and the HKFE Rules allow the sole business requirement to be waived in writing by the SFC. Please refer to paragraph 302 of the Rules of the SEHK and paragraph 502 of the Rules of the HKFE.</p> <p>We agree with the comments and have removed paragraphs 7(a), 10(a) to (d) and paragraph 13 of Schedule 4 from the revised Code. We believe that generally all duplicative provisions have now been duly removed.</p>
37.	Schedule 4 - Paragraph 1A	<u>Telephone tape recording for confirmations to clients on executed trades</u>	[Simmons] The commentator suggested to clarify whether the obligation to confirm a transaction applies independent of the requirement to issue contract notes.	Please refer to our response in item 14 above.
38.	Schedule 4 - Paragraph 20	<u>Other requirements</u>	<p>[MH] The commentator pointed that most of the circulars were outdated and cited some examples. The commentator suggested the Commission to review these circulars and produce a more meaningful guideline to licensed or registered persons.</p> <p>[Linklaters] The commentator</p>	Comment noted. We will pass the comments to HKEx.

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			recommended that copies of circulars listed in paragraph 20 of Schedule 4 be made available on the HKEx website for the access of legal advisers or persons interested in becoming HKFE exchange participants. The commentator is of the view that having copies on the website would provide an easily accessible reference source for participants.	
39.	Schedule 4 - Paragraph 20 (c)	<p>A licensed or registered person which is an exchange participant of HKFE should also comply with the following rules (including the rules, regulations, guidelines, procedures and circulars of HKFE updated from time to time) of HKFE where applicable:</p> <p>(c) Circular dated 30/1/1997 (Ref. No. CMP/CIR/9701010) and 13/6/1997 (Ref. No. MEM/CIR/9706036) on large open position (reporting) procedures (including HSI Futures, HSI Options and NYMEX contracts), including prescribed forms, and Circular dated 14/7/1999 (Ref. No. CIR/CMP/990271) on delta position limits;</p>	[Commentator has reserved anonymity] The commentator is aware that a Guidance Note on Contract Limits and Reportable Position Rules would be issued which might necessitate amendment to paragraph 20(c) of Schedule 4.	The Guidance Note is still in consultation stage and we will make amendments to this paragraph (if necessary) upon the finalization of the Guidance Note.
40.	Schedule 5 - Paragraph 5	<p><u>Prudent Bank Borrowing</u></p> <p>To avoid potential over-borrowing, a licensed person should ensure that the aggregate of all outstanding bank borrowings, overdrafts, advances etc. secured by the pledging or deposit of</p>	[HKSbA] The commentator noted that the Code requires the pledging of securities collateral belonging to margin clients to be prudent. The commentator argued that stockbrokers are now obliged to adhere to stringent FR Rules with a high gearing adjustment and various haircuts. The	The Financial Resources Rules ("FRR") only sets out the minimum liquid capital requirement of a licensed person which is a totally different concept from business risk management. To ensure the proper management of risks to which licensed person and its clients are exposed, prudent risk management policy and procedures

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		<p>securities collateral belonging to margin clients remains prudent when compared to the aggregate of all outstanding margin loans made to margin clients. As a general guide, the amount of such bank borrowings, overdrafts and advances should not exceed 120% of the value of outstanding margin loans.</p>	<p>commentator suggested that a reference to the compliance of the FRR should be sufficient for complying with the Code in this regard.</p>	<p>shall be established and maintained by the licensed person.</p> <p>Moreover, the current gearing and illiquid collateral adjustments under the FRR are short-term measures only. We will consider necessary amendments to the Code once a new financial regulatory framework is established.</p>
41.	Schedule 5 - Paragraph 6	<p><u>Client agreement</u></p> <p>A licensed person should ensure that a written Margin Client Agreement is entered into with a client before margin lending is provided to that client. The Margin Client Agreement shall specify that the account is a "margin account".</p>	<p>[MH] The commentator considered that paragraph 6 has an implied meaning that once a client signs a Margin Client Agreement, the account shall be specified as "margin account".</p> <p>The commentator argued that in practice clients might sign a Margin Client Agreement for convenience sake and in fact operate the account as "cash clients" until they request for a margin lending facility. Therefore the commentator suggested amending the Code to the extent that a client is required to acknowledge that he is a "Margin Client". That is, a client will not automatically become a margin client even if he has signed a Margin Client Agreement. Rather, all clients are "cash client" unless they specifically agree to be "margin clients" and intend to borrow money from the securities broker at that very moment.</p>	<p>Generally, we would expect a client to sign a "margin client agreement" only if margin lending facility is considered necessary as the terms of the agreement and the protection offered to the client under a cash client agreement and a margin client agreement is likely to be different. At any rate, there is nothing to stop margin clients from paying the consideration in full on settlement date so that they effectively operate as cash clients.</p>
42.	Schedule 5 - Paragraph 12	<p><u>The margin lending policy framework</u></p>	<p>[HKSbA] & [HSBC] The commentators argued that the requirements set out in paragraph 12 are detailed operational procedures which are beyond the framework of a policy or a code. The commentator suggested that the Code</p>	<p>Paragraph 12 only provides a general guideline to market participants as to what a lending policy framework should cover. It does not go into the detailed operational procedures of a licensed person.</p>

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			should only state the general principles to be observed by licensed persons when providing margin lending and leave the operational details to be worked out by the licensed persons themselves in accordance with their own circumstances.	
43.	Schedule 6	<u>Additional Requirements for Licensed or Registered Persons Engaging in Leveraged Foreign Exchange Trading</u>	<p>[Commentator has reserved anonymity] The commentator noticed that only 3 of the 11 proposals recommended in the "Response of the Securities and Futures Commission to the Public Consultation on the Review of the Leveraged Foreign Exchange Trading Regulatory System" in April 1997 are either discussed or reviewed in other consultation related to FRR. The commentator was wondering why the rest of the 8 proposals had not been followed up, in particular for the dealing with "No Over Loss Rule".</p> <p>The commentator also believed that SFC should allow a trader to set its own margin level for its client as long as the "No Over Loss Rule" is observed. The commentator therefore proposed to amend paragraph 23 accordingly.</p>	<p>We have indeed considered all proposals made in 1997's review by way of soft consultation. After careful consideration and also taking into account the comments received during the consultation, we considered that it might not be appropriate to adopt all the 11 proposals in this revision, especially the "No-Over Loss Rules" proposal where certain market participants have expressed concerns and reservations.</p> <p>Given the comments received during the consultation and the minimalist change approach adopted in this revision, we only propose to incorporate those recommendations made in 1997's review which are necessary for rationalization purposes.</p>
44.	Schedule 6 paragraph 6 to 10	<u>Discretionary account</u>	<p>[Simmons] The commentator noted that the requirement to enter into a written client agreement under paragraph 1 has been waived in respect of professional investors. The commentator queried whether paragraphs 6 to 10 containing requirements in respect of discretionary accounts could also be waived.</p>	<p>We do not intend to waive the client agreement in respect of discretionary accounts as required under paragraphs 6 to 10 given the more specific terms and conditions provided therein.</p>
45.	Schedule 6	<u>Client orders</u>	[Commentator has reserved anonymity]	The Commission has so far not received any

Item No.	Section No.	Details of the Requirements	Respondent's Comments	SFC's Response
	- Paragraph 20	Where a licensed person does not have the client's confirmation on tape or on an order form as required by paragraph 19(a) above and the client disputes the order within 10 business days of its execution, it should be voidable at the option of the client.	The commentator suggested scrapping the provisions that allow orders to be voided if a trader does not have the client's confirmation on tape or on a signed order form. The commentator argued that these provisions favour the client while putting the trader at disadvantage, in particular when the order is in dispute and the trader fails to provide verbal or written evidences.	other comments from the market regarding the practical difficulties in complying with this provision. Unless we hear any other substantive objections based on real situations, we do not propose to make any amendment in this revision.
46.	Schedule 6 - Paragraph 23	<p><u>Client's margin</u></p> <p>A licensed person should set the initial margin and maintenance margin level for its clients at not less than 5% and 3% respectively of the gross principal value of the contract offered by the licensed person. For cross currency trades and locked positions (i.e. situation where a client simultaneously holds an equal long and short position of the same currency), only one set of margin is required.</p>	<p>[Commentator has reserved anonymity]</p> <p>The commentator does not agree that margin deposit is still required to cover the risk of a locked position.</p>	<p>We do not and should not encourage free margin as the margin requirement is for protecting the trader from credit risks (and floating profits entitled by the trader).</p> <p>In addition, there might be practical problem if margin is not to be collected for locked positions. For instance, as the two contracts of opposite directions might not be opened at the same time, margin would have been collected for the first contract upon initial opening. It would mean that the trader would have to refund if the client were to open an opposite contract.</p>
47.	Schedule 6 - Paragraph 39	<p><u>Random checking over the telephone tape recordings</u></p> <p>A licensed person should-</p> <p>(b) carry out random checks at intervals of not less than once every week to ensure that all applicable laws, rules and regulations have been complied with.</p>	<p>[Simmons] The commentator would like the Commission to confirm whether it is the Commission's intention to require active monitoring of tapes regardless of whether any complaints or suspicious circumstances exist. In view of the fact that confirmations must be given, unless circumstances exist where such monitoring is warranted, the commentator does not believe that a licensed person should be obliged to carry out random checks every week to ensure compliance.</p>	<p>Regular review of tapes constitutes part of the internal control procedures which are necessary for the licensed person to ensure compliance with all applicable laws, rules and regulations, e.g. to ensure if all telephone recordings are taped, whether client priority rule has been observed in execution of client orders etc.</p> <p>This is indeed an important control procedure which we expect a licensed person to put in place in the absence of other compensating controls.</p>

List of Respondents

Date received	Respondent
11 December 2002	Marcus Hung (“MH”)
14 December 2002	- (Commentator has reserved anonymity)
17 December 2002	Simmons & Simmons (“Simmons”)
19 December 2002	HSBC Broking Securities (Asia) Limited (“HSBC”)
20 December 2002	Consumer Council (“CC”)
20 December 2002	Hong Kong Association of Banks (“HKAB”)
20 December 2002	The Hong Kong Association of Online Brokers (“HKAObR”)
20 December 2002	The Institute of Securities Dealers Ltd (“ISDL”)
20 December 2002	Linklaters (“Linklaters”) representing <ul style="list-style-type: none"> • Credit Suisse First Boston (Hong Kong) Limited • Goldman Sachs (Asia) L.L.C. • J.P Morgan Securities (Asia Pacific) Limited • Merrill Lynch (Asia Pacific) Ltd • Morgan Stanley Dean Witter Asia Ltd • Salomon Smith Barney Hong Kong Ltd • UBS Warburg Asia Limited
20 December 2002	The Law Society of Hong Kong (“LSHK”)
20 December 2002	Phillip Securities (HK) Limited (“PSHKL”)
20 December 2002	- (Commentator has reserved anonymity)
27 December 2002	- (Commentator has reserved anonymity)
31 December 2002	Hong Kong Stockbrokers Association Ltd (“HKSbA”)
<i>Respondent with no specific comments on the Rules</i>	
13 December 2002	Hong Kong Society of Accountants (“HKSA”)

Revised Draft

**Code of Conduct for Persons Licensed by or
Registered with the Securities and Futures
Commission**

Securities and Futures Commission
Hong Kong

April 2003

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Explanatory notes

The Commission will be guided by this Code of Conduct (“the “Code”) in considering whether a licensed or registered person satisfies the requirement that it is fit and proper to remain licensed or registered, and in that context, will have regard to the general principles, as well as the letter, of the Code. For the purposes of the Code, a registered person includes a “relevant individual” as defined in section 20(10) of the Banking Ordinance (Cap.155), and “registered” shall be construed accordingly. The Code has been published in the Gazette.

Where the Commission has information which suggests that a licensed or registered person is not a fit and proper person to remain licensed or registered, it may conduct an investigation under section 182(1)(e) of the Securities and Futures Ordinance (Cap. 571) (“the SFO”). This information may refer to how the licensed or registered person conducts the business for which the person is licensed or registered or, in the case of an individual who is licensed or registered how he carries on the activity for which he is licensed or registered, or it may refer to other matters. The Commission places great importance on licensed or registered persons being fit and proper.

Licensed or registered persons should note the various Schedules to the Code. These are part of the Code and provide, among other things, supplemental materials such as risk disclosure statements. There are also specific Schedules of provisions that apply to licensed or registered persons which deal in securities and/or futures contracts listed or traded on The Stock Exchange of Hong Kong Limited or Hong Kong Futures Exchange Ltd or trade in leveraged foreign exchange contracts. These are derived primarily from former rules of the Exchanges and the repealed Leveraged Foreign Exchange Trading Ordinance. Licensed or registered persons are expected under paragraph 12.1 of the Code to comply with the rules of exchanges and clearing houses of which they are members or participants.

To reflect the realities of today’s markets, the Commission recognizes that conduct of business principles should be flexible enough to differentiate between professional and non-professional investors and some provisions of the Code need not be observed in the case of professionals.

Unless otherwise specified or the context otherwise requires, words and phrases in the Code shall be interpreted by reference to any definition of such word or phrase in Part 1 of Schedule 1 to the SFO.

This Code does not have the force of law and should not be interpreted in a way that would override the provision of any law.

Effective date

The revised Code will become effective on 1 April 2003.

General principles

The Commission has modelled the Code on principles developed and recognized by the International Organization of Securities Commissions and other principles the Commission believes to be fundamental to the undertaking of a licensed or registered person's business.

GP1. Honesty and fairness

In conducting its business activities, a licensed or registered person should act honestly, fairly, and in the best interests of its clients and the integrity of the market.

GP2. Diligence

In conducting its business activities, a licensed or registered person should act with due skill, care and diligence, in the best interests of its clients and the integrity of the market.

GP3. Capabilities

A licensed or registered person should have and employ effectively the resources and procedures which are needed for the proper performance of its business activities.

GP4. Information about clients

A licensed or registered person should seek from its clients information about their financial situation, investment experience and investment objectives relevant to the services to be provided.

GP5. Information for clients

A licensed or registered person should make adequate disclosure of relevant material information in its dealings with its clients.

GP6. Conflicts of interest

A licensed or registered person should try to avoid conflicts of interest, and when they cannot be avoided, should ensure that its clients are fairly treated.

GP7. Compliance

A licensed or registered person should comply with all regulatory requirements applicable to the conduct of its business activities so as to promote the best interests of clients and the integrity of the market.

GP8. Client assets

A licensed or registered person should ensure that client assets are promptly and properly accounted for and adequately safeguarded.

GP9. Responsibility of senior management

The senior management of a licensed or registered person should bear primary responsibility for ensuring the maintenance of appropriate standards of conduct and adherence to proper procedures by the firm. In determining where responsibility lies, and the degree of responsibility of a particular individual, regard shall be had to that individual's apparent or actual authority in relation to the particular business operations, and the factors referred to in paragraph 1.3 below.

CODE OF CONDUCT

Interpretation and application

1.1 Definition: representative, registered person, person

- (a) A reference in the Code to a “representative” has the same meaning as under section 167 of the SFO.
- (b) A reference in the Code to a “registered person” means a “registered institution” and, except where the context otherwise requires, includes a “relevant individual” as defined in section 20(10) of the Banking Ordinance (Cap.155), and “registered” shall be construed accordingly.
- (c) A reference in the Code to a “person” includes any public body and any body of persons, corporate or unincorporate.

1.2 Interpretation

A reference in the Code to “it” or “its” in relation to a licensed or registered person shall, except where the context otherwise requires, be construed as including a reference to “him” or “his” (as the case may be).

1.3 Persons to which the Code applies

Although the Code applies to all licensed or registered persons in carrying on the regulated activities for which the persons are licensed or registered, the Commission recognizes that some aspects of compliance with the Code may not be within the control of a representative. In considering the conduct of representatives under the Code, the Commission will consider their levels of responsibility within the firm, any supervisory duties they may perform, and the levels of control or knowledge they may have concerning any failure by their firms or persons under their supervision to follow the Code.

1.4 Persons to which the Code does not apply

To the extent that a licensed or registered person acts in the capacity of a management company in relation to the discretionary management of collective investment schemes (whether authorised or unauthorised), the Code does not apply to such activity. In relation to such activities, such licensed or registered persons are subject to the Fund Manager Code of Conduct issued by the Commission.

1.5 Effect of breach of the Code

A failure by any person to comply with any provision of the Code that applies to it –

- (a) shall not by itself render it liable to any judicial or other proceedings, but in any proceedings under the SFO before any court the Code shall be admissible in evidence, and if any provision set out in the Code appears to the court to be relevant to any question arising in the proceedings it shall be taken into account in determining the question; and
- (b) the Commission shall consider whether such failure tends to reflect adversely on the person's fitness and properness.

Honesty and fairness

2.1 Accurate representations

Where a licensed or registered person advises or acts on behalf of a client, it should ensure that any representations made and information provided to the client are accurate and not misleading.

2.2 Fair and reasonable charges

The general course of dealing or advising concerning a client, the provision of margin lending, and the charges, mark-ups, or fees affecting a client should be fair and reasonable in the circumstances, and be characterized by good faith.

2.3 Advertising

A licensed or registered person should ensure that invitations and advertisements do not contain information that is false, disparaging, misleading or deceptive.

2.4 Anti-bribery guidelines

A licensed or registered person should be familiar with the Prevention of Bribery Ordinance (Cap. 201) (“PBO”) and follow related guidance issued by the Independent Commission Against Corruption. The PBO may prohibit an agent (normally an employee) from soliciting or accepting an advantage without the permission of the principal (normally the employer) when conducting the principal’s business. A person who offers the advantage may also commit an offence.

Diligence

3.1 Prompt execution

A licensed or registered person should take all reasonable steps to execute promptly client orders in accordance with clients' instructions.

3.2 Best execution

A licensed or registered person when acting for or with clients should execute client orders on the best available terms.

3.3 Prompt and fair allocation

A licensed or registered person should ensure that transactions executed on behalf of clients are promptly and fairly allocated to the accounts of the clients on whose behalf the transactions were executed.

3.4 Advice to clients: due skill, care and diligence

When providing advice to a client a licensed or registered person should act diligently and carefully in providing the advice and ensure that its advice and recommendations are based on thorough analysis and take into account available alternatives.

3.5 No withholding of orders for convenience

A licensed or registered person should not withdraw or withhold client orders for its own convenience or for the convenience of any other person. For the avoidance of doubt, this only applies in respect of market orders and limit orders that can be executed in the market at the relevant price.

3.6 Collection of margins

In dealing or trading for its clients in securities, futures contracts or leveraged foreign exchange contracts that require the provision of margin (including collateral), a licensed or registered person should collect promptly from clients any amounts due as margin.

3.7 Separate accounts

A licensed or registered person should keep separate accounts for each client for dealings in securities, futures contracts or trading in leveraged foreign exchange contracts, and where relevant, for transactions concluded on a cash basis or a margin basis.

3.8 Derivative position and reporting limits

A licensed or registered person should inform clients of applicable derivative position and reporting limits and, in relation to positions maintained with the licensed or registered person, monitor compliance with those limits.

3.9 Order recording

Except as otherwise provided in Schedule 3 and Schedule 6 to the Code, a licensed or registered person should record and immediately time stamp records of the particulars of the instructions for agency orders and internally generated orders (such as proprietary accounts and staff accounts). Where order instructions are received from clients through the telephone, a licensed or registered person should use a telephone recording system to record the instructions and maintain telephone recordings as part of its records for at least three months.

Note

The Commission notes that mobile telephones are widely used in Hong Kong. In this regard, the Commission expects licensed or registered persons to arrange for the use of a telephone recording system in their offices. Although use of mobile phones for receiving client order instructions is discouraged, where orders are accepted by mobile phones, the time of receipt and the order details should be recorded immediately (e.g. by a call to the office system or in writing by hand).

3.10 Best interests of clients

A licensed or registered person should act in the best interests of its clients in providing services or recommending the services of an affiliated person to its clients.

Capabilities

4.1 Fit and proper staff

A licensed or registered person should ensure that any person it employs or appoints to conduct business is fit and proper and otherwise qualified to act in the capacity so employed or appointed (including having relevant professional training or experience).

4.2 Staff supervision

A licensed or registered person should ensure that it has adequate resources to supervise diligently and does supervise diligently persons employed or appointed by it to conduct business on its behalf.

4.3 Internal control, financial and operational resources

A licensed or registered person should have internal control procedures and financial and operational capabilities which can be reasonably expected to protect its operations, its clients and other licensed or registered persons from financial loss arising from theft, fraud, and other dishonest acts, professional misconduct or omissions.

Information about clients

5.1 Know your client: in general

- (a) A licensed or registered person should take all reasonable steps to establish the true and full identity of each of its clients, and of each client's financial situation, investment experience, and investment objectives. Where an account opening procedure other than a face-to-face approach is used, it should be one that satisfactorily ensures the identity of the client. Where the account opening documents are not executed in the presence of an employee of the licensed or registered person, the signing of the Client Agreement (as defined in paragraph 6.1) and sighting of related identity documents should be certified by any other licensed or registered person, an affiliate of a licensed or registered person, a JP (Justice of the Peace), or a professional person such as a branch manager of a bank, certified public accountant, lawyer or notary public. Certification services that are recognized by the Electronic Transactions Ordinance (Cap. 553), such as the certification services available from the Hongkong Post, may also be employed.
- (b) Alternatively, the identity of the client (other than corporate entities), may be properly verified if the licensed or registered person complies with the following procedural steps:
- (i) the new client sends to the licensed or registered person a signed physical copy of the Client Agreement (see paragraph 6.2) together with a copy of the client's identity document (identity card or relevant sections of the client's passport) for verification of the client's signature and identity;
 - (ii) the licensed or registered person should obtain and encash a cheque (amount not less than HK\$10,000¹ and bearing the client's name as shown in his identity document) issued by the new client and drawn on the client's account with a licensed bank in Hong Kong;

¹ The minimum cheque amount required is subject to periodic review and will be revised when appropriate.

- (iii) the signature on the cheque issued by the client and the signature on the Client Agreement must be the same;
- (iv) the client is informed (in the Client Agreement or by way of a notice) of this account opening procedure and the conditions imposed, in particular the condition that the new account will not be activated until the cheque is cleared; and
- (v) proper records are kept by the licensed or registered person to demonstrate that the client identification procedures have been followed satisfactorily.

5.2 Know your client: reasonable advice

Having regard to information about the client of which the licensed or registered person is or should be aware through the exercise of due diligence, the licensed or registered person should, when making a recommendation or solicitation, ensure the suitability of the recommendation or solicitation for that client is reasonable in all the circumstances.

5.3 Know your client: derivative products

A licensed or registered person providing services to a client in derivative products, including futures contracts or options, or any leveraged transaction should assure itself that the client understands the nature and risks of the products and has sufficient net worth to be able to assume the risks and bear the potential losses of trading in the products.

5.4 Client identity: origination of instructions and beneficiaries

- (a) Subject to paragraph 5.4(e), a licensed or registered person should be satisfied on reasonable grounds about:
 - (i) the identity, address and contact details of :
 - (A) the person or entity (legal or otherwise) ultimately responsible for originating the instruction in relation to a transaction; and

- (B) except in the case of paragraph 5.4(d) below, the person or entity (legal or otherwise) that stands to gain the commercial or economic benefit of the transaction and/or bear its commercial or economic risk; and
 - (ii) the instruction given by the person or entity referred to in paragraph 5.4(a)(i)(A).
- (b) A licensed or registered person should keep in Hong Kong a record of the details referred to in paragraph 5.4(a) and give the Commission access to that record upon request.
- (c) A licensed or registered person should not do anything to effect a transaction unless it has first complied with paragraphs 5.4(a) and (b).
- (d) In relation to a collective investment scheme or discretionary account, the "entity" referred to in paragraph 5.4(a) is the collective investment scheme or account, and the manager of that collective investment scheme or account, not those who hold a beneficial interest in that collective investment scheme or account (e.g., the unitholders of a unit trust).
- (e) Paragraph 5.4(a) applies only where the transaction involves securities or futures contracts that are listed or traded on a recognized stock market or a recognized futures market or a derivative, including an over-the-counter derivative, written over such securities or futures contracts.

Client agreement

6.1 Client agreement in writing

Licensed or registered persons should enter into a written agreement (Client Agreement) with each client before services are provided to the client. The Client Agreement should be in Chinese or English according to the language preference of the client, as should any other agreement, authority, risk disclosure, or supporting document. Licensed or registered persons should provide a copy of these documents to the client and draw to the client's attention the relevant risks. Where an account opening procedure other than a face-to-face approach is used, the covering correspondence should specifically direct the client's attention to the appropriate risk disclosure statements. As explained below, the type of Client Agreement may vary depending on the services provided.

6.2 Minimum content of client agreement

Subject to paragraph 6.4 and Schedules 1, 3, 4 and 6 to the Code, a Client Agreement should contain at least provisions to the following effect:

- (a) the full name and address of the client as verified by a retained copy of the identity card, relevant sections of the passport, business registration certificate, corporation documents, or any other official document which uniquely identifies the client;
- (b) the full name and address of the licensed or registered person's business including the licensed or registered person's licensing or registration status with the Commission and the CE number (being the unique identifier assigned by the Commission);
- (c) undertakings by the licensed or registered person and the client to notify the other in the event of any material change to the information (as specified in paragraphs 6.2(a), (b), (d), (e) and (f)) provided in the Client Agreement;
- (d) a description of the nature of services to be provided to or available to the client, such as securities cash account, securities margin account, discretionary account, portfolio management, investment advice, unit trusts, futures/options account, or leveraged foreign exchange trading account;
- (e) a description of any remuneration (and the basis for payment) that is to be paid by the client to the licensed or registered person, such as commission, brokerage, and any other fees and charges;

- (f) if margin or short selling facilities are to be provided to the client, details of margin requirements, interest charges, margin calls, and the circumstances under which a client's positions may be closed without the client's consent;
- (g) if services are to be provided to the client in relation to derivative products, including futures contracts or options, (1) a statement that the licensed or registered person shall provide to the client upon request product specifications and any prospectus or other offering document covering such products and (2) a full explanation of margin procedures and the circumstances under which a client's positions may be closed without the client's consent; and
- (h) the risk disclosure statements as specified in Schedule 1 to the Code.

6.3 No circumvention of legal requirements

A licensed or registered person should ensure that it complies with its obligations under a Client Agreement and that a Client Agreement does not operate to remove, exclude or restrict any rights of a client or obligations of the licensed or registered person under the law.

6.4 Limited provision of services

A Client Agreement should properly reflect the services to be provided. Where the services to be provided are limited in nature, the Client Agreement may be limited accordingly. For example, where the services to be provided by a licensed or registered person to a client are limited to effecting one-off disposals of securities in connection with initial public offerings, the Client Agreement would only need to contain the provisions set out in paragraph 6.2(a), (b), (d) and (e).

Discretionary accounts

7.1 Authorization and operation of a discretionary account

- (a) A licensed or registered person should not effect a transaction for a client unless before the transaction is effected (i) the client, or a person designated by the client, has specifically authorized the transaction; or (ii) the client has authorized in writing the licensed or registered person or any person employed by the licensed or registered person (who should in turn be a licensed or registered person) to effect transactions for the client without the client's specific authorization.
- (b) Where a client wishes to grant an authority described under paragraph 7.1(a)(ii), the licensed or registered person or a person employed by it should explain the terms of the authority to the client. If an authority is granted to an employee or agent of the licensed or registered person, the authority should state that the person is an employee or agent of the licensed or registered person. If an authority is granted to a person who is not an employee or agent of the licensed or registered person, the authority should state that the person is not an employee or agent of the licensed or registered person. The licensed or registered person should also confirm with the client at least on an annual basis whether that client wishes to revoke such authority. For the avoidance of doubt, it will be acceptable for the licensed or registered person to send a notification to the client before the expiry date of its discretionary authority and inform the client that such authority is automatically renewed unless the client specifically revokes it in writing before the expiry date.
- (c) If a licensed or registered person has obtained an authority described under paragraph 7.1(a)(ii), the Client Agreement and the licensed or registered person's records should designate such accounts as "discretionary accounts".
- (d) Senior management should approve the opening of discretionary accounts.
- (e) A licensed or registered person should implement internal control procedures to ensure proper supervision of the operation of discretionary accounts.

Information for clients

8.1 Information about the firm: in general

- (a) A licensed or registered person should provide clients with adequate and appropriate information about its business, including contact details, services available to clients, and the identity and status of employees and others acting on its behalf with whom the client may have contact.
- (b) Where employees act for more than one company within a financial services group, a licensed or registered person should ensure that there is no reasonable basis for confusion on the part of the client as to the company for which these employees are acting.

8.2 Prompt confirmation

- (a) Unless specifically agreed otherwise in writing by the client, after a licensed or registered person has effected a transaction for a client, it should endeavour to confirm promptly with the client the essential features of the transaction. This does not apply in relation to a discretionary account.
- (b) Where a licensed or registered person trades in options contracts for its clients, it should provide each client with a trade confirmation promptly after effecting such trading that includes:
 - (i) the number of contracts purchased or sold, the underlying asset, expiry month, strike price, option type (put or call), version number (if not 0) and whether they were closing contracts or opening contracts; and
 - (ii) the price and the unit of the asset comprised in each lot the subject of such contract.

8.3 *[Repealed]*

8.4 Information about the firm: financials

A licensed or registered person should, upon request, disclose the financial condition of its business to a client by providing a copy of the latest audited balance sheet and profit and loss account required to be filed with the Commission and disclose any material changes which adversely affect the licensed or registered person's financial condition after the date of the accounts.

8.5 Information on corporate actions

A licensed or registered person that has control of a client's assets should respond promptly to the client's requests for information on corporate actions in relation to those assets.

Client priority

9.1 Priority for client orders: order handling and recording

A licensed or registered person should handle orders of clients fairly and in the order in which they are received. Orders of clients or transactions to be undertaken on behalf of clients should have priority over orders for the account of the licensed or registered person, or any account in which the licensed or registered person has an interest or the account of any employee or agent of the licensed or registered person.

9.2 Priority for client orders: order allocation

A licensed or registered person should, where it has aggregated an order for a client with an order for another client, or with an order for its own account, give priority to satisfying orders of clients, in any subsequent allocation if all orders cannot be filled.

9.3 Non-public, material information

A licensed or registered person should have procedures in place to ensure that its employees do not deal (for the benefit of the licensed or registered person, the employee or a client) in securities or futures contracts where the employee concerned effects the dealing in order to “front-run” pending transactions for or with clients, or on the basis of other non-public information which would be expected to materially affect prices of those securities or futures contracts and which is to be released to the market.

9.4 Withdrawal from business

A licensed or registered person that withdraws in whole or in part from providing any investment or related services should ensure that affected clients are promptly notified of the action and that any business which remains outstanding is promptly completed or transferred to another licensed or registered person in accordance with any instructions of the affected clients.

Conflicts of interest

10.1 Disclosure and fair treatment

Where a licensed or registered person has a material interest in a transaction with or for a client or a relationship which gives rise to an actual or potential conflict of interest in relation to the transaction, it should neither advise, nor deal in relation to the transaction unless it has disclosed that material interest or conflict to the client and has taken all reasonable steps to ensure fair treatment of the client.

Client assets

11.1 Handling of client assets

- (a) A licensed or registered person should, in the handling of client transactions and client assets, act to ensure that client assets are accounted for properly and promptly. Where the licensed or registered person or a third party on behalf of the licensed or registered person is in possession or control of client positions or assets, the licensed or registered person should ensure that client positions or assets are adequately safeguarded.

- (b) Where a client's assets are received or held overseas, additional risk disclosures should be provided to the client, as such assets may not enjoy the same protection as that conferred under the SFO, the Securities and Futures (Client Money) Rules and the Securities and Futures (Client Securities) Rules.

Compliance

12.1 Compliance: in general

A licensed or registered person should comply with, and implement and maintain measures appropriate to ensuring compliance with the law, rules, regulations and codes administered or issued by the Commission, the rules of any exchange or clearing house of which it is a member or participant, and the requirements of any regulatory authority which apply to the licensed or registered person.

12.2 Employee dealings

- (a) A licensed or registered person should have a policy which has been communicated to employees in writing on whether employees are permitted to deal or trade for their own accounts in securities, futures contracts or leveraged foreign exchange contracts. For purposes of paragraph 12.2, the term “employees” includes directors (other than non-executive directors) of a licensed or registered person.
- (b) In the event that employees of a licensed or registered person are permitted to deal or trade for their own accounts in securities, futures contracts or leveraged foreign exchange contracts:
 - (i) the written policy should specify the conditions on which employees may deal for their own accounts;
 - (ii) employees should be required to identify all related accounts and report them to senior management. For purposes of paragraph 12.2, the term “related accounts” includes accounts of their minor children and accounts in which the employees hold beneficial interests;
 - (iii) employees should generally be required to deal through the licensed or registered person or its affiliates;
 - (iv) if the licensed or registered person provides services in securities or futures contracts listed or traded on a recognized stock market or a recognized futures market or in derivatives, including over-the-counter derivatives written over such securities or futures contracts, and its employees are permitted to deal through another dealer, in those

securities or futures contracts, the licensed or registered person and employee should arrange for duplicate trade confirmations and statements of account to be provided to senior management of the licensed or registered person;

- (v) any transactions for employees' accounts and related accounts should be separately recorded and clearly identified in the records of the licensed or registered person; and
 - (vi) transactions of employees' accounts and related accounts should be reported to and actively monitored by senior management of the licensed or registered person who should not have any beneficial or other interest in the transactions and who should maintain procedures to detect irregularities and ensure that the handling by the licensed or registered person of these transactions or orders is not prejudicial to the interests of the licensed or registered person's other clients.
- (c) A licensed or registered person should not knowingly deal in securities or futures contracts for another licensed or registered person's employee unless it has received written consent from that licensed or registered person.

12.3 Complaints

A licensed or registered person should ensure that:

- (a) complaints from clients relating to its business are handled in a timely and appropriate manner;
- (b) steps are taken to investigate and respond promptly to the complaints; and
- (c) where a complaint is not remedied promptly, the client is advised of any further steps which may be available to the client under the regulatory system.

12.4 Responsibility for acts of employees

A licensed or registered person should be responsible for the acts or omissions of its employees and agents in respect to the conduct of its business.

12.5 Notifications to the Commission

A licensed or registered person, as a firm, should report to the Commission immediately upon the happening of any one or more of the following:

- (a) any material breach, infringement of or non-compliance with any law, rules, regulations, and codes administered or issued by the Commission, the rules of any exchange or clearing house of which it is a member or participant, and the requirements of any regulatory authority which apply to the licensed or registered person, or where it suspects any such breach, infringement or non-compliance whether by:
 - (i) itself; or
 - (ii) persons it employs or appoints to conduct business with clients or other licensed or registered persons,giving particulars of the breach, infringement or non-compliance, or suspected breach, infringement or non-compliance, and relevant information and documents;
- (b) the passing of any resolutions, the initiation of any proceedings, or the making of any order which may result in the appointment of a receiver, provisional liquidator, liquidator or administrator or the winding-up, re-organisation, reconstruction, amalgamation, dissolution or bankruptcy of the licensed or registered person or any of its substantial shareholders or the making of any receiving order or arrangement or composition with creditors;
- (c) the bankruptcy of any of its directors;

- (d) the exercise of any disciplinary measure against it by any regulatory or other professional or trade body or the refusal, suspension or revocation of any regulatory licence, consent or approval required in connection with its business; and
- (e) any material failure, error or defect in the operation or functioning of its trading, accounting, clearing or settlement systems or equipment.

Rebates, soft dollars, and connected transactions

Retention of rebates, soft dollars and connected transactions

- 13.1 A licensed or registered person that acts for a client in the exercise of investment discretion may receive goods or services (i.e. soft dollars) from a broker in consideration of directing transaction business on behalf of the client to the broker only if:
- (a) the goods or services are of demonstrable benefit to the licensed or registered person's clients;
 - (b) transaction execution is consistent with best execution standards and brokerage rates are not in excess of customary full-service brokerage rates;
 - (c) the client has consented in writing to the receipt of the goods and services; and
 - (d) disclosure is made of the licensed or registered person's practices for receiving the goods and services, including a description of the goods and services received.

Notes

Goods and services may include: research and advisory services; economic and political analysis; portfolio analysis, including valuation and performance measurement; market analysis, data and quotation services; computer hardware and software incidental to the above goods and services; clearing and custodian services and investment-related publications. The goods and services may not include travel, accommodation, entertainment, general administrative goods or services, general office equipment or premises, membership fees, employee salaries, or direct money payments. This note is not exhaustive and may be amended from time to time.

Disclosure and consent may be made or given in the Client Agreement or other investment management agreement (or an addendum thereto). Whichever form of document is used, it must include a specific statement describing the licensed or registered person's soft dollar practices. In addition, at least annually the client must be given a statement describing the licensed or registered person's soft dollar practices, including a description of the goods and services received by the manager.

- 13.2 A licensed or registered person described in paragraph 13.1 that intends to receive and retain cash or money rebates in relation to client transactions may retain those rebates only if :
- (a) the client has consented in writing to the retention of rebates;
 - (b) brokerage rates are not in excess of customary full-service brokerage rates; and
 - (c) disclosure of the rebates and their approximate value is made to the client.

Note

Disclosure and consent may be made or given in the Client Agreement or other investment management agreement (or an addendum thereto). Whichever form of document is used it must include a specific statement that the manager may receive and retain brokerage commission rebates and describe the licensed or registered person's practices in regard to the rebates. In addition, at least twice annually the client must be provided with a quantification of the value of rebates received in relation to the client's account. Alternatively, this may be done in each contract note provided to the client. Quantification of rebates may involve estimates taken from aggregate commission and rebate data provided the estimates are reasonably accurate in relation to the client's account.

- 13.3 A licensed or registered person described in paragraph 13.1 should ensure and be able to demonstrate that any transactions undertaken or services acquired in relation to a client's account that involve payments from client assets directly or indirectly to a person connected with the licensed or registered person are undertaken at arm's length terms and in the best interests of the client. Essentially, this requires that such terms not be less favourable than those generally available in the market.
- 13.4 A licensed or registered person that provides a portfolio manager with goods, services, or cash rebates has a responsibility to satisfy itself that the portfolio manager is mindful of the requirements of this section. In addition, the licensed or registered person should make further enquiries if the type of goods and services listed in the invoices presented for payment by the portfolio manager appear not to be of the type described in paragraph 13.1. This is in addition to any legal duties that the licensed or registered person and the portfolio manager may have, including those imposed by the Prevention of Bribery Ordinance (Cap. 201).

Responsibility of senior management

14.1 Responsibility of senior management

Senior management of a licensed or registered person should properly manage the risks associated with the business of the licensed or registered person, including performing periodic evaluation of its risk management processes. Senior management should understand the nature of the business of the licensed or registered person, its internal control procedures and its policies on the assumption of risk. They should clearly understand the extent of their own authority and responsibilities. In respect of that authority and those responsibilities:

- (a) they should have access to all relevant information about the business on a timely basis; and
- (b) they should have available to them and seek where appropriate all necessary advice on that business and on their own responsibilities.

In determining the responsibility of particular individuals, regard should be had to the factors referred to in GP9.

Professional investors

15.1 Professional Investors : in general

Where a client of a licensed or registered person is a Professional Investor referred to in paragraph 15.2A or paragraph 15.2B (who has sufficient knowledge and expertise in relevant products and markets), the licensed or registered person will not be required to fulfil the requirements set out in paragraph 15.5 while serving such clients in respect of relevant products and/or markets of which they are treated as Professional Investors.

15.2 Professional Investors

There are 2 categories of Professional Investors:

- A. A person falling under paragraphs (a) to (i) of the definition of “professional investor” in Part 1 of Schedule 1 to the SFO.
- B. A person falling under paragraph (j) of the definition of “professional investor” in Part 1 of Schedule 1 to the SFO.

15.3 Before waiving the requirements set out in paragraph 15.5 for persons referred to in paragraph 15.2B above, the licensed or registered person should assess and be reasonably satisfied that the person is knowledgeable and has sufficient expertise in relevant products and markets. In assessing the investment experience of any of the persons referred to in paragraph 15.2B above, the licensed or registered person should have regard to:

- (a) the type of products in which the person has traded;
- (b) the frequency and size of trades (a Professional Investor would be expected to have traded not less than 40 transactions per annum);
- (c) the person’s dealing experience (a Professional Investor would be expected to have been active in the relevant market for at least 2 years); and
- (d) his awareness of the risks involved in trading in the relevant markets.

15.4 Prior to treating persons referred to in paragraph 15.2B as Professional Investors, the licensed or registered person should:

- (a) provide a written explanation to the person explaining the risks and consequences of being treated as a Professional Investor, in particular, the information that will not be provided to him. This written explanation should also inform him that he has a right to withdraw from being treated as a Professional Investor whether in respect of all products or markets or any part thereof;
- (b) obtain a written and signed declaration from the person that the consequences of consenting to being treated as a Professional Investor and the right to withdraw from being treated as such have been explained to him and that he wishes to be treated as a Professional Investor; and
- (c) have in place procedures to enable it to carry out a confirmation exercise annually to enable it to ensure that clients falling within paragraph 15.2B and who have elected to be treated as Professional Investors continue to fulfil the requisite requirements under the Securities and Futures (Professional Investor) Rules.

15.5 Provisions that may be waived for Professional Investors

- (a) Information about clients
 - (i) the need to establish a client's financial situation, investment experience and investment objectives (paragraph 5.1 and paragraphs 2(d) and 2(e) of Schedule 6 to the Code), except where the licensed or registered person is providing advice on corporate finance work; and
 - (ii) the need to ensure the suitability of a recommendation or solicitation (paragraph 5.2 and paragraph 49 of Schedule 6 to the Code);
- (b) Client agreement
 - (i) the need to enter into a written agreement and the provision of relevant risk disclosure statements (paragraph 6.1, paragraph 2 of Schedule 3, paragraph 2 of Schedule 4 and paragraph 1 of Schedule 6 to the Code);
- (c) Discretionary accounts
 - (i) the need for a licensed or registered person to obtain from the client an authority in a written form prior to effecting transactions for the client without his specific authority (paragraph 7.1(a)(ii)); and
 - (ii) the need to explain the authority described under paragraph 7.1(a)(ii) and the need to confirm it on an annual basis (paragraph 7.1(b));

(For the avoidance of doubt, a licensed or registered person should still obtain an authorization from a client in order to effect transactions on the client's behalf, however where Professional Investors are concerned the procedures for obtaining such authorizations are relaxed as described in (i) and (ii) above.)
- (d) Information for clients
 - (i) the need to inform the client about the licensed or registered person and the identity and status of its employees and others acting on its behalf (paragraph 8.1);

- (ii) the need to confirm promptly with the client the essential features of a transaction after effecting a transaction for a client (paragraph 8.2, paragraph 4 of Schedule 3 and paragraph 18 of Schedule 6 to the Code); and
- (iii) *[Repealed]*
- (iv) the need to provide the client with documentation on the Nasdaq-Amex Pilot Program (paragraph 1 of Schedule 3 to the Code).

SCHEDULE 1 RISK DISCLOSURE STATEMENTS

EXPLANATION

A Client Agreement under paragraph 6 of the Code should include applicable risk disclosures, declaration by staff and acknowledgement by client in substantially the following form and should be in print at least as large as other text in the Client Agreement.

The substance contained in the following risk disclosure statements is considered to be the minimum required. A licensed or registered person may elect to provide additional risk disclosure information as appropriate.

Where any of the following risk disclosure statements are applicable, a declaration by staff and acknowledgement by client should be executed. The substance contained in the following declaration by staff and acknowledgement by client is considered to be the minimum required.

DECLARATION BY STAFF

A member of staff, who should be a licensed or registered person, should sign and date a declaration confirming that the licensed or registered person has:

- provided the risk disclosure statement in a language of the client's choice (English or Chinese); and
- invited the client to read the risk disclosure statement, ask questions and take independent advice if the client wishes.

The name and CE number of that staff member should be stated in block letters in the risk disclosure statement.

ACKNOWLEDGEMENT BY CLIENT

The client shall sign and date an acknowledgement confirming that:

- the risk disclosure statement was provided in a language of the client's choice (English or Chinese); and

- the client was invited to read the risk disclosure statement, to ask questions and take independent advice if the client wishes.

Notes for licensed or registered persons

The declaration by staff and acknowledgement by client are needed when the client signs the first authority and not for any later renewal. The staff member should explain to the client the purposes for which the authority is to be used.

RISK DISCLOSURE STATEMENTS

The following risk disclosures should be given where they apply to the expected or actual activity of the client.

RISK OF SECURITIES TRADING

The prices of securities fluctuate, sometimes dramatically. The price of a security may move up or down, and may become valueless. It is as likely that losses will be incurred rather than profit made as a result of buying and selling securities.

RISK OF TRADING FUTURES AND OPTIONS

The risk of loss in trading futures contracts or options is substantial. In some circumstances, you may sustain losses in excess of your initial margin funds. Placing contingent orders, such as "stop-loss" or "stop-limit" orders, will not necessarily avoid loss. Market conditions may make it impossible to execute such orders. You may be called upon at short notice to deposit additional margin funds. If the required funds are not provided within the prescribed time, your position may be liquidated. You will remain liable for any resulting deficit in your account. You should therefore study and understand futures contracts and options before you trade and carefully consider whether such trading is suitable in the light of your own financial position and investment objectives. If you trade options you should inform yourself of exercise and expiration procedures and your rights and obligations upon exercise or expiry.

RISK OF TRADING IN LEVERAGED FOREIGN EXCHANGE CONTRACTS

The risk of loss in leveraged foreign exchange trading can be substantial. You may sustain losses in excess of your initial margin funds. Placing contingent orders, such as "stop-loss" or "stop-limit" orders, will not necessarily limit losses to the intended amounts. Market conditions may make it impossible to execute such orders. You may be called upon at short notice to deposit additional margin funds. If the required funds are not provided within the prescribed time, your position may be liquidated. You will remain liable for any resulting deficit in your account. You should therefore carefully consider whether such trading is suitable in light of your own financial position and investment objectives.

RISK OF TRADING GROWTH ENTERPRISE MARKET STOCKS

Growth Enterprise Market (GEM) stocks involve a high investment risk. In particular, companies may list on GEM with neither a track record of profitability nor any obligation to forecast future profitability. GEM stocks may be very volatile and illiquid.

You should make the decision to invest only after due and careful consideration. The greater risk profile and other characteristics of GEM mean that it is a market more suited to professional and other sophisticated investors.

Current information on GEM stocks may only be found on the internet website operated by The Stock Exchange of Hong Kong Limited. GEM Companies are usually not required to issue paid announcements in gazetted newspapers.

You should seek independent professional advice if you are uncertain of or have not understood any aspect of this risk disclosure statement or the nature and risks involved in trading of GEM stocks.

RISKS OF CLIENT ASSETS RECEIVED OR HELD OUTSIDE HONG KONG

Client assets received or held by the licensed or registered person outside Hong Kong are subject to the applicable laws and regulations of the relevant overseas jurisdiction which may be different from the Securities and Futures Ordinance (Cap.571) and the rules made thereunder.

Consequently, such client assets may not enjoy the same protection as that conferred on client assets received or held in Hong Kong.

RISK OF PROVIDING AN AUTHORITY TO REPLEDGE YOUR SECURITIES COLLATERAL ETC.

There is risk if you provide the licensed or registered person with an authority that allows it to apply your securities or securities collateral pursuant to a securities borrowing and lending agreement, repledge your securities collateral for financial accommodation or deposit your securities collateral as collateral for the discharge and satisfaction of its settlement obligations and liabilities.

If your securities or securities collateral are received or held by the licensed or registered person in Hong Kong, the above arrangement is allowed only if you consent in writing. Moreover, unless you are a professional investor, your authority must specify the period for which it is current and be limited to not more than 12 months. If you are a professional investor, these restrictions do not apply.

Additionally, your authority may be deemed to be renewed (i.e. without your written consent) if the licensed or registered person issues you a reminder at least 14 days prior to the expiry of the authority, and you do not object to such deemed renewal before the expiry date of your then existing authority.

You are not required by any law to sign these authorities. But an authority may be required by licensed or registered persons, for example, to facilitate margin lending to you or to allow your securities or securities collateral to be lent to or deposited as collateral with third parties. The licensed or registered person should explain to you the purposes for which one of these authorities is to be used.

If you sign one of these authorities and your securities or securities collateral are lent to or deposited with third parties, those third parties will have a lien or charge on your securities or securities collateral. Although the licensed or registered person is responsible to you for securities or securities collateral lent or deposited under your authority, a default by it could result in the loss of your securities or securities collateral.

A cash account not involving securities borrowing and lending is available from most licensed or registered persons. If you do not require margin facilities or do not wish your securities or securities collateral to be lent or

pledged, do not sign the above authorities and ask to open this type of cash account.

RISK OF PROVIDING AN AUTHORITY TO HOLD MAIL OR TO DIRECT MAIL TO THIRD PARTIES

If you provide the licensed or registered person with an authority to hold mail or to direct mail to third parties, it is important for you to promptly collect in person all contract notes and statements of your account and review them in detail to ensure that any anomalies or mistakes can be detected in a timely fashion.

Note for licensed or registered persons

The licensed or registered person should confirm with the client at least on an annual basis whether that client wishes to revoke the authority. For the avoidance of doubt, it will be acceptable for the licensed or registered person to send a notification to the client before the expiry date of the authority and inform the client that it is automatically renewed unless the client specifically revokes it in writing before the expiry date.

RISK OF MARGIN TRADING

The risk of loss in financing a transaction by deposit of collateral is significant. You may sustain losses in excess of your cash and any other assets deposited as collateral with the licensed or registered person. Market conditions may make it impossible to execute contingent orders, such as "stop-loss" or "stop-limit" orders. You may be called upon at short notice to make additional margin deposits or interest payments. If the required margin deposits or interest payments are not made within the prescribed time, your collateral may be liquidated without your consent. Moreover, you will remain liable for any resulting deficit in your account and interest charged on your account. You should therefore carefully consider whether such a financing arrangement is suitable in light of your own financial position and investment objectives.

RISK OF TRADING NASDAQ-AMEX SECURITIES AT THE STOCK EXCHANGE OF HONG KONG LIMITED

The securities under the Nasdaq-Amex Pilot Program (“PP”) are aimed at sophisticated investors. You should consult the licensed or registered person and become familiarised with the PP before trading in the PP securities. You should be aware that the PP securities are not regulated as a primary or secondary listing on the Main Board or the Growth Enterprise Market of The Stock Exchange of Hong Kong Limited.

The following additional risk disclosure concerning futures and options trading may be provided to clients if licensed or registered persons so desire.

ADDITIONAL RISK DISCLOSURE FOR FUTURES AND OPTIONS TRADING

This brief statement does not disclose all of the risks and other significant aspects of trading in futures and options. In light of the risks, you should undertake such transactions only if you understand the nature of the contracts (and contractual relationships) into which you are entering and the extent of your exposure to risk. Trading in futures and options is not suitable for many members of the public. You should carefully consider whether trading is appropriate for you in light of your experience, objectives, financial resources and other relevant circumstances.

FUTURES

1. Effect of “Leverage” or “Gearing”

Transactions in futures carry a high degree of risk. The amount of initial margin is small relative to the value of the futures contract so that transactions are “leveraged” or “geared”. A relatively small market movement will have a proportionately larger impact on the funds you have deposited or will have to deposit: this may work against you as well as for you. You may sustain a total loss of initial margin funds and any additional funds deposited with the firm to maintain your position. If the market moves against your position or margin levels are increased, you may be called upon to pay substantial additional funds on short notice to maintain your position. If you fail to comply with a request for additional funds within the

time prescribed, your position may be liquidated at a loss and you will be liable for any resulting deficit.

2. Risk-reducing orders or strategies

The placing of certain orders (e.g. “stop-loss” orders, or “stop-limit” orders) which are intended to limit losses to certain amounts may not be effective because market conditions may make it impossible to execute such orders. Strategies using combinations of positions, such as “spread” and “straddle” positions may be as risky as taking simple “long” or “short” positions.

3. *[Repealed]*

OPTIONS

4. Variable degree of risk

Transactions in options carry a high degree of risk. Purchasers and sellers of options should familiarise themselves with the type of option (i.e. put or call) which they contemplate trading and the associated risks. You should calculate the extent to which the value of the options must increase for your position to become profitable, taking into account the premium and all transaction costs.

The purchaser of options may offset or exercise the options or allow the options to expire. The exercise of an option results either in a cash settlement or in the purchaser acquiring or delivering the underlying interest. If the option is on a futures contract, the purchaser will acquire a futures position with associated liabilities for margin (see the section on Futures above). If the purchased options expire worthless, you will suffer a total loss of your investment which will consist of the option premium plus transaction costs. If you are contemplating purchasing deep-out-of-the-money options, you should be aware that the chance of such options becoming profitable ordinarily is remote.

Selling (“writing” or “granting”) an option generally entails considerably greater risk than purchasing options. Although the premium received by the seller is fixed, the seller may sustain a loss well in excess of that amount. The seller will be liable for additional margin to maintain the position if the market moves unfavourably.

The seller will also be exposed to the risk of the purchaser exercising the option and the seller will be obligated to either settle the option in cash or to acquire or deliver the underlying interest. If the option is on a futures contract, the seller will acquire a position in a futures contract with associated liabilities for margin (see the section on Futures above). If the option is “covered” by the seller holding a corresponding position in the underlying interest or a futures contract or another option, the risk may be reduced. If the option is not covered, the risk of loss can be unlimited.

Certain exchanges in some jurisdictions permit deferred payment of the option premium, exposing the purchaser to liability for margin payments not exceeding the amount of the premium. The purchaser is still subject to the risk of losing the premium and transaction costs. When the option is exercised or expires, the purchaser is responsible for any unpaid premium outstanding at that time.

ADDITIONAL RISKS COMMON TO FUTURES AND OPTIONS

5. Terms and conditions of contracts

You should ask the firm with which you deal about the terms and conditions of the specific futures or options which you are trading and associated obligations (e.g. the circumstances under which you may become obliged to make or take delivery of the underlying interest of a futures contract and, in respect of options, expiration dates and restrictions on the time for exercise). Under certain circumstances the specifications of outstanding contracts (including the exercise price of an option) may be modified by the exchange or clearing house to reflect changes in the underlying interest.

6. Suspension or restriction of trading and pricing relationships

Market conditions (e.g. illiquidity) and/or the operation of the rules of certain markets (e.g. the suspension of trading in any contract or contract month because of price limits or “circuit breakers”) may increase the risk of loss by making it difficult or impossible to effect transactions or liquidate/offset positions. If you have sold options, this may increase the risk of loss.

Further, normal pricing relationships between the underlying interest and the futures, and the underlying interest and the option may not

exist. This can occur when, for example, the futures contract underlying the option is subject to price limits while the option is not. The absence of an underlying reference price may make it difficult to judge “fair value”.

7. Deposited cash and property

You should familiarise yourself with the protections given to money or other property you deposit for domestic and foreign transactions, particularly in the event of a firm insolvency or bankruptcy. The extent to which you may recover your money or property may be governed by specific legislation or local rules. In some jurisdictions, property which had been specifically identifiable as your own will be pro-rated in the same manner as cash for purposes of distribution in the event of a shortfall.

8. Commission and other charges

Before you begin to trade, you should obtain a clear explanation of all commission, fees and other charges for which you will be liable. These charges will affect your net profit (if any) or increase your loss.

9. Transactions in other jurisdictions

Transactions on markets in other jurisdictions, including markets formally linked to a domestic market, may expose you to additional risk. Such markets may be subject to regulation which may offer different or diminished investor protection. Before you trade you should enquire about any rules relevant to your particular transactions. Your local regulatory authority will be unable to compel the enforcement of the rules of regulatory authorities or markets in other jurisdictions where your transactions have been effected. You should ask the firm with which you deal for details about the types of redress available in both your home jurisdiction and other relevant jurisdictions before you start to trade.

10. Currency risks

The profit or loss in transactions in foreign currency-denominated contracts (whether they are traded in your own or another jurisdiction) will be affected by fluctuations in currency rates where there is a need to convert from the currency denomination of the contract to another currency.

11. Trading facilities

Electronic trading facilities are supported by computer-based component systems for the order-routing, execution, matching, registration or clearing of trades. As with all facilities and systems, they are vulnerable to temporary disruption or failure. Your ability to recover certain losses may be subject to limits on liability imposed by the system provider, the market, the clearing house and/or participant firms. Such limits may vary: you should ask the firm with which you deal for details in this respect.

12. Electronic trading

Trading on an electronic trading system may differ from trading on other electronic trading systems. If you undertake transactions on an electronic trading system, you will be exposed to risks associated with the system including the failure of hardware and software. The result of any system failure may be that your order is either not executed according to your instructions or is not executed at all.

13. Off-exchange transactions

In some jurisdictions, and only then in restricted circumstances, firms are permitted to effect off-exchange transactions. The firm with which you deal may be acting as your counterparty to the transaction. It may be difficult or impossible to liquidate an existing position, to assess the value, to determine a fair price or to assess the exposure to risk. For these reasons, these transactions may involve increased risks. Off-exchange transactions may be less regulated or subject to a separate regulatory regime. Before you undertake such transactions, you should familiarise yourself with applicable rules and attendant risks.

SCHEDULE 2 CLIENT IDENTITY GUIDANCE NOTE

Paragraph 5.4 of the Code requires that licensed or registered persons:

- satisfy themselves about information that identifies those who are ultimately responsible for originating instructions about a transaction and those who will ultimately benefit from a transaction or bear its risk and
- record that information in Hong Kong,

before doing anything to effect such a transaction.

Paragraph 5.4 of the Code supplements the existing "know your client" in paragraph 5.1 of the Code.

Paragraph 5.4 of the Code is intended to improve the transparency of trading in securities or futures contracts listed or traded on a recognized stock market or a recognized futures market or in derivatives, including over-the-counter derivatives, written over such securities or futures contracts, wherever such trading occurs, by improving the information that is available to the Commission about the identity of those interested in transactions on those markets.

Like the rest of the Code, paragraph 5.4 of the Code uses simple language. Licensed or registered persons should interpret paragraph 5.4 sensibly in accordance with its spirit and not interpret paragraph 5.4 technically or literally. Licensed or registered persons must satisfy themselves about and record information that identifies those who are really behind a transaction: those who *ultimately* originate instructions in relation to a transaction and those who *ultimately* benefit from, or bear the risk of, that transaction. The Commission is concerned about the substance of what is going on with a transaction and not the technicalities.

For example, if a licensed or registered person's client was a company incorporated in the British Virgin Islands, the licensed or registered person would have to satisfy itself whether or not a shareholder or director of that company had originated the instructions in relation to the transaction and would receive the ultimate benefit from, or bear the risk of, the transaction. The licensed or registered person would also have to satisfy itself whether or not the company was being used as a nominee to conceal that person's identity. If it was the shareholder who turned out to be relevant and not the company, and the relevant shares turned out to be held on trust, the licensed or registered person would have to be satisfied

about who was giving instructions in relation to the trust and who would benefit from, or bear the risk of, the transaction.

In relation to a collective investment scheme or discretionary account, the Commission does not intend that licensed or registered persons concern themselves with those who have a beneficial interest in that collective investment scheme or discretionary account, unless they are ultimately responsible for originating instructions in relation to a specific transaction.

For example, in relation to a collective investment scheme or discretionary account, licensed or registered persons must only satisfy themselves about and record information about the scheme or account and the manager of that scheme or account if they are the person giving instructions. However, licensed or registered persons must record information about a beneficiary of the scheme or account rather than the investment manager if that beneficiary has overridden the manager's discretion and originated the instructions in relation to a transaction.

SCHEDULE 3 ADDITIONAL REQUIREMENTS FOR LICENSED OR REGISTERED PERSONS DEALING IN SECURITIES LISTED OR TRADED ON THE STOCK EXCHANGE OF HONG KONG LIMITED

The provisions in this Schedule apply to all licensed or registered persons in the course of their dealing in securities listed or traded on The Stock Exchange of Hong Kong Limited (“SEHK”), except as otherwise specified in certain paragraphs which do not apply to licensed or registered persons which are not exchange participants of SEHK.

For the purposes of this Schedule, the defined terms and expressions set out below have the meanings assigned to them under the rules (including the Options Trading Rules of The Stock Exchange of Hong Kong Limited (“Options Trading Rules”) and Operational Trading Procedures for Options Trading Exchange Participants of The Stock Exchange of Hong Kong Limited (“Operational Trading Procedures”) for Options Trading Exchange Participants) of SEHK. Where such defined terms and expressions are applied to exchange participants of SEHK, they are deemed to apply with the same meaning to licensed or registered persons which are not exchange participants wherever the context so permits.

Nasdaq-Amex pilot program

1. Before accepting or operating a securities trading account for any person in relation to securities admitted to trading under the Nasdaq-Amex Pilot Program, a licensed or registered person which is an exchange participant of SEHK should provide the person with documentation on the Nasdaq-Amex Pilot Program as prescribed by SEHK in either the Chinese or English language according to the language preference of the person.

Options client agreement

2. Without prejudice to paragraphs 6.1 to 6.3 of the Code, before any services are provided to a person (the client) in relation to the Options Contracts, a licensed or registered person which is an Options Exchange Participant or engages in Exchange Traded Options Business should ensure that the Client Agreement (“Options Client Agreement”) contains at least statements to the effect that:

- (a) the licensed or registered person will keep information relating to the client's options account confidential, but may provide any such information to the Commission and, where the licensed or registered person is an Options Exchange Participant, also to the SEHK and Hong Kong Exchanges and Clearing Limited to comply with their requirements or requests for information;
- (b) the client will confirm that:
 - (i) the options account is operated solely for the client's account and benefit, and not for the benefit of any other person; or
 - (ii) the client has disclosed to the licensed or registered person in writing the name of the person(s) for whose benefit the options account is being operated; or
 - (iii) the client has requested the licensed or registered person to operate the options account as an Omnibus Account, and will immediately notify the licensed or registered person, on request, of the identity of any person(s) ultimately beneficially interested in Client Contracts;
- (c) where the licensed or registered person is an Options Exchange Participant, all Exchange Traded Options Business shall be effected in accordance with all laws, rules and regulatory directions (the "Rules") applying to the licensed or registered person, which include the Options Trading Rules of SEHK, the Clearing Rules of The SEHK Options Clearing House Limited ("SEOCH") and the rules of the Hong Kong Securities Clearing Company Limited ("HKSCC"); and in particular, SEOCH has authority under the Rules to make adjustments to the terms of Contracts, the licensed or registered person should notify the client of any such adjustments which affect Client Contracts to which the client is a party, and all actions taken by the licensed or registered person, by SEHK, by SEOCH or by HKSCC in accordance with such Rules shall be binding on the client;
- (d) where the licensed or registered person is not an Options Exchange Participant, the licensed or registered person will collect margin requirements and premium in accordance with the Rules;
- (e) the client agrees that the terms of the Standard Contract for the relevant options series shall apply to each Client Contract between the licensed or registered person and the client, and that all Client

Contracts shall be created, exercised, settled and discharged in accordance with the Rules;

- (f) the client agrees to provide the licensed or registered person with cash and/or securities and/or other assets (“Margin”) as may be agreed from time to time, as security for the client’s obligations to the licensed or registered person under the Options Client Agreement; such Margin should be paid or delivered as demanded by the licensed or registered person from time to time; and the amounts required by way of Margin should not be less than, but may exceed, the amounts as may be required by the Rules in respect of the client’s open positions and delivery obligations, and further Margin may be required to reflect changes in market value;
- (g) if the licensed or registered person accepts securities by way of Margin, the client will on request provide the licensed or registered person with such authority as the licensed or registered person may require under the Rules to authorize the licensed or registered person to deliver such securities, directly or through an Options Exchange Participant, to SEOCH as SEOCH Collateral in respect of Exchange Traded Options Business resulting from the client’s instructions to the licensed or registered person; and the licensed or registered person does not have any further authority from the client to borrow or lend the client’s securities or otherwise part with possession (except to the client or on the client’s instructions) of any of the client’s securities for any other purpose;
- (h) the client agrees to indemnify the licensed or registered person, and the licensed or registered person’s employees and agents, against all losses and expenses resulting from breach of the client’s obligation under the Options Client Agreement, including costs reasonably incurred in collecting debts from the client, and in closing the options account;
- (i) if the client fails to comply with any of the client’s obligations and/or to meet the client’s liabilities under the Options Client Agreement, including failure to provide Margin, the licensed or registered person may:
 - (i) decline to accept further instructions from the client in respect of Exchange Traded Options Business;

- (ii) close out some or all of the client's Client Contracts with the licensed or registered person;
- (iii) enter into Contracts, or into transactions in securities, futures or commodities, in order to settle obligations arising or to hedge the risks to which the licensed or registered person is exposed in relation to the client's failure;
- (iv) dispose of Margin, and apply the proceeds thereof to discharge the client's liabilities to the licensed or registered person,

and any proceeds remaining after discharge of all the client's liabilities to the licensed or registered person should be paid to the client;

- (j) the client agrees to pay interest on all overdue balances (including interest arising after a judgement debt is obtained against the client) at such rates and on such other terms as the licensed or registered person has notified to the client from time to time;
- (k) in respect of all Contracts effected on the client's instructions, the client will pay the licensed or registered person, within the time period notified by the licensed or registered person, Premium, the licensed or registered person's commission and any other charges, and applicable levies imposed by SEHK, as have been notified to the client; and the licensed or registered person may deduct such Premium, commissions, charges and levies from the options account;
- (l) the licensed or registered person may place limits on the open positions or delivery obligations that the client may have at any time;
- (m) where the licensed or registered person is an Options Exchange Participant, an acknowledgement by the client that:
 - (i) the licensed or registered person may be required to close out Client Contracts to comply with position limits imposed by SEHK; and
 - (ii) if the licensed or registered person goes into default, the default procedures of SEHK may result in Client Contracts being closed out, or replaced by Client Contracts between the client and another Options Exchange Participant;

- (n) where the licensed or registered person is an Options Exchange Participant, at the client's request, it may agree to the Client Contracts between itself and the client being replaced, in accordance with the Rules, by Client Contracts between the client and another Options Exchange Participant;
- (o) on exercise of a Client Contract by or against the client, the client will perform the client's delivery obligations under the relevant contract, in accordance with the Standard Contract and as the client has been notified by the licensed or registered person;
- (p) where the licensed or registered person is an Options Exchange Participant, the client acknowledges that, although all Options Contracts are to be executed on SEHK, the client and the licensed or registered person shall contract as principals under Client Contracts;
- (q) the licensed or registered person agrees to provide the client, upon request, with the product specifications for Options Contracts;
- (r) where the licensed or registered person is an Options Exchange Participant, if the licensed or registered person fails to meet its obligations to the client pursuant to the Options Client Agreement, the client shall have a right to claim under the Investor Compensation Fund established under the SFO, subject to the terms of the Investor Compensation Fund from time to time;
- (s) the licensed or registered person will notify the client of material changes in respect of the licensed or registered person's business which may affect the services the licensed or registered person provide to the client;
- (t) the client confirms that the client has read and agrees to the terms of the Options Client Agreement, which have been explained to the client in a language that the client prefers;
- (u) the Options Client Agreement is governed by, and may be enforced in accordance with, the laws of the Special Administrative Region of Hong Kong;
- (v) where the licensed or registered person is an Options Exchange Participant, the category of Options Exchange participation under which it is registered and the full name and contact details of the Options Officer or Options Representative who will be primarily

responsible for the client's affairs should also be provided. A licensed or registered person which is subject to the Long-Only Restriction in accordance with Options Trading Rule 207 should also deliver to such client a written statement to the effect that: (i) the licensed or registered person is registered by SEHK as an Options Broker Exchange Participant, and not as an Options Trading Exchange Participant; (ii) as a condition of such registration, the only Exchange Traded Options Business which the licensed or registered person may conduct for clients is the purchase, closing, exercise, settlement and discharge of long options transactions; and (iii) therefore a client cannot write options through the client's options account with the licensed or registered person, or otherwise create any short open position;

- (w) where the licensed or registered person is an Options Exchange Participant, on the expiry day but only on the expiry day, the Options System will automatically generate exercise instructions in respect of all open long positions which are in-the-money by or above the percentage prescribed by SEOCH from time to time;
- (x) where the licensed or registered person is an Options Exchange Participant, the client may instruct the licensed or registered person to override an "automatically generated exercise instruction" referred to in subparagraph (w) above before the System Closure on the expiry day in accordance with the Operational Clearing Procedures of SEOCH; and
- (y) risk disclosure statements as specified in Schedule 1 to the Code will be attached.

Time stamping

3. Without prejudice to paragraph 3.9 of the Code:

- (a) a licensed or registered person should maintain a record of the date and time at which it receives each instruction from a client in respect of the purchase, sale or exercise of Client Contracts. It must also maintain a record of the date and time at which it originates a purchase or sale of the Options Contracts for its House Account. A licensed or registered person should immediately time stamp the records of instructions received from clients and the origination of orders for its House Account;

- (b) notwithstanding paragraph 3(a) of this Schedule, a licensed or registered person which is a Market Maker, when fulfilling its Market Maker obligations, may choose not to time stamp the records of its quotes entered into the Options System, but it should continue to abide by all other conditions of paragraph 3(a) of this Schedule; and
- (c) notwithstanding paragraph 3(b) of this Schedule, where an Authorized User, in the course of the same day, enters orders in respect of both market making activity and client business, all orders, including quotes, so entered that day by that Authorized User should be time stamped in the manner described above.

Options trade confirmations

- 4. Where the licensed or registered person is an Options Exchange Participant, it should provide an Options Trade Confirmation that includes:
 - (a) the number of Client Contracts or Options Broker Client Contracts purchased or sold, the underlying security, expiry month, strike price, option type (put or call), version number (if not 0) and whether they were closing contracts or opening contracts;
 - (b) the price and the number of securities comprised in each lot the subject of the Client Contract or Options Broker Client Contract;
 - (c) a risk disclosure statement to the following effect: “Options can involve a high degree of risk and may not be suitable for every investor. Investors should ensure they understand those risks before participating in the options market”;
 - (d) a statement that one or more Options Contracts on the same terms as the Client Contracts or Options Broker Client Contracts were executed by the licensed or registered person which is an Options Exchange Participant (or, if applicable, by an Options Trading Exchange Participant on its behalf) on SEHK;
 - (e) a statement that, in the event of a default committed by the licensed or registered person resulting in the client suffering pecuniary loss, the client shall have a right to claim under the Investor Compensation Fund established under the SFO, subject to the terms of the Investor Compensation Fund from time to time; and

- (f) a statement that all Exchange Traded Options Business made for or on behalf of a client shall be subject to the relevant provisions of the constitution, Rules of The Stock Exchange of Hong Kong Limited (“SEHK Rules”), regulations, the Articles, customs and usages of SEHK, the Options Trading Rules, the Clearing Rules of SEOCH, the CCASS Rules and of the laws of Hong Kong, which shall be binding on both the licensed or registered person and the client.

Exercise of client contracts

- 5. (a) Following notification of exercise pursuant to Clearing Rule 505 of SEOCH in respect of an OCH Contract or an NCP Contract comprised in a short open position of a licensed or registered person which is an Options Trading Exchange Participant allocated to its Client Account, that licensed or registered person should, by a random selection process, select a Client Contract from among all Client Contracts comprised in short open positions of clients in the same option series as that Contract. The Client Contract so selected should, by operation of the Options Client Agreement and Options Trading Rule 416, for all purposes be treated as having been validly exercised at the time of the selection. The licensed or registered person should notify its client of the details of such exercise as soon as possible.
 - (b) Where a licensed or registered person which is an Options Broker Exchange Participant receives notification pursuant to Options Trading Rule 416A in respect of the exercise of an Options Broker Client Contract, the licensed or registered person should, by a random selection process, select a Client Contract from among all Client Contracts comprised in short open positions of clients in the same option series as that Options Broker Client Contract. The Client Contract so selected shall also be treated for all purposes as having been validly exercised. The licensed or registered person should notify its client of the details of the exercise as soon as possible.
6. Where a licensed or registered person which is not an Options Exchange Participant receives notification from another licensed or registered person for the exercise of a Client Contract, the first-mentioned licensed or registered person should, by a random selection process, select a Client Contract from among all Client Contracts comprised in short open positions of clients in the same option series as that Client Contract. The Client

Contract so selected shall also be treated for all purposes as having been validly exercised. The first-mentioned licensed or registered person should notify its client of the details of the exercise as soon as possible.

Adjustments to contracts (“capital adjustments”)

7. Where SEOCH makes adjustments to the terms of the Contracts of an option series in accordance with the Clearing Rules, a licensed or registered person which is an Options Exchange Participant, should:
 - (a) by no later than the next Business Day after such adjustments have been announced, notify all its clients affected by such adjustments of the details of the adjustments; and
 - (b) as soon as possible but in any event no later than 1 Business Day after the adjustment takes effect, notify all its clients of any changes to the terms of any Contracts in the client’s account resulting from such adjustments.
8. Where a licensed or registered person which is not an Options Exchange Participant receives a notification about capital adjustments from an Options Exchange Participant, it should promptly inform its clients of the same.

Omnibus Accounts

9. Where a licensed or registered person which is an Options Exchange Participant accepts as a client a person whom the licensed or registered person knows to be engaging in Exchange Traded Options Business on behalf of other persons, the licensed or registered person should open one or more Omnibus Account(s) in the name of the client and should ensure that the client, to the fullest extent possible, calculates and collects appropriate amounts of margin and Premium from such other persons.

Client’s Money in relation to Exchange Traded Options Business

10. *[Repealed]*
11. Without prejudice to paragraph 3.7 of the Code, each licensed or registered person should maintain a separate ledger account for each of its clients into which should be entered sufficient particulars to identify uniquely and unambiguously all Exchange Traded Options Business in relation to each

client. Each such ledger account must contain information which is sufficient, at any given time, to enable all collateral and money received from each client to be separately identified and allocated to each aspect of Exchange Traded Options Business conducted on behalf of that client.

Securities borrowing and lending

12. *[Repealed]*

13. *[Repealed]*

Short selling

14. *[Repealed]*

Other requirements

15. A licensed or registered person which is an exchange participant of SEHK should also comply with the following rules (including the rules, regulations, guidelines, procedures and circulars updated from time to time) of the SEHK where applicable:

(a) *[Repealed]*

(b) *[Repealed]*

(c) Options Trading Rules 424 to 426A and Operational Trading Procedures paragraphs 5.4 to 5.6 and Appendix H on client margin requirements; and

(d) Options Trading Rules 435 to 441 and Operational Trading Procedures paragraphs 5.9 to 5.12 of SEHK on position limits.

Schedule 3A *[Repealed]*

Schedule 3B *[Repealed]*

SCHEDULE 4 ADDITIONAL REQUIREMENTS FOR LICENSED OR REGISTERED PERSONS DEALING IN FUTURES CONTRACTS AND/OR OPTIONS CONTRACTS TRADED ON HONG KONG FUTURES EXCHANGE LTD.

The provisions in this Schedule apply to all licensed or registered persons in the course of their dealing in Futures Contracts and/or Options Contracts traded on Hong Kong Futures Exchange Ltd. (“HKFE”) except as otherwise specified in certain paragraphs which do not apply to licensed or registered persons which are not exchange participants of HKFE.

For the purposes of this Schedule, the defined terms and expressions set out below have the meanings assigned to them under the rules of HKFE. Where such defined terms and expressions are applied to exchange participants of HKFE, they are deemed to apply with the same meaning to licensed or registered persons which are not exchange participants wherever the context so permits.

Books and accounts

1. A licensed or registered person which is an exchange participant of HKFE should maintain proper books and records which, inter alia, correctly and clearly record:
 - (a) the financial position of each client's trading account;
 - (b) the time, date and complete particulars of instructions received from and trades executed for clients;
 - (c) the time, date and complete particulars of the licensed or registered person's own orders and trades;
 - (d) particulars of all the open positions of the licensed or registered person and of each of its clients (that is, not simply the net open positions);
 - (e) the amount of margin deposited from time to time by the licensed or registered person with
 - (i) the Clearing House (where applicable); and

- (ii) executing agents,

identifying each such agent and the amount of margin deposited with each;
 - (f) the amount of variation adjustment paid by the licensed or registered person to
 - (i) the Clearing House (where applicable); and
 - (ii) executing agents,

identifying each such agent and the amount of variation adjustment paid to each;
 - (g) the amount of margin deposited or required to be deposited by each client;
 - (h) the amount of variation adjustment collected or required to be collected from clients;
 - (i) all payments and assets received or held by the licensed or registered person to satisfy margin requirements;
 - (j) particulars of all margin calls and demands for variation adjustment made; and
 - (k) any other particulars from time to time required by HKFE to be kept in the books and records of the licensed or registered person.
- 1A. Where confirmations of executed trades are made to clients through the telephone, a licensed or registered person should use a telephone recording system to record such confirmations and maintain telephone recordings as part of its records for at least three months.

Note

The Commission notes that mobile telephones are widely used in Hong Kong. In this regard, the Commission expects licensed or registered persons to arrange for the use of a telephone recording system in their offices. Although use of mobile phones for confirming executed trades is

discouraged, where executed trades are confirmed by mobile phones, the time of confirmation and relevant details should be recorded immediately (e.g. in writing by hand).

Client agreement

2. Without prejudice to paragraphs 6.1 to 6.3 of the Code, before any services are provided to a client in relation to the transaction of any Futures Contracts and/or Options Contracts, a licensed or registered person should ensure that the Client Agreement contains at least provisions to the following effect that:
 - (a) (where a licensed or registered person is an exchange participant of HKFE) the category of exchange participant under which the licensed or registered person is registered. The particulars of every licence or registration (including the CE number) maintained by the licensed or registered person (for both exchange participants and non-exchange participants) pursuant to the SFO or any other regulatory provisions, and the full name of the employee primarily responsible for the client's affairs and particulars of the licence or registration maintained by that employee (including the CE number) pursuant to the SFO or any other regulatory provisions;
 - (b) (where a licensed or registered person is an exchange participant of HKFE) every Exchange Contract shall be subject to the charge of a Investor Compensation Fund levy and a levy pursuant to the SFO, the cost of both of which shall be borne by the client;
 - (c) (where a licensed or registered person is an exchange participant of HKFE) if the client suffers pecuniary loss by reason of the licensed or registered person's default, the liability of the Investor Compensation Fund will be restricted to valid claims as provided for in the SFO and the relevant subsidiary legislation and will be subject to the monetary limits specified in the Securities and Futures (Investor Compensation – Compensation Limits) Rules and accordingly there can be no assurance that any pecuniary loss sustained by reason of such a default will necessarily be recouped from the Investor Compensation Fund in full, in part or at all;
 - (d) transactions related to exchange traded futures and options contracts shall be subject to the rules of the relevant markets and

exchanges. A statement that the licensed or registered person is required, upon the request of HKFE (in the case where the licensed or registered person is an exchange participant of HKFE) or the Commission, to disclose the name, beneficial identity and such other information concerning the client as the Exchange or the Commission may require and that the client agrees to provide such information concerning the client as the licensed or registered person may require in order for the licensed or registered person to comply with this requirement;

- (e) the client may have varying level and type of protection in relation to transactions on different markets and exchanges;
- (f) (if appropriate, then prominently displayed and in bold type) the licensed or registered person may, subject to the provisions of the SFO and any applicable law, take the opposite position to the client's order in relation to any exchange traded futures and options contracts, whether on the licensed or registered person's own account or for the account of its associated company or other clients of the licensed or registered person, provided that such trade is executed competitively on or through the facilities of HKFE in accordance with its rules or the facilities of any other commodity, futures or options exchange in accordance with the rules and regulations of such other exchange;
- (g) (where a licensed or registered person is an exchange participant of HKFE) the client acknowledges that the Clearing House may do all things necessary to transfer any open positions held by the licensed or registered person on the client's behalf and any money and security standing to the credit of its account with the licensed or registered person to another exchange participant of HKFE in the event the rights of the licensed or registered person as an exchange participant of HKFE are suspended or revoked;
- (h) all monies, securities and other property received by the licensed or registered person from the client or from any other person (including a clearing house) for the account of the client shall be held by the licensed or registered person as trustee and segregated from the licensed or registered person's own assets. These assets so held by the licensed or registered person shall not form part of the assets of the licensed or registered person for insolvency or winding up purposes but shall be returned to the client promptly upon the appointment of a provisional liquidator, liquidator or similar officer

over all or any part of the licensed or registered person's business or assets;

- (i) (where a licensed or registered person is an exchange participant of HKFE) any monies, approved debt securities or approved securities received by the licensed or registered person from the client or from any other person (including the Clearing House) are held in the manner specified under paragraphs 7 to 12 of this Schedule and the client authorises the licensed or registered person to apply any such monies, approved debt securities or approved securities in the manner specified under paragraphs 14 to 15. In particular, the licensed or registered person may apply such monies, approved debt securities or approved securities in or towards meeting the licensed or registered person's obligations to any party insofar as such obligations arise in connection with or incidental to F.O. Business transacted on that client's behalf;
- (j) (where a licensed or registered person is an exchange participant of HKFE) the client acknowledges that in respect of any account of the licensed or registered person maintained with the Clearing House, whether or not such account is maintained wholly or partly in respect of F.O. Business transacted on behalf of that client and whether or not monies, approved debt securities or approved securities paid or deposited by that client has been paid to or deposited with the Clearing House, as between the licensed or registered person and the Clearing House, the licensed or registered person deals as principal and accordingly no such account is impressed with any trust or other equitable interest in favour of the client and monies, approved debt securities and approved securities paid to or deposited with the Clearing House are thereby freed from the trust referred to in paragraph 2(h) of this Schedule;
- (k) (where a licensed or registered person is an exchange participant of HKFE) the period within which margin calls and demands for variation adjustments must be met, the licensed or registered person may be required to report to HKFE and the Commission particulars of all open positions in respect of which two successive margin calls and demands for variation adjustments are not met within the period specified by the licensed or registered person and the licensed or registered person may require more margin or variation adjustments than that specified by the Exchange and/or the Clearing House and may close out open positions in respect of which any margin calls and demands for variation adjustments are

not met within the period specified by the licensed or registered person or at the time of making such call(s) or demand(s);

- (l) (where a licensed or registered person is an exchange participant of HKFE) the client acknowledges that the licensed or registered person is bound by Rules of Hong Kong Futures Exchange Ltd (“HKFE Rules”) which permit HKFE to take steps to limit the positions or require the closing out of contracts on behalf of such clients who in the opinion of the Exchange are accumulating positions which are or may be detrimental to any particular Market or Markets, or which are or may be capable of adversely affecting the fair and orderly operation of any Market or Markets as the case may be; and
- (m) risk disclosure statements as specified in Schedule 1 to the Code will be attached.

Discretionary accounts

- 3. (a) In the event that the net equity in a discretionary account falls below such sum as is specified by the client in writing to the licensed or registered person from time to time or if, in any period of three or fewer consecutive trading days, it falls by more than 50 per cent from the level at which it stood at the beginning of that period, a licensed or registered person should forthwith notify the client in writing of the level of net equity and, except with the prior written consent of the client to every subsequent transaction, should not initiate any new trades in respect of that discretionary account (except in order to close out existing open positions) until such time as the net equity in the discretionary account exceeds the specified amount or (as the case may be) is restored to the level at which it stood at the beginning of the period.
 - (b) For the purpose of paragraph 3(a) of this Schedule, "net equity" at any time means the balance at that time shown in the ledger account relating to the discretionary account plus any floating profit or less any floating loss in respect of the discretionary account, and after adjusting for any levies or commission due from the client.
- 4. (a) A licensed or registered person should not:
 - (i) accept, carry or initiate on behalf of a discretionary account more than two day trades in any Market; or

(ii) open short options positions in a discretionary account,

unless it has obtained from the client on whose instructions the discretionary account was opened prior written approval specifically authorising such transactions.

(b) For the purpose of paragraph 4(a) of this Schedule, a "day trade" is a transaction whereby a licensed or registered person executes in the same day an order to buy and an order to sell Exchange Contracts on the same Market in the same futures contract month, option series, or Currency Contract Type for the same client.

Omnibus Accounts

5. A licensed or registered person which is an exchange participant of HKFE should maintain the following information of all omnibus accounts carried by it:

(a) the name of the client on whose instructions the account is operated and an indication as to whether or not it is an exchange participant of HKFE;

(b) the title of the account in the books of the licensed or registered person;

(c) the address of the client;

(d) whether the business transacted in respect of the account is HKFE Trade or Non-HKFE Trade; and

(e) whether the client is authorised under the Ordinances or the laws of its jurisdiction to operate an omnibus account and whether the client is a dealer registered under the Ordinances or under the laws of its relevant jurisdiction.

6. (a) A licensed or registered person which is an exchange participant of HKFE should ensure that a client who operates an omnibus account and who is not an exchange participant of HKFE should:

- (i) in the client's dealings with the person(s) from whom it receives instructions with respect to the omnibus account, comply with and enforce the margin and variation adjustment requirements and procedures as stipulated in the rules as though the client were an exchange participant of HKFE and as though the person(s) for whose account or benefit such instructions are given were clients;
 - (ii) cause Exchange Contracts to be entered into in fulfillment of such instructions, so that there shall in no circumstances be any dealing with the instructions in a manner which constitutes unlawful dealing in differences in market quotations of commodities under the laws of Hong Kong or any other applicable jurisdiction or in a manner which constitutes or involves betting, wagering, gaming or gambling with respect to such items in contravention of Hong Kong laws or any other applicable laws; and
 - (iii) ensure that the persons from whom the client receives instructions comply with the margin and variation adjustment requirements as stipulated in the rules, with the result that, as between HKFE and the licensed or registered person, the licensed or registered person should be responsible for ensuring that such requirements are complied with by all persons through whom instructions pass with respect to the omnibus account as if each in turn was the client for whom such omnibus account was operated.
- (b) A licensed or registered person should not operate an omnibus account unless it is able, whether by virtue of the contractual terms applying between it and its client or otherwise, to comply strictly with paragraph 6(a) of this Schedule.

Client's monies, approved debt securities and approved securities of clients

7. (a) *[Repealed]*

- (b) Every licensed or registered person which is an exchange participant of HKFE and which transacts on behalf of its clients both HKFE Trade and Non-HKFE Trade should maintain at least two segregated bank accounts and should ensure that client's money relating to HKFE Trade is paid into one segregated bank account designated as

an “HKFE Trade” account whilst client’s money relating to Non-HKFE Trade is paid into another segregated bank account designated as a “Non-HKFE Trade” account, and should procure that client’s money received and paid by the licensed or registered person in respect of HKFE Trade and Non-HKFE Trade is always kept separately and accounted for separately.

8. (a) Every licensed or registered person which is an exchange participant of HKFE and which receives from clients collateral for margin requirements in the form of approved debt securities should establish and keep with a recognized dealer registered with the Hong Kong Monetary Authority (in the case of Exchange Fund Bills or Notes) or any bank, depository or institution approved by the Clearing House from time to time (in the case of other approved debt securities) at least one debt securities account in the name of the licensed or registered person and in the title of which the word “client”, “segregated”, “Non-House” or other similar word or phrase appears and which constitutes a segregated debt securities account.
 - (b) Every licensed or registered person which is an exchange participant of HKFE and which receives from clients collateral for margin requirements in the form of approved debt securities and which transacts on behalf of clients both HKFE Trade and Non-HKFE Trade should maintain at least two segregated debt securities accounts and should ensure that clients’ approved debt securities relating to HKFE Trade are deposited into one segregated debt securities account designated as an “HKFE Trade” account whilst clients’ approved debt securities relating to Non-HKFE Trade are deposited into another segregated debt securities account designated as a “Non-HKFE Trade” account, and should procure that clients’ approved debt securities received and deposited by the licensed or registered person in respect of HKFE Trade and Non-HKFE Trade are always kept separately and accounted for separately.
9. (a) Every licensed or registered person which is an exchange participant of HKFE and which receives from clients collateral for margin requirements in the form of approved securities should establish and keep with a registered participant of the Central Clearing and Settlement System operated by Hong Kong Securities Clearing Company Limited (“HKSCC”) or any other depository, institution or clearing house approved by the Clearing House from time to time at

least one securities account in the name of the licensed or registered person and in the title of which the word “client”, “segregated”, “Non-House” or other similar word or phrase appears and which constitutes a segregated securities account.

- (b) Every licensed or registered person which is an exchange participant of HKFE and which receives from clients collateral for margin requirements in the form of approved securities and which transacts on behalf of clients both HKFE Trade and Non-HKFE Trade should maintain at least two segregated securities accounts and should ensure that clients’ approved securities relating to HKFE Trade are deposited into one segregated securities account designated as an “HKFE Trade” account whilst clients’ approved securities relating to Non-HKFE Trade are deposited into another segregated securities account designated as a “Non-HKFE Trade” account, and should procure that clients’ approved securities received and deposited by the licensed or registered person in respect of HKFE Trade and Non-HKFE Trade are always kept separately and accounted for separately.

10. (a) to (d) [*Repealed*]

- (e) Each licensed or registered person, whether an exchange participant of HKFE or not, should ensure that client’s money maintained in segregated bank accounts is at all times sufficiently liquid to satisfy readily all margin requirements or other trading related liabilities in respect of F.O. Business conducted on behalf of clients. In this connection, each licensed or registered person should ensure that prudent cash flow management procedures are employed.

11. (a) All approved debt securities received by a licensed or registered person which is an exchange participant of HKFE from a client or from any other person (including the Clearing House) for the account of the client should be held by the licensed or registered person as trustee, segregated from the licensed or registered person’s own assets and deposited into a segregated debt securities account of the licensed or registered person.

- (b) Unless clients’ approved debt securities are deposited directly into the licensed or registered person’s segregated debt securities account, every licensed or registered person which is an exchange participant

of HKFE holds or receives clients' approved debt securities should as soon as practicable and in any event within the next business day after its receipt deposit clients' approved debt securities into the licensed or registered person's segregated debt securities account.

- (c) No clients' approved debt securities may be deposited by a licensed or registered person which is an exchange participant of HKFE into any account other than a segregated debt securities account maintained by that licensed or registered person.
 - (d) No approved debt securities or other debt securities other than clients' approved debt securities may be deposited by a licensed or registered person which is an exchange participant of HKFE into a segregated debt securities account.
- 12.
- (a) All approved securities received by a licensed or registered person which is an exchange participant of HKFE from a client or from any other person (including the Clearing House and HKSCC) for the account of the client should be held by the licensed or registered person as trustee, segregated from the licensed or registered person's own assets and deposited into a segregated securities account of the licensed or registered person.
 - (b) Unless clients' approved securities are deposited directly into the licensed or registered person's segregated securities account, every licensed or registered person which is an exchange participant of HKFE holds or receives clients' approved securities should as soon as practicable and in any event within the next business day after its receipt deposit clients' approved securities into the licensed or registered person's segregated securities account.
 - (c) No clients' approved securities may be deposited by a licensed or registered person which is an exchange participant of HKFE into any account other than a segregated securities account maintained by that licensed or registered person.
 - (d) No approved securities or other securities other than clients' approved securities may be deposited by a licensed or registered person which is an exchange participant of HKFE into a segregated securities account.

13. *[Repealed]*
14. Where a licensed or registered person is an exchange participant of HKFE, there may be withdrawn from a segregated debt securities account:
- (a) approved debt securities required to meet obligations of the licensed or registered person to the Clearing House or an executing agent arising in connection with F.O. Business transacted by the licensed or registered person on the instructions of one or more clients provided that no withdrawal may be made which would have the effect that Clearing House margin, variation adjustment requirements or other trading related liabilities in respect of F.O. Business conducted on behalf of any client are thereby financed by other clients' approved debt securities;
 - (b) approved debt securities which are transferred to another segregated debt securities account; and
 - (c) approved debt securities returned to or in accordance with the directions of a client, but in such a case notwithstanding the client's directions, no approved debt securities may be deposited into another account of the licensed or registered person unless that account is a segregated debt securities account.
15. Subject to a licensed or registered person which is an exchange participant of HKFE having obtained from its clients specific written authority and such other consent(s) as may be required under applicable laws, rules and regulations, the following may be withdrawn from a segregated securities account:
- (a) approved securities required to meet the obligations of the licensed or registered person to the Clearing House or an executing agent arising in connection with F.O. Business transacted by the licensed or registered person on the instructions of one or more clients provided that no withdrawal may be made which would have the effect that Clearing House margin, variation adjustment requirements or other trading related liabilities in respect of F.O. Business conducted on behalf of any client are thereby financed by other clients' approved securities;

- (b) approved securities which are transferred to another segregated securities account; and
- (c) approved securities returned to or in accordance with the directions of a client, but in such a case notwithstanding the client's directions, no approved securities may be deposited into another account of the licensed or registered person unless that account is a segregated securities account.

No set-off between licensed or registered person's accounts and client's accounts

16. (a) No licensed or registered person should apply, permit or suffer any monies, securities or any other forms of collateral standing to the credit of any client's ledger account to be applied for the benefit of its own trading accounts, accounts of its directors or employees or for the benefit of trading accounts of any other clients.
- (b) No licensed or registered person should apply, permit or suffer any monies, securities or any other forms of collateral received from clients to be applied against debts of its own trading account or accounts of its directors or employees.

Client's ledgers

17. Every licensed or registered person which is an exchange participant of HKFE should maintain in its books and records separate ledger accounts for every client in respect of:
- (a) all HKFE Trade;
 - (b) all Non-HKFE Trade;
 - (c) all trade which is neither HKFE Trade nor Non-HKFE Trade and is consequently not F.O. Business, of that client.
18. (a) Every licensed or registered person which is an exchange participant of HKFE and which receives from clients collateral for margin requirements in the form of approved debt securities or approved securities (or which arranges for approved debt securities or approved securities of clients to be deposited directly with the Clearing House) should maintain proper books and records which

correctly and clearly record, inter alia, the following details of all approved debt securities and approved securities received from each client:

- (i) a complete description of each type of approved debt securities and approved securities; and
 - (ii) the quantity and face value of approved debt securities and approved securities deposited with or withdrawn from the Clearing House or each depository, institution or other clearing house with which the segregated debt securities account or segregated securities account is maintained and the date of any such deposit or withdrawal.
- (b) Every licensed or registered person which is an exchange participant of HKFE should ensure that all regular statements of account to clients contain the details listed in subparagraph (a) above.
19. Every licensed or registered person which is an exchange participant of HKFE should segregate its clients' HKFE Trade ledger accounts and Non-HKFE Trade ledger accounts and any other ledger accounts so that, except by actual cash payments or approved debt securities transfers, credit balances on any given type of trade account may not be used to offset debit balances, or to meet margin requirements or demands for variation adjustment on any other type of trade account.

Other requirements

20. A licensed or registered person which is an exchange participant of HKFE should also comply with the following rules (including the rules, regulations, guidelines, procedures and circulars of HKFE updated from time to time) of HKFE where applicable:
- (a) Circular dated 31/7/1998 (Ref. No. CIR/LEGAL/980274) on disclaimer and Circular dated 8/5/1998 (Ref. No. CIR/LEGAL/980141) on HKFE disclaimer;
 - (b) HKFE Rule 617 on minimum margin requirements, including Circular dated 7/12/1993 (Ref. No. MEM/CIR/9312050/017) on the requirements governing omnibus accounts; Circular dated

27/8/1998 (Ref. No. CIR/CMP/980310) on day trade margin requirements; and Circular dated 3/3/1997 (Ref. No. AUD/9703001) on Guidelines on Margin Procedures;

- (c) Circular dated 30/1/1997 (Ref. No. CMP/CIR/9701010) and 13/6/1997 (Ref. No. MEM/CIR/9706036) on large open position (reporting) procedures (including HSI Futures, HSI Options and NYMEX contracts), including prescribed forms, and Circular dated 14/7/1999 (Ref. No. CIR/CMP/990271) on delta position limits; and
- (d) Circular dated 10/3/1995 (Ref. No. MEM/CIR/9503029/023) on stock futures (client margining, large open positions and position limits, client account documentation and general).

SCHEDULE 5 ADDITIONAL REQUIREMENTS FOR LICENSED PERSONS PROVIDING MARGIN LENDING

General

1. The provisions in this Schedule apply to persons licensed for :
 - (a) Type 8 regulated activity, namely securities margin financing; and
 - (b) Type 1 regulated activity, namely dealing in securities, that provide financial accommodation to any of their clients in order to facilitate acquisitions or holdings of listed securities by the persons for their clients,except as otherwise specified.

Margin Lending policy

2. A licensed person should have a prudent margin lending and margin call policy set out in writing and properly communicated to its staff.
3. A licensed person should assure itself that the margin client has the financial capacity to meet obligations arising from instructions the margin client gives and in the absence of such assurance, it shall not accept instructions from such margin client.

Differentiation between cash and margin accounts

4. Where a client operates both a cash and a margin account, the licensed person should have adequate systems and resources to ensure that transactions and assets booked under one account are not commingled with those booked under the other.

Prudent bank borrowing

5. To avoid potential over-borrowing, a licensed person should ensure that the aggregate of all outstanding bank borrowings, overdrafts, advances etc. secured by the pledging or deposit of securities collateral belonging to margin clients remains prudent when compared to the aggregate of all

outstanding margin loans made to margin clients. As a general guide, the amount of such bank borrowings, overdrafts and advances should not exceed 120% of the value of outstanding margin loans.

Client agreement

6. A licensed person should ensure that a written Margin Client Agreement is entered into with a client before margin lending is provided to that client. The Margin Client Agreement shall specify that the account is a “margin account”.
7. In the case of a person licensed for Type 8 regulated activity, the Margin Client Agreement should, in addition to the requirements set out in paragraph 6 of the Code, contain a statement that:
 - (a) the licensed person is subject to the sole business requirement and it can only provide financial accommodation to facilitate the acquisition of listed securities and, where applicable, for the continued holding of those securities. The client will not be able to withdraw funds under the facility unless they are for such purposes; and
 - (b) the licensed person cannot effect dealing in securities for or on behalf of clients, except for the liquidation of their securities collateral in order to collect margin calls or outstanding debts.

Information for clients

8. A licensed person should clearly inform margin clients in writing of its margin lending and margin call policy as it affects them.
9. *[Repealed]*

Internal controls

10. A licensed person should, where possible, assign the responsibility for margin lending to a senior officer or committee that is independent of the sales or trading function. A clear margin lending policy should be developed, documented and communicated to all relevant staff for strict

enforcement. Such policy should include at least the following objectives:

- (a) to provide a basis for protecting the capital of the licensed person;
- (b) to ensure adequate procedures are in place for identification of risks, effective monitoring and corrective action; and
- (c) to ensure there is a consistent risk management policy.

11. In particular, this policy should:

- (a) ensure exposure to individual margin clients or “groups of related margin clients” (as defined in the Securities and Futures (Financial Resources) Rules) (“FRR”) is adequately secured;
- (b) avoid building up excessive exposure to individual margin clients or groups of related margin clients; and
- (c) avoid building up excessive exposure to individual item of securities deposited as collateral.

12. The margin lending policy framework should address, among other things, the following:

- (a) the form of objective proof of net income or net worth such as: tax returns, salaries advice and bank statements. This should be used as a reference for setting credit limits and should be subject to strict enforcement and regular review;
- (b) the list of securities acceptable as collateral, and the different haircuts applicable to collateral, bearing in mind their liquidity and volatility in prevailing market conditions;
- (c) the procedures to identify groups of related margin clients;
- (d) the monitoring of changes in concentrated collateral positions, and consider the need to amend the list of securities acceptable as collateral for additional advances;
- (e) the monitoring of changes in concentrated securities margin loans and consider whether additional advances would be prudent where there is such concentration;

- (f) the triggering level for making the first and successive margin calls, including intra-day calls;
- (g) the giving of warnings to clients with outstanding margin calls specifying the steps the firm plans to take and when;
- (h) the maintenance of appropriate detailed records to ensure that the case history of margin calls for each individual client can be readily established;
- (i) the triggering level for stopping further advances to clients, for example where there are outstanding margin calls yet to be met;
- (j) the triggering level for forced liquidation of a client's collateral;
- (k) a procedure in the case of a forced liquidation of a client's collateral to ensure the best available terms to the client and reduction of the firm's exposure to that client to an acceptable level;
- (l) the circumstances in which deviation from the policy, supported by written explanations, may be approved by management, specifying the limits applicable to each level of the management; and where such deviation has an adverse effect on the firm's liquid capital position, the steps taken to ensure that the firm will not, as a result, be in breach of the FRR; and
- (m) the management reports (especially exception reports) necessary to ensure efficient monitoring over margin lending on an ongoing basis, readily showing
 - (i) outstanding margin loan balance per account;
 - (ii) margin call status of each margin client;
 - (iii) analysis of collateral received;
 - (iv) margin ratios for different collateral items; and
 - (v) concentration of exposure to securities collateral or clients.

13. In the case of a person licensed for Type 8 regulated activity, the licensed person should make appropriate enquiries of a margin client when that margin client wishes to draw against the client's account. Generally, any advance in excess of the realisable value of the securities collateral would indicate lending outside the scope of providing financial accommodation for facilitating the acquisition or any continued holding of listed securities.

SCHEDULE 6 ADDITIONAL REQUIREMENTS FOR LICENSED PERSONS ENGAGING IN LEVERAGED FOREIGN EXCHANGE TRADING

The provisions in this Schedule apply to the carrying on of Type 3 regulated activity, namely leveraged foreign exchange trading, by persons licensed to conduct such activity.

PART I GENERAL CONDUCT OF BUSINESS REQUIREMENTS

Client Agreement

1. Without prejudice to paragraphs 6.1 to 6.3 of the Code, before entering into a leveraged foreign exchange contract (“contract”) with or on behalf of a client, the licensed person should ensure that the Client Agreement contains at least the followings-
 - (a) a statement by the client-
 - (i) that the client is trading on his own behalf; or
 - (ii) if the client is not trading on his own behalf, of the name of the ultimate beneficiary on whose behalf the client is trading;
 - (b) a statement by the client as to whether he is to operate his account by giving orders himself or by appointing another person to give orders on his behalf, and in the latter case, the name and address of the person appointed, to be accompanied by an appointment in writing;
 - (c) a statement by the licensed person that none of its employees or representatives should accept appointment by the client as agent to operate the client's account for the purposes of paragraph (b) unless a separate agreement is entered into in accordance with paragraph 6 of this Schedule;
 - (d) a statement by the licensed person as to whether it may take the opposite position to a client's order;

- (e) a statement as to whether or not any employee or representative of the licensed person may be allowed to trade contracts on his own account pursuant to the policy established under paragraph 12.2(a) of the Code;
- (f) a statement that all telephone conversations between the licensed person and the client made in the course of business will be recorded on a centralized tape recording system operated by the licensed person;
- (g) specification of all services and contracts which the licensed person may provide to, transact with, or undertake on behalf of, the client and of all terms and conditions attached to those services and to the trading of contracts;
- (h) where the terms of its licence so requires, a statement that in relation to any dispute between the licensed person and the client, the licensed person should, if the client so requires, agree to refer the dispute to arbitration in accordance with the Securities and Futures (Leveraged Foreign Exchange Trading - Arbitration) Rules;
- (i) details of margin requirements and the time within which any initial margin or other margin deposits must be paid;
- (j) the circumstances in which contracts transacted with or undertaken on behalf of the client may be closed out without the client's consent;
- (k) a description of the methods or procedures adopted by the licensed person in choosing the prices or interest rates for the purposes of marking to market the client's open positions and in calculating the client's interest income and expenses;
- (l) a statement that the client may be affected by any curtailment of, or restriction on, the capacity of the licensed person to trade in respect of open positions as a result of action taken by the Commission under applicable rules and regulations or for any other reason, and that in such circumstances, the client may be required to reduce or close out his open positions with the licensed person; and

- (m) a statement to the effect that the Client Agreement and all rights, obligations and liabilities under it should be governed by and construed in accordance with the laws of the Hong Kong SAR.

Statement of client information

2. A licensed person should obtain from each of its clients a written statement which contains the following information about that client-
 - (a) the name, address, telephone number and facsimile number, if any, of the client;
 - (b)
 - (i) in the case of an individual, details of that individual's Hong Kong identity card or, if the client is not the holder of an identity card, details of his passport, travel or other document issued by a competent government agency providing proof of identity;
 - (ii) in the case of a corporation, details of its certificate of incorporation or similar document issued by the relevant authority of the country of incorporation;
 - (iii) in the case of a partnership, details of its business registration certificate or similar document issued by the relevant authority of the country where the partnership was formed or, where not available, the partnership agreement or other document constituting the partnership;
 - (c)
 - (i) in the case of an individual, his occupation, position and years spent in that occupation;
 - (ii) in the case of a corporation, the type of business and the number of years in the business;
 - (iii) in the case of a partnership, the type of business and the number of years in that business;
 - (d) details of the financial position of the client; and
 - (e) details of the client's investment objectives and strategy.
3. Where a client has appointed another person to trade on his behalf, the licensed person should obtain the information required in paragraph 2(a),

(b) and (c) above in relation to that person and a statement of his relationship with the client.

4. A licensed person should obtain from each of its clients, and from any person who is authorized by the client to trade on his behalf, a written declaration to the effect that-
 - (a) the statement provided under paragraph 2 above is true, complete and correct; and
 - (b) the client and the authorized person will notify the licensed person of any material changes to that information.
5. A client who is a sole proprietor should, notwithstanding that he is trading in the name of his firm, be deemed to be trading as an individual for the purposes of paragraphs 2 to 4 of this Schedule.

Discretionary accounts

6. A licensed person who wishes to offer discretionary account services to its clients should enter into a separate written discretionary account agreement (Discretionary Account Agreement) with the client which, together with the Client Agreement required by paragraph 6.1 of the Code, will govern the relationship between the licensed person and the client.
7. A licensed person should, before entering into any contract with or on behalf of a client under a discretionary account-
 - (a) inform the client that a Discretionary Account Agreement is required to be entered into between them in writing in either English or Chinese;
 - (b) explain to the client the contents of the Discretionary Account Agreement; and
 - (c) enter into a Discretionary Account Agreement with the client.

8. The Discretionary Account Agreement should include-
- (a) a description by the licensed person as to the way in which the discretionary account will be managed by it, including information required pursuant to paragraph 10 of this Schedule;
 - (b) a statement that the client appoints the licensed person to manage his account;
 - (c) a statement by the licensed person of-
 - (i) the name of the representative managing the account;
 - (ii) the name of the supervisor of that representative; and
 - (iii) whether that representative is permitted to trade for his own account pursuant to the policy established under paragraph 12.2(a) of the Code;
 - (d) details of the terms and conditions specified by the client for management of the account, which should include-
 - (i) the amount deposited by the client;
 - (ii) the terms and conditions of any stop-loss or stop-limit order by the client; and
 - (iii) any specifications imposed by the client concerning his investment objectives and strategy including the size of transactions, frequency of trading and the currencies to be traded in;
 - (e) details of all charges, commission, brokerage or remuneration payable by the client in addition to the charges, commission, brokerage or remuneration payable under the Client Agreement;
 - (f) a statement that any modifications to the Discretionary Account Agreement must be in writing and accepted by both parties in writing except for the terms and conditions specified in paragraph (d), which may be amended unilaterally at any time by the client;
 - (g) a statement that either party may suspend or terminate the Discretionary Account Agreement at any time by giving notice of suspension or termination to the other by telephone or in writing, such suspension or termination to take effect upon receipt of the notice;

- (h) a statement by the client that he understands that he is not obliged to enter into a Discretionary Account Agreement before he can retain other non-discretionary services of the licensed person, that he understands the contents of the Discretionary Account Agreement and that he accepts the terms and conditions contained therein;
 - (i) the risk disclosure statement prescribed by Schedule 1 to the Code; and
 - (j) an explanation of the additional risks of giving discretionary powers to a licensed person to manage an account on his behalf, including the total dependence by the client on the integrity and skill of the licensed person and the inherent risk of conflict of interest in that a licensed person may take the opposite position to a client's order while acting for the client.
9. A licensed person should not accept or carry a discretionary account unless it-
- (a) has obtained, in addition to a duly signed Discretionary Account Agreement under paragraph 6 of this Schedule, a signed copy of a power of attorney or other document by which trading authority is given or restricted; and
 - (b) has designated such an account in its books and records as a discretionary account.
10. A licensed person should comply with the following procedures in managing a discretionary account-
- (a) whenever the net equity in a discretionary account falls during any one calendar month by more than 30% from the level at which it stood at the beginning of that month, the licensed person-
 - (i) should immediately notify the client of the level of net equity, the amount of trading loss and the amount of income generated to the licensed person from the account during that month;
 - (ii) should not, except in order to close out existing open positions, initiate any new contracts in respect of the discretionary account unless the client consents and subject to such conditions as may be imposed by the client;

- (b) in the case of any discretionary account to which paragraph (a)(ii) applies-
 - (i) the licensed person should assign a member of its senior management to review and approve every contract executed for the discretionary account before the consent of the client has been received; and
 - (ii) where the consent of the client to continue trading is duly given, the licensed person should continue to comply with the requirements of paragraph (a), by using the net equity standing at the beginning of the day on which his consent is given as a new starting point.
- 11. For the purposes of paragraph 10 of this Schedule, the net equity standing at the beginning of any calendar month should be treated as including any cash deposits made to, and as excluding any cash withdrawal made from, the account by the client during that month.
- 12. For the purposes of paragraphs 6 to 15 of this Schedule, the consent of the client is duly given only if it is given in writing or is recorded on the centralized tape recording system of the licensed person.
- 13. A licensed person should not maintain a trading position for a client where the client holds an equal outstanding long and short position of the same foreign currency at the same time, unless such position is specifically requested by the client in each instance.
- 14. All attempts to telephone the client should be recorded on the centralized tape recording system.
- 15. Each discretionary account should be reviewed by a member of the senior management of the licensed person at least once every 3 business days to ensure that it is being operated in conformity with the specific instructions of the client, if any, the Client Agreement, the Discretionary Account Agreement and relevant requirements governing discretionary accounts.

Client orders

- 16. Without prejudice to paragraph 3.9 of the Code, a licensed person should-

- (a) ensure that all telephone orders from a client are recorded on the centralized tape recording system operated by it; and
 - (b) record in writing each order, whether made by telephone or otherwise, immediately after it is received.
17. The record required to be made under paragraph 16 of this Schedule should include-
- (a) the name of the client and, if applicable, the person who is authorized by the client to give the order and the account number of the client;
 - (b) the time and date at which the order was received;
 - (c) the method by which the order was given;
 - (d) the type, price and quantity of the contracts ordered;
 - (e) the name of the representative or employee of the licensed person who received the order; and
 - (f) detailed particulars of the instructions in respect of the order.
18. A licensed person should confirm the details of each order executed as soon as possible with that client or his agent, as the case may be, through a telephone connected to the centralized tape recording system.
19. Where the voice of a client cannot be recorded on the centralized tape recording system for any reason, the licensed person should-
- (a) in the absence of any written instructions given by the client in respect of the order, require the client to sign an order form; and
 - (b) confirm details of the contract with the client once an order has been executed.
20. Where a licensed person does not have the client's confirmation on tape or on an order form as required by paragraph 19(a) above and the client disputes the order within 10 business days of its execution, it should be voidable at the option of the client.
21. Where a client gives any instructions involving closing positions or closing an entire account, a licensed person should ensure that all necessary contracts that may be required in order to implement those instructions are executed promptly and that the price and terms and

conditions of such contracts do not differ in any material respect from contracts entered into with or on behalf of other clients.

Payment to clients

22. A licensed person should ensure that any instructions given by a client relating to payment to the client of any net equity, floating profit or margin excess are complied with within 1 business day.

Client's margin

23. A licensed person should set the initial margin and maintenance margin level for its clients at not less than 5% and 3% respectively of the gross principal value of the contract offered by the licensed person. For cross currency trades and locked positions (i.e. situation where a client simultaneously holds an equal long and short position of the same currency), only one set of margin is required.
24. Except as provided in paragraph 25 of this Schedule, no licensed person should execute any contract for a client until and unless the licensed person has received from the client a margin deposit adequate to cover the initial margin required.
25. A licensed person may execute a contract for a client, other than a discretionary account client, without first having received the initial margin from that client if it is reasonably satisfied that, given the investment objectives, investment strategy and financial position of that client, the full amount of the initial margin will be deposited by the client within the next business day or such shorter period as may be specified by the licensed person.
26. Paragraph 25 above does not apply to a client-
 - (a) who has never entered into a contract through or with the licensed person;
 - (b) who has never paid, or been asked to pay, any initial margin to the licensed person; or
 - (c) who has failed to satisfy the initial margin requirement as specified in paragraph 25 above on at least 2 occasions during the period of 1 year immediately preceding the transaction for which the deferral of the deposit of initial margin is requested by the client.

27. For the purposes of calculating the amount of any margin deposit required, the basis and method of valuation applicable to margins as provided in section 41 of the Securities and Futures (Financial Resources) Rules should be adopted.

No credit on margin

28. Except as expressly provided in paragraph 25 of this Schedule, a licensed person should not extend any credit or give any rebate of any kind to a client which has the effect of circumventing or evading the margin requirements specified herein.

Restricted use of margin collateral

29. A licensed person should ensure that margin deposits and other assets of its clients and recognized counterparties are properly safeguarded and are held separately from the assets of the licensed person.

Personal trading by staff

30. No representative or employee of a licensed person should be a client of another licensed person for trading in leveraged foreign exchange contracts.
31. A licensed person must make reasonable enquiries to ensure that none of its representatives or employees contravenes paragraph 30 above.
32. Without prejudice to paragraph 30 of this Schedule and paragraph 12.2 of the Code, a licensed person who permits its representatives or employees to trade for their own account in leveraged foreign exchange contracts should ensure that contracts undertaken for the account of a representative or employee must be reported to and reviewed on a daily basis by senior management of the licensed person.

Advertisements

33. Without prejudice to paragraph 2.3 of the Code, where a licensed person issues an advertisement in relation to its business, it should ensure that the advertisement contains a risk disclosure statement as prescribed by Schedule 1 to the Code.
34. Any material issued by the licensed person which is intended to promote, or which has the effect of promoting, interest in the business of the

licensed person should be deemed to be an advertisement for the purposes of paragraph 33 above.

Taping

35. Without prejudice to paragraph 3.9 of the Code, a licensed person should install at its place of business a centralized tape recording system to record all telephone conversations conducted by it or its representatives with prospective clients, clients and recognized counterparties.
36. All telephone lines used by employees or representatives of the licensed person responsible for making calls, confirming orders, executing contracts, transferring funds, or carrying out instructions incidental thereto, should be routed through the centralized tape recording system.
37. Tapes from the centralized tape recording system should be kept for at least 3 months.
38. A licensed person should ensure that access to tapes of the centralized tape recording system, whether in use or in storage, is strictly controlled.
39. A licensed person should-
 - (a) use its best endeavours to ensure that the centralized tape recording system functions properly at all times; and
 - (b) carry out random checks at intervals of not less than once every week to ensure that all applicable laws, rules and regulations have been complied with.

Trading practices

40. A licensed person should-
 - (a) disclose its trading hours to its clients, specifying the beginning and ending hours of a business day; and
 - (b) display at each of its places of business a prominent notice which shows the information specified in paragraph (a).
41. A licensed person should quote both the bid and offer prices at the request of a client.

42. A licensed person should not quote a price for a contract without specifying whether the price is, for a given quantity of contracts, a firm one or merely indicative.
43. A licensed person quoting a price for a contract to any person should inform that person that the price given by it is available only for a limited period of time and, where practicable, specify the time period in question.
44. A licensed person quoting a firm price should trade at that price.
45. All contracts should be recorded in trading slips which are time stamped.

Record of client's complaints

46. Without prejudice to paragraph 12.3 of the Code, a licensed person should-
 - (a) maintain a written record of any complaints from clients; and
 - (b) establish and implement proper procedures for handling and investigating such complaints.
47. A licensed person should ensure that client complaints are dealt with promptly and remedial action is taken as soon as possible.
48. A licensed person should inform a client of the results of any complaints made by him as soon as practicable and in any event within 3 business days of determining the results of that complaint.

PART II SPECIFIC GUIDELINES

Client relations

49. Client orders

A licensed person should ensure that it has adequately considered the client's investment objectives, investment strategy and financial position when making recommendations to a client.

50. Trading limits of clients

- (a) A licensed person should set limits on the size of the positions which each client may establish in the light of the financial position and investment objectives, and strategy of the client.
- (b) The limits set under paragraph (a) and any changes thereafter should be notified forthwith to the client in writing.

51. Adequate communication

A licensed person should ensure that there are adequate lines of communication with clients.

52. Confidentiality

A licensed person should maintain confidentiality in respect of information relating to their clients. Except as required by law, a licensed person should not disclose to a third party any information relating to their clients without their explicit permission.

53. Cessation

Where a licensed person decides to withdraw from providing services to its clients, it should notify the clients concerned and the Commission immediately. It should take reasonable steps to protect its clients' outstanding positions.

Trading procedures

54. Quotation

Prices quoted and interest rates applied by a licensed person should be fair and reasonable having regard to all relevant circumstances.

55. Concluding a trade

Oral agreements are considered binding, and subsequent written confirmation is regarded as evidence of the trade and should not override terms agreed orally.

Staff Trading and other activities

56. Trading limits of staff

Where representatives or employees of a licensed person are allowed to trade, the licensed person should apply the same procedures, specified in paragraph 50 of this Schedule, in respect of any trading by its staff as are applied to other persons.

57. Staff trading not to be prejudicial to the interest of clients

A licensed person should maintain and enforce proper and effective procedures to ensure that trading by its representatives and employees for their own account, if permitted under the policy on trading by staff of a licensed person as disclosed in the Client Agreement, are not prejudicial to the interests of clients of the licensed person.

58. Outside business activities

A licensed person should formulate policies on whether its employees and representatives are allowed to engage in outside employment or business activities, and ensure that if such activities are allowed, they do not compromise the position of the employees or representatives concerned, or that of the licensed person or its clients.

Management control

59. Supervision

A licensed person should take all reasonable steps to ensure that:-

- (a) its representatives and employees are suitably qualified and properly trained to a level commensurate with their responsibilities; and
- (b) its representatives and employees are aware of their responsibility to act professionally at all times.

60. Internal management system

- (a) A licensed person should have an appropriate internal management system which can capture, monitor and control risks in relation to the business and which can reasonably be expected to protect its

business from financial loss arising from theft, fraud and other dishonest acts or omissions.

- (b) A licensed person should formulate operating procedures for the business, including contingency plans to cater for disasters and emergencies, in a comprehensive operations manual and should regularly conduct reviews of such operating procedures based on it.

61. Responsibility for trading activities

A licensed person should clearly set out in writing the policies and practices which trading and support staff should follow. These should include-

- (a) general trading policy including reporting procedures;
- (b) persons authorized to trade;
- (c) instruments and contracts to be dealt in;
- (d) limits on open positions, mismatch positions, recognized counterparties, stop-loss limits;
- (e) confirmation and settlement procedures;
- (f) trading relationships with banks, brokers, clients or other licensed persons; and
- (g) other relevant guidance as considered appropriate.

62. Position limits

A licensed person should establish a comprehensive framework of limits to control the overall foreign exchange exposure of the business. These should include limits on gross and net open positions in individual currencies and on the aggregate of all currencies, both during the day and overnight, with clients and recognized counterparties.

63. Trading and back office monitoring

A licensed person should ensure that-

- (a) senior managerial staff are located in the trading room to ensure the efficient and proper functioning of the trading room;
- (b) access to the trading room is restricted to authorized personnel only;

- (c) all open positions of the licensed person, of all clients and of all recognized counterparties are monitored and revalued continuously;
- (d) daily reports comparing actual positions against internal limits are routinely prepared for, and reviewed by, its management, and that excesses and irregularities are promptly reported to senior management;
- (e) trades are processed promptly; and
- (f) all positions generated by the trading room are regularly reconciled with back office records.

64. Internal audit

Each licensed person should have staff performing internal audit functions, including periodic review of the systems and procedures in place to ensure-

- (a) accuracy and completeness of recording of all trading transactions;
- (b) effective segregation of duties between trading, settlement and accounting staff; and
- (c) effectiveness and accuracy of reporting of excesses, irregularities and potential exposures.

Market integrity

65. Market terminology

A licensed person should ensure that when its representatives communicate with its clients and prospective clients-

- (a) the terminology used is clear and unambiguous; and
- (b) any explanation given is understood by the clients or prospective clients.