



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

Consultation Conclusions on the 2017 Further Consultation on Proposed Changes to the Securities and Futures (Financial Resources) Rules

Consultation on draft FRR amendments, Guidelines for Internal Models Approach for FRR Market Risk Charges Calculation and General Principles for Model Risk Management

14 July 2025

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Foreword

(a) This paper

summarizes the SFC's responses to the comments received on a consultation conducted in 2017¹ on some modifications of a consulted framework² of capital requirements for licensed corporations (**LCs**) engaging in OTC derivative activities (**2017 Concluded Framework**); and

(b) consults the public on the following:

- some minor finetuning of the 2017 Concluded Framework;
- additional proposals for market development purposes;
- a set of draft amendments of the Securities and Futures (Financial Resources) Rules (**FRR**) for implementing the 2017 Concluded Framework and additional proposals;
- a draft *Guidelines for Internal Models Approach for FRR Market Risk Charges Calculation* (**IMA Guidelines**); and
- a draft *General Principles for Model Risk Management* (**MRM Principles**).

Since the volume of the draft FRR amendments is significant, the Chinese version of the draft FRR amendments will take time to prepare. We started this round of consultation with the English draft first to give the industry an early opportunity to consider the amendments. The Chinese draft FRR amendments will be consulted on separately once available.

Interested parties are invited to submit written comments on the additional proposals, draft FRR amendments, draft IMA Guidelines and draft MRM Principles by one of the following methods on or before 13 October 2025.

- By mail to:
Intermediaries Division
Securities and Futures Commission
54/F, One Island East
18 Westlands Road, Quarry Bay, Hong Kong
Attn: Coolky Sit, Intermediaries Division
- By fax to: (852) 2523 4598
- By online submission: www.sfc.hk/edistributionWeb/gateway/EN/consultation/
- By email to: frr_consultation@sfc.hk

¹ The modifications were proposed in the *Consultation Conclusions and Further Consultation on Proposed Changes to the Securities and Futures (Financial Resources) Rules* published by the SFC on 24 July 2017 (**2017 Consultation Conclusions and Further Consultation Paper**).

² The OTCD capital framework was proposed in 2015 under the *Consultation Paper on Proposed Changes to the Securities and Futures (Financial Resources) Rules* published by the SFC on 17 July 2015 (**2015 Consultation Paper**) and concluded to be appropriate in the 2017 Consultation Conclusions and Further Consultation Paper.



Please provide the name of the organization (if any) the respondent is representing in the submission.

Please note that the names of respondents and the contents of their submissions may be published, in whole or in part, on the SFC's website and in other documents published by the SFC. In this connection, please read the Personal Information Collection Statement attached to this paper.

If any respondent does not wish his/her name or submission to be published by the SFC, please state so in the submission.

Abbreviations, acronyms and glossaries

2015 Consultation Paper	<i>Consultation Paper on Proposed Changes to the Securities and Futures (Financial Resources) Rules</i> , published by the SFC on 17 July 2015
2017 Consultation Conclusions and Further Consultation Paper	<i>Consultation Conclusions and Further Consultation on Proposed Changes to the Securities and Futures (Financial Resources) Rules</i> , published by the SFC on 24 July 2017
ATS	Automated trading services
Basel II	<i>International Convergence of Capital Measurement and Capital Standards, A Revised Framework Comprehensive Version</i> , published by BCBS in June 2006
Basel 2.5	The market risk framework set out in Section VI (Market Risk) of Part 2 in Basel II as amended by <i>Revisions to the Basel II market risk framework, July 2009</i> and <i>Revisions to the Basel II market risk framework - updated as of 31 December 2010</i> , published by BCBS in July 2009 and February 2011 respectively
Basel III reform package	<p>The following standards that have been incorporated into the Basel Framework:</p> <ul style="list-style-type: none"> - <i>Basel III: A global regulatory framework for more resilient banks and banking systems, December 2010 (rev June 2011)</i>, published by BCBS in June 2011; - <i>The standardized approach for measuring counterparty credit risk exposures, March 2014 (rev. April 2014)</i>, published by BCBS in April 2014; - <i>Basel III: Finalising post-crisis reforms, December 2017</i>, published by BCBS in December 2017; - <i>Minimum capital requirements for market risk, January 2019 (rev. February 2019)</i>, published by BCBS in February 2019; and - <i>Targeted revisions to the credit valuation adjustment risk framework, July 2020</i>, published by BCBS in July 2020
Basel Framework	The document named <i>The Basel Framework</i> posted on BCBS's website, which consolidates all banking supervision and capital standards
BCBS	Basel Committee on Banking Supervision
BMRA	Basic Market Risk Approach
BOCCRA	Basic OTCD Counterparty Credit Risk Approach
CCP	Central counterparty
CFTC	Commodity Futures Trading Commission

CVA	Credit valuation adjustment
ES	Expected shortfall
EU	European Union
FRR	Securities and Futures (Financial Resources) Rules
HKMA	Hong Kong Monetary Authority
IMA Guidelines	Guidelines for Internal Models Approach for FRR Market Risk Charges Calculation
IMM	Internal Models Method for counterparty credit risk calculation
IOSCO	International Organization of Securities Commissions
IRC	Incremental risk charge
LC	Licensed corporation
MRM Principles	General Principles for Model Risk Management
OTC	Over-the-counter
OTCD	Over-the-counter derivatives
PLA	Profit and loss attribution
PSE	Public sector entity
Repo	Repurchase transaction
RNIM	Risks-not-in-IMA model
RLC	Required liquid capital, as defined in section 2(1) of the FRR
SA-CCR	The Standardized Approach to Counterparty Credit Risk introduced by <i>The standardized approach for measuring counterparty credit risk exposures, March 2014 (rev. April 2014)</i> published by BCBS in April 2014
SA-CR	The new standardized approach for credit risk weighting introduced by <i>Basel III: Finalising post-crisis reforms, December 2017</i> published by BCBS in December 2017
SEC	Securities and Exchange Commission
SFC	Securities and Futures Commission
SFO	Securities and Futures Ordinance
SMRA	Standardized Market Risk Approach

SOC CRA	Standardized OTCD Counterparty Credit Risk Approach
VA	Virtual asset
VaR	Value-at-risk

I. Executive Summary

1. In 2017, we issued the 2017 Consultation Conclusions and Further Consultation Paper to conclude on a proposed capital framework for LCs engaging in OTCD activities³. In that paper we concluded that the proposed framework (**2017 Concluded Framework**) was appropriate given the respondents' support for the proposed framework. We also further proposed certain modifications to the framework and other changes to the FRR. A total of ten submissions in response to those further changes were received⁴. Key comments received and our responses are discussed in Parts III to VII of this paper⁵.
2. The key components of 2017 Concluded Framework include
 - (a) a set of minimum capital requirements for LCs engaging in OTCD activities, which has the following key features:
 - (i) the requirements were benchmarked to similar capital requirements proposed by the US SEC and CFTC for similar activities or adopted by OTCD CCPs for clearing participants; and
 - (ii) the requirements vary with the level of risk and activities of the LC;
 - (b) a set of **basic** market risk and counterparty credit risk capital requirements, which has the following key features:
 - (i) the requirements involve simple calculations;
 - (ii) the requirements are intended for use by LCs engaging in OTCD activities not as a regulated activity and LCs engaging in OTCD activities as a regulated activity but subject to certain restrictions; and
 - (iii) LCs may switch to the standardized approaches if they fulfil certain conditions;
 - (c) a set of **standardized** market risk and counterparty credit risk capital requirements, which has the following key features:
 - (i) the requirements were mainly benchmarked to Basel II's standardized market risk approach, current exposure method for counterparty credit risk, and the CVA risk approach applied at the early stage of the Basel III reform package;
 - (ii) the requirements are intended for use by LCs engaging in OTCD activities as a regulated activity (except where the activities are subject to certain restrictions);
 - (iii) LC may switch to the basic approaches if they fulfil certain conditions; and

³ The framework was consulted in 2015. For details, please refer to the 2015 Consultation Paper.

⁴ Four respondents requested that both their names and submissions or just their names be withheld from publication. A list of the respondents (other than those who requested anonymity) is set out in Appendix 1.

⁵ The full texts of the comments received, other than those from respondents who requested that their submissions not be published, can be viewed on the SFC's website at www.sfc.hk.

- (d) an advanced approach that permits LCs to use internal models or the latest Basel capital standards in their calculation of market risk or counterparty credit risk capital requirements with SFC approval.

International development and finetuning of 2017 Concluded Framework

3. Subsequent to the 2017 consultation, there have been major developments in the regulation of OTCD activities in the US and in Basel capital standards:
 - (a) the US SEC and CFTC had implemented their capital requirements for OTCD dealers in 2021;
 - (b) the BCBS had finalized the Basel III reform package⁶ that replaced Basel II and the new standards have been consolidated into one single document, namely, the Basel Framework. Most of the new standards took effect in 2023.
4. Certain key changes in the Basel Framework are relevant to the 2017 Concluded Framework, including its new approaches⁷ to calculating capital requirements for market risk and counterparty credit risk. It also replaced the CVA risk approach applied at the early stage of the Basel III reform package with new approaches. Certain aspects of the credit risk weighting approach for calculating counterparty credit risk capital requirements have also been updated.
5. Although most of these new approaches apply sophisticated and complex calculation methods, the Basel Framework provides the following simpler calculation approaches for banks with less exposures:
 - (a) a simplified market risk approach⁸, which is a slightly modified version of the Basel II approach that the 2017 Concluded Framework was benchmarked to; and
 - (b) an alternative CVA risk approach, which calculates CVA risk capital requirement as equal to the bank's counterparty credit risk capital requirement (such alternative approach is referred to as "**CVA substitute approach**").
6. Major financial centres have since implemented all or part of the changes in the Basel Framework⁹. However, some jurisdictions have yet to finalize their implementation timetable and details. For example, the US banking regulators have not yet decided on how to revise their capital rules, which has led to some jurisdictions postponing their implementation timetables.
7. In Hong Kong, the Banking (Capital) Rules have been updated this year to align with the Basel Framework. In adopting the CVA substitute approach, the Banking (Capital) Rules allow banks with total notional amount of non-centrally cleared OTC derivative transactions not exceeding HK\$1 trillion on a permanent basis to use the approach.

⁶ The reform aimed at strengthening the capital requirements and supervision for internationally active banks in view of the problems revealed by the 2008 global financial crisis.

⁷ Both standardized and internal models-based approaches.

⁸ Namely, "simplified standardized approach".

⁹ The implementation status is summarized in Appendix 9.

8. In addition, the Banking (Capital) Rules allow banks with less exposures to use a slightly modified version of the current exposure method (**modified current exposure method**) for counterparty credit risk capital calculation, which is also the benchmark for the 2017 Concluded OTCD Capital Framework.
9. Having considered these regulatory developments, and the fact that the 2017 Concluded Framework's standardized approaches for market risk and counterparty credit risk capital requirements are almost the same as those approaches offered to small banks by the Banking (Capital) Rules, we consider that the 2017 Concluded Framework remains appropriate.
10. Certain finetuning of the framework is necessary to align with the approaches adopted by the Banking (Capital) Rules and address the comments received in the 2017 consultation. These key updates to the 2017 Concluded Framework are summarized below:
 - (a) expand the definition of *asset management group central OTCD dealer*¹⁰ to include central dealers serving an affiliated asset manager that is regulated in or by any of the following jurisdictions or regulators so that they can also enjoy lower minimum capital requirements:
 - any jurisdiction on the list of recognised jurisdiction schemes or the list of inspection regimes posted on the SFC website¹¹;
 - an EU member state;
 - a member of IOSCO's Committee on Regulation of Market Intermediaries or Committee on Investment Management;
 - (b) reduce the minimum capital requirements¹² and computation burden¹³ for OTCD dealers that are an inter-dealer broker¹⁴ in view of the lower risk of their activities;
 - (c) require LCs approved to use the latest Basel capital standards for market risk or counterparty credit risk to comply with the same minimum capital requirements as those for LCs approved to use the FRR's standardized approaches (i.e. SMRA and SOCCRA);
 - (d) modify the FRR's standardized approach for market risk (i.e. SMRA) by
 - (i) applying a scaling factor in the calculation of market risk capital requirements¹⁵ to align with the Banking (Capital) Rules' simplified standardized approach;

¹⁰ Formerly referred to as OTCD central dealing desk dealer in the 2017 consultation.

¹¹ <https://www.sfc.hk/en/Regulatory-functions/Products/List-of-publicly-offered-investment-products/List-of-recognised-jurisdiction-schemes-and-inspection-regimes>.

¹² Their tangible capital requirement is replaced with a minimum paid-up share capital requirement of HK\$60 million and their floor RLC is reduced to HK\$30 million.

¹³ They are required to use the basic approaches (instead of standardized approaches) to calculate market risk and counterparty credit risk capital requirements.

¹⁴ i.e. a broker who intermediates between institutional or corporate professional investors in OTC derivative transactions without interposing itself in the transactions as counterparty and does not hold client assets or incur any liability to any person in respect of any OTCD transaction entered into by its clients.

- (ii) extending the netting treatments for opposite positions in gold of different fineness to gold suitable for delivery under a contract traded on the Hong Kong Gold Exchange¹⁶;
 - (iii) reducing the market risk capital requirement for an index arbitrage portfolio that is referenced to CSI 300 Index;
- (e) modify the FRR's standardized approach for counterparty credit risk (i.e. SOCCRA) by
 - (i) applying an alpha of 1.4 in exposure amount calculation to align with the Banking (Capital) Rules' modified current exposure method;
 - (ii) allowing inclusion of negative market value of OTCD in net exposure calculation if the transaction is subject to daily revaluation;
 - (iii) allowing netting between collateral posted and collateral received if they are the same asset or denominated in the same currency;
 - (iv) updating the credit risk weighting approach for calculating counterparty credit risk capital requirements on exposures to counterparties and CCPs to align with the Banking (Capital) Rules; and
 - (v) applying the CVA substitute approach to LCs using SOCCRA to align with the Banking (Capital) Rules¹⁷;
- (f) modify the FRR's basic approach for counterparty credit risk (i.e. BOCCRA) in a similar way as described in subparagraphs (e)(i) and (ii);
- (g) replace the proposed requirement to file annual risk control self-assessment return on OTCD activities and liquidity risk management measures by control guidelines (we will consult on the control guidelines separately); and
- (h) replace the proposed election-based approach for switching between SMRA and BMRA (or between SOCCRA and BOCCRA) by an LC by an approval-based approach¹⁸ because such a switch may have significant impact on the LC's capital requirements.

Capital requirement for trading loss sharing arrangement proposed in the 2017 Consultation Conclusions and Further Consultation Paper

11. In response to market comments, we have replaced the proposed capital requirements on risk arising from trading loss sharing arrangement by a set of notification requirements to ensure LCs properly monitor their exposure and adequacy of their liquid capital to cover such risk.

¹⁵ Except where the market risk charge percentages under SMRA are considered prudent enough, such as the percentages for equities.

¹⁶ Formerly known as Chinese Gold and Silver Exchange.

¹⁷ The SFC may consider the need to require an LC with positions exceeding HK\$1 trillion to use the CVA framework in the Basel Framework by varying the FRR for the LC under section 145A of the SFO.

¹⁸ i.e. SFC approval is required for the switch.

New general FRR proposals

12. We propose the following general FRR changes to promote greater connection with the Mainland markets, to facilitate business diversification into emerging markets, commodity trading, virtual assets (**VA**s) derivative trading and central clearing of repurchase transactions (**repos**), and to improve the control over elections made under the FRR:
- (a) lower the haircut percentages for constituents of FTSE China A50 Index and MSCI China A 50 Connect Index from 30% to 15% and the haircut percentage for constituents of CSI 300 Index from 30% to 20% respectively;
 - (b) classify The Saudi Exchange, Hochiminh Stock Exchange, Indonesia Stock Exchange and three commodity exchanges as specified exchanges so that products listed or traded on them will be subject to lower risk charges;
 - (c) classify a wide range of energy, carbon and freight rate products as tradable commodities so that they will be subject to lower risk charges;
 - (d) extend the FRR treatments of futures and options traded on a specified exchange to VA-based¹⁹ futures or options traded on a licensed VA exchange;
 - (e) exempt repos that are centrally cleared through approved central counterparty from counterparty credit risk charge; and
 - (f) allow the SFC to override elections made by LCs under the FRR if the SFC is satisfied that it is prudent to do so, taking into account the risks associated with the LCs.
13. In addition to the above changes, incidental changes have been made to enhance the operability and clarity of the 2017 Concluded Framework. Some technical changes have also been made to enhance the FRR. The major incidental and technical changes and reasons for change are summarized in Appendix 3.

Draft FRR amendments, IMA Guidelines and MRM Principles

14. We have drafted the FRR amendments required for implementing the above changes. A copy of the draft FRR amendments is attached in Appendix 4 for consultation.
15. LCs seeking approval to use internal models approach are required to comply with the IMA Guidelines, a draft of which is attached in Appendix 5 for consultation. These guidelines provide detailed guidance on qualitative and quantitative standards for modelling market risks. In the guidelines, we have replaced some prescriptive requirements proposed in the previous consultation papers with high level guidance and included enhancements that aim to achieve similar control objectives of the internal models approach in the Basel Framework. Please refer to Appendix 6 for a summary of the major enhancements and other technical changes in the draft IMA Guidelines.

¹⁹ Including VA indices.

16. LCs seeking approval to use internal models approach are also required to comply with the MRM Principles, a draft of which is attached in Appendix 7 for consultation. These principles are also applicable to LCs engaging in OTC derivative dealing or clearing or approved to use the latest Basel capital standards in liquid capital calculation.

II. Introduction

17. In 2017, we issued the 2017 Consultation Conclusions and Further Consultation Paper to conclude on a proposed capital framework for LCs engaging in OTCD activities. In that paper, we concluded that the proposed framework was appropriate given the respondents' support for the proposed framework. We also further proposed certain modifications to the framework and other changes to the FRR. A total of ten submissions in response to those further changes were received. Key comments received and our responses are discussed in Parts III to VII of this paper.
18. The key components of the 2017 Concluded Framework include
- (a) a set of minimum capital requirements for LCs engaging in OTCD activities, which has the following key features:
 - (i) the capital requirements were benchmarked to similar capital requirements proposed by the US SEC and CFTC for similar activities or adopted by OTCD CCPs for clearing participants; and
 - (ii) they vary with the level of risk and activities of the LC;
 - (b) a set of **basic** market risk and counterparty credit risk capital requirements, which has the following key features:
 - (i) the requirements involve simple calculations;
 - (ii) the requirements are intended for use by LCs engaging in OTCD activities not as a regulated activity and LCs engaging in OTCD activities as a regulated activity but subject to certain restrictions; and
 - (iii) LCs may switch to the standardized approaches if they fulfil certain conditions;
 - (c) a set of **standardized** market risk and counterparty credit risk capital requirements, which has the following key features:
 - (i) the requirements were mainly benchmarked to Basel II's standardized market risk approach, current exposure method for counterparty credit risk, and the CVA risk approach applied at the early stage of the Basel III reform package;
 - (ii) the requirements are intended for use by LCs engaging in OTCD activities as a regulated activity (except where the activities are subject to certain restrictions); and
 - (iii) LC may switch to the basic approaches if they fulfil certain conditions; and
 - (d) an advanced approach that permits LCs to use internal models or the latest Basel capital standards in their calculation of market risk or counterparty credit risk capital requirements with SFC approval.

19. Since the 2017 consultation, there have been international developments that are relevant to the proposed framework, including:
- (a) the US SEC and CFTC have implemented the capital requirements for security-based swap dealers and swap dealers since October 2021;
 - (b) BCBS has finalized the Basel III reform package²⁰ that replaced Basel II. The new banking capital and supervision standards have been consolidated into a single document, namely the Basel Framework. Most of the new standards took effect on 1 January 2023. The key developments of the Basel III reform are summarized in Appendix 8.
20. The key changes in the capital standards in the Basel Framework over the Basel II standards that the 2017 Concluded Framework had been benchmarked to are summarized below:
- (a) A new market risk framework²¹ is introduced. It consists of
 - (i) a “standardized approach”, which is more complicated than the one used in Basel II;
 - (ii) a “simplified standardized approach”, which is for banks with lower levels of exposure as BCBS recognized that the new standardized approach may present implementation difficulties for such banks. The simplified standardized approach is a slightly modified version of Basel II’s standardized approach (also the approach the 2017 Concluded Framework had been benchmarked to) with minor adjustments to ensure the conservativeness of the capital requirements²²;
 - (iii) an “internal models approach”, which measures market risk by expected shortfall (**ES**) instead of VaR in Basel II.
 - (b) A new CVA framework²³ is introduced. It consists of
 - (i) a simple approach (referred to as CVA substitute approach in this paper), which allows a bank to calculate its CVA risk capital requirement at 100% of its counterparty credit risk capital requirement. The approach is available for banks with a lower level of activities in non-centrally cleared derivatives;
 - (ii) a “reduced basic approach”, which is similar to the superseded CVA risk approach that the 2017 Concluded Framework had been benchmarked to but it does not recognize the effect of CVA risk hedge and applies a new scalar and a new risk weighting approach that is benchmarked to the new market risk framework;

²⁰ The reform aimed at strengthening the capital requirements and supervision for internationally active banks in view of the problems revealed by the 2008 global financial crisis.

²¹ Formerly known as “Fundamental Review of Trading Book” or “FRTB”.

²² The most notable change is the application of a scaling factor ranging from 1.2 to 3.5 to Basel II’s market risk capital requirements to ensure the conservativeness of the capital requirements.

²³ The model-based approach in the previous framework has been abolished by BCBS in the Basel Framework.

- (iii) a “full basic approach”, which is similar to the superseded CVA risk approach, accepts a wider range of CVA risk hedges but requires an additional calculation to address CVA risk hedge misalignment, and applies a new scalar and a capital floor based on the capital requirement calculated under the reduced basic approach; and
 - (iv) a “standardized approach”, which applies complicated calculation methods that are adapted from the standardized approach in the new market risk framework.
 - (c) A new standardized approach to using external ratings for weighting credit risk exposures is introduced. It is largely the same as the approach in Basel II with updates in some areas (such as new risk weights for unrated exposures and exposures to financial institutions that are not a bank or securities firm).
 - (d) A new standardized approach to calculating counterparty credit risk capital requirement, namely Standardized Approach to Counterparty Credit Risk (**SA-CCR**), is introduced. We had proposed in the 2017 Consultation Conclusions and Further Consultation Paper that SA-CCR can be used by LC with SFC approval. An internal models method for measuring counterparty credit risk exposure amount, which is based on Basel II’s standards with certain improvements, is also available in the Basel Framework.
21. Banking regulators in major financial centres have since implemented or are implementing the new standards in the Basel Framework. However, some jurisdictions have yet to finalize their implementation timetable and details. For example, the US banking regulators have not yet decided on how to revise their capital rules. As a result, some jurisdictions have postponed their implementation timetables. Please refer to Appendix 9 for a summary of the status of implementation of the Basel Framework by major financial centres.
 22. In Hong Kong, the Banking (Capital) Rules have implemented the standards in the Basel Framework. In respect of the use of CVA substitute approach, the Banking (Capital) Rules allow banks with total notional amount of non-centrally OTC derivative transactions not exceeding HK\$1 trillion on a permanent basis to use the approach. The Banking (Capital) Rules also provide the modified current exposure method²⁴ for use by banks with a lower level of activities. The approach is a slightly modified version of the current exposure method that the 2017 Concluded Framework had been benchmarked to.
 23. Having considered these regulatory developments, and the fact that the 2017 Concluded Framework’s standardized approaches for market risk and counterparty credit risk capital requirements are almost the same as those approaches offered to small banks by the Banking (Capital) Rules, we consider that the framework remains appropriate.
 24. Certain minor finetuning of the framework is necessary to align with the approaches adopted by the Banking (Capital) Rules and address the comments received in the 2017 consultation. Moreover, incidental changes are made to enhance the operability and clarity of the framework.

²⁴ The most notable change is the application of a multiplier of 1.4 (which is based on the value of alpha used in SA-CCR) to the exposure amount calculated by current exposure method to ensure the capital requirement is sufficiently conservative.

25. In addition, we have proposed certain changes to other areas of the FRR to enhance the FRR and promote market development and business diversification. Moreover, some technical changes are made to enhance some existing FRR treatments, such as ensuring consistent treatments of similar products.
26. The major updates to the 2017 Concluded Framework and additional FRR changes are discussed in Parts III to VII. The major incidental and technical changes are summarized in Appendix 3.
27. A copy of the draft FRR amendments required for implementing the 2017 Concluded Framework and the other changes is attached in Appendix 4 for consultation.

III. Minimum capital requirements²⁵

Major comments received in 2017 consultation and SFC responses

2017 Concluded Framework

Finetuning minimum capital requirements for asset management group central OTCD dealers²⁶

28. Respondents generally agreed with the proposal to apply lower minimum capital requirements to asset management group central OTCD dealers²⁷. Only one respondent considered the proposed capital requirements excessive. One respondent suggested treating all jurisdictions outside Hong Kong as a specified jurisdiction²⁸ for qualifying a dealer as asset management group central OTCD dealer.
29. We believe it is important to retain control over the list of specified jurisdictions in view of the significant reduction in capital requirements available for such dealers. On balance, we consider it appropriate to treat central dealers serving an affiliated asset manager that is regulated in or by any of the following jurisdictions or regulators as asset management group central OTCD dealers:
- (a) a jurisdiction on the list of recognised jurisdiction schemes or the list of inspection regimes posted on the SFC website;
 - (b) an EU member state;
 - (c) a member of IOSCO's Committee on Regulation of Market Intermediaries or Committee on Investment Management.
30. The list of the above jurisdictions and regulators will be published on the SFC website when the FRR amendments take effect.
31. One respondent queried the relevance of the proposed condition of requiring asset management group central OTCD dealers not to hold client assets. Another respondent sought clarification on the scope of client assets in the condition.
32. We consider that the condition is necessary to minimize the dealers' operational risk, given that their minimum capital requirements are significantly lower than a full service OTCD dealer. We also clarify that the condition only applies to client assets received or held in respect of the dealer's OTCD dealing, such as initial margins.
33. Two respondents suggested relaxing the restriction preventing asset management group central OTCD dealers from being a contracting party to OTCD transactions by allowing them to enter into OTC derivative transactions with their group affiliates to hedge their own foreign exchange risks.

²⁵ The minimum requirements proposed in the 2017 Concluded Framework as modified by the proposals in this paper are summarized in Appendix 2.

²⁶ Formerly referred to as "OTCD central dealing desk dealer" in the 2017 Consultation Conclusions and Further Consultation Paper.

²⁷ A floor RLC of HK\$15 million and a minimum paid-up share capital requirement of HK\$30 million were proposed in the 2017 Consultation Conclusions and Further Consultation Paper.

²⁸ i.e. a jurisdiction that has similar licensing requirements as Hong Kong for asset management activities carried out in that jurisdiction.

34. We clarify that the restriction only applies to dealings that constitute regulated activities. Asset management group central OTCD dealers may enter into OTCD transactions that are covered by the exemptions in the SFO applicable to the regulated activity for which they are licensed, for example, entering into an OTCD transaction as a price taker²⁹.

Finetuning minimum capital requirements for OTCD inter-dealer brokers

35. Two respondents suggested reducing the minimum capital requirements for OTCD dealers that introduce or induce clients to enter into OTCD transactions and do not take liability for the transactions executed.
36. We have identified some licensed inter-dealer brokers in Hong Kong that intermediate between financial institutions in OTCD and do not enter into the transactions introduced by them or hold client assets (**OTCD inter-dealer brokers**). Given that such business model does not expose such dealers to significant market or counterparty credit risk and their target clients are professional clients, there is room to lower the capital requirements for such dealers.
37. Considering OTCD inter-dealer brokers' average financial resources and their wider roles in the OTCD market than asset management group central OTCD dealers, we consider that OTCD inter-dealer brokers should be subject to higher minimum capital requirements than asset management group central OTCD dealers. We propose the following minimum capital requirements for OTCD inter-dealer brokers:
- (a) a floor RLC of HK\$30 million (compared to the HK\$78 million or HK\$156 million floor RLC proposed for OTCD dealers in general); and
 - (b) a minimum paid-up share capital requirement of HK\$60 million (compared to the HK\$500 million or HK\$1 billion tangible capital requirement proposed for OTCD dealers in general).
38. To be eligible for these minimum capital requirements, OTCD inter-dealer brokers must meet the following requirements:
- (a) in respect of their OTCD dealing,
 - (i) their OTCD clients must be professional investors who are not an individual and they only provide to their clients services of negotiating, arranging or facilitating the entering into OTCD transactions between their clients;
 - (ii) they must not be a counterparty to any OTCD transaction entered into by their clients;
 - (iii) they must not incur any liability to any person in respect of any OTCD transaction entered into by their clients (except for as a result of their own negligence, wilful default or fraud); and
 - (iv) they must not hold client assets; and

²⁹ Entering into OTCD transactions as a price taker is carved out from the definition of "dealing in OTC derivative products" under section 2(g) of Part 2A of Schedule 5 to the SFO introduced by the Securities and Futures (Amendment) Ordinance 2014.

- (b) they must not provide to their clients any clearing or settlement service for OTCD transactions.

39. We propose to require OTCD inter-dealer brokers to use the FRR's basic approaches to calculate market risk and counterparty credit risk capital requirements.

Questions:

1. Do you agree that OTCD inter-dealer brokers should be subject to a floor RLC of HK\$30 million and a minimum paid-up share capital requirement of HK\$60 million? If not, please explain.
2. Do you agree that OTCD inter-dealer brokers should be required to use the FRR's basic approaches to calculate market risk and counterparty credit risk capital requirements? If not, please explain.

Scope of OTCD activities for applying reduced capital requirements³⁰

40. One respondent asked whether an LC's OTCD activities include introducing business in determining its eligibility to apply the proposed reduced capital requirements. We clarify that OTCD transactions entered into by clients as a result of an LC's introducing or inducing acts only³¹ need not be included in the LC's OTCD activities for such purpose.

List of Regulated CCPs approved for FRR purpose

41. One respondent suggested expanding the list and announcing additions as soon as possible.
42. We will include CCPs that are well-regulated and commonly used by the industry for clearing OTCD in the list of approved Regulated CCPs. The list will be updated on a needs basis. LCs are welcomed to nominate suitable candidates for our consideration. We will publish the list on our website when the FRR amendments take effect.

Other major policy update or new proposals

Proposed minimum capital requirements for LCs approved to use the latest Basel capital standards

43. We propose to require LCs (whether they engage in OTCD activities) approved to use the latest Basel capital standards (other than any model-based approaches) to comply with the same minimum capital requirements as those proposed for LCs approved to use the FRR's standardized approaches to ensure a fair and balanced framework. Since some approaches in the latest Basel capital standards require the use of complex calculations and more advanced risk data, significant amount of capital may be required to maintain sophisticated risk management systems to

³⁰ Formerly known as "OTCD de minimis reduction" in the previous consultation papers.

³¹ i.e. acts that fall within paragraph (b) of the definition of "dealing in OTC derivative products" in Part 2 of Schedule 5 to the SFO introduced by the Securities and Futures (Amendment) Ordinance 2014.

support the use of such approaches. Where necessary, we may require LCs to meet higher minimum capital requirements by variation of the LC's FRR requirements³².

Question:

3. Do you agree that LCs approved to use the latest Basel capital standards (other than any model-based approaches) should be required to comply with the same minimum capital requirements as those proposed for LCs approved to use the FRR's standardized approaches? If not, please explain.

Clarification of minimum capital requirements for LCs that are not an OTCD dealer but are approved to use internal models approach

44. We clarify that LCs which are not an OTCD dealer but are approved to use internal models approach will also be subject to the same minimum capital requirements as an OTCD dealer approved to use internal models approach, i.e. HK\$2 billion tangible capital requirement and a floor RLC of HK\$156 million.

Compliance analysis

45. We have recently conducted a survey on the OTCD activities of 127 LCs and their affiliates in 2024 and their capital positions³³ (**Survey**). The survey results help us understand the survey respondents' OTCD activities and ability to comply with the proposed minimum capital requirements.
46. According to the Survey:
- (a) 124 survey respondents reported that they were dealing in OTC derivative products (**OTCD dealer respondents**), with 8 indicating they intend to adopt internal models approach (**IMA OTCD dealer respondents**);
 - (b) 1 survey respondent reported that it was providing client clearing services for OTC derivative transactions (**Type 12 RA respondent**); and
 - (c) 2 survey respondents reported that they were providing ATS for trading of OTC derivative products (**New Type 7 activity respondents**).
47. Among the 116 OTCD dealer respondents that are not IMA OTCD dealer respondents,
- (a) 19 indicated that they are central dealing desk dealers within an asset management group or all of their OTC derivative transactions were cleared through central counterparties (**central dealing or centrally-cleared products only respondents**);
 - (b) 11 indicated that they are inter-dealer brokers (**inter-dealer broker respondents**); and

³² Section 145A of the SFO empowers the SFC to vary the FRR for particular LCs.

³³ The Survey was conducted in February 2025. LCs and non-licensed corporate affiliates of LCs that were dealing in OTC derivative products, providing client clearing services for OTC derivative transactions, or providing ATS for OTC derivative transactions were invited to participate in the Survey.

(c) 86 did not make the indication described in subparagraph (a) or (b) above
(general OTCD dealer respondents).

48. We have compared the survey respondents' capital³⁴ with the applicable proposed minimum capital requirements to assess their ability to comply with those requirements. The results are summarized in the table below:

Column 1	Column 2	Column 3	Column 4	Column 5
Proposed minimum capital requirements	Number (percentage) of survey respondents that could fulfill the applicable minimum capital requirements / Their aggregate share of total turnover of the same category of survey respondents ³⁵	Number of survey respondents that could not fulfill one or more applicable minimum capital requirements	Range of tangible capital shortfalls / paid-up share capital shortfalls ³⁶ of those respondents in column 3 (HK\$)	Range of liquid capital shortfalls ³⁷ of those respondents in column 3 (HK\$)
IMA OTCD dealer respondents (8 in total)				
HK\$2 billion tangible capital requirement HK\$156 million floor RLC	8 (100%) / 100%	Not applicable	Not applicable	Not applicable
Central dealing or centrally-cleared products only respondents (19 in total)				
HK\$30 million paid-up share capital requirement HK\$15 million floor RLC	15 (79%) / 94%	4 (could not meet paid-up share capital requirement only)	5 million to 25 million	Not applicable
Inter-dealer broker respondents (11 in total)				
HK\$60 million paid-up share capital requirement HK\$30 million floor RLC	6 firms (55%) / 97%	<ul style="list-style-type: none"> 1 (could not meet both paid-up share capital requirement and floor RLC) 2 (could not 	16 million to 53 million	2 million to 7 million

³⁴ For the comparison, we have taken into account the paid-up share capital, liquid capital and tangible capital as of 31 December 2024 reported by survey respondents. Such capital amounts are collectively referred to as "reference paid-up share capital", "reference liquid capital", or "reference tangible capital".

³⁵ A survey respondent's turnover is measured by the 2024 aggregate notional amount of OTCD transactions reported in the Survey. A category of survey respondents refers to one of the categories described in paragraphs 46 and 47.

³⁶ "Tangible capital shortfall" means the difference between a survey respondent's reference tangible capital and the applicable tangible capital requirement. "Paid-up share capital shortfall" means the difference between a survey respondent's reference paid-up share capital and the applicable paid-up share capital requirement.

³⁷ "Liquid capital shortfall" means the difference between a survey respondent's reference liquid capital and the applicable floor RLC.

Column 1	Column 2	Column 3	Column 4	Column 5
Proposed minimum capital requirements	Number (percentage) of survey respondents that could fulfill the applicable minimum capital requirements / Their aggregate share of total turnover of the same category of survey respondents ³⁵	Number of survey respondents that could not fulfill one or more applicable minimum capital requirements	Range of tangible capital shortfalls / paid-up share capital shortfalls ³⁶ of those respondents in column 3 (HK\$)	Range of liquid capital shortfalls ³⁷ of those respondents in column 3 (HK\$)
		meet paid-up share capital requirement only) • 2 (could not meet floor RLC only)		
General OTCD dealer respondents (86 in total)				
For LCs qualified for reduced capital requirements: • HK\$500 million tangible capital requirement • HK\$78 million floor RLC	22	• 30 (could not meet both tangible capital requirement and floor RLC) • 13 (could not meet tangible capital requirement only)	55 million to 496 million	3 million to 74 million
For LCs not qualified for reduced capital requirements: • HK\$1 billion tangible capital requirement • HK\$156 million floor RLC	18	• 2 (could not meet both tangible capital requirement and floor RLC) • 1 (could not meet tangible capital requirement only)	832 million to 991 million	121 million to 150 million
Subtotal (for all OTCD dealer respondents)	69	55		
OTCD dealer respondents that will increase capital or have enough reserves for conversion into capital	20	(20)		

Column 1	Column 2	Column 3	Column 4	Column 5
Proposed minimum capital requirements	Number (percentage) of survey respondents that could fulfill the applicable minimum capital requirements / Their aggregate share of total turnover of the same category of survey respondents ³⁵	Number of survey respondents that could not fulfill one or more applicable minimum capital requirements	Range of tangible capital shortfalls / paid-up share capital shortfalls ³⁶ of those respondents in column 3 (HK\$)	Range of liquid capital shortfalls ³⁷ of those respondents in column 3 (HK\$)
Total OTCD dealer respondents who will be able to meet the proposed minimum capital requirements	89 (72%) / 99%	35		
Type 12 RA respondent (1 in total)				
For LCs qualified for reduced capital requirements • HK\$1 billion tangible capital requirement • HK\$195 million floor RLC	1 (100%) / 100%	Not applicable	Not applicable	Not applicable
New Type 7 activity respondents (2 in total)				
For ATS providers licensed for trading of OTC derivative products: • HK\$1 billion tangible capital requirement • HK\$156 million floor RLC	1 (50%) / 95%	1 (could not meet both tangible capital requirement and floor RLC)	965 million	144 million
Total number of survey respondents who will be (Column 2) / will not be (Column 3) able to meet the proposed minimum capital requirements	91 (72%)	36 (28%)		

49. In summary,
- (a) 89 OTCD dealer respondents will be able to meet the applicable minimum capital requirements proposed (representing 72% in number) and they in aggregate accounted for 99% of the total turnover of all OTCD dealer respondents;
 - (b) the only Type 12 RA respondent could meet the applicable minimum capital requirements proposed for Type 12 RA;
 - (c) one of the two New Type 7 activity respondents could meet the proposed minimum capital requirements, and it accounted for 95% of the total aggregate notional amount of OTCD transactions of this type of respondents; and
 - (d) in total 91 survey respondents (representing 72% in number) will meet the applicable minimum capital requirements and their turnover accounted for 95 to 100% of the total turnover of their respective categories.
50. For those survey respondents who do not have enough capital to meet the proposed minimum capital requirements, they may consider increasing their capital before the FRR amendments take effect or switching to a business model that attracts lower minimum capital requirements. For instance, 11 general OTCD dealer respondents would be able to comply with the minimum capital requirements if they change their business model to OTCD Inter-dealer broker, and if they do so, the compliance rate would be increased to 80%.

IV. Market risk requirements

Major comments received in 2017 consultation and SFC responses

2017 Concluded Framework - SMRA

Scope of application of section 51A

51. A respondent sought clarification on whether section 51A of the FRR would apply to foreign exchange positions in addition to the standardized foreign exchange risk framework under SMRA. We confirm that LCs adopting SMRA would not be subject to section 51A of the FRR.

Continuous options

52. One respondent asked for examples of continuous and non-continuous options. As explained in the 2015 Consultation Paper, continuous option refers to an option the gamma and vega of which are respectively a continuous function of the price and implied volatility of its underlying. Examples of continuous options are plain vanilla call or put options³⁸. Non-continuous options include all options with knock-in/out features.

Other major policy updates or new proposals

2017 Concluded Framework - SMRA

Proposed application of scaling factors to market risk charges

53. We propose to add scaling factors to the calculation of market risk charges to align with the approach adopted by the Banking (Capital) Rules' simplified standardized approach for market risk. The change does not apply to equities, non-investment grade or unrated debt securities and illiquid investments because their market risk charge percentages under SMRA are already prudent enough.

Proposed extension of netting treatment to opposite positions in gold tradable on Hong Kong Gold Exchange

54. We propose to expand the netting treatments for positions in gold of different fineness³⁹ to gold which is of a quantity, quality and condition suitable for delivery under a contract traded on Hong Kong Gold Exchange in view of that exchange is an established market for gold trading in Hong Kong.

Proposed extension of capital allowance for index arbitrage portfolios to portfolios with CSI 300 Index as underlying index

³⁸ Including listed warrants.

³⁹ In the 2015 Consultation Paper we proposed to allow netting if the gold is suitable for delivery under the same futures or options contract traded on a specified exchange.

55. To facilitate cross-boundary trading in the Mainland stock markets, we propose to include CSI 300 Index in the list of underlying indices⁴⁰ that are eligible for capital allowance for arbitrage portfolios under SMRA.

Question:

4. Do you agree with the measures proposed in paragraphs 53 to 55? If not, please explain.

⁴⁰ In the 2015 Consultation Paper we proposed to cover HSI, HSCEI, FTSE 100 Index, S&P 500 Index, Nikkei Stock Average, Euro Stoxx 50 Index in the list.

V. Counterparty credit risk requirements

Major comments received in 2017 consultation and SFC responses

2017 Concluded Framework - BOCCRA and SOCCRA

Overlap with section 50 of FRR

56. One respondent suggested repealing section 50 of the FRR to avoid the risk charge thereunder overlapping with the risk charges on OTCD that are foreign exchange agreements. We are aware of the potential overlap and has made changes to the FRR to exclude derivatives from the definition of “foreign exchange agreement”.

Treatment of collateral posted for OTCD transactions in liquid assets

57. One respondent suggested admitting collateral posted in respect of OTCD transactions as liquid assets. We agree with this suggestion and have made changes to section 19 of the FRR to prevent collateral posted in respect of OTCD transactions from being excluded from liquid assets.

Basel-like treatments for repo-style transactions⁴¹

58. Respondents generally supported allowing LCs using SOCCRA to apply a modified version of Basel II's comprehensive approach for collateralized transactions to calculate capital requirements on repo-style transactions. One respondent asked the reason for using 8% of risk-weighted net credit exposure to calculate risk charges on repo-style transactions.
59. The proposal to calculate capital requirements at 8% of risk-weighted net credit exposure is benchmarked to the Basel capital standard that requires a bank's total capital must not be less than 8% of its total risk-weighted assets.
60. Another respondent suggested allowing LCs to use Basel II's haircut percentages for securities to calculate the capital requirements.
61. We maintain our view that FRR haircut percentages for securities can better reflect the price risk of securities of different qualities and liquidity.

Other major policy updates or new proposals

2017 Concluded Framework - BOCCRA and SOCCRA

Proposed application of a multiplier of 1.4 to risk charges for counterparty credit risk of OTCD transactions

62. We propose to add a multiplier of 1.4 to the risk charges for counterparty credit risk of OTCD transactions calculated under SOCCRA to align with the approach adopted by the modified current exposure method in the Banking (Capital) Rules⁴². The change will ensure the conservativeness of the risk charges and bring them closer to the approach taken by the Banking (Capital) Rules. The multiplier will not apply to exposures that are subject to a 100% risk charge.

⁴¹ Including repos and securities borrowing and lending.

⁴² known as α in section 226MB(1) of the Banking (Capital) Rules.

63. We also propose to apply a similar multiplier to the risk charges calculated under BOCCRA.

Proposed netting in the calculation of CCR exposure amounts for OTCD transactions

64. We propose to enhance the calculation of the exposure amount under SOCCRA by
- (a) allowing offsetting of positive exposures and negative market value of an OTCD transaction if it is subject to daily revaluation. The proposed change is similar to the approach taken by the FRR for exchange-traded futures and options contracts and Banking (Capital) Rules' SA-CCR. The exposure amount calculation can take into account the cushion effect of negative market value of the transaction because daily revaluation ensures any subsequent change of the market value can be reflected in the calculation in a timely manner; and
 - (b) allowing offsetting of assets posted and received as collateral that are of the same type or denominated in the same currency when calculating haircuts for price risk or foreign exchange risk. The change is in line with the Banking (Capital) Rules' modified current exposure method and comprehensive approach for collateralized transactions.
65. Similar changes are proposed for the calculation of the net uncollateralized exposure amount under BOCCRA.

Proposed updated risk-weighting approach

66. We have updated the risk-weighting approach of SOCCRA to align with the external-ratings based approach in Banking (Capital) Rules. The key differences between the previous approach and the new approach are:
- (a) a higher risk weight is allocated to unrated exposures to LCs, or banks or securities firms applying Basel capital standards;
 - (b) exposure to an authorized insurer or a designated insurance holding company within the meaning of the Insurance Ordinance (Cap. 41) is subject to the same risk weighting as that applied to LCs.

Proposed adoption of a simplified CVA risk charge for SOCCRA

67. The Banking (Capital) Rules permit banks with total notional amount of non-centrally cleared derivative transactions not exceeding HK\$1 trillion to calculate their CVA risk capital requirement at 100% of the corresponding counterparty credit risk capital requirement.
68. We see merit in this approach. Based on information collected by the Survey and other sources, we note that the OTCD positions of most LCs and their affiliates are unlikely to exceed HK\$1 trillion. In light of this, we propose to require CVA risk charge to be equal to the LC's counterparty credit risk capital requirement on the same OTCD transactions. In case an LC's total OTCD positions exceed HK\$1 trillion, we will consider the need to require it to use the CVA framework in the Basel Framework to calculate CVA risk charge, for example, by varying the FRR for the LC under section 145A of the SFO. In any event, LCs interested in using the CVA framework in the Basel Framework to calculate CVA risk charges may apply to the SFC for approval.

Proposed inclusion of specified liquidity risk management measures in control guidelines

69. The specified liquidity risk management measures for LC using SOCCRA proposed in previous consultations are mostly control requirements. It would be more appropriate to set out those control requirements by way of guidelines than FRR. The 2017 Consultation Conclusions and Further Consultation Paper also suggested applying those measures to LCs not using SOCCRA but exhibiting high liquidity risk. We will set out those control requirements in a set of guidelines, which will be published for public consultation separately.

Question:

5. Do you agree with the proposals in paragraphs 62 to 69? If not, please explain.

VI. Use of internal models approach and latest Basel capital standards

Major comments received in 2017 consultation and SFC responses

Use of market risk internal models approach

Trade day PLA and intraday risk

70. One respondent was concerned that the trade day profit and loss attribution (**PLA**) requirement may deviate from the PLA requirements applied by the LC's home regulator and require an LC to install separate, complex infrastructure. The respondent further sought clarification on the operation details of the requirement. One respondent opined that it would be too prescriptive to mandate automated intraday delta risk limit monitoring for warrant issuers or liquidity providers.
71. Since traditional market risk measurement models, such as VaR model, do not effectively capture intraday risk, LCs must prudently and effectively control their intraday exposures and maintain adequate capital to cover such risk. Strong risk management is especially important for listed warrant issuers as warrant holders are exposed to their credit risk. After considering the comments, we have converted the requirements into high level guidance in the IMA Guidelines to allow LCs greater flexibility in designing their controls over intraday risk.

Data aggregation process

72. One respondent commented that the requirement of automation of risk data aggregation process was stricter than the corresponding Basel capital standards and did not consider the circumstances and mitigation controls of individual LCs.
73. We believe the integrity and accuracy of risk data are fundamental to the effective operation of an internal model. Automated risk data aggregation can minimize operational risk and enhance efficiency. If full automation is not cost-efficient for an LC, it may use other aggregation processes if it exercises effective control to prevent and detect errors, omissions and unauthorized intervention in a timely manner. We have provided additional guidance and greater flexibility in this regard in the IMA Guidelines.

Onshore-offshore exchange rates basis risk

74. One respondent suggested exempting an LC from the SMRA risk charge for non-freely floating foreign currency if its VaR model can capture onshore-offshore exchange rates basis risk.
75. Applicants for internal model approval will be required to set out in their application the market risks that their models can measure. In granting approval, we will inform the applicant the specific FRR requirements that can be substituted by the model-based capital requirements.

Use of latest Basel capital standards

76. One respondent recommended the SFC to take into consideration home regulators' requirements and implementation timelines of FRTB standards to minimize home-host divergence in market risk internal model approval standards and implementation timetables.
77. We have proposed in the draft FRR amendments the power to approve the use of the latest Basel capital standards to calculate risk charges for market risk and counterparty credit risk. With this power, we would be able to allow LCs to adopt the latest Basel capital standards, including their standardized and internal models approaches.
78. In relation to such approval power, we are preparing application guidelines for approval to use the respective advanced approaches under the Basel Framework, including its standardized market risk approach, ES-based internal models approach, SA-CCR and the new CVA framework. Those guidelines will be published for public consultation once available.

Other major policy updates or new proposals

Proposed IMA Guidelines

79. In 2018 we issued a circular⁴³ inviting interested LCs to contact us to discuss the detailed requirements on using internal models approach for market risk capital calculation. We have since held discussions with some interested LCs deliberating on the practical application of Basel 2.5's market risk internal model approach.
80. Having considered these discussions and benchmarked to Basel 2.5 and standards adopted by other regulators⁴⁴, we have drafted a set of application guidelines for market risk models, namely *Guidelines for Internal Models Approach for FRR Market Risk Charges Calculation* for consultation. Please refer to Appendix 5 for details.
81. These guidelines provide guidance on the qualitative and quantitative standards for modelling market risks and related risk controls and set out the application procedures and information required to be submitted with the application. Those standards have adopted the standards in Basel 2.5 with enhancements modelled on the latest standards in the Basel Framework. Please refer to Appendix 6 for a summary of the major enhancements and other technical changes we have made in the IMA Guidelines.

Question:

6. Do you have any comment on the proposed IMA Guidelines?

⁴³ Circular to Licensed Corporations on Internal Models Approach for Market Risk, 2 August 2018.

⁴⁴ Including *Supervisory Policy Manual - Use of Internal Models Approach to Calculate Market Risk* published by the HKMA.

Proposed General Principles for Model Risk Management

82. We have prepared a draft of *General Principles for Model Risk Management* for consultation. Please refer to Appendix 7 for details. These principles set out detailed governance and control requirements on model risk management, which have been benchmarked to similar principles published by regulators of other international financial centres.
83. The following LCs must comply with these general principles:
- (a) LC engaging in OTCD dealing or clearing, as they may make extensive use of financial models in their business;
 - (b) LCs approved by the SFC to use internal models to calculate FRR risk charges; or
 - (c) LCs approved by the SFC to use the latest Basel capital standards to calculate FRR risk charges, as outputs of financial models are often used in the calculations under those standards.
84. Other LCs may also refer to these principles in managing financial models used in their operations.

Question:

7. Do you agree with the scope of application of the General Principles for Model Risk Management proposed in paragraph 83? If not, please explain.

Use of internal models for counterparty credit risk measurement (referred to as “IMM” in the 2015 Consultation Paper)

85. We note that major financial centres hold different views on the use of IMM for regulatory capital calculation purpose⁴⁵. We will continue to monitor international developments and update the market on the policy regarding the use of IMM for FRR purposes.

⁴⁵ While BCBS continues to allow the use of IMM in the Basel Framework, the US banking regulators have proposed replacing the use of banking organizations' internal models for counterparty credit risk with standardized approach (reference: *Regulatory Capital Rule: Large Banking Organizations and Banking Organizations With Significant Trading Activity*, published by The Office of the Comptroller of the Currency, the Board of Governors of the Federal Reserve System and the Federal Deposit Insurance Corporation on 27 July 2023). The reasons for the US banking regulators' proposal include these internal models rely on a banking organization's choice of modelling assumptions and supporting data which include a degree of subjectivity, which can result in great variation in the risk-based capital requirements for similar exposures. They have observed that the advanced approaches have produced unwarranted variability across banking organizations in requirements for exposures with similar risks. Moreover, empirical verification of modelling choices can require many years of historical experience because severe credit risk losses can occur infrequently.

VII. Sundry requirements

Major comments received in 2017 consultation and SFC responses

2017 Concluded Framework - submission of annual risk control self-assessment return on proprietary trading and OTCD activities

86. Three respondents suggested exempting asset management group central OTCD dealers or introducing dealers from submitting annual risk control self-assessment return on proprietary trading and OTCD activities.
87. We consider that regular self-assessments of risk controls can raise LCs' risk awareness. It helps LCs to ensure their proprietary trading and OTCD activities are carried out under proper control. To allow LCs greater flexibility in designing their control systems and alleviate their administrative burden of making annual submission, the proposed requirement will be replaced with a set of control guidelines. The guidelines will provide guidance on risk controls expected of LCs engaging in regulated activities concerning OTCD dealing or clearing or approved to use SMRA, SOCCRA, internal models approach or the latest Basel capital standards in their liquid capital calculation. We are preparing the draft control guidelines and will consult on them separately.

General FRR change proposed in 2017 consultation - capital requirement for trading profit or loss sharing arrangement

88. We proposed in the 2017 consultation to require an LC which enters into a trading profit or loss sharing arrangement⁴⁶ with a group company in respect of proprietary transactions booked in the group company (**risk booking affiliate**) to provide capital to cover the market risks of such transactions in a timely manner.
89. One respondent considered that the proposal could help ensure LCs assess their capital adequacy conservatively, whereas another considered that the proposed requirement would create volatility in capital management for the LC or be difficult to implement. Other respondents were concerned about ensuring a level playing field with other jurisdictions. Some respondents asked for implementation details and recognition of the regulatory capital requirements the risk booking affiliate is subject to.
90. To balance risk management and compliance burden, we have revised the regulatory approach. This ensures reasonable control over the LC's risk and financial resources and prompt notification to the SFC if the LC's condition weakens. The revised approach is summarized below:
- (a) An LC, which is a party to an agreement that may impose a liability to bear the loss of any person or to pay a profit share to any person (**Agreement**), must, within 1 business day after entering into the Agreement⁴⁷, submit a copy of the Agreement to the SFC and notify the SFC in writing:
- (i) the purpose of the Agreement;

⁴⁶ Include arrangements whereby trading profit of an affiliate previously shared by an LC is clawed back subsequently or losses arising from an affiliate's proprietary trading book is shared by an LC.

⁴⁷ If it enters into the Agreement before the commencement date of this notification requirement, within 1 business day after the commencement date.

- (ii) the reason for entering into the Agreement; and
 - (iii) the measures it adopts to prevent its liquid capital from falling below 120% of its required liquid capital in case certain liabilities arise under the Agreement (**Preventive Measures**);
- (b) the LC must, within 1 business day after becoming aware of any of the following matters, notify the SFC in writing of that matter:
- (i) it is unable to maintain the Preventive Measures;
 - (ii) its liquid capital falls below 150% of its required liquid capital or any other percentage of its required liquid capital that is notified to it in writing by the SFC; and
- (c) a notice submitted on a matter described in subparagraph 90(b) must include full details of the matter, the reason for the matter and any steps the LC is taking, has taken or proposes to take to prevent its liquid capital from falling below its required liquid capital or to improve its liquidity.

Question:

8. Do you agree that the proposed notification requirements for transfer pricing arrangement can ensure LCs monitor and control the impact on its financial positions of liabilities that may arise under such arrangement? If not, please explain.

Other comment received

91. One respondent suggested reviewing the policy of excluding intercompany receivables from liquid assets.
92. The FRR apply a prudent approach to receivables arising from regulated activities which applies equally to receivables arising from regulated transactions with group companies. Regarding other kinds of receivables (including intercompany loans and receivables), they are usually unsecured and do not have a fixed repayment date. As such, they should not be treated as liquid assets for liquid capital calculation purposes.

Other major policy update or new proposals

Finetuning of the 2017 Concluded Framework – Proposed control over switching between the FRR's basic and standardized approaches

93. The 2017 Concluded Framework adopted an election-based approach for switching between SMRA and BMRA (or between SOCCRA and BOCCRA) by an LC. After considering the significant impact a switch may have on the LC's capital requirements, we propose to replace the proposed approach with an approval-based approach (i.e. SFC approval is required for the switch).

New general FRR proposals

Facilitating commodity trading

94. To facilitate commodity trading, we propose the following changes:
- (a) classify the following energy, carbon and freight rate products as *tradable commodity* in the FRR:
 - (i) energy products, carbon trading products and freight rates underlying and deliverable under a futures, forward or options contract traded on a specified exchange;
 - (ii) carbon trading products traded on a specified exchange or any of the following exchanges:
 - Core Climate Global Limited;
 - China Beijing Green Exchange;
 - Guangzhou Emissions Exchange;
 - Shanghai Environment and Energy Exchange;
 - Tianjin Climate Exchange; and
 - (b) classify 3 commodity exchanges as specified exchanges in the FRR, namely
 - (i) European Energy Exchange AG;
 - (ii) Guangzhou Futures Exchange; and
 - (iii) MIAX Futures Exchange, LLC.

Facilitating diversification into emerging markets

95. To facilitate business diversification into emerging markets, we propose to classify the following exchanges as specified exchanges in the FRR so that shares listed on these exchanges will enjoy lower haircut percentages:
- (a) The Saudi Exchange;
 - (b) Hochiminh Stock Exchange; and
 - (c) Indonesia Stock Exchange.

Facilitate greater connection with the Mainland stock markets

96. We propose to lower the FRR haircut percentages of constituents of the following Mainland stock indices to better reflect their market risk and facilitate greater connection with the Mainland stock markets:
- (a) FTSE China A50 Index and MSCI China A 50 Connect Index – lowered from 30% to 15%;
 - (b) CSI 300 Index – lowered from 30% to 20%.

Proposed FRR treatments of VA futures and options

97. To facilitate VA derivative trading and diversify the services and products available to investors in Hong Kong on licensed VA exchanges, we propose to extend the application of the existing FRR treatments for futures and options contracts traded on a specified exchange to futures and options contracts that have VA (including VA index) as underlying and are traded on a licensed VA exchange⁴⁸.
98. The policy is premised on the SFC's regulation of licensed VA exchanges and the services and products provided by such exchanges through imposing specific licensing conditions and other regulatory tools. In granting the licence to a VA exchange and permitting any new business to be undertaken by the exchange, the SFC will ensure the exchange has the necessary governance, infrastructure, financial resources and risk management framework for undertaking the new business (such as trading, settlement, collateral and default management, etc).
99. Nevertheless, the product characteristics of VA futures and options as well as the operating models of VA exchanges offering these products may be materially different from those traded at specified exchanges, and may give rise to different risk profiles at LCs engaging in these products. To facilitate market development and accommodate different product characteristics of VA derivatives, an LC engaging in VA derivative transactions may be required to comply with additional financial resources requirements to cater for potential incremental risks incurred by the LC.

Question:

9. Do you agree that VA futures and options traded on a licensed VA exchange should be treated in the same way as futures and options traded on a specified exchange under the FRR? If not, please explain.

Proposed exemption for centrally-cleared repos

100. Repos can be traded with or without central clearing. The benefits of central clearing repos for market participants include counterparty credit risk reduction (through facing the CCP rather than the repo counterparty), netting of risk exposures and margin, and regulatory capital benefits.
101. Some overseas CCPs already provide central clearing services for repos. For example, via the RepoClear service, LCH Ltd in the UK offers members the ability to clear UK government cash bonds and repos, whereas LCH SA in France enables members to clear cash bond and repo transactions across 13 European debt markets. In the US, Depository Trust and Clearing Corporation's Fixed Income Clearing Corporation provides central clearing services for repos.

⁴⁸ "Licensed VA exchange" means a VA exchange operated by an LC that is licensed for Type 2 and Type 7 regulated activities and is granted a licence under section 53ZRK of the Anti-Money Laundering and Counter-Terrorist Financing Ordinance (Cap. 615) in respect of the operation of the VA exchange.

102. In addition, in December 2023 the US SEC had mandated central clearing for US Treasuries and repos by 31 December 2025 and 30 June 2026 respectively. In February 2025, the US SEC extended the compliance deadline by 1 year to 31 December 2026 and 30 June 2027 for cash market and repo transactions respectively⁴⁹.
103. In line with the Hong Kong Government's goal of enhancing Hong Kong's status as an international financial centre, the SFC is exploring the feasibility of establishing central clearing services for repos to facilitate the development of Hong Kong into a regional hub for fixed income and currency activities.
104. Given that central clearing can reduce counterparty credit risk of repos, there is room for reducing the FRR risk charges on repos that are centrally cleared by a well-regulated CCP. This is consistent with the existing treatment under the FRR for a securities borrowing and lending agreement entered into with an approved securities borrowing and lending counterparty which is exempted from the risk charge for counterparty credit risk.
105. To facilitate the development of the inter-dealer repo market in Hong Kong and promote central clearing of repos, we propose to exempt repos that are centrally cleared by a CCP approved for the purposes of the FRR by the SFC from the risk charge for counterparty credit risk⁵⁰.

Question:

10. Do you agree that repos that are centrally cleared by an approved CCP should be exempt from the risk charge for counterparty credit risk? If not, please explain.

Proposed control over election made by LC under the FRR

106. Currently, an LC may elect to use an alternative calculation method provided in the FRR⁵¹ at their own volition. There is no provision in the FRR that enables the SFC to override an election made by an LC, even if the SFC considers that the election may not be suitable in the circumstances.
107. To improve the SFC's control over elections made by LCs under the FRR, we propose to allow the SFC to override an election made by the LC if the SFC is satisfied that it is prudent to do so, taking into account the risks associated with the LC.

Question:

11. Do you agree that the SFC should have the power to override an election made by an LC under the FRR if the SFC is satisfied that it is prudent to do so, taking into account the risks associated with the LC?

⁴⁹ <https://www.sec.gov/newsroom/press-releases/2025-43>.

⁵⁰ i.e. the ranking liabilities referred to in section 46(1) and (2) of the FRR.

⁵¹ For example, an LC may elect under section 21(2) to set off, on a client-by-client basis, any amount receivable from, and amount payable to, a client arising from securities transactions, subject to client written authorisation to set off such amounts and dispose of the client's securities.

VIII. Concluding remarks

108. We take this opportunity to thank all respondents who took the time and effort to provide useful comments on the proposals in the 2017 Consultation Conclusions and Further Consultation Paper. The comments and suggestions have helped us refine and finalize many key aspects of the changes to the FRR.
109. We invite the public to submit their comments on the proposals discussed in this paper and the appended draft FRR amendments, IMA Guidelines and MRM Principles.

Appendix 1: List of respondents

(in alphabetical order)

1. BlackRock Asset Management North Asia Limited
2. ComplianceAsia Consulting Limited
3. CompliancePlus Consulting Limited
4. Credit Suisse (Hong Kong) Limited
5. Hong Kong Investment Funds Association
6. International Swaps and Derivatives Association, Inc.

Appendix 2: Proposed minimum capital requirements⁵² and default approach for Market risk and Counterparty credit risk calculation for different types of LCs

Applicable LCs	Paid-up share capital requirement ⁵³	Tangible capital requirement	Required liquid capital (floor requirement)	Default approach for Market risk and Counterparty credit risk calculation
LCs conducting OTCD dealing under Type 1, 2, 3 or 11 regulated activity				
(a) deals in OTCDs cleared by regulated central counterparty only	HK\$30 million	Not applicable	HK\$15 million	Standardized
(b) deals as affiliated asset manager's central dealing desk only	HK\$30 million	Not applicable	HK\$15 million	Basic
(c) deals as inter-dealer broker only	HK\$60 million	Not applicable	HK\$30 million	Basic
(d) in any other case				
(i) OTCD activity level below specified thresholds	Not applicable	HK\$500 million	HK\$78 million	Standardized
(ii) in any other case	Not applicable	HK\$1 billion	HK\$156 million	Standardized
LCs conducting OTCD clearing under Type 12 regulated activity				
(a) OTCD activity level below specified thresholds	Not applicable	HK\$1 billion	HK\$195 million	Standardized
(b) in any other case	Not applicable	HK\$2 billion	HK\$390 million	Standardized
LCs operating OTCD platform under Type 7 regulated activity				
(a) OTCD dealing platform	Not applicable	HK\$1 billion	HK\$156 million	Standardized
(b) OTCD clearing platform	Not applicable	HK\$2 billion	HK\$390 million	Standardized
LCs conducting OTCD advising under Type 4, 5 or 11 regulated activity				
(a) cannot hold client assets	Not applicable	Not applicable	HK\$100,000	Basic
(b) in any other case	HK\$5 million	Not applicable	HK\$3 million	Basic

⁵² An LC is required to comply with the highest of the capital requirements applicable to its activities.

⁵³ Not applicable if the LC is subject to tangible capital requirement under other items.

Applicable LCs	Paid-up share capital requirement ⁵³	Tangible capital requirement	Required liquid capital (floor requirement)	Default approach for Market risk and Counterparty credit risk calculation
LCs conducting OTCD asset management under Type 9 regulated activity				
(a) cannot hold client assets	Not applicable	Not applicable	HK\$100,000	Basic
(b) in any other case	HK\$5 million	Not applicable	HK\$3 million	Basic
LCs approved to use latest Basel capital standards				
(a) has no OTCD activity	HK\$30 million	Not applicable	HK\$15 million	Basic
(b) has OTCD activity				
(i) deals in OTCDs cleared by regulated central counterparty only and does not clear OTCDs	HK\$30 million	Not applicable	HK\$15 million	The approach applicable to the type of OTCD activity
(ii) in any other case				
(A) OTCD activity level below specified thresholds	Not applicable	HK\$500 million	HK\$78 million	The approach applicable to the type of OTCD activity
(B) in any other case	Not applicable	HK\$1 billion	HK\$156 million	The approach applicable to the type of OTCD activity
LCs approved to use internal models approach	Not applicable	HK\$2 billion	HK\$156 million	The approach applicable to the type of OTCD activity

Appendix 3: Summary of major incidental and technical changes

A. Minimum capital requirements

Description of change	Reason for change
1. Allow the reference date adopted for the comparison of OTCD activities with the applicable thresholds ⁵⁴ for reduced capital requirements ⁵⁵ to be within one month before the effective date of opting for reduced capital requirements or submission date of semi-annual return on the comparison results	Allow sufficient time for LCs to gather and analyse the necessary data for the comparison
2. Exclude from the definition of <i>non-RA11 OTCD dealer</i> LCs whose OTC derivative dealing is limited to OTC derivative products that are listed securities or futures or options contracts traded on a specified exchange or licensed VA exchange	Align the FRR treatments for regulated activities of similar nature
3. Require LCs licensed for Type 12 regulated activity to comply with the same minimum capital requirements as Type 1 or 2 regulated activity if their Type 12 regulated activity involves only listed securities or futures or options contracts traded on a specified exchange or licensed VA exchange	Align the FRR treatments for regulated activities of similar nature
4. Require LCs carrying on new Type 7 activity to comply with the same minimum capital requirements as the existing Type 7 regulated activity if the new Type 7 activity involves only listed securities or futures or options contracts traded on a specified exchange or licensed VA exchange	Align the FRR treatments for regulated activities of similar nature

⁵⁴ Referred to as OTCD de minimis thresholds in the 2015 Consultation Paper.

⁵⁵ Referred to as OTCD de minimis reduction in the 2015 Consultation Paper.

B. Market risk

Description of change	Reason for change
SMRA	
1. Calculate market risk charge for positions in a basket of equities, debt securities or commodities, or an index on such baskets based on the highest or weighted average of the market risk charge percentages applicable to the constituents of the basket	Align with the existing FRR policy for special debt securities, equity-linked instruments and index funds
2. Update the specific risk charge percentages for investment grade securitization and re-securitization issues based on the risk weights applied by the Banking (Capital) Rules ⁵⁶	Align with the approach taken by the Banking (Capital) Rules
3. Exclude matched positions not subject to specific risk charge from general risk charge calculation in the interest rate risk framework	Align the general risk charge and specific risk charge treatments of matched positions
4. No offsetting of the gamma impacts and vega impacts of options contracts on illiquid investments, baskets constituted by illiquid investments only or indices based on such baskets	Ensure prudent treatments of options on illiquid underlying
5. Classify contract for differences as common derivative	Ensure policy consistency for derivatives with similar risk profiles
6. Limit the application of the simplified approach in option risk framework to options on an underlying subject matter which is not a derivative contract	Ensure options on derivatives are subject to delta-plus approach in option risk framework
7. Exempt positions in gold, foreign currencies, exchange rates or interest rates from concentration risk charge	Positions in these matters are less prone to concentration risk given the depth and breadth of their underlying markets

⁵⁶ Benchmarked to Table 25 in section 265(4) of the Banking (Capital) Rules.

Description of change	Reason for change
BMRA	
1. Carve out OTC derivative products that are listed securities or futures or options contracts traded on a specified exchange or licensed VA exchange from the application of the market risk charges on OTC derivative products. Such products will be covered by the current FRR treatments for listed securities or futures or options contracts.	Align the FRR treatments for products of similar nature
2. Align the treatment of futures contracts and options contracts traded other than on a specified exchange	Ensure policy consistency
3. Limit the application of the concentration risk charge under section 44 of the FRR to net spot positions, extend its coverage to miscellaneous investments and illiquid investments, and disapply the risk charge to gold and net long spot positions in securities and investments that are subject to 100% haircut	Rationalise the scope of application of concentration risk charge
4. Align the haircut percentage for a qualifying debt security that is a securitization or re-securitization issue with the specific risk charge percentage proposed under SMRA for such securities	Ensure consistency with SMRA
Applicable to both SMRA and BMRA	
1. Apply an 8% risk charge for foreign exchange risk if the underlying exposure of the following products is denominated in a foreign currency: (a) SMRA - uncommon derivatives; (b) BMRA - OTC derivative products and miscellaneous derivatives	Ensure sufficient capital to cover foreign exchange risk
2. Assign a 30% haircut to closed-end funds	Reflect the higher risk of close-end funds due to redemption restrictions

C. Counterparty credit risk

Description of change	Reason for change
Applicable to both SOCCRA and BOCCRA	
1. Exclude cash collateral posted and held in a segregated account from the calculation of certain risk charges	Complement the segregation requirement for non-centrally cleared OTCD ⁵⁷ and reflect the lower default risk of segregated cash collateral
2. Carve out from the application of SOCCRA and BOCCRA transactions in OTC derivative products that are listed securities or futures or options contracts traded on a specified exchange or licensed VA exchange. Such transactions will be covered by their current applicable FRR treatments	Align the FRR treatments for products of similar nature
SOCCRA	
1. Allow recognition of eligible guarantee and eligible credit derivative contract in the calculation of risk charge for past due OTCD transactions	Rationalise the basis of risk charge calculation
2. Remove the cap of 100% for the risk weight for Hong Kong PSE exposure ⁵⁸	Align with the approach taken by the Banking (Capital) Rules
3. Treat certificates of deposits issued by an authorized financial institution or an approved bank incorporated outside Hong Kong as eligible collateral	Align with the policy in other parts of the FRR
4. Cap the haircut percentage for collateral at 100%	Rationalise the haircut percentages for collateral
5. Expand the CVA charge exemption to exposures to clearing intermediaries of Regulated CCP that are qualified to be allocated a 4% risk weight ⁵⁹	Align with the approach taken by the Banking (Capital) Rules

⁵⁷ Please see paragraph 24 of Part III of Schedule 10 to the Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission.

⁵⁸ Benchmarked to section 57(1) of Banking (Capital) Rules.

⁵⁹ Benchmarked to section 1(c) and (ca) of Schedule 1A of the Banking (Capital) Rules.

Description of change	Reason for change
6. Use a longer minimum holding period for calculation of haircut on collateral and currency mismatch in specified circumstances (for example, where the netting agreement covers more than 5,000 transactions) ⁶⁰	Align with the approach taken by the Banking (Capital) Rules
7. Update PFE percentages used in modified current exposure method ⁶¹	Align with the approach taken by the Banking (Capital) Rules
8. Clarify that PFE amount of a derivative with multiple underlyings shall be calculated as the highest of the PFE amounts calculated on each underlying unless otherwise specified by the SFC using an alternative method	Clarify calculation details
9. Require apportioning collateral received or posted for multiple transactions by the number of transactions covered or on an approved alternative basis	Clarify calculation details
10. Require apportioning eligible guarantee or eligible credit derivative contract protecting multiple transactions according to the terms of the guarantee or contract	Clarify calculation details
11. Exclude n th -to-default credit derivatives from eligible credit risk mitigation ⁶²	Align with the approach taken by the Banking (Capital) Rules
12. Include LCs in the list of eligible credit protection providers ⁶³	Align with the approach taken by the Banking (Capital) Rules
13. Exclude from the list of eligible credit protection providers entities that are insolvent or bankrupt or have defaulted on long-term senior unsecured debt securities	Ensure the credit quality of eligible credit protection provider

⁶⁰ Benchmarked to section 226M of the Banking (Capital) Rules.

⁶¹ Benchmarked to section 226MD of the Banking (Capital) Rules.

⁶² Benchmarked to section 99(1)(a) of the Banking (Capital) Rules.

⁶³ Benchmarked to section 99A(2)(a)(vii) of the Banking (Capital) Rules.

Description of change	Reason for change
Basel-like approach for repo-style transactions	
1. Provide treatments for margins exchanged by counterparties	Reflect market practice
2. Allow offsetting of exposure and collateral of a transaction that are in the same asset or denominated in the same currency	Ensure policy consistency with SOCCRA
3. Recognize the credit risk mitigation effect of eligible guarantee and eligible credit derivative contract	Ensure policy consistency with SOCCRA
4. Exclude collateral posted and held in a bankruptcy remote manner from exposure calculation	Ensure policy consistency with SOCCRA

D. Sundry requirements

Description of change	Reason for change
1. Include LCs that have been carrying on Type 7 regulated activity on OTC derivative products for 2 years or more immediately before the commencement date of the OTCD licensing regime (commencement date) into the coverage of the transitional arrangement of the 2017 Concluded Framework proposed for LCs that have been carrying on Type 1, 2 or 3 regulated activity on OTC derivative products for 2 years or more immediately before the commencement date	Ensure a level playing field for pre-existing OTCD LCs licensed for Type 7 regulated activity and pre-existing OTCD LCs licensed for Type 1, 2 or 3 regulated activity that have been carrying on OTCD business during similar period of time
2. Provide a transitional arrangement in the first 6 months after the commencement date for LCs that have been carrying on Type 1, 2, 3 or 7 regulated activity on OTC derivative products for less than 2 years immediately before the commencement date. Such LCs must comply with all applicable requirements after the expiry of this 6-month transitional period	Ensure a level playing field for pre-existing OTCD LCs licensed for Type 1, 2, 3 or 7 regulated activity and unlicensed firms that have been carrying on OTCD business during similar period of time

Description of change	Reason for change
3. Change the criteria of qualifying a bank as approved bank incorporated outside Hong Kong from its place of incorporation to whether it is subject to Basel capital requirements and has an investment grade credit rating	Enhance the objectivity of the basis of recognition of such banks
4. Remove all references to “specific and general provisions for bad or doubtful debts”	Align with the latest accounting principles relating to expected credit losses
5. Require LCs providing client clearing and settlement services for transactions in miscellaneous derivatives ⁶⁴ other than derivative note to include client margin shortfall in ranking liabilities	Ensure policy consistency with SOCCRA

⁶⁴ “Miscellaneous derivative” refers to a derivative that is not traded on an exchange but excludes an OTC derivative product.

Appendix 4: Draft amendments to the Securities and Futures (Financial Resources) Rules

Please see separate document

Appendix 5: Draft Guidelines for Internal Models Approach for FRR Market Risk Charges Calculation

Please see separate document

Appendix 6: Major enhancements of Basel 2.5 standards and other major technical changes in draft IMA Guidelines

Major enhancements of Basel 2.5 standards in IMA Guidelines	
Description of enhancements	Reason for change
1. Exclude securitization issues and correlation trading portfolios from the use of internal models approach	Align with the latest Basel capital standards
2. Require the approved LCs to identify, measure, monitor, manage and report illiquidity risks	Ensure illiquidity risks are properly managed
3. Require the approved LCs to quantify impact on liquid capital of risks-not-in-IMA model (RNIM)	Ensure proper coverage of market risks that are excluded from or cannot be properly measured by its internal models.
4. Require the approved LCs to maintain sufficient excess liquid capital to cover illiquidity risks and RNIM	Ensure proper coverage of illiquidity risks and RNIM
5. Require an approved LC to provide documentation of its routine process, which are additional to its back-testing and model validation processes, to ensure its internal models provide reasonably accurate assessment of the risks arising from in-scope positions, such as comparison of hypothetical P&L with the P&L calculated by the internal models' valuation methodologies	Require approved LCs to closely monitor the materiality of differences in risk assessment that might be caused by simplifications of the way positions are valued by the internal models compared to front office system
6. Require an approved LC to compare trends of Regulatory VaR against ES and trends of Regulatory Stressed VaR against Stressed ES	Encourage approved LCs to identify significant tail risks
Other major technical changes after the 2017 Consultation Conclusions and Further Consultation Paper	
Description of change	Reason for change
1. Allow an approved LC to, subject to the SFC's approval, include all listed equity and listed equity-based derivative positions of a trading desk in incremental risk charge (IRC) model if such positions are included in its internal measurement and management of incremental risk at the trading desk level. Alternatively, the SFC may request the LC to include all or	Align with Basel 2.5 standards

part of these equity positions in its IRC model	
2. Require an approved LC to submit an annual written attestation confirming compliance with the IMA Guidelines and the conditions on the approval	Enhance compliance control over the approval

Appendix 7: Draft General Principles for Model Risk Management

Please see separate document

Appendix 8: Key developments of Basel III Reform

Timeline	Major developments
June 2011	BCBS published <i>Basel III: A global regulatory framework for more resilient banks and banking systems, December 2010 (rev. June 2011)</i> , which included a CVA risk framework which took effect on 1 January 2013.
April 2014	BCBS published <i>The standardized approach for measuring counterparty credit risk exposures, March 2014 (rev. April 2014)</i> , which took effect on 1 January 2017.
July 2015	BCBS published <i>Consultative Document - Review of the Credit Valuation Adjustment Risk Framework Issued, July 2015</i>
January 2016	BCBS published <i>Minimum capital requirements for market risk, January 2016</i> , which was scheduled to take effect in January 2019.
December 2017	BCBS published <i>Basel III: Finalising post-crisis reforms (Final Basel III reform package)</i> , which included SA-CR and a new CVA risk framework. The Final Basel III reform package was scheduled to take effect on 1 January 2022.
March 2018	BCBS published <i>Consultative Document – Revisions to the minimum capital requirements for market risk, March 2018</i> .
February 2019	BCBS published <i>Minimum capital requirements for market risk, January 2019 (rev. February 2019)(Final market risk framework)</i> , which was scheduled to take effect on 1 January 2022.
November 2019	BCBS published <i>Consultative Document - Credit Valuation Adjustment risk: targeted final revisions, November 2019</i> .
March 2020	BCBS announced deferral of the implementation of the Final Basel III reform package and final market risk framework to 1 January 2023.
July 2020	BCBS published <i>Targeted revisions to the credit valuation adjustment risk framework, July 2020 (Final CVA risk framework)</i> , which would be consolidated into the Basel Framework.
January 2023	The Final Basel III reform package, Final market risk framework and Final CVA risk framework took effect on 1 January 2023.

Appendix 9: Summary of status of implementation of the Basel Framework of major financial centres

Standards in the Basel Framework	Implementation status					
	HKMA	Singapore	EU	UK	US	Australia
SA-CCR	Implemented	Implemented	Implemented	Implemented	Implemented	Implemented
SA-CR	Implemented	Implemented	Implemented	Target: 1/1/2027 ⁶⁵	No published timeline ⁶⁶	Implemented
Final CVA risk framework	Implemented	Implemented	Implemented			No published timeline ⁶⁷
Final market risk framework	Implemented	Implemented	Target: 1/1/2027 ⁶⁸			

⁶⁵ The Prudential Regulation Authority announced on 17 January 2025 that it has decided to delay the implementation of the Basel III-related proposed rules in the UK by one year until 1 January 2027. <https://www.bankofengland.co.uk/news/2025/january/the-pra-announces-a-delay-to-the-implementation-of-basel-3-1>

⁶⁶ Federal Reserve Board announced on 10 September 2024 its intent to re-propose the Basel III-related proposed rules. No re-proposal had been published when this paper was issued. <https://www.federalreserve.gov/newsevents/speech/barr20240910a.htm>

⁶⁷ In an information paper on policy initiatives published in February 2023, Australian Prudential Regulation Authority stated that it expected to consult in 2024 on revisions to Prudential Standard APS 116 Market Risk (APS 116) and Prudential Standard APS 180 Counterparty Credit Risk (APS 180), and will delay effective dates to 2026. No consultation had been published when this paper was issued. <https://www.apra.gov.au/information-paper-apra%E2%80%99s-policy-priorities>

⁶⁸ The European Commission announced on 12 June 2025 that it had adopted a delegated act to postpone, by one additional year until 1 January 2027, the date of application of the Basel III market risk standards (i.e. Fundamental Review of the Trading Book) in the EU. https://ec.europa.eu/commission/presscorner/detail/en/ip_25_1478

Personal information collection statement

1. This Personal Information Collection Statement (**PICS**) is made in accordance with the guidelines issued by the Privacy Commissioner for Personal Data. The PICS sets out the purposes for which your Personal Data⁶⁹ will be used following collection, what you are agreeing to with respect to the SFC's use of your Personal Data and your rights under the Personal Data (Privacy) Ordinance (Cap 486) (**PDPO**).

Purpose of collection

2. The Personal Data provided in your submission to the SFC in response to this consultation paper may be used by the SFC for one or more of the following purposes:
 - (a) to administer the relevant provisions⁷⁰ and codes and guidelines published pursuant to the powers vested in the SFC;
 - (b) in performing the SFC's statutory functions under the relevant provisions;
 - (c) for research and statistical purposes; and
 - (d) for other purposes permitted by law.

Transfer of personal data

3. Personal Data may be disclosed by the SFC to members of the public in Hong Kong and elsewhere as part of the public consultation on this consultation paper. The names of persons who submit comments on this consultation paper, together with the whole or part of their submissions, may be disclosed to members of the public. This will be done by publishing this information on the SFC's website and in documents to be published by the SFC during the consultation period or at its conclusion.

Access to data

4. You have the right to request access to and correction of your Personal Data in accordance with the provisions of the PDPO. Your right of access includes the right to request a copy of your Personal Data provided in your submission on this consultation paper. The SFC has the right to charge a reasonable fee for processing any data access request.

Retention

5. Personal Data provided to the SFC in response to this consultation paper will be retained for such period as may be necessary for the proper discharge of the SFC's functions.

⁶⁹ Personal Data means personal data as defined in the Personal Data (Privacy) Ordinance (Cap 486).

⁷⁰ The term "relevant provisions" is defined in section 1 of Part 1 of Schedule 1 to the Securities and Futures Ordinance (Cap 571) and refers to the provisions of that Ordinance, together with certain provisions in the Companies (Winding Up and Miscellaneous Provisions) Ordinance (Cap 32), the Companies Ordinance (Cap 622) and the Anti-Money Laundering and Counter-Terrorist Financing Ordinance (Cap 615).

Enquiries

6. Any enquiries regarding the Personal Data provided in your submission on this consultation paper, or requests for access to Personal Data or correction of Personal Data should be addressed in writing to:

Data Privacy Officer
Securities and Futures Commission
54/F One Island East
18 Westlands Road
Quarry Bay
Hong Kong
7. A copy of the Privacy Policy Statement adopted by the SFC is available upon request.

Securities and Futures (Financial Resources) Rules

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Securities and Futures (Financial Resources) Rules

(Cap. 571, sections 145 and 397)

[1 April 2003]

Part 1

Preliminary

1. (Omitted as spent)

2. Interpretation

(1) In these Rules, unless the context otherwise requires—

adjusted liabilities (經調整負債), for the purpose of calculating the variable required liquid capital in relation to a licensed corporation, means the sum of its on-balance sheet liabilities including provisions made for liabilities already incurred or for contingent liabilities, but excluding—

(a) amounts payable to clients in respect of—

- (i) client money held by it in a segregated account in accordance with the Securities and Futures (Client Money) Rules (Cap. 571 sub. leg. I);
- (ii) ~~to the extent not covered in subparagraph (i),~~ client money held by it in a segregated account with an authorized financial institution;
- (iii) client money held by it in a segregated account with an approved bank incorporated outside Hong Kong;
- (iv) client money held by it in a segregated account with a **specified** futures or options clearing house **or regulated CCP**; or

~~— (v) client money held by it with—~~

~~— (A) a clearing house other than a futures or options clearing house;~~

~~— (B) a clearing participant;~~

~~— (C) a futures dealer; or~~

~~— (D) a securities dealer,~~

~~as margin in respect of outstanding futures contracts and outstanding unlisted options contracts held by it on behalf of its clients;~~

~~(v) client money held by it as margin for opening a position or maintaining an existing position in any of the following contracts that is cleared by it on behalf of or for a client—~~

~~(A) an outstanding non-OTCD futures contract;~~

~~(B) an outstanding non-OTCD unlisted options contract;~~

(ab) any amount of scheme money held by a licensed corporation licensed for Type 13 regulated activity in—

- (i) a segregated account in accordance with the Securities and Futures (Client Money) Rules (Cap. 571 sub. leg. I);
- (ii) ~~to the extent not covered in subparagraph (i),~~ a segregated account with an authorized financial institution; or
- (iii) a segregated account with a bank incorporated outside Hong Kong;

- (ac) any amount held by a licensed corporation licensed for Type 13 regulated activity on behalf of—
 - (i) subscribers or scheme participants of a relevant CIS constituting subscription proceeds in respect of the relevant CIS;
 - (ii) unit holders, shareholders or scheme participants of a relevant CIS constituting redemption proceeds in respect of the relevant CIS; or
 - (iii) unit holders, shareholders or scheme participants of a relevant CIS constituting distribution proceeds in respect of the relevant CIS,
 in an account which is separate from its own account and designated for holding such proceeds maintained with an authorized financial institution, a bank incorporated outside Hong Kong or a person approved by the Commission under section 4(2) or 10B(2) of the Securities and Futures (Client Money) Rules (Cap. 571 sub. leg. I) for the purposes of those Rules;
- (ad) any amount payable to another person in respect of money held by it as OTCD initial margin in respect of any outstanding OTCD transaction effected by it;
- (b) an approved subordinated loan provided to it; and
- (c) any amount of its on-balance sheet liabilities which—
 - (i) arises from a tenancy agreement entered into by it in respect of any premises which it uses in carrying on the regulated activity for which it is licensed; and
 - (ii) is equal to the total value of its assets arising from the tenancy agreement which are not included in its liquid assets under any provision in Division 3 of Part 4;

adjusted OTCD receivable amount ()—see section 2FA(1)(a);

aggregate gross foreign currency position (合計外幣總持倉量), in relation to a licensed corporation licensed for Type 3 regulated activity, means the aggregate of all the gross foreign currency positions ~~held by a licensed corporation licensed for Type 3 regulated activity~~ of foreign currencies in respect of which the licensed corporation holds a position, excluding positions held with a recognized counterparty;

amount of margin required to be deposited (按規定須存放的保證金數額) means the amount of money required to be deposited as margin (whether the requirement is met by depositing money or any other asset, providing any other form of security, or any combination of both ~~the amount of money or by the provision of security instead of making such deposit~~)—

(a)—upon opening a position; or

(b)—for maintaining an existing position,

for opening a position or maintaining an existing position in a non-OTCD futures contract or ~~an~~ a non-OTCD unlisted options contract (**relevant contract**), calculated as the highest of the prevailing ~~margin~~ amounts set by—

- (~~ea~~) the exchange on which the ~~futures contract or unlisted options~~-relevant contract is traded;
- (~~eb~~) the clearing house who registers such trade;
- (~~ec~~) the agent who executes such trade for the licensed corporation;
- (~~ed~~) the counterparty who executes such trade with the licensed corporation; and
- (~~ee~~) the licensed corporation itself;

applicable threshold (), in relation to a licensed corporation's OTCD activity level—see section 2EB(5);

approved bank incorporated outside Hong Kong (核准的在香港以外成立為法團的銀行) means—

- (a) ~~a bank incorporated under the law or other authority of a prescribed country, a~~ Basel-covered bank, other than an authorized financial institution, that is currently rated by, or has an issue or issues currently rated by—
 - (i) Moody's Investors Service at either Baa3 or P-3 or above;
 - (ii) Standard & Poor's Corporation at either BBB- or A-3 or above; or
 - (iii) Fitch Ratings at either BBB- or F3 or above,
 and includes any of its branches or wholly owned subsidiaries which is a bank; or
- (b) any other bank approved as such under section 58(1)(a), and includes any of its branches or wholly owned subsidiaries which is a bank;

approved BMRA-LC () means a licensed corporation that is approved as such under section 58(4B)(d);

approved BOCCRA-LC () means a licensed corporation that is approved as such under section 58(4B)(c);

approved credit rating agency (核准信貸評級機構) means a person approved as such under section 58(1)(b);

approved internal model LC () means a licensed corporation that is approved under section 58(5B) to adopt a model described in paragraph (b) of the definition of **alternative approach** in section 53A(4);

approved latest Basel LC () means a licensed corporation that is approved under section 58(5B) to adopt the methodologies described in paragraph (a) of the definition of **alternative approach** in section 53A(4);

approved introducing agent (核准介紹代理人) means a licensed corporation approved as such under section 58(4);

approved redeemable shares (核准可贖回股份) means redeemable shares in the share capital of a licensed corporation approved as such under section 58(5)(a);

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

- (a) a recognized clearing house; or
- (b) a person approved as such under section 58(1)(c);

approved SMRA-LC () means a licensed corporation that is approved as such under section 58(4B)(b);

approved SOCCRA-LC () means a licensed corporation that is approved as such under section 58(4B)(a);

approved standardized approach LC () means—

- (a) an approved SOCCRA-LC; or
- (b) an approved SMRA-LC;

approved standby subordinated loan facility (核准備用後償貸款融通) means a standby subordinated loan facility obtained by a licensed corporation licensed for Type 1, Type 2, Type 3 or Type 8 regulated activity, which is approved as such under section 58(5)(c);

approved subordinated loan (核准後償貸款) means a subordinated loan obtained by a licensed corporation approved as such under section 58(5)(b);

asset management group central OTCD dealer ()—see section 2EE(2);

authorized financial institution (認可財務機構) means—

- (a) a bank within the meaning of section 2(1) of the Banking Ordinance (Cap. 155) and includes any of its branches;
- (b) any wholly owned subsidiary of a bank referred to in paragraph (a) which is a bank; or
- (c) the principal place of business in Hong Kong, and any local branch, of a restricted licence bank or a deposit-taking company, in each case within the meaning of section 2(1) of the Banking Ordinance (Cap. 155);

authorized fund (認可基金) means a unit trust or mutual fund that is authorized by the Commission under section 104 of the Ordinance;

Basel Committee () has the meaning given by section 2(1) of the Banking Ordinance (Cap. 155);

Basel-covered bank () has the meaning given by section 1(1) of Schedule 6;

Basel-covered securities firm () has the meaning given by section 1(1) of Schedule 6;

basic amount (基本數額), in relation to a licensed corporation, means 5% of the aggregate of—

- (a) its adjusted liabilities;
- (b) other than a licensed corporation licensed for Type 13 regulated activity in relation to the carrying on by it of Type 13 regulated activity, the aggregate of the initial margin requirements in respect of outstanding **non-OTCD** futures contracts and outstanding **non-OTCD** unlisted options contracts ~~held-cleared~~ by it on behalf of ~~or for~~ its clients (**outstanding contracts**); and
- (c) other than a licensed corporation licensed for Type 13 regulated activity in relation to the carrying on by it of Type 13 regulated activity, the aggregate of the amounts of margin required to be deposited in respect of ~~outstanding futures contracts and outstanding unlisted options contracts held by it on behalf of its clients—the~~ **outstanding contracts**, to the extent that ~~such—the~~ outstanding contracts are not subject to payment of initial margin requirements;

BMRA-LC ()—see section 2EF(4);

BOCCRA-LC ()—see section 2EF(2);

CCP portfolio ()—see section 2EC(3);

CCP transaction ()—see section 2J(4);

clearing client ()—see section 2AA(b);

clearing house (結算所) means a person—

- (a) whose activities or objects include the provision of services for the clearing and settlement of transactions in, or the day-to-day adjustment of the financial position of, **non-OTCD** futures contracts or **non-OTCD** unlisted options contracts effected on an exchange;
- (b) whose activities or objects include the provision of services for the clearing and settlement of transactions in **non-OTCD** securities effected on an exchange; or
- (c) who guarantees the settlement of any such transactions as are referred to in paragraph (a) or (b),

but does not include a corporation operated by or on behalf of the Government;

clearing intermediary ()—see section 2AA(a);

clearing participant (結算所參與者)—

- (a) in relation to a recognized clearing house, means a clearing participant within the meaning of section 1 of Part 1 of Schedule 1 to the Ordinance; ~~or~~
- (b) in relation to a clearing house other than a recognized clearing house, means a person who, in accordance with the rules of the clearing house, may participate in one or more of the services provided by the clearing house in its capacity as a clearing house, and whose name is entered in a list, roll or register kept by the clearing house as a person who may participate in one or more of the services provided by the clearing house; ~~or~~
- (c) in relation to a central counterparty, means—
 - (i) a member of, or a direct participant in, the central counterparty that is entitled to enter into (or arrange another person to enter into) a transaction with the central counterparty; or
 - (ii) if the following conditions are satisfied in relation to another central counterparty (**other CCP**), the other CCP—
 - (A) the other CCP has a link to the central counterparty; and
 - (B) a member of, or a direct participant in, the other CCP—
 - (I) is entitled to enter into (or arrange another person to enter into) a transaction with the other CCP; and
 - (II) is able to clear transactions through the central counterparty via the link;

clearing portfolio (agency clearing) ()—see section 2EC(2)(c);

clearing portfolio with client ()—see section 2EC(2)(a);

clearing transaction with client ()—see section 2J(3)(a);

collateral (抵押品), in relation to a licensed corporation, means—

- (a) any listed shares;
 - (ab) any listed depositary receipts;
 - (b) any specified securities;
 - (c) any qualifying debt securities; or
 - (d) any special debt securities,
- which—
- (e) are deposited as security by the licensed corporation with another person; or
 - (f) are deposited as security with the licensed corporation by another person, and—
 - (i) are unencumbered in its possession and readily realizable by it;
 - (ii) are encumbered only by virtue of being lent, deposited or pledged by it in accordance with the requirements of the Securities and Futures (Client Securities) Rules (Cap. 571 sub. leg. H); or
 - (iii) to which the Securities and Futures (Client Securities) Rules (Cap. 571 sub. leg. H) do not apply, are encumbered only by virtue of being deposited or pledged by it with or to—
 - (A) an authorized financial institution or an approved bank incorporated outside Hong Kong;
 - (B) a person who is licensed, registered or authorized by an authority or regulatory organization outside Hong Kong, for an activity which, if

carried on in Hong Kong, would constitute Type 1, Type 2, Type 3 or Type 8 regulated activity; or

- (C) a clearing house of a specified exchange or any of its clearing participants to secure its obligation to meet its clearing obligations or liabilities;

collateralized warrants (有抵押權證) means derivative warrants listed on a recognized stock market in respect of which the issuer owns all of the underlying securities or other assets to which the warrants relate and grants a charge over those securities or assets in favour of an independent trustee who acts for the benefit of the warrant holders;

commodity () excludes gold;

commodity index () means an index that is calculated by reference to the price or value of a basket of commodities;

common client (共同客戶) means a client of a securities dealer who is also a client of a licensed corporation licensed for Type 8 regulated activity and whose dealings in securities by the securities dealer are settled on his behalf by the licensed corporation;

common commodity derivative ()—see section 2N(2)(a);

common credit derivative ()—see section 2N(2)(g);

common debt security derivative ()—see section 2N(2)(b);

common derivative ()—see section 2N(1)(a);

common equity derivative ()—see section 2N(2)(c);

common exchange rate derivative ()—see section 2N(2)(d);

common gold derivative ()—see section 2N(2)(e);

common interest rate derivative ()—see section 2N(2)(f);

continuous options contract () has the meaning given by section 53ZZI;

controlled asset (受管制資產) means an asset—

- (a) that is an amount of a currency which, because a relevant prohibition applies to the currency, cannot (or cannot without approval from an authority or regulatory organization)—
 - (i) be remitted to Hong Kong; or
 - (ii) be exchanged into another currency which can be remitted to Hong Kong; or
- (b) the proceeds of which on realization cannot (or cannot without approval from an authority or regulatory organization) be remitted to Hong Kong, because a relevant prohibition applies to the proceeds;

coupon payment (票息付款), in relation to any securities or instrument, means a payment of interest (or other periodic return of a similar nature) to the holder of the securities or instrument during the tenor of the securities or instrument, that is calculated by reference to the principal value in accordance with the terms and conditions of the securities or instrument;

credit quality grade ()—see section 2 of Schedule 6;

currency () does not include a notional currency;

currency exchange rate (), in relation to a licensed corporation, means any exchange rate of a pair of currencies;

currency exchange rate index () means an index that is calculated by reference to the value of a basket of currency exchange rates or currencies;

debt securities () includes a certificate of deposit;

debt security index () means an index that is calculated by reference to the price or value of a basket of debt securities;

derivative contract (衍生工具合約) ~~means an agreement the purpose or effect of which is to obtain a profit or avoid a loss by reference to the value or price of property of any description or an index or other factor designated for that purpose in the agreement, and includes a futures contract or an options contract;~~

derivative instrument ()—see section 2AAB;

derivative note () means a derivative instrument that is in the form of shares, depositary receipts, stocks, debentures, loan stocks, bonds, notes, deposits or certificates of deposit;

derivative note with embedded common continuous option () means a derivative note that confers on either its issuer or holder (but not both) an option or right on the underlying subject matter of the note that, if it stood as a separate contract, would be a common derivative that is in the form of a continuous options contract;

direct offsetting portfolio ()—see section 2EC(2)(b);

direct offsetting transaction ()—see section 2J(3)(b);

equities (股本) means—

- (a) shares issued by a corporation (including shares in a mutual fund), ~~except shares constituting a derivative note; and~~
- (b) depositary receipts; or
- (c) units in a unit trust;

equity index () means an index that is calculated by reference to the price or value of a basket of equities;

equity-linked instruments (股票掛鉤票據) means securities within the description of such instruments under rules made under section 23 or 36 of the Ordinance governing the listing of securities and which are listed on a recognized stock market;

exchange participant (交易所參與者)—

- (a) in relation to a recognized exchange company, means an exchange participant within the meaning of section 1 of Part 1 of Schedule 1 to the Ordinance; or
- (b) in relation to an exchange outside Hong Kong, means a person who, in accordance with the rules of the exchange, may trade through that exchange, and whose name is entered in a list, roll or register kept by the exchange as a person who may trade through that exchange;

excluded liabilities (豁除負債), in relation to the on-balance sheet liabilities of a licensed corporation, means—

- (a) amounts payable to clients in respect of—
 - (i) client money held by it in a segregated account in accordance with the Securities and Futures (Client Money) Rules (Cap. 571 sub. leg. I);
 - (ii) client money held by it in a segregated account with an approved bank incorporated outside Hong Kong and, to the extent not covered in subparagraph (i), in a segregated account with an authorized financial institution;

- (iii) client money held by it in a segregated account with a recognized clearing house;
- (b) any amount of scheme money held by a licensed corporation licensed for Type 13 regulated activity in—
 - (i) a segregated account in accordance with the Securities and Futures (Client Money) Rules (Cap. 571 sub. leg. I); or
 - (ii) a segregated account with a bank incorporated outside Hong Kong and, to the extent not covered in subparagraph (i), a segregated account with an authorized financial institution; and
- (c) any amount held by a licensed corporation licensed for Type 13 regulated activity on behalf of—
 - (i) subscribers or scheme participants of a relevant CIS constituting subscription proceeds in respect of the relevant CIS;
 - (ii) unit holders, shareholders or scheme participants of a relevant CIS constituting redemption proceeds in respect of the relevant CIS; or
 - (iii) unit holders, shareholders or scheme participants of a relevant CIS constituting distribution proceeds in respect of the relevant CIS,
 in an account which is separate from its own account and designated for holding such proceeds maintained with an authorized financial institution, a bank incorporated outside Hong Kong or a person approved by the Commission under section 4(2) or 10B(2) of the Securities and Futures (Client Money) Rules (Cap. 571 sub. leg. I) for the purposes of those Rules;

floating losses (浮動虧損) means unrealized losses calculated by marking to market an open position in—

- ~~(a) a futures contract;~~
- (b) any securities;
- ~~(c) an options contract;~~
- (d) a derivative ~~contract~~ instrument;
- (e) a leveraged foreign exchange contract;
- (f) a foreign exchange agreement;
- ~~(g) an interest rate swap agreement;~~
- (h) a specified investment;
- (i) an illiquid investment; or
- (j) a miscellaneous investment;

floating profits (浮動利潤) means unrealized profits calculated by marking to market an open position in—

- ~~(a) a futures contract;~~
- (b) any securities;
- ~~(c) an options contract;~~
- (d) a derivative ~~contract~~ instrument;
- (e) a leveraged foreign exchange contract;
- (f) a foreign exchange agreement;
- ~~(g) an interest rate swap agreement;~~
- (h) a specified investment;

- (i) an illiquid investment; or
- (j) a miscellaneous investment;

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

- (a) its reporting currency; and
- (b) any currency which has an exchange rate which is linked to the reporting currency under the linked exchange rate system operated by the Hong Kong Monetary Authority or a similar official system operated by an authority in a jurisdiction outside Hong Kong;

foreign exchange agreement (外匯協議) means an agreement other than ~~a futures contract and an options contract~~ derivative instrument, whereby the parties to the agreement agree to exchange different currencies at a future time;

forward contract ()—

- (a) includes a forward rate agreement; and
- (b) does not include an options contract or futures contract;

free delivery basis (信用交付形式) means the basis on which a sale or purchase of securities is effected, under which—

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

futures contract (期貨合約) has the meaning assigned to it by section 1 of Part 1 of Schedule 1 to the Ordinance save that it does not include an options contract;

~~**futures dealer** (期貨交易商) means—~~

- ~~—(a) a licensed corporation licensed for Type 2 regulated activity; or~~
- ~~—(b) a person licensed, registered or authorized by an authority or regulatory organization outside Hong Kong for an activity which, if carried on in Hong Kong, would constitute Type 2 regulated activity;~~

futures non-clearing dealer (期貨非結算交易商) means a licensed corporation licensed for Type 2 regulated activity which is an exchange participant of a recognized futures market, but is not a clearing participant of a recognized clearing house;

general clearing participant of HKSCC (香港結算公司全面結算所參與者) means a clearing participant of HKSCC that is authorized in accordance with the rules of HKSCC to provide general clearing services to exchange participants of the Stock Exchange Company;

general risk percentage ()—see section 4(1) of Schedule 9;

gross foreign currency position (外幣總持倉量)—see section 2A;

group of margined OTCD transactions ()—see section 2EC(1)(c);

haircut amount (扣減數額)—see section 2B;

haircut percentage (扣減百分率)—see section 2C;

HKSCC (香港結算公司) means the recognized clearing house known as Hong Kong Securities Clearing Company Limited;

home authority (), in relation to a non-freely floating foreign currency, means an authority of the jurisdiction of which the currency is the lawful currency;

Hong Kong Exchange Fund (香港外匯基金) means the Exchange Fund established under the Exchange Fund Ordinance (Cap. 66);

Hong Kong public sector entity () has the meaning given by section 1(1) of Schedule 6;

illiquid investment (低流通性投資項目) means—

- (a) shares that are not listed, except shares in a mutual fund that do not fall within paragraph (b);
- (b) units in a unit trust or shares in a mutual fund, where the unit trust or mutual fund—
 - (i) is not an authorized fund, a recognized jurisdiction fund or a specified exchange traded fund; or
 - (ii) is an authorized fund or a recognized jurisdiction fund, but—
 - (A) is not a specified exchange traded fund; and
 - (B) the units or shares are not redeemable within 30 days;
- (ba) a depositary receipt that is not listed;
- (c) debt securities that are not marketable debt securities;
- (d) listed securities that have been suspended from trading for at least 3 trading days on which the exchange on which the securities are listed is open for trading or ceased trading on any exchange on which the securities were listed, except where the securities can continue to be traded on any other exchange on which the securities are listed; or
- (e) ~~a commodity that is not~~ a non-tradable commodity;

initial margin requirement (規定開倉保證金) means the amount of money required to be deposited as margin (whether the requirement is met by depositing money or any other asset, providing any other form of security, or any combination of both ~~the amount of money or by the provision of security instead of making such deposit~~) ~~upon~~ for opening a position in a non-OTCD futures contract or ~~an~~ a non-OTCD unlisted options contract (**relevant contract**), calculated as the highest of the prevailing ~~margin~~ amounts set by—

- (a) the exchange on which the ~~futures contract or unlisted options relevant~~ contract is traded;
- (b) the clearing house who registers such trade;
- (c) the agent who executes such trade for the licensed corporation;
- (d) the counterparty who executes such trade with the licensed corporation; and
- (e) the licensed corporation itself;

interest rate swap agreement (掉期息率協議) ~~means an agreement whereby the parties to the agreement agree to exchange a series of interest payments over time;~~

in-the-money amount (價內值) means the amount calculated according to the following applicable formula—

- (a) in relation to a call options contract, $N \times (M - S)$; or
- (b) in relation to a put options contract, $N \times (S - M)$; ~~or,~~
- ~~(c) in relation to a call warrant on listed shares, $N \times (M - S)$;~~

where—

“N” represents—

- ~~—— (i) if the asset underlying the options contract or warrant is shares—the number of such shares;~~
- ~~—— (ii) if the asset underlying the options contract is an asset other than shares—the number of units of such asset; or~~
- ~~—— (iii) if an index underlies the options contract—the contract multiplier;~~
 - (i) if the underlying subject matter is securities, commodity, gold, currency or property (**asset**)—the number of units of such asset;
 - (ii) if the underlying subject matter is a basket of assets—the number of such basket;
 - (iii) if the underlying subject matter is an index—the contract multiplier;
 - (iv) if the underlying subject matter is an interest rate or currency exchange rate—the notional principal of such rate;
 - (v) if the underlying subject matter is a basket of indexes, interest rates or currency exchange rates—the number of such basket multiplied by—
 - (A) the monetary value per unit of, or per unit of change in, the value of the basket, determined according to the terms of the options contract; or
 - (B) an equivalent of such monetary value;
 - (vi) if the underlying subject matter is an instrument or a basket of instruments—the number of such instrument or basket;

“M” represents—

- ~~—— (i) if the asset underlying the options contract or warrant is shares—the market value of one such share;~~
- ~~—— (ii) if the asset underlying the options contract is an asset other than shares—the market value of one unit of such asset; or~~
- ~~—— (iii) if an index underlies the options contract—the current level of the index; and~~
 - (i) if the underlying subject matter is securities, commodity, gold, currency or property (**asset**)—the market value of one unit of such asset;
 - (ii) if the underlying subject matter is a basket of assets—the market value of such basket;
 - (iii) if the underlying subject matter is an index—the current level of the index;
 - (iv) if the underlying subject matter is an interest rate or currency exchange rate—the current level of the rate;
 - (v) if the underlying subject matter is a basket of indexes, interest rates or currency exchange rates—the current value of one such basket;
 - (vi) if the underlying subject matter is an instrument that is not a derivative instrument or a basket of such instruments—the market value of one such instrument or basket; or
 - (vii) if the underlying subject matter is a derivative instrument or a basket of derivative instruments—the price of one such instrument or basket;

“S” represents the strike price of the options contract ~~or the exercise price of the warrant—~~

- ~~—— (i) if the asset underlying the options contract or warrant is shares—for one such share;~~
- ~~—— (ii) if the asset underlying the options contract is an asset other than shares—for one unit of such asset; or~~

~~—(iii) if an index underlies the options contract—for the index;~~

- (i) if the underlying subject matter is securities, commodity, gold, currency or property (**asset**)—for one unit of such asset;
- (ii) if the underlying subject matter is an index—for the index;
- (iii) if the underlying subject matter is an interest rate or currency exchange rate—for the rate;
- (iv) if the underlying subject matter is a basket of assets, indexes, interest rates or currency exchange rates—for one such basket;
- (v) if the underlying subject matter is an instrument or a basket of instruments—for one such instrument or basket;

intermediary transaction (agency clearing) ()—see section 2J(2)(d);

intermediary transaction (principal clearing) ()—see section 2J(2)(c);

JAA () has the meaning given by section 1(1) of Schedule 6;

JAA-equivalent non-Hong Kong public sector entity () has the meaning given by section 1(1) of Schedule 6;

liquid assets (速動資產), in relation to a licensed corporation, means the aggregate of the amounts required to be included in its liquid assets under the provisions of Division 3 of Part 4;

liquid capital (速動資金), in relation to a licensed corporation, means the amount by which its liquid assets exceeds its ranking liabilities;

listed (上市)—see section 2D;

long-term SCRA issue specific rating () has the meaning given by section 1(1) of Schedule 6;

margin client (保證金客戶)—

- (a) in relation to a licensed corporation licensed for Type 1 regulated activity, means a client to whom the licensed corporation provides securities margin financing; or
- (b) in relation to a licensed corporation licensed for Type 8 regulated activity, means any of its clients;

margin requiring party ()—see section 2DA(1);

market risk percentage ()—see section 1 of Schedule 9;

marketable debt securities (有價債務證券) means—

- (a) certificates of deposit issued by an authorized financial institution or an approved bank incorporated outside Hong Kong; or
- (b) debt securities (other than certificates of deposit referred to in paragraph (a)) in respect of which—
 - (i) there are genuine offers to buy and sell so that a price reasonably related to the last sales price or current bid and offer quotations can be determined within 1 business day, and transactions can be settled at that determined price promptly in accordance with trading conventions; or
 - (ii) quotations are available within 1 business day from any combination of 2 or more of the following persons who customarily deal in the debt securities—
 - (A) market makers;
 - (B) banks;
 - (C) securities dealers outside Hong Kong;

(D) licensed corporations;

marking to market (按照市值計算差額) means the method or procedure of adjusting the valuation of an open position in—

- ~~(a) a futures contract;~~
 - (b) any securities;
 - ~~(c) an options contract;~~
 - (d) a derivative ~~contract~~ instrument;
 - (e) a leveraged foreign exchange contract;
 - (f) a foreign exchange agreement;
 - ~~(g) an interest rate swap agreement;~~
 - (h) a specified investment;
 - (i) an illiquid investment; or
 - (j) a miscellaneous investment,
- to reflect its current market value;

miscellaneous derivative ()—see section 2N(1)(c);

miscellaneous investment (雜項投資項目)—see section 2E;

multilateral body () has the meaning given by section 1(1) of Schedule 6;

multilateral development bank () has the meaning given by section 1(1) of Schedule 6;

multiple-name credit default swap () does not include an nth-to-default credit default swap;

multiple-name credit linked note () does not include an nth-to-default credit linked note;

mutual fund (互惠基金) means any arrangement made for the purpose, or having the effect, of providing facilities for investment in shares in a corporation which is or holds itself out as being engaged primarily in the business of investing, reinvesting or trading in securities or any other property whatsoever and which is offering for sale or has outstanding any redeemable shares of which it is the issuer;

net PFE amount (), in relation to an OTCD netting set, means the amount determined in accordance with section 3 of Schedule 8;

no dealing licensing condition (), in relation to a licensed corporation licensed for Type 11 regulated activity, means a licensing condition that the licensed corporation must not engage in any activity that constitutes dealing in OTC derivative products;

no sponsor work licensing condition (不任保薦人發牌條件), in relation to a licensed corporation licensed for Type 6 regulated activity, means a licensing condition that the licensed corporation must not act as a sponsor in respect of an application for the listing on a recognized stock market of any securities;

non-collateralized warrants (非抵押權證) means derivative warrants listed on a recognized stock market other than collateralized warrants;

non-freely floating foreign currency (), in relation to a licensed corporation, means a foreign currency in respect of which its home authority specifies, for one or more foreign exchange markets specified by the authority—

- (a) the rate at which the currency is permitted by the authority to be converted into one or more other currencies; or
- (b) a range of rates within which the currency is permitted by the authority to be converted into one or more other currencies;

non-Hong Kong public sector entity () has the meaning given by section 1(1) of Schedule 6;

non-OTCD futures contract () means a futures contract that is not an OTCD futures contract;

non-OTCD securities () means securities that are not OTCD securities;

non-OTCD unlisted options contract () means an unlisted options contract that is not an OTCD unlisted options contract;

non-RA11 OTCD dealer () means a licensed corporation that—

- (a) is licensed for Type 1, Type 2 or Type 3 regulated activity; and
- (b) carries out acts that would constitute dealing in OTC derivative products but for the exclusion under section 2(a)(i), (ii) or (iii) (as the case may be) of Part 2A of Schedule 5 to the Ordinance in respect of OTCD transactions;

non-tradable commodity () means a commodity that is not a tradable commodity;

non-trading position ()—see section 2EA;

note issuance and revolving underwriting facility (票據的發行及循環式包銷融通) means an arrangement under which a borrower may draw down funds up to an agreed limit over an agreed period of time (the term to maturity of the facility) by making repeated note issues to the market, and where, should an issue prove unable to be placed in the market, the unplaced amount is to be taken up or funds made available by the underwriter of the facility;

notional principal (), in relation to an underlying subject matter of a derivative instrument, means—

- (a) subject to subparagraph (ii), the nominal, face, par or similar value, or any other reference amount, designated in the instrument as the amount on which the return, amount due or method of settlement (as applicable) determined by reference to the underlying subject matter is based (**designated amount**); or
- (b) if the structure of the instrument provides any leverage or enhancement to the designated amount—the designated amount as adjusted by the leverage or enhancement;

~~**off-exchange traded derivative contracts** (場外買賣衍生工具合約) means derivative contracts which are traded other than on an exchange;~~

omnibus account (客戶匯集綜合帳戶) means an account opened with a licensed corporation by a client of the licensed corporation, and the client has notified it that the account is to be operated by him as agent for the benefit of 2 or more other persons;

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

- (a) buy or sell—
 - (i) at an agreed consideration an agreed quantity of ~~a specified futures contract, share or other property~~ any securities, commodity, gold, property or instrument (including any combination or basket of such matters) specified in the contract; or
 - (ii) an agreed value of ~~a specified futures contract, share or other property~~ any securities, commodity, gold, property or instrument (including any combination or basket of such matters) specified in the contract; or
- (b) be paid an amount of money calculated by reference to the price, value or level of ~~such futures contract, share or other property or by reference to the level of an~~

~~index, as may be any securities, commodity, gold, index, property, interest rate, currency exchange rate or instrument (including any combination or basket of such matters) specified in the contract;~~

OTC derivative dealing act () has the meaning given by Part 2 of Schedule 5 to the Ordinance;

OTCD activity level ()—

- (a) where it is counted for reduced capital requirements—see section 2EB(1); or
- (b) where it is counted for basic approach approval—see section 2EB(3);

OTCD cash margin (), in relation to an OTCD transaction, means cash posted as OTCD initial margin or OTCD variation margin;

OTCD floor initial margin amount ()—see section 2ED(1)(c);

OTCD futures contract () means a futures contract—

- (a) that is an OTC derivative product; and
- (b) that—
 - (i) is not traded on a specified exchange; and
 - (ii) is not a specified VA futures contract;

OTCD initial margin (), in relation to an OTCD transaction, means assets posted as security in respect of the transaction against any credit risk exposure that could arise from future changes in the value of the transaction during the time it takes to close out and replace the transaction in the event of default;

OTCD initial margin amount (), in relation to an OTCD portfolio, means the amount of assets required to be posted as OTCD initial margin for the outstanding OTCD transactions within the portfolio;

OTCD inter-dealer broker ()—see section 2EE(3);

OTCD netting set ()—see section 2EC(1)(d);

OTCD payable amount ()—see section 2FA(1)(d);

OTCD portfolio ()—see section 2EC(1)(a);

OTCD receivable amount ()—see section 2FA(1)(b);

OTCD receivable deduction amount ()—see section 2FA(1)(c);

OTCD securities () means securities that—

- (a) are OTC derivative products; and
- (b) are not listed securities;

OTCD transaction ()—

- (a) means a transaction in an OTC derivative product other than—
 - (i) non-OTCD securities;
 - (ii) a non-OTCD futures contract; or
 - (iii) a non-OTCD unlisted options contract; and
- (b) in relation to a licensed corporation licensed for Type 3 regulated activity—does not include a transaction in a specified leveraged foreign exchange contract;

OTCD unlisted options contract () means an unlisted options contract—

- (a) that is an OTC derivative product; and
- (b) that—
 - (i) is not traded on a specified exchange; and

- (ii) is not a specified VA unlisted options contract;

OTCD variable amount ()—see section 2ED(1)(a);

OTCD variation margin (), in relation to an OTCD portfolio, means assets posted as security in respect of the portfolio against a credit risk exposure arising from a change in the mark-to-market value of any OTCD transaction within the portfolio after the transaction is executed;

out-of-the-money amount (價外值) means the amount calculated according to the following applicable formula—

- (a) in relation to a call options contract, $N \times (S - M)$;
- (b) in relation to a put options contract, $N \times (M - S)$; or
- (c) in relation to a call warrant ~~on listed shares~~, $N \times (S - M)$,

where—

“N” represents the number of listed shares or listed depositary receipts that are the underlying subject matter of the contract or warrant;—

- (i) ~~where the asset underlying the options contract or warrant is shares, the number of such shares; or~~
- (ii) ~~where the asset underlying the options contract is an asset other than shares, the number of units of such asset;~~

“M” represents the market value of one such share or depositary receipt; and—

- (i) ~~where the asset underlying the options contract or warrant is shares, one such share; or~~
- (ii) ~~where the asset underlying the options contract is an asset other than shares, one unit of such asset; and~~

“S” represents the strike price of the options contract or the exercise price of the warrant for one such share or depositary receipt;—

- (i) ~~where the asset underlying the options contract or warrant is shares, for one such share; or~~
- (ii) ~~where the asset underlying the options contract is an asset other than shares, for one unit of such asset;~~

permitted rate (), in relation to a non-freely floating foreign currency, means the rate quoted or traded in a foreign exchange market specified by its home authority, being the rate (or a rate that is within a range of rates) specified in respect of the market by the authority as the rate at which the currency is permitted to be converted into another currency;

PFE amount (), in relation to an OTCD transaction, means the amount determined in accordance with section 2 of Schedule 8;

prescribed country (訂明國家) means—

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

principal value (本金額), in relation to any securities or instrument, means the nominal, face, par or similar value of the securities or instrument;

proprietary transaction (clearing) ()—see section 2J(2)(b);

proprietary transaction (non-clearing) ()—see section 2J(2)(a);

qualifying debt securities (合資格債務證券) means—

- (a) debenture stock, loan stock, debentures, bonds, notes and any securities or other instruments acknowledging, evidencing or creating indebtedness—
 - (i) which are issued or guaranteed by—
 - (A) the Central People's Government of the People's Republic of China or the People's Bank of China;
 - (B) the Government; or
 - (C) the Hong Kong Exchange Fund;
 - (ii) which are issued by the Hong Kong Mortgage Corporation;
 - (iii) *(Repealed)*
 - (iv) ~~the issuer of which has at least one issue currently rated by that is currently rated by, or ranks equally with or higher than another issue by the same issuer that is currently rated by—~~
 - (A) Moody's Investors Service at either Baa3 or ~~Prime~~-3 or above;
 - (B) Standard & Poor's Corporation at either BBB- or A-3 or above;
 - (BA) Fitch Ratings at either BBB- or F3 or above; or
 - (C) an approved credit rating agency at or above a grade specified by the Commission under section 58(2)(b); or
 - (v) the guarantor of which has at least one issue ~~that ranks equally with or lower than the guarantor's obligation under the guarantee and is~~ currently rated by—
 - (A) Moody's Investors Service at either A3 or ~~Prime~~-2 or above;
 - (B) Standard & Poor's Corporation at either A- or A-2 or above;
 - (BA) Fitch Ratings at either A- or F2 or above; or
 - (C) an approved credit rating agency at or above a grade specified by the Commission under section 58(2)(b),
- but does not include—
 - (vi) any special debt securities;
 - (vii) any I-owe-you;
 - (viii) any securities or any instrument acknowledging, evidencing or creating a subordinated loan or a debt due from a corporation within a group of companies of which the holder of the securities or instrument is a member;
 - (ix) any structured product other than a bond—
 - (A) that has a coupon rate which has an inverse relationship to a money market or interbank reference interest rate that is widely quoted; or
 - (B) under which the principal value or coupon payments are linked to an inflation rate;
 - (x) any securities or instrument the terms and conditions of which provide that, on the occurrence of one or more events specified in the terms and conditions, one or both of the following must apply in relation to the principal value—
 - (A) the principal value is to be fully or partially converted into or exchanged for shares of the issuer or a related corporation of the issuer;
 - (B) the principal value is to be fully or partially written down; or
 - (xi) an illiquid investment; or

- (b) certificates of deposit issued by an authorized financial institution or an approved bank incorporated outside Hong Kong;

RA7 service provider for OTCD clearing () means a licensed corporation that—

- (a) is licensed for Type 7 regulated activity; and
- (b) provides services referred to in paragraph (d) of the definition of **automated trading services** in Part 2 of Schedule 5 to the Ordinance in respect of OTCD transactions, excluding such services provided by a corporation operated by or on behalf of the Government or any excluded services (as defined by that Part);

RA7 service provider for OTCD trading () means a licensed corporation that—

- (a) is licensed for Type 7 regulated activity; and
- (b) provides services referred to in paragraph (ab) or (ba) of the definition of **automated trading services** in Part 2 of Schedule 5 to the Ordinance in respect of OTCD transactions, excluding such services provided by a corporation operated by or on behalf of the Government or any excluded services (as defined by that Part);

RA11 dealer () means a licensed corporation that—

- (a) is licensed for Type 11 regulated activity; and
- (b) is not subject to the no dealing licensing condition;

ranking liabilities (認可負債), in relation to a licensed corporation, means the aggregate of the amounts required to be included in its ranking liabilities under the provisions of Division 4 of Part 4, **Part 4A and Part 4B**;

RCCP-cleared OTCD dealer ()—see section 2EE(1);

recognized jurisdiction fund (認可司法管轄區基金) means a unit trust or mutual fund that—

- (a) is regulated in a jurisdiction outside Hong Kong, regardless of whether it is also an authorized fund; and
- (b) falls within all of the criteria (including, as to the jurisdiction outside Hong Kong in which it is regulated, the applicable laws of that jurisdiction and the type of scheme that it constitutes under those laws) published on the Commission's website for the purposes of the provisions of UT Code relating to recognition of certain overseas collective investment schemes;

redeemable shares (可贖回股份) means shares in the share capital of a corporation which are redeemable at the option of the holder of the shares or the corporation;

regulated CCP () means—

- (a) a recognized clearing house that clears and settles OTCD transactions;
- (b) a person designated under section 101J(1) of the Ordinance as a central counterparty; or
- (c) a person approved as an approved OTCD central counterparty under section 58(1)(d);

relevant CIS (相關集體投資計劃) has the meaning given by Part 2 of Schedule 5 to the Ordinance;

relevant CIS property (相關集體投資計劃財產) has the meaning given by Part 2 of Schedule 5 to the Ordinance;

relevant international organization () has the meaning given by section 1(1) of Schedule 6;

relevant prohibition (相關禁制), in relation to a controlled asset or the proceeds of a controlled asset, means a prohibition imposed under the laws of, or by an authority or regulatory organization in, a jurisdiction, and includes a prohibition that does not apply to a person in relation to the controlled asset or proceeds only if the person obtains approval from a particular authority or regulatory organization in the jurisdiction;

repledge (再質押), in relation to a licensed corporation, means an act by which the licensed corporation or an associated entity of such licensed corporation deposits securities collateral of the licensed corporation as collateral for financial accommodation provided to the licensed corporation;

reporting currency (申報貨幣), in relation to a licensed corporation, means the currency in which its financial statements, required under section 156 of the Ordinance to be submitted to the Commission, are denominated, or intended to be denominated;

repurchase transaction (回購交易) means a transaction under which there is a sale of securities and a further arrangement obliging the seller of the securities to repurchase from the purchaser, or obliging the purchaser to resell to the seller, securities of the same description (including any equities or debt securities of the same category) as the securities first sold, at a pre-determined consideration and date;

required liquid capital (規定速動資金), in relation to a licensed corporation, means an amount equal to the higher of—

~~(a) where it is—~~

~~(i) licensed for only one regulated activity specified in column 1 of Table 2 in Schedule 1, the amount specified in column 2 of the Table opposite the regulated activity or, where any further description is set out for the regulated activity in column 1 of the Table, opposite the applicable description; or~~

~~(ii) licensed for 2 or more regulated activities specified in column 1 of the Table, the amount which is the higher or highest upon comparing each amount specified in column 2 of the Table opposite any of such regulated activities or, where any further description is set out for any of such activities in column 1 of the Table, opposite any of such activities or any of the applicable descriptions; and~~

~~(a) the minimum amount of required liquid capital applicable to it under section 3 of Schedule 1; and~~

~~(b) its variable required liquid capital;~~

required liquid capital deficit (規定速動資金短欠數額), in relation to a licensed corporation, means the amount by which its required liquid capital exceeds its liquid capital;

~~re-securitization issues () has the meaning given by section 53ZI;~~

~~risk weight (), in relation to a SOCCRA-LC's exposure, means the risk weight allocated in accordance with Part 2 of Schedule 6;~~

~~rolling spot leveraged foreign exchange contract () means a leveraged foreign exchange contract under the terms of which a date for settlement of the contract—~~

~~(a) is not specified; or~~

~~(b) is specified and falls within, but may be extended by one or both of the parties to the contract to a date later than, the longest of the any of the following periods that are applicable—~~

- (i) the period generally accepted in the market as the standard delivery period for the type of currency exchange required under—
 - (A) the contract; or
 - (B) a spot contract for currency exchange at the same type of currency exchange rate as that of the leveraged foreign exchange contract;
- (ii) if the contract is entered into in Hong Kong—2 business days after the date of entering into the contract;
- (iii) if the contract is settled outside Hong Kong—2 days on which each settlement facility necessary to settle the transaction is open for business, after the date of entering into the contract;

rules (規章)—

- (a) in relation to an exchange other than a recognized exchange company, includes its constitution and any rules, regulations, guidelines or directions, by whatever name they may be called and wherever contained, governing—
 - (i) its exchange participants;
 - (ii) the persons who may participate in any of the services it provides or trade on it;
 - (iii) the setting and levying of fees;
 - (iv) the listing of securities;
 - (v) the trading of securities, futures contracts, options contracts or leveraged foreign exchange contracts through or on it;
 - (vi) the provision of other services; or
 - (vii) generally, its management, operations or procedures; or
- (b) in relation to a clearing house other than a recognized clearing house, includes its constitution and any rules, regulations, guidelines or directions, by whatever name they may be called and wherever contained, governing—
 - (i) its clearing participants;
 - (ii) the persons who may participate in any of the services it provides;
 - (iii) the setting and levying of fees;
 - (iv) the clearing and settlement of transactions, whether or not executed on an exchange, of which it is the clearing house;
 - (v) the imposition of margin requirements and matters pertaining to the deposit or collection of margin;
 - (vi) the manner of making and receiving payment of monies in respect of the provision by it of any service, including the ~~setting-off~~ set-off of such amounts receivable and amounts payable to it;
 - (vii) the provision of other services; or
 - (viii) generally, its management, operations or procedures;

scaling factor ()—

- (a) in relation to a market risk percentage specified in column 3 of Table 1 in Schedule 9—means the number specified in column 4 of that Table opposite that percentage; or
- (b) in relation to a specific risk percentage specified in column 4 of Table 3 or 4 in Schedule 9—means the number specified in column 5 of that Table opposite that percentage;

scheme money (計劃款項), in relation to a licensed corporation licensed for Type 13 regulated activity, means any client money—

- (a) received or held by the licensed corporation in the course of the conduct of Type 13 regulated activity; or
- (b) received or held by any corporation which is in a controlling entity relationship with the licensed corporation, in relation to such conduct of Type 13 regulated activity,

that constitutes relevant CIS property in respect of a relevant CIS, and includes any accretions to it whether as capital or income;

SCRA () has the meaning given by section 1(1) of Schedule 6;

SCRA issue specific rating () has the meaning given by section 1(1) of Schedule 6;

SCRA issuer rating () has the meaning given by section 1(1) of Schedule 6;

SCRA rating () has the meaning given by section 1(1) of Schedule 6;

securities dealer (證券交易商) means—

- (a) a licensed corporation licensed for Type 1 regulated activity; or
- (b) a person licensed, registered or authorized by an authority or regulatory organization outside Hong Kong for an activity which, if carried on in Hong Kong, would constitute Type 1 regulated activity;

securities margin financing (證券保證金融資) has the meaning assigned to it by Part 2 of Schedule 5 to the Ordinance, save that notwithstanding paragraph (iii) of that definition, it includes the provision of financial accommodation by a licensed corporation licensed for Type 1 regulated activity to a client of the licensed corporation to facilitate—

- (a) the acquisition of securities listed on any stock market, whether a recognized stock market or any other stock market outside Hong Kong; or
- (b) (where applicable) the continued holding of those securities;

securitization issues () has the meaning given by section 53ZI;

segregated account (獨立帳戶), in relation to a licensed corporation, means an account established and maintained by it, which—

- (a) is a segregated account within the meaning of section 2 of the Securities and Futures (Client Money) Rules (Cap. 571 sub. leg. I);
- (b) is an account for holding client money which is separate from its own account; or
- (c) in the case of a licensed corporation licensed for Type 13 regulated activity in relation to the carrying on by it of Type 13 regulated activity, is an account for holding scheme money which is separate from its own account;

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

- (a) in the case of a transaction effected on an exchange, the date on which payment for the securities is first due in accordance with the rules or conventions of the exchange on which the securities are traded; or
- (b) in any other case, the date on which payment for the securities is first due as agreed between the parties to the transaction,

but in either case, the date not exceeding 20 business days after the trade date;

short selling (賣空) means a sale of securities where at the time of the sale—

- (a) the seller does not have a presently exercisable and unconditional right to vest the securities in the purchaser of them; or

- (b) the seller has a presently exercisable and unconditional right to vest the securities in the purchaser of them by virtue of having entered into a securities borrowing and lending agreement;

short-term SCRA issue specific rating () has the meaning given by section 1(1) of Schedule 6;

single OTCD transaction ()—see section 2EC(1)(b);

SMRA-LC ()—see section 2EF(3);

SOCORA-LC ()—see section 2EF(1);

special debt securities (特別債務證券) means structured notes, specified convertible debt securities, specified bonds and non-interest bearing debt securities—

- (a) which are issued or guaranteed by—
 - (i) the Central People's Government of the People's Republic of China or the People's Bank of China;
 - (ii) the Government; or
 - (iii) the Hong Kong Exchange Fund;
- (b) which are issued by the Hong Kong Mortgage Corporation;
- (c) (*Repealed*)
- (d) ~~the issuer of which has at least one issue currently rated by that are currently rated by, or rank equally with or higher than another issue by the same issuer that is currently rated by—~~
 - (i) Moody's Investors Service at either Baa3 or ~~Prime~~-3 or above;
 - (ii) Standard & Poor's Corporation at either BBB- or A-3 or above;
 - (iia) Fitch Ratings at either BBB- or F3 or above; or
 - (iii) an approved credit rating agency at or above a grade specified by the Commission under section 58(2)(b); or
- (e) the guarantor of which has at least one issue ~~that ranks equally with or lower than the guarantor's obligation under the guarantee and is~~ currently rated by—
 - (i) Moody's Investors Service at either A3 or ~~Prime~~-2 or above;
 - (ii) Standard & Poor's Corporation at either A- or A-2 or above;
 - (iia) Fitch Ratings at either A- or F2 or above; or
 - (iii) an approved credit rating agency at or above a grade specified by the Commission under section 58(2)(b),

but does not include—

- (f) any I-owe-you;
- (g) any securities or any instrument acknowledging, evidencing or creating a subordinated loan or a debt due from a corporation within a group of companies of which the holder of the securities or instrument is a member;
- (h) any securities or instrument the terms and conditions of which provide that, on the occurrence of one or more events specified in the terms and conditions, one or both of the following must apply in relation to the principal value—
 - (i) the principal value is to be fully or partially converted into or exchanged for shares of the issuer or a related corporation of the issuer;
 - (ii) the principal value is to be fully or partially written down; or
- (i) an illiquid investment;

specific risk percentage ()—

- (a) in relation to a marketable debt security (other than a securitization issue)—see section 2(1) of Schedule 9; or
- (b) in relation to a marketable debt security that is a securitization issue—see section 3(1) of Schedule 9;

specified bond (指明債券) means a bond with non-detachable warrants under which the holder of the bond has the right (but not the obligation) to buy a specified number of shares in the issuer (or a related corporation of the issuer) of the bond;

specified convertible debt securities (指明可轉換債務證券) means convertible debt securities under which the holder of the securities has the right (but not the obligation) to buy a specified number of shares in the issuer (or a related corporation of the issuer) of the securities;

specified exchange (指明交易所) means an exchange specified in Schedule 3;

specified exchange traded fund (指明交易所買賣基金) means a unit trust or mutual fund the units or shares of which are listed on a specified exchange;

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

- (a) a recognized clearing house other than—
 - (i) a recognized clearing house whose activities or objects include the provision of services for the clearing and settlement of transactions in securities (other than unlisted options contracts); or
 - (ii) a recognized clearing house whose activities or objects include the provision of services for the clearing and settlement of OTCD transactions;
- (b) a person—
 - (i) whose activities or objects include the provision of services for—
 - (A) the clearing and settlement of transactions in futures contracts or unlisted options contracts; or
 - (B) the day-to-day adjustment of the financial position of futures contracts or unlisted options contracts, effected on a specified exchange, or subject to the rules of a specified exchange; or
 - (ii) who guarantees the settlement of any such transactions as are referred to in subparagraph (i), but does not include a corporation operated by or on behalf of the Government;
- (c) a specified VA exchange on which specified VA futures contracts or specified VA unlisted options contracts are traded; or
- (d) a person—
 - (i) whose activities or objects include the provision of services for—
 - (A) the clearing and settlement of transactions in specified VA futures contracts or specified VA unlisted options contracts; or
 - (B) the day-to-day adjustment of the financial position of specified VA futures contracts or specified VA unlisted options contracts, traded on a specified VA exchange, or subject to the rules of a specified VA exchange; or
 - (ii) who guarantees the settlement of any such transactions as are referred to in subparagraph (i),

but does not include a corporation operated by or on behalf of the Government;

specified investment (指明投資項目) means an investment specified in column 2 of Table 8 in Schedule 2, but does not include an illiquid investment;

specified leveraged foreign exchange contract () means a leveraged foreign exchange contract that—

- (a) is not an OTC derivative product; or
- (b) if it is an OTC derivative product—
 - (i) is a rolling spot leveraged foreign exchange contract; and
 - (ii) is not an options contract;

specified licensing condition (指明發牌條件), in relation to a licensed corporation ~~licensed for Type 4, Type 5, Type 6, Type 9 or Type 10 regulated activity~~, means a licensing condition that the licensed corporation must not hold client assets;

specified OTCD dealer () means—

- (a) an RCCP-cleared OTCD dealer;
- (b) an asset management group central OTCD dealer; or
- (c) an OTCD inter-dealer broker;

specified RA12 LC () means a licensed corporation licensed for Type 12 regulated activity where the Type 12 regulated activity carried on by it does not involve any OTCD transaction;

specified securities (指明證券) means the securities specified in column 2 of Table 7 in Schedule 2, but does not include an illiquid investment;

specified VA exchange () means a VA exchange (as described in item 1 of Part 1 of Schedule 3B to the Anti-Money Laundering and Counter-Terrorist Financing Ordinance (Cap. 615)) operated by a licensed corporation that—

- (a) is licensed for Type 2 and Type 7 regulated activities; and
- (b) is granted a licence under section 53ZRK of that Ordinance in respect of the operation of the VA exchange;

specified VA futures contract () means a futures contract—

- (a) the underlying subject matter of which is—
 - (i) a virtual asset;
 - (ii) a basket of virtual assets; or
 - (iii) an index that is calculated by reference to the price or value of a virtual asset or a basket of virtual assets; and
- (b) that is traded on a specified VA exchange;

specified VA unlisted options contract () means an unlisted options contract—

- (a) the underlying subject matter of which is—
 - (i) a virtual asset;
 - (ii) a basket of virtual assets; or
 - (iii) an index that is calculated by reference to the price or value of a virtual asset or a basket of virtual assets; and
- (b) that is traded on a specified VA exchange;

spot contract (現貨合約) means a contract for the sale of any type or combination of types of securities, commodity, gold, index, property, interest rate or currency

exchange rate under the terms of which the settlement of the contract is scheduled to be made within the longest of the following periods—

- (a) if the contract is—
 - (i) entered into in Hong Kong, 2 business days after the date of entering into the contract; or
 - (ii) settled outside Hong Kong, 2 days on which each settlement facility necessary to settle the transaction is open for business, after the date of entering into the contract;
- (b) the period generally accepted in the market for that type or combination of types of securities, commodity, gold, index, property, interest rate or currency exchange rate as the standard delivery period;

SRF security () means specific risk-free security;

standby subordinated loan facility (備用後償貸款融通) means a loan facility provided to a licensed corporation licensed for Type 1, Type 2, Type 3 or Type 8 regulated activity under which the lender's claim in respect of any drawdown by the licensed corporation is subordinated to the prior payment, or provision for payment, in full of all claims of all other present and future creditors of the licensed corporation;

stock futures contract (股票期貨合約) means a contract traded on a specified exchange, the effect of which is that—

- (a) one party to the contract agrees to deliver to the other party to the contract at an agreed future time an agreed quantity of a specific listed share at an agreed consideration; or
- (b) the parties to the contract will make an adjustment between themselves at an agreed future time according to whether at that time an agreed quantity of a specific listed share is worth more or less than a value agreed at the time the contract is made;

stock options contract (股票期權合約) means an unlisted options contract traded on a specified exchange, the effect of which is that one party to the contract agrees to provide to the other party to the contract the right to sell or purchase at an agreed consideration an agreed quantity of a specific listed share at or before an agreed future time;

structured note (結構性票據)—see section 2F;

subordinated loan (後償貸款) means a loan provided to a person under which the lender's claim in respect of the loan is subordinated to the prior payment, or provision for payment, in full of all claims of all other present and future creditors of the person;

swap ()—

- (a) means a contract under which two parties agree to exchange assets, liabilities or cash flows according to specified terms over a specified period; but
- (b) does not include an options contract, futures contract or forward contract;

tangible capital (), in relation to a licensed corporation, means the sum of its—

- (a) tangible equity; and
- (b) approved subordinated loans, but only up to an amount equal to its tangible equity;

tangible equity (), in relation to a licensed corporation, means the amount calculated in accordance with the following formula—

$$A + B - C$$

where—

- A is its equity attributable to its shareholders;
- B is its cumulative losses due to the impact of changes in its own credit spread on the fair values of its financial assets and financial liabilities; and
- C is the sum of—
 - (a) its intangible assets;
 - (b) its cumulative gains due to the impact of changes in its own credit spread on the fair values of its financial assets and financial liabilities; and
 - (c) its deferred tax assets that rely on its future profitability;

tenor (), in relation to an interest rate that is the underlying subject matter of a derivative instrument, means the interval between each interest rate fixing date under the instrument;

top OTCD initial margin amount ()—see section 2ED(1)(b);

tradable commodity (流通商品) means—

- (a) a physical commodity, energy product or carbon trading product of a quantity, quality and condition suitable for delivery under a tradable contract;
- (b) a freight rate that is the underlying subject matter of a tradable contract; or
- (c) a carbon trading product of a quantity, quality and condition suitable for trading on a specified exchange or any of the following exchanges—
 - (i) Core Climate Global Limited;
 - (ii) China Beijing Green Exchange;
 - (iii) China Emissions Exchange Guangzhou;
 - (iv) Shanghai Environment and Energy Exchange;
 - (v) Tianjin Climate Exchange;

tradable contract (流通合約) means a futures contract, forward contract or an unlisted options contract that is traded on a specified exchange;

trade date (交易日期), in relation to a transaction in—

- ~~(a) a futures contract;~~
 - (b) any securities;
 - ~~(c) an options contract;~~
 - (d) a derivative ~~contract~~ instrument;
 - (e) a leveraged foreign exchange contract;
 - (f) a foreign exchange agreement;
 - ~~(g) an interest rate swap agreement;~~
 - (h) a specified investment;
 - (ha) an illiquid investment; or
 - (hb) a miscellaneous investment,
- means—
- (i) in the case of a transaction on any exchange, the date on which the transaction is executed; or
 - (j) in any other case, the date on which the agreement between the parties is made;

trader (買賣商)—

- (a) means a licensed corporation licensed for Type 1 or Type 2 regulated activity ~~which that—~~
 - (i) does not hold client assets or handle clients' orders; and
 - (ii) in carrying on the regulated activity for which it is licensed, conducts no business other than effecting, or offering to effect, dealings in securities, futures contracts or options contracts for its own account; **but**
- (b) does not include a non-RA11 OTCD dealer;

~~**trading day** (交易日), in relation to listed securities, means a day on which the exchange on which the securities are listed is open for trading;~~

uncommon derivative ()—see section 2N(1)(b);

underlying subject matter (), in relation to a derivative instrument—see section 2M(1);

unit trust (單位信託) means any arrangement made for the purpose, or having the effect, of providing facilities for the participation by persons as beneficiaries under a trust, in profits or income arising from the acquisition, holding, management or disposal of securities or any other property whatsoever;

unlisted options contract (非上市期權合約) means an options contract that is not listed securities;

UT Code (《單位信託守則》) means the Code on Unit Trusts and Mutual Funds published by the Commission under section 399 of the Ordinance;

variable required liquid capital (可變動規定速動資金)—

- (a) in relation to a licensed corporation licensed for Type 3 regulated activity (whether or not it is also licensed for any other regulated activity), means the sum of—
 - (i) the basic amount;
 - (ii) the aggregate of the OTCD variable amounts of the OTCD portfolios effected by it, except for—
 - (A) any direct offsetting portfolio of a clearing portfolio with client; and
 - (B) any sub-portfolio within the meaning of section 2ED(1)(b)(iii); and
 - (iii) 1.5% of its aggregate gross foreign currency position; or
- (b) in relation to a licensed corporation licensed for any regulated activity other than Type 3 regulated activity, means the ~~sum of—~~
 - (i) the basic amount; **and**
 - (ii) the aggregate of the OTCD variable amounts of the OTCD portfolios effected by it, except for—
 - (A) any direct offsetting portfolio of a clearing portfolio with client; and
 - (B) any sub-portfolio within the meaning of section 2ED(1)(b)(iii);

virtual asset () has the meaning given by section 53ZRA(1) of the Anti-Money Laundering and Counter-Terrorist Financing Ordinance (Cap. 615);

volatility adjustment percentage (), in relation to an asset or currency mismatch, means the percentage calculated in accordance with section 1 of Schedule 7;

weighted average general risk percentage ()—

- (a) in relation to a basket of debt securities—means the weighted average of the general risk percentages applicable to each of the debt securities that constitute the basket, the adoption of which is approved under section 58(5)(ha)(ii); and

- (b) in relation to a debt security index—means the weighted average general risk percentage applicable to the basket of debt securities underlying the index;

weighted average haircut percentage ()—

- (a) in relation to a basket of securities—means the weighted average of the haircut percentages applicable to each of the securities that constitute the basket, the adoption of which is approved under section 58(5)(h); and
- (b) in relation to an index that has a basket of securities underlying it—means the weighted average haircut percentage applicable to that basket of securities;

weighted average market risk percentage ()—

- (a) in relation to a basket of commodities—means the weighted average of the market risk percentages applicable to each of the commodities that constitute the basket, the adoption of which is approved under section 58(5)(hb); and
- (b) in relation to a commodity index—means the weighted average market risk percentage applicable to the basket of commodities underlying the index;

weighted average specific risk percentage ()—

- (a) in relation to a basket of debt securities—means the weighted average of the specific risk percentages applicable to each of the debt securities that constitute the basket, the adoption of which is approved under section 58(5)(ha)(i); and
- (b) in relation to a debt security index—means the weighted average specific risk percentage applicable to the basket of debt securities underlying the index.

(2) *(Repealed)*

2AA. Meaning of clearing intermediary and clearing client

For the purposes of these Rules, where OTCD transactions are entered into in the course of the clearing and settlement of an OTCD transaction—

- (a) a person (**A**) is, in so far as any such transaction is concerned, a clearing intermediary of another person (**B**) if A provides any clearing and settlement service for B as an intermediary between B and any other person in relation to the transaction; and
- (b) a person (**C**) is, in so far as any such transaction is concerned, a clearing client of another person (**D**) if D provides any clearing and settlement service for C as an intermediary between C and any other person in relation to the transaction.

2AAB. Meaning of derivative instrument

(1) In these Rules, subject to subsection (2), **derivative instrument ()—**

- (a) means an instrument under which some or all of the return or amount due (or both the return and the amount due) or the method of settlement is determined by reference to one or more of—
 - (i) changes in the price, value or level (or a range within the price, value or level) of any type or combination of types of securities, commodity, gold, index, property, interest rate, currency exchange rate or instrument;
 - (ii) changes in the price, value or level (or a range within the price, value or level) of any basket of more than one type, or any combination of types, of securities, commodity, gold, index, property, interest rate, currency exchange rate or instrument; or
 - (iii) the occurrence or non-occurrence of any specified event or events, excluding an event or events relating only to any of the following persons—

- (A) the issuer of the instrument;
- (B) one or more contracting parties to the instrument;
- (C) the guarantor of the instrument or such contracting parties; and
- (b) includes any structured product or OTC derivative product that does not fall within paragraph (a).
- (2) A **derivative instrument** does not include—
 - (a) a spot contract;
 - (b) a collective investment scheme;
 - (c) a depositary receipt;
 - (d) a debenture that would come within subsection (1)(a) only because it has a variable interest rate that is reset periodically to equate to a money market or interbank reference interest rate that is widely quoted (whether or not subject to a predetermined maximum or minimum rate) plus or minus a specified rate (if any);
 - (e) a contract of insurance in relation to any class of insurance business specified in Schedule 1 to the Insurance Ordinance (Cap. 41); or
 - (f) a specified leveraged foreign exchange contract.

2A. Meaning of **gross foreign currency position**

- (1) In these Rules—

gross foreign currency position (外幣總持倉量), in relation to a foreign currency for a licensed corporation's ~~position in a foreign currency~~, means the total of—

- (a) the aggregate of—
 - (i) the value of assets, other than fixed assets, beneficially owned by the licensed corporation which are denominated in the foreign currency; and
 - (ii) all of the licensed corporation's on-balance sheet liabilities, other than excluded liabilities, which are denominated in the foreign currency; and
- (b) subject to subsection (2), the aggregate of—
 - (i) the total amount of the foreign currency in respect of which the licensed corporation is exposed to the risk of a decline in the value of the foreign currency under outstanding contracts (including spot contracts **but excluding OTCD transactions**); and
 - (ii) the total amount of the foreign currency in respect of which the licensed corporation is exposed to the risk of a rise in the value of the foreign currency under outstanding contracts (including spot contracts **but excluding OTCD transactions**).
- (2) In respect of a pair of outstanding contracts referred to in subsection (3), the licensed corporation must include in the amounts referred to in paragraph (b) of the definition of **gross foreign currency position** in subsection (1) the amounts specified in subsection (4).
- (3) Subsection (2) applies in respect of a pair of outstanding contracts which the licensed corporation holds with a client (except a client whose account with the licensed corporation is an omnibus account) if the licensed corporation—
 - (a) under one of the contracts (**contract 1**), is exposed to the risk of a decline in the value of an amount of a currency (**currency A**) and to the risk of a rise in the value of an amount (**amount X**) of another currency (**currency B**); and

- (b) under the other contract (**contract 2**), is exposed to the risk of a decline in the value of amount X of currency B and to the risk of a rise in the value of an amount of currency A.
- (4) The amounts specified are—
 - (a) in relation to currency A—the higher of the amounts in respect of which the licensed corporation is exposed to the risk of a decline in the value of currency A under contract 1 and to the risk of a rise in the value of currency A under contract 2; and
 - (b) in relation to currency B—the amount X.

2B. Meaning of *haircut amount*

- (1) In these Rules—

haircut amount (扣減數額), subject to subsection (2), means, in relation to—

- (a) any listed shares (except shares that are specified securities or an illiquid investment)—an amount derived by multiplying the market value of the shares by the haircut percentage in relation to the shares;
 - (ab) a listed depositary receipt (except a depositary receipt that is an illiquid investment)—an amount derived by multiplying the market value of the receipt by the haircut percentage in relation to the receipt;
 - (b) any qualifying debt securities—an amount derived by multiplying the market value of the qualifying debt securities by the haircut percentage in relation to the qualifying debt securities;
 - (c) any special debt securities—an amount derived by multiplying the market value of the special debt securities by the haircut percentage in relation to the special debt securities;
 - (d) any specified securities—an amount derived by multiplying the market value of the specified securities by the haircut percentage in relation to the specified securities;
 - (e) a specified investment—an amount derived by multiplying the market value of the specified investment by the haircut percentage in relation to the specified investment;
 - (f) an illiquid investment—an amount derived by multiplying the market value of the illiquid investment by the haircut percentage in relation to the illiquid investment; or
 - (g) a miscellaneous investment—an amount derived by multiplying the market value of the miscellaneous investment by the haircut percentage in relation to the miscellaneous investment.
- (2) In relation to any securities or investment referred to in paragraph (a), (ab), (b), (c), (d), (e), (f) or (g) of the definition of **haircut amount** in subsection (1) that aims to deliver a daily return on the securities or investment that is equivalent to a certain multiple (**leverage factor**) of the daily return on a particular index or particular reference asset, **haircut amount** (扣減數額) means—
 - (a) if the maximum loss that may be incurred in relation to the securities or investment is the market value of the securities or investment and the relevant holding is not a short position—the lower of—
 - (i) the market value; and

- (ii) an amount derived by multiplying the amount referred to in paragraph (a), ~~(ab)~~, (b), (c), (d), (e), (f) or (g) of the definition of **haircut amount** in subsection (1) (as applicable) by the leverage factor; or
- (b) in any other case—an amount derived by multiplying the amount referred to in paragraph (a), ~~(ab)~~, (b), (c), (d), (e), (f) or (g) of the definition of **haircut amount** in subsection (1) (as applicable) by the leverage factor.

2C. Meaning of **haircut percentage**

(1) In these Rules—

haircut percentage (扣減百分率) means, in relation to—

- (a) any listed shares (except shares that are specified securities or an illiquid investment)—the percentage specified in subsection (2) or (3);
 - ~~(ab) a listed depositary receipt (except a depositary receipt that is an illiquid investment)—the percentage specified in subsection (2) or (3);~~
 - (b) any qualifying debt securities—the percentage specified in subsection (4);
 - (c) any special debt securities—the percentage specified in subsection (5);
 - (d) any specified securities—the percentage specified in subsection (6);
 - (e) a specified investment—the percentage specified in subsection (7); or
 - (f) an illiquid investment or a miscellaneous investment—the percentage specified in subsection (8).
- (2) Subject to subsection (3), ~~in relation to any listed shares (except shares that are specified securities or an illiquid investment),~~ the percentage specified for ~~the purposes of any listed shares or listed depositary receipt covered by~~ paragraph (a) or ~~(ab)~~ of the definition of **haircut percentage** in subsection (1) is—
- (a) subject to paragraphs (b) and (c), the percentage specified in column 3 of Table 1 in Schedule 2 (**Table 1**) opposite the applicable description set out in column 2 of Table 1;
 - (b) if the shares ~~fall or depositary receipt falls~~ within more than one of the descriptions set out in column 2 of Table 1—~~the percentage specified in column 3 of Table 1 opposite any of the applicable descriptions set out in column 2 of Table 1, as elected by a licensed corporation; or because the shares or depositary receipt is listed on more than 1 exchange—~~
 - (i) where the shares or depositary receipt has a primary listing on 1 exchange and one or more secondary listings on other exchanges—the percentage specified in column 3 of Table 1 opposite the description applicable to shares or depositary receipt listed on the primary listing exchange; or
 - (ii) where the shares or depositary receipt has primary listings on 2 or more exchanges (regardless of whether the shares have secondary listings on other exchanges)—the percentage specified in column 3 of Table 1 opposite either of the descriptions applicable to shares or depositary receipt listed on the primary listing exchanges, as elected by the licensed corporation;
 - (c) if the shares ~~fall or depositary receipt falls~~ within a description set out in—
 - (i) item 1(a) or (b) in column 2 of Table 1—the percentage specified in column 3 of Table 1 opposite the description set out in item 1(c) in column 2 of Table 1, if elected by a licensed corporation;

- (ii) item 2(a)(i) in column 2 of Table 1—the percentage specified in column 3 of Table 1 opposite the description set out in item 2(a)(ii) in column 2 of Table 1, if elected by a licensed corporation;
 - (iii) item 3(a)(i) in column 2 of Table 1—the percentage specified in column 3 of Table 1 opposite the description set out in item 3(a)(ii) in column 2 of Table 1, if elected by a licensed corporation;
 - (iv) item 4(a)(i) in column 2 of Table 1—the percentage specified in column 3 of Table 1 opposite the description set out in item 4(a)(ii) in column 2 of Table 1, if elected by a licensed corporation; or
 - (v) item 5(a) in column 2 of Table 1—the percentage specified in column 3 of Table 1 opposite the description set out in item 5(b) in column 2 of Table 1, if elected by a licensed corporation.
- (3) For the purpose of calculating the haircut amount under section 22(1)(b)(i), ~~in relation to any listed shares (except shares that are specified securities or an illiquid investment) that are the~~ percentage specified for any listed shares or listed depositary receipt covered by paragraph (a) or (ab) of the definition of **haircut percentage** in subsection (1) that is listed on a recognized stock market and specified in column 2 of Table 1A in Schedule 2 (**Table 1A**), ~~the percentage specified for the purposes of paragraph (a) of the definition of haircut percentage in subsection (1)~~ is—
- (a) subject to paragraphs (b) and (c) (and regardless of whether the shares ~~or depositary receipt~~ also ~~fall-falls~~ within any of the descriptions set out in column 2 of Table 1), the percentage specified in column 3 of Table 1A opposite the applicable description set out in column 2 of Table 1A;
 - (b) if, in a particular month, the shares ~~or depositary receipt~~ described in item 1(a), (b), (c) or (d) in column 2 of Table 1A ~~cease-ceases~~ to be a constituent of the applicable index and the cessation would result in the assignment to the shares ~~or depositary receipt~~ of a percentage specified in column 3 of Table 1A that is higher than the percentage which applied to the shares ~~or depositary receipt~~ immediately prior to the cessation (**original percentage**)—the original percentage, but only in relation to the particular month and for the period of the next 3 consecutive months; or
 - (c) if the shares ~~fall-or depositary receipt falls~~ within a description set out in item 1(a), (b), (c) or (d) in column 2 of Table 1A—the percentage specified in column 3 of Table 1A opposite the applicable description set out in item 1(e) in column 2 of Table 1A, if elected by a licensed corporation.
- (4) In relation to any qualifying debt securities, the percentage specified for the purposes of paragraph (b) of the definition of **haircut percentage** in subsection (1) is the aggregate of—
- (a) the percentage specified in column 3 of Table 4 in Schedule 2 opposite the applicable description set out in column 2 of that Table; and
 - (b) the percentage specified in column 2 or 3 (as the case may be) of Table 5 in Schedule 2 opposite the applicable description set out in column 1 of that Table.
- (5) In relation to any special debt securities, the percentage specified for the purposes of paragraph (c) of the definition of **haircut percentage** in subsection (1) is the percentage specified in column 3 of Table 6 in Schedule 2 opposite the applicable description set out in column 2 of that Table.
- (6) In relation to any specified securities, the percentage specified for the purposes of paragraph (d) of the definition of **haircut percentage** in subsection (1) is the

percentage specified in column 3 of Table 7 in Schedule 2 opposite the applicable description set out in column 2 of that Table.

- (7) In relation to a specified investment, the percentage specified for the purposes of paragraph (e) of the definition of **haircut percentage** in subsection (1) is the percentage specified in column 3 of Table 8 in Schedule 2 opposite the applicable description set out in column 2 of that Table.
- (8) In relation to an illiquid investment or a miscellaneous investment, the percentage specified for the purposes of paragraph (f) of the definition of **haircut percentage** in subsection (1) is the percentage specified in column 3 of Table 9 in Schedule 2 opposite the applicable description set out in column 2 of that Table.

2D. Meaning of **listed**

(1) In these Rules—

listed (上市), in relation to securities which—

- (a) for the purposes of the definition of **listed** in section 1 of Part 1 of Schedule 1 to the Ordinance are regarded as listed on a recognized stock market—has the meaning given by that section;
- (b) are regarded as listed on an exchange located in a jurisdiction outside Hong Kong under the laws or regulations of the jurisdiction—means listed on that exchange; or
- (c) are admitted to trading on an exchange—means listed on that exchange if—
 - (i) under the laws or regulations of the jurisdiction in which the exchange is located, the securities are regarded as listed on a different exchange located in the same jurisdiction; or
 - (ii) under the laws or regulations of a jurisdiction other than the jurisdiction in which the exchange is located, the securities are regarded as listed on an exchange located in that other jurisdiction.
- (2) For the purposes of the definition of **listed** in subsection (1), securities are to continue to be regarded as listed on, or admitted to trading on, a particular exchange during a period of suspension of dealings in the securities on that exchange.
- (3) Despite the definition of **listed** in subsection (1), securities are not to be regarded as listed on, or admitted to trading on, a particular exchange merely because the exchange provides (directly or indirectly) facilities for—
 - (a) effecting transactions in the securities on a different exchange; or
 - (b) transmitting or otherwise communicating by any means offers to effect transactions in the securities on a different exchange.
- (4) Despite the definition of **listed** in subsection (1), securities that are options contracts with standardized contractual terms and conditions specified by a particular exchange are not to be regarded as listed on the particular exchange or on any other exchange on which they are admitted to trading.

2DA. Meaning of **margin requiring party to OTCD portfolio**

(1) In these Rules, subject to subsection (2)—

margin requiring party (), in relation to an OTCD portfolio, means—

- (a) for a clearing portfolio with client entered into by a licensed corporation—the licensed corporation;
- (b) for a clearing portfolio (agency clearing) effected by a licensed corporation—

- (i) the licensed corporation; or
 - (ii) the person with whom the portfolio is entered into by the clearing client of the licensed corporation;
- (c) for a direct offsetting portfolio of a clearing portfolio with client entered into by a licensed corporation—
 - (i) the person with whom the direct offsetting portfolio is entered into by the licensed corporation; or
 - (ii) any clearing intermediary through which the licensed corporation entered into the direct offsetting portfolio;
- (d) for a CCP portfolio in respect of an OTCD portfolio effected by a licensed corporation—the central counterparty to the CCP portfolio; or
- (e) for any other OTCD portfolio effected by a licensed corporation—
 - (i) the person with whom the portfolio is entered into by the licensed corporation; or
 - (ii) any clearing intermediary through which the licensed corporation entered into the portfolio.
- (2) For paragraph (b)(ii), (c)(i) or (e)(i) of the definition of **margin requiring party** in subsection (1), if the person specified in that paragraph entered into the transaction through the person's clearing intermediary, the margin requiring party of the transaction is the person's clearing intermediary.

2E. Meaning of *miscellaneous investment*

- (1) In these Rules—

miscellaneous investment (雜項投資項目), subject to subsection (2), means any asset or instrument held **or issued** by a person for the purpose, or with the intention, of—

- (a) resale;
- (b) securing a profit from fluctuations in the value of the asset or instrument;
- (c) locking in arbitrage profits; or
- (d) hedging **any-one or more** risks of any other asset or instrument held by the person which falls within paragraph (a), (b) or (c).

- (2) A **miscellaneous investment** does not include the following assets or instruments held **or issued** by a person—

- ~~(a) any securities that fall within any of the descriptions set out in—~~
 - ~~— (i) column 2 of Table 1, 1A, 4, 6 or 7 in Schedule 2;~~
 - ~~— (ii) column 2 or 3 of Table 5 in Schedule 2; or~~
 - ~~— (iii) item 2 in column 2 of Table 8 in Schedule 2;~~
- ~~(b) any securities that are unlisted options contracts;~~
- ~~(c) a derivative contract that is not securities;~~
 - (ca) any listed shares;
 - (cb) a listed depositary receipt;
 - (cc) any qualifying debt securities;
 - (cd) any special debt securities;
 - (ce) any specified securities;
 - (d) a specified investment;

- (e) an illiquid investment;
- (f) a foreign exchange agreement;
- (g) a leveraged foreign exchange contract;
- (ga) a derivative instrument other than listed securities;
- (h) a fixed asset;
- (i) cash;
- (j) a bank deposit;
- (k) any loan, advance, credit facility or other financial accommodation provided by the person to another person;
- (l) any amount receivable by the person.

2EA. Meaning of *non-trading position*

- (1) For the purposes of these Rules, a licensed corporation's position is a non-trading position if—
 - (a) for a position in a commodity—the position is not held by the licensed corporation for any of the purposes, or with any of the intentions, specified in subsection (2); or
 - (b) for a position in securities—
 - (i) the position is—
 - (A) a long spot position in shares or debt securities issued by—
 - (I) a member of a group of companies of which the licensed corporation is a member; or
 - (II) a person in whom the licensed corporation invests (*investee*) where the investment is accounted for by equity method; and
 - (B) not held by it for any of the purposes, or with an any of the intentions, specified in subsection (2); or
 - (ii) the position is—
 - (A) a short spot position in securities issued by the licensed corporation that arises solely from the issuance of the securities for capital or fund raising purposes; and
 - (B) not held by it for any of the purposes, or with any of the intentions, specified in subsection (2).
- (2) The purposes or intentions specified for subsection (1) are—
 - (a) short-term resale;
 - (b) securing a profit from fluctuations in the value of the position;
 - (c) locking in arbitrage profits; and
 - (d) hedging one or more risks of any other position in any securities, commodity, gold, currency, index, property, interest rate, currency exchange rate or instrument held by it for a purpose, or with an intention, specified in paragraph (a), (b) or (c).
- (3) In this section—

equity method (), in relation to an investment of a licensed corporation, means a method of accounting adopted by the licensed corporation by which, in the financial statements of the licensed corporation—

- (a) the investment is initially recognized at cost and adjusted afterwards for the post-acquisition change in the licensed corporation's share of the net assets of the investee; and
- (b) the licensed corporation's share of the profit or loss of the investee is included in the profit or loss of the licensed corporation.

2EB. Meaning of *OTCD activity level* and *applicable threshold*

- (1) The OTCD activity level of a licensed corporation as at a date, where it is counted for reduced capital requirements, is each of the following sums—
 - (a) the sum of the initial primary notional principals of the licensed corporation's OTCD transactions specified in subsection (2) each of which is a transaction in a credit derivative;
 - (b) the sum of the initial primary notional principals of the licensed corporation's OTCD transactions specified in subsection (2) each of which—
 - (i) is not a transaction in a credit derivative; and
 - (ii) is a transaction the underlying subject matter of which is an equity or debt security;
 - (c) the sum of the initial primary notional principals of the licensed corporation's OTCD transactions specified in subsection (2) each of which is a transaction that does not fall within paragraph (a) or (b).
- (2) The OTCD transactions specified for subsection (1) are those that the licensed corporation has, during the 12 months ending with the date referred to in subsection (1)—
 - (a) if it is licensed for Type 12 regulated activity—cleared for another person in the course of carrying on that regulated activity; or
 - (b) if it is not licensed for Type 12 regulated activity—
 - (i) entered into for its own account or for another person (but not cleared through a regulated CCP); or
 - (ii) cleared for another person.
- (3) The OTCD activity level of a licensed corporation as at a date, where it is counted for basic approach approval, is each of the following sums—
 - (a) the sum of the initial primary notional principals of the licensed corporation's OTCD transactions specified in subsection (4) each of which is a transaction in a credit derivative;
 - (b) the sum of the initial primary notional principals of the licensed corporation's OTCD transactions specified in subsection (4) each of which—
 - (i) is not a transaction in a credit derivative; and
 - (ii) is a transaction the underlying subject matter of which is an equity or debt security;
 - (c) the sum of the initial primary notional principals of the licensed corporation's OTCD transactions specified in subsection (4) each of which is a transaction that does not fall within paragraph (a) or (b).
- (4) The OTCD transactions specified for subsection (3) are those that the licensed corporation has, during the 12 months ending with the date referred to in subsection (3)—
 - (a) entered into for its own account or for another person; or
 - (b) cleared for another person.

- (5) For the purposes of these Rules, the applicable threshold for a licensed corporation's OTCD activity level that is counted for reduced capital requirements or basic approach approval is—
- (a) for the sum referred to in subsection (1)(a) or (3)(a)—\$32 billion;
 - (b) for the sum referred to in subsection (1)(b) or (3)(b)—\$1.6 billion; and
 - (c) for the sum referred to in subsection (1)(c) or (3)(c)—\$32 billion.

- (6) In this section—

credit derivative () means a derivative instrument the underlying subject matter of which is one or more events relating to the credit risks of one or more reference obligations;

initial primary notional principal (), in relation to an OTCD transaction, means—

- (a) the notional principal of the underlying subject matter of the OTC derivative product that is the subject of the transaction; or
- (b) if the OTC derivative product has 2 or more underlying subject matters—the highest of the notional principal of each of such matters.

2EC. Meaning of OTCD portfolio and related terms

- (1) In these Rules—

- (a) **OTCD portfolio** () means—

- (i) a single OTCD transaction;
- (ii) a group of margined OTCD transactions; or
- (iii) an OTCD netting set;

- (b) **single OTCD transaction** () means an OTCD transaction that does not form part of a group of margined transactions or OTCD netting set;

- (c) **group of margined OTCD transactions** () means 2 or more OTCD transactions that are covered by the same margin agreement, excluding any such transactions that form part of an OTCD netting set;

- (d) **OTCD netting set** () means 2 or more OTCD transactions that are treated as an OTCD netting set under section 53T(1)(a)(i).

- (2) For the purposes of these Rules, an OTCD portfolio effected by a licensed corporation is—

- (a) where it consists of one or more clearing transactions with client of the licensed corporation that is or are entered into by the licensed corporation with a particular clearing client—a **clearing portfolio with client**;
- (b) where it consists of one or more direct offsetting transactions of the transactions within a clearing portfolio with client of the licensed corporation that is or are entered into by the licensed corporation with a particular person—a **direct offsetting portfolio** of that clearing portfolio with client; or
- (c) where it consists of one or more intermediary transactions (agency clearing) of the licensed corporation that is or are entered into by a particular clearing client with other persons—a **clearing portfolio (agency clearing)**.

- (3) In these Rules, where an OTCD portfolio effected by a licensed corporation (**subject portfolio**) consists of OTCD transactions that are centrally cleared, a reference to the **CCP portfolio** in respect of the subject portfolio is a reference to—

- (a) where the subject portfolio is entered into by a particular central counterparty—the subject portfolio; or

- (b) in any other case—an OTCD portfolio consisting of OTCD transactions that are entered into by a particular central counterparty as part of the clearing and settlement process during which the subject portfolio is entered into.

2ED. Meaning of *OTCD variable amount* and related terms

(1) In these Rules—

- (a) **OTCD variable amount** (), in relation to an OTCD portfolio effected by a licensed corporation, means—
 - (i) if all of the outstanding OTCD transactions within the portfolio are centrally cleared through OTC Clearing Hong Kong Limited—5% of the top OTCD initial margin amount of the portfolio;
 - (ii) if all of the outstanding OTCD transactions within the portfolio are centrally cleared through one or more regulated CCPs (but not all through OTC Clearing Hong Kong Limited)—8% of the top OTCD initial margin amount of the portfolio; or
 - (iii) in any other case—8% of the higher of—
 - (A) the top OTCD initial margin amount of the portfolio; and
 - (B) the OTCD floor initial margin amount of the portfolio;
- (b) **top OTCD initial margin amount** (), in relation to an OTCD portfolio effected by a licensed corporation, means—
 - (i) subject to subparagraph (ii) or (iii)—the highest margin requiring party amount of the portfolio;
 - (ii) if the portfolio is a clearing portfolio with client—the OTCD initial margin amount of the portfolio set by the licensed corporation; or
 - (iii) if the portfolio consists of transactions entered into by a clearing client through a clearing intermediary with 2 or more persons (**master portfolio**) and the transactions entered into with each person constitute an OTCD portfolio (**sub-portfolio**), where the licensed corporation is either the clearing client or the clearing intermediary, the higher of—
 - (A) the OTCD initial margin amount of the master portfolio set by the clearing intermediary; and
 - (B) the sum of the highest margin requiring party amounts of all sub-portfolios; and
- (c) **OTCD floor initial margin amount** (), in relation to an OTCD portfolio effected by a licensed corporation, means—
 - (i) if the portfolio is a single OTCD transaction—the PFE amount of the transaction;
 - (ii) if the portfolio is a group of margined OTCD transactions—the sum of the PFE amounts of the transactions within the group; or
 - (iii) if the portfolio is an OTCD netting set—the net PFE amount of the OTCD netting set.

- (2) In determining the highest margin requiring party amount of an OTCD portfolio, a licensed corporation is only required to take into account the OTCD initial margin amounts of which it has information.

(3) In this section—

highest margin requiring party amount (), in relation to an OTCD portfolio effected by a licensed corporation (**subject portfolio**)—

- (a) means the highest OTCD initial margin amount of the portfolio set by a margin requiring party to the subject portfolio; but
- (b) if the OTCD transactions within the subject portfolio are all centrally cleared—means the higher of—
 - (i) the amount referred to in paragraph (a); and
 - (ii) the sum of the OTCD initial margin amounts set by the central counterparties for the CCP portfolios in respect of the subject portfolio.

2EE. Meaning of *RCCP-cleared OTCD dealer*, *asset management group central OTCD dealer* and *OTCD inter-dealer broker*

(1) In these Rules—

RCCP-cleared OTCD dealer () means a specified dealer whose activities (including activities that do not constitute any regulated activity)—

- (a) to the extent that they constitute OTC derivative dealing acts in respect of OTCD transactions—only involve OTCD transactions cleared through regulated CCPs; and
- (b) do not constitute providing services to another person for the clearing or settlement of OTCD transactions.

(2) In these Rules—

asset management group central OTCD dealer () means a specified dealer that, in carrying out its specified dealing acts—

- (a) does not hold client assets;
- (b) only carries out such acts pursuant to instructions given to it by any of its affiliates for the accounts of the affiliate's clients in the course of the affiliate's regulated asset management activity;
- (c) is not a counterparty to any OTCD transaction, except where it is merely named in or has signed transaction documentation as an agent with authority to sign such documentation for and on behalf of the affiliate or the affiliate's clients;
- (d) will not incur any liability to any person in respect of any OTCD transaction except in respect of its own negligence, wilful default or fraud; and
- (e) does not carry out any market making activity in respect of OTCD transactions, except between it and the affiliate or the affiliate's clients for the purpose referred to in paragraph (b).

(3) In these Rules—

OTCD inter-dealer broker () means a specified dealer—

- (a) that, in carrying out its specified dealing acts—
 - (i) does not hold client assets;
 - (ii) only provides to professional investors that are not individuals services of negotiating, arranging or facilitating the entering into of OTCD transactions between such investors;
 - (iii) is not a counterparty to any OTCD transaction entered into by such investors; and
 - (iv) will not incur any liability to any person in respect of any OTCD transaction entered into by such investors except for its own negligence, wilful default or fraud; and

- (b) whose activities (including activities that do not constitute regulated activity) do not constitute providing services to another person for the clearing or settlement of OTCD transactions.

(4) In this section—

affiliate (), in relation to a licensed corporation, means—

- (a) a corporation in the same group of companies as the licensed corporation that is—
 - (i) licensed for Type 9 regulated activity; or
 - (ii) authorized (however described) by an authority or regulatory organization in a comparable jurisdiction for a Type 9-equivalent activity; or
- (b) an entity approved as an approved affiliate of the licensed corporation under section 58(5)(ca);

client (), in relation to an affiliate of a licensed corporation, means a person for whom the affiliate provides a service the provision of which constitutes a regulated asset management activity;

comparable jurisdiction () means a jurisdiction that, in the Commission's opinion, has legal or regulatory requirements comparable to those of Hong Kong for regulating a Type 9-equivalent activity;

regulated asset management activity (), in relation to an affiliate of a licensed corporation, means—

- (a) if the affiliate is licensed for Type 9 regulated activity—that regulated activity; or
- (b) in any other case—the Type 9-equivalent activity for which the affiliate is authorized (however described);

specified dealer () means—

- (a) an RA11 dealer that carries out acts constituting dealing in OTC derivative products in respect of OTCD transactions; or
- (b) a non-RA11 OTCD dealer;

specified dealing acts (), in relation to a specified dealer, means the following acts in so far as they relate to it—

- (a) if it falls within paragraph (a) of the definition of **specified dealer** in this subsection—the acts described in that paragraph;
- (b) if it falls within paragraph (b) of that definition—the acts described in paragraph (b) of the definition of **non-RA11 OTCD dealer** in section 2(1);

Type 9-equivalent activity () means an activity that, if carried on in Hong Kong, would constitute Type 9 regulated activity.

2EF. Meaning of SOCCRA-LC, BOCCRA-LC, SMRA-LC and BMRA-LC

(1) In these Rules—

SOCCRA-LC ()—

- (a) means—
 - (i) a licensed corporation the default approach for which is SOCCRA; or
 - (ii) an approved SOCCRA-LC; but
- (b) does not include an approved BOCCRA-LC.

(2) In these Rules—

BOCCRA-LC ()—

- (a) means—
 - (i) a licensed corporation the default approach for which is BOCCRA; or
 - (ii) an approved BOCCRA-LC; but
 - (b) does not include an approved SOCCRA-LC.
- (3) In these Rules—
- SMRA-LC ()—**
- (a) means—
 - (i) a licensed corporation the default approach for which is SMRA; or
 - (ii) an approved SMRA-LC; but
 - (b) does not include an approved BMRA-LC.
- (4) In these Rules—
- BMRA-LC ()—**
- (a) means—
 - (i) a licensed corporation the default approach for which is BMRA; or
 - (ii) an approved BMRA-LC; but
 - (b) does not include an approved SMRA-LC.
- (5) In this section—
- (a) a reference to a licensed corporation the default approach for which is SOCCRA or SMRA is a reference to—
 - (i) a non-RA11 OTCD dealer, except—
 - (A) an asset management group central OTCD dealer; or
 - (B) an OTCD inter-dealer broker;
 - (ii) an RA7 service provider for OTCD trading;
 - (iii) an RA7 service provider for OTCD clearing;
 - (iv) an RA11 dealer, except—
 - (A) an asset management group central OTCD dealer; or
 - (B) an OTCD inter-dealer broker; or
 - (v) a licensed corporation licensed for Type 12 regulated activity; and
 - (b) a reference to a licensed corporation the default approach for which is BOCCRA or BMRA is a reference to a licensed corporation that does not fall within paragraph (a).

Note—

In this section—

- (a) **SOCCRA** stands for the standardized OTC derivative counterparty credit risk approach;
- (b) **BOCCRA** stands for the basic OTC derivative counterparty credit risk approach;
- (c) **SMRA** stands for the standardized market risk approach; and
- (d) **BMRA** stands for the basic market risk approach.

2F. Meaning of *structured note*

(1) In these Rules—

structured note (結構性票據) means an instrument—

- (a) that is in the form of a bond, debenture or note;

- (b) that acknowledges, evidences or creates indebtedness, regardless of whether—
 - (i) the holder of the instrument has the right to receive the principal value on or before maturity; or
 - (ii) the issuer of the instrument has the right to terminate the instrument before maturity;
- (c) that is a structured product within the meaning of section 1A of Part 1 of Schedule 1 to the Ordinance, except a structured product that—
 - (i) falls within subsection (1)(a)(ii) or (iii) or (b) of that section; or
 - (ii) is an OTC derivative product; and
- (d) under the terms and conditions of which the holder is to receive a bearish return or a bullish return (whether or not subject to any deduction or payment of any expense or charge under those terms and conditions) that is determined by comparing the strike price and the settlement price of—
 - (i) a permitted underlying asset; or
 - (ii) a permitted underlying type of rate or index.

(2) For the purposes of the definition of **structured note** in subsection (1)—

bearish return (看跌式回報), in relation to an instrument, means—

- (a) both of the following—
 - (i) on or before maturity or termination, one or more coupon payments;
 - (ii) on or after maturity or termination, an amount referred to in paragraph (b); or
- (b) any of the following, on or after maturity or termination—
 - (i) if the settlement price is below the strike price—settlement amount 1;
 - (ii) if the settlement price exceeds the strike price—settlement amount 4;
 - (iii) if the settlement price is equal to the strike price—
 - (A) settlement amount 1; or
 - (B) settlement amount 4;

bullish return (看漲式回報), in relation to an instrument, means—

- (a) both of the following—
 - (i) on or before maturity or termination, one or more coupon payments;
 - (ii) on or after maturity or termination, an amount or quantity referred to in paragraph (b); or
- (b) any of the following, on or after maturity or termination—
 - (i) if the settlement price exceeds the strike price—settlement amount 1;
 - (ii) if the settlement price is below the strike price and the instrument has a permitted underlying asset—
 - (A) the settlement quantity;
 - (B) settlement amount 2; or
 - (C) an amount and a number of units of the permitted underlying asset which together are equivalent in value to settlement amount 2;
 - (iii) if the settlement price is below the strike price and the instrument has a permitted underlying type of rate or index—settlement amount 3;

- (iv) if the settlement price is equal to the strike price and the instrument has a permitted underlying asset—
 - (A) the settlement quantity;
 - (B) settlement amount 1;
 - (C) settlement amount 2; or
 - (D) an amount and a number of units of the permitted underlying asset which together are equivalent in value to settlement amount 2;
- (v) if the settlement price is equal to the strike price and the instrument has a permitted underlying type of rate or index—
 - (A) settlement amount 1; or
 - (B) settlement amount 3;

maturity (到期), in relation to an instrument, means the date on which the instrument is due to mature;

permitted interest rate (許可利率) means a money market or interbank reference interest rate for a lawful currency of a jurisdiction that is widely quoted in a market where the JAA of the jurisdiction has an issuer rating assigned by ~~that is domiciled in a jurisdiction which is rated by~~—

- (a) Moody's Investors Service at either Baa3 or Prime-3 or above;
- (b) Standard & Poor's Corporation at either BBB- or A-3 or above; or
- (c) Fitch Ratings at either BBB- or F3 or above;

permitted securities (許可證券) means securities other than—

- (a) special debt securities;
- (b) an illiquid investment;
- (c) a miscellaneous investment;
- (d) a derivative ~~contract instrument~~; or
- (e) a structured product;

permitted underlying asset (許可相關資產), in relation to an instrument, means a single asset that is—

- (a) permitted securities; or
- (b) a tradable commodity;

permitted underlying type of rate or index (屬許可類別的相關比率或指數), in relation to an instrument, means a single type of—

- (a) permitted interest rate;
- (b) currency exchange rate;
- (c) tradable securities index;
- (d) tradable commodity index; or
- (e) tradable currency exchange rate index;

settlement amount 1 (交收數額1), in relation to an instrument, means the sum of the principal value and the outstanding coupon payments;

settlement amount 2 (交收數額2), in relation to an instrument that has a permitted underlying asset, means the value of the settlement quantity calculated in accordance with the following formula—

settlement quantity × settlement price;

settlement amount 3 (交收數額3), in relation to an instrument that has a permitted underlying type of rate or index, means an amount calculated in accordance with the following formula—

$$\frac{\text{settlement amount 1}}{\text{strike price}} \times \text{settlement price};$$

settlement amount 4 (交收數額4), in relation to an instrument, means the higher of—

(a) an amount calculated in accordance with the following formula—

$$\text{settlement amount 1} - \frac{\text{settlement amount 1}}{\text{strike price}} \times (\text{settlement price} - \text{strike price}); \text{ and}$$

(b) zero;

settlement price (交收價) means a price or value of 1 unit of a permitted underlying asset or a level of a permitted underlying type of rate or index that, for the purposes of determining the bearish return or the bullish return under the terms and conditions of an instrument, is—

- (a) quoted in a market specified in those terms and conditions at a time specified in, or to be determined in accordance with a method specified in, those terms and conditions; or
- (b) determined in accordance with a method specified in those terms and conditions;

settlement quantity (交收數量), in relation to an instrument that has a permitted underlying asset, means the number of units of the asset calculated in accordance with the following formula—

$$\text{settlement amount 1} \div \text{strike price};$$

strike price (行使價) means a price or value of 1 unit of a permitted underlying asset or a level of a permitted underlying type of rate or index that is specified in the terms and conditions of an instrument for the purposes of determining the bearish return or the bullish return under those terms and conditions;

termination (終止), in relation to an instrument, means a date before maturity on which the instrument terminates in accordance with the terms and conditions of the instrument or by agreement between the parties to the instrument;

tradable commodity index (流通商品指數) means a tradable index that is calculated by reference to ~~changes in~~ the price or value of a basket of tradable commodities;

tradable currency exchange rate index (流通貨幣匯率指數) means a tradable index that is ~~a currency exchange rate index calculated by reference to changes in the level of a combination of more than one type of currency exchange rate;~~

tradable index (流通指數) means an index that is traded under a tradable contract;

tradable securities index (流通證券指數) means a tradable index that is calculated by reference to ~~changes in~~ the price or value of a basket of permitted securities.

2FA. Meaning of terms relating to amounts receivable or payable under OTCD transaction

(1) For the purposes of these Rules, in relation to an OTCD transaction effected by a licensed corporation—

- (a) the **adjusted OTCD receivable amount** () from a person is the difference between—

- (i) any OTCD receivable amount from the person; and
 - (ii) any OTCD receivable deduction amount applicable to the person;
 - (b) the **OTCD receivable amount** () from a person is the sum of—
 - (i) any positive amount receivable from the person; and
 - (ii) any other amount receivable from the person arising from the transaction, except any amount that constitutes—
 - (A) OTCD cash margin posted to the person; or
 - (B) excluded cash deposited with the person;
 - (c) the **OTCD receivable deduction amount** () applicable to a person is any amount by which the past due cash flow receivable from the person exceeds the sum of—
 - (i) the OTCD payable amount to the person; and
 - (ii) the volatility adjusted values of any assets, being assets posted by the person as security in respect of the transaction, that are eligible collateral; and
 - (d) the **OTCD payable amount** () to a person is the sum of—
 - (i) any negative amount payable to the person; and
 - (ii) any other amount payable to the person arising from the transaction, except any amount that constitutes OTCD cash margin posted by the person.
- (2) In subsection (1), in relation to an OTCD transaction effected by a licensed corporation—
- (a) the **positive amount** () receivable from a person is—
 - (i) for a transaction other than an intermediary transaction (agency clearing)—any amount receivable from the person that represents the positive market value of the transaction in the account of the licensed corporation; or
 - (ii) for an intermediary transaction (agency clearing)—
 - (A) if the person is the licensed corporation's clearing client—any amount receivable from the clearing client that represents the negative market value of the transaction in the account of the clearing client; or
 - (B) in any other case—any amount receivable from the person that represents the positive market value of the transaction in the account of the licensed corporation's clearing client;
 - (b) the **negative amount** () payable to a person is—
 - (i) for a transaction other than an intermediary transaction (agency clearing)—any amount payable to the person that represents the negative market value of the transaction in the account of the licensed corporation; or
 - (ii) for an intermediary transaction (agency clearing)—
 - (A) if the person is the licensed corporation's clearing client—any amount payable to the clearing client that represents the positive market value of the transaction in the account of the clearing client; or
 - (B) in any other case—any amount payable to the person that represents the negative market value of the transaction in the account of the licensed corporation's clearing client;

- (c) the ***past due cash flow receivable*** () from a person is any amount receivable from the person arising from the transaction that—
 - (i) represents the cash flow under the transaction; and
 - (ii) has been outstanding for more than 3 business days after the settlement date; and
- (d) the ***excluded cash*** () deposited with a person is any cash deposited in respect of the transaction by the licensed corporation with the person as—
 - (i) if the person is not a recognized clearing house—
 - (A) admission fees; or
 - (B) security against the general obligations of the licensed corporation; or
 - (ii) if the person is a recognized clearing house—a matter mentioned in section 28(1)(c), (d) or (e).
- (3) For the purposes of subsection (1)(c)(ii)—
 - (a) a licensed corporation may, in relation to an OTCD transaction effected by it, treat an asset posted to it by a person as security in respect of the transaction as eligible collateral if—
 - (i) the asset is of any of the descriptions specified in section 53U(2); and
 - (ii) the requirements specified in section 53U(3) are satisfied; and
 - (b) ***volatility adjusted value*** (), in relation to an asset treated as eligible collateral under paragraph (a), has the meaning given by section 53C as if such asset were eligible collateral within the meaning of Part 4A.

2FB. References to basket of certain matters and basket underlying index

- (1) In these Rules—
 - (a) a reference to a basket of equities is a reference to a basket of different categories of equity;
 - (b) a reference to a basket of debt securities is a reference to a basket of different categories of debt securities;
 - (c) a reference to a basket of gold is a reference to a basket of different categories of gold; and
 - (d) a reference to a basket of commodities is a reference to a basket of different categories of commodities.
- (2) In these Rules, a reference to a basket underlying an index is a reference to the basket by reference to the price or value of which the index is calculated.

2G. References to exchange and clearing house

In these Rules, a reference to—

- (a) an exchange includes a reference to any market operated by that exchange; and
- (b) an exchange or clearing house that is specified by name and, after the day on which it is specified—
 - (i) changes its name, is to be read as if it is a reference to the name by which the exchange or clearing house is presently known; or
 - (ii) is succeeded by another exchange or clearing house (whether by reason of merger, amalgamation or otherwise), is to be read as if it is a reference to the successor exchange or clearing house.

2H. Reference to licensed corporation's position

(1) In these Rules—

- (a) a reference to a licensed corporation's position in a particular matter is a reference to its spot position or notional position in that matter;
- (b) a reference to a licensed corporation's long position in a particular matter is a reference to its long spot position or long notional position in that matter; and
- (c) a reference to a licensed corporation's short position in a particular matter is a reference to its short spot position or short notional position in that matter.

(2) In this section—

particular matter () includes—

- (a) any type or combination of types of matters; and
- (b) any basket of more than one type of, or any combination of types of, matters.

2I. References to licensed corporation treated as RCCP-cleared OTCD dealer

For the purposes of these Rules, an approved standardized approach LC or approved latest Basel LC that is not an RCCP-cleared OTCD dealer is nevertheless treated as an RCCP-cleared OTCD dealer if its activities (including activities that do not constitute any regulated activity) constitute neither of the following—

- (a) OTC derivative dealing acts in respect of OTCD transactions, except where the acts only involve OTCD transactions cleared through regulated CCPs;
- (b) providing services to another person for the clearing or settlement of OTCD transactions.

2J. References to OTCD transaction effected by licensed corporation

(1) In these Rules, a reference to an OTCD transaction effected by a licensed corporation is a reference to any of the following transactions in relation to the licensed corporation—

- (a) a proprietary transaction (non-clearing);
- (b) a proprietary transaction (clearing);
- (c) an intermediary transaction (principal clearing);
- (d) an intermediary transaction (agency clearing).

(2) In these Rules—

- (a) **proprietary transaction (non-clearing)** (), in relation to a licensed corporation, means an OTCD transaction entered into by the licensed corporation for its own account, except a proprietary transaction (clearing);
- (b) **proprietary transaction (clearing)** (), in relation to a licensed corporation, means an OTCD transaction entered into by the licensed corporation for its own account with or through a person where the person is acting as a clearing intermediary of the licensed corporation;
- (c) **intermediary transaction (principal clearing)** (), in relation to a licensed corporation, means an OTCD transaction entered into by the licensed corporation where it is acting as a clearing intermediary of another person; or
- (d) **intermediary transaction (agency clearing)** (), in relation to a licensed corporation, means an OTCD transaction entered into by a person with another person through the licensed corporation where the licensed corporation is acting as a clearing intermediary of the first-mentioned person.

- (3) In these Rules, an intermediary transaction (principal clearing) entered into by a licensed corporation is—
- (a) a **clearing transaction with client** () if it is entered into by the licensed corporation with its clearing client; or
 - (b) a **direct offsetting transaction** () of a clearing transaction with client if it is entered into by the licensed corporation with a person other than its clearing client as part of the clearing and settlement process during which the clearing transaction with client is entered into.
- (4) In these Rules, where an OTCD transaction effected by a licensed corporation (**subject transaction**) is centrally cleared, a reference to the **CCP transaction** in respect of the subject transaction is a reference to—
- (a) where the subject transaction is entered into by the central counterparty—the subject transaction; or
 - (b) in any other case—an OTCD transaction that is entered into by the central counterparty as part of the clearing and settlement process during which the subject transaction is entered into.

2K. References to OTCD transaction being centrally cleared etc.

- (1) For the purposes of these Rules, an OTCD transaction is centrally cleared if it is entered into in the course of the clearing and settlement of another OTCD transaction (**initial transaction**) through a central counterparty.
- (2) In these Rules—
- (a) a reference to the central counterparty to an OTCD transaction that is centrally cleared is a reference to the central counterparty through which the initial transaction for the OTCD transaction is cleared and settled; and
 - (b) a reference to an OTCD transaction entered into by a central counterparty is a reference to such a transaction entered into by the central counterparty acting in its capacity as a central counterparty.

2L. Reference to size of licensed corporation's position

In these Rules, a reference to the size of a licensed corporation's position is a reference to—

- (a) for a position in any securities, commodity, gold, currency, property or instrument—the amount or quantity of the securities, commodity, gold, currency, property or instrument comprising the position, expressed in the units in which they are commonly quoted in the market in which they are traded;
- (b) for a position in a basket of securities, commodities, gold, currencies, property or instruments—the number of the baskets comprising the position;
- (c) for a notional position in an index—the monetary value of 1 index point, or per index point change, determined according to the terms of the instrument having the index as an underlying subject matter;
- (d) for a notional position in an interest rate or currency exchange rate—the notional principal of the rate;
- (e) for a notional position in a basket of indexes, interest rates or currency exchange rates—the number of baskets comprising the position multiplied by—
 - (i) the monetary value per unit of, or per unit of change in, the value of the basket, determined according to the terms of the instrument having the basket as an underlying subject matter; or

- (ii) an equivalent of such monetary value; or
- (f) for a notional position in a notional currency—the size of the licensed corporation's notional position in the basket of currencies, basket of currency exchange rates or currency exchange rate index that the notional currency represents;
- (g) for a notional position in an SRF security—the market value of the position.

2M. References to *underlying subject matter* of a derivative instrument

- (1) In these Rules, in relation to a derivative instrument—

underlying subject matter () means any particular matter specified in the instrument by reference to which, including by reference to changes in the price, value or level (or a range within the price, value or level) of which or by reference to the occurrence or non-occurrence of which, some or all of the return or amount due (or both the return and the amount due) or the method of settlement under the instrument is determined.

- (2) In this section—

particular matter () includes—

- (a) any type or combination of types of matters; and
- (b) any basket of more than one type of, or any combination of types of, matters.

2N. Types of derivatives

- (1) In these Rules—

- (a) ***common derivative*** () means—

- (i) a common commodity derivative;
- (ii) a common debt security derivative;
- (iii) a common equity derivative;
- (iv) a common exchange rate derivative;
- (v) a common gold derivative;
- (vi) a common interest rate derivative; or
- (vii) a common credit derivative;

- (b) ***uncommon derivative*** ()—

- (i) means—

- (A) a derivative instrument that is not a common derivative; or
- (B) an instrument approved by the Commission under section 58(5)(cb) as being an uncommon derivative; but

- (ii) does not include a derivative instrument approved by the Commission under section 58(5)(cc) as not being an uncommon derivative; and

- (c) ***miscellaneous derivative*** ()—

- (i) means—

- (A) a derivative instrument that is in a form other than—
 - (I) qualifying debt securities;
 - (II) special debt securities;
 - (III) specified securities;
 - (IV) listed securities;
 - (V) an illiquid investment;

- (VI) a futures contract;
 - (VII) an options contract;
 - (VIII) a leveraged foreign exchange contract; and
 - (IX) an OTC derivative product; or
 - (B) an instrument approved by the Commission under section 58(5)(cd) as being a miscellaneous derivative; but
 - (ii) does not include a derivative instrument approved by the Commission under section 58(5)(ce) as not being a miscellaneous derivative.
- (2) In these Rules—
- (a) **common commodity derivative ()**—
 - (i) means—
 - (A) a derivative instrument—
 - (I) that is in the form of a continuous options contract, futures contract, forward contract, swap, contract for difference or derivative note with embedded common continuous option; and
 - (II) the underlying subject matter of which is or includes—
 - (AA) a category of commodity;
 - (BB) a basket of commodities; or
 - (CC) a commodity index;
 - (B) a derivative instrument—
 - (I) that is in the form of a continuous options contract; and
 - (II) the underlying subject matter of which is another derivative instrument—
 - (AA) that is in the form of a futures contract, forward contract or swap; and
 - (BB) the underlying subject matter of which is or includes a matter referred to in sub-subparagraph (A)(II)(AA), (BB) or (CC); or
 - (C) an instrument approved by the Commission under section 58(5)(cf) as being a common commodity derivative; but
 - (ii) does not include a derivative instrument approved by the Commission under section 58(5)(cg) as not being a common commodity derivative;
 - (b) **common debt security derivative ()**—
 - (i) means—
 - (A) a derivative instrument—
 - (I) that is in the form of a continuous options contract, futures contract, forward contract, swap, contract for difference or derivative note with embedded common continuous option; and
 - (II) the underlying subject matter of which is or includes—
 - (AA) a category of debt security that is not a derivative note;
 - (BB) a basket of debt securities in which none of the debt securities is a derivative note; or
 - (CC) a debt security index that has a basket of debt securities referred to in sub-subparagraph (BB) underlying it;
 - (B) a derivative instrument—

- (I) that is in the form of a continuous options contract; and
 - (II) the underlying subject matter of which is another derivative instrument—
 - (AA) that is in the form of a futures contract, forward contract or swap; and
 - (BB) the underlying subject matter of which is or includes a matter referred to in sub-subparagraph (A)(II)(AA), (BB) or (CC); or
 - (C) an instrument approved by the Commission under section 58(5)(ch) as being a common debt security derivative; but
- (ii) does not include—
 - (A) a common credit derivative; or
 - (B) a derivative instrument approved by the Commission under section 58(5)(ci) as not being a common debt security derivative;
- (c) **common equity derivative** ()—
 - (i) means—
 - (A) a derivative instrument—
 - (I) that is in the form of a continuous options contract, futures contract, forward contract, swap, contract for difference or derivative note with embedded common continuous option; and
 - (II) the underlying subject matter of which is or includes—
 - (AA) a category of equity;
 - (BB) a basket of equities; or
 - (CC) an equity index;
 - (B) a derivative instrument—
 - (I) that is in the form of a continuous options contract; and
 - (II) the underlying subject matter of which is another derivative instrument—
 - (AA) that is in the form of a futures contract, forward contract or swap; and
 - (BB) the underlying subject matter of which is or includes a matter referred to in sub-subparagraph (A)(II)(AA), (BB) or (CC); or
 - (C) an instrument approved by the Commission under section 58(5)(cj) as being a common equity derivative; but
 - (ii) does not include a derivative instrument approved by the Commission under section 58(5)(ck) as not being a common equity derivative;
 - (d) **common exchange rate derivative** ()—
 - (i) means—
 - (A) a derivative instrument—
 - (I) that is in the form of a continuous options contract, futures contract, forward contract, swap, contract for difference or derivative note with embedded common continuous option; and
 - (II) the underlying subject matter of which is or includes—
 - (AA) a currency;
 - (BB) a basket of currencies;

- (CC) a currency exchange rate;
 - (DD) a basket of currency exchange rates; or
 - (EE) a currency exchange rate index; or
 - (B) a derivative instrument—
 - (I) that is in the form of a continuous options contract; and
 - (II) the underlying subject matter of which is another derivative instrument—
 - (AA) that is in the form of a futures contract, forward contract or swap; and
 - (BB) the underlying subject matter of which is or includes a matter referred to in sub-subparagraph (A)(II)(AA), (BB), (CC), (DD) or (EE); or
 - (C) an instrument approved by the Commission under section 58(5)(cl) as being a common exchange rate derivative; but
 - (ii) does not include a derivative instrument approved by the Commission under section 58(5)(cm) as not being a common exchange rate derivative;
- (e) **common gold derivative** ()—
- (i) means—
 - (A) a derivative instrument—
 - (I) that is in the form of a continuous options contract, futures contract, forward contract, swap, contract for difference or derivative note with embedded common continuous option; and
 - (II) the underlying subject matter of which is or includes—
 - (AA) a category of gold;
 - (BB) a basket of gold; or
 - (CC) an interest in a collective investment scheme referred to in item 2 of Table 8 in Schedule 2;
 - (B) a derivative instrument—
 - (I) that is in the form of a continuous options contract; and
 - (II) the underlying subject matter of which is another derivative instrument—
 - (AA) that is in the form of a futures contract, forward contract or swap; and
 - (BB) the underlying subject matter of which is or includes a matter referred to in sub-subparagraph (A)(I)(AA), (BB) or (CC); or
 - (C) an instrument approved by the Commission under section 58(5)(cn) as being a common gold derivative; but
 - (ii) does not include a derivative instrument approved by the Commission under section 58(5)(co) as not being a common gold derivative;
- (f) **common interest rate derivative** ()—
- (i) means—
 - (A) a derivative instrument—
 - (I) that is in the form of a continuous options contract, futures contract, forward contract, swap, contract for difference or derivative note with embedded common continuous option; and

- (II) the underlying subject matter of which is or includes one or more interest rates;
 - (B) a derivative instrument—
 - (I) that is in the form of a continuous options contract; and
 - (II) the underlying subject matter of which is another derivative instrument—
 - (AA) that is in the form of a futures contract, forward contract or swap; and
 - (BB) the underlying subject matter of which is or includes one or more interest rates; or
 - (C) an instrument approved by the Commission under section 58(5)(cp) as being a common interest rate derivative; but
 - (ii) does not include a derivative instrument approved by the Commission under section 58(5)(cq) as not being a common interest rate derivative; and
 - (g) **common credit derivative** ()—
 - (i) means—
 - (A) a derivative instrument that is—
 - (I) a single-name credit default swap;
 - (II) a single-name credit linked note;
 - (III) a single-name total return swap;
 - (IV) a multiple-name credit default swap;
 - (V) a multiple-name credit linked note;
 - (VI) a multiple-name total return swap;
 - (VII) a nth-to-default credit default swap; or
 - (VIII) a nth-to-default credit linked note;
 - (B) a derivative instrument—
 - (I) that is in the form of a continuous options contract; and
 - (II) the underlying subject matter of which is a single-name total return swap or multiple-name total return swap; or
 - (C) an instrument approved by the Commission under section 58(5)(cr) as being a common credit derivative; but
 - (ii) does not include a derivative instrument approved by the Commission under section 58(5)(cs) as not being a common credit derivative.
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Part 2

Accounting Treatment

3. Accounting treatment

- (1) For the purposes of these Rules and subject to subsection (3), a licensed corporation must account for all assets and liabilities—
 - (a) in accordance with generally accepted accounting principles, unless otherwise specified in these Rules; and
 - (b) in a way that recognizes the substance of a transaction, arrangement or position.
 - (2) Subject to subsection (3), a licensed corporation must not without notifying the Commission under section 55(5), change any of its accounting principles, other than those referred to in subsection (1)(a), in a way that may materially affect the liquid capital, ~~or~~ paid-up share capital **or tangible capital** that it maintains or is required to maintain under Part 3.
 - (3) A licensed corporation may, with the Commission's prior written approval under section 58(5)(d), adopt an accounting principle other than one of those referred to in subsection (1)(a).
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Part 3

Financial Resources Requirements

4. Licensed corporations to maintain financial resources

A licensed corporation must at all times maintain financial resources in the amount required of it under this Part.

5. Paid-up share capital requirement for licensed corporations

(1) For the purposes of section 4, a licensed corporation to which this section applies must at all times maintain paid-up share capital of not less than the minimum amount of paid-up share capital applicable to it under section 1 of Schedule 1.

(2) This section applies to ~~For the purposes of section 4,~~ a licensed corporation other than—

- (a) a licensed corporation to which section 5A applies; or
- (b) a licensed corporation that ~~one which~~ carries on a regulated activity solely as one or more of the following—
 - (ai) an approved introducing agent who is not a licensed corporation licensed for Type 3 regulated activity;
 - (bii) a trader;
 - (eiii) a futures non-clearing dealer;
 - (div) a licensed corporation licensed for Type 4, Type 5, Type 9 or Type 10 regulated activity, ~~which that~~ is subject to the specified licensing condition;
 - (dav) a licensed corporation licensed for Type 6 regulated activity, ~~which that~~ is subject to both the specified licensing condition and the no sponsor work licensing condition;;
 - (vi) a licensed corporation licensed for Type 11 regulated activity that is subject to both the specified licensing condition and the no dealing licensing condition.

~~must at all times maintain paid-up share capital of not less than—~~

- ~~(e) where it is licensed for only one regulated activity specified in column 1 of Table 1 in Schedule 1, the amount specified in column 2 of the Table opposite the regulated activity or, where any further description is set out for the regulated activity in column 1 of the Table, opposite the applicable description; or~~
- ~~(f) where it is licensed for 2 or more regulated activities specified in column 1 of the Table, the amount which is the higher or highest upon comparing each amount specified in column 2 of the Table opposite any of such regulated activities or, where any further description is set out for any of such activities in column 1 of the Table, opposite any of such activities or any of the applicable descriptions.~~

5A. Tangible capital requirement for licensed corporations

(1) For the purposes of section 4, a licensed corporation to which this section applies must at all times maintain tangible capital of not less than the minimum amount of tangible capital applicable to it under section 2 of Schedule 1.

(2) This section applies to—

- (a) an RA11 dealer, except a specified OTCD dealer;
- (b) a non-RA11 OTCD dealer, except a specified OTCD dealer;

- (c) an RA7 service provider for OTCD trading;
- (d) an RA7 service provider for OTCD clearing;
- (e) a licensed corporation licensed for Type 12 regulated activity, except a specified RA12 LC;
- (f) an approved standardized approach LC or an approved latest Basel LC that is not, and is not treated as, an RCCP-cleared OTCD dealer; and
- (g) an approved internal model LC.

6. Liquid capital requirement for licensed corporations

- (1) For the purposes of section 4, a licensed corporation must at all times maintain liquid capital which is not less than its required liquid capital.
- (2) Subsections (3) and (4) apply in respect of a licensed corporation licensed for one or more of the following—
 - (a) Type 1 regulated activity;
 - (b) Type 2 regulated activity;
 - (c) Type 3 regulated activity;
 - (d) Type 8 regulated activity,
 unless it is—
 - (e) in the case of paragraph (a), an approved introducing agent or a trader;
 - (f) in the case of paragraph (b), an approved introducing agent, a trader or a futures non-clearing dealer; or
 - (g) in the case of paragraph (c), an approved introducing agent.
- (3) Subject to subsection (4)—
 - (a) on any particular business day on which a licensed corporation's required liquid capital rises above its liquid capital; and
 - (b) where applicable, on any one or more consecutive business days immediately following the day referred to in paragraph (a) on which there continues to be a required liquid capital deficit,
 the licensed corporation will be regarded as having complied with subsection (1) if—
 - (c) it is entitled to draw down an amount not less than the required liquid capital deficit under an approved standby subordinated loan facility; and
 - (d) its required liquid capital on the day that its required liquid capital rises above its liquid capital is at least 20% more than its required liquid capital at the close of business on the previous business day, as a result of—
 - (i) an increase in its adjusted liabilities which is attributable to an increase in its dealings in **non-OTCD** securities for its clients;
 - (ii) an increase in the aggregate of the initial margin requirements, or of the amounts of margin required to be deposited, in respect of outstanding **non-OTCD** futures contracts or outstanding **non-OTCD** unlisted options contracts ~~held-cleared~~ by it on behalf of **or for** its clients;
 - (iii) an increase in its aggregate gross foreign currency position;
 - (iv) an increase in its adjusted liabilities which is attributable to an increase in the aggregate of the amounts receivable from its margin clients; or
 - (v) where applicable, the aggregate of the increases described in 2 or more of subparagraph (i), (ii), (iii) or (iv).

- (4) Subsection (3) only applies on a day referred to in subsection (3)(a) or (b) if, during the 60 days immediately preceding that day, the required liquid capital of the licensed corporation has exceeded its liquid capital on 4 or less business days.

6A. Option for reduced capital requirements

- (1) A licensed corporation may opt for reduced capital requirements if none of its OTCD activity levels that are counted for reduced capital requirements exceeds the applicable threshold.
- (2) For the purposes of these Rules—
 - (a) a licensed corporation is regarded as opting for reduced capital requirements during the period for which an option made by it under subsection (1) has effect; and
 - (b) an option made by a licensed corporation under subsection (1) has effect for the period beginning on the date on which the option is made and ending on the earliest of—
 - (i) the date on which the licensed corporation withdraws the option;
 - (ii) the date on which an objection under subsection (3) to the option takes effect; and
 - (iii) the date on which the option expires under subsection (5).
- (3) For the purposes of subsection (2)(b)(ii), the Commission may, by notice in writing served on a licensed corporation that makes an option under subsection (1), object to the option if it is satisfied that it is prudent to do so taking into account risks associated with the licensed corporation.
- (4) An objection under subsection (3) to an option takes effect on the later of—
 - (a) the date on which the notice of objection is served; and
 - (b) the date specified in the notice.
- (5) For the purposes of subsection (2)(b)(iii), an option made by a licensed corporation under subsection (1) expires, if any of the licensed corporation's OTCD activity levels that are counted for reduced capital requirements exceeds the applicable threshold (**specified event**), on the expiry of 90 days beginning on the date on which the licensed corporation becomes aware of the specified event.

Part 4

Liquid Capital

Division 1—General

7. Calculation of liquid capital and required liquid capital

- (1) Subject to subsection (2), a licensed corporation, for the purposes of calculating its liquid capital and required liquid capital, must account for all its assets, liabilities and transactions in accordance with this Part, Part 4A and Part 4B.
- (2) A licensed corporation to which an approval under section 58(5B)(b)(i) applies must, in place of a provision of this Part, Part 4A or Part 4B that is specified in the approval, account for its assets, liabilities or transactions (as the case may be) on the alternative basis specified in the approval.

Division 2—Computation basis

8. Accounting for transactions on trade date basis

A licensed corporation, for the purposes of calculating its liquid capital and required liquid capital, must account on a trade date basis for all transactions effected by it, whether as principal or agent, in relation to any dealing or trading in, or entering into—

- ~~(a) a futures contract;~~
- (b) any securities;
- ~~(c) an options contract;~~
- (d) a derivative ~~contract~~ instrument;
- (e) a specified investment;
- (f) a **specified** leveraged foreign exchange contract;
- (g) a foreign exchange agreement;
- ~~(h) an interest rate swap agreement;~~
- (i) an illiquid investment; or
- (j) a miscellaneous investment.

9. Valuations

- (1) This section applies to a **BMRA-LC in relation to** the following instruments ~~or~~, assets **or matter**—
 - ~~(a) a futures contract;~~
 - (b) any securities;
 - ~~(c) an options contract;~~
 - (d) a derivative ~~contract~~ instrument;
 - (e) a specified investment;
 - (f) a **specified** leveraged foreign exchange contract;
 - (g) a foreign exchange agreement;
 - ~~(h) an interest rate swap agreement;~~
 - ~~(i) an asset underlying a non-collateralized warrant that is issued by a licensed corporation;~~

- ~~(j) an asset, other than shares, underlying an options contract;~~
 - (k) an illiquid investment;
 - (l) a miscellaneous investment;
 - (m) an underlying subject matter of a derivative instrument.
- (1A) This section applies to an SMRA-LC in relation to—
- (a) any instrument, asset or underlying subject matter referred to in subsection (1); or
 - (b) a basket of any of the instruments or assets referred to in a paragraph (other than paragraph (m)) of subsection (1).
- (2) Any reference in these Rules to the market value of an instrument ~~or asset, asset or underlying subject matter~~ referred to in subsection (1) is, if there is no published market price in respect of the instrument ~~or asset, asset or matter~~, to be construed as referring to the fair value (as determined in accordance with generally accepted accounting principles) of the instrument ~~or asset, asset or matter~~.
- (2A) For an SMRA-LC, any reference in these Rules to the market value of a basket referred to in subsection (1A)(b) is, if there is no published market price in respect of the basket, to be construed as referring to the fair value (as determined in accordance with generally accepted accounting principles) of the basket.
- (3) Subject to subsection (3A), ~~a~~ licensed corporation must, for the purposes of calculating its liquid capital and required liquid capital, value at market value any ~~open-spot~~ position held by it for its own account in—
- (a) for a BMRA-LC—an instrument or asset referred to in subsection (1); or
 - (b) for an SMRA-LC—an instrument, asset or basket referred to in subsection (1A).
- (3A) Subsection (3) does not apply to a licensed corporation in relation to—
- (a) any non-trading position in securities;
 - (b) any non-trading position in a commodity; or
 - (c) any long spot position in an asset or instrument—
 - (i) that has a maximum possible loss not exceeding its positive market value; and
 - (ii) the positive market value of which is not included in the liquid assets of the licensed corporation.
- (4) Despite subsection (2) or (3), for the purposes of calculating the liquid capital and required liquid capital of a licensed corporation, any reference in these Rules to the market value of the securities ~~or positions~~ referred to in subsection (5), (6) or (7) is to be construed as referring to the value (including any nil value) at which the securities ~~or positions~~ are required to be valued under subsection (5), (6) or (7).
- (5) Listed securities that ~~have been suspended from trading for at least 3 trading days or ceased trading on any exchange on which the securities were listed must, unless the securities can continue to be traded on any other exchange on which the securities are listed, are~~ an illiquid investment must be valued by a licensed corporation—
- (a) ~~for long positions—at nil; or for a long notional position in such securities that arises from a derivative instrument held by the licensed corporation for its own account—at the higher of—~~
 - (i) the fair value of the securities; and
 - (ii) the last closing price of the securities before the suspension or cessation of trading by virtue of which the securities became an illiquid investment;
 - (ab) for any other long position in such securities held by the licensed corporation for its own account—at nil;

- (b) ~~for short positions~~ for a short position in such securities held by the licensed corporation for its own account—at the higher of the fair value and the last closing price before the suspension or cessation of trading; ~~by virtue of which the securities became an illiquid investment; or~~
 - (c) ~~for such securities that are client securities of the licensed corporation or an asset posted to the licensed corporation as security—at nil.~~
- (6) Marketable debt securities, in respect of which there is no published market price, must be valued—
- (a) for certificates of deposit—at the value quoted by the issuer; or
 - (b) for debt securities other than certificates of deposit—
 - (i) at the average value of quotations obtained from any combination of 2 or more of the following persons who customarily deal in the debt securities—
 - (A) market makers;
 - (B) banks;
 - (C) securities dealers outside Hong Kong;
 - (D) licensed corporations; or
 - (ii) if the quotations referred to in subparagraph (i) cannot be obtained—at fair value.
- (7) Debt securities that are not marketable debt securities must be valued ~~by a licensed corporation—~~
- (a) ~~for long positions—at nil; or for a long notional position in such securities that arises from a derivative instrument held by the licensed corporation for its own account—at the higher of—~~
 - (i) fair value of the debt securities; and
 - (ii) the face value of the debt securities;
 - (ab) for any other long position in the securities held by the licensed corporation for its own account—at nil;
 - (b) ~~for short positions~~ for a short position in the securities held by the licensed corporation for its own account—at the higher of fair value and the face value of the debt securities; ~~or~~
 - (c) for such securities that are client securities of the licensed corporation or an asset posted to the licensed corporation as security—at nil.

9A. Calculation of market value of certain positions

- (1) A licensed corporation must calculate the market value of its following position as follows—
 - (a) for a position in a category of equity, debt security, commodity or gold—as the market value per unit of that category of equity, debt security, commodity or gold, multiplied by the size of the position;
 - (b) for a position in a basket of equities, debt securities, commodities or gold—as the sum of the market values of each category of equity, debt security, commodity or gold that constitutes the basket, multiplied by the size of the position.
- (2) For subsection (1)(b), the market value of each category of equity, debt security, commodity or gold that constitutes the basket is the market value of the licensed corporation's position in that category, calculated in accordance with subsection (1)(a) as if the licensed corporation holds a position in each such category.

- (3) A licensed corporation must calculate the market value of its following position as follows—
 - (a) for a position in a currency—
 - (i) where the currency is the licensed corporation's reporting currency—as the size of the position; or
 - (ii) where the currency is not the licensed corporation's reporting currency—by translating the size of the position at the spot currency exchange rate into its reporting currency;
 - (b) for a position in a basket of currencies—as the sum of the market values of each currency that constitutes the basket, multiplied by the size of the position; or
 - (c) for a notional position in a notional currency—as the market value of the licensed corporation's notional position in the basket of currencies, basket of currency exchange rates or currency exchange rate index that the notional currency represents, multiplied by the size of the notional position in the notional currency.
- (4) A licensed corporation must calculate the market value of its following position as follows—
 - (a) for a notional position in an index—as the current level of the index, multiplied by the size of the position;
 - (b) for a notional position in an interest rate or currency exchange rate—as the size of the position; or
 - (c) for a notional position in a basket of indexes, basket of interest rates or basket of currency exchange rates—as the current value of the basket, determined according to the terms of the instrument having the basket as an underlying subject matter, multiplied by the size of the position.
- (5) A licensed corporation must calculate the market value of its following position as follows—
 - (a) for a notional position in any property (except a position covered by subsection (1)(a) or (b))—as the market value per unit of that property, multiplied by the size of the position; or
 - (b) for a notional position in an instrument (except a position covered by subsection (1)(a))—as the size of the position multiplied by—
 - (i) if the instrument is a derivative instrument and—
 - (A) the instrument specifies a nominal, face, par or similar value, or any other reference amount, as the amount on which the return, amount due or method of settlement (as applicable) of the instrument is based—that value or reference amount;
 - (B) the instrument specifies a designated amount (within the meaning of the definition of ***notional principal*** in section 2(1)) of an underlying subject matter of the instrument—
 - (I) where the designated amount of 1 underlying subject matter is specified—the notional principal of that underlying subject matter;
 - (II) where the designated amounts of 2 or more underlying subject matters are specified—the highest of the notional principals of those underlying subject matters; or
 - (C) in any other case—

- (I) where the instrument is a futures contract—the futures price of the underlying subject matter of the instrument, multiplied by the size of the licensed corporation's notional position in that matter;
- (II) where the instrument is a forward contract—the forward price of the underlying subject matter of the instrument, multiplied by the size of the licensed corporation's notional position in that matter; or
- (III) in any other case—
 - (AA) if the instrument has 1 underlying subject matter—the market value of the licensed corporation's notional position in that matter; or
 - (BB) if the instrument has 2 or more underlying subject matter—the highest of the market values of the licensed corporation's notional positions in those matters; or
- (ii) if the instrument is not a derivative instrument—the higher of the face value and market value of the instrument.

9B. Calculation of market value of notional position in SRF security: SMRA-LC

- (1) An SMRA-LC must calculate the market value of its notional position in an SRF security arising from a common derivative as either—
 - (a) an amount that is equal to the sum of the present values of all the future or notional cash flows represented by the position, as specified in subsection (3); or
 - (b) an amount that is equal to—
 - (i) subject to subparagraph (ii)—the market value of the notional position in the underlying subject matter of the common derivative; or
 - (ii) if the common derivative is—
 - (A) a common interest rate derivative—the notional principal of the interest rate from which the coupon payments of the SRF security are derived;
 - (B) a common exchange rate derivative the underlying subject matter of which is or includes a currency—the notional principal of that currency;
 - (C) a common exchange rate derivative the underlying subject matter of which is or includes a currency exchange rate—the notional principal of that rate; or
 - (D) a common credit derivative that is a single-name credit default swap, multiple-name credit default swap or nth-to-default credit default swap—the amount of premium or interest payment to be made or received by the SMRA-LC (as the case may be) that is represented by the SRF security.
- (2) For subsection (1)—
 - (a) an SMRA-LC must use the same calculation method for all of its notional positions in SRF securities that are denominated in the same currency; and
 - (b) the currency in which an SRF security is denominated is, if the SMRA-LC calculates the market value of the SRF security under—
 - (i) subsection (1)(a)—the currency in which the future or notional cash flows represented by the position is denominated;
 - (ii) subsection (1)(b)(i)—the currency in which the notional principal of the underlying subject matter mentioned in that subsection is denominated; or

- (iii) subsection (1)(b)(ii)(A), (B) or (C)—the currency in which the notional principal mentioned in that subsection is denominated;
 - (iv) subsection (1)(b)(ii)(D)—the currency in which the premium or interest payment mentioned in that subsection is to be made or received.
- (3) The future or notional cash flows represented by a notional position in an SRF security, specified for subsection (1)(a), are—
 - (a) for a position arising from a common derivative (except a common interest rate derivative) that is in the form of a futures contract, forward contract, continuous options contract or foreign currency swap—
 - (i) if the contract is physically settled—the payment to be received (for a long notional position) or made (for a short notional position) by the SMRA-LC under the contract during the residual maturity of the SRF security; or
 - (ii) in any other case—the payment that would be received (for a long notional position) or made (for a short notional position) by the SMRA-LC under the contract during the residual maturity of the SRF security if the contract was physically settled; or
 - (b) for a position arising from a common derivative (except a common interest rate derivative) that is in the form of a swap under which the SMRA-LC receives or pays fixed rate interest or floating rate interest—
 - (i) the notional principal of the swap on which the interest to be received (for a long notional position) or paid (for a short notional position) by the SMRA-LC under the swap is calculated; and
 - (ii) the following interest—
 - (A) if the swap is physically settled—the interest to be received (for a long notional position) or paid (for a short notional position) by the SMRA-LC under the swap during the residual maturity of the SRF security; or
 - (B) in any other case—the interest that would be received (for a long notional position) or paid (for a short notional position) by the SMRA-LC under the swap during the residual maturity of the SRF security if the swap was physically settled;
 - (c) if the position arises from a common interest rate derivative that is in the form of an interest rate swap or cross-currency interest rate swap—
 - (i) where the swap is settled by an exchange of principal and interest—
 - (A) the notional principal of the swap to be received (for a long notional position) or paid (for a short notional position) by the SMRA-LC under the swap; and
 - (B) the interest to be received (for a long notional position) or paid (for a short notional position) by the SMRA-LC under the swap during the residual maturity of the SRF security;
 - (ii) where the swap is settled by an exchange of interest—
 - (A) the notional principal of the swap that would be received (for a long notional position) or paid (for a short notional position) by the SMRA-LC under swap if there was an exchange of principal; and
 - (B) the interest to be received (for a long notional position) or paid (for a short notional position) by the SMRA-LC under the swap during the residual maturity of the SRF security; or
 - (iii) where the swap is settled by a net payment—

- (A) the notional principal of the swap that would be received (for a long notional position) or paid (for a short notional position) by the SMRA-LC under swap if there was an exchange of principal; and
 - (B) the interest that would be received (for a long notional position) or paid (for a short notional position) by the SMRA-LC under the swap during the residual maturity of the SRF security if there was an exchange of interest;
- (d) if the position arises from a common interest rate derivative that is in the form of a contract for difference, futures contract, forward contract or continuous options contract—
 - (i) where the position is one referred to in section 53ZN(1) and—
 - (A) the contract is physically settled—the notional principal of the contract to be received (for a long notional position) or paid (for a short notional position) by the SMRA-LC under the contract during the residual maturity of the SRF security; or
 - (B) in any other case—the notional principal of the contract that would be received (for a long notional position) or paid (for a short notional position) by the SMRA-LC under the contract during the residual maturity of the SRF security if the contract was physically settled; or
 - (ii) where the position is one referred to in section 53ZN(2) and—
 - (A) the contract is physically settled—
 - (I) the notional principal of the contract to be received (for a long notional position) or paid (for a short notional position) by the SMRA-LC under the contract during the residual maturity of the SRF security; and
 - (II) the interest to be received (for a long notional position) or paid (for a short notional position) by the SMRA-LC under the contract during the residual maturity of the SRF security; or
 - (B) in any other case—
 - (I) the notional principal of the contract that would be received (for a long notional position) or paid (for a short notional position) by the SMRA-LC under the contract during the residual maturity of the SRF security if the contract was physically settled; and
 - (II) the interest that would be received (for a long notional position) or paid (for a short notional position) by the SMRA-LC under the contract during the residual maturity of the SRF security if the contract was physically settled; or
 - (iii) where the position is one referred to in section 53ZN(3)(a)—the notional principal of the agreement that would be received (for a long notional position) or paid (for a short notional position) by the SMRA-LC under the agreement if the contract was physically settled; or
 - (iv) where the position is one referred to in section 53ZN(3)(b)—
 - (A) the notional principal of the agreement that would be received (for a long notional position) or paid (for a short notional position) by the SMRA-LC under the agreement during the residual maturity of the SRF security if the agreement was physically settled; and
 - (B) the interest that would be received (for a long notional position) or paid (for a short notional position) by the SMRA-LC under the agreement during

the residual maturity of the SRF security if the agreement was physically settled;

- (e) where the position is one referred to in section 53ZP(2)(b)—
 - (i) the notional principal of the swap on which the premium or interest to be received (for a long notional position) or paid (for a short notional position) by the SMRA-LC is calculated; and
 - (ii) the following premium or interest—
 - (A) if the swap is physically settled—the premium or interest to be received (for a long notional position) or paid (for a short notional position) by the SMRA-LC under the swap during the residual maturity of the SRF security; or
 - (B) in any other case—the premium or interest that would be received (for long short notional position) or paid (for a short notional position) by the SMRA-LC under the swap during the residual maturity of the SRF security if the swap was physically settled; or
 - (f) where the position is one referred to in section 53ZP(3)(b) or (4)(b) or 53ZQ(1)(b)—the premium or interest to be received (for a long notional position) or paid (for a short notional position) by the SMRA-LC under the swap during the residual maturity of the SRF security.
- (4) In subsection (3)—
- (a) a reference to the residual maturity of an SRF security, where it is mentioned in relation to notional principal or interest that would be received or paid under a contract, agreement or swap if the contract, agreement or swap was physically settled, is a reference to the actual residual maturity of the SRF security (not the residual maturity that the SRF security would have if the contract, agreement or swap was physically settled); and
 - (b) a reference to the premium or interest to be received or paid (or that would be received or paid) under a contract, agreement or swap, where the premium or interest is calculated at a floating rate of the notional principal of the contract, agreement or swap, includes only the next premium or interest.

9C. Certain circumstances under which spot position in securities, commodity, gold, property or instrument arises

- (1) Subject to subsection (4), a licensed corporation is regarded as holding a long spot position in the amount or quantity of any securities, commodity, gold, property or instrument that it beneficially owns.
- (2) A licensed corporation is regarded as holding a short spot position in the amount or quantity of—
 - (a) any securities, commodity, gold, property or instrument that it—
 - (i) as principal, is liable, responsible or obliged to vest in another person; and
 - (ii) does not beneficially own;
 - (b) any securities, commodity, gold, property or instrument that it—
 - (i) used to hold, but no longer holds, for another person as a custodian or pledgee pursuant to an agreement with the person; and
 - (ii) has failed or is unable to return to the person in accordance with the agreement; or
 - (c) subject to subsection (4), any securities issued by it.

- (3) An SMRA-LC that holds an interest in a collective investment scheme referred to in item 2 of Table 8 in Schedule 2 is regarded as a holding a long spot position in the amount of gold bullion or gold coins (or both), as applicable, that are represented by the interest in the scheme.
- (4) A licensed corporation that is a contracting party to an instrument (including where the instrument is also securities) is regarded as holding—
 - (a) if the instrument exposes the licensed corporation to the risk of a decline in the price or value of the instrument—a long spot position in the instrument; or
 - (b) if the instrument exposes the licensed corporation to the risk of a rise in the price or value of the instrument—a short spot position in the instrument.

9D. Licensed corporation regarded as holding notional position in underlying subject matter of derivative instrument

- (1) If a licensed corporation holds a position in a derivative instrument—
 - (a) the licensed corporation is regarded as also holding a notional position in each of the underlying subject matters of the instrument; and
 - (b) where the underlying subject matter is any securities, commodity, gold, currency, property or instrument, or a basket of any such matters—such a position is comprised of the amount or quantity of the underlying subject matter as specified in or determined according to the terms of the instrument.
- (2) The notional position under subsection (1) is—
 - (a) if it exposes the licensed corporation to the risk of a decline in the price, value or level (as applicable) of the underlying subject matter—a long notional position; or
 - (b) if it exposes the licensed corporation to the risk of a rise in the price, value or level (as applicable) of the underlying subject matter—a short notional position.

9E. Certain circumstances in which position in currency arises

- (1) A licensed corporation is regarded as holding—
 - (a) in relation to an on-balance sheet asset or liability (except, for an SMRA-LC, an asset or liability that is a common derivative)—
 - (i) for an asset that is an amount of a currency or denominated in a currency—a long spot position in an amount of the currency that is equal to the value of that asset; or
 - (ii) for a liability that is an amount of a currency or is denominated in a currency—a short spot position in an amount of the currency that is equal to the value of that liability;
 - (b) in relation to a foreign exchange agreement—
 - (i) where the licensed corporation is, under the contract, committed to purchase a currency—a long spot position in an amount of the currency that is equal to the amount committed; or
 - (ii) where the licensed corporation is, under the contract, committed to sell a currency—a short spot position in an amount of the currency that is equal to the amount committed; and
 - (c) in relation to a specified leveraged foreign exchange contract (except a foreign exchange agreement)—
 - (i) where the licensed corporation is, under the contract, exposed to the risk of a decline in the value of a currency—a long spot (if the contract is not an OTC derivative product) or notional (if the contract is an OTC derivative product)

- position in an amount of the currency that is equal to the amount specified in or determined according to the terms of the contract; or
- (ii) where the licensed corporation is, under the contract, exposed to the risk of a rise in the value of a currency—a short spot (if the contract is not an OTC derivative product) or notional (if the contract is an OTC derivative product) position in an amount of the currency that is equal to the amount specified in or determined according to the terms of the contract.
- (2) Subsection (3) applies if—
- (a) a licensed corporation has provided a guarantee, or is bound by an instrument of similar effect;
 - (b) any payment under the guarantee or instrument is denominated in a currency; and
 - (c) the licensed corporation is reasonably satisfied that the payment is—
 - (i) certain to be called; and
 - (ii) likely to be irrevocable.
- (3) The licensed corporation referred to in subsection (2) is, in relation to the guarantee or instrument—
- (a) regarded as holding a short notional position in the currency in an amount that is equal to the amount of the payment; and
 - (b) no longer regarded as such when the payment is called and becomes an on-balance sheet liability.
- (4) An SMRA-LC that is regarded under section 9D as holding a notional position in an underlying subject matter of a common derivative (**primary position**) is regarded as also holding—
- (a) where the underlying subject matter is a basket of currencies—
 - (i) if the primary position is a long notional position—
 - (A) a long notional position in a separate notional currency that represents the basket; or
 - (B) if elected by the licensed corporation—a long notional position in each currency within the basket; or
 - (ii) if the primary position is a short notional position—
 - (A) a short notional position in a separate notional currency that represents the basket; or
 - (B) if elected by the licensed corporation—a short notional position in each currency within the basket; or
 - (b) where the underlying subject matter is a currency exchange rate—
 - (i) if the primary position is a long notional position—
 - (A) a long notional position in the currency (**currency A**) referred to in the rate that will, if the rate rises, appreciate against the other currency (**currency B**) referred to in the rate; and
 - (B) a short notional position in currency B; or
 - (ii) if the primary position is a short notional position—
 - (A) a short notional position in the currency (**currency C**) referred to in the rate that will, if the rate rises, appreciate against the other currency (**currency D**) referred to in the rate; and
 - (B) a long notional position in currency D;

- (c) where the underlying subject matter is a basket of currency exchange rates or a currency exchange rate index—
 - (i) if the primary position is a long notional position—a long notional position in a separate notional currency that represents the basket or index; or
 - (ii) if the primary position is a short notional position—a short notional position in a separate notional currency that represents the basket or index; or
- (d) where the underlying subject matter is any other matter (except a currency, interest rate or another common derivative)—
 - (i) if the primary position is a long notional position—a long notional position in the currency in which the market value of the primary position is denominated; or
 - (ii) if the primary position is a short notional position—a short notional position in the currency in which the market value of the primary position is denominated.
- (5) An SMRA-LC that is regarded under Division 3 (except section 53ZO(2) and (5)) of Part 4B as holding a notional position in an SRF security (**primary position**) is also regarded as holding—
 - (a) if the primary position is a long notional position—a long notional position in the currency in which the market value of the primary position is denominated; or
 - (b) if the primary position is a short notional position—a short notional position in the currency in which the market value of the primary position is denominated.
- (6) The amount of currency comprising a notional position under subsection (4) or (5) is—
 - (a) for a notional position arising under subsection (4)(a)—
 - (i) where the position is in a notional currency that represents a basket of currencies—such units of the notional currency that is equal to the size of the primary position; or
 - (ii) where the position is in a currency within a basket of currencies—the amount of the currency constituting the basket, multiplied by the size of the primary position;
 - (b) for a notional position arising under subsection (4)(b) in a currency referred to in a currency exchange rate—an amount that is equal to notional principal of the currency exchange rate;
 - (c) for a notional position arising under subsection (4)(c)—
 - (i) where the position is in a notional currency that represents a basket of currency exchange rates—an amount that is equal to the monetary value per unit of, or per unit of change in, the value of the basket, determined according to the terms of the instrument having the basket as an underlying subject matter, multiplied by the size of the primary position;
 - (ii) where the position is in a notional currency that represents a currency exchange rate index—an amount that is equal to the monetary value of 1 index point, or per index point change, determined according to the terms of the instrument having the index as an underlying subject matter;
 - (d) for a notional position arising under subsection (4)(d) in a currency in which the market value of a primary position in a matter is denominated—an amount that is equal to the market value of the primary position;
 - (e) for a notional position arising under subsection (5) in a currency in which the market value of a primary position in an SRF security is denominated—an amount that is equal to the market value of the primary position.

9F. Positions relating to derivative note with embedded common continuous option: SMRA-LC

- (1) If an SMRA-LC holds a spot position in a derivative instrument that is in the form of a derivative note with embedded common continuous option—
 - (a) the spot position is regarded as a spot position in the derivative note as a debt security; and
 - (b) the SMRA-LC is regarded as also holding a notional position in a separate notional contract that represents the option or right conferred by the derivative note.
- (2) The notional contract under subsection (1) is regarded as a common derivative that is in the form of a continuous options contract, having the underlying subject matter of the derivative note as its underlying subject matter.
- (3) The notional position under subsection (1) is—
 - (a) if the SMRA-LC holds a long spot position in the derivative note and the option or right is conferred on—
 - (i) the issuer of the note—a short notional position; or
 - (ii) the holder of the note—a long notional position; or
 - (b) if the SMRA-LC holds a short spot position in the derivative note and the option or right is conferred on—
 - (i) the issuer of the note—a long notional position; or
 - (ii) the holder of the note—a short notional position.

9G. Circumstances in which equities, debt securities, commodities, gold bullion or gold coins, etc. treated as being same

- (1) A licensed corporation must, for the purposes of calculating its liquid capital and required liquid capital—
 - (a) treat 2 or more equities as being the same category of equity if they—
 - (i) have the same issuer;
 - (ii) enjoy the same rights in all respects; and
 - (iii) are fungible with each other for trading and settlement purposes;
 - (b) treat 2 or more baskets of equities as being the same basket of equities if they are constituted by the same quantities of the same category of equity; and
 - (c) treat 2 or more equity indexes as being the same equity index if they—
 - (i) have the same basket of equities underlying them; and
 - (ii) are calculated by the same methodology.
- (2) A licensed corporation must, for the purposes of calculating its liquid capital and required liquid capital—
 - (a) treat 2 or more debt securities as being the same category of debt security if they—
 - (i) have the same principal value;
 - (ii) are denominated in the same currency;
 - (iii) have the same issuer, coupon payments and residual maturity;
 - (iv) enjoy the same rights in all respects; and
 - (v) are fungible with each other for trading and settlement purposes;
 - (b) treat 2 or more baskets of debt securities as being the same basket of debt securities if they are constituted by the same quantities of the same category of debt security; and

- (c) treat 2 or more debt security indexes as being the same debt security index if they—
 - (i) have the same basket of debt securities underlying them; and
 - (ii) are calculated by the same methodology.
- (3) A licensed corporation must, for the purposes of calculating its liquid capital and required liquid capital—
 - (a) treat 2 or more commodities as being the same category of commodity if they—
 - (i) are of the same class of commodity (regardless of grades or brands); and
 - (ii) are suitable, in terms of quantity, quality and condition, for delivery under the same tradable contract;
 - (b) treat 2 or more baskets of commodities as being the same basket of commodities if they—
 - (i) are suitable, in terms of quantity, quality and condition, for delivery under the same tradable contract; or
 - (ii) are constituted by the same quantities of the same category of commodity; and
 - (c) treat 2 or more commodity indexes as being the same commodity index if they—
 - (i) have the same basket of commodities underlying them; and
 - (ii) are calculated by the same methodology.
- (4) A licensed corporation must, for the purposes of calculating its liquid capital and required liquid capital—
 - (a) treat 2 or more gold bullion or gold coins (in any combination) as being the same category of gold if they—
 - (i) are of the same fineness; or
 - (ii) are of differing fineness but are suitable, in terms of quantity, quality and condition, for delivery under the same spot contract, forward contract, futures contract or unlisted options contract that is traded on a specified exchange or on the Hong Kong Gold Exchange; and
 - (b) treat 2 or more baskets of gold bullion or gold coins (in any combination) as being the same basket of gold if they are constituted by the same quantities of the same category of gold.

9H. Calculation of market value of certain positions where equities, debt securities, gold bullion or gold coins, commodities, etc. regarded as same but have different market prices

- (1) If any 2 or more subject matters (***constituent matters***) that are treated by a licensed corporation as being the same category of subject matter under section 9G(1)(a), (2)(a), (3)(a) or (4)(a) have different market prices, the licensed corporation must calculate the market value of its following position in that category of subject matter as follows—
 - (a) for its net position in the category—as the difference between—
 - (i) the sum of the market values of its long positions in each constituent matter; and
 - (ii) the sum of the market values of its short positions in each constituent matter;
 - (b) for its aggregate long position in the category—as the sum of the market values of its long positions in each constituent matter; and
 - (c) for its aggregate short position in the category—as the sum of the market values of its short positions in each constituent matter.

- (2) If any 2 or more baskets of subject matters (**constituent baskets**) that are treated by a licensed corporation as being the same basket of subject matters under section 9G(1)(b), (2)(b), (3)(b) or (4)(b) have different market values, the licensed corporation must calculate the market value of its following position in that basket of subject matters as follows—
- (a) for its net position in the basket—as the difference between—
 - (i) the sum of the market values of its long positions in each constituent basket; and
 - (ii) the sum of the market values of its short positions in each constituent basket;
 - (b) for its aggregate long position in the basket—as the sum of the market values of its long positions in each constituent basket; and
 - (c) for its aggregate short position in the basket—as the sum of the market values of its short positions in each constituent basket.
- (3) If any 2 or more subject matter indexes (**constituent indexes**) that are treated by a licensed corporation as being the same subject matter index under section 9G(1)(c), (2)(c) or (3)(c) have different current levels, the licensed corporation must calculate the market value of its following position in that subject matter index as follows—
- (a) for its net position in the index—as the difference between—
 - (i) the sum of the market value of its long positions in each constituent index; and
 - (ii) the sum of the market value of its short positions in each constituent index;
 - (b) for its aggregate long position in the index—as the sum of the market values of its long positions in each constituent index; and
 - (c) for its aggregate short position in the index—as the sum of the market values of its short positions in each constituent index.
- (4) In this section—
- subject matter** () means—
- (a) equity;
 - (b) debt security;
 - (c) commodity; or
 - (d) gold coins or gold bullion.

10. Pairs of transactions

A licensed corporation which enters into a pair of transactions in which its respective roles are opposite, but which otherwise have identical or similar terms, must account for the transactions as separate transactions.

11. No ~~set-off~~ offsetting

- ~~(1) Subject to subsections (2), (3), (4), (5), (6) and (7) and section 48(2), the assets and liabilities of a licensed corporation must be treated separately on a gross basis and must not be set-off against each other.~~
- (1) Subject to subsections (2), (4), (5), (6) and (7), amounts receivable by a licensed corporation from a person, and amounts payable by it to a person, must be treated separately on a gross basis and must not be offset against each other if such amounts arise from—
- (a) the subscription, purchase or sale of securities by the licensed corporation or person; or
 - (b) a transaction in securities that is cleared by the licensed corporation or person.

(2) Subsection (1) does not apply in respect of any amounts receivable by a licensed corporation from, ~~and any amounts payable by it to, a recognized clearing house, a clearing house, and any amounts payable by it to the clearing house,~~ where the rules of the clearing house permit the ~~setting-off~~ set-off of such amounts against each other for settlement purposes.

~~(3) Subsection (1) does not apply in respect of any amounts receivable by a licensed corporation from a person, and any amounts payable by it to the person, where—~~

~~(a) such amounts—~~

~~(i) do not arise from the carrying on of any regulated activity for which it is licensed; and~~

~~(ii) do not include—~~

~~(A) amounts receivable by it from, and amounts payable by it to, a general clearing participant of HKSCC which arise from transactions in securities that are cleared for it or its clients by the participant with HKSCC;~~

~~(B) if the licensed corporation is a general clearing participant of HKSCC amounts receivable by it from the person, and amounts payable by it to the person, which arise from transactions in securities that are cleared for the person by it with HKSCC; or~~

~~(C) amounts receivable referred to in section 23(1)(f); and~~

~~(b) it has a legally enforceable right to set-off such amounts against each other.~~

(4) Subsection (1) does not apply in respect of any amounts receivable by a licensed corporation from, and any amounts payable by it to, a client of the licensed corporation, where such amounts arise from—

(a) the purchase and sale by the client of securities of the same description (including any equities or debt securities of the same category) due to be settled on a cash-against-delivery basis and the client has authorized the licensed corporation to set-off such amounts;

(b) the purchase and sale by the client of securities in relation to which the licensed corporation has elected to ~~set-off~~ offset such amounts against each other under section 21(2); or

(c) the provision by it to the client of securities margin financing.

(5) Subsection (1) does not apply in respect of any amounts receivable by a licensed corporation licensed for Type 8 regulated activity from, and any amounts payable by it to, each securities dealer with which it has common clients, where such amounts arise from dealings in securities by the securities dealer for those clients.

(6) Subsection (1) does not apply in respect of any amounts receivable by a licensed corporation licensed for Type 1 regulated activity from, and any amounts payable by it to, each licensed corporation licensed for Type 8 regulated activity with which it has common clients, where such amounts arise from dealings in securities by it for those clients.

(7) If a licensed corporation has obtained an approval under section 58(5)(i), subsection (1) does not apply in respect of amounts receivable (except amounts receivable referred to in section 23(1)(f)) by it from, and amounts payable by it to, a general clearing participant of HKSCC which arise from transactions in securities that are cleared for it or its clients by the participant with HKSCC.

12. Transactions in margined accounts

- (1) A licensed corporation must not ~~set-off-offset~~ amounts receivable by it from, and amounts payable by it to, a client of the licensed corporation arising from transactions in different margined accounts maintained with it by the client.
- (2) Where a licensed corporation has a client who—
 - (a) maintains with it more than one margined account;
 - (b) has deposited with it security against his liabilities to it in the form of—
 - (i) cash;
 - (ii) collateral; or
 - (iii) a bank guarantee issued by an authorized financial institution or an approved bank incorporated outside Hong Kong; and
 - (c) has authorized it to apply such security to satisfy any liabilities to it arising from the execution by it of any transaction in relation to any of his margined accounts, the licensed corporation may, subject to subsections (3) and (4)—
 - (d) for the purpose of calculating—
 - (i) a specified shortfall amount in relation to a margined account of the client; or
 - (ii) a margin shortfall amount under section 22(1)(b) in relation to the client, deem all or part of such security to be deposited by the client as security to the margined account in relation to which such shortfall amount is calculated; or
 - (e) for the purpose of calculating any amount to be included in its ranking liabilities under section 45(1) or 46(1) in relation to a margined account of the client, reduce any such amount by—
 - (i) where the client has deposited cash referred to in paragraph (b)(i), the amount of such cash;
 - (ii) where the client has deposited collateral referred to in paragraph (b)(ii), the amount of the market value of such collateral, less the haircut amount in relation to the collateral; or
 - (iii) where the client has deposited a bank guarantee referred to in paragraph (b)(iii), the amount that it can draw down under such bank guarantee.
- (3) A licensed corporation must not—
 - (a) under subsection (2)(d), deem—
 - (i) any amount of cash;
 - (ii) any collateral; or
 - (iii) any amount that it can draw down under a bank guarantee, to be security to the margined account concerned; or
 - (b) effect any reduction under subsection (2)(e) in respect of such security, if—
 - (c) such security has been deemed under subsection (2)(d) to be deposited as security to another margined account of the client; or
 - (d) in respect of such security a reduction under subsection (2)(e) has been effected in relation to another margined account of the client.
- (4) For the purposes of these Rules, a licensed corporation must cease to treat—
 - (a) any cash referred to in subsection (2)(b)(i);
 - (b) any collateral referred to in subsection (2)(b)(ii); or

- (c) any bank guarantee referred to in subsection (2)(b)(iii), as security in relation to the margined account of the client into which it was deposited, to the extent that such security—
 - (d) has been deemed under subsection (2)(d) to be deposited as security to another margined account of the client; or
 - (e) has been utilized to effect a reduction under subsection (2)(e).
- (5) For the purposes of subsection (2), **specified shortfall amount** (指明短欠數額) means an amount to be included in the licensed corporation's ranking liabilities under—
- (a) section 40(1);
 - (b) section 41(1);
 - (c) section ~~43(10)~~ 43B;
 - (d) section 45(2); or
 - (e) section 46(2).
- (6) In this section, **margined account** (以保證金形式操作的帳戶), in relation to a client of a licensed corporation, means—
- (a) an account maintained with a licensed corporation licensed for Type 1 regulated activity by the client for the provision to him by the licensed corporation of securities margin financing; or
 - (b) an account maintained with the licensed corporation by the client for—
 - (i) short selling;
 - (ii) dealings in futures contracts;
 - (iii) dealings in unlisted options contracts;
 - (iv) securities borrowing and lending;
 - (v) trading in **specified** leveraged foreign exchange contracts; or
 - (vi) entering into repurchase transactions.

13. Treatment of exercised options contracts

A licensed corporation must, immediately upon the exercise of an options contract purchased, written or cleared by it, treat the options contract as having ceased to exist and account for—

- (a) all its assets; and
- (b) all its liabilities,

arising from such exercise.

14. Assignments

- (1) A licensed corporation must not include in its liquid assets any amount receivable by it from any of its clients if such amount has been assigned by it to another person.
- (2) A licensed corporation must not treat any collateral or any other type of security deposited with it by any of its clients as so deposited where such collateral or other type of security has been assigned by it to another person.

15. Treatment of securities borrowing and lending agreements

- (1) A licensed corporation which, under a securities borrowing and lending agreement, is the borrower of any securities, is deemed for the purposes of these Rules—
 - (a) to remain the **beneficial** owner of any collateral beneficially owned by it and provided by it as security to the lender of the securities under the agreement;

- (b) to have an amount receivable from that lender equal to the amount of cash provided by it as security to that lender; and
 - (c) not to **beneficially** own the securities borrowed under the agreement.
- (2) A licensed corporation which, under a securities borrowing and lending agreement, is the lender of any securities, is deemed for the purposes of these Rules—
- (a) where the securities lent under the agreement are beneficially owned by it, to remain the beneficial owner of the securities ~~for the purposes of section 27~~;
 - (b) not to **beneficially** own any collateral deposited with it as security by the borrower of the securities under the agreement; and
 - (c) to have an amount payable to that borrower equal to the amount of cash deposited with it as security by that borrower, unless the cash—
 - (i) is not included in its liquid assets under section 20; and
 - (ii) is held in a segregated account.

16. Treatment of repurchase transactions

- (1) Where a licensed corporation is the purchaser in the first instance of any securities under a repurchase transaction, it is deemed for the purposes of these Rules—
- (a) to have an amount receivable from the seller of the securities equal to the consideration for which it purchased the securities; and
 - (b) not to **beneficially** own the securities purchased ~~and so must not include them in its liquid assets under section 27~~.
- (2) Where a licensed corporation is the seller in the first instance of any securities beneficially owned by it under a repurchase transaction, it is deemed for the purposes of these Rules—
- (a) to remain the **beneficial** owner of the securities sold by it; and
 - (b) to be liable to the purchaser of the securities for an amount equal to the consideration for which it sold the securities.

16A. Treatment of depositary receipts

- (1) A depositary receipt that represents a number of shares is, if elected by a licensed corporation for the purposes of these Rules, regarded as the number of shares it represents instead of a depositary receipt.
- (2) If an election is made by a licensed corporation under subsection (1) in relation to a depositary receipt—
 - (a) the election has effect in relation to all, and not just some, provisions of these Rules; and
 - (b) the depositary receipt is, for the purposes of these Rules, regarded as the number of shares represented instead of a depositary receipt.

~~Division 3—Liquid assets~~

~~17.—Computation basis~~

~~A licensed corporation must, for the purpose of calculating its liquid assets under the provisions of this Division, apply the computation basis prescribed in Division 2.~~

18. Exclusion of branch assets required to be maintained outside Hong Kong

- (1) A licensed corporation which operates a branch in a place outside Hong Kong must not include in its liquid assets any asset which it is required by an authority or regulatory

organization in, or under the law of, that place, to maintain in that place in order for the branch to obtain or maintain a licence, registration, membership or authorization to carry on an activity which, if carried on in Hong Kong, would constitute a regulated activity.

(2) *(Repealed)*

18A. Exclusion of assets where remittance or exchange controls apply

- (1) Except in the circumstances referred to in subsections (2) and (3), a licensed corporation must not include a controlled asset in its liquid assets.
- (2) A licensed corporation must include a controlled asset in its liquid assets (in an amount calculated in accordance with the provisions of this Division which apply to it in relation to the controlled asset) if, in relation to the relevant prohibition applicable to the controlled asset or the proceeds of the controlled asset, it reasonably believes that it will be able to obtain the required approval from the relevant authority or regulatory organization within 1 week after applying for the approval.
- (3) Subject to subsection (4), a licensed corporation may elect to include in its liquid assets a controlled asset (other than a controlled asset referred to in subsection (2)) that it is able to freely apply to meet its existing obligations or liabilities that are denominated in the same currency as the asset.
- (4) If a licensed corporation makes an election under subsection (3) in relation to a controlled asset, the amount to be included in its liquid assets in respect of the controlled asset is to be calculated—
 - (a) in accordance with the provisions of this Division which apply to it in relation to the controlled asset; and
 - (b) on the basis that sections 27(2), (3), (4), (6) and (7) and 31(2) and (3) do not apply to it in relation to the controlled asset.

19. Assets provided to others as security

- (1) A licensed corporation, for the purpose of calculating its liquid capital, subject to subsection (2), is deemed not to own any asset which it beneficially owns and has provided to another person as security for any liabilities or obligations.
- (2) A licensed corporation is deemed to remain the owner of any asset which it beneficially owns and has provided as security—
 - (a) to—
 - (i) an authorized financial institution;
 - (ii) an approved bank incorporated outside Hong Kong; or
 - (iii) another licensed corporation,
 for credit facilities provided to it by the institution, bank or corporation (as the case may be);
 - (b) under a securities borrowing and lending agreement under which it is the borrower of securities;
 - (c) in the form of margin deposited in respect of any short selling by it;
 - (d) in the form of margin deposited in respect of any dealing in futures contracts or unlisted options contracts by it;
 - (e) in the form of margin deposited in respect of any trading in leveraged foreign exchange contracts by it;
 - (ea) in the form of margin deposited in respect of an OTCD transaction effected by it;

- (f) to obtain a bank guarantee for the purpose of fulfilling its obligations under the rules of a recognized exchange company to furnish the exchange company with a guarantee as an alternative to participating in the Fidelity Fund established under the rules;
- (g) to, or to obtain a bank guarantee in favour of, a recognized clearing house for the purpose of enabling it to fulfil its obligations under the rules of the clearing house (other than rules which relate to the Guarantee Fund or the Reserve Fund); or
- (h) in relation to collateralized warrants of which it is the issuer, in the form of a charge over the underlying securities or other assets to which the warrants relate in favour of an independent trustee.

Division 3—Liquid assets

19A. Computation basis

A licensed corporation must, for the purpose of calculating its liquid assets under the provisions of this Division, apply the computation basis prescribed in Division 2.

20. Cash in hand and at bank

- (1) Other than a licensed corporation licensed for Type 13 regulated activity in relation to the carrying on by it of Type 13 regulated activity, a licensed corporation must include in its liquid assets—
 - (a) cash in hand which it beneficially owns;
 - (b) money which it beneficially owns and holds in an account in its name, or in a segregated account, with an authorized financial institution or an approved bank incorporated outside Hong Kong in the form of—
 - (i) a demand deposit; or
 - (ii) a time deposit which will mature in 6 months or less;
 - (c) interest accrued on any deposit referred to in paragraph (b)(ii); and
 - (d) money which it holds on behalf of a client in an account in its name, or in a segregated account, with an authorized financial institution or an approved bank incorporated outside Hong Kong, and which it has received from the client for the purposes of settling a purchase of, or subscription for, securities by it on behalf of the client.
- (2) A licensed corporation licensed for Type 13 regulated activity in relation to the carrying on by it of Type 13 regulated activity must, **subject to subsection (3)**, include in its liquid assets—
 - (a) cash in hand which it beneficially owns;
 - (b) money which it beneficially owns and holds in an account in its name, or in a segregated account, with an authorized financial institution or an approved bank incorporated outside Hong Kong in the form of—
 - (i) a demand deposit; or
 - (ii) a time deposit which will mature in 6 months or less; and
 - (c) interest accrued on any deposit referred to in paragraph (b)(ii).
- (3) A licensed corporation licensed for Type 13 regulated activity must not include in its liquid assets—
 - (a) any amount of scheme money held by the licensed corporation—

- (i) in a segregated account with an authorized financial institution or a bank incorporated outside Hong Kong;
 - (ii) in a segregated account—
 - (A) that is referred to in paragraph (a) of the definition of **segregated account** in section 2(1); and
 - (B) with a person approved by the Commission under section 4(2) or 10B(2) of the Securities and Futures (Client Money) Rules (Cap. 571 sub. leg. I) for the purposes of those Rules;
 - (iii) in a relevant CIS account within the meaning of section 10A of the Securities and Futures (Client Money) Rules (Cap. 571 sub. leg. I); or
 - (iv) in an account maintained with an authorized financial institution or a bank incorporated outside Hong Kong which is separate from the own account of the licensed corporation; and
- (b) any amount held by the licensed corporation—
- (i) on behalf of subscribers or scheme participants of a relevant CIS constituting subscription proceeds in respect of the relevant CIS;
 - (ii) on behalf of unit holders, shareholders or scheme participants of a relevant CIS constituting redemption proceeds in respect of the relevant CIS; or
 - (iii) on behalf of unit holders, shareholders or scheme participants of a relevant CIS constituting distribution proceeds in respect of the relevant CIS,
- in an account which is separate from its own account and designated for holding such proceeds maintained with an authorized financial institution, a bank incorporated outside Hong Kong or a person approved by the Commission under section 4(2) or 10B(2) of the Securities and Futures (Client Money) Rules (Cap. 571 sub. leg. I) for the purposes of those Rules.

21. Amounts receivable from clients in respect of purchase of and subscription for securities

- (1) Subject to subsections (3) ~~and (7)~~, a licensed corporation must include in its liquid assets the following amounts arising from the purchase by any of its clients of securities on a cash-against-delivery basis—
- (a) any amount receivable from the client which, when calculated on a transaction-by-transaction basis, is not yet due for settlement according to the settlement date or has been outstanding for 5 business days or less after the settlement date;
 - (b) in respect of any amount receivable from the client which, when calculated on a transaction-by-transaction basis, has been outstanding for more than 5 business days but less than 1 month after the settlement date—the amount which, when calculated on a transaction-by-transaction basis, is the lower of—
 - (i) the amount receivable ~~less any specific provision for bad or doubtful debts made in respect of the amount receivable~~; and
 - (ii) the market value of the securities to which the amount receivable relates.
- (2) A licensed corporation may, subject to subsection (2A), elect to ~~set-off~~ **offset**, on a client-by-client basis, any amount receivable from, and amount payable to, a client where such amounts arise from the purchase and sale of securities by the client on a cash-against-delivery basis, if the licensed corporation has obtained from the client a written authorization to—
- (a) set-off such amounts against each other; and

- (b) dispose of securities held for the client for the purpose of settling any of the amounts payable by the client to the licensed corporation.
- (2A) An election made by a licensed corporation under subsection (2) must be in respect of all of its clients from whom it has obtained a written authorization referred to in that subsection.
- (3) ~~Subject to subsection (7), where~~ If a licensed corporation makes an election under subsection (2), it must include in its liquid assets in respect of the amount receivable by it from and the amount payable by it to a client which arise from the purchase and sale of securities by the client on a cash-against-delivery basis the amount which is the lower, when calculated on a client-by-client basis, of—
 - (a) any amount receivable that remains after the ~~set-off offsetting~~ referred to in subsection (2) ~~less any specific provision for bad or doubtful debts made in respect of such amount receivable~~; and
 - (b) the market value of the securities held for the client, less the haircut amounts in relation to the securities.
- (4) ~~Subject to subsection (7), a~~ A licensed corporation must include in its liquid assets any amount receivable from any of its clients arising from the purchase by the client of securities on a free delivery basis which, when calculated on a transaction-by-transaction basis—
 - (a) in the case where the clearing system of the exchange on which the securities are traded effects settlement only on a free delivery basis—
 - (i) is not yet due for settlement according to the settlement date; or
 - (ii) has been outstanding for 2 weeks or less after the settlement date; or
 - (b) in any other case—is not yet due for settlement according to the settlement date.
- (5) ~~Subject to subsection (7), a~~ A licensed corporation must, in respect of securities subscribed for on behalf of any of its clients, include, prior to the commencement of trading of the securities on any exchange on which they are listed, in its liquid assets the amount which is the lower, when calculated on a transaction-by-transaction basis, of—
 - (a) 90% of the total costs to the client of subscribing for the securities; and
 - (b) any amount receivable from the client for subscribing for the securities.
- (6) ~~Subject to subsection (7), a~~ A licensed corporation must, in respect of securities subscribed for on behalf of any of its clients, include, after the commencement of trading of the securities on any exchange on which they are listed, in its liquid assets any amount receivable from the client arising from subscribing for the securities in accordance with subsection (1) or (3) as if the securities had been purchased on a cash-against-delivery basis.
- ~~(7) The aggregate of amounts that a licensed corporation includes in its liquid assets under subsections (1), (3), (4), (5) and (6) must not exceed the aggregate of amounts receivable from its clients referred to in those subsections less the aggregate of amounts of specific and general provisions for bad or doubtful debts made in respect of such aggregate of amounts receivable.~~
- (8) In subsections (2) and (2A), **written authorization** (書面授權) includes an agreement in writing within the meaning of the Securities and Futures (Client Securities) Rules (Cap. 571 sub. leg. H).
- (9) This section does not apply to a licensed corporation licensed for Type 13 regulated activity in relation to the carrying on by it of Type 13 regulated activity.
- (10) This section does not apply to a licensed corporation in relation to any securities that are unlisted options contracts.

22. Amounts receivable in respect of providing securities margin financing

- (1) Subject to subsections (2) ~~and (3)~~, a licensed corporation licensed for Type 1 or Type 8 regulated activity must include in its liquid assets any net amount receivable from any of its margin clients, calculated as the amount by which the amount receivable from the ~~margin~~-client exceeds the amount payable by it to the ~~margin~~-client arising from the provision by it of securities margin financing (**initial net amount**), after deducting, ~~if applicable the higher of—~~
 - ~~(a) any specific provision for bad or doubtful debts made in respect of such net amount receivable; and~~
 - (b) the margin shortfall amount, calculated as the amount by which the **initial** net amount ~~receivable~~ exceeds the aggregate of—
 - (i) the market value of collateral, other than illiquid collateral, provided by the client, less the haircut amount in relation to such collateral;
 - (ii) the market value of all illiquid collateral provided by the client, multiplied by—
 - (A) in the case of listed shares **or listed depositary receipt**, 20%; and
 - (B) in the case of listed warrants, 0%;
 - (iii) the amount of cash deposited as security by the client; and
 - (iv) in the case of a licensed corporation licensed for Type 1 regulated activity, the maximum amount that it can draw under a bank guarantee provided to it by the client and issued by an authorized financial institution or an approved bank incorporated outside Hong Kong.
- (2) Notwithstanding section 8, a licensed corporation licensed for Type 1 or Type 8 regulated activity may, in ~~calculating the margin shortfall amount referred to in subsection (1)(b) determining whether the initial net amount exceeds the aggregate of the amounts referred to in subsection (1)(b)(i), (ii), (iii) and (iv) in relation to any of its margin clients, elect in respect of all its clients to exclude, on a client-by-client basis, from the calculation of the initial net amount receivable from the client, any—~~
 - ~~(a) amount receivable from the client; and~~
 - ~~(b) amount payable by it to the client,~~

any amount receivable from, and any amount payable by it to, the client arising from dealings in securities ~~which that~~ are not yet due for settlement according to the settlement date.
- (2A) ~~If a licensed corporation makes an election under subsection (2), the determination under that subsection is to be made whereupon subsection (1)(b) applies to it as if such the~~ dealings in securities ~~referred to in that subsection—~~
 - ~~(ea)~~ had not given rise to any amount receivable from, or any amount payable by it to, the client; and
 - ~~(eb)~~ had not given rise to any change in the amount of collateral provided to it by the client.
- ~~(3) The aggregate of amounts that a licensed corporation includes in its liquid assets under subsection (1) must not exceed the aggregate of net amounts receivable from its margin clients referred to under that subsection less the aggregate of amounts of specific and general provisions for bad or doubtful debts made in respect of such aggregate of net amounts receivable.~~
- (4) In subsection (1)(b)(i) and (ii), **illiquid collateral** (非速動抵押品), in relation to any collateral provided to a licensed corporation licensed for Type 1 or Type 8 regulated activity by its margin clients, means any listed share, **listed depositary receipt** or listed warrant which is of the same description as that identified as top 3 collateral provided by

any top margin client of the licensed corporation (including where such shares or depositary receipts are equities of the same category), where—

- (a) if it is a share, the aggregate market value of all shares of the same description as that share provided to the licensed corporation by its margin clients as collateral is equal to or greater than—
 - (i) the average monthly turnover of that share; or
 - (ii) 5% of the market capitalization of that share as at the end of the month immediately preceding the month prior to the month in which the calculation is made; ~~or~~
- (ab) if it is a depositary receipt, the aggregate market value of all depositary receipts of the same description as that depositary receipt provided to the licensed corporation by its margin clients as collateral is equal to or greater than—
 - (i) the average monthly turnover of that depositary receipt; or
 - (ii) 5% of the market capitalization of that depositary receipt as at the end of the month immediately preceding the month prior to the month in which the calculation is made; or
- (b) if it is a warrant, the aggregate market value of all warrants of the same description as that warrant provided to the licensed corporation by its margin clients as collateral is equal to or greater than—
 - (i) the average monthly turnover of that warrant; or
 - (ii) 5% of the value of the relevant warrant issue as at the end of the month immediately preceding the month prior to the month in which the calculation is made,

but does not include—

- (c) any listed share, listed depositary receipt or listed warrant which has been listed on a particular exchange for less than 6 consecutive months (including any period during which the share, depositary receipt or warrant is suspended from trading on the exchange) immediately preceding the month prior to the month in which the calculation is made; and
 - (d) any listed share or listed depositary receipt which is a constituent stock of any of the following ~~indices~~ indexes—
 - (i) Hang Seng Index;
 - (ii) Hang Seng Composite LargeCap Index;
 - (iii) FTSE 100 Index;
 - (iv) Nikkei Stock Average; or
 - (v) S&P 500 Index.
 - (vi) *(Repealed)*
- (5) In subsection (4)—

average monthly turnover (平均每月成交額), in relation to a listed share, listed depositary receipt or listed warrant, means one sixth of the aggregate value of transactions in that share, depositary receipt or warrant on a particular exchange on which it is listed for a period of 6 consecutive months (including any period during which the share, depositary receipt or warrant is suspended from trading on the exchange) immediately preceding the month prior to the month in which the calculation is made;

calculation (有關計算) means a calculation made for the purposes of subsection (1);

market capitalization (市場資本值), in relation to a listed share or listed depositary receipt, means the amount of the total number of shares or depositary receipts of the same description as that share or depositary receipt issued by the issuer of that share or depositary receipt (including where such shares or depositary receipts are equities of the same category) multiplied by their market price;

top 3 collateral (首3位抵押品), in relation to a top margin client of a licensed corporation licensed for Type 1 or Type 8 regulated activity, means any of the 3 highest listed shares, listed depositary receipts or listed warrants in terms of market value among all listed shares, listed depositary receipts and listed warrants provided by him to the licensed corporation as collateral;

top margin client (前列保證金客戶), in relation to a licensed corporation licensed for Type 1 or Type 8 regulated activity, means—

- (a) where it has less than 20 margin clients, all its margin clients with outstanding margin loan balance; or
 - (b) where it has 20 or more margin clients, the 20 margin clients with the largest outstanding margin loan balance.
- (6) In the definition of **top 3 collateral** in subsection (5), **market value** (市值), in relation to a listed share, listed depositary receipt or listed warrant provided by a margin client to the licensed corporation, means the market value of all such listed shares, listed depositary receipts or listed warrants of the same description as that share, depositary receipt or warrant (as the case may be) (including where such shares or depositary receipts are equities of the same category) provided by the margin client to the licensed corporation.

23. Amounts receivable from other dealers and clearing participants etc. in respect of securities

- (1) ~~Subject to subsection (2), a~~ licensed corporation must include in its liquid assets the following amounts—
- (a) any amount receivable from any securities dealer which—
 - (i) arises from the sale of securities by it to or through the securities dealer on a cash-against-delivery basis; and
 - (ii) when calculated on a transaction-by-transaction basis—
 - (A) is not yet due for settlement according to the settlement date; or
 - (B) has been outstanding for 2 weeks or less after the settlement date;
 - (b) in respect of any amount receivable from any securities dealer which arises from the sale of securities by it to or through the securities dealer on a cash-against-delivery basis, and which, when calculated on a transaction-by-transaction basis, has been outstanding for more than 2 weeks but less than 1 month after the settlement date—the amount which, when calculated on a transaction-by-transaction basis, is the lower of—
 - (i) the amount receivable ~~less any specific provision for bad or doubtful debts made in respect of the amount receivable~~; and
 - (ii) the market value of the securities to which the amount receivable relates;
 - (c) any amount receivable from any securities dealer which—
 - (i) arises from the sale of securities by it to or through the securities dealer on a free delivery basis; and
 - (ii) when calculated on a transaction-by-transaction basis—

- (A) in the case where the clearing system of the exchange on which the securities are traded effects settlement only on a free delivery basis—
 - (I) is not yet due for settlement according to the settlement date; or
 - (II) has been outstanding for 2 weeks or less after the settlement date; or
 - (B) in any other case—is not yet due for settlement according to the settlement date;
 - (d) any amount receivable from a general clearing participant of HKSCC which—
 - (i) arises from a transaction in securities that is cleared for it or its clients by the participant with HKSCC and is to be settled on a cash-against-delivery basis; and
 - (ii) when calculated on a transaction-by-transaction basis, is not yet due for settlement according to the settlement date;
 - (e) if it is a general clearing participant of HKSCC—any amount receivable from a person which—
 - (i) arises from a transaction in securities that is cleared for the person by it with HKSCC and is to be settled on a cash-against-delivery basis; and
 - (ii) when calculated on a transaction-by-transaction basis, is not yet due for settlement according to the settlement date;
 - (f) any amount receivable from a China Connect General Clearing Participant which—
 - (i) arises from transactions in China Connect Securities on a China Connect Market that have been or are to be cleared for it or its clients by the participant; and
 - (ii) is receivable in respect of amounts paid by it to the participant for the purposes of fulfilling the participant's obligation to provide to HKSCC amounts of Mainland Settlement Deposit or Mainland Security Deposit in accordance with the rules of HKSCC.
- ~~(2) The aggregate of amounts that a licensed corporation includes in its liquid assets under subsection (1) must not exceed the aggregate of amounts receivable from the persons referred to in that subsection less the aggregate of amounts of specific and general provisions for bad or doubtful debts made in respect of such aggregate of amounts receivable.~~
- (2A) This section does not apply to a licensed corporation in relation to any securities that are unlisted options contracts.
- (3) In this section—
- China Connect General Clearing Participant** (中華通全面結算所參與者) means a general clearing participant of HKSCC that is registered by HKSCC as a “China Connect Clearing Participant” in accordance with the rules of HKSCC;
- China Connect Market** (中華通市場) means a stock market that is determined by the Stock Exchange Company to be a “China Connect Market” in accordance with the rules of the Stock Exchange Company;
- China Connect Securities** (中華通證券) means securities that are determined by the Stock Exchange Company to be “China Connect Securities” in accordance with the rules of the Stock Exchange Company;
- Mainland Security Deposit** (內地結算備付金) means an amount that is determined by HKSCC to be “Mainland Security Deposit” in accordance with the rules of HKSCC;
- Mainland Settlement Deposit** (內地證券結算保證金) means an amount that is determined by HKSCC to be “Mainland Settlement Deposit” in accordance with the rules of HKSCC.

24. Amounts receivable in respect of dealings in securities by common clients

- (1) A licensed corporation licensed for Type 8 regulated activity must include in its liquid assets the net amount receivable from each securities dealer with which it has common clients, calculated as the amount by which the amount receivable from such securities dealer exceeds the amount payable by it to the securities dealer, where such amounts arise from any dealing in securities by such securities dealer for those clients, to the extent that such amount does not exceed the total amount receivable from such securities dealer arising from any such dealing in securities which is not yet due for settlement according to the settlement date.
- (2) A licensed corporation licensed for Type 1 regulated activity must include in its liquid assets the net amount receivable from each licensed corporation licensed for Type 8 regulated activity with which it has common clients, calculated as the amount by which the amount receivable from such second-mentioned licensed corporation exceeds the amount payable by it to such second-mentioned licensed corporation, where such amounts arise from any dealing in securities by it for those clients, to the extent that such amount does not exceed the total amount receivable from such second-mentioned licensed corporation arising from any such dealing in securities which is not yet due for settlement according to the settlement date.
- (3) This section does not apply to a licensed corporation in relation to any securities that are unlisted options contracts.

25. Amounts receivable from licensed corporations licensed for Type 8 regulated activity

- (1) ~~Subject to subsection (2), a~~ A licensed corporation licensed for Type 1 regulated activity must include in its liquid assets the aggregate of any amount receivable from each licensed corporation licensed for Type 8 regulated activity and any net amount receivable from such second-mentioned licensed corporation referred to in section 24(2) that has not been included in its liquid assets under that section, in the amount which, in relation to each such second-mentioned licensed corporation, is the lower of—
 - (a) such aggregate amount ~~less any specific provision for bad or doubtful debts made in respect of each such aggregate amount~~; and
 - (b) the sum of—
 - (i) the amount of cash deposited with it as security by such second-mentioned licensed corporation;
 - (ii) the market value of collateral deposited with it by such second-mentioned licensed corporation, less the haircut amount in relation to such collateral; and
 - (iii) the maximum amount that it can draw under a bank guarantee provided to it by such second-mentioned licensed corporation and issued by an authorized financial institution or an approved bank incorporated outside Hong Kong.
- ~~(2) The aggregate of amounts that a licensed corporation includes in its liquid assets under subsection (1) must not exceed the aggregate of amounts receivable from other licensed corporations referred to in that subsection less the aggregate of amounts of specific and general provisions for bad or doubtful debts made in respect of such aggregate of amounts receivable.~~
- (3) This section does not apply to a licensed corporation in relation to any securities that are unlisted options contracts.

26. Cash provided as security for short selling

A licensed corporation must include in its liquid assets an amount receivable in the amount of any cash (including interest accrued on it) provided by it as security to the counterparty in

respect of a short selling by it of securities where it has not yet delivered the securities to the counterparty for settlement, where the counterparty is—

- (a) a securities dealer;
- (b) a specified exchange;
- (c) a clearing house of a specified exchange; or
- (d) a clearing participant of a clearing house referred to in paragraph (c).

27. Proprietary positions of ~~licensed corporation-BMRA-LC~~

(1) A ~~licensed corporation-BMRA-LC~~ must include in its liquid assets any of the following assets that it beneficially owns—

(a) subject to subsections (2), (3), (4), (6) and (7), listed shares;

(ab) a listed depositary receipt;

(b) qualifying debt securities;

(c) special debt securities;

(d) specified securities;

(e) specified investments,

at market value, less the haircut amounts in relation to the securities or specified investments concerned.

(1A) Subsection (1) does not apply to a BMRA-LC in relation to any non-trading position held by it in—

(a) securities; or

(b) a tradable commodity.

(2) Subject to subsection (5), where a ~~licensed corporation-BMRA-LC~~ beneficially owns any listed shares and writes a call stock options contract on such shares, to the extent that the number of shares underlying the options contract is equal to the number of such shares, subsection (1)(a) does not apply in respect of such shares and section 40(3) and (4) does not apply in respect of the options contract and it must include in its liquid assets such shares in the amount which is the lower of—

(a) the market value of such shares, less the haircut amount in relation to such shares; and

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

(3) Subject to subsection (5), where a ~~licensed corporation-BMRA-LC~~ beneficially owns any listed shares and holds a short position in a stock futures contract in respect of such shares, to the extent that the number of shares underlying the futures contract is equal to the number of such shares, subsection (1)(a) does not apply in respect of such shares and section 40(4) does not apply in respect of the futures contract and it must include in its liquid assets such shares at market value.

(4) Subject to subsection (5), where a ~~licensed corporation-BMRA-LC~~ beneficially owns any listed shares and holds a put stock options contract, which is not subject to any margin requirement, in respect of such shares, to the extent that the number of shares underlying the options contract is equal to the number of such shares, it may elect not to apply subsection (1)(a) in respect of such shares and section 31(1)(b) in respect of the options contract whereupon it must include in its liquid assets such shares in the amount which is the higher of—

(a) the market value of such shares, less the haircut amount in relation to such shares; and

- (b) the number of such shares multiplied by the strike price of such options contract.
- (5) Subsections (2), (3) and (4) do not apply in respect of a stock futures contract or a stock options contract which has been grouped with other positions for the purpose of calculating a net amount of margin required to be deposited by the ~~licensed corporation~~ **BMRA-LC**.
- (6) Where a ~~licensed corporation~~ **BMRA-LC** beneficially owns any listed shares and issues any call non-collateralized warrants on such shares, to the extent that the number of shares underlying the warrants which are outstanding is equal to the number of such shares, subsection (1)(a) does not apply in respect of such shares and section 43(1), (2)(d) and (3) does not apply in respect of such warrants and it must include in its liquid assets such shares in the amount which is the lower of—
 - (a) the market value of such shares, less the haircut amount in relation to such shares; and
 - (b) the number of such shares multiplied by the exercise price of such warrants.
- (7) Where a ~~licensed corporation~~ **BMRA-LC** beneficially owns any listed shares which are charged for the purpose of issuing any call collateralized warrants on such shares, subsection (1)(a) does not apply in respect of such shares and section 43(1), (2)(d) and (3) does not apply in respect of such warrants and it must include in its liquid assets such shares in the amount which is the lower of—
 - (a) the market value of such shares, less the haircut amount in relation to such shares; and
 - (b) the number of such shares multiplied by the exercise price of such warrants.

27A. Proprietary positions of SMRA-LC

- (1) An SMRA-LC must include in its liquid assets—
 - (a) the market value of any long spot position (except a non-trading position) that it holds for its own account in any securities, except securities that are—
 - (i) an illiquid investment;
 - (ii) an uncommon derivative;
 - (iii) OTCD securities; or
 - (iv) an unlisted options contract;
 - (b) the market value of any long spot position that it holds for its own account in any unlisted options contract traded on a specified exchange, except any such contract that is an uncommon derivative;
 - (c) the market value of any long position that it holds for its own account in any specified VA unlisted options contract, except any such contract that is an uncommon derivative; and
 - (d) the market value of any long spot position that it holds for its own account in any specified investment, except a non-trading position in a tradable commodity.
- (2) Subsection (1)(a), (b) and (c) do not apply to any securities or unlisted options contract the market value of which has been included in the calculation of an amount included in the SMRA-LC's liquid assets under section 28 or 29.

28. Amounts receivable from clearing houses, etc.

- (1) ~~Subject to subsection (3A), a~~ **A** licensed corporation must include in its liquid assets—
 - (a) amounts receivable from a recognized clearing house; and
 - (b) cash deposited with such clearing house,

other than—

- (c) admission fees it has paid to such clearing house;
 - (d) ~~contributions it has made to the Guarantee Fund or Reserve Fund of such clearing house~~ cash it has deposited with such clearing house as security against its general obligations; and
 - (e) client money held in a segregated account with such clearing house.
- (2) ~~Subject to subsection (3A), a A~~ licensed corporation must include in its liquid assets amounts receivable from, and cash deposited with, a prescribed clearing house (except admission fees it has paid to the prescribed clearing house, and cash it has deposited with the prescribed clearing house as security against its general obligations), in respect of—
- (a) any dealing or trading by it in, or its entering into—
 - ~~(i) a futures contract;~~
 - (ii) any securities;
 - ~~(iii) an options contract;~~
 - (iv) a derivative ~~contract~~ instrument;
 - (v) a specified investment;
 - (vi) a leveraged foreign exchange contract; or
 - (vii) a foreign exchange agreement; or
 - ~~(viii) an interest rate swap agreement; or~~
 - (b) any clearing by it with the prescribed clearing house (whether for its own account or on behalf of its clients) of a transaction in—
 - ~~(i) a futures contract;~~
 - (ii) any securities;
 - ~~(iii) an options contract;~~
 - (iv) a derivative ~~contract~~ instrument;
 - (v) a specified investment;
 - (vi) a leveraged foreign exchange contract; or
 - (vii) a foreign exchange agreement; ~~or.~~
 - ~~(viii) an interest rate swap agreement.~~
- (3) ~~Subject to subsection (3A), a A~~ licensed corporation must include in its liquid assets amounts receivable from, and cash deposited with, a **specified** futures or options clearing house other than a recognized clearing house (except admission fees it has paid to the **specified** futures or options clearing house, and cash it has deposited with the **specified** futures or options clearing house as security against its general obligations), in respect of—
- (a) any dealing by it in futures contracts or unlisted options contracts;
 - (b) any trading by it in leveraged foreign exchange contracts; or
 - (c) any clearing by it with the **specified** futures or options clearing house (whether for its own account or on behalf of its clients) of a transaction in a futures contract, unlisted options contract or leveraged foreign exchange contract.
- (3A) ~~Subsections (1), (2) and (3) do not apply to any amount that a licensed corporation is required to include under section 34A.~~
- (4) In this section—

prescribed clearing house (訂明結算所) means—

- (a) Euroclear Bank S.A./N.V.;
- (b) Euroclear France S.A.;
- (c) Clearstream Banking S.A.;
- (d) Clearstream Banking AG; or
- (e) Korea Securities Finance Corporation.

29. Amounts receivable from other dealers and clearing participants in respect of futures contracts, unlisted options contracts and leveraged foreign exchange contracts

- (1) Subject to subsection (2), a licensed corporation must include in its liquid assets amounts receivable from, and cash deposited with, a licensed corporation licensed for Type 1 or Type 2 regulated activity (**dealer**) or a clearing participant of a **specified** futures or options clearing house (**participant**), in respect of—
 - (a) any dealing by it in futures contracts or unlisted options;
 - (b) any trading by it in leveraged foreign exchange contracts; ~~or~~
 - (c) any clearing by the dealer or the participant for it (whether for its own account or on behalf of its clients) of a transaction in a futures contract, unlisted options contract or leveraged foreign exchange contract; ~~or~~
 - (d) **if it is a specified VA exchange—any clearing by it of a transaction in—**
 - (i) **a specified VA futures contract; or**
 - (ii) **a specified VA unlisted options contract.**
- (2) Subsection (1) does not apply to—
 - (a) admission fees the licensed corporation has paid to the dealer or the participant; ~~and~~
 - (b) cash the licensed corporation has deposited with the dealer or the participant as security against its general obligations; ~~and~~
 - (c) **any amount that a licensed corporation is required to include under section 34A.**

30. Amounts receivable from clients in respect of purchase of exchange-traded unlisted options contracts

- (1) A licensed corporation must include in its liquid assets any amount receivable from any of its clients arising from the purchase of any unlisted options contract traded on a specified exchange **or any specified VA unlisted options contract that which**, when calculated on a transaction-by-transaction basis—
 - (a) is not yet due for settlement according to the settlement date; or
 - (b) has been outstanding for 5 business days or less after the settlement date.
- (2) This section does not apply to a licensed corporation licensed for Type 13 regulated activity in relation to the carrying on by it of Type 13 regulated activity.

31. Exchange-traded unlisted options contracts trading for own account: **BMRA-LC**

- (1) Where a ~~licensed corporation~~ **BMRA-LC** purchases for its own account any unlisted options contract traded on a specified exchange **or any specified VA unlisted options contract**, it must include in its liquid assets—
 - (a) in the case where the unlisted options contract has been grouped with any other position held by the licensed corporation in—
 - (i) a **non-OTCD** futures contract; or

- (ii) any other **non-OTCD** unlisted options contract,
for the purpose of calculating a net amount of margin required to be deposited by it in respect of such positions, any amount receivable by it (other than any such amount receivable which has already been included in its liquid assets under section 28(1), (2) or (3) or 29) from—
 - (iii) a licensed corporation licensed for Type 1 or Type 2 regulated activity;
 - (iv) a **specified** futures or options clearing house; or
 - (v) a clearing participant of a **specified** futures or options clearing house,
arising from such calculation; or
 - (b) in any other case, subject to subsections (2) and (3) and sections 27(4), 40(7) and (8) and 43(6), an amount which equals 60% of the market value of such unlisted options contract.
- (2) Subject to subsection (4) and without prejudice to section 40(7), where a **licensed corporation-BMRA-LC** holds a long position in a stock futures contract and holds a put stock options contract, which is not subject to any margin requirement, in respect of the same underlying listed shares, to the extent that the number of shares underlying the futures contract is equal to the number of shares underlying the options contract, subsection (1)(b) does not apply in respect of the options contract and section 40(4) does not apply in respect of the futures contract and it must include in its liquid assets the options contract at market value.
 - (3) Subject to subsection (4) and without prejudice to section 40(8), where a **licensed corporation-BMRA-LC** holds a short position in a stock futures contract and holds a call stock options contract, which is not subject to any margin requirement, in respect of the same underlying listed shares, to the extent that the number of shares underlying the futures contract is equal to the number of shares underlying the options contract, subsection (1)(b) does not apply in respect of the options contract and section 40(4) does not apply in respect of the futures contract and it must include in its liquid assets the options contract at market value.
 - (4) Subsections (2) and (3) do not apply in respect of a stock futures contract or a stock options contract which has been grouped with other positions for the purpose of calculating a net amount of margin required to be deposited by the **licensed corporation-BMRA-LC**.

32. Amounts receivable under securities borrowing and lending agreements

A licensed corporation which is the borrower of securities under a securities borrowing and lending agreement must include in its liquid assets any amount receivable from the lender of the securities that it is deemed under section 15(1)(b) to have in respect of any cash provided by it as security to the lender.

33. Amounts receivable under repurchase transactions

A licensed corporation which is the purchaser in the first instance of any securities under a repurchase transaction must include in its liquid assets any amount receivable from the seller of the securities that it is deemed under section 16(1)(a) to have in respect of the consideration for which it purchased the securities.

34. Amounts receivable in respect of leveraged foreign exchange trading

- (1) A licensed corporation licensed for Type 3 regulated activity must include in its liquid assets, in respect of any trading by it in **specified** leveraged foreign exchange contracts—
 - (a) any amount receivable from a recognized counterparty; and

- (b) the amount of any cash deposited by it with the recognized counterparty.
- (2) A licensed corporation licensed for Type 3 regulated activity must include in its liquid assets the amount of any floating profits in respect of outstanding foreign exchange agreements and **specified** leveraged foreign exchange contracts to which it is a party.

34A. Amounts receivable under OTCD transactions

- (1) A licensed corporation must include in its liquid assets the following amounts for each specified person in respect of an OTCD transaction effected by it—
 - (a) any adjusted OTCD receivable amount from the specified person; and
 - (b) any amount that constitutes OTCD cash margin posted by the licensed corporation to the specified person as security in respect of the transaction.
- (2) Subject to subsection (3), a reference to a specified person of an OTCD transaction effected by a licensed corporation in subsection (1) is a reference to—
 - (a) for a proprietary transaction (non-clearing)—the person with whom the transaction is entered into by the licensed corporation;
 - (b) for a proprietary transaction (clearing)—the licensed corporation's clearing intermediary;
 - (c) for an intermediary transaction (principal clearing)—
 - (i) if the transaction is entered into with a clearing client—the clearing client; or
 - (ii) if the transaction is entered into with a person other than a clearing client—that person; or
 - (d) for an intermediary transaction (agency clearing)—
 - (i) the licensed corporation's clearing client; or
 - (ii) the person with whom the transaction is entered into by the clearing client.
- (3) For subsection (2)(a), (c)(ii) or (d)(ii), if the person specified in that subsection entered into the transaction through the person's clearing intermediary, the specified person of the transaction is the person's clearing intermediary.

35. Miscellaneous assets

A licensed corporation must include in its liquid assets any of the following assets—

- (a) the amount of any fees, commissions, commission rebates and interest charges to which it is beneficially entitled which arise from the carrying on by it of any regulated activity for which it is licensed and—
 - (i) which have accrued and will first be due for billing or payment within the next 3 months; or
 - (ii) which have been billed or fallen due for payment and remain outstanding for one month or less after the date on which they were billed or fell due;
- (ab) if fees receivable by it in respect of its underwriting of an issue or a sale of securities (**underwriting fees**) do not fall within paragraph (a)(i) or (ii) and, in respect of the issue or sale it has entered into one or more sub-underwriting agreements under which it is obliged to pay fees to the sub-underwriters—the amount of the underwriting fees—
 - (i) but only up to the total amount of the fees which it is obliged to pay to the sub-underwriters; and
 - (ii) only if the fees which it is obliged to pay to the sub-underwriters will not fall due for payment until on or after the day on which it receives the underwriting fees;

- (b) deposits which it beneficially owns and maintains with, and in accordance with the rules or requirements of, a recognized exchange company as security for its obligations or liabilities owed to the recognized exchange company for stamp duty chargeable under the Stamp Duty Ordinance (Cap. 117) on contract notes specified in an agreement under section 5A of that Ordinance;
- (c) prepaid operating expenses which will be incurred within the next 3 months;
- (d) tax reserve certificates issued by the Commissioner of Inland Revenue in accordance with the Tax Reserve Certificates Ordinance (Cap. 289) which it beneficially owns;
- ~~(e) interest accrued to it under an interest rate swap agreement to which it is a party, other than interest which remains outstanding after it is first due for payment;~~
- (f) amounts paid by it for its own account for subscribing for—
 - (i) listed shares or shares pending their being listed;
 - ~~(ia) listed depositary receipts or depositary receipts pending their being listed;~~
 - (ii) qualifying debt securities;
 - (iii) special debt securities;
 - (iv) specified securities,
 less an amount equal to such amounts as multiplied by 50% of the haircut percentages in relation to such shares, ~~depositary receipts~~ or securities;
- (g) dividends receivable on shares ~~or depositary receipts~~ listed on a recognized stock market or on a specified exchange that are traded on an ex-dividend basis and which it beneficially owns;
- (h) interest accrued on qualifying debt securities or special debt securities that are traded on an ex-interest basis and which it beneficially owns.

Division 4—Ranking liabilities

36. Computation basis

A licensed corporation must, for the purpose of calculating its ranking liabilities under the provisions of this Division, apply the computation basis prescribed in Division 2.

36A. Controlled assets where election made under section 18A(3)

If a licensed corporation makes an election under section 18A(3) to include a controlled asset in its liquid assets, the amount to be included in its ranking liabilities in respect of the controlled asset is to be calculated—

- (a) in accordance with the provisions of this Division which apply to it in relation to the controlled asset; and
- (b) on the basis that sections 40(7) and (8) and 43(6) do not apply to it in relation to the controlled asset.

37. Amounts payable to clients, etc.

- (1) A licensed corporation must include in its ranking liabilities any amount payable to any of its clients or any counterparty or clearing house which arises from the carrying on of any regulated activity for which it is licensed, other than—
 - (a) an amount payable to any of its clients in respect of client money held by it—

- (i) in a segregated account with an authorized financial institution, an approved bank incorporated outside Hong Kong or a recognized clearing house (except money included in its liquid assets under section 20(1)(d)); or
- (ii) in a segregated account—
 - (A) that is referred to in paragraph (a) of the definition of **segregated account** in section 2(1); and
 - (B) with a person approved by the Commission under section 4(2) of the Securities and Futures (Client Money) Rules (Cap. 571 sub. leg. I) for the purposes of those Rules; and
- (b) an amount payable to any of its clients which is ~~set-off~~ offset against an amount receivable from the client under section ~~21(3)~~ 21(2).
- (2) This section does not apply to a licensed corporation licensed for Type 13 regulated activity in relation to the carrying on by it of Type 13 regulated activity.

37A. Scheme money and other proceeds related to relevant CIS

A licensed corporation licensed for Type 13 regulated activity must include in its ranking liabilities—

- (a) any amount of scheme money in respect of a relevant CIS held by the licensed corporation other than an amount of scheme money held by it—
 - (i) in a segregated account with an authorized financial institution or a bank incorporated outside Hong Kong;
 - (ii) in a segregated account—
 - (A) that is referred to in paragraph (a) of the definition of **segregated account** in section 2(1); and
 - (B) with a person approved by the Commission under section 4(2) or 10B(2) of the Securities and Futures (Client Money) Rules (Cap. 571 sub. leg. I) for the purposes of those Rules;
 - (iii) in a relevant CIS account within the meaning of section 10A of the Securities and Futures (Client Money) Rules (Cap. 571 sub. leg. I); or
 - (iv) in an account maintained with an authorized financial institution or a bank incorporated outside Hong Kong which is separate from the own account of the licensed corporation;
- (b) any amount held by the licensed corporation—
 - (i) on behalf of subscribers or scheme participants of a relevant CIS constituting subscription proceeds in respect of the relevant CIS;
 - (ii) on behalf of unit holders, shareholders or scheme participants of a relevant CIS constituting redemption proceeds in respect of the relevant CIS; or
 - (iii) on behalf of unit holders, shareholders or scheme participants of a relevant CIS constituting distribution proceeds in respect of the relevant CIS,

other than an amount of these proceeds held by the licensed corporation in an account which is separate from its own account and designated for holding such proceeds maintained with an authorized financial institution, a bank incorporated outside Hong Kong or a person approved by the Commission under section 4(2) or 10B(2) of the Securities and Futures (Client Money) Rules (Cap. 571 sub. leg. I) for the purposes of those Rules; and
- (c) any amount payable to any person which arises from the carrying on of Type 13 regulated activity in relation to any obligation incurred solely on behalf of a relevant

CIS other than an amount payable without recourse to the assets of the licensed corporation.

38. Amounts payable in respect of dealing in securities

- (1) A licensed corporation must include in its ranking liabilities, in respect of a sale of securities—
 - (a) by it for a client who is in default of his obligation to deliver the securities for—
 - (i) more than 2 weeks after the settlement date; or
 - (ii) (A) more than 5 business days but not more than 2 weeks after the settlement date; and
 - (B) the market value of the securities is more than 200% of the consideration for which they were sold; and
 - (b) which it has not settled with securities purchased at its own expense, the amount by which the market value of the securities exceeds the consideration for which they were sold.
- (2) This section does not apply to a licensed corporation in relation to any securities that are unlisted options contracts.

39. Amounts payable in respect of dealing in securities by common clients

- (1) A licensed corporation licensed for Type 1 regulated activity must include in its ranking liabilities the net amount payable to each licensed corporation licensed for Type 8 regulated activity with which it has common clients, calculated as the amount by which the amount payable to each such second-mentioned licensed corporation exceeds the amount receivable by it from such second-mentioned licensed corporation, where such amounts arise from any dealing in securities by it for any of those clients.
- (2) A licensed corporation licensed for Type 8 regulated activity must include in its ranking liabilities the net amount payable to each securities dealer with which it has common clients, calculated as the amount by which the amount payable to each such securities dealer exceeds the amount receivable by it from such securities dealer, where such amounts arise from any dealing in securities by such securities dealer for any of those clients.
- (3) This section does not apply to a licensed corporation in relation to any securities that are unlisted options contracts.

40. Futures contracts and unlisted options contracts dealing etc.

- (1) Subject to subsection (2), a licensed corporation must include in its ranking liabilities, in respect of—
 - (a) any dealing by it in any non-OTCD futures contract;
 - (b) any non-OTCD unlisted options contract written by it; or
 - (c) any non-OTCD futures contract or non-OTCD unlisted options contract cleared by it, for another person, the amount, when calculated on an account-by-account basis, by which the aggregate of the amount of margin required to be deposited with it by the person and the amount of any floating losses incurred by the person on the contract less the amount of any floating profits made by the person on the contract exceeds the aggregate of—
 - (d) the amount of cash deposited with it as security by the person;
 - (e) the market value of collateral deposited with it by the person, less the haircut amounts in relation to such collateral;

- (f) the market value of specified investments deposited with it as security by the person, less the haircut amounts in relation to such investments; and
 - (g) the maximum amount that it can draw under a bank guarantee provided to it as security by the person and issued by an authorized financial institution or an approved bank incorporated outside Hong Kong.
- (2) Subsection (1) does not apply to a licensed corporation on the day or days on which it is allowed, under the rules or conventions of the exchange on which the futures contract or unlisted options contract is traded, not to collect from the other person the margin required to be deposited by the other person in respect of the futures contract or unlisted options contract.
- (3) Subject to subsections (5), (6) and (9) and sections 27(2) and 43(5), a ~~licensed corporation~~ **BMRA-LC** must include in its ranking liabilities—
- (a) the market value of any unlisted options contract written by it for its own account and traded on a specified exchange; and
 - (b) ~~the market value of any specified VA unlisted options contract written by it for its own account,~~
- to the extent that the market value of the unlisted options contract exceeds the amount of margin required to be deposited by it in respect of the unlisted options contract.
- (4) Subject to subsections (5), (6), (7), (8) and (9) and sections 27(2) and (3), 31(2) and (3) and 43(4) and (5), a ~~licensed corporation~~ **BMRA-LC** must include in its ranking liabilities the amount of margin required to be deposited by it in respect of—
- (a) any futures contract which is traded by it for its own account ~~on a specified exchange;~~ **and**
 - (ab) ~~any specified VA futures contract which is traded by it for its own account;~~
 - (b) any unlisted options contract which is purchased or written by it for its own account and traded on a specified exchange; **and**
 - (c) ~~any specified VA unlisted options contract which is purchased or written by it for its own account.~~
- (5) Subject to subsection (10), where a ~~licensed corporation~~ **BMRA-LC** borrows any listed shares under a securities borrowing and lending agreement for the purpose of depositing them to cover a call stock options contract written by it, to the extent that the number of shares underlying the options contract is equal to the number of such shares, it may elect not to apply subsections (3) and (4) in respect of the options contract and not to apply section 45(1) in respect of the securities borrowing and lending agreement, whereupon it must include in its ranking liabilities an amount in the aggregate of the in-the-money amount of the options contract and the higher of—
- (a) the haircut amount in relation to such shares; and
 - (b) the amount that would, but for this subsection, be required to be included in its ranking liabilities under section 45(1).
- (6) Subject to subsection (10), where a ~~licensed corporation~~ **BMRA-LC** holds a long position in a stock futures contract and writes a call stock options contract in respect of the same underlying listed shares, to the extent that the number of shares underlying the futures contract is equal to the number of shares underlying the options contract, subsections (3) and (4) do not apply in respect of the futures contract and the options contract and it must include in its ranking liabilities an amount which is the higher of—
- (a) the amount of margin required to be deposited by it in respect of the futures contract; and
 - (b) the in-the-money amount of the options contract.

- (7) Subject to subsection (10) and without prejudice to section 31(2), where a ~~licensed corporation~~ **BMRA-LC** holds a long position in a stock futures contract and holds a put stock options contract, which is not subject to any margin requirement, in respect of the same underlying listed shares, to the extent that the number of shares underlying the futures contract is equal to the number of shares underlying the options contract, subsection (4) does not apply in respect of the futures contract and section 31(1)(b) does not apply in respect of the options contract and, if the options contract is out-of-the-money, it must include in its ranking liabilities the lower of—
- (a) the amount of margin required to be deposited by it in respect of the futures contract; and
 - (b) the out-of-the-money amount of the options contract.
- (8) Subject to subsection (10) and without prejudice to section 31(3), where a ~~licensed corporation~~ **BMRA-LC** holds a short position in a stock futures contract and holds a call stock options contract, which is not subject to any margin requirement, in respect of the same underlying listed shares, to the extent that the number of shares underlying the futures contract is equal to the number of shares underlying the options contract, subsection (4) does not apply in respect of the futures contract and section 31(1)(b) does not apply in respect of the options contract and, if the options contract is out-of-the-money, it must include in its ranking liabilities the lower of—
- (a) the amount of margin required to be deposited by it in respect of the futures contract; and
 - (b) the out-of-the-money amount of the options contract.
- (9) Subject to subsection (10), where a ~~licensed corporation~~ **BMRA-LC** holds a short position in a stock futures contract and writes a put stock options contract in respect of the same underlying listed shares, to the extent that the number of shares underlying the futures contract is equal to the number of shares underlying the options contract, subsections (3) and (4) do not apply in respect of the futures contract and the options contract and it must include in its ranking liabilities an amount which is the higher of—
- (a) the amount of margin required to be deposited by it in respect of the futures contract; and
 - (b) the in-the-money amount of the options contract.
- (10) Subsections (5), (6), (7), (8) and (9) do not apply in respect of a stock futures contract or a stock options contract which has been grouped with other positions for the purpose of calculating a net amount of margin required to be deposited by the ~~licensed corporation~~ **BMRA-LC**.
- (11) A ~~licensed corporation~~ **BMRA-LC** must include in its ranking liabilities, in respect of any **non-OTCD** unlisted options contract (other than a put unlisted options contract) which is written by it for its own account and **is not covered by subsection (4) traded other than on a specified exchange or not exchange traded**, an amount which is the highest of—
- (a) 200% of the market value of the unlisted options contract;
 - (b) 200% of the in-the-money amount of the unlisted options contract; and
 - (c) 200% of the amount of margin required to be deposited by it.
- (12) A ~~licensed corporation~~ **BMRA-LC** must include in its ranking liabilities, in respect of any put **non-OTCD** unlisted options contract which is written by it for its own account and **is not covered by subsection (4) traded other than on a specified exchange or not exchange traded**, an amount, not exceeding the value of the assets **or any other matter** underlying the unlisted options contract stated at the strike price of the unlisted options contract, which is the highest of—
- (a) 200% of the market value of the unlisted options contract;

- (b) 200% of the in-the-money amount of the unlisted options contract; and
 - (c) 200% of the amount of margin required to be deposited by it.
- (13) A BMRA-LC must include in its ranking liabilities, in respect of any non-OTCD futures contract that is traded by it for its own account and is not covered by subsection (4), an amount that is the higher of—
- (a) 200% of the market value of the futures contract; and
 - (b) 200% of the amount of margin required to be deposited by it.

40A. Margin shortfall on cleared miscellaneous derivative

- (1) Subject to subsection (4), a licensed corporation must include in its ranking liabilities, in respect of a miscellaneous derivative (except a derivative note) cleared by it for another person (**client**), the amount, when calculated on an account-by-account basis, by which the aggregate of the debit amounts specified in subsection (2) exceeds the aggregate of the credit amounts specified in subsection (3).
- (2) The debit amounts specified for subsection (1) are—
 - (a) any amount of margin required to be deposited with the licensed corporation by the client;
 - (b) any amount receivable from the client that represents the negative market value of the miscellaneous derivative in the account of the client; and
 - (c) any other amount receivable from the client.
- (3) The credit amounts specified for subsection (1) are—
 - (a) any amount payable to the client that represents the positive market value of the miscellaneous derivative in the account of the client;
 - (b) any amount of cash deposited with the licensed corporation as security by the client;
 - (c) any other amount payable to the client;
 - (d) the market value of any collateral deposited with the licensed corporation by the client, less the haircut amounts in relation to such collateral;
 - (e) the market value of any specified investments deposited with the licensed corporation as security by the client, less the haircut amounts in relation to such investments; and
 - (f) the maximum amount that the licensed corporation can draw under a bank guarantee provided to it as security by the client and issued by an authorized financial institution or an approved bank incorporated outside Hong Kong.
- (4) Subsection (1) does not apply to a licensed corporation, in respect of a miscellaneous derivative that is cleared by any of the entities specified in subsection (5), on the day or days on which the licensed corporation is allowed, under the rules of the specified entity, not to collect from the client the margin required to be deposited by the client in respect of the miscellaneous derivative.
- (5) The entities specified for subsection (4) are—
 - (a) a recognized clearing house;
 - (b) a prescribed clearing house (as defined by section 28(4));
 - (c) a regulated CCP; and
 - (d) a clearing house of a specified exchange.
- (6) In this section—

amount of margin required to be deposited () has the meaning given by its definition in section 2(1) as if the references to a non-OTCD futures contract and a non-OTCD unlisted options contract in that definition were references to a miscellaneous derivative.

41. Leveraged foreign exchange trading

- (1) A licensed corporation licensed for Type 3 regulated activity must include in its ranking liabilities—
 - (a) in respect of all outstanding **specified** leveraged foreign exchange contracts which it has with any of its clients, the excess, when calculated on a client-by-client basis, of the amount by which the aggregate of—
 - (i) 3% of the aggregate of the amount of the gross principal values of the contracts;
 - (ii) the amount of any floating losses incurred by, and due from, the client on the contracts; and
 - (iii) the amount of any accrued interest, fees and commissions receivable from the client in respect of any such contracts, exceeds the aggregate of—
 - (iv) 100% of the amount of cash in the Hong Kong currency (or any currency linked to the Hong Kong currency) deposited with it as security by the client;
 - (v) 95% of the amount of cash in such foreign currency as may be approved under section 58(5)(f) deposited with it as security by the client;
 - (vi) 95% of the amount of any time deposit in the Hong Kong currency (or currency linked to the Hong Kong currency) which—
 - (A) is placed with a local branch or the principal place of business in Hong Kong of an authorized financial institution;
 - (B) will become payable within 6 months; and
 - (C) has been assigned to it by the client;
 - (vii) the market value of collateral deposited with it by the client, less the haircut amounts in relation to such collateral;
 - (viii) the amount of any floating profits made by, and due to, the client on the contracts;
 - (ix) 90% of the maximum amount that it can draw under a letter of credit issued in favour of it as security by an authorized financial institution or an approved bank incorporated outside Hong Kong; and
 - (x) the amount of any accrued interest payable to the client in respect of any such contracts; and
 - (b) the amount of any floating losses incurred by it on any outstanding foreign exchange agreements and outstanding **specified** leveraged foreign exchange contracts to which it is a party.
 - (2) Where a licensed corporation holds with any of its clients (other than a client whose account with the licensed corporation is an omnibus account) any outstanding **specified** leveraged foreign exchange contracts, for the purpose of calculating the aggregate of the amount of the gross principal values of the outstanding contracts, it may elect not to include in such aggregate the gross principal values of any 2 outstanding contracts where—
 - (a) under one of the contracts it is obliged to purchase an amount of a currency (“A”) and sell an amount (“X”) of another currency (“B”); and

- (b) under the other contract it is obliged to purchase the same amount ("X") of the other currency ("B") and sell an amount of the first-mentioned currency ("A"), whereupon it must include in the aggregate the highest of the equivalent amount of its reporting currency of—
 - (c) the amount "X" of currency "B";
 - (d) the amount of currency "A" which it is obliged to purchase under the contract referred to in paragraph (a); and
 - (e) the amount of currency "A" which it is obliged to sell under the contract referred to in paragraph (b).
- (3) In this section, **gross principal value** (本金總額), in relation to an outstanding **specified leveraged foreign exchange contract**, means the higher of the equivalent amounts in the reporting currency of the licensed corporation of the 2 amounts of currencies that the contract is intended to exchange.

42. Provision of securities margin financing

- (1) A licensed corporation licensed for Type 1 or Type 8 regulated activity must include in its ranking liabilities the amount, when calculated on a client-by-client basis, by which—
 - (a) any amount receivable from any of its margin clients; or
 - (b) in the case of a group of related margin clients, the aggregate of amounts receivable from the group,
 included in its liquid assets under section 22(1), exceeds 10% of the aggregate of amounts receivable from its margin clients included in its liquid assets in accordance with that section.
- (2) Where a licensed corporation licensed for Type 1 or Type 8 regulated activity obtains any financial accommodation wholly or partly secured by collateral provided by any of its margin clients, it must include in its ranking liabilities the amount by which such financial accommodation exceeds 80% of the aggregate of amounts receivable from its margin clients arising from the provision of securities margin financing.
- (3) In subsection (1), **group of related margin clients** (一組關連保證金客戶) means any 2 or more margin clients of a licensed corporation licensed for Type 1 or Type 8 regulated activity and—
 - (a) where it is a group of 2 margin clients, one is the spouse of the other;
 - (b) where one or more of the margin clients are corporations, one is in control, either alone or with his spouse, of 35% or more of the voting rights of that other margin client or each of the other margin clients (as the case may be); or
 - (c) where the margin clients are corporations, they are members of the same group of companies.

43. **Proprietary Short-short positions in securities (other than unlisted options contracts) and investments: BMRA-LC**

- (1) Subject to subsections (2), (3), (6), (8) and (9) and section 27(6) and (7), a ~~licensed corporation~~ **BMRA-LC** which holds for its own account a short **spot** position in ~~any securities or investments referred to in subsection (2)—securities (other than unlisted options contracts), specified investments, illiquid investments or miscellaneous investments, whether by short selling or otherwise,~~ must include in its ranking liabilities the market value of those securities or investments.
- (2) Subject to subsection (3), a ~~licensed corporation~~ **BMRA-LC** which holds for its own account a short **spot** position, ~~whether by short selling or otherwise,~~ in—

- (a) subject to subsections (4), (5) and (6) and section 45(5), listed shares;
 - (ab) listed depositary receipts;
 - (b) qualifying debt securities;
 - (c) special debt securities;
 - (d) subject to subsections (8) and (9) and section 27(6) and (7), specified securities;
 - (e) specified investments;
 - (f) illiquid investments; or
 - (g) miscellaneous investments,
- must increase the amount required to be included in its ranking liabilities under subsection (1) by the haircut amounts in relation thereto.
- (3) Subject to subsections (4), (5), (6), (8) and (9) and sections 27(6) and (7) and 45(5), a ~~licensed corporation-BMRA-LC~~ which holds for its own account a short spot position ~~in securities, whether by short selling or otherwise, referred to in subsection (2), where the position is in any securities~~ which constitute more than 5% by market value of all securities of the same description issued by a particular corporation (including any equities or debt securities of the same category), must increase the amount required to be included in its ranking liabilities under subsection (1) by the market value of the securities.
 - (4) Subject to subsection (7), where a ~~licensed corporation-BMRA-LC~~ short sells any listed shares and holds a long position in a stock futures contract in respect of such shares, to the extent that the number of shares underlying the futures contract is equal to the number of shares short sold by it, subsections (2) and (3) do not apply in respect of the shares short sold and section 40(4) does not apply in respect of the futures contract.
 - (5) Subject to subsection (7), where a ~~licensed corporation-BMRA-LC~~ short sells any listed shares and writes a put stock options contract in respect of such shares, to the extent that the number of shares underlying the options contract is equal to the number of shares short sold by it, subsections (2) and (3) do not apply in respect of the shares short sold and section 40(3) and (4) does not apply in respect of the options contract and it must include in its ranking liabilities the higher of—
 - (a) the increased amount that would, but for this subsection, arise under subsection (2) or (3); and
 - (b) the in-the-money amount of the options contract.
 - (6) Subject to subsection (7), where a ~~licensed corporation-BMRA-LC~~ short sells any listed shares and holds a call stock options contract, which is not subject to any margin requirement, in respect of such shares, to the extent that the number of shares underlying the options contract is equal to the number of shares short sold by it, it may elect not to apply subsections (1), (2) and (3) in respect of the shares short sold and not to apply section 31(1)(b) in respect of the options contract, whereupon it must include in its ranking liabilities the lower of—
 - (a) the aggregate of the market value of such shares sold short and the increased amount that would, but for this subsection, arise under subsection (2) or (3); and
 - (b) the number of shares short sold multiplied by the strike price of the options contract.
 - (7) Subsections (4), (5) and (6) do not apply in respect of a stock futures contract or a stock options contract which has been grouped with other positions for the purpose of calculating a net amount of margin required to be deposited by the ~~licensed corporation-BMRA-LC~~.
 - (8) A ~~licensed corporation-BMRA-LC~~ which is the issuer of any call non-collateralized warrants issued on listed shares or listed depositary receipts must increase the amount

included in its ranking liabilities under subsection (1) in respect of any outstanding call non-collateralized warrants so issued which it does not cover by holding the underlying shares ~~or depositary receipts~~, by the amount by which the haircut amount in relation to the underlying shares ~~or depositary receipts~~ which are not so held exceeds the aggregate of the out-of-the-money amounts of the warrants.

- (9) A ~~licensed corporation~~ **BMRA-LC** must increase the amount included in its ranking liabilities under subsection (1) in respect of any outstanding non-collateralized warrants issued by it on any assets other than shares ~~or depositary receipts~~, by 30% of the market value of the assets underlying such warrants.
- ~~(10) A licensed corporation must include in its ranking liabilities, in respect of the short selling of securities for any of its clients, save where such securities have been delivered to it by the client or are not yet due for settlement according to the settlement date, the amount by which the aggregate of—~~
- ~~— (a) the market value of such securities; and~~
 - ~~— (b) the haircut amount in relation to such securities, exceeds the aggregate of—~~
 - ~~— (c) the amount of cash deposited with it by the client and the amount of proceeds of sale of such securities withheld by it as security for delivery of securities by the client to the licensed corporation;~~
 - ~~— (d) the maximum amount that it can draw under a bank guarantee provided to it as security by the client and issued by an authorized financial institution or an approved bank incorporated outside Hong Kong; and~~
 - ~~— (e) the market value of collateral deposited with it by the client, less the haircut amount in relation to such collateral.~~
- (11) In this section, a reference to a short spot position, where the position is in any securities or commodity, does not include a non-trading position.

43A. Proprietary short positions etc.: SMRA-LC

- (1) Subject to subsection (2), an SMRA-LC must include in its ranking liabilities the market value of a short spot position that it holds for its own account in any of the following matters—
- (a) an equity (except if the position is a non-trading position);
 - (b) a debt security (except if the position is a non-trading position);
 - (c) a commodity (except if the position is a non-trading position);
 - (d) any specified securities;
 - (e) a specified investment;
 - (f) an illiquid investment;
 - (g) a miscellaneous investment.
- (2) Subsection (1) does not apply to a short spot position held by an SMRA-LC if—
- (a) the position is a short spot position in an illiquid equity investment (as defined by section 53ZD(1)), and the SMRA-LC has excluded under section 53ZH(2)(a) or (b) the position from its calculation of its aggregate short position in the investment; or
 - (b) the position is a short spot position in an illiquid debt security investment (as defined by section 53ZI), and the SMRA-LC has excluded under section 53ZV(2)(b) or (c) the position from its calculation of its aggregate short position in the investment.
- (3) An SMRA-LC that holds a short spot position in a miscellaneous investment for its own account must include in its ranking liabilities the haircut amount of the investment, unless

the position has been taken into account in the calculation of any amount required to be included in the ranking liabilities of the SMRA-LC under Part 4B.

- (4) An SMRA-LC that holds a spot position in a derivative instrument (except listed securities) for its own account must include in its ranking liabilities any negative market value of the instrument, unless the negative market value of the position has been taken into account in the calculation of any other amount required to be included in the liquid assets or ranking liabilities of the SMRA-LC under these Rules.

43B. Short selling securities for clients

- (1) A licensed corporation must include in its ranking liabilities, in respect of the short selling of securities for any of its clients, except where such securities have been delivered to it by the client or are not yet due for settlement according to the settlement date, the amount by which the aggregate of the market value of such securities and the haircut amount in relation to such securities exceeds the aggregate of—
 - (a) the amount of cash deposited with it by the client and the amount of proceeds of sale of such securities withheld by it as security for delivery of securities by the client to the licensed corporation;
 - (b) the maximum amount that it can draw under a bank guarantee provided to it as security by the client and issued by an authorized financial institution or an approved bank incorporated outside Hong Kong; and
 - (c) the market value of collateral deposited with it by the client, less the haircut amount in relation to such collateral.
- (2) This section does not apply to a licensed corporation in relation to any securities that are unlisted options contracts.

44. Concentrated proprietary positions: **BMRA-LC**

- (1) ~~Where a licensed corporation~~ Subject to subsection (1A), where a BMRA-LC holds for its own account ~~one or more spot positions in—~~
 - (a) ~~listed shares that are not illiquid investments;~~
 - (ab) ~~listed depositary receipts that are not illiquid investments;~~
 - (b) ~~qualifying debt securities;~~
 - (c) ~~special debt securities;~~
 - (d) ~~specified securities; or~~
 - (e) ~~specified investments; that are tradable commodities;~~
 - (ea) ~~illiquid investments; or~~
 - (eb) ~~miscellaneous investments,~~

and the ~~net~~-absolute value of the market value of its net spot position in any such securities or ~~specified~~-investments (as the case may be) which are of the same description (including any equities, debt securities or commodities of the same category) equals 25% or more of its required liquid capital, it must include in its ranking liabilities—

 - (f) where ~~the net market-such~~ absolute value is 25% or more but less than 51% of its required liquid capital, 5% of such ~~net market-absolute~~ value; or
 - (g) where ~~the net market-such~~ absolute value is 51% or more of its required liquid capital, 10% of such ~~net market-absolute~~ value.
- (1A) Subsection (1) does not apply in relation to a net spot position in securities or investments if the position is a long position and the haircut percentage applicable to the securities or investments is 100%.

~~(2) In subsection (1), **net market value** (淨市值), in relation to any securities and any specified investments referred to in that subsection, means the market value that remains after netting each long and short position in securities and specified investments (as the case may be) of the same description.~~

(2) In this section—

net spot position (), in relation to any securities or investments, means the difference between the total long spot positions and the total short spot positions (except non-trading positions) in such securities or investments.

45. Securities borrowing and lending agreements

- (1) Subject to subsections (5) and (6) and sections 40(5) and 46A(1), a licensed corporation which is the borrower of securities under a securities borrowing and lending agreement must include in its ranking liabilities the amount by which the aggregate of—
 - (a) the amount of cash deposited by it with the lender under the agreement as security; and
 - (b) the market value of collateral provided by it to the lender, less the haircut amount in relation to such collateral,
 exceeds—
 - (c) in the case where the securities are—
 - (i) shares listed on a specified exchange;
 - (ii) qualifying debt securities; or
 - (iii) special debt securities,
 110% of their market value; or
 - (d) in any other case, 50% of the market value of the securities.
- (2) Subject to subsection (6) and section 46A(1), a licensed corporation which, under a securities borrowing and lending agreement, is the lender of securities which are included in its liquid assets under section 27 or 27A, must include in its ranking liabilities the amount by which the market value of the securities, less the haircut amount in relation to such securities, exceeds the aggregate of—
 - (a) the maximum amount that it can draw under a bank guarantee provided to it as security by the borrower under the agreement and issued by an authorized financial institution or an approved bank incorporated outside Hong Kong;
 - (b) the amount of cash deposited with it as security by the borrower;
 - (c) the market value of—
 - (i) any shares listed on a specified exchange;
 - (ii) any qualifying debt securities; and
 - (iii) any special debt securities,
 deposited with it by the borrower as collateral, less the haircut amount in relation to such collateral; and
 - (d) 50% of the market value of any collateral, other than collateral referred to in paragraph (c), deposited with it by the borrower.
- (3) Subject to subsection (6) and section 46A(1), a licensed corporation which, under a securities borrowing and lending agreement, is the lender of any securities as agent for another person; or ~~where is~~ the lender of any securities ~~are~~ borrowed by it under another securities borrowing and lending agreement, must include in its ranking liabilities the amount by which the market value of the securities exceeds the aggregate of—

- (a) the maximum amount that it can draw under a bank guarantee provided to it as security by the borrower under the agreement and issued by an authorized financial institution or an approved bank incorporated outside Hong Kong;
 - (b) the amount of cash deposited with it as security by the borrower;
 - (c) the market value of—
 - (i) any shares listed on a specified exchange;
 - (ii) any qualifying debt securities; and
 - (iii) any special debt securities, deposited with it by the borrower as collateral, less the haircut amount in relation to such collateral; and
 - (d) 50% of the market value of any collateral, other than collateral referred to in paragraph (c), deposited with it by the borrower.
- (4) A licensed corporation which is the lender of securities under a securities borrowing and lending agreement must include in its ranking liabilities the amount payable to the borrower under the agreement in respect of any cash deposited with it as security by the borrower, save where the cash—
- (a) is held in a segregated account; and
 - (b) is not included in its liquid assets under section 20.
- (5) **Subject to section 46A(1), where ~~Where~~ a ~~licensed corporation~~ BMRA-LC borrows** listed shares under a securities borrowing and lending agreement for the purpose of short selling for its own account, to the extent that the number of shares borrowed is equal to the number of shares short sold by it, subsection (1) does not apply in respect of the agreement and section 43(2) and (3) does not apply in respect of the shares short sold and it must include in its ranking liabilities the amount which is the higher of—
- (a) the amount that would arise under subsection (1); and
 - (b) the increased amount that would arise under section 43(2) or (3), but for this subsection.
- (6) Subsections (1), (2) and (3) do not apply in respect of a securities borrowing and lending agreement to which a licensed corporation is a party, where the other party to the agreement is an approved securities borrowing and lending counterparty.

46. Repurchase transactions

- (1) **Subject to subsection (2A) and section 46A(1), a ~~A~~-licensed corporation** which is the purchaser in the first instance of any securities in a repurchase transaction must include in its ranking liabilities the amount by which the amount included in its liquid assets under section 33 exceeds—
 - (a) in the case where the securities are—
 - (i) shares listed on a specified exchange;
 - (ii) qualifying debt securities; or
 - (iii) special debt securities, 110% of their market value; or
 - (b) in any other case, 50% of the market value of the securities.
- (2) **Subject to subsection (2A) and section 46A(1), a ~~A~~-licensed corporation** which is the seller in the first instance of any securities in a repurchase transaction must include in its ranking liabilities the amount by which the market value of the securities, less the haircut amount in relation to such securities, exceeds the aggregate of—

- (a) the maximum amount that it can draw under a bank guarantee provided to it as security by the purchaser of the securities and issued by an authorized financial institution or an approved bank incorporated outside Hong Kong;
 - (b) the amount of proceeds of sale of such securities received by it from the purchaser;
 - (c) the market value of—
 - (i) any shares listed on a specified exchange;
 - (ii) any qualifying debt securities; and
 - (iii) any special debt securities, deposited with it by the purchaser as collateral, less the haircut amount in relation to such collateral; and
 - (d) 50% of the market value of any collateral, other than collateral referred to in paragraph (c), deposited with it by the purchaser.
- (2A) Subsections (1) and (2) do not apply in respect of a repurchase transaction that is cleared through a person approved as an approved repurchase central counterparty under section 58(1)(e).
- (3) A licensed corporation which is the seller in the first instance of any securities in a repurchase transaction must include in its ranking liabilities the amount of the consideration for which it sold the securities.

46A. Alternative treatment for securities borrowing and lending agreements and repurchase transactions—SOCCRA-LC

- (1) A SOCCRA-LC may, in respect of all securities borrowing and lending agreements and repurchase transactions entered into by it (except one referred to in section 45(6) or 46(2A)), elect to include in its ranking liabilities amounts calculated under section 53R instead of complying with—
 - (a) section 45(1), (2), (3) or (5), in respect of the securities borrowing and lending agreements; and
 - (b) section 46(1) or (2), in respect of the repurchase transactions.
- (2) To avoid doubt, sections 45(4) and 46(3) continue to apply to a SOCCRA-LC that makes an election under subsection (1).

47. Net underwriting commitments

- (1) Subject to subsection (2), a licensed corporation which underwrites or sub-underwrites an issue or a sale of securities must include in its ranking liabilities—
 - (a) for a rights issue where the market price of the securities is less than or equal to their subscription price, the lower of—
 - (i) the aggregate of—
 - (A) 50% of the haircut percentage in relation to the securities multiplied by the net underwriting commitment; and
 - (B) the amount by which the net underwriting commitment exceeds the market value of the securities; and
 - (ii) the net underwriting commitment;
 - (ab) for a rights issue where the market price of the securities is greater than their subscription price, 5% of the haircut percentage in relation to the securities multiplied by the net underwriting commitment; or
 - (b) in any other case, 50% of the haircut percentage in relation to the securities multiplied by the net underwriting commitment.

- (2) This section does not apply to a licensed corporation on the day on which it acquires an underwriting or a sub-underwriting commitment in respect of an issue or a sale of securities and the business day following that day.
- (3) For the purposes of subsection (2), a licensed corporation acquires an underwriting or a sub-underwriting commitment in respect of an issue or a sale of securities at the later of—
 - (a) the time when it commits itself to underwrite or sub-underwrite the securities; and
 - (b) the time when the lead underwriter or co-lead underwriter signs the underwriting agreement with the issuer or the seller (as the case may be) of the securities.
- (4) In subsection (1), **net underwriting commitment** (包銷承擔淨額) means the total costs of subscribing for or purchasing securities underwritten or sub-underwritten by a licensed corporation other than—
 - (a) securities which are sub-underwritten; and
 - (b) securities which are the subject of a legally binding contract for the subscription for or purchase of such securities,
 through or from that licensed corporation by another person.

~~48. Off-exchange traded derivative contracts~~

- ~~(1) Subject to subsection (2), a licensed corporation must include in its ranking liabilities the amount of any floating losses incurred by it in respect of any position in any off-exchange traded derivative contract.~~
- ~~(2) Where a licensed corporation has entered into a bilateral netting agreement in respect of 2 or more off-exchange traded derivative contracts with the counterparty with whom it maintains the positions, it must include in its ranking liabilities the amount by which the amount of any floating losses incurred by it exceeds the amount of any floating profits made by it in respect of the contracts.~~
- ~~(3) In subsection (2), **bilateral netting agreement** (雙邊淨額結算協議) means an agreement between the licensed corporation and the counterparty with whom it maintains positions in off-exchange traded derivative contracts under which each party has a single obligation to the other in respect of all such contracts covered by the agreement and which provides that, in the event that the counterparty fails to comply with its obligation under the agreement, the licensed corporation will have—~~
 - ~~(a) a single claim to receive only the net amount of the aggregate positive mark-to-market value of any contract covered by the agreement, calculated by deducting from the aggregate positive mark-to-market value of any contract covered by the agreement the aggregate negative mark-to-market value of any other contract covered by the agreement; or~~
 - ~~(b) a single obligation to pay only the net amount of the aggregate negative mark-to-market value of any contract covered by the agreement, calculated by deducting from the aggregate negative mark-to-market value of any contract covered by the agreement the aggregate positive mark-to-market value of any other contract covered by the agreement.~~

~~48A. Risk charge for positions in OTCD products cleared with regulated CCP: BMRA-LC~~

- ~~(1) This section applies to a BMRA-LC in relation to the following positions that fall within the descriptions specified in subsection (2)—~~
 - ~~(a) its long spot position or short spot position in 1 OTCD product; and~~
 - ~~(b) its long spot positions or short spot positions (or both) in 2 or more OTCD products.~~
- ~~(2) The descriptions specified for subsection (1) are that—~~

- (a) the OTCD product or products are subject to clearing and settlement by a regulated CCP; and
- (b) an amount of opening margin in respect of the position or positions has been set by one or more of the following persons—
 - (i) the regulated CCP;
 - (ii) one or more persons who provide any clearing and settlement service in the clearing and settlement referred to in paragraph (a).
- (3) A BMRA-LC must, in respect of each position, or group of positions, referred to in subsection (1), include in its ranking liabilities the highest of the amounts of opening margin set by the persons referred to in subsection (2)(b).
- (4) In this section—

opening margin (), in relation to a BMRA-LC's position or group of positions, means assets posted as security in respect of the position or positions against any credit risk exposure that could arise from future changes in the value of the position or positions during the time it takes to close out and replace the position or positions in the event of default;

OTCD product ()—

- (a) means an OTC derivative product other than—
 - (i) non-OTCD securities;
 - (ii) a non-OTCD futures contract; or
 - (iii) a non-OTCD unlisted options contract; and
- (b) in relation to a BMRA-LC licensed for Type 3 regulated activity—does not include a specified leveraged foreign exchange contract.

48B. Risk charge for positions in other OTCD products: BMRA-LC

- (1) A BMRA-LC must, in respect of each of its long spot positions and short spot positions in an OTCD product, except a position (or a position within a portfolio of positions) to which section 48A applies, include in its ranking liabilities—
 - (a) an amount, not exceeding the maximum possible loss of the position, that is the highest of the amounts specified in subsection (2) when calculated on a transaction-by-transaction basis; or
 - (b) with the Commission's approval in writing under section 58(5)(j), an amount that is calculated in accordance with the conditions of the approval.
- (2) The amounts specified for subsection (1)(a) are—
 - (a) the higher of the fair value and the market value of the position in the OTCD product;
 - (b) subject to subsection (3), if one or more amounts of opening margin have been set in respect of the position in the OTCD product—the highest of such amounts of opening margin;
 - (c) if the OTCD product is in the form of a call or put options contract—the in-the-money amount of the options contract; and
 - (d) subject to subsection (4), if the OTCD product—
 - (i) has 1 reference underlying—the higher of—
 - (A) the product of—
 - (I) the market risk percentage applicable to the reference underlying; and
 - (II) the higher of the fair value and the market value of the BMRA-LC's notional position in the reference underlying; and

- (B) the product of—
 - (I) the market risk percentage applicable to the reference underlying; and
 - (II) the notional principal (if any) of the reference underlying; or
- (ii) has 2 or more reference underlyings—the higher of—
 - (A) the sum, for the BMRA-LC's notional positions in the reference underlyings, of the product of—
 - (I) the market risk percentage applicable to a particular reference underlying; and
 - (II) the higher of the fair value and the market value of the BMRA-LC's notional position in that reference underlying; and
 - (B) the sum, for the BMRA-LC's notional positions in the reference underlyings, of the product of—
 - (I) the market risk percentage applicable to a particular reference underlying; and
 - (II) the notional principal (if any) of that reference underlying.
- (3) Subsection (2)(b) does not apply to an amount of opening margin set in respect of a portfolio of positions to which the position in the OTCD product belongs.
- (4) For subsection (2)(d), if an OTCD product is an nth-to-default credit default swap or nth-to-default credit linked note (where n is more than 1) and 2 or more debt securities are specified as the reference obligation in the derivative, the (n-1) debt securities to which the lowest haircut percentages apply are not to be regarded as a reference underlying of the OTCD product.
- (5) In this section—
 - opening margin** () has the meaning given by section 48A(4);
 - OTCD product** () has the meaning given by section 48A(4);
 - reference underlying** (), in relation to an OTCD product, means—
 - (a) subject to paragraph (b)—the underlying subject matter of the OTCD product;
 - (b) if the underlying subject matter of the OTCD product is a derivative instrument (**underlying derivative**)—the underlying subject matter of the underlying derivative.

48C. Risk charge for positions in miscellaneous derivatives with negative market value: BMRA-LC

A BMRA-LC must, in respect of its spot position in a miscellaneous derivative, include in its ranking liabilities any negative market value of the derivative in its account.

48D. Risk charge for positions in certain cleared miscellaneous derivatives: BMRA-LC

- (1) This section applies to a BMRA-LC in relation to the following positions in respect of which the conditions specified in subsection (2) are satisfied—
 - (a) its long spot position or short spot position in 1 miscellaneous derivative; or
 - (b) its long spot positions or short spot positions (or both) in 2 or more miscellaneous derivatives.
- (2) The conditions specified for subsection (1) are that—
 - (a) the miscellaneous derivative or derivatives are subject to clearing and settlement by any of the following persons—
 - (i) a specified exchange;

- (ii) a clearing house of a specified exchange;
 - (iii) a regulated CCP; and
- (b) an amount of opening margin in respect of the position or positions has been set by one or more of the following persons—
 - (i) the specified exchange;
 - (ii) the clearing house;
 - (iii) the regulated CCP;
 - (iv) one or more persons who provide any clearing and settlement service in the clearing and settlement referred to in paragraph (a).
- (3) A BMRA-LC must, in respect of each position, or group of positions, referred to in subsection (1), include in its ranking liabilities the highest of the amounts of opening margin set by the persons referred to in subsection (2)(b).
- (4) In this section—
opening margin () has the meaning given by section 48A(4).

48E. Risk charge for positions in other miscellaneous derivatives: BMRA-LC

- (1) A BMRA-LC must, in respect of each of its long spot positions and short spot positions in a miscellaneous derivative, except a position (or a position within a portfolio of positions) to which section 48D applies, include in its ranking liabilities—
 - (a) an amount, not exceeding the maximum possible loss of the position, that is the highest of the amounts specified in subsection (2) when calculated on a transaction-by-transaction basis; or
 - (b) with the Commission's approval in writing under section 58(5)(k), an amount that is calculated in accordance with the conditions of the approval.
- (2) The amounts specified for subsection (1)(a) are—
 - (a) the higher of the fair value and the market value of the position in the miscellaneous derivative;
 - (b) subject to subsection (3), if one or more amounts of opening margin have been set in respect of the position in the miscellaneous derivative—the highest of the amounts of opening margin; and
 - (c) if the miscellaneous derivative—
 - (i) has 1 reference underlying—the higher of—
 - (A) the product of—
 - (I) the market risk percentage applicable to the reference underlying; and
 - (II) the higher of the fair value and the market value of the BMRA-LC's notional position in the reference underlying; and
 - (B) the product of—
 - (I) the market risk percentage applicable to the reference underlying; and
 - (II) the notional principal (if any) of the reference underlying; or
 - (ii) has 2 or more reference underlyings—the higher of—
 - (A) the sum, for the BMRA-LC's notional positions in the reference underlyings, of the product of—

- (I) the market risk percentage applicable to a particular reference underlying; and
 - (II) the higher of the fair value and the market value of the BMRA-LC's notional position in that reference underlying; and
- (B) the sum, for the BMRA-LC's notional positions in the reference underlyings, of the product of—
 - (I) the market risk percentage applicable to a particular reference underlying; and
 - (II) the notional principal (if any) of that reference underlying.
- (3) Subsection (2)(b) does not apply to an amount of opening margin set in respect of a portfolio of positions to which the position in the miscellaneous derivative belongs.
- (4) In this section—

opening margin () has the meaning given by section 48A(4);

reference underlying (), in relation to a miscellaneous derivative, means—

 - (a) subject to paragraph (b)—the underlying subject matter of the miscellaneous derivative;
 - (b) if the underlying subject matter of the miscellaneous derivative is a derivative instrument (**underlying derivative**)—the underlying subject matter of the underlying derivative.

49. Interest rate swap agreements

- ~~(1) A licensed corporation which is a party to an interest rate swap agreement must include in its ranking liabilities the notional principal amount multiplied by the percentage specified in column 3 of Table 1 in Schedule 4 opposite the description of the remaining term to maturity in column 2 of the Table which is applicable to the agreement.~~
- ~~(2) In subsection (1), **notional principal amount** (名義本金額) means the theoretical amount agreed upon by the parties to an interest rate swap agreement on the basis of which any interest payment to be made under the agreement is calculated.~~

50. Foreign exchange agreements

A licensed corporation which is a party to a foreign exchange agreement must include in its ranking liabilities the amount of currency to be delivered by it under the agreement multiplied by the percentage specified in column 3 of Table 2 in Schedule 4 opposite the description of the counterparty and the remaining term to maturity in column 2 of the Table which is applicable to the agreement.

51. Introduction of transactions

- (1) Subject to subsection (2), where a licensed corporation introduces transactions which involve—
 - (a) a dealing in any securities;
 - (b) a dealing in a futures contract or an unlisted options contract;
 - (c) a trading in a leveraged foreign exchange contract,
 to another person for execution or clearing on behalf of any of its clients and—
 - (d) it does not include the amount receivable by it or payable to it in respect of any such transaction in the calculation of its liquid capital under this Part; and
 - (e) there is neither express agreement nor a clear market practice that exempts it from any liability to the client or the other person in relation to such transaction,

it must include in its ranking liabilities the amount by which its required liquid capital would have been increased had one or more of the following amounts been included in the calculation of its variable required liquid capital (as if the transaction had been executed or cleared by it)—

- (f) (where the transaction introduced is a dealing in securities and the transaction has not been fully settled by the client or the other person (as the case may be)) the total value of the transaction entered into as a result of the introduction;
 - (g) (where the transaction introduced is a dealing in a futures contract or an unlisted options contract) the total amount of margin required to be deposited in respect of the futures contract or the unlisted options contract entered into as a result of the introduction which remains outstanding;
 - (h) (where the transaction introduced is a trading in a leveraged foreign exchange contract) the aggregate gross foreign currency position arising from the leveraged foreign exchange contract entered into as a result of the introduction which remains outstanding.
- (2) Subsection (1) does not apply where—
- (a) the person to whom the transaction is introduced is a member of a group of companies of which the licensed corporation is a member;
 - (b) the person to whom the transaction is introduced has entered into an agreement with the client for providing the execution or clearing service to the client and is contractually liable to the client for any default in the execution or clearing of the transaction; and
 - (c) the licensed corporation is not liable to the client for execution or clearing of such transactions or default by the person to whom the transaction is introduced.

51A. Foreign currency positions: **BMRA-LC**

- (1) Subject to subsections (2) and (3), a ~~licensed corporation~~ **BMRA-LC** must include in its ranking liabilities 5% of its net position in each foreign currency.
- (2) In calculating the net position in a foreign currency, a ~~licensed corporation~~ **BMRA-LC** may elect to exclude **any of the following** from the calculation—
 - (a) the value of any asset which is denominated in that foreign currency and not included in its liquid assets under any provision in Division 3;
 - (b) **any notional position in the foreign currency arising from—**
 - (i) **a futures contract in relation to which an amount is included under section 40(4) or (13);**
 - (ii) **an unlisted options contract in relation to which an amount is included under section 31(1), 40(4), (11) or (12);**
 - (iii) **an OTCD product in relation to which an amount is included under section 48A or 48B;**
 - (iv) **a miscellaneous derivative in relation to which an amount is included under section 48D or 48E.**
- (3) If, in relation to a non-freely floating foreign currency, a ~~licensed corporation~~ **BMRA-LC** has **both an onshore net position in the currency and an offshore net positions** in the currency ~~which are attributable to both the onshore and offshore markets in the currency,~~ the ~~licensed corporation~~ **BMRA-LC** must include in its ranking liabilities—
 - (a) if its onshore net position in the currency and its offshore net position in the currency are both long positions or are both short positions—5% of the aggregate of the onshore net position and the offshore net position; or

- (b) if paragraph (a) does not apply to it in relation to the currency—
 - (i) 1.5% of the lower of its onshore net position in the currency and its offshore net position in the currency; and
 - (ii) 5% of **the absolute value of** the difference between its onshore net position in the currency and its offshore net position in the currency.
- (4) In this section—

net position (淨持倉量), in relation to a ~~licensed corporation~~ **BMRA-LC**'s position in a foreign currency, means the difference between—

 - (a) the aggregate of—
 - (i) the value of assets, other than fixed assets, beneficially owned by ~~the licensed corporation~~ **it** which are denominated in the foreign currency; and
 - (ii) the total amount of the foreign currency in respect of which ~~the licensed corporation~~ **it** is exposed to the risk of a decline in the value of the foreign currency under outstanding contracts (including spot contracts); and
 - (b) the aggregate of—
 - (i) all of ~~the licensed corporation's~~ **its** on-balance sheet liabilities, other than excluded liabilities, which are denominated in the foreign currency; and
 - (ii) the total amount of the foreign currency in respect of which ~~the licensed corporation~~ **it** is exposed to the risk of a rise in the value of the foreign currency under outstanding contracts (including spot contracts);

~~**non-freely floating foreign currency** (非自由浮動外幣) means a foreign currency in respect of which an authority of the jurisdiction of which the currency is the lawful currency specifies, in respect of one or more foreign exchange markets specified by the authority—~~

 - ~~—(a) the rate at which the currency is permitted by the authority to be converted into one or more other currencies; or~~
 - ~~—(b) a range of rates within which the currency is permitted by the authority to be converted into one or more other currencies;~~

~~**offshore net position** (境外淨持倉量), in relation to a licensed corporation's net position in a non-freely floating foreign currency, means its net position in the currency which is attributable to the offshore market in the currency; means a BMRA-LC's net position in a non-freely floating foreign currency that is constituted only by the BMRA-LC's positions in the currency that not are required by the home authority of the currency to be valued or settled at the permitted rate;~~

~~**onshore net position** (境內淨持倉量), in relation to a licensed corporation's net position in a non-freely floating foreign currency, means its net position in the currency which is attributable to the onshore market in the currency. means a BMRA-LC's net position in a non-freely floating foreign currency that is constituted only by the BMRA-LC's positions in the currency that are required by the home authority of the currency to be valued or settled at the permitted rate.~~

52. Miscellaneous

- (1) A licensed corporation must include in its ranking liabilities—
 - (a) 10% of the amount of any guarantee, indemnity or other similar financial commitment provided by it, directly or indirectly (including the pledging of assets for the purpose of obtaining a bank guarantee), other than a guarantee, an indemnity and other financial commitment provided by it in respect of its own liabilities and obligations;

- (b) the amount by which the liabilities of any subsidiary of it (excluding any amounts due to it from the subsidiary) exceed the assets of the subsidiary;
- (c) the consideration it is obliged to pay for the redemption of redeemable shares, other than approved redeemable shares, which have not yet been redeemed;
- (d) if it has made one or more elections under section 18A(3) in relation to one or more controlled assets denominated in a particular currency, the amount (if it exceeds zero) calculated in accordance with the following formula—

$$A - L$$

where—

- “A” is, **subject to subsection (1A)**, the aggregate of the amounts that it is required to include in its liquid assets in respect of the controlled assets denominated in the currency; and
 - “L” is the aggregate of the amounts of its existing obligations or liabilities denominated in the currency (which the controlled assets may be freely applied to meet) that it is required (apart from by this paragraph) to include in its ranking liabilities; and
 - (e) where it is the underwriter of a note issuance and revolving underwriting facility, the maximum amount that can be drawn down by the issuer under the facility by issuing notes less the amount that has been drawn down by the issuer by issuing and placing notes multiplied by the percentage specified in column 3 of Schedule 5 opposite the description of the remaining term to maturity in column 2 of the Schedule which is applicable to the facility.
- (1A) For an SMRA-LC, the aggregate of amounts counted towards the variable “A” in the formula in subsection (1)(d) is to be deducted by—**
- (a) the amount that it is required to include under section 27A(1)(a) in respect of any of the controlled assets that are securities, multiplied by the product of—**
 - (i) the market risk percentage applicable to—**
 - (A) if the securities are not a derivative instrument—the securities; or**
 - (B) if the securities are a derivative instrument—the underlying subject matter of the securities; and**
 - (ii) the scaling factor applicable to that percentage;**
 - (b) 40% of the amount that it is required to include under section 27A(1)(b) or (c) in respect of any of the controlled assets that is an unlisted options contract; and**
 - (c) the amount that it is required to include under section 27A(1)(d) in respect of any of the controlled assets that is a specified investment, multiplied by the product of—**
 - (i) the market risk percentage applicable to the investment; and**
 - (ii) the scaling factor applicable to that percentage.**

(2)-(3) (Repealed)

53. Other liabilities

- (1) Subject to subsections (1A) and (2), a licensed corporation must include in its ranking liabilities all its liabilities not otherwise required to be included in its ranking liabilities under any other provision of this Division, including—
 - (a) any amount payable by it in relation to any overdraft obtained by it;
 - (b) any amount payable by it in relation to any loan obtained by it;
 - (c) any accrued interest payable by it to any other person;

- (d) any accrued expenses incurred by it;
 - (e) any tax payable by it, less any tax prepaid by it, to the extent that the tax payable and the tax prepaid are of the same description and levied by the same taxation authority;
 - (f) any provision made by it for contingent liabilities;
 - (g) any provision made by it for floating losses in respect of open positions held for its own account; and
 - (h) any other liabilities provided for in accordance with generally accepted accounting principles.
- (1A) In relation to any liabilities of a licensed corporation which arise from a tenancy agreement entered into by it in respect of any premises which it uses in carrying on the regulated activity for which it is licensed, subsection (1) only applies to any amount by which its on-balance sheet liabilities arising from the tenancy agreement exceeds the total value of its assets arising from the tenancy agreement which are not included in its liquid assets under any provision in Division 3.
- (2) A licensed corporation must not include in its ranking liabilities—
- (a) any approved subordinated loan provided to it; ~~or~~
 - (b) any liability that it is not required to settle within the next 12 months and is secured by a first legal charge on immovable property beneficially owned by it and used in carrying on the regulated activity for which it is licensed, to the extent that the net realizable value of that property equals such liability-; ~~or~~
 - (c) any amount payable to a specified person (within the meaning of section 34A) of an OTCD transaction effected by the licensed corporation that constitutes OTCD cash margin posted by the specified person that—
 - (i) is held by the licensed corporation in a segregated account with an authorized financial institution or an approved bank incorporated outside Hong Kong; but
 - (ii) is not beneficially owned by the licensed corporation.

Division 5—Alternative approach

53A. Alternative approach for amounts relating to counterparty credit risks or market risks

- (1) A licensed corporation may, with the approval of the Commission under section 58(5B)(a), adopt an alternative approach for—
 - (a) calculating one or more amounts in respect of the counterparty credit risks of one or more transactions entered into by, or through, the licensed corporation; or
 - (b) calculating one or more amounts in respect of the market risks of one or more positions held by the licensed corporation for its own account in any instruments or assets.
- (2) If an approval under subsection (1) is given to a licensed corporation to adopt an alternative approach, the licensed corporation must include in its liquid assets or ranking liabilities (as the case may be) the amounts calculated by adopting the alternative approach (**substitute amounts**) in place of the following amounts (**prescribed amounts**) specified in the approval—
 - (a) if the substitute amounts relate to counterparty credit risks—one or more amounts referred to in this Part or Part 4A that relate to the counterparty credit risks of one or more transactions entered into by, or through, the licensed corporation; or

- (b) if the substitute amounts relate to market risks—one or more amounts referred to in this Part or Part 4B that relate to the market risks of one or more positions held by the licensed corporation for its own account in any instruments or assets.
- (3) For the purposes of subsection (2)—
 - (a) the approval may specify one or more prescribed amounts or all prescribed amounts generally; and
 - (b) the substitute amounts need not relate to the same transactions, or same positions in instruments or assets, as those to which the prescribed amounts relate.
- (4) In this section—

alternative approach (), in relation to a licensed corporation, means either, or a combination of both, of the following—

- (a) one or more methodologies based on those set out in the prevailing banking supervisory standards issued by the Basel Committee (except one described as involving the use of any model that requires approval by a supervisory authority);
- (b) one or more methodologies involving the use of any model proposed by the licensed corporation;

counterparty credit risk (), in relation to a transaction entered into by, or through, a licensed corporation—

- (a) means the risk of loss arising, before the final settlement of the cash or asset flows of the transaction, from—
 - (i) any default, in respect of the transaction, of a person (other than the licensed corporation) who is a party to the transaction or who provides services for the clearing and settlement of the transaction; or
 - (ii) any asset posted as security in respect of the transaction; and
- (b) includes the risk of loss arising from a change in the credit valuation adjustment for the transaction;

market risk (), in relation to a position held by a licensed corporation for its own account in an instrument or asset, means the risk of loss arising from any fluctuation in the market value of the instrument or asset.

Part 4A

Counterparty Credit Risk

Division 1—Preliminary

53B. Interpretation

In this Part—

current exposure amount ()—

- (a) in relation to an OTCD transaction that does not form part of an OTCD netting set—
 - (i) means the replacement value of the transaction; but
 - (ii) if the replacement value is negative, means zero; or
- (b) in relation to 2 or more OTCD transactions that constitute an OTCD netting set—
 - (i) means the net replacement value of the transactions; but
 - (ii) if the net replacement value is negative, means zero;

eligible collateral (), in relation to an OTCD transaction or repo-style transaction, means an asset treated as eligible collateral under section 53T(1)(b) in respect of the transaction;

eligible credit risk swap (), in relation to an OTCD transaction or repo-style transaction, means a credit risk swap treated as an eligible credit risk swap under section 53T(1)(d) in respect of the transaction;

eligible guarantee (), in relation to an OTCD transaction or repo-style transaction, means a guarantee treated as an eligible guarantee under section 53T(1)(c) in respect of the transaction;

net replacement value (), in relation to 2 or more OTCD transactions that constitute an OTCD netting set, means the sum of the replacement values of the transactions;

replacement value (), in relation to an OTCD transaction, means the amount arrived at by deducting from the absolute value of the adjusted OTCD receivable amount from the specified person of the transaction the absolute value of the OTCD payable amount to that person;

repo-style netting set () means 2 or more repo-style transactions that are treated as a repo-style netting set under section 53T(1)(a)(ii);

repo-style transaction (), in relation to a SOCCRA-LC, means a securities borrowing and lending agreement or a repurchase transaction in respect of which an election is made by the SOCCRA-LC under section 46A(1);

specified person () means—

- (a) for an OTCD transaction referred to in section 53J, 53K, 53M, 53P or 53Q—the counterparty within the meaning of that section; or
- (b) for an OTCD transaction referred to in section 53L—the clearing client within the meaning of that section.

53C. Meaning of *volatility adjusted value* in relation to eligible collateral

In this Part—

volatility adjusted value (), in relation to an asset that is eligible collateral in respect of an OTCD transaction, means the value calculated using Formula 1.

Formula 1

Calculation of volatility adjusted value of asset that is eligible collateral

$$HV = CR \times \max(0, 1 - H_c - H_{ccy})$$

Where—

CR is—

- (a) if the asset is cash—the amount of cash; or
- (b) for any other asset—the market value of the asset;

H_c is the volatility adjustment percentage applicable to the asset; and

H_{ccy} is, for any currency mismatch arising, the volatility adjustment percentage applicable to the currency mismatch.

53D. Reference to asset posted by licensed corporation to person as security does not include asset that is bankruptcy remote from person

- (1) In this Part, a reference to an asset posted by a licensed corporation to a person (**receiver**) as security in respect of an OTCD transaction or repo-style transaction does not include any such asset that is excluded by subsection (2) or (3).
- (2) For the purposes of subsection (1), an asset is excluded by this subsection if the asset is bankruptcy remote from the receiver and is either—
 - (a) held by a custodian; or
 - (b) being an amount of cash, held by the receiver in the following account—
 - (i) if the receiver is not a licensed corporation—an account that is—
 - (A) established and maintained with an authorized financial institution or an approved bank incorporated outside Hong Kong; and
 - (B) separate from the receiver's own account that holds any money beneficially owned by the receiver; or
 - (ii) if the receiver is a licensed corporation—an account that is—
 - (A) a segregated account with an authorized financial institution or an approved bank incorporated outside Hong Kong; or
 - (B) a segregated account—
 - (I) that is referred to in paragraph (a) of the definition of **segregated account** in section 2(1); and
 - (II) with a person approved by the Commission under section 4(2) of the Securities and Futures (Client Money) Rules (Cap. 571 sub. leg. I) for the purposes of those Rules.
- (3) For the purposes of subsection (1), an asset is excluded by this subsection if—
 - (a) the asset is posted as security in respect of an OTCD transaction that falls within section 11(2) or (5) of Schedule 6 and in respect of which a risk weight of 2% may be allocated under section 11(3)(a) or (6)(a) of that Schedule; and
 - (b) the asset is bankruptcy remote from the regulated CCP mentioned in section 11(2) or (5) of that Schedule and is either—
 - (i) held by a custodian; or

- (ii) being an amount of cash, held by the regulated CCP in a bank account that is separate from the regulated CCP's own account that holds any money beneficially owned by the regulated CCP.
- (4) For the purposes of subsections (2) and (3), an asset posted by a licensed corporation as security in respect of an OTCD transaction or repo-style transaction is bankruptcy remote from a person if the asset is covered by an arrangement that has the effect of protecting the licensed corporation from incurring loss in respect of the security due to any default, bankruptcy or insolvency of (or any other similar circumstances affecting) the person.
- (5) In this section—
 - custodian** () means a person that holds property in a way—
 - (a) that does not give the person a beneficial interest in the property; and
 - (b) that will not result in the property being subject to legally-enforceable claims by the person's creditors, or to a court-ordered stay of the return of the property, if the person becomes insolvent or bankrupt.

53E. References to transaction ended with past due and transaction with party in default

- (1) For the purposes of this Part, an OTCD transaction effected by a licensed corporation is a transaction ended with past due if—
 - (a) the transaction has been closed or terminated; and
 - (b) any amount receivable from the specified person of the transaction arising from the transaction—
 - (i) if the specified person is the counterparty within the meaning of section 53J, 53K, 53M, 53P or 53Q—has been outstanding for more than 3 business days after the settlement date; or
 - (ii) if the specified person is the clearing client within the meaning of section 53L—is due for settlement according to the settlement date.
- (2) For the purposes of these Rules, an OTCD transaction effected by a licensed corporation is a transaction with a party in default if the specified person of the transaction—
 - (a) has defaulted on any senior unsecured debt security that has an original maturity of not less than 1 year issued by the specified person; or
 - (b) is insolvent or bankrupt.

53F. Reference to transactions subject to eligible netting arrangement or nettable CCP transactions

- (1) For the purposes of this Part, the following transactions are subject to an eligible netting arrangement with a transaction counterparty if the conditions specified in subsection (2) are satisfied—
 - (a) 2 or more OTCD transactions effected by a licensed corporation; or
 - (b) 2 or more repo-style transactions entered into by a licensed corporation.
- (2) The conditions specified for subsection (1) are that—
 - (a) the licensed corporation has entered into an agreement in writing that—
 - (i) creates a single legal obligation in respect of all transactions covered by the agreement (**covered transactions**) such that the licensed corporation would have a single claim to receive, or a single obligation to pay, only the net amount of the sum of the nettable values if a party to the agreement (or

- a person to whom the agreement has been validly assigned) (**defaulter**) fails to comply with any obligation specified in the agreement due to default, insolvency, bankruptcy or similar circumstances; and
- (ii) is not subject to a provision that permits the non-defaulting party to make only limited payment, or no payment at all, to the defaulter or the estate of the defaulter, whether or not the defaulter is a net creditor; and
- (b) the licensed corporation—
- (i) has obtained independent legal advice in writing (and has adequate internal control processes for ensuring that such advice remains current) to the effect that in the event of any legal challenge (including a challenge resulting from default, insolvency, bankruptcy or similar circumstances), the relevant arbiter would find the licensed corporation's exposure to be the net amount under—
 - (A) the law of the jurisdiction in which the defaulter is incorporated or located (as applicable);
 - (B) the law that governs any of the covered transactions; or
 - (C) the law that governs the agreement;
 - (ii) manages the covered transactions on a net basis; and
 - (iii) maintains records adequate to support the netting of the covered transactions.
- (3) For the purposes of these Rules, 2 or more OTCD transactions effected by a licensed corporation are nettable CCP transactions with a central counterparty if—
- (a) the transactions are entered into by the licensed corporation or another person with the central counterparty, either as a clearing participant, or as a clearing client of a clearing participant, of the central counterparty;
 - (b) the transactions are booked in an account maintained with the central counterparty; and
 - (c) either—
 - (i) the central counterparty may set off nettable values in the account for settlement purposes according to the rules of the central counterparty; or
 - (ii) the rules of the central counterparty create a single legal obligation in respect of all transactions in the account such that the central counterparty would have a single claim to receive, or a single obligation to pay, only the net amount of the sum of the nettable values in the account if a clearing participant fails to comply with any obligation under the transactions or the rules due to default, insolvency, bankruptcy or similar circumstances.
- (4) In this section—
- nettable values** (), in relation to 2 or more OTCD transactions or repo-style transactions, means—
- (a) the positive and negative market values of the transactions;
 - (b) the market values of any securities lent or sold under the transactions; and
 - (c) any other amounts receivable, amounts payable and the amount of any cash and market values of any other assets held or posted as security under the transactions;
- transaction counterparty** ()—
- (a) in relation to 2 or more OTCD transactions effected by a licensed corporation, means the specified person of the transactions; and

- (b) in relation to 2 or more repo-style transactions entered into by a licensed corporation, means the person with whom the transactions are entered into by the licensed corporation.

53G. Circumstances in which currency mismatch arises

- (1) This section applies to a licensed corporation in determining whether, in relation to an OTCD transaction effected by it or a repo-style transaction entered into by it, a currency mismatch arises in respect of—
 - (a) an asset, being asset posted by a person to the licensed corporation as security in respect of the transaction, that is eligible collateral;
 - (b) a guarantee that is an eligible guarantee in respect of the transaction;
 - (c) a credit risk swap that is an eligible credit risk swap in respect of the transaction;
 - (d) an asset that is posted by the licensed corporation to a person as security in respect of the transaction; or
 - (e) an asset falling within the definition of *RST collateral* or *RST exposure* in section 53R(5).
- (2) Subject to subsection (3), the licensed corporation must regard a currency mismatch as arising if the asset, guarantee or credit risk swap is denominated in a currency that is different from—
 - (a) where an OTCD transaction that does not form part of an OTCD netting set is involved—the settlement currency of the transaction;
 - (b) where OTCD transactions that constitute an OTCD netting set are involved and—
 - (i) the transactions are subject to an eligible netting arrangement—the settlement currency of the eligible netting arrangement; or
 - (ii) the transactions are nettable CCP transactions—the settlement currency of the transactions under the rules of the relevant central counterparty;
 - (c) where a repo-style transaction that does not form part of a repo-style netting set is involved—the settlement currency of the transaction; or
 - (d) where repo-style transactions that constitute a repo-style netting set are involved—the settlement currency of the eligible netting arrangement.
- (3) A currency mismatch does not arise if the licensed corporation has entered into a hedging agreement under which the risks to the licensed corporation of foreign currency losses arising from a difference in currencies referred to in subsection (2) are eliminated.

53H. Apportionment of asset posted by licensed corporation as security in respect of group of transactions

- (1) This section applies if a licensed corporation posts an asset to a person as security in respect of a group of transactions comprising any combination of 2 or more of the following transactions—
 - (a) an OTCD transaction effected by it;
 - (b) a repo-style transaction entered into by it; or
 - (c) any other transaction entered into by it.
- (2) The licensed corporation must, for the purposes of calculating an amount to be included in its ranking liabilities under this Part in respect of an OTCD transaction or

repo-style transaction within the group of transactions, divide the asset posted into portions for each transaction within the group of transactions, using—

- (a) Formula 2; or
- (b) with the Commission's approval in writing under section 58(5)(l)—another method in accordance with the conditions of the approval.

Formula 2

Apportionment of asset posted by licensed corporation in respect of group of transactions

$$CP_{transaction, i} = \frac{CP}{N}$$

Where—

$CP_{transaction, i}$ is the amount of the portion of asset regarded as posted for each transaction within the group of transactions;

CP is—

- (a) if the asset is cash—the amount of cash; or
- (b) for any other asset—the market value of the asset; and

N is the total number of transactions comprising the group of transactions.

53I. Apportionment of asset posted to licensed corporation as security in respect of group of transactions that is eligible collateral

(1) This section applies if—

- (a) an asset is posted to a licensed corporation by a person as security in respect of a group of transactions comprising any combination of 2 or more of the following transactions—
 - (i) an OTCD transaction effected by it;
 - (ii) a repo-style transaction entered into by it; or
 - (iii) any other transaction entered into by it; and
- (b) the licensed corporation, in calculating an amount to be included in its ranking liabilities under Division 2, 3, 5 or 6 of this Part in respect of an OTCD transaction or repo-style transaction within the group of transactions, treats the asset as eligible collateral in respect of the transaction under section 53T(1)(b).

(2) The licensed corporation must, for the purposes of the calculation referred to in subsection (1)(b), divide the asset posted into portions for each transaction within the group of transactions, using—

- (a) Formula 3; or
- (b) with the Commission's approval in writing under section 58(5)(m)—another method in accordance with the conditions of the approval.

Formula 3

Apportionment of eligible collateral posted to licensed corporation in respect of group of transactions

$$CR_{transaction, i} = \frac{CR}{N}$$

Where—

$CR_{transaction, i}$ is the amount of the portion of asset regarded as posted for each transaction within the group of transactions;

CR is—

- (a) if the asset is cash—the amount of cash; or
- (b) for any other asset—the market value of the asset; and

N is the total number of transactions comprising the group of transactions.

Division 2—Counterparty credit risk charges

53J. Counterparty credit risk charges—SOCCRA-LC

- (1) A SOCCRA-LC must, in respect of each covered OTCD transaction that does not form part of an OTCD netting set, include in its ranking liabilities an amount calculated using Formula 4.

Formula 4

Calculation of CCR charge (OTCD transaction)

$$K_T = E_T \times RW_T \times 8\%$$

Where—

- (a) E_T is the exposure amount of the transaction, calculated using Formula 5; and
- (b) RW_T is the risk weight applicable to the SOCCRA-LC's exposure arising from the transaction; but
- (c) if the SOCCRA-LC takes into account any eligible guarantee or eligible credit risk swap in respect of the transaction, " $E_T \times RW_T$ " is to be substituted by the amount calculated using Formula 28 in section 53Y(1).

Formula 5

Calculation of exposure amount (OTCD transaction)

$$E_T = \alpha \times \max [0, V_T + PFE + CP - CR + \sum_i (NCV_{asset, i} \times H_{asset, i}) + \sum_j (NCV_{ccy, j} \times H_{ccy, j})]$$

Where—

α is—

- (a) 1.4; but
- (b) if the value of RW_T for the transaction in Formula 4 is 1250%—1;

V_T is—

- (a) the replacement value of the transaction; but
- (b) if the transaction is not subject to revaluation every business day—the current exposure amount of the transaction;

PFE is—

- (a) if the transaction is centrally cleared through a regulated CCP and the CCP transaction in respect of the transaction is subject to any requirement of OTCD initial margin—the OTCD initial margin amount set by the regulated CCP for the CCP transaction; or
 - (b) in any other case—the higher of—
 - (i) the PFE amount of the transaction; and
 - (ii) the top OTCD initial margin amount of the transaction;
- CP is the sum of the amounts of any cash, and the market values of any other assets, posted by the SOCCRA-LC to the counterparty as security in respect of the transaction;
- CR is the sum of the amounts of any cash, and the market values of any other assets, being cash and assets posted by the counterparty as security in respect of the transaction, that are eligible collateral;
- NCV_{asset, i} is, where the SOCCRA-LC takes into account in calculating CP or CR any assets (other than cash) that are asset *i*—the absolute value of the difference between—
 - (a) the sum of the market values of all assets that are asset *i* and are taken into account in calculating CP; and
 - (b) the sum of the market values of all assets that are asset *i* and are taken into account in calculating CR;
- H_{asset, i} is, for an asset *i* referred to in the description of NCV_{asset, i}—
 - (a) if the sum of the market values of all assets that are asset *i* and are taken into account in calculating CR is greater than the sum of the market values of all assets that are asset *i* and are taken into account in calculating CP—the lower of—
 - (i) 100%; and
 - (ii) the volatility adjustment percentage applicable to asset *i*; or
 - (b) in any other case—the volatility adjustment percentage applicable to asset *i*;
- NCV_{ccy, j} is, where the SOCCRA-LC takes into account in calculating CP or CR any cash in currency *j*, or any other assets denominated in currency *j*, in respect of which a currency mismatch arises—the absolute value of the difference between—
 - (a) the sum of the amounts of all such cash in currency *j*, and the market values of all such other assets denominated in currency *j* (other than excluded collateral), taken into account in calculating CP; and
 - (b) the sum of the amounts of all such cash in currency *j*, and the market values of all such other assets denominated in currency *j* (other than excluded collateral), taken into account in calculating CR; and
- H_{ccy} is, for a currency mismatch referred to in NCV_{ccy, j}, the volatility adjustment percentage applicable to the currency mismatch.
- (2) For the purposes the description of NCV_{ccy, j} in Formula 5 in subsection (1), an asset that is asset *i* and denominated in currency *j* is **excluded collateral** if the value of H_{asset, i} applicable to asset *i* according to the Formula is, by virtue of paragraph (a) of the description of H_{asset, i} in the Formula, 100%.

- (3) A SOCCRA-LC must, in respect of the covered OTCD transactions that constitute each OTCD netting set, include in its ranking liabilities an amount calculated using Formula 6.

Formula 6

Calculation of CCR charge (OTCD netting set)

$$K_{NS} = E_{NS} \times RW_{NS} \times 8\%$$

Where—

- (a) E_{NS} is the exposure amount of the OTCD netting set, calculated using Formula 7; and
- (b) RW_{NS} is the risk weight applicable to the SOCCRA-LC's exposure arising from the OTCD netting set; but
- (c) if the SOCCRA-LC takes into account any eligible guarantee or eligible credit risk swap in respect of the OTCD netting set, " $E_{NS} \times RW_{NS}$ " is to be substituted by the amount calculated using Formula 28 in section 53Y(1).

Formula 7

Calculation of exposure amount (OTCD netting set)

$$E_{NS} = \alpha \times \max [0, V_{NS} + PFE_{NS} + CP_{NS} - CR_{NS} + \sum_i (NCV_{NSasset, i} \times H_{asset, i}) + \sum_j (NCV_{NSccy, j} \times H_{ccy, j})]$$

Where—

- α is—
 - (a) 1.4; but
 - (b) if the value of RW_{NS} for the OTCD netting set in Formula 6 is 1250%—1;
- V_{NS} is—
 - (a) the net replacement value of the transactions; but
 - (b) if the covered OTCD transactions that constitute the OTCD netting set are not all subject to revaluation every business day—the current exposure amount of the transactions;
- PFE_{NS} is—
 - (a) if all of the covered OTCD transactions that constitute the OTCD netting set are centrally cleared through a regulated CCP and the CCP transactions in respect of the covered OTCD transactions are subject to any requirement of OTCD initial margin—the OTCD initial margin amount set by the regulated CCP for the CCP transactions; or
 - (b) in any other case—the higher of—
 - (i) the net PFE amount of the OTCD netting set; and
 - (ii) the top OTCD initial margin amount of the OTCD netting set;
- CP_{NS} is the sum of the amounts of any cash, and the market values of any other assets, posted by the SOCCRA-LC to the counterparty as security in respect of any of the covered OTCD transactions;

- CR_{NS} is the sum of the amounts of any cash, and the market values of any other assets, being cash and assets posted by the counterparty as security in respect of any of the covered OTCD transactions, that are eligible collateral;
- $NCV_{NSasset, i}$ is, where the SOCCRA-LC takes into account in calculating CP_{NS} or CR_{NS} any assets (other than cash) that are asset i —the absolute value of the difference between—
- (a) the sum of the market values of all assets that are asset i and are taken into account in calculating CP_{NS} ; and
 - (b) the sum of the market values of all assets that are asset i and are taken into account in calculating CR_{NS} ;
- $H_{asset, i}$ is, for an asset i referred to in the description of $NCV_{NSasset, i}$ —
- (a) if the sum of the market values of all assets that are asset i and are taken into account in calculating CR_{NS} is greater than the sum of the market values of all assets that are asset i and are taken into account in calculating CP_{NS} —the lower of—
 - (i) 100%; and
 - (ii) the volatility adjustment percentage applicable to asset i ; or
 - (b) in any other case, the volatility adjustment percentage applicable to asset i ;
- $NCV_{NSccy, j}$ is, where the SOCCRA-LC takes into account in calculating CP_{NS} or CR_{NS} any cash in currency j , or any other assets denominated in currency j , in respect of which a currency mismatch arises—the absolute value of the difference between—
- (a) the sum of the amounts of all such cash in currency j , and the market values of all such other assets denominated in currency j (other than excluded collateral), taken into account in calculating CP_{NS} ; and
 - (b) the sum of the amounts of all such cash in currency j , and the market values of all such other assets denominated in currency j (other than excluded collateral), taken into account in calculating CR_{NS} ; and
- H_{ccy} is, for a currency mismatch referred to in NCV_{NSccy} , the volatility adjustment percentage applicable to the currency mismatch.
- (4) For the purposes of the description of NCV_{NSccy} in Formula 7 in subsection (3), an asset that is asset i and denominated in currency j is **excluded collateral** if the value of $H_{asset, i}$ applicable to asset i according to the Formula is, by virtue of paragraph (a) of the description of $H_{asset, i}$ in the Formula, 100%.
 - (5) A SOCCRA-LC must, in addition to subsection (3), in respect of each OTCD netting set referred to in that subsection that includes one or more covered OTCD transactions that are transactions ended with past due, include in its ranking liabilities an amount calculated using—
 - (a) Formula 8; but
 - (b) if section 53X applies to the calculation of the amount to be included in subsection (3)—Formula 9.

Formula 8

Calculation of CCR charge (past due additional charge)

$$K_{PD} = \min (E_{NS}, CE_{PD}) \times (1 - \alpha \times RW_{NS} \times 8\%)$$

Where—

- E_{NS} has the same meaning as in Formula 6 in subsection (3);
- CE_{PD} is the current exposure amount of all of the covered OTCD transactions constituting the OTCD netting set that are transactions ended with past due;
- α has the same meaning as in Formula 7 in subsection (3); and
- RW_{NS} has the same meaning as in Formula 6 in subsection (3).

Formula 9

Calculation of CCR charge (past due additional charge—uncovered portion)

$$K_{PD} = \min (UE_{NS}, CE_{PD}) \times (1 - \alpha \times RW_{NS} \times 8\%)$$

Where—

- UE_{NS} is the credit protection uncovered portion of the exposure amount of the OTCD netting set, calculated according to section 53X(1)(b);
- CE_{PD} is the current exposure amount of all of the covered OTCD transactions constituting the OTCD netting set that are transactions ended with past due;
- α has the same meaning as in Formula 7 in subsection (3); and
- RW_{NS} has the same meaning as in Formula 6 in subsection (3).

(6) In this section—

counterparty (), in relation to a covered OTCD transaction of a SOCCRA-LC, means—

- (a) for a transaction other than a proprietary transaction (clearing)—
 - (i) subject to subparagraph (ii), the person with whom the SOCCRA-LC or, for an intermediary transaction (agency clearing), the SOCCRA-LC's clearing client, entered into the transaction;
 - (ii) if the person mentioned in subparagraph (i) entered into the transaction through the person's clearing intermediary—the person's clearing intermediary; or
- (b) for a transaction that is a proprietary transaction (clearing)—the SOCCRA-LC's clearing intermediary;

covered OTCD transaction (), in relation to a SOCCRA-LC, means any of the following transactions effected by it—

- (a) a proprietary transaction (non-clearing);
- (b) a proprietary transaction (clearing);
- (c) an intermediary transaction (principal clearing)—
 - (i) that is entered into by the SOCCRA-LC with a person other than its clearing client; and
 - (ii) in respect of which—

- (A) the clearing client is not obliged to reimburse the SOCCRA-LC for any loss suffered by the SOCCRA-LC due to any change in the value of the transaction in the event of default by that person; or
- (B) the SOCCRA-LC is obliged to reimburse the clearing client for any loss suffered by the clearing client due to any change in the value of the clearing client's transaction with the SOCCRA-LC in the event of default by that person;
- (d) an intermediary transaction (agency clearing)—
 - (i) that is entered into by the SOCCRA-LC's clearing client with another person; and
 - (ii) in respect of which the SOCCRA-LC is obliged to reimburse the clearing client for any loss suffered by the clearing client due to any change in the value of the transaction in the event of default by that person.

53K. Counterparty credit risk charges—BOCCRA-LC

- (1) A BOCCRA-LC must, in respect of each covered OTCD transaction that does not form part of an OTCD netting set, include in its ranking liabilities an amount calculated using Formula 10.

Formula 10

Calculation of CCR charge (OTCD transaction)

$$K_T = UE_T \times SP$$

Where—

- UE_T is the uncollateralized exposure amount of the transaction, calculated using Formula 11; and
- SP is the specified percentage applicable to the transaction.

Formula 11

Calculation of uncollateralized exposure amount (OTCD transaction)

$$UE_T = \max(0, V_T + PFE + CP - CRHV)$$

Where—

- V_T is—
 - (a) the replacement value of the transaction; but
 - (b) if the transaction is not subject to revaluation every business day—the current exposure amount of the transaction;
- PFE is—
 - (a) if the transaction is centrally cleared through a regulated CCP and the CCP transaction in respect of the transaction is subject to any requirement of OTCD initial margin—the OTCD initial margin amount set by the regulated CCP for the CCP transaction; or

- (b) in any other case—the higher of—
 - (i) the PFE amount of the transaction; and
 - (ii) the top OTCD initial margin amount of the transaction;
- CP is sum of the amounts of any cash, and the market values of any other assets, posted by the BOCCRA-LC to the counterparty as security in respect of the transaction; and
- CRHV is the sum of the volatility adjusted values of any assets, being assets posted by the counterparty as security in respect of the transaction, that are eligible collateral.
- (2) A BOCCRA-LC must, in respect of the covered OTCD transactions that constitute each OTCD netting set, include in its ranking liabilities an amount calculated using Formula 12.

Formula 12

Calculation of CCR charge (OTCD netting set)

$$K_{NS} = UE_{NS} \times SP$$

Where—

- UE_{NS} is the uncollateralized exposure amount of the OTCD netting set, calculated using Formula 13; and
- SP is the specified percentage applicable to the covered OTCD transactions in the OTCD netting set.

Formula 13

Calculation of uncollateralized exposure amount (OTCD netting set)

$$UE_{NS} = \max(0, V_{NS} + PFE_{NS} + CP_{NS} - CRHV_{NS})$$

Where—

- V_{NS} is—
 - (a) the net replacement value of the transactions; but
 - (b) if the covered OTCD transactions that constitute the OTCD netting set are not all subject to revaluation every business day—the current exposure amount of the transactions;
- PFE_{NS} is—
 - (a) if all of the covered OTCD transactions that constitute the OTCD netting set are centrally cleared through a regulated CCP and the CCP transactions in respect of the covered OTCD transactions are subject to any requirement of OTCD initial margin—the OTCD initial margin amount set by the regulated CCP for the CCP transactions; or
 - (b) in any other case—the higher of—
 - (i) the net PFE amount of the OTCD netting set; and
 - (ii) the top OTCD initial margin amount of the OTCD netting set;

- CP_{NS} is sum of the amounts of any cash, and the market values of any other assets, posted by the BOCCRA-LC to the counterparty as security in respect of any of the covered OTCD transactions; and
- $CRHV_{NS}$ is the sum of the volatility adjusted values of any assets, being assets posted by the counterparty in respect of any of the covered OTCD transactions, that are eligible collateral.
- (3) A BOCCRA-LC must, in addition to subsection (2), in respect of each OTCD netting set referred to in that subsection that includes one or more covered OTCD transactions that are transactions ended with past due, include in its ranking liabilities an amount calculated using Formula 14.

Formula 14

Calculation of CCR charge (past due additional charge)

$$K_{PD} = \min (UE_{NS}, CE_{PD}) \times (1 - SP)$$

Where—

- UE_{NS} has the same meaning as in Formula 12 in subsection (2);
- CE_{PD} is the current exposure amount of all of the covered OTCD transactions constituting the OTCD netting set that are transactions ended with past due; and
- SP is the specified percentage applicable to the covered OTCD transactions constituting the OTCD netting set.

(4) In this section—

counterparty (), in relation to a covered OTCD transaction of a BOCCRA-LC, means—

- (a) for a transaction other than a proprietary transaction (clearing)—
 - (i) subject to subparagraph (ii), the person with whom the BOCCRA-LC or, for an intermediary transaction (agency clearing), the BOCCRA-LC's clearing client, entered into the transaction;
 - (ii) if the person mentioned in subparagraph (i) entered into the transaction through the person's clearing intermediary—the person's clearing intermediary; or
- (b) for a transaction that is a proprietary transaction (clearing)—the BOCCRA-LC's clearing intermediary;

covered OTCD transaction (), in relation to a BOCCRA-LC—

- (a) means any of the following transactions effected by it—
 - (i) a proprietary transaction (non-clearing);
 - (ii) a proprietary transaction (clearing);
 - (iii) an intermediary transaction (principal clearing)—
 - (A) that is entered into by the BOCCRA-LC with a person other than its clearing client; and
 - (B) in respect of which—
 - (I) the clearing client is not obliged to reimburse the BOCCRA-LC for any loss suffered by the BOCCRA-LC due to any change in the value of the transaction in the event of default by that person; or

- (II) the BOCCRA-LC is obliged to reimburse the clearing client for any loss suffered by the clearing client due to any change in the value of the clearing client's transaction with the BOCCRA-LC in the event of default by that person;
 - (iv) an intermediary transaction (agency clearing)—
 - (A) that is entered into by the BOCCRA-LC's clearing client with another person; and
 - (B) in respect of which the BOCCRA-LC is obliged to reimburse the clearing client for any loss suffered by the clearing client due to any change in the value of the transaction in the event of default by that person; but
 - (b) does not include such a transaction that forms part of an OTCD portfolio (counterparty-related) as defined by section 53M(4);
- excluded transaction** () means a covered OTCD transaction effected by a BOCCRA-LC that is—
- (a) a transaction with a party in default;
 - (b) a transaction ended with past due that does not form part of an OTCD netting set; or
 - (c) a transaction ended with past due that forms part of an OTCD netting set constituted solely by transactions ended with past due;
- specified percentage** (), in relation to a covered OTCD transaction of a BOCCRA-LC, means—
- (a) subject to paragraph (b)—100%;
 - (b) if the transaction is not an excluded transaction and is centrally cleared through a regulated CCP—
 - (i) where the transaction falls within section 11(1) of Schedule 6—0.224%;
 - (ii) where the transaction falls within section 11(2) or (5) of Schedule 6, and, had the BOCCRA-LC been a SOCCRA-LC—
 - (A) a risk weight of 2% could have been allocated in respect of the transaction under section 11(3)(a) or (6)(a) of that Schedule—0.224%;
 - (B) a risk weight of 4% could have been allocated in respect of the transaction under section 11(3)(b) or (6)(b)—0.448%; or
 - (iii) in any other case—where the transaction is effected through or entered into by—
 - (A) a clearing participant of the CCP or a licensed corporation licensed for RA12—5.6%; or
 - (B) any other clearing intermediary of the BOCCRA-LC—16.8%.

Division 3—Margin shortfall charges

53L. Clearing client margin shortfall charge—SOCCRA-LC and BOCCRA-LC

- (1) A licensed corporation must, in respect of each OTCD portfolio (clearing client-related), calculate a clearing client margin shortfall amount (**CCMS amount**) using Formula 15 on each business day until the expiry of the clearing client's obligations to the licensed corporation under the portfolio.

Formula 15

Calculation of CCMS amount of OTCD portfolio (clearing client-related)

$$\text{CCMS amount} = \max(0, \text{RM}_{\text{CC}} - \text{CRHV}_{\text{CC}})$$

Where—

RM_{CC} is the sum of—

- (a) the following amount—
 - (i) if all of the transactions constituting the portfolio are centrally cleared through one or more regulated CCPs and the CCP transactions in respect of the transactions are subject to any requirement of OTCD initial margin—the top OTCD initial margin amount of the portfolio; or
 - (ii) in any other case—the higher of—
 - (A) the top OTCD initial margin amount of the portfolio; and
 - (B) the OTCD floor initial margin amount of the portfolio; and
- (b) if the portfolio is—
 - (i) a single OTCD transaction—the sum of—
 - (A) the replacement value of the transaction; and
 - (B) the sum of the amounts of any cash, and the market values of any other assets, posted by the licensed corporation to the clearing client as security in respect of the transaction;
 - (ii) a group of margined OTCD transactions—
 - (A) where, in the calculation of amounts of margin calls under the applicable margin agreement, the variation margins of all of the transactions within the group are offsetable—the sum of—
 - (I) the replacement values of the transactions; and
 - (II) the sum of the amounts of any cash, and the market values of any other assets, posted by the licensed corporation to the clearing client as security in respect of any of the transactions;
 - (B) in any other case—the sum of—
 - (I) any replacement values of the transactions that are positive; and
 - (II) the sum of the amounts of any cash, and the market values of any other assets, posted by the licensed corporation to the clearing client as security in respect of any of the transactions each of which has a replacement value that is positive; or
 - (iii) an OTCD netting set—the sum of—
 - (A) the net replacement value of transactions that constitute the OTCD netting set; and
 - (B) the sum of the amounts of any cash, and the market values of any other assets, posted by the licensed corporation to the clearing client as security in respect of the any of the transactions within the OTCD netting set;

CRHV_{CC} is the sum of the volatility adjusted values of any assets, being assets posted by the clearing client as security in respect of any of the transactions

constituting the portfolio, that are eligible collateral.

- (2) A licensed corporation must, in relation to the OTCD portfolio (clearing client-related) in respect of which a CCMS amount is calculated under subsection (1), include in its ranking liabilities on the day specified in subsection (3) an amount calculated using Formula 16.

Formula 16

Calculation of CCMS charge for OTCD portfolio (clearing client-related)

$$K_{\text{CCMS}} = \max(0, \text{CCMS} - \sum \text{CRHV}_{\text{Additional}})$$

Where—

CCMS is the CCMS amount calculated under subsection (1) in respect of the portfolio;

CRHV_{Additional} is the volatility adjusted value of any asset, being an asset posted by the clearing client in respect of any of the transactions constituting the portfolio after the licensed corporation calculated the CCMS amount, that is eligible collateral, as at the end of the business day on which the asset is posted.

- (3) The day specified for subsection (2) is—

- (a) if the OTCD portfolio (clearing client-related), or all of the direct offsetting portfolios or CCP portfolios in respect of it (where applicable), is subject to any requirement of OTCD initial margin or OTCD variation margin and regular remargining—
 - (i) the post-settlement day; or
 - (ii) if elected by the licensed corporation—the CCMS amount calculation day; or
- (b) in any other case—the CCMS amount calculation day.

- (4) In this section—

CCMS amount calculation day (), in relation to an OTCD portfolio (clearing client-related) in respect of which a particular CCMS amount is calculated under subsection (1), means the day on which the CCMS amount is calculated;

OTCD portfolio (clearing client-related) (), in relation to a licensed corporation, means any of the following OTCD portfolios—

- (a) an OTCD portfolio consisting of one or more intermediary transactions (principal clearing) entered into by the licensed corporation with a particular clearing client of the licensed corporation;
- (b) an OTCD portfolio consisting of one or more intermediary transactions (agency clearing) entered into by a particular clearing client of the licensed corporation with other persons;

post-settlement day (), in relation to an OTCD portfolio (clearing-client related) referred to in subsection (3)(a), means—

- (a) where all of the transactions constituting the portfolio are centrally cleared through a regulated CCP—the day following the earliest of the standard due dates for settlement of a margin call that would have been set by the margin requiring parties if regular remargining had been carried out and a margin call

had been made in respect of any of the portfolios referred to in subsection (3)(a) on the CCMS amount calculation day; or

- (b) in any other case—the earlier of—
 - (i) the day referred to in paragraph (a); and
 - (ii) the day after the expiry of the standard settlement cycle for the assets to be posted as security for settlement of a margin call that would have been required by the margin requiring parties if regular remargining had been carried out and a margin call had been made in respect of any of the portfolios referred to in subsection (3)(a) on the CCMS amount calculation day;

regular remargining (), in relation to an OTCD portfolio (clearing client-related), means the calculation at regular time intervals of the amount of assets required to be posted as OTCD initial margin or OTCD variation margin for the outstanding transactions within the portfolio.

53M. Counterparty margin shortfall charge—BOCCRA-LC

- (1) A BOCCRA-LC must, in respect of each OTCD portfolio (counterparty-related), calculate a counterparty margin shortfall amount (**CMS amount**) using Formula 17 on each business day until the expiry of the counterparty's obligations to the BOCCRA-LC under the portfolio.

Formula 17

Calculation of CMS amount of OTCD portfolio (counterparty-related)

$$\text{CMS amount} = \max (0, \text{RM}_{\text{CP}} - \text{CRHV}_{\text{CP}})$$

Where—

RM_{CP} is the sum of—

- (a) the higher of—
 - (i) the top OTCD initial margin amount of the portfolio; and
 - (ii) the OTCD floor initial margin amount of the portfolio; and
- (b) if the portfolio is—
 - (i) a single OTCD transaction—the sum of—
 - (A) the replacement value of the transaction; and
 - (B) the sum of the amounts of any cash, and the market values of any other assets, posted by the BOCCRA-LC to the counterparty as security in respect of the transaction;
 - (ii) a group of margined OTCD transactions—
 - (A) where, in the calculation of amounts of margin calls under the applicable margin agreement, the variation margins of all of the transactions within the group are offsetable—the sum of—
 - (I) the replacement values of the transactions; and
 - (II) the sum of the amounts of any cash, and the market values of any other assets, posted by the BOCCRA-LC to the counterparty as security in respect of the any of transactions; or

- (B) in any other case—the sum of—
 - (I) any replacement values of the transactions that are positive; and
 - (II) the sum of the amounts of any cash, and the market values of any other assets, posted by the BOCCRA-LC to the counterparty as security in respect of any of the transactions each of which has a replacement value that is positive; or
- (iii) an OTCD netting set—the sum of—
 - (A) the net replacement value of the transactions that constitute the OTCD netting set; and
 - (B) the sum of the amounts of any cash, and the market values of any other assets, posted by the BOCCRA-LC to the counterparty as security in respect of any of the transactions within the OTCD netting set;

$CRHV_{CP}$ is the sum of the volatility adjusted values of any assets, being assets posted by the counterparty as security in respect of any of the transactions constituting the portfolio, that are eligible collateral.

- (2) A BOCCRA-LC must, in relation to the OTCD portfolio (counterparty-related) in respect of which a CMS amount was calculated under subsection (1), include in its ranking liabilities on the day specified in subsection (3) an amount calculated using Formula 18.

Formula 18

Calculation of CMS charge for OTCD portfolio (counterparty-related)

$$K_{CMS} = \max(0, CMS - \sum CRHV_{Additional})$$

Where—

CMS is the CMS amount calculated under subsection (1) in respect of the portfolio; and

$CRHV_{Additional}$ is the volatility adjusted value of any asset, being an asset posted by the counterparty as security in respect of any of the transactions constituting the portfolio after the BOCCRA-LC calculated the CMS amount, that is eligible collateral, as at the end of the business day on which the asset is posted.

- (3) The day specified for subsection (2) is—
 - (a) if the OTCD portfolio (counterparty-related) is subject to any requirement of OTCD initial margin or OTCD variation margin and regular remargining—
 - (i) the post-settlement day; or
 - (ii) if elected by the BOCCRA-LC—the CMS amount calculation day; or
 - (b) in any other case—the CMS amount calculation day.

- (4) In this section—

CMS amount calculation day (), in relation to an OTCD portfolio (counterparty-related) in respect of which a particular CMS amount is calculated under subsection (1), means the day on which the CMS amount is calculated;

counterparty (), in relation to an OTCD portfolio (counterparty-related) of a BOCCRA-LC, means—

- (a) subject to paragraph (b), the person with whom the BOCCRA-LC or, for a portfolio consisting of one or more intermediary transactions (agency clearing), the BOCCRA-LC's clearing client, entered into the transactions that constitute the portfolio;
- (b) if the person mentioned in paragraph (a) entered into the transactions through the person's clearing intermediary—the person's clearing intermediary;

OTCD portfolio (counterparty-related) (), in relation to a BOCCRA-LC—

- (a) means any of the following OTCD portfolios—
 - (i) an OTCD portfolio consisting of one or more proprietary transactions (non-clearing) entered into by the BOCCRA-LC with a particular person;
 - (ii) an OTCD portfolio consisting of one or more intermediary transactions (principal clearing)—
 - (A) that is or are entered into by the BOCCRA-LC with a particular person other than the BOCCRA-LC's clearing client; and
 - (B) in respect of which—
 - (I) the clearing client is not obliged to reimburse the BOCCRA-LC for any loss suffered by the BOCCRA-LC due to any change in the value of the transactions in the event of default by that person; or
 - (II) the BOCCRA-LC is obliged to reimburse the clearing client for any loss suffered by the clearing client due to any change in the value of the clearing client's transactions with the BOCCRA-LC in the event of default by that person;
 - (iii) an OTCD portfolio consisting of one or more intermediary transactions (agency clearing)—
 - (A) that is or are entered into by the BOCCRA-LC's clearing client with a particular person; and
 - (B) in respect of which the BOCCRA-LC is obliged to reimburse the clearing client for any loss suffered by the clearing client due to any change in the values of the transactions in the event of default by that person; but
- (b) does not include such a portfolio if all of the transactions that constitute the portfolio are—
 - (i) centrally cleared; or
 - (ii) entered into with or through the BOCCRA-LC's clearing intermediary;

post-settlement day (), in relation to an OTCD portfolio (counterparty-related) referred to in subsection (3)(a), means the earlier of—

- (a) the day following the earliest of the standard due dates for settlement of a margin call that would have been set by the margin requiring parties if regular remargining had been carried out and a margin call had been made in respect of the portfolio on the CMS amount calculation day; and
- (b) the day after the expiry of the standard settlement cycle for the assets to be posted as security for settlement of a margin call that would have been required by the margin requiring parties if regular remargining had been carried out and a margin call had been made in respect of the portfolio on the CMS amount calculation day;

regular remargining (), in relation to an OTCD portfolio (counterparty-related), means the calculation at regular time intervals of the amount of assets required to be posted as OTCD initial margin or OTCD variation margin for the outstanding transactions within the portfolio.

Division 4—Credit valuation adjustment risk charge

53N. Credit valuation adjustment risk charge—SOCCRA-LC

- (1) A SOCCRA-LC must, in respect of all of its covered OTCD transactions, include in its ranking liabilities an amount equal to the sum of the amounts included in its ranking liabilities in respect of the transactions under section 53J(1) and (3).
- (2) A SOCCRA-LC may treat any of its covered OTCD transactions within the meaning of section 53J(6) that is otherwise excluded by paragraph (a), (b), (c) or (d) of the definition of **covered OTCD transaction** in subsection (3) as a covered OTCD transaction for the purposes of subsection (1).
- (3) In this section—

covered OTCD transaction (), in relation to a SOCCRA-LC, has the meaning given by section 53J(6) but, subject to subsection (2), does not include an OTCD transaction that—

- (a) either—
 - (i) falls within section 11(1) of Schedule 6; or
 - (ii) falls within section 11(2) or (5) of Schedule 6 and in respect of which a risk weight of 2% or 4% may be allocated under section 11(3) or (6) of that Schedule;
- (b) is a transaction ended with past due;
- (c) is a transaction with a party in default; or
- (d) is in default as determined under the terms and conditions of the transaction, and in respect of which—
 - (i) the SOCCRA-LC has, in accordance with generally accepted accounting principles, recognized the losses incurred by it due to the default; and
 - (ii) the exposures have been transformed into simple claims that do not have the risk characteristics of OTCD transactions.

Division 5—Counterparty concentration charge and liquidity adjustment charge

53O. Interpretation

In this Division—

aggregate adjusted uncollateralized current exposure amount (), in relation to covered OTCD transactions of a SOCCRA-LC having the same person as the counterparty, means the sum of—

- (a) the adjusted uncollateralized current exposure amounts for each such transaction that does not form part of an OTCD netting set, calculated using Formula 19; and
- (b) the adjusted uncollateralized current exposure amounts for each OTCD netting set constituted by such transactions, calculated using Formula 20;

Formula 19**Calculation of adjusted uncollateralized current exposure amount (OTCD transaction not in OTCD netting set)**

$$AUCE_T = \max (CE_T - CRHV_T, 0) \times (1 - \alpha \times RW_T \times 8\%)$$

Where—

α is 1.4;

CE_T is the current exposure amount of the transaction;

$CRHV_T$ is the sum of the volatility adjusted values of any assets, being assets posted by the counterparty as security in respect of the transaction, that are eligible collateral; and

RW_T is the risk weight applicable to the SOCCRA-LC's exposure arising from the transaction that the SOCCRA-LC used in its calculation using Formula 4 in section 53J(1) in respect of the transaction;

Formula 20**Calculation of adjusted uncollateralized current exposure amount (OTCD netting set)**

$$AUCE_{NS} = \max (CE_{NS} - CRHV_{NS}, 0) \times (1 - \alpha \times RW_{NS} \times 8\%)$$

Where—

α is 1.4;

CE_{NS} is the current exposure amount of the transactions that constitute the OTCD netting set;

$CRHV_{NS}$ is the sum of the volatility adjusted values of any assets, being assets posted by the counterparty as security in respect of any of the transactions constituting the OTCD netting set, that are eligible collateral; and

RW_{NS} is the risk weight applicable to the SOCCRA-LC's exposure arising from the OTCD netting set that the SOCCRA-LC used in its calculation using Formula 6 in section 53J(3) in respect of the netting set;

reported tangible capital (), in relation to a SOCCRA-LC, means the amount of tangible capital maintained by it as stated in its most recent return submitted under section 56(1).

53P. Counterparty concentration charge—SOCCRA-LC

- (1) A SOCCRA-LC must, in respect of all covered OTCD transactions effected by it that have the same person as the counterparty, include in its ranking liabilities an amount calculated using Formula 21.

Formula 21**Calculation of counterparty concentration charge (OTCD transactions with each counterparty)**

$$K = \max [0, AAUCE - CCC_{\text{threshold}}] \times CCC_{\text{percentage}}$$

Where—

AAUCE is the aggregate adjusted uncollateralized current exposure amount of the covered OTCD transactions;

CCC_{threshold} is an amount that is equal to 5% of the SOCCRA-LC's reported tangible capital; and

CCC_{percentage} is, if the highest risk weight used in the calculation of AAUCE is—

- (a) not more than 20%—5%;
- (b) more than 20% but not more than 50%—20%; or
- (c) more than 50%—50%.

(2) In this section—

counterparty (), in relation to a covered OTCD transaction of a SOCCRA-LC, has the meaning given by section 53J(6);

covered OTCD transaction (), in relation to a SOCCRA-LC, has the meaning given by section 53J(6) but does not include an OTCD transaction that—

- (a) is a transaction ended with past due;
- (b) is a transaction with a party in default; or
- (c) is centrally cleared.

53Q. Liquidity adjustment charge—SOCCRA-LC

- (1) A SOCCRA-LC must, in respect of all covered OTCD transactions effected by it, include in its ranking liabilities an amount calculated using Formula 22.

Formula 22

Calculation of liquidity adjustment charge

$$K_{LA} = \max (0, \sum_i AAUCE_i - LAC_{\text{threshold}})$$

Where—

AAUCE_i is the aggregate adjusted uncollateralized current exposure amount of the covered OTCD transactions that have the same person “i” as the counterparty; and

LAC_{threshold} is an amount that is equal to 50% of the SOCCRA-LC's reported tangible capital.

(2) In this section—

counterparty (), in relation to a covered OTCD transaction of a SOCCRA-LC, means—

- (a) for a transaction that is a proprietary transaction (non-clearing)—
 - (i) subject to subparagraph (ii), the person with whom the SOCCRA-LC entered into the transaction;
 - (ii) if the person mentioned in subparagraph (i) entered into the transaction through the person's clearing intermediary—the person's clearing intermediary; or

- (b) for a transaction that is a proprietary transaction (clearing)—the SOCCRA-LC's clearing intermediary;

covered OTCD transaction (), in relation to a SOCCRA-LC—

- (a) means any of the following transactions effected by it—
- (i) a proprietary transaction (non-clearing);
 - (ii) a proprietary transaction (clearing); but
- (b) does not include such a transaction that—
- (i) is a transaction ended with past due;
 - (ii) is a transaction with a party in default; or
 - (iii) is centrally cleared.

Division 6—Repo-style transactions charges

53R. Repo-style transactions charges—SOCCRA-LC

- (1) A SOCCRA-LC must, in respect of each repo-style transaction that does not form part of a repo-style netting set, include in its ranking liabilities an amount calculated using Formula 23.

Formula 23

Calculation of RST charge (single repo-style transaction)

$$K_{RT} = E_{RT} \times RW_{RT} \times 8\%$$

Where—

- (a) E_{RT} is the exposure amount of the transaction, calculated using Formula 24; and
- (b) RW_{RT} is the risk weight applicable to the SOCCRA-LC's exposure arising from the transaction; but
- (c) if the SOCCRA-LC takes into account any eligible guarantee or eligible credit risk swap in respect of the transaction, " $E_{RT} \times RW_{RT}$ " is to be substituted by the amount calculated using Formula 28 in section 53Y(1).

Formula 24

Calculation of exposure amount (single repo-style transaction)

$$E_{RT} = \max [0, RSTE - RSTC + \sum_i (ANV_{asset, i} \times H_{asset, i}) + \sum_j (ANV_{ccy, j} \times H_{ccy, j})]$$

Where—

- RSTE** is the sum of the amounts of any cash, and the market values of any other assets, that are RST exposures for the transaction;
- RSTC** is the sum of the amounts of any cash, and the market values of any other assets, that are RST collateral for the transaction;
- $ANV_{asset, i}$ is, where the SOCCRA-LC takes into account in calculating RSTE or RSTC any RST exposure or RST collateral (other than cash) that is asset i —the absolute value of the difference between—

- (a) the sum of the market values of all assets that are asset *i* and are taken into account in calculating RSTE; and
- (b) the sum of the market values of all assets that are asset *i* and are taken into account in calculating RSTC;

$H_{asset, i}$ is, for an asset *i* referred to in the description of $ANV_{asset, i}$ —

- (a) if the sum of the market values of all assets that are asset *i* and are taken into account in calculating RSTC is greater than the sum of the market values of all assets that are asset *i* and are taken into account in calculating RSTE—the lower of—
 - (i) 100%; and
 - (ii) the volatility adjustment percentage applicable to asset *i*; or
- (b) in any other case—the volatility adjustment percentage applicable to asset *i*;

$ANV_{ccy, j}$ is, where the SOCCRA-LC takes into account in calculating RSTE or RSTC any RST exposure or RST collateral that is cash in currency *j*, or any other RST exposure or RST collateral denominated in currency *j*, in respect of which a currency mismatch arises—the absolute value of the difference between—

- (a) the sum of the amounts of all such cash in currency *j*, and the market values of all such other assets denominated in currency *j* (other than excluded collateral), taken into account in calculating RSTE; and
- (b) the sum of the amounts of all such cash in currency *j*, and the market values of all such other assets denominated in currency *j* (other than excluded collateral), taken into account in calculating RSTC;

H_{ccy} is, for a currency mismatch referred to in $ANV_{ccy, j}$, the volatility adjustment percentage applicable to the currency mismatch.

- (2) For the purposes of the description of $ANV_{ccy, j}$ in Formula 24 in subsection (1), an asset that is asset *i* and denominated in currency *j* is **excluded collateral** if the value of $H_{asset, i}$ applicable to asset *i* according to the Formula is, by virtue of paragraph (a) of the description of $H_{asset, i}$ in the Formula, 100%.
- (3) A SOCCRA-LC must, in respect of the repo-style transactions that constitute each repo-style netting set, include in its ranking liabilities an amount calculated using Formula 25.

Formula 25

Calculation of RST charge (repo-style netting set)

$$K_{RNS} = E_{RNS} \times RW_{RNS} \times 8\%$$

Where—

- (a) E_{RNS} is the exposure amount of the repo-style netting set, calculated using Formula 26; and
- (b) RW_{RNS} is the risk weight applicable to the SOCCRA-LC's exposure arising from the repo-style netting set; but

- (c) if the SOCCRA-LC takes into account any eligible guarantee or eligible credit risk swap in respect of the transaction, “ $E_{RNS} \times RW_{RNS}$ ” is to be substituted by the amount calculated using Formula 28 in section 53Y(1).

Formula 26

Calculation of exposure amount (repo-style netting set)

$$E_{RNS} = \max \{0, [\sum_i RSTE_i - \sum_i RSTC_i + \sum_i (ANV_{asset, i} \times H_{asset, i}) + \sum_m (ANV_{ccy, m} \times H_{ccy})]\}$$

Where—

$RSTE_i$ is the sum of the amounts of any cash, and the market values of any other assets, that are RST exposures for transaction i that forms part of the repo-style netting set;

$RSTC_i$ is the sum of the amounts of any cash, and the market values of any other assets, that are RST collateral for transaction i that forms part of the repo-style netting set;

$ANV_{asset, i}$ is, where the SOCCRA-LC takes into account in calculating $\sum_i RSTE_i$ or $\sum_i RSTC_i$ any assets (other than cash) that are asset i —the absolute value of the difference between—

- (a) the sum of the market values of all assets that are asset i and are taken into account in calculating $\sum_i RSTE_i$; and
- (b) the sum of the market values of all assets that are asset i and are taken into account in calculating $\sum_i RSTC_i$;

$H_{asset, i}$ is, for an asset i referred to in the description of $ANV_{asset, i}$ —

- (a) if the sum of the market values of all assets that are asset i and are taken into account in calculating $\sum_i RSTC_i$ is greater than the sum of the market values of all assets that are asset i and taken into account in calculating $\sum_i RSTE_i$ —the lower of—
 - (i) 100%; and
 - (ii) the volatility adjustment percentage applicable to asset i ; or
- (b) in any other case—the volatility adjustment percentage applicable to asset i ;

$ANV_{ccy, m}$ is, where the SOCCRA-LC takes into account in calculating $\sum_i RSTE_i$ or $\sum_i RSTC_i$ any cash in currency m , or any other assets denominated in currency m , in respect of which a currency mismatch arises—the absolute value of the difference between—

- (a) the sum of the amounts of all such cash in currency m , and the market values of all such other assets denominated in currency m (other than excluded collateral), taken into account in calculating $\sum_i RSTE_i$; and
- (b) the sum of the amounts of all such cash in currency m , and the market values of all such other assets denominated in currency m (other than excluded collateral), taken into account in calculating $\sum_i RSTC_i$; and

H_{ccy} is, for a currency mismatch referred to in $ANV_{ccy, m}$, the volatility adjustment

percentage applicable to the currency mismatch.

- (4) For the purposes of the description of $ANV_{ccy, m}$ in Formula 26 in subsection (3), an asset that is asset I and denominated in currency m is **excluded collateral** if the value of $H_{asset, I}$ applicable to asset I according to the Formula is, by virtue of paragraph (a) of the description of $H_{asset, I}$ in the Formula, 100%.

- (5) In this section—

RST collateral (), in relation to a repo-style transaction, means—

- (a) for a securities borrowing and lending agreement—
 - (i) if the SOCCRA-LC is the borrower of securities under the agreement—the securities borrowed by the SOCCRA-LC under the agreement; or
 - (ii) if the SOCCRA-LC is the lender of securities under the agreement—any assets, being assets posted to the SOCCRA-LC by the borrower of the securities under the agreement as security in respect of the agreement, that are eligible collateral; or
- (b) for a repurchase transaction—
 - (i) if the SOCCRA-LC is the purchaser in the first instance of securities under the transaction—
 - (A) the securities purchased by the SOCCRA-LC under the transaction; and
 - (B) any assets, being assets posted to the SOCCRA-LC by the seller in the first instance of the securities under the transaction as security in respect of the transaction, that are eligible collateral; or
 - (ii) if the SOCCRA-LC is the seller in the first instance of securities under the transaction—
 - (A) the consideration for which the SOCCRA-LC sold the securities; and
 - (B) any assets, being assets posted to the SOCCRA-LC by the purchaser in the first instance of the securities under the transaction as security in respect of the transaction, that are eligible collateral;

RST exposure (), in relation to a repo-style transaction, means—

- (a) for a securities borrowing and lending agreement—
 - (i) if the SOCCRA-LC is the borrower of securities under the agreement—any assets posted by the SOCCRA-LC to the lender of the securities under the agreement as security in respect of the agreement; or
 - (ii) if the SOCCRA-LC is the lender of securities under the agreement—the securities lent by the SOCCRA-LC under the agreement;
- (b) for a repurchase transaction—
 - (i) if the SOCCRA-LC is the purchaser in the first instance of securities under the transaction—
 - (A) the consideration for which the SOCCRA-LC purchased the securities; and
 - (B) any assets posted by the SOCCRA-LC to the seller in the first instance of the securities under the transaction as security in respect of the transaction; or
 - (ii) if the SOCCRA-LC is the seller in the first instance of securities under the transaction—

- (A) the securities sold by the SOCCRA-LC under the transaction; and
- (B) any assets posted by the SOCCRA-LC to the purchaser in the first instance of the securities under the transaction as security in respect of the transaction.

Division 7—Eligible credit risk mitigation

53S. Interpretation

(1) In this Division—

counterparty () means—

- (a) in relation to an OTCD transaction in respect of which a licensed corporation is required to include an amount under section 53J, 53K, 53M, 53P or 53Q—the counterparty within the meaning of that section; or
- (b) in relation to a repo-style transaction in respect of which a licensed corporation is required to include an amount under section 53R—
 - (i) if the transaction is a securities borrowing and lending agreement—
 - (A) where the licensed corporation is the borrower of securities under the agreement—the lender of securities under the agreement; or
 - (B) where the licensed corporation is the lender of securities under the agreement—the borrower of securities under the agreement; or
 - (ii) if the transaction is a repurchase transaction—
 - (A) where the licensed corporation is the purchaser in the first instance of securities under the transaction—the seller in the first instance of securities under the transaction; or
 - (B) where the licensed corporation is the seller in the first instance of securities under the transaction—the purchaser in the first instance of securities under the transaction;

credit event (), in relation to a credit risk swap, means an event specified in the swap which, if it occurs, obliges the protection seller to make a payment to the protection buyer;

credit protection covered portion ()—see section 53X(1)(a);

credit protection provider ()—

- (a) in relation to a guarantee, means the guarantor under the guarantee; or
- (b) in relation to a credit risk swap, means the protection seller under the swap;

credit protection uncovered portion ()—see section 53X(1)(b);

eligible credit protection provider () means an entity or person—

- (a) that—
 - (i) has not defaulted on any senior unsecured debt security issued by the entity or person that has an original maturity of not less than 1 year; and
 - (ii) is not insolvent or bankrupt or affected by similar circumstances; and
- (b) is—
 - (i) a JAA;
 - (ii) a relevant international organization;
 - (iii) a multilateral development bank;
 - (iv) a Hong Kong public sector entity;

- (v) a non-Hong Kong public sector entity;
 - (vi) a Basel-covered bank;
 - (vii) a licensed corporation;
 - (viii) a Basel-covered securities firm; or
 - (ix) any other entity or person that has a relevant SCRA issuer rating the applicable credit quality grade of which is 1, 2 or 3.
- (2) For the purposes of paragraph (b)(ix) of the definition of **eligible credit protection provider** in subsection (1)—
- (a) a reference to a relevant SCRA issuer rating is a reference to a solicited SCRA issuer rating issued by an SCRA selected, under section 14 of Schedule 6, by the licensed corporation for its portfolio to which the entity or person mentioned in that paragraph relates; and
 - (b) if the entity or person has 2 or more relevant SCRA issuer ratings, the entity or person is regarded as falling within that paragraph only if the applicable credit quality grade of each of those ratings is 1, 2 or 3.
- (3) In this subsection and sections 53V, 53W, 53X, 53Y and 53Z—
- (a) **charge unit** (), in relation to a SOCCRA-LC, means—
 - (i) a covered OTCD transaction that does not form part of an OTCD netting set, as referred to in section 53J(1);
 - (ii) the covered OTCD transactions that constitute an OTCD netting set, as referred to in section 53J(3);
 - (iii) a repo-style transaction that does not form part of a repo-style netting set, as referred to in section 53R(1); or
 - (iv) the repo-style transactions that constitute a repo-style netting set, as referred to in section 53R(3);
 - (b) **charge calculation** (), in relation to a charge unit, means the calculation of the amount required to be included in respect of the charge unit under section 53J(1), 53J(3), 53R(1) or 53R(3) (as applicable);
 - (c) **exposure amount** (), in relation to a charge unit, means the exposure amount of the charge unit used in the charge calculation; and
 - (d) **counterparty** (), in relation to a charge unit, means—
 - (i) for a covered OTCD transaction referred to in section 53J(1) or (3)—the counterparty (within the meaning of that section) in relation to the transaction; or
 - (ii) for a repo-style transaction referred to in section 53R(1) or (3)—
 - (A) if the transaction is a securities borrowing and lending agreement—
 - (I) where the licensed corporation is the borrower of securities under the agreement—the lender of securities under the agreement; or
 - (II) where the licensed corporation is the lender of securities under the agreement—the borrower of securities under the agreement; or
 - (B) if the transaction is a repurchase transaction—
 - (I) where the licensed corporation is the purchaser in the first instance of securities under the transaction—the seller in the first instance of securities under the transaction; or

- (II) where the licensed corporation is the seller in the first instance of securities under the transaction—the purchaser in the first instance of securities under the transaction.

53T. Calculations may take into account effect of credit risk mitigation

- (1) Subject to subsection (2), a licensed corporation may, in calculating an amount to be included in its ranking liabilities under this Part, apply any of the following treatments—
 - (a) where the amount is to be included—
 - (i) under Division 2, 3 or 5, in respect of its exposure arising from 2 or more OTCD transactions that are—
 - (A) subject to an eligible netting arrangement with a particular person; or
 - (B) nettable CCP transactions with a particular central counterparty, treating the transactions as an OTCD netting set; or
 - (ii) under Division 6, in respect of its exposure arising from 2 or more repo-style transactions that are subject to an eligible netting arrangement with a particular person—treating the transactions as a repo-style netting set;
 - (b) subject to section 53U, where the amount is to be included—
 - (i) under Division 2, 3 or 5, in respect of its exposure arising from an OTCD transaction; or
 - (ii) under Division 6, in respect of its exposure arising from a repo-style transaction;

treating an asset posted to it by a person as security in respect of the transaction as eligible collateral; or
 - (c) for a SOCCRA-LC, subject to section 53V, where the amount is to be included—
 - (i) under Division 2, in respect of its exposure arising from an OTCD transaction; or
 - (ii) under Division 6, in respect of its exposure arising from a repo-style transaction,

treating a guarantee as an eligible guarantee;
 - (d) for a SOCCRA-LC only, subject to section 53W, where the amount is to be included—
 - (i) under Division 2, in respect of its exposure arising from an OTCD transaction; or
 - (ii) under Division 6, in respect of its exposure arising from a repo-style transaction,

treating a credit risk swap as an eligible credit risk swap.
- (2) Where a licensed corporation calculates an amount to be included in its ranking liabilities under this Part in respect of its exposure on the basis of an SCRA issue specific rating, the licensed corporation must not apply a treatment referred to in subsection (1) if the credit risk mitigating effect of the following matter has already been taken into account in that rating—
 - (a) for a treatment referred to in—
 - (i) subsection (1)(a)(i)(A) or (ii)—the eligible netting arrangement; or
 - (ii) subsection (1)(a)(i)(B)—the netting among the nettable CCP transactions;
 - (b) for a treatment referred to in subsection (1)(b)—the asset posted as security;

- (c) for a treatment referred to in subsection (1)(c)—the guarantee; or
- (d) for a treatment referred to in subsection (1)(d)—the credit risk swap.

53U. Conditions for treating asset as eligible collateral

- (1) For the purposes of section 53T(1)(b), a licensed corporation may treat an asset posted by a person (***collateral provider***) as security in respect of an OTCD transaction or a repo-style transaction as eligible collateral if—
 - (a) the asset is of any of the descriptions specified in subsection (2); and
 - (b) the requirements specified in subsection (3) are satisfied.
- (2) The descriptions of assets specified for subsection (1)(a) are—
 - (a) cash;
 - (b) gold coins or gold bullion;
 - (c) certificates of deposit issued by—
 - (i) an authorized financial institution; or
 - (ii) an approved bank incorporated outside Hong Kong;
 - (d) listed shares;
 - (e) units in a unit trust and shares in a mutual fund, the bid and offer quotations of which are available every business day;
 - (f) debt securities (including convertible bonds) that have an SCRA issue specific rating the applicable credit quality grade of which is 1, 2 or 3;
 - (g) where the asset is posted as security in respect of one or more OTCD transactions that are centrally cleared by a regulated CCP—any asset that is acceptable as security for the transactions under the rules of the regulated CCP; and
 - (h) where the asset is posted as security in respect of one or more OTCD transactions that are subject to mandatory margining requirements—
 - (i) under the Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission published by the Commission under section 169 and 399 of the Ordinance—any asset that is prescribed in the Code as being acceptable for satisfying the mandatory margining requirements; or
 - (ii) under any law or regulation of, or imposed by an authority or regulatory organization in, a jurisdiction—any asset that is prescribed in the law or regulation, or by the authority or regulatory organization, as being acceptable for satisfying the mandatory margining requirements.
- (3) The requirements specified for subsection (1)(b) are that—
 - (a) the legal mechanism by which the asset is pledged or transferred must ensure that the licensed corporation has the right to liquidate or take legal possession of the asset in a timely manner in the event of any default, insolvency, or bankruptcy of (or any similar circumstances affecting), or any other event specified in the relevant documentation applicable to, any of the following persons—
 - (i) the collateral provider;
 - (ii) the custodian, if any, holding the asset;

- (b) the licensed corporation must have adequate internal control processes for ensuring that in an event referred to in paragraph (a) the asset is liquidated promptly;
- (c) the licensed corporation must have taken all steps necessary to fulfil applicable legal requirements for obtaining and maintaining an enforceable security interest in the asset, whether by registration or otherwise, or for exercising a right to set-off in relation to the asset where title is transferred;
- (d) if the asset is to be held by a custodian, the licensed corporation must have taken reasonable steps to ensure that the custodian segregates the asset from the custodian's assets;
- (e) there must not be a material positive correlation between the credit quality of the collateral provider and the market value of the asset;
- (f) the licensed corporation must have adequate internal control processes for ensuring that it manages the asset properly, including revaluation of the asset as needed;
- (g) the licensed corporation must—
 - (i) have conducted sufficient legal review to verify, and have a well-founded basis for believing, that all documentation creating the security and providing for the obligations of the parties with respect to each other in respect of the security is binding on all relevant parties and legally enforceable in all relevant jurisdictions; and
 - (ii) re-conduct legal reviews as necessary to ensure continuing enforceability of such documentation; and
- (h) if the asset is provided under a margin agreement covering OTCD transactions or repo-style transactions (or both), the licensed corporation must have—
 - (i) adequate internal control processes for ensuring that it devotes sufficient resources to the orderly operation of the agreement; and
 - (ii) collateral management policies to control, monitor and report—
 - (A) risks (including liquidity risk and concentration risk) associated with the agreement;
 - (B) reuse of assets posted as security; and
 - (C) any rights ceded by it in respect of assets posted as security.

53V. Conditions for treating guarantee as eligible guarantee

- (1) For the purposes of section 53T(1)(c), a SOCCRA-LC may treat a guarantee provided to it as credit protection in respect of a charge unit as an eligible guarantee if—
 - (a) the guarantee is provided by an eligible credit protection provider; and
 - (b) the requirements specified in subsection (2) are satisfied.
- (2) The requirements specified for subsection (1)(b) are that—
 - (a) the risk weight that would be allocated to the SOCCRA-LC's exposure arising from the guarantee must be lower than the risk weight that would be allocated to the SOCCRA-LC's exposure arising from the charge unit;
 - (b) the guarantee must give the SOCCRA-LC a direct claim against the guarantor;
 - (c) the credit protection provided by the guarantee must relate to a specific exposure or specific group of exposures of the SOCCRA-LC;

- (d) the extent of the credit protection provided by the guarantee must be clearly documented and defined, including the undertaking of the guarantor to make payment in specified circumstances relating to the charge unit;
 - (e) there must not be any term in the guarantee, the satisfaction of which is outside the direct control of the SOCCRA-LC, that would allow the guarantor to terminate the guarantee unilaterally or that would increase the effective cost of the credit protection provided by the guarantee as a result of the deteriorating credit quality of the charge unit, except a term permitting termination in the event of a failure by the SOCCRA-LC to pay sums due from it under the terms of the guarantee;
 - (f) there must not be any term in the guarantee, the satisfaction of which is outside the direct control of the SOCCRA-LC, that could operate to prevent the guarantor from being obliged to pay out promptly in the event that the counterparty to the charge unit defaults in making any payments due to the SOCCRA-LC in respect of the charge unit;
 - (g) any payment that the guarantor may be obliged to make to the SOCCRA-LC under the terms of the guarantee must not be a controlled asset unless, in relation to the relevant prohibition applicable to the controlled asset or proceeds of the controlled asset, the SOCCRA-LC reasonably believes that it will be able to obtain the required approval from the relevant authority or regulatory organization within 1 week after applying for the approval;
 - (h) the guarantor must not have recourse to the SOCCRA-LC for any losses suffered by the guarantor as a result of the guarantor being obliged to make any payment to the SOCCRA-LC under the terms of the guarantee;
 - (i) the SOCCRA-LC must have the right to receive payment from the guarantor without having to take legal action in order to pursue the counterparty to the charge unit for payment;
 - (j) there must not be a material positive correlation between the credit quality of the guarantor and the credit quality of the counterparty to the charge unit, unless the guarantor is a specified guarantor; and
 - (k) the licensed corporation must—
 - (i) have conducted sufficient legal review to verify, and have a well-founded basis for believing, that the guarantee and all relevant arrangements (including all relevant documentation) with respect to the guarantee are binding on all relevant parties and legally enforceable in all relevant jurisdictions; and
 - (ii) re-conduct legal reviews as necessary to ensure continuing enforceability of the guarantee and the arrangements.
- (3) For the purposes of subsection (2)(j)—
- (a) a guarantor is a specified guarantor if—
 - (i) where it has 1 relevant SCRA issuer rating—the applicable credit quality grade of the rating is 1, 2 or 3; or
 - (ii) where it has 2 or more relevant SCRA issuer ratings—the applicable credit quality grade of each of those ratings is 1, 2 or 3; and
 - (b) a reference to a relevant SCRA issuer rating in paragraph (a) is a reference to a solicited SCRA issuer rating issued by an SCRA selected, under section 14 of Schedule 6, by the licensed corporation for its portfolio to which the guarantor relates.

53W. Conditions for treating credit risk swap as eligible credit risk swap

- (1) For the purposes of section 53T(1)(d), a SOCCRA-LC may treat a credit risk swap that is entered into by it as a protection buyer with a protection seller as credit protection in respect of a charge unit as an eligible credit risk swap in relation to the charge unit if—
 - (a) the protection seller is an eligible credit protection provider;
 - (b) the credit risk swap is of any of the descriptions specified in subsection (2); and
 - (c) the requirements specified in subsection (3) are satisfied.
- (2) The descriptions of credit risk swaps specified for subsection (1)(b) are—
 - (a) a credit default swap;
 - (b) a total return swap.
- (3) The requirements specified for subsection (1)(c) are that—
 - (a) the risk weight that would be allocated to the SOCCRA-LC's exposure arising from the credit risk swap must be lower than the risk weight that would be allocated to the SOCCRA-LC's exposure arising from the charge unit;
 - (b) (for a total return swap only) the SOCCRA-LC—
 - (i) must not account for the net payments received by it under the swap as net income; or
 - (ii) if it does so, must also account for the deterioration in value of the charge unit through reductions in fair value of the charge unit or additions to reserves;
 - (c) the credit protection provided by the swap in respect of the charge unit must be equivalent to that provided by a guarantee;
 - (d) the swap must give the SOCCRA-LC a direct claim against the protection seller;
 - (e) the credit protection provided by the swap must relate to a specific exposure or specific group of exposures of the SOCCRA-LC;
 - (f) the extent of the credit protection provided by the swap must be clearly documented and defined, including the undertaking of the protection seller to make payment in specified circumstances relating to the charge unit;
 - (g) there must not be any term in the swap, the satisfaction of which is outside the direct control of the SOCCRA-LC, that would allow the protection seller to terminate the swap unilaterally or that would increase the effective cost of the credit protection provided by the swap as a result of the deteriorating credit quality of the charge unit, except a term permitting termination in the event of a failure by the SOCCRA-LC to pay sums due from it under the terms of the swap;
 - (h) there must not be any term in the swap, the satisfaction of which is outside the direct control of the SOCCRA-LC, that could operate to prevent the protection seller from being obliged to pay out promptly in the event that the counterparty to the charge unit defaults in making any payments due to the SOCCRA-LC in respect of the charge unit;
 - (i) any payment that the protection seller may be obliged to make to the SOCCRA-LC under the terms of the swap must not be a controlled asset unless, in relation to the relevant prohibition applicable to the controlled asset or proceeds of the controlled asset, the SOCCRA-LC reasonably believes that it will be able to obtain the required approval from the relevant authority or regulatory organization within 1 week after applying for the approval;

- (j) the protection seller must not have recourse to the SOCCRA-LC for any losses suffered by the protection seller as a result of the protection seller being obliged to make any payment to the SOCCRA-LC under the terms of the swap;
- (k) the swap must oblige the protection seller to make payment to the SOCCRA-LC on the occurrence of the following credit event—
 - (i) any failure by the counterparty to the charge unit to pay any amount due under the terms of the charge unit (subject to any grace period in the swap that is of substantially similar duration to any grace period provided for in the terms of the charge unit);
 - (ii) any insolvency or bankruptcy of (or any similar circumstances affecting) the counterparty to the charge unit, any failure or inability by the counterparty to pay its debts as they fall due or any admission by the counterparty in writing of the counterparty's inability generally to pay its debts as they fall due; or
 - (iii) subject to subsection (4), the restructuring of the charge unit involving forgiveness or postponement of payment of any principal or interest or fees that results in the SOCCRA-LC making allowance for expected credit losses;
- (l) if the charge unit provides a grace period within which the counterparty to the charge unit may make good a default in payment, the swap must not be capable of terminating prior to the expiry of the grace period;
- (m) if the terms of the swap provide for settlement in cash, the terms must provide an adequate mechanism for valuation of the loss incurred by the SOCCRA-LC in respect of the charge unit and specify a reasonable period within which that valuation is to be arrived at following the occurrence of a credit event;
- (n) if the reference obligation or the obligation used for the purposes of determining whether a credit event has occurred as specified in the swap (***specified obligation***) does not include or is different from the charge unit—
 - (i) the specified obligation must rank equally with, or junior to, the charge unit; and
 - (ii) the counterparty to the charge unit must be a person who has the primary obligation to repay, pay or otherwise settle the specified obligation, and legally enforceable cross default or cross acceleration terms must be included in the terms of both the charge unit and the specified obligation;
- (o) if, under the terms of the swap, it is a condition of settlement that the SOCCRA-LC must transfer its rights in respect of the charge unit to the protection seller, the terms of the charge unit must provide that any consent that may be required from the counterparty to the charge unit must not be unreasonably withheld;
- (p) the swap must specify clearly the identity of the person who is empowered to determine whether a credit event has occurred, and—
 - (i) such person must not be solely the protection seller; and
 - (ii) the SOCCRA-LC must be entitled, under the terms of the swap, to inform the protection seller of the occurrence of a credit event;
- (q) there must not be a material positive correlation between the credit quality of the protection seller and the credit quality of the counterparty to the charge unit; and
- (r) the SOCCRA-LC must—
 - (i) have conducted sufficient legal review to verify, and have a well-founded basis for believing, that the credit risk swap and all relevant arrangements

- (including all relevant documentation) with respect to the swap are binding on all relevant parties and legally enforceable in all relevant jurisdictions; and
- (ii) re-conduct legal reviews as necessary to ensure continuing enforceability of the swap and the arrangements.
- (4) If, under the terms of the credit risk swap, the protection seller is not required to pay the SOCCRA-LC in the event that the charge unit is restructured, the swap is to be regarded as an eligible credit risk swap that provides credit protection only up to the following value—
- (a) if the maximum liability to the SOCCRA-LC under the swap is more than the exposure amount of the charge unit—60% of the exposure amount; or
- (b) if the maximum liability to the SOCCRA-LC under the swap is less than, or equal to, the exposure amount of the charge unit—60% of the maximum liability.

53X. Preliminary steps for taking into account eligible guarantee and eligible credit risk swap in charge calculation

- (1) Subject to subsection (3), a SOCCRA-LC intending to take into account one or more eligible guarantees or eligible credit risk swaps in a charge calculation must divide the exposure amount of the charge unit into—
- (a) for each such eligible guarantee or eligible credit risk swap—a portion (or the whole) of the exposure amount (***credit protection covered portion***) that is covered by the amount of the maximum liability of the credit protection provider to the SOCCRA-LC under the eligible guarantee or eligible credit risk swap, where such amount of maximum liability must first be adjusted for—
- (i) any currency mismatch, under subsection (2); and
- (ii) any maturity mismatch, under section 53ZA; and
- (b) any remaining portion of the exposure amount after deducting the sum of the credit protection covered portions calculated under paragraph (a) (***credit protection uncovered portion***).
- (2) A SOCCRA-LC must, if there is a currency mismatch between a charge unit and an eligible guarantee or eligible credit risk swap that it intends to take into account in a charge calculation in respect of the charge unit, adjust the amount of the maximum liability of the credit protection provider to the SOCCRA-LC under the eligible guarantee or eligible credit risk swap using Formula 27.

Formula 27

Calculation of adjusted maximum liability of credit protection provider for currency mismatch

$$G_a = G \times (1 - H_{ccy})$$

Where—

- G** is the amount of the maximum liability of the credit protection provider to the SOCCRA-LC under the eligible guarantee or eligible credit risk swap; and
- H_{ccy}** is the volatility adjustment percentage applicable to the currency mismatch.

- (3) If, under the terms of an eligible credit risk swap that a SOCCRA-LC intends to take into account in a charge calculation, the protection seller under the swap is, on the occurrence of a credit event, only obliged to make a payment in respect of any loss to the extent that the loss exceeds a specified amount, then—
 - (a) to avoid doubt, the credit protection covered portion referred to in subsection (1)(a) does not include the materiality threshold portion of the exposure amount, which is—
 - (i) if the specified amount is less than the exposure amount—the portion of the exposure amount that is equal to the specified amount; or
 - (ii) if the specified amount is equal to or more than the exposure amount—the whole of the exposure amount; and
 - (b) the credit protection uncovered portion referred to in subsection (1)(b) is to be made up of—
 - (i) the materiality threshold portion of the exposure amount; and
 - (ii) any part of the credit protection uncovered portion that remains after deducting the materiality threshold portion from the credit protection uncovered portion.
- (4) A SOCCRA-LC may take into account the credit protection of one or more eligible guarantees or eligible credit risk swaps in a charge calculation in respect of a charge unit—
 - (a) only if—
 - (i) the credit protection covered portions and the credit protection uncovered portion of the exposure amount of the charge unit rank equally; or
 - (ii) the sum of the credit protection covered portions is equal to or more than the exposure amount of the charge unit; and
 - (b) only to the extent that the sum of the credit protection covered portions does not exceed the exposure amount of the charge unit.
- (5) For the purposes of this section, a SOCCRA-LC that intends to take into account an eligible guarantee or eligible credit risk swap that is credit protection for 2 or more charge units (**original protection**) in the charge calculations in respect of the charge units must—
 - (a) if the terms of the original protection specify the credit protection for each charge unit—treat each charge unit as being covered by a separate eligible guarantee or eligible credit risk swap (as applicable)—
 - (i) that provides the same credit protection for the charge unit as specified in the original protection; and
 - (ii) under which the maximum liability of the credit protection provider to the SOCCRA-LC is limited to the provider's maximum liability to the SOCCRA-LC in respect of the charge unit under the original protection; or
 - (b) in any other case—treat each charge unit as being covered by a separate eligible guarantee or eligible credit risk swap (as applicable)—
 - (i) that has the same terms as the original protection, except that the coverage is limited to the charge unit; and
 - (ii) under which the maximum liability of the credit protection provider to the SOCCRA-LC is limited to the portion of the provider's maximum liability to the SOCCRA-LC in respect of the charge unit under the original protection, calculated on a pro rata basis according to the exposure amounts of the charge units covered by the original protection.

53Y. Amount to be substituted if eligible guarantee or eligible credit risk swap taken into account

- (1) This subsection sets out Formula 28 referred to in—
- (a) paragraph (c) of Formula 4 in section 53J(1);
 - (b) paragraph (c) of Formula 6 in section 53J(3);
 - (c) paragraph (c) of Formula 23 in section 53R(1); and
 - (d) paragraph (c) of Formula 25 in section 53R(3).

Formula 28

Amount to be substituted into Formula 4, 6, 23 or 25 if eligible guarantee or eligible credit risk swap taken into account

$$K = \sum_i (E_{protected, i} \times RW_{protected, i}) + E_{unprotected} \times RW_{unprotected}$$

Where—

$E_{protected, i}$ is, for an eligible guarantee or eligible credit risk swap i that the SOCCRA-LC takes into account in the charge calculation in respect of a charge unit—the credit protection covered portion of the exposure amount of the charge unit calculated for the guarantee or swap;

$RW_{protected, i}$ is, for an eligible guarantee or eligible credit risk swap i referred to in $E_{protected, i}$ —the risk weight applicable to the SOCCRA-LC's exposure arising from the guarantee or swap;

$E_{unprotected}$ is the credit protection uncovered portion of the exposure amount of the charge unit; and

$RW_{unprotected}$ is the risk weight applicable to the SOCCRA-LC's exposure arising from the charge unit.

- (2) For the purposes of Formula 28 in subsection (1), if section 53X(3) applies, the SOCCRA-LC must—
- (a) if the credit protection uncovered portion of the exposure amount is wholly made up of the materiality threshold portion referred to in section 53X(3)(b)(i)—take $RW_{unprotected}$ as 1250%; or
 - (b) if the credit protection uncovered portion of the exposure amount is made up of both the materiality threshold portion referred to in section 53X(3)(b)(i) and the part referred to in section 53X(3)(b)(ii) (**remaining part**)—substitute " $E_{unprotected} \times RW_{unprotected}$ " in the Formula by the sum of—
 - (i) the materiality threshold portion multiplied by 1250%; and
 - (ii) the remaining part multiplied by the risk weight applicable to the SOCCRA-LC's exposure arising from the charge unit.

53Z. Treatments for JAA-related guarantees

- (1) A SOCCRA-LC that, in the charge calculation in respect of a charge unit, takes into account an eligible guarantee provided to it by a JAA may allocate to the credit protection covered portion of the exposure amount of the charge unit the risk weight

that a SOCCRA-LC may, under section 5(4) of Schedule 6, allocate to an exposure falling within that section if—

- (a) the credit protection covered portion is funded by liabilities of the licensed corporation in the local currency (as defined by section 1(1) of Schedule 6) of the JAA; and
 - (b) the eligible guarantee is denominated in that currency.
- (2) For the purposes of the charge calculation in respect of a charge unit, if a SOCCRA-LC is provided an eligible guarantee in respect of the charge unit (**original guarantee**) that is counter-guaranteed by a JAA (**counter-guarantee**), the SOCCRA-LC may, in respect of the credit protection covered portion of the exposure amount of the charge unit that is calculated for the original guarantee, treat the counter-guarantee as if it were the original guarantee if—
- (a) the counter-guarantee covers all credit risk elements of the charge unit to the extent that it relates to the credit protection covered portion;
 - (b) the counter-guarantee is given in such terms that it can be called if—
 - (i) for any reason the counterparty to the charge unit fails to make payments due in respect of the charge unit; and
 - (ii) the original guarantee could be called;
 - (c) the counter-guarantee meets all of the conditions for being treated as an eligible guarantee specified in section 53V (except the requirements specified in section 53V(2)(b) and (c)); and
 - (d) the SOCCRA-LC is reasonably satisfied that—
 - (i) the coverage of the counter-guarantee is adequate and effective; and
 - (ii) there is no historical evidence to suggest that the coverage of the counter-guarantee is less effective than that of a direct guarantee provided by the JAA.

53ZA. Maturity mismatch between credit protection and covered exposure

- (1) A licensed corporation that, in calculating an amount to be included in its ranking liabilities under this Part in respect of an exposure (**Part 4A calculation**), takes into account an asset that is eligible collateral, an eligible guarantee or an eligible credit risk swap (**eligible credit protection**), must regard a maturity mismatch as arising if the eligible credit protection has a residual maturity that is shorter than the residual maturity of the exposure.
- (2) If there is a maturity mismatch in respect of an eligible credit protection, the licensed corporation must adjust the value of the eligible credit protection that it takes into account in the Part 4A calculation by using Formula 29.

Formula 29

Calculation of adjusted value of credit protection for maturity mismatch

$$P_a = P \times (t - 0.25) / (T - 0.25)$$

Where—

P is—

- (a) for an asset that is eligible collateral—

- (i) if the asset is cash—the amount of cash; or
 - (ii) for any other asset—the market value of the asset; or
 - (b) for an eligible guarantee or eligible credit risk swap—the amount of the maximum liability of the credit protection provider to the licensed corporation under the guarantee or swap, after adjusting such amount of maximum liability for any currency mismatch under section 53X(2);
- t is Min (T, the residual maturity of the eligible credit protection) expressed in years; and
- T is Min (5, the residual maturity of the exposure) expressed in years.
- (3) A licensed corporation must not take into account an eligible credit protection if—
- (a) there is a maturity mismatch in respect of the protection; and
 - (b) the protection has an original maturity of less than 1 year or a residual maturity of less than 3 months.
- (4) For the purposes of this section, a licensed corporation must—
- (a) if the terms of the eligible credit protection provide for an option that may reduce the original maturity and residual maturity of the credit protection—take the original maturity and residual maturity of the credit protection to be periods ending on the earliest date on which the option may be exercised;
 - (b) if the terms of the eligible credit protection provide that the credit protection provider may terminate the credit protection before maturity—take the original maturity and residual maturity of the credit protection to be periods ending on the earliest date on which the credit protection provider may terminate the credit protection;
 - (c) if the terms of the eligible credit protection provide that the licensed corporation may terminate the credit protection before maturity and such terms, at origination, contain a positive incentive for the licensed corporation to do so—take the original maturity and residual maturity of the credit protection to be periods ending on the earliest date on which it may terminate the credit protection; and
 - (d) if the eligible credit protection is an asset that is eligible collateral and the asset does not have a finite maturity—take the original maturity and residual maturity to be periods for which the asset will continue to meet the conditions for being treated as eligible collateral specified in section 53U.
- (5) In this section, a reference to the residual maturity of an exposure of a licensed corporation is a reference to—
- (a) if the exposure arises from—
 - (i) an OTCD transaction effected by the licensed corporation that does not form part of an OTCD netting set; or
 - (ii) an asset posted as security by the licensed corporation in respect of an OTCD transaction referred to in subparagraph (i),
 the residual maturity of the transaction;
 - (b) if the exposure arises from—
 - (i) OTCD transactions effected by the licensed corporation that constitute an OTCD netting set; or
 - (ii) an asset posted as security by the licensed corporation in respect of OTCD transactions referred to in subparagraph (i),
 the longest of the residual maturities of the transactions;

- (c) if the exposure arises from—
 - (i) a repo-style transaction entered into by the licensed corporation that does not form part of a repo-style netting set; or
 - (ii) an asset posted as security by the licensed corporation in respect of a repo-style transaction referred to in subparagraph (i),
the residual maturity of the transaction; or
 - (d) if the exposure arises from—
 - (i) repo-style transactions entered into by the licensed corporation that constitute a repo-style netting set; or
 - (ii) an asset posted as security by the licensed corporation in respect of repo-style transactions referred to in subparagraph (i),
the longest of the residual maturities of the transactions.
- (6) For the purposes of subsection (5), in determining the residual maturity of a transaction, a licensed corporation must, at any time before the other party to the transaction performs its obligations, take the residual maturity of the transaction to be the remaining time to the maturity of the transaction after taking into account any applicable grace period provided for in the terms of the transaction.
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Part 4B

Market Risk—SMRA-LC

Division 1—Preliminary

53ZB. Meaning of *controlled asset position*

For the purposes of this Part, an SMRA-LC's position in a particular matter is a controlled asset position if—

- (a) either—
 - (i) it is a position in a controlled asset; or
 - (ii) the proceeds of the realization of the position would be a controlled asset; and
- (b) such controlled asset or proceeds cannot be freely applied to settle the SMRA-LC's obligations arising from—
 - (i) if the position is a long position—any of its short positions in the particular matter; or
 - (ii) if the position is a short position—any of its long positions in the particular matter.

53ZC. References to SMRA-LC's position and size of such position

- (1) In this Part, a reference to an SMRA-LC's position does not include—
 - (a) a spot position in any securities, commodity, gold, currency, property or instrument that has a positive market value that—
 - (i) is not included in the SMRA-LC's liquid assets; and
 - (ii) is not exceeded by the maximum possible loss of the position; or
 - (b) a non-trading position in any securities or commodity.
- (2) In this Part—
 - (a) a reference to an SMRA-LC's ***aggregate long position*** () in a particular matter is a reference to a position the size of which is equal to the sum of—
 - (i) the sizes of all of its long spot positions in the particular matter; and
 - (ii) the sizes of all of its long notional positions in the particular matter;
 - (b) a reference to an SMRA-LC's ***aggregate short position*** () in a particular matter is a reference to a position the size of which is equal to the sum of—
 - (i) the sizes of all of its short spot positions in the particular matter; and
 - (ii) the sizes of all of its short notional positions in the particular matter; and
 - (c) a reference to an SMRA-LC's ***net position*** () in a particular matter is a reference to a position the size of which is equal to the difference between—
 - (i) the size of its aggregate long position in the particular matter; and
 - (ii) the size of its aggregate short position in the particular matter.
- (3) For the purposes of this Part, an SMRA-LC's net position in a particular matter is, if, in the calculation under subsection (2)(c)—
 - (a) the size of the aggregate long position is greater than the size of the aggregate short position—a net long position; or

- (b) the size of the aggregate short position is greater than the size of the aggregate long position—a net short position.
- (4) In Divisions 2, 3, 4, 5 and 6 of this Part, a reference to the size of an SMRA-LC's notional position in a particular matter is, where the notional position arises from an applicable continuous options contract and the SMRA-LC complies with the delta-plus approach, a reference to the delta-weighted size of the notional position calculated under section 53ZZL(a).
- (5) In this section—
 - applicable continuous options contract*** () has the meaning given by section 53ZZI;
 - delta-plus approach*** () has the meaning given by section 53ZZI;
 - particular matter*** () means—
 - (a) a category of equity, debt security, gold or commodity;
 - (b) a currency, currency exchange rate or interest rate;
 - (c) a basket of any of the matters referred to in paragraph (a) or (b);
 - (d) an index that has a basket referred to in paragraph (c) underlying it;
 - (e) a notional currency; or
 - (f) an SRF security.

Division 2—Equity risk

53ZD. Interpretation

- (1) In this Division—
 - EIF contract*** () means a futures contract the underlying subject matter of which is an equity index;
 - illiquid equity investment*** () means—
 - (a) a category of equity that is an illiquid investment;
 - (b) a basket of equities that is constituted only by equities that are illiquid investments; or
 - (c) an equity index that has a basket of equities referred to in paragraph (b) underlying it;
 - liquid equity investment*** () means—
 - (a) a category of equity that is not an illiquid investment;
 - (b) a basket of equities that is constituted—
 - (i) only by equities that are not illiquid investments; or
 - (ii) by both equities that are not illiquid investments and equities that are illiquid investments; or
 - (c) an equity index that has a basket of equities referred to in paragraph (b) underlying it;
 - specified equity index*** () means—
 - (a) the Hang Seng Index;
 - (b) the Hang Seng China Enterprise Index;
 - (c) the FTSE 100 Index;
 - (d) the S&P 500 Index;
 - (e) the Nikkei Stock Average;

- (f) the Euro Stoxx 50 Index;
 - (g) the CSI 300 Index; or
 - (h) an equity index approved by the Commission as a specified equity index under section 58(5)(n).
- (2) In this Division, a reference to a position in an equity index arising from an EIF contract is a reference to a position in an equity index that arises from—
- (a) a common equity derivative that is an EIF contract; or
 - (b) a common equity derivative that has an EIF contract as its underlying subject matter.

53ZE. Application of Division to positions in equities

Subject to sections 53ZZP(6) and 53ZZR(4), this Division applies to an SMRA-LC in relation to the following positions—

- (a) its spot position in—
 - (i) a category of equity; or
 - (ii) a basket of equities; and
- (b) its notional position in any of the following matters arising from a common equity derivative—
 - (i) a category of equity;
 - (ii) a basket of equities;
 - (iii) an equity index.

53ZF. Market risk charges for positions in liquid equity investments

- (1) Subject to subsection (2), an SMRA-LC must, in respect of each net position in a liquid equity investment, include in its ranking liabilities an amount equal to the market value of the net position, multiplied by—
- (a) for a net position in a category of equity—the haircut percentage applicable to that category of equity;
 - (b) for a net position in a basket of equities—
 - (i) the highest of the haircut percentages applicable to each of the equities that constitute the basket; or
 - (ii) the weighted average haircut percentage applicable to the basket; or
 - (c) for a net position in an equity index—
 - (i) the highest of the haircut percentages applicable to each of the equities that constitute the basket underlying the index; or
 - (ii) the weighted average haircut percentage applicable to the index.
- (2) An SMRA-LC, in calculating its net position in a liquid equity investment for subsection (1), must exclude—
- (a) a controlled asset position in the investment;
 - (b) a position in the investment (or the part of the position) that forms one side of a pair of matched positions under section 53ZG(1)(a), (b) or (c) or (4)(a) or (b); and
 - (c) a position in an equity index arising from an EIF contract that is not excluded under paragraph (a) or (b).

- (3) Subject to subsection (4), an SMRA-LC must, in respect of each controlled asset position in a liquid equity investment, include in its ranking liabilities an amount that is equal to the market value of the position, multiplied by—
 - (a) for a position in a category of equity—the haircut percentage applicable to the category of equity;
 - (b) for a position in a basket of equities—
 - (i) the highest of the haircut percentages applicable to each of the equities that constitute the basket; or
 - (ii) the weighted average haircut percentage applicable to the basket; or
 - (c) for a position in an equity index—
 - (i) the highest of the haircut percentages applicable to each of equities that constitute the basket underlying the index; or
 - (ii) the weighted average haircut percentage applicable to the index.
- (4) The total amount to be included under subsection (3) in respect of an SMRA-LC's controlled asset positions in a liquid equity investment that are opposite to the SMRA-LC's net long or short position in that investment calculated for subsection (1) is to be reduced, down to zero at most, by the amount included in the SMRA-LC's ranking liabilities under subsection (1) in respect of the net position.
- (5) An SMRA-LC must, in respect of each pair of matched positions under section 53ZG(1)(a), (b) or (c) (except a pair of matched positions treated as such by virtue of section 53ZG(2)(a)), include in its ranking liabilities an amount equal to the higher of the market values of the pair of matched positions, multiplied by—
 - (a) subject to paragraph (b)—2%;
 - (b) if the pair of matched positions is treated as such by virtue of section 53ZG(2)(d)—4%.
- (6) An SMRA-LC must, in respect of each pair of matched positions under section 53ZG(4)(a) or (b), include in its ranking liabilities an amount equal to the market value of either of the pair of matched positions, multiplied by 4%.
- (7) An SMRA-LC must, in respect of each position in an equity index referred to in subsection (2)(c), include in its ranking liabilities an amount equal to the market value of the position, multiplied by—
 - (a) the highest of the haircut percentages applicable to each of the equities that constitute the basket underlying the index; or
 - (b) the weighted average haircut percentage applicable to the index.

53ZG. Matched positions in liquid equity investments

- (1) Each of the following pairs of an SMRA-LC's positions in a liquid equity investment may be treated, to the extent that the sizes of the positions are equal, as a pair of matched positions—
 - (a) if the conditions specified in subsection (2) are satisfied, a pair of—
 - (i) an aggregate long position in an equity index that is constituted by long positions arising from EIF contracts; and
 - (ii) an aggregate short position in the same index that is constituted by short positions arising from EIF contracts;
 - (b) a pair of—
 - (i) an aggregate long position in a specified equity index that is constituted by long positions arising from EIF contracts; and

- (ii) an aggregate short position in the same index that is constituted by short positions that do not arise from EIF contracts;
- (c) a pair of—
 - (i) an aggregate short position in a specified equity index that is constituted by short positions arising from EIF contracts; and
 - (ii) an aggregate long position in the same index that is constituted by long positions that do not arise from EIF contracts.
- (2) The conditions specified for subsection (1)(a) are that—
 - (a) all of the EIF contracts—
 - (i) are traded on the same exchange; and
 - (ii) have the same delivery date;
 - (b) the equity index is a specified equity index and—
 - (i) all of the EIF contracts are traded on the same exchange; and
 - (ii) not all of the EIF contracts have the same delivery date;
 - (c) the equity index is a specified equity index and—
 - (i) not all of the EIF contracts are traded on the same exchange; and
 - (ii) all of the EIF contracts have the same delivery date; or
 - (d) the equity index is a specified equity index and the EIF contracts are not traded on the same exchange nor have the same delivery date.
- (3) For subsection (2), 2 EIF contracts (**contract A** and **contract B**) that are traded on 2 different exchanges are regarded as being traded on the same exchange if both exchanges accept a spot position in contract A traded on one of the exchanges to offset an opposite spot position in contract B traded on the other exchange.
- (4) Each of the following pairs of an SMRA-LC's positions in liquid equity investments may, if the conditions specified in subsection (5) are satisfied and if elected by the SMRA-LC, be treated, to the extent that market values of the positions are equal, as a pair of matched positions—
 - (a) a pair of—
 - (i) a net long position in a specified equity index; and
 - (ii) a net short position in a basket of equities; or
 - (b) a pair of—
 - (i) a net short position in a specified equity index; and
 - (ii) a net long position in a basket of equities.
- (5) The conditions specified for subsection (4) are that—
 - (a) the SMRA-LC entered into the positions that form part of the pair of matched positions for the purpose of arbitrage and separately manages such positions as an arbitrage portfolio; and
 - (b) the percentage that indicates the representation of the basket of equities in the composition of the specified equity index, as calculated using Formula 30, is 90% or above—

Formula 30

Calculation of basket representation in index composition

$$100\% - \sum s\%$$

where—

s% is, for each of the equities that constitute the basket of equities underlying the index, the absolute value of the difference between—

- (i) the weight of that equity in the index, expressed as a percentage of the market value of the basket of equities underlying the index; and
- (ii) the weight of that equity in the basket of equities, expressed as a percentage of the total market value of that basket of equities.

(6) An SMRA-LC—

- (a) must not include a controlled asset position (or any part of it) in any pair of matched positions under subsection (1) or (4); and
- (b) may include a long or short position (or a part of it) only in 1 pair of matched positions under subsection (1) or (4).

53ZH. Market risk charge for positions in illiquid equity investments

- (1) Subject to subsection (2), an SMRA-LC must, in respect of its positions in an illiquid equity investment, include in its ranking liabilities an amount equal to the higher of—
 - (a) the market value of its aggregate long position in the illiquid equity investment; and
 - (b) the market value of its aggregate short position in the illiquid equity investment.
- (2) An SMRA-LC may exclude from the calculation of its aggregate long position and aggregate short position in an illiquid equity investment—
 - (a) a pair of the following positions that can be applied to offset or settle the obligations arising from each other, to the extent that the sizes of the positions are equal—
 - (i) an aggregate long position in a category of equity, a basket of equities or an equity index; and
 - (ii) an aggregate short position in the same category of equity, basket of equities or equity index; and
 - (b) a short position in a category of equity or a basket of equities (or the part of the position) that can be settled by a long spot position in the same category of equity or basket of equities.

Division 3—Interest rate risk

Subdivision 1—Preliminary

53ZI. Interpretation

In this Division—

credit enhancement (), in relation to a securitization exposure under a securitization transaction, means a contractual arrangement whereby a person—

- (a) retains or assumes credit risk in respect of the exposure; and
- (b) provides, in substance, some degree of credit protection to one or more than one other party to the transaction;

debt security investment () means—

- (a) a category of debt security;

- (b) a basket of debt securities; or
- (c) a debt security index;

early amortization provision (), in relation to a securitization transaction in which the underlying exposures are revolving in nature, means a mechanism which, once triggered, allows investors in the securitization issues to be paid out prior to the originally stated maturity of the securitization issues held by the investors;

general risk charge () means an amount that an SMRA-LC is required to include in its ranking liabilities under section 53ZZA(1);

illiquid debt security investment () means—

- (a) a category of debt security that is not a marketable debt security;
- (b) a basket of debt securities that is constituted only by debt securities that are not marketable debt securities; or
- (c) a debt security index that has a basket of debt securities referred to in paragraph (b) underlying it;

liquid debt security investment () means—

- (a) a category of security that is a marketable debt security;
- (b) a basket of debt securities that is constituted—
 - (i) only by marketable debt securities; or
 - (ii) by both marketable debt securities and debt securities that not marketable debt securities; or
- (c) a debt security index that is has a basket of debt securities referred to in paragraph (b) underlying it;

liquidity facility () means a contractual agreement pursuant to which a person provides funding in respect of a securitization transaction to ensure the timeliness of cash flows to investors in the securitization issues in the transaction;

non-securitization exposure () means an exposure that is not a securitization exposure;

re-securitization issues () means the securities issued by the issuer in a re-securitization transaction;

re-securitization transaction () means a securitization transaction in respect of which not less than one of the underlying exposures of the transaction is a securitization exposure;

revolving (), in relation to an underlying exposure in a securitization transaction, means that the borrower's outstanding balance of the exposure is permitted to fluctuate based on the borrower's decision to borrow and repay, up to an agreed limit;

securitization exposure () means an exposure of a person arising from a securitization transaction, including such an exposure arising from—

- (a) the purchase or repurchase of securitization issues;
- (b) the provision of credit protection or credit enhancement to any of the parties to the transaction;
- (c) the retention of one or more than one exposure arising from a tranche in the transaction;
- (d) the provision of a liquidity facility or servicer cash advance facility for the transaction; or
- (e) the obligation to acquire any investors' interest in the underlying exposures of the transaction if the transaction is subject to an early amortization provision;

securitization issues () means the securities issued by the issuer in a securitization transaction;

securitization transaction () means a transaction involving the tranching of credit risk associated with a pool of underlying exposures and in respect of which—

- (a) there are not less than 2 different tranches;
- (b) payments to investors or other parties to the transaction depend on the performance of the underlying exposures; and
- (c) the subordination of tranches determines the distribution of losses during the life of the transaction;

servicer cash advance facility () means a contractual agreement pursuant to which a person advances cash in respect of a securitization transaction to ensure an uninterrupted flow of payments to investors in the securitization issues in the transaction;

specific risk charge () means an amount that an SMRA-LC is required to include in its ranking liabilities under section 53ZU, 53ZV, 53ZW, 53ZX or 53ZY;

tranche () means a contractually established segment (**relevant segment**) of the credit risk associated with a pool of underlying exposures in a securitization transaction where—

- (a) a position in the relevant segment entails a risk of credit loss greater than, or less than, that of a position of the same amount in each other contractually established segment; and
- (b) no account is taken of credit protection provided by third parties directly to the holders of positions in the relevant segment or in other contractually established segments;

underlying exposure ()—

- (a) in relation to a securitization transaction that is not a re-securitization transaction, means one or more than one on-balance sheet or off-balance sheet non-securitization exposure in respect of which credit risk is transferred to one or more than one person by the originator in the transaction; or
- (b) in relation to a re-securitization transaction—
 - (i) either—
 - (A) means one or more than one on-balance sheet or off-balance sheet securitization exposure being re-securitized through the transaction; or
 - (B) means one or more than one on-balance sheet or off-balance sheet securitization exposure being re-securitized through the transaction and one or more than one on-balance sheet or off-balance sheet non-securitization exposure being securitized through the transaction; and
 - (ii) does not include the underlying exposures in respect of the original securitization transaction that gave rise to the securitization exposure referred to in subparagraph (i)(A) or (B).

53ZJ. Reference to debt security issued or guaranteed by reference entity specified in credit default swap or credit linked note

In this Division, a reference to the debt security issued or guaranteed by a reference entity specified in a common credit derivative that is a credit default swap or credit linked note is a reference to—

- (a) if only 1 debt security issued or guaranteed by the reference entity is specified as the reference obligation in the derivative—that debt security;
- (b) if no debt security issued or guaranteed by the reference entity is specified as the reference obligation in the derivative—the debt security issued or guaranteed by the reference entity to which, among all debt securities issued or guaranteed by the reference entity, the highest specific risk percentage applies; or
- (c) if, under the terms and conditions of the derivative, more than 1 debt security issued or guaranteed by the reference entity may be selected as the reference obligation—the debt security issued or guaranteed by the reference entity to which, among the debt securities that may be selected, the highest specific risk percentage applies.

53ZK. Reference to notional principal of total return swap, credit default swap or credit linked note

In this Division, a reference to the notional principal of a common credit derivative that is a total return swap, credit default swap or credit linked note is a reference to the nominal, face, par or similar value, or any other reference amount, designated in the derivative as the amount on which the return, amount due or method of settlement (as applicable) of the derivative is based.

53ZL. Application of Division to positions in debt securities and SRF securities

Subject to sections 53ZZP(6) and 53ZZR(4), this Division applies to an SMRA-LC in relation to the following positions—

- (a) its spot position in—
 - (i) a category of debt security; or
 - (ii) a basket of debt securities;
- (b) its notional position in any of the following matters arising from a common credit derivative or common debt security derivative—
 - (i) a category of debt security;
 - (ii) a basket of debt securities;
 - (iii) a debt security index;
- (c) its position in an SRF security arising from a common derivative.

53ZM. Notional positions in cheapest-to-deliver debt securities arising from certain common debt security derivatives

- (1) Subsection (2) applies if—
 - (a) an SMRA-LC holds a position in a common debt security derivative—
 - (i) that is in the form of a continuous options contract, futures contract, forward contract, swap or contract for difference; and
 - (ii) the underlying subject matter of which is or includes a category of debt security; and
 - (b) the contract or swap can be settled by delivery of any debt security from a range of debt securities specified in it.
- (2) The SMRA-LC referred to in subsection (1) is, despite section 9D(1)(a), regarded as also holding a notional position in the cheapest-to-deliver debt security in relation to the contract or swap, instead of a notional position in the category of debt security that is the underlying subject matter of the common debt security derivative.

(3) In this section—

cheapest-to-deliver debt security (), in relation to a contract or swap that can be settled by an SMRA-LC by delivery of any debt security from a range of debt securities specified in it, means the debt security in that range that is readily identifiable as the most profitable for the SMRA-LC to deliver after taking into account the conversion factor;

conversion factor (), in relation to a contract or swap that can be settled by delivery of any debt security from a range of debt securities specified in it, means—

- (a) for a futures contract—a number published by the futures exchange on which the contract is traded for determining the price for each debt security that can be delivered against the contract; or
- (b) for a forward contract, swap, contract for difference or continuous options contract—a number specified in the contract or swap for determining the price for each debt security that can be delivered against the contract or swap.

53ZN. Notional positions in SRF securities arising from certain common interest rate derivatives

- (1) If an SMRA-LC holds a long (or short) position in a common interest rate derivative that is in the form of a futures contract, forward contract (other than a forward rate agreement) and the underlying subject matter of the derivative is or includes an interest rate, the SMRA-LC is regarded as also holding a short (or long) notional position in an SRF security with—
 - (a) zero coupon; and
 - (b) a residual maturity equal to the period up to and including—
 - (i) if the contract is physically settled—the delivery date specified in the contract; or
 - (ii) in any other case—the day on which the settlement price of the contract is to be determined.
- (2) If an SMRA-LC holds a long (or short) position in a common interest rate derivative that is in the form of a futures contract, forward contract (other than a forward rate agreement), contract for difference or continuous options contract and the underlying subject matter of the derivative is or includes an interest rate, the SMRA-LC is regarded as also holding a long (or short) notional position in an SRF security with—
 - (a) zero coupon; and
 - (b) a residual maturity equal to the tenor of the interest rate plus the period up to and including—
 - (i) if the contract is physically settled—the delivery date specified in the contract; or
 - (ii) in any other case—the day on which the settlement price of the contract is to be determined.
- (3) If an SMRA-LC holds a long (or short) position in a common interest rate derivative that is in the form of a forward rate agreement, the SMRA-LC is regarded as also holding—
 - (a) a long (or short) notional position in an SRF security with—
 - (i) zero coupon; and
 - (ii) a residual maturity equal to the period up to and including the settlement date of the agreement; and

- (b) a short (or long) notional position in an SRF security with—
 - (i) zero coupon; and
 - (ii) a residual maturity equal to the period up to and including the settlement date of the agreement plus the maturity of the underlying notional borrowing (or deposit) of the agreement.
- (4) If an SMRA-LC holds a position in a common interest rate derivative that is in the form of an interest rate swap or a cross-currency interest rate swap under which it receives (or pays) floating rate interest and pays (or receives) fixed rate interest, the SMRA-LC is regarded as also holding—
 - (a) a short (or long) notional position in an SRF security with—
 - (i) coupon payments equal to the remaining fixed interest rate payments under the swap; and
 - (ii) a residual maturity equal to the residual maturity of the swap; and
 - (b) a long (or short) notional position in an SRF security with—
 - (i) a coupon payment equal to the next floating rate interest payment under the swap; and
 - (ii) a residual maturity equal to the period up to and including the next interest fixing date under the swap.
- (5) If an SMRA-LC holds a position in a common interest rate derivative that is in the form of an interest rate swap or a cross-currency interest rate swap under which it receives interest at a floating rate (**rate 1**) and pays interest at another floating rate (**rate 2**), the SMRA-LC is regarded as also holding—
 - (a) a short notional position in a SRF security with—
 - (i) a coupon payment equal to the next interest payment at rate 2 under the swap; and
 - (ii) a residual maturity equal to the period up to and including the next interest fixing date for rate 2 under the swap; and
 - (b) a long notional position in an SRF security with—
 - (i) a coupon payment equal to the next interest payment at rate 1 under the swap; and
 - (ii) a residual maturity equal to the period up to and including the next interest fixing date for rate 1 under the swap.

53ZO. Notional positions in SRF securities arising from certain common derivatives

- (1) If an SMRA-LC holds a long (or short) position in a common derivative specified in subsection (6) that is in the form of a futures contract or forward contract and the underlying subject matter of which does not include a currency, the SMRA-LC is regarded as also holding a short (or long) notional position in an SRF security with—
 - (a) zero coupon; and
 - (b) a residual maturity equal to the period up to and including—
 - (i) if the contract is physically settled—the delivery date specified in the contract; or
 - (ii) in any other case—the day on which the settlement price of the contract is to be determined.

- (2) If an SMRA-LC holds a position in a common derivative specified in subsection (6) that is in the form of a futures contract or forward contract and the underlying subject matter of which is or includes a currency, the SMRA-LC is regarded as also holding—
 - (a) a long notional position in an SRF security, denominated in the currency that it will purchase under the contract, with—
 - (i) zero coupon; and
 - (ii) a residual maturity equal to the period up to and including—
 - (A) if the contract is physically settled—the delivery date specified in the contract; or
 - (B) in any other case—the day on which the settlement price of the contract is to be determined; and
 - (b) a short notional position in an SRF security, denominated in the currency that it will sell under the contract, with—
 - (i) zero coupon; and
 - (ii) a residual maturity equal to the period up to and including—
 - (A) if the contract is physically settled—the delivery date specified in the contract; or
 - (B) in any other case—the day on which the settlement price of the contract is to be determined.
- (3) Subsection (4) applies if an SMRA-LC holds a position in a common derivative specified in subsection (6) that is form of a swap under which it—
 - (a) either—
 - (i) receives (or delivers) the underlying subject matter of the contract; or
 - (ii) receives (or pays) an amount calculated by reference to a change in the value of the underlying subject matter of the swap; and
 - (b) pays (or receives) fixed rate interest or floating rate interest.
- (4) The SMRA-LC referred to in subsection (3) is regarded as also holding—
 - (a) if it pays (or receives) fixed rate interest—a short (or long) notional position in an SRF security with—
 - (i) coupon payments equal to the remaining fixed rate interest payments under the swap; and
 - (ii) a residual maturity equal to the period up to and including—
 - (A) if the swap is physically settled—the delivery date specified in the swap; or
 - (B) in any other case—the residual maturity of the swap; or
 - (b) if it pays (or receives) floating rate interest—a short (or long) notional position in an SRF security with—
 - (i) a coupon payment equal to the next floating rate interest payment under the swap; and
 - (ii) a residual maturity equal to the period up to and including the next interest fixing date under the swap.
- (5) If an SMRA-LC holds a position in a common derivative specified in subsection (6) that is in the form of a foreign currency swap is regarded as also holding—
 - (a) a long notional position in an SRF security, denominated in the currency that it will receive on settlement of the swap, with—

- (i) zero coupon; and
 - (ii) a residual maturity equal to the period up to and including—
 - (A) if the swap is physically settled—the delivery date specified in the swap; or
 - (B) in any other case—the residual maturity of the swap; and
- (b) a short notional position in an SRF security, denominated in the currency that it will deliver on settlement of the swap, with—
 - (i) zero coupon; and
 - (ii) a residual maturity equal to the period up to and including—
 - (A) if the swap is physically settled—the delivery date specified in the swap; or
 - (B) in any other case—the residual maturity of the swap.
- (6) The common derivatives specified for subsections (1), (2), (3) and (5) are—
 - (a) a common equity derivative;
 - (b) a common debt security derivative;
 - (c) a common commodity derivative;
 - (d) a common gold derivative; and
 - (e) a common exchange rate derivative.

53ZP. Notional positions in debt securities and SRF security arising from common credit derivatives except nth-to-default credit default swaps or credit linked notes

- (1) Subsection (2) applies if an SMRA-LC holds—
 - (a) a position in a common credit derivative that is a single-name total return swap under which it is the protection seller or buyer and the underlying subject matter of which is a debt security; or
 - (b) a position in a common credit derivative that is a multiple-name total return swap under which it is the protection seller or buyer and the underlying subject matter of which is a basket of debt securities.
- (2) The SMRA-LC referred to in subsection (1) is regarded as also holding—
 - (a) for the purposes of calculating the general risk charge and the specific risk charge under section 53ZW—a long (if it is the protection seller) or short (if it is the protection buyer) notional position in the debt security or basket of securities (as the case may be), where the notional position has a notional value equal to the notional principal of the swap; and
 - (b) if premium or interest payments are to be received or made by the SMRA-LC under the swap, for the purposes of calculating the general risk charge—a long (if payments are to be received) or short (if payments are to be made) notional position in an SRF security with—
 - (i) if the payments are calculated at a fixed rate of the notional principal of the swap—
 - (A) coupon payments equal to the remaining premium or interest payments; and
 - (B) a residual maturity equal to the residual maturity of the swap; or
 - (ii) if the payments are calculated at a floating rate of the notional principal of the swap—
 - (A) a coupon payment equal to the next premium or interest payment; and

- (B) a residual maturity equal to the period up to and including the next interest fixing date for the floating rate under the swap.
- (3) If an SMRA-LC holds a position in a common credit derivative that is a single-name credit default swap under which it is the protection seller or buyer, the SMRA-LC is regarded as also holding—
 - (a) for the purposes of calculating the specific risk charge under section 53ZW—a long (if it is the protection seller) or short (if it is the protection buyer) notional position in the debt security issued or guaranteed by the reference entity specified in the derivative, where—
 - (i) the notional position has a notional value equal to the notional principal of the derivative; and
 - (ii) the debt security has a residual maturity equal to the residual maturity of the derivative; and
 - (b) if premium or interest payments are to be received or made by the SMRA-LC under the swap, for the purposes of calculating the general risk charge, in respect of each payment—a long (if payments are to be received) or short (if payments are to be made) notional position in an SRF security with—
 - (i) zero coupon; and
 - (ii) a residual maturity equal to the period up to and including the due date of the payment.
- (4) If an SMRA-LC holds a position in a common credit derivative that is a multiple-name credit default swap under which it is the protection seller or buyer, the SMRA-LC is regarded as also holding—
 - (a) for the purposes of calculating the specific risk charge under section 53ZW—a long (if it is the protection seller) or short (if it is the protection buyer) notional position in the debt security issued or guaranteed by each reference entity specified in the derivative, where—
 - (i) the notional position has a notional value equal to the proportion of the notional principal of the derivative that the SMRA-LC's exposure to the reference entity represents; and
 - (ii) the debt security has a residual maturity equal to the residual maturity of the derivative; and
 - (b) if premium or interest payments are to be received or made by the SMRA-LC under the swap, for the purposes of calculating the general risk charge, in respect of each payment—a long (if payments are to be received) or short (if payments are to be made) notional position in an SRF security with—
 - (i) zero coupon; and
 - (ii) a residual maturity equal to the period up to and including the due date of the payment.
- (5) Subject to subsection (7), if an SMRA-LC holds a spot position in a common credit derivative that is a single-name credit linked note under which it is the protection seller or buyer, the SMRA-LC is, for the purposes of calculating the specific risk charge under section 53ZW, regarded as also holding a long (if it is the protection seller) or short (if it is the protection buyer) notional position in the debt security issued or guaranteed by the reference entity specified in the note, where—
 - (a) the notional position has a notional value equal to the notional principal of the note; and

- (b) the debt security has a residual maturity equal to the residual maturity of the note.
- (6) Subject to subsection (7), if an SMRA-LC holds a spot position in a common credit derivative that is a multiple-name credit linked note under which it is the protection seller or buyer, the SMRA-LC is, for the purposes of calculating the specific risk charge under section 53ZW, regarded as also holding a long (if it is the protection seller) or short (if it is the protection buyer) notional position in the debt security issued or guaranteed by each reference entity specified in the note, where—
 - (a) the notional position has a notional value equal to the proportion of the notional principal of the note that the SMRA-LC's exposure to the reference entity represents; and
 - (b) the debt security has a residual maturity equal to the residual maturity of the note.
- (7) The SMRA-LC referred to in subsection (5) or (6) may disregard that subsection if the single-name credit linked note or multiple-name credit linked note—
 - (a) is a marketable debt security; and
 - (b) has an SCRA issue specific rating with a credit quality grade of 1, 2 or 3.

53ZQ. Notional positions in debt securities and SRF securities arising from common credit derivatives that are nth-to-default credit default swaps or credit linked notes

- (1) If an SMRA-LC holds a position in a common credit derivative that is an nth-to-default credit default swap under which it is the protection seller or buyer, the SMRA-LC is regarded as also holding—
 - (a) subject to subsection (2), for the purposes of calculating the specific risk charge under section 53ZX—
 - (i) if “n” is 1—a long (if it is the protection seller) or short (if it is the protection buyer) notional position in the debt security issued or guaranteed by each reference entity specified in the swap, where—
 - (A) the notional position has a notional value equal to the notional principal of the swap; and
 - (B) the debt security has a residual maturity equal to the residual maturity of the swap; or
 - (ii) if “n” is more than 1—a long (if it is the protection seller) or short (if it is the protection buyer) notional position in the debt security issued or guaranteed by each reference entity specified in the swap, except the (n-1) debt securities to which the lowest specific risk percentages apply, where—
 - (A) the notional position has a notional value equal to the notional principal of the swap; and
 - (B) the debt security has a residual maturity equal to the residual maturity of the swap; and
 - (b) if premium or interest payments are to be received or made by the SMRA-LC under the swap, for the purposes of calculating the general risk charge, in respect of each payment—a long (if payments are to be received) or short (if payments are to be made) notional position in an SRF security with—
 - (i) zero coupon; and
 - (ii) a residual maturity equal to the period up to and including the due date of the payment.

- (2) An SMRA-LC must, in the circumstances specified in subsection (3), regard itself as also holding, instead of the positions referred to in subsection (1)(a), a long notional position in a marketable debt security that is a securitization issue (other than a re-securitization issue), where—
 - (a) the securitization issue has an SCRA issue specific rating that is the same as that of the swap; and
 - (b) the notional position has a notional value that is equal to the notional principal of the swap.
- (3) The circumstances specified for subsection (2) are that—
 - (a) the SMRA-LC is the protection seller under the swap referred to in subsection (1);
 - (b) the swap has an SCRA issue specific rating; and
 - (c) the notional position referred to in subsection (1)(a) does not form one side of a pair of matched positions under section 53ZS(7).
- (4) Subject to subsection (5), if an SMRA-LC holds a position in a common credit derivative that is an nth-to-default credit linked note under which it is the protection seller or buyer, the SMRA-LC is, for the purposes of calculating the specific risk charge under section 53ZX, regarded as also holding—
 - (a) if “n” is 1—a long (if it is the protection seller) or short (if it is the protection buyer) notional position in the debt security issued or guaranteed by each reference entity specified in the note, where—
 - (i) the notional position has a notional value equal to the notional principal of the note; and
 - (ii) the debt security has a residual maturity equal to the residual maturity of the note; or
 - (b) if “n” is more than 1—a long (if it is the protection seller) or short (if it is the protection buyer) notional position in the debt security issued or guaranteed by each reference entity specified in the note, except the (n-1) debt securities to which the lowest specific risk percentages apply, where—
 - (i) the notional position has a notional value equal to the notional principal of the note; and
 - (ii) the debt security has a residual maturity equal to the residual maturity of the note.
- (5) The SMRA-LC referred to in subsection (4) may disregard that subsection if the nth-to-default credit linked note—
 - (a) is a marketable debt security; and
 - (b) has an SCRA issue specific rating with a credit quality grade of 1, 2 or 3.

53ZR. Matched positions in liquid debt security investments and SRF securities, except positions arising from common credit derivatives

- (1) This section applies to an SMRA-LC in relation to its following positions, except a notional position arising from a common credit derivative—
 - (a) a position in a liquid debt security investment;
 - (b) a notional position in an SRF security.
- (2) Each of the following pairs of an SMRA-LC’s positions may be treated, to the extent that the sizes of the positions are equal, as a pair of matched positions—
 - (a) a pair of—

- (i) an aggregate long spot position in a category of debt security or basket of debt securities; and
 - (ii) an aggregate short notional position in the same category or basket arising from common debt security derivatives that are in the form of futures contracts or forward contract;
- (b) a pair of—
 - (i) an aggregate short spot position in a category of debt security or basket of debt securities; and
 - (ii) an aggregate long notional position in the same category or basket arising from common debt security derivatives that are in the form of futures contracts or forward contracts.
- (3) Each of following pairs of an SMRA-LC's positions in respect of which the conditions specified in subsection (4) are satisfied may be treated, to the extent that the sizes of the positions are equal, as a pair of matched positions—
 - (a) a pair of—
 - (i) a long notional position in a liquid debt security investment arising from a common debt security derivative that is in the form of a futures contract; and
 - (ii) a short notional position in the same investment arising from another common debt security derivative that is in the form of a futures contract;
 - (b) a pair of the following positions arising under section 53ZN(1) or 53ZO(1)—
 - (i) short notional position in an SRF security arising from a long position in a common interest rate derivative or common debt security derivative that is in the form of a futures contract; and
 - (ii) a long notional position in an SRF security arising from a short position in another common interest rate derivative or common debt security derivative (as the case may be) that is in the form of a futures contract;
 - (c) a pair of the following positions arising under section 53ZN(2)—
 - (i) a long notional position in an SRF security arising from a long position in a common interest rate derivative that is in the form of a futures contract; and
 - (ii) a short notional position in an SRF security arising from a short position in another common interest rate derivative that is in the form of a futures contract.
- (4) The conditions specified for subsection (3) are that the futures contracts—
 - (a) have the same underlying subject matter;
 - (b) are denominated in the same currency; and
 - (c) mature within 7 days of each other.
- (5) Each of the following pairs of an SMRA-LC's positions in respect of which the conditions specified in subsection (6) are satisfied may be treated, to the extent that the sizes of the positions are equal, as a pair of matched positions—
 - (a) a pair of—
 - (i) a long notional position in a liquid debt security investment arising from a common debt security derivative that is in the form of a forward contract; and
 - (ii) a short notional position in the same investment arising from another common debt security derivative that is in the form of a forward contract;

- (b) a pair of the following positions arising under section 53ZN(1)—
 - (i) a short notional position in an SRF security arising from a long position in a common interest rate derivative that is in the form of a forward contract; and
 - (ii) a long notional position in an SRF security arising from a short position in another common interest rate derivative that is in the form of a forward contract;
- (c) a pair of the following positions arising under section 53ZN(2)—
 - (i) a long notional position in an SRF security arising from a long position in a common interest rate derivative that is in the form of a forward contract; and
 - (ii) a short notional position in an SRF security arising from a short position in another common interest rate derivative that is in the form of a forward contract;
- (d) a pair of the following positions arising under section 53ZN(3)(a)—
 - (i) a short notional position in an SRF security arising from a common interest rate derivative that is in the form of a forward rate agreement; and
 - (ii) a long notional position in an SRF security arising from another common interest rate derivative that is in the form of a forward rate agreement;
- (e) a pair of the following positions arising under section 53ZN(3)(b)—
 - (i) a short notional position in an SRF security arising from a common interest rate derivative that is in the form of a forward rate agreement; and
 - (ii) a long notional position in an SRF security arising from another common interest rate derivative that is in the form of a forward rate agreement;
- (f) a pair of the following positions arising under section 53ZN(4)(a)—
 - (i) a short notional position in an SRF security arising from a position in a common interest rate derivative that is the form of an interest rate swap or cross-currency interest rate swap; and
 - (ii) a long notional position in an SRF security arising from a position in another common interest rate derivative that is the form of an interest rate swap or cross-currency interest rate swap;
- (g) a pair of the following positions arising under the same paragraph among section 53ZN(4)(b), (5)(a) or (5)(b)—
 - (i) a short notional position in an SRF security arising from a position in a common interest rate derivative that is the form of an interest rate swap or a cross-currency interest rate swap under which the interest payments to be made by the SMRA-LC are calculated at a particular floating rate; and
 - (ii) a long notional position in an SRF security arising from a position in another common interest rate derivative that is the form of an interest rate swap or cross-currency interest rate swap (as the case may be) under which the interest payments to be received by the SMRA-LC are calculated at the same floating rate;
- (h) a pair of the following positions arising under section 53ZO(1)—
 - (i) a short notional position in an SRF security arising from a long position in a common debt security derivative—
 - (A) that is in the form of a forward contract; and
 - (B) the underlying subject matter of which is a liquid debt security investment; and

- (ii) a long notional position in an SRF security arising from a short position in another common debt security derivative—
 - (A) that is in the form of a forward contract; and
 - (B) the underlying subject matter of which is the same investment.
- (6) The conditions specified for subsection (5) are that—
 - (a) both of the common debt security derivatives or common interest rate derivatives (as applicable)—
 - (i) for common debt security derivatives or common interest rate derivatives that are in the form of forward contracts—have the same underlying subject matter;
 - (ii) for common interest rate derivatives that are in the form of forward rate agreements or forward contracts—are denominated in the same currency; or
 - (iii) for common interest rate derivatives that are in the form of interest rate swaps or cross-currency interest rate swaps—have underlying subject matters that are denominated in the same currency;
 - (b) for a pair of positions referred to in subsection (5)(b), (c), (d), (e), (f), (g) or (h)—the residual maturity of the SRF securities—
 - (i) are the same as each other and each being a period of not more than 1 month;
 - (ii) are within 7 days of each other and each being a period of more than 1 month but not more than 1 year; or
 - (iii) are within 30 days of each other and each being a period of more than 1 year;
 - (c) for common interest rate derivatives that are in the form of interest rate swaps, cross-currency interest rate swaps or forward rate agreements—both swaps or agreements (as applicable)—
 - (i) have the same floating interest rate (if each of them has 1 floating interest rate) or the same pair of floating interest rates (if each of them has a pair of floating interest rates) as their underlying subject matters, where the next interest fixing dates for each pair of same floating interest rates—
 - (A) are the same as each other and each falling on a date within 1 month;
 - (B) within 7 days of each other and each falling on a date beyond 1 month but within 1 year; or
 - (C) within 30 days of each other and each falling on a date beyond 1 year; and
 - (ii) have a difference (if any) between their fixed interest rates (if any) of not more than 15 basis points.

53ZS. Matched positions involving certain common credit derivatives

- (1) An SMRA-LC's long spot position in a debt security (**debt security A**) and its short notional position in a debt security of the same category (**debt security B**) arising from its spot position in a common credit derivative that is a single-name total return swap may be treated, to the extent that the sizes of the spot and notional positions in debt security A and debt security B are equal, as a pair of matched positions if—
 - (a) both debt security A and debt security B are marketable debt securities;

- (b) debt security A, debt security B and the derivative are denominated in the same currency;
 - (c) the spot position in debt security A and the spot position in the derivative are held for hedging each other; and
 - (d) the market values of the spot position in debt security A and the spot position in the derivative always move in the opposite direction and broadly to the same extent.
- (2) An SMRA-LC's long spot position in a basket of debt securities and its short notional position in the same basket of debt securities arising from its spot position in a common credit derivative that is a total return swap may be treated, to the extent that the sizes of the spot and notional positions in the basket of debt securities are equal, as a pair of matched positions if—
- (a) the basket of debt securities is a liquid debt security investment;
 - (b) the debt securities constituting the basket and the derivative are denominated in the same currency;
 - (c) the spot position in the basket of debt securities and the spot position in the derivative are held for hedging each other; and
 - (d) the market values of the spot position in the basket of debt securities and the spot position in the derivative always move in the opposite direction and broadly to the same extent.
- (3) An SMRA-LC's opposite notional positions in one or more debt securities of the same category arising from its spot positions in 2 common credit derivatives that are single-name total return swaps may be treated, to the extent that the sizes of the notional positions in the debt securities are equal, as a pair of matched positions if—
- (a) the debt securities are marketable debt securities;
 - (b) the derivatives are denominated in the same currency;
 - (c) the spot positions in the derivatives are held for hedging each other; and
 - (d) the market values of the spot positions in the derivatives always move in the opposite direction and broadly to the same extent.
- (4) An SMRA-LC's opposite notional positions in the same basket of debt securities arising from its spot positions in 2 common credit derivatives that are total return swaps may be treated, to the extent that the sizes of the notional positions in the basket of debt securities are equal, as a pair of matched positions if—
- (a) the basket of debt securities is a liquid debt security investment;
 - (b) the derivatives are denominated in the same currency;
 - (c) the spot positions in the derivatives are held for hedging each other; and
 - (d) the market values of the spot positions in the derivatives always move in the opposite direction and broadly to the same extent.
- (5) An SMRA-LC's long spot position in a debt security (**debt security A**) and its short notional position in a debt security of a different category (**debt security B**) arising from its spot position in a common credit derivative that is a single-name total return swap may be treated, to the extent that the sizes of the spot and notional positions in debt security A and debt security B are equal, as a pair of matched positions if—
- (a) both debt security A and debt security B are marketable debt securities;
 - (b) debt security A, debt security B and the derivative are denominated in the same currency;

- (c) the spot position in debt security A and the spot position in the derivative are held for hedging each other;
 - (d) the market values of the spot position in debt security A and the spot position in the derivative usually move in the opposite direction;
 - (e) debt security A and debt security B have the same issuer;
 - (f) legally enforceable cross-default or cross-acceleration clauses are included in the terms and conditions of debt security A and debt security B; and
 - (g) debt security B ranks for payment or repayment equally with, or junior to, debt security A.
- (6) An SMRA-LC's long notional position in a debt security (**debt security A**) arising from its spot position in a common credit derivative that is a single-name total return swap and its short notional position in a debt security of a different category (**debt security B**) arising from its spot position in another common credit derivative that is a single-name total return swap may be treated, to the extent that the sizes of the notional positions in debt security A and debt security B are equal, as a pair of matched positions if—
- (a) both debt security A and debt security B are liquid debt securities investments;
 - (b) debt security A and debt security B are denominated in the same currency;
 - (c) the derivatives are denominated in the same currency;
 - (d) the spot positions in the derivatives are held for hedging each other;
 - (e) the market values of the spot positions in the derivatives usually move in the opposite direction;
 - (f) debt security A and debt security B have the same issuer;
 - (g) legally enforceable cross-default or cross-acceleration clauses are included in the terms and conditions of debt security A and debt security B; and
 - (h) debt security B ranks for payment or repayment equally with, or junior to, debt security A.
- (7) An SMRA-LC's opposite notional positions in one or more debt securities of the same category arising from its spot positions in 2 identical common credit derivatives may be treated, to the extent that the sizes of the notional positions in the debt securities are equal, as a pair of matched positions if—
- (a) the spot positions in the derivatives are held for hedging each other; and
 - (b) the market values of the spot positions in the derivatives always move in the opposite direction and broadly to the same extent.
- (8) An SMRA-LC's opposite notional positions in one or more debt securities of the same category arising from its spot positions in 2 common credit derivatives that are both single-name credit default swaps, single-name credit linked notes or single-name total return swaps may be treated, to the extent that the sizes of the notional positions in the debt securities are equal, as a pair of matched positions if—
- (a) the debt securities are marketable debt securities;
 - (b) the spot positions in the derivatives are held for hedging each other;
 - (c) the market values of the spot positions in the derivatives usually move in the opposite direction; and
 - (d) the derivatives are identical in all respects except that—
 - (i) for single-name total return swaps, they—
 - (A) are denominated in different currencies; or

- (B) are denominated in different currencies and have different maturities; or
 - (ii) for single-name credit default swaps or single-name credit linked notes, they—
 - (A) are denominated in different currencies;
 - (B) have different maturities; or
 - (C) are denominated in different currencies and have different maturities.
- (9) An SMRA-LC's long spot position in a debt security (**debt security A**) and its short notional position in a debt security of the same category (**debt security B**) arising from its spot position in a common credit derivative that is a single-name credit default swap or a single-name credit linked note may be treated, to the extent that the sizes of the spot and notional positions in debt security A and debt security B are equal, as a pair of matched positions if—
 - (a) both debt security A and debt security B are marketable debt securities;
 - (b) the spot position in debt security A and the spot position in the derivative are held for hedging each other;
 - (c) the market values of the spot position in debt security A and the spot position in the derivative always move in the opposite direction but not broadly to the same extent;
 - (d) debt security A and the derivative have the same maturity and are denominated in the same currency;
 - (e) the credit event definitions and settlement mechanisms and other key factors of the derivative do not cause the price movements of the derivative to deviate more than 20% from the price movements of debt security A; and
 - (f) the derivative transfers risk effectively taking account of any restrictive payout provisions (including fixed payouts and materiality thresholds).
- (10) An SMRA-LC's opposite notional positions in one or more debt securities of the same category arising from its spot positions in 2 common credit derivatives of which one is a single-name credit default swap or single-name credit linked note and the other is a single-name credit default swap, single-name credit linked note or single-name total return swap may be treated, to the extent that the sizes of the notional positions in the debt securities are equal, as a pair of matched positions if—
 - (a) the debt securities are marketable debt securities;
 - (b) the spot positions in the derivatives are held for hedging each other;
 - (c) the market values of the spot positions in the derivatives always move in the opposite direction but not broadly to the same extent;
 - (d) the derivatives have the same maturity and are denominated in the same currency;
 - (e) the credit event definitions and settlement mechanisms and other key factors of one of the derivatives do not cause its price movements to deviate more than 20% from the price movements of the other derivative; and
 - (f) the derivatives transfer risk effectively taking account of any restrictive payout provisions (including fixed payouts and materiality thresholds).
- (11) An SMRA-LC's long spot position in a debt security (**debt security A**) and its short notional position in a debt security of the same category (**debt security B**) arising from its spot position in a common credit derivative that is a single-name credit default swap, single-name credit linked note or single-name total return swap may be treated,

to the extent that the sizes of the spot and notional positions in debt security A and debt security B are equal, as a pair of matched positions if—

- (a) both debt security A and debt security B are marketable debt securities;
 - (b) the spot position in debt security A and the spot position in the derivative are held for hedging each other;
 - (c) the market values of the spot position in debt security A and the spot position in the derivative usually move in the opposite direction;
 - (d) debt security A and the derivative—
 - (i) for a single-name total return swap—are denominated in different currencies; or
 - (ii) for a single-name credit default swap or single-name credit linked note—
 - (A) are denominated in different currencies;
 - (B) have different maturities; or
 - (C) are denominated in different currencies and have different maturities;
 - (e) the credit event definitions and settlement mechanisms and other key factors of the derivative do not cause the price movements of the derivative to deviate more than 20% from the price movements of debt security A; and
 - (f) the derivative transfers risk effectively taking account of any restrictive payout provisions (including fixed payouts and materiality thresholds).
- (12) An SMRA-LC's opposite notional positions in one or more debt securities of the same category arising from its spot positions in 2 common credit derivatives that are any combination of, or are both, single-name credit default swaps, single-name credit linked notes or single-name total return swaps may be treated, to the extent that the sizes of the notional positions in the debt securities are equal, as a pair of matched positions if—
- (a) the debt securities are marketable debt securities;
 - (b) the spot positions in the derivatives are held for hedging each other;
 - (c) the market values of the spot positions in the derivatives usually move in the opposite direction;
 - (d) the derivatives—
 - (i) if both are single-name total return swaps—are denominated in different currencies; or
 - (ii) in any other case—
 - (A) are denominated in different currencies;
 - (B) have different maturities; or
 - (C) are denominated in different currencies and have different maturities;
 - (e) the credit event definitions and settlement mechanisms and other key factors of one of the derivatives do not cause its price movements to deviate more than 20% from the price movements of the other derivative; and
 - (f) the derivatives transfer risk effectively taking account of any restrictive payout provisions (including fixed payouts and materiality thresholds).
- (13) An SMRA-LC's long spot position in a debt security (**debt security A**) and its short notional position in a debt security of a different category (**debt security B**) arising from its spot position in a common credit derivative that is a single-name credit default swap or single-name credit linked note may be treated, to the extent that the sizes of

the spot and notional positions in debt security A and debt security B are equal, as a pair of matched positions if—

- (a) both debt security A and debt security B are marketable debt securities;
 - (b) debt security A is a deliverable obligation specified in the terms and conditions of the derivative;
 - (c) the spot position in debt security A and the spot position in the derivative are held for hedging each other;
 - (d) the market values of the spot position in debt security A and the spot position in the derivative usually move in the opposite direction;
 - (e) debt security A and the derivative have the same maturity and are denominated in the same currency;
 - (f) the credit event definitions and settlement mechanisms and other key factors of the derivative do not cause the price movements of the derivative to deviate more than 20% from the price movements of debt security A; and
 - (g) the derivative transfers risk effectively taking account of any restrictive payout provisions (including fixed payouts and materiality thresholds).
- (14) An SMRA-LC's long notional position in a debt security (**debt security A**) arising from its spot position in a common credit derivative and its short notional position in a debt security of a different category (**debt security B**) arising from its spot position in another common credit derivative may be treated, to the extent that the sizes of the notional positions in debt security A and debt security B are equal, as a pair of matched positions if—
- (a) both debt security A and debt security B are marketable debt securities;
 - (b) one of the derivatives is a single-name credit default swap or single-name credit linked note and the other derivative is a single-name credit default swap, single-name credit linked note or single-name total return swap;
 - (c) the debt security underlying one of the derivatives is the deliverable obligation specified in the terms and conditions of the other derivative;
 - (d) the spot positions in the derivatives are held for hedging each other;
 - (e) the market values of the spot positions in the derivatives usually move in the opposite direction;
 - (f) the derivatives have the same maturity and are denominated in the same currency;
 - (g) the credit event definitions and settlement mechanisms and other key factors of one of the derivatives do not cause its price movements to deviate more than 20% from the price movements of the other derivative; and
 - (h) the derivatives transfer risk effectively taking account of any restrictive payout provisions (including fixed payouts and materiality thresholds).
- (15) An SMRA-LC may include a long or short position (or a part of it) only in 1 pair of matched positions under this section.

53ZT. Matched positions involving common credit derivatives that are first-to-default credit default swaps or first-to-default credit linked notes

- (1) Subject to subsection (2), an SMRA-LC's long spot position in a debt security (**debt security A**) and its notional position in a debt security of the same category (**debt security B**) arising from its spot position in a common credit derivative that is a first-to-default credit default swap or first-to-default credit linked note may be treated,

to the extent that the sizes of the spot and notional positions in debt security A and debt security B are equal, as a pair of matched positions if—

- (a) both debt security A and debt security B are marketable debt securities;
 - (b) the SMRA-LC is the protection buyer under the derivative;
 - (c) the spot position in debt security A and the spot position in the derivative are held for hedging each other; and
 - (d) the notional position in debt security B does not form one side of a pair of matched positions under section 53ZS(7).
- (2) If the SMRA-LC referred to in subsection (1) holds long spot positions in 2 or more categories of debt securities, the SMRA-LC may treat only its long spot positions in the category of debt security to which the lowest specific risk charge percentage applies and its notional positions in debt securities of the same category as pairs of matched positions under subsection (1).

Subdivision 2—Specific risk charges

53ZU. Specific risk charge for positions in liquid debt security investments except notional positions arising from common credit derivatives

- (1) Subject to subsection (2), an SMRA-LC must, in respect of its net position in a liquid debt security investment, include in its ranking liabilities an amount that is equal to the lower of—
- (a) the default risk-related loss of the net position; and
 - (b) the market value of the net position, multiplied by—
 - (i) for a net position in a category of debt security—the product of—
 - (A) the specific risk percentage applicable to that category of debt security; and
 - (B) the scaling factor applicable to that percentage; or
 - (ii) for a net position in a basket of debt securities or a debt security index—
 - (A) the product of—
 - (I) the highest of the specific risk percentages applicable to each of the categories of debt securities that constitute the basket or the basket underlying the index; and
 - (II) the scaling factor applicable to that highest percentage; or
 - (B) the product of—
 - (I) the weighted average specific risk percentage applicable to the basket or index; and
 - (II) the scaling factor 1.3.
- (2) An SMRA-LC, in calculating its net position in a liquid debt security investment for subsection (1), must exclude—
- (a) a controlled asset position in the investment;
 - (b) a position in the investment (or the part of the position) that forms one side of a pair of matched positions under section 53ZR(2)(a) or (b), (3)(a) or (5)(a);
 - (c) a long spot position in the investment (or the part of the position) that forms one side of a pair of matched positions under section 53ZS(1), (2), (5), (9), (11), (13) or 53ZT(1);

- (d) a spot position in the investment where the investment is common credit derivative that is a single-name credit linked note, multiple-name credit linked note or nth-to-default credit linked note, and—
 - (i) the SMRA-LC is the protection buyer under the note; and
 - (ii) the note does not have an SCRA issue specific rating with a credit quality grade of 1, 2 or 3; and
 - (e) a notional position in the investment arising from a common credit derivative.
- (3) An SMRA-LC must, in respect of each controlled asset position in a liquid debt security investment (except a position falling within subsection (2)(d) or (e)), include in its ranking liabilities an amount that is equal to lower of—
- (a) the default risk-related loss of the position; and
 - (b) subject to subsection (4), the market value of the position, multiplied by—
 - (i) for a position in a category of debt security—the product of—
 - (A) the specific risk percentage applicable to the category of debt security; and
 - (B) the scaling factor applicable to that percentage; or
 - (ii) for a position in a basket of debt securities or a debt security index—
 - (A) the product of—
 - (I) the highest of the specific risk percentages applicable to each of the categories of debt securities that constitute the basket or the basket underlying the index; and
 - (II) the scaling factor applicable to that highest percentage; or
 - (B) the product of—
 - (I) the weighted average specific risk percentage applicable to the basket or index; and
 - (II) the scaling factor 1.3.
- (4) The total amount to be included under subsection (3)(b) in respect of an SMRA-LC's controlled asset positions in a liquid debt security investment that are opposite to the SMRA-LC's net long or short position in that investment calculated for subsection (1) is to be reduced, down to zero at most, by the amount included in the SMRA-LC's ranking liabilities under subsection (1) in respect of the net position.
- (5) In this section—
- default risk-related loss** (), in relation to an SMRA-LC's—
- (a) position in a category of debt security—means the SMRA-LC's maximum possible loss if—
 - (i) for a long position—the issuer of the category of debt security was to default immediately with zero recoveries; or
 - (ii) for a short position—the category of debt security was to become immediately default risk-free; or
 - (b) position in a basket of debt securities or a debt security index—means the SMRA-LC's maximum possible loss if—
 - (i) for a long position—all of the issuers of the categories of debt securities that constitute the basket, or the basket underlying the index, were to default immediately with zero recoveries; or

- (ii) for a short position—all of the categories of debt securities that constitute the basket or the basket underlying the index were to become immediately default risk-free.

53ZV. Specific risk charge for positions in illiquid debt security investments except notional positions arising from common credit derivatives

- (1) Subject to subsection (2), an SMRA-LC must, in respect of its positions in an illiquid debt security investment, include in its ranking liabilities an amount equal to the higher of—
 - (a) the market value of its aggregate long position in the illiquid debt security investment; and
 - (b) the market value of its aggregate short position in the illiquid debt security investment.
- (2) An SMRA-LC, in calculating its aggregate long position and aggregate short position in the illiquid debt security investment—
 - (a) must exclude a notional position in the investment arising from a common credit derivative;
 - (b) may exclude an aggregate long position and an aggregate short position in the investment, to the extent that the sizes of the positions are equal, if the positions can be applied to offset or settle the obligations arising from each other; and
 - (c) if the investment is a category of debt security or basket of debt securities, may exclude a short position in the category or basket (or the part of the position) that can be settled by a long spot position in the same category or basket.

53ZW. Specific risk charge for notional positions in debt securities arising from common credit derivatives except nth-to-default credit default swaps or credit linked notes

- (1) Subject to subsection (2), an SMRA-LC must, in respect of each of the following, include in its ranking liabilities the amount specified in subsection (3)—
 - (a) its notional position in a debt security arising from a single-name total return swap under section 53ZP(2)(a);
 - (b) its notional position in a basket of debt securities arising from multiple-name total return swap under section 53ZP(2)(a);
 - (c) its notional position in a debt security arising from a single-name credit default swap under section 53ZP(3)(a);
 - (d) all of its notional positions in debt securities arising from a multiple-name credit default swap under section 53ZP(4)(a);
 - (e) its notional position in a debt security from a single-name credit linked note under section 53ZP(5);
 - (f) all of its notional positions in debt securities arising from multiple-name credit linked note under section 53ZP(6).
- (2) An SMRA-LC must exclude from its calculation of the amount for subsection (1) a notional position (or the part of the position) that forms one side of a pair of matched positions under section 53ZS.
- (3) The amount specified for subsection (1) is the lower of—
 - (a) in the case of—
 - (i) a notional position referred to in subsection (1)(a), (b), (c) or (e)—the specified amount of that notional position; or

- (ii) notional positions referred to in subsection (1)(d) or (f)—the sum of the specified amounts of all of the notional positions; and
- (b) the SMRA-LC's maximum possible loss under the swap or note if the debt security, basket of debt securities or debt securities referred to in subsection (1)(a), (b), (c), (d), (e) or (f) (as the case may be) were to—
 - (i) where the SMRA-LC is the protection buyer under the swap or note—become immediately default risk-free; or
 - (ii) where the SMRA-LC is the protection seller under the swap or note—default immediately with zero recoveries.

(4) In this section—

specified amount ()—

- (a) in relation to a notional position in a debt security—means the notional value of the position, multiplied by the product of—
 - (i) the specific risk percentage applicable to that debt security; and
 - (ii) the scaling factor applicable to that percentage; or
- (b) in relation to a notional position in a basket of debt securities—means the notional value of the position, multiplied by—
 - (i) the product of—
 - (A) the highest of the specific risk percentages applicable to each of the debt securities that constitute the basket; and
 - (B) the scaling factor applicable to that highest percentage; or
 - (ii) the product of—
 - (A) the weighted average specific risk percentage applicable to the basket; and
 - (B) the scaling factor 1.3.

53ZX. Specific risk charge for notional positions in debt securities and securitization issues arising from nth-to-default credit default swaps or credit linked notes

- (1) Subject to subsection (2), an SMRA-LC must, in respect each of the following, include in its ranking liabilities the amount specified in subsection (3)—
 - (a) its notional positions in debt securities arising from an nth-to-default credit default swap under section 53ZQ(1)(a);
 - (b) its notional position in a securitization issue arising from an nth-to-default credit default swap under section 53ZQ(2) in place of notional positions in debt securities that would otherwise arise from the swap under section 53ZQ(1)(a);
 - (c) its notional positions in debt securities arising from an nth-to-default credit linked note under section 53ZQ(4).
- (2) An SMRA-LC must exclude from its calculation of the amount for subsection (1) a notional position in a debt security (or the part of the position) that forms one side of a pair of matched positions under section 53ZS(7) or 53ZT(1).
- (3) The amount specified for subsection (1) is the lower of—
 - (a) in the case of—
 - (i) notional positions referred to in subsection (1)(a) or (c)—the sum of the specified amounts of all of the notional positions; and
 - (ii) a notional position referred to in subsection (1)(b)—the specified amount of that notional position; and

- (b) the SMRA-LC's maximum possible loss under the swap or note if the debt securities referred to in subsection (1)(a), (b) or (c) (as the case may be) were to—
 - (i) where the SMRA-LC is the protection buyer under the swap or note—become immediately default risk-free; or
 - (ii) where the SMRA-LC is the protection seller under the swap or note—default immediately with zero recoveries.
- (4) In this section—

specified amount ()—

 - (a) in relation to a notional position in a debt security—means the notional value of the position, multiplied by the product of—
 - (i) the specific risk percentage applicable to that debt security; and
 - (ii) the scaling factor applicable to that percentage;
 - (b) in relation to a notional position in a securitization issue—means the notional value of the position, multiplied by the product of—
 - (i) the specific risk percentage applicable to that securitization issue; and
 - (ii) the scaling factor applicable to that percentage.

53ZY. Specific risk charge for certain matched positions arising from common credit derivatives

- (1) An SMRA-LC must, in respect of each following pair of positions, include in its ranking liabilities the amount specified in subsection (2)—
 - (a) a long spot position in a debt security (or the part of it) that forms one side of a pair of matched positions under section 53ZS(5), (11) or (13) (**excluded spot position**); and
 - (b) a notional position in a debt security (or the part of it) that forms the other side of that pair of matched positions (**excluded notional position**).
- (2) The amount to be included under subsection (1) is an amount equal to the higher of—
 - (a) the lower of—
 - (i) the default risk-related loss of the excluded spot position; and
 - (ii) the market value of the excluded spot position, multiplied by the product of—
 - (A) the specific risk percentage applicable to the debt security referred to in subsection (1)(a); and
 - (B) the scaling factor applicable to that percentage; and
 - (b) the lower of—
 - (i) the SMRA-LC's maximum possible loss under the common credit derivative from which the excluded notional position arises if the debt security referred to in subsection (1)(b) was to become immediately default risk-free; and
 - (ii) the notional value of the excluded notional position, multiplied by the product of—
 - (A) the specific risk percentage applicable to that debt security; and
 - (B) the scaling factor applicable to that percentage.
- (3) An SMRA-LC must, in respect of each pair of notional positions in debt securities (or the parts of the positions) that form a pair of matched positions under section 53ZS(6),

- (8), (12) or (14) (**excluded notional positions**), include in its ranking liabilities an amount equal to the higher of the following absolute value for each of the excluded notional positions, that is, the lower of—
- (a) the notional value of the excluded notional position, multiplied by the product of—
 - (i) the specific risk percentage applicable to the debt security to which the excluded notional position relates (**relevant debt security**); and
 - (ii) the scaling factor applicable to that percentage; and
 - (b) the SMRA-LC's maximum possible loss under the common credit derivative from which the excluded notional position arises if the relevant debt security was to—
 - (i) where the SMRA-LC is the protection buyer under the derivative—become immediately default risk-free; or
 - (ii) where the SMRA-LC is the protection seller under the derivative—default immediately with zero recoveries.
- (4) An SMRA-LC must, in respect of each following pair of positions, include in its ranking liabilities the amount specified in subsection (5)—
- (a) a long spot position in a debt security (or the part of it) that forms one side of a pair of matched positions under section 53ZS(9) (**excluded spot position**); and
 - (b) a notional position in a debt security that forms the other side of that pair of matched positions (**excluded notional position**).
- (5) The amount to be included under subsection (4) is an amount equal to 20% of the higher of—
- (a) the lower of—
 - (i) the default risk-related loss of the excluded spot position; and
 - (ii) the market value of the excluded spot position, multiplied by the product of—
 - (A) the specific risk percentage applicable to the debt security referred to in subsection (4)(a); and
 - (B) the scaling factor applicable to that percentage; and
 - (b) the lower of—
 - (i) the SMRA-LC's maximum possible loss under the common credit derivative from which the excluded notional position arises if the debt security referred to in subsection (4)(b) was to become immediately default risk-free; and
 - (ii) the notional value of the excluded notional position, multiplied by the product of—
 - (A) the specific risk percentage applicable to that debt security; and
 - (B) the scaling factor applicable to that percentage.
- (6) An SMRA-LC must, in respect of each pair of notional positions in debt securities (or the parts of the positions) that form a pair of matched positions under section 53ZS(10) (**excluded notional positions**), include in its ranking liabilities an amount equal to 20% of the higher of the following absolute value for each of the excluded notional positions, that is, the lower of—
- (a) the notional value of the excluded notional position, multiplied by the product of—

- (i) the specific risk percentage applicable to the debt security to which the excluded notional position relates (**relevant debt security**); and
 - (ii) the scaling factor applicable to that percentage; and
- (b) the SMRA-LC's maximum possible loss under the common credit derivative from which the excluded notional position arises if the relevant debt security was to—
 - (i) where the SMRA-LC is the protection buyer under the derivative—become immediately default risk-free; or
 - (ii) where the SMRA-LC is the protection seller under the derivative—default immediately with zero recoveries.
- (7) An SMRA-LC must, in respect of each following pair of positions, include in its ranking liabilities the amount specified in subsection (8)—
 - (a) a long spot position in a debt security (or the part of it) that forms one side of a pair of matched positions under section 53ZT(1) (**excluded spot position**); and
 - (b) a notional position in a debt security that forms the other side of that pair of matched positions (**excluded notional position**).
- (8) The amount to be included under subsection (7) is an amount equal to the absolute value of the difference between—
 - (a) the lower of—
 - (i) the default risk-related loss of the excluded spot position; and
 - (ii) the market value of the excluded spot position, multiplied by the product of—
 - (A) the specific risk percentage applicable to the debt security referred to in subsection (7)(a); and
 - (B) the scaling factor applicable to that percentage; and
 - (b) the lower of—
 - (i) the SMRA-LC's maximum possible loss under the common credit derivative from which the excluded notional position arises if the debt security referred to in subsection (7)(b) was to become immediately default risk-free; and
 - (ii) the notional value of the excluded notional position, multiplied by the product of—
 - (A) the specific risk percentage applicable to that debt security; and
 - (B) the scaling factor applicable to that percentage.
- (9) In this section—
default risk-related loss () has the meaning given by section 53ZU(5).

Subdivision 3—General risk charge

53ZZ. Currency in which basket of debt securities or debt security index is denominated

- (1) For the purposes of this Subdivision, an SMRA-LC must, in relation to a position in a basket of debt securities—
 - (a) if the basket is constituted by debt securities that are denominated in a single currency—treat the basket as being denominated in that currency; or
 - (b) if the basket is constituted by debt securities that are denominated in 2 or more currencies (**original basket**)—treat the position in the original basket as

separate notional positions, each in a basket of debt securities constituted by the debt securities in the original basket that are denominated in the same currency.

- (2) For the purposes of this Subdivision, an SMRA-LC must, in relation to a position in a debt security index—
 - (a) if the basket of debt securities underlying the index is constituted debt securities that are denominated in a single currency—treat the index as being denominated in that currency; or
 - (b) if the basket of debt securities underlying the index is constituted by debt securities that are denominated in 2 or more currencies (**original basket**)—
 - (i) treat the position in the index as separate notional positions, each in a basket of debt securities that is constituted by the debt securities in the original basket that are denominated in the same currency; and
 - (ii) despite section 9A(1)(b), calculate the market value of each such basket by multiplying the market value of the SMRA-LC's position in the index by the weighting of the currency in which the basket is denominated within the original basket.

53ZZA. General risk charge

- (1) Subject to subsection (2), an SMRA-LC must, in respect of all of its following positions that are denominated in a particular currency, include in its ranking liabilities an amount calculated in accordance with subsection (4)—
 - (a) a spot position in—
 - (i) a category of debt security; or
 - (ii) a basket of debt securities;
 - (b) a notional position in any of the following matters arising from a common derivative—
 - (i) a category of debt securities
 - (ii) a basket of debt securities;
 - (iii) a debt security index;
 - (iv) an SRF security.
- (2) An SMRA-LC, in calculating the general risk charge—
 - (a) may exclude its net long position in any of the following matters to which the specific risk percentage applicable is 100%—
 - (i) a category of debt security;
 - (ii) a basket of debt securities;
 - (iii) a debt security index;
 - (b) may exclude its short position in a category of debt security that is an illiquid investment (or the part of the position) that can be settled by its long spot position in the same category of debt security;
 - (c) may exclude its short position in a basket of debt securities that is constituted only by illiquid investments (**subject basket**) (or the part of the position) that can be settled by its long spot position in another basket of debt securities that is identical to the subject basket; and
 - (d) must exclude its position (or the part of the position) that forms one side of a pair of matched positions referred to in section 53ZR(2), (3) or (5) or 53ZS(1), (2), (3), (4) or (7).

- (3) For subsection (1), an SMRA-LC must, in relation to its positions denominated in each currency that is a non-freely floating foreign currency, calculate and include in its ranking liabilities separate general risk charges for—
 - (a) such positions that are onshore positions as defined by section 53ZZH(8)(a)(i); and
 - (b) such positions that are offshore positions as defined by section 53ZZH(8)(a)(ii).
- (4) The amount to be included under subsection (1) in relation to a currency is the sum of the following amounts, multiplied by the scaling factor 1.3—
 - (a) the overall risk-weighted net position value referred to in subsection (5)(g);
 - (b) the sum of the vertical disallowances for all time bands referred to in subsection (5)(d);
 - (c) the sum of the horizontal disallowances for all zones referred to in subsection (5)(e); and
 - (d) the sum of the horizontal disallowances between the zones referred to in subsection (5)(f).
- (5) For subsection (4), the SMRA-LC must allocate each net long position or net short position in a debt security, basket of debt securities or debt security index, or each notional position in an SRF security, to a time band set out in column 2 of Table 5 of Schedule 9 (**time band**) opposite the general risk percentage applicable to that security, basket or index, and calculate—
 - (a) the risk-weighted value of each such net position, by multiplying the market value of the position by the applicable general risk percentage;
 - (b) the total risk-weighted value of—
 - (i) all net long positions in debt securities, baskets of debt securities and debt security indexes and all long positions in SRF securities (**relevant long positions**) for each time band, by aggregating all of the risk-weighted values calculated under paragraph (a) for relevant long positions in the time band; and
 - (ii) all net short positions in debt securities, baskets of debt securities and debt security indexes and all short positions in SRF securities (**relevant short positions**) for each time band, by aggregating all of the risk-weighted values calculated under paragraph (a) for relevant short positions in the time band;
 - (c) the risk-weighted net position value for each time band, by offsetting the total risk-weighted value of all relevant long positions in the time band calculated under paragraph (b)(i) and the total risk-weighted value of all relevant short positions in the time band calculated under paragraph (b)(ii);
 - (d) the vertical disallowance for each time band, by multiplying the lower of the absolute value of the total risk-weighted value of all relevant long positions in the time band calculated under paragraph (b)(i) and the absolute value of the total risk-weighted value of all relevant short positions in the time band calculated under paragraph (b)(ii) by 10%;
 - (e) the horizontal disallowance for each zone set out in column 1 of that Table (**zone**), by—
 - (i) calculating—
 - (A) the sum of all risk-weighted net long position values for all of the time bands in the zone (**aggregate risk-weighted net long position value**); and

- (B) the sum of all risk-weighted net short position values for all of the time bands in the zone (***aggregate risk-weighted net short position value***);
- (ii) multiplying the lower of the absolute values of the aggregate risk-weighted net long position value and aggregate risk-weighted net short position value by—
 - (A) for zone 1—40%;
 - (B) for zone 2—30%; or
 - (C) for zone 3—30%;
- (f) the horizontal disallowance between the zones, by—
 - (i) calculating the risk-weighted net position value for each zone by offsetting the aggregate risk-weighted net long position value and aggregate risk-weighted net short position value for the zone;
 - (ii) calculating the cross-zone netting balance for zone 1—
 - (A) if zone 1 has a net long zone risk-weighted net position value and zone 2 has a net short zone risk-weighted net position value (or vice versa)—
 - (I) by offsetting those values; but
 - (II) if the absolute value of the risk-weighted net position value for zone 1 is less than the absolute value of the risk-weighted net position value for zone 2—by taking zero as the cross-zone netting balance for zone 1; or
 - (B) in any other case—as the risk-weighted net position value for zone 1;
 - (iii) calculating the cross-zone netting balance for zone 2—
 - (A) if zone 1 has a net long zone risk-weighted net position value and zone 2 has a net short zone risk-weighted net position value (or vice versa)—
 - (I) by offsetting those values; but
 - (II) if the absolute value of the risk-weighted net position value for zone 2 is less than the absolute value of the risk-weighted net position value for zone 1—by taking zero as the cross-zone netting balance for zone 2; or
 - (B) in any other case—as the risk-weighted net position value for zone 2;
 - (iv) calculating the cross-zone netting balance for zone 3—
 - (A) if zone 2 has a net long zone risk-weighted net position value and zone 3 has a net short zone risk-weighted net position value (or vice versa)—
 - (I) by offsetting those values; but
 - (II) if the absolute value of the risk-weighted net position value for zone 3 is less than the absolute value of the risk-weighted net position value for zone 2—by taking zero as the cross-zone netting balance for zone 3; or
 - (B) in any other case—as the risk-weighted net position value for zone 3;
 - (v) multiplying—

- (A) if zone 1 has a net long zone risk-weighted net position value and zone 2 has a net short zone risk-weighted net position value (or vice versa)—the lower of the following amounts by 40%—
 - (I) the absolute value of the risk-weighted net position value for zone 1; and
 - (II) the absolute value of the risk-weighted net position value for zone 2;
 - (B) if zone 2 has a net long zone risk-weighted net position value and zone 3 has a net short zone risk-weighted net position value (or vice versa)—the lower of the following amounts by 40%—
 - (I) the absolute value of the cross-zone netting balance for zone 2; and
 - (II) the absolute value of the risk-weighted net position value for zone 3; and
 - (C) if zone 1 has a net long zone risk-weighted net position value and zone 3 has a net short zone risk-weighted net position value (or vice versa)—the lower of the following amounts by 100%—
 - (I) the absolute value of the cross-zone netting balance for zone 1; and
 - (II) the absolute value of the cross-zone netting balance for zone 3; and
- (g) the overall risk-weighted net position value for all of the zones, as the difference between—
 - (i) the absolute value of sum of the net long zone risk-weighted net position values for zones 1, 2 and 3; and
 - (ii) the absolute value of the sum of the net short zone risk-weighted net position values of zones 1, 2 and 3.
- (6) For the purposes of subsection (5)(e), the risk-weighted net position value for a time band calculated under subsection (5)(c) is—
 - (a) if the absolute value of the total risk-weighted value of all relevant long positions in the time band calculated under subsection (5)(b)(i) is greater than the absolute value of the total risk-weighted value of all relevant short positions in the time band calculated under subsection (5)(b)(ii)—a risk-weighted net long position value; or
 - (b) if the absolute value of the total risk-weighted value of all relevant short positions in the time band calculated under subsection (5)(b)(ii) is greater than the absolute value of the total risk-weighted value of all relevant long positions in the time band calculated under subsection (5)(b)(i)—a risk-weighted net short position value.
- (7) For the purposes of subsection (5)(f)(ii), (iii), (iv) and (v) and (g), the risk-weighted net position value for a zone is—
 - (a) if the absolute value of the aggregate risk-weighted net long position value for the zone is greater than the absolute value of the aggregate risk-weighted net short position value for the zone—a net long zone risk-weighted net position value; or
 - (b) if the absolute value of the aggregate risk-weighted net short position value for the zone is greater than the absolute value of the aggregate risk-weighted net

long position value for the zone—a net short zone risk-weighted net position value.

Division 4—Commodity risk

53ZZB. Application of Division to positions in commodities

Subject to sections 53ZZP(6) and 53ZZR(4), this Division applies to an SMRA-LC in relation to the following positions—

- (a) its spot position in—
 - (i) a category of commodity; or
 - (ii) a basket of commodities; and
- (b) its notional position in any of the following matters arising from a common commodity derivative—
 - (i) a category of commodity;
 - (ii) a basket of commodities;
 - (iii) a commodity index.

53ZZC. Market risk charges for positions in tradable commodities, etc.

- (1) This section applies to an SMRA-LC in relation to its position in the following matters—
 - (a) a category of commodity that is a tradable commodity;
 - (b) a basket of commodities that is constituted only by tradable commodities;
 - (c) a commodity index that has a basket of commodities referred to in paragraph (b) underlying it;
 - (d) a basket of commodities that is constituted by both tradable commodities and non-tradable commodities; and
 - (e) a commodity index that has a basket of commodities referred to in paragraph (d) underlying it.
- (2) Subject to subsection (3), an SMRA-LC must, in respect of its net position in a matter referred to in subsection (1), include in its ranking liabilities an amount equal to—
 - (a) for a position in a matter referred to in subsection (1)(a), (b) or (c)—the market value of the position, multiplied by the product of 15% and the scaling factor 1.9;
 - (b) for a position in a basket of commodities referred to in subsection (1)(d)—the market value of the position, multiplied by—
 - (i) 100%; or
 - (ii) the product of the weighted average market risk percentage applicable to the basket and the scaling factor 1.9; or
 - (c) for a position in a commodity index referred to in subsection (1)(e)—the market value of the position, multiplied by—
 - (i) 100%; or
 - (ii) the product of the weighted average market risk percentage applicable to the index and the scaling factor 1.9.
- (3) An SMRA-LC, in calculating its net position in a matter referred to in subsection (1) for subsection (2), must exclude a controlled asset position in that matter.

- (4) Subject to subsection (5), an SMRA-LC must, in respect of each controlled asset position in a matter referred to in subsection (1), include in its ranking liabilities an amount that is equal to the market value of the position, multiplied by—
 - (a) for a position in a matter referred to in subsection (1)(a), (b) or (c)—the product of 15% and the scaling factor 1.9;
 - (b) for a position in a basket of commodities referred to in subsection (1)(d)—
 - (i) 100%; or
 - (ii) the product of the weighted average market risk percentage applicable to the basket and the scaling factor 1.9; or
 - (c) for a position in a commodity index referred to in subsection (1)(e)—
 - (i) 100%; or
 - (ii) the product of the weighted average market risk percentage applicable to the index and the scaling factor 1.9.
- (5) The total amount to be included under subsection (4) in respect of an SMRA-LC's controlled asset positions in a matter referred to in subsection (1) that are opposite to the SMRA-LC's net long or short position in that matter calculated for subsection (2) is to be reduced, down to zero at most, by the amount included in the SMRA-LC's ranking liabilities under subsection (2) in respect of the net position.
- (6) Subject to subsection (7) and (8), an SMRA-LC must, in respect of its aggregate long position and aggregate short position in a matter referred to in subsection (1), include in its ranking liabilities an amount equal to the sum of the market values of the positions, multiplied by the product of 3% and the scaling factor 1.9.
- (7) An SMRA-LC is not required to include an amount under subsection (6) in respect of its aggregate long and short positions in a matter referred to in subsection (1)(d) or (e) if—
 - (a) the net position in that matter calculated for subsection (2) is a net long position; and
 - (b) the SMRA-LC uses 100% under subsection (2)(b)(i) or (c)(i) in its calculation of an amount for the net long position under subsection (2).
- (8) An SMRA-LC, in calculating its aggregate long and short positions in a matter referred to in subsection (1)(d) or (e) for subsection (6), must exclude a controlled asset position in that matter if it uses 100% under subsection (4)(b)(i) or (c)(i) in its calculation of an amount for the controlled asset position under subsection (4).

53ZZD. Market risk charges for positions in non-tradable commodities

- (1) This section applies to an SMRA-LC in relation to its position in the following—
 - (a) a category of commodity that is a non-tradable commodity;
 - (b) a basket of commodities that is constituted only by non-tradable commodities;
 - (c) a commodity index that has a basket of commodities referred to in paragraph (b) underlying it.
- (2) An SMRA-LC must, in respect of its positions in each category of commodity, basket of commodities or commodity index referred to in subsection (1), include in its ranking liabilities an amount that is equal to the sum of the market values of its aggregate long position and aggregate short position in that category, basket or index.

Division 5—Gold risk

53ZZE. Application of Division to positions in gold

Subject to sections 53ZZP(6) and 53ZZR(4), this Division applies to an SMRA-LC in relation to the following positions—

- (a) its spot position in—
 - (i) a category of gold; or
 - (ii) a basket of gold; and
- (b) its notional position in any of the following matters arising from a common gold derivative—
 - (i) a category of gold;
 - (ii) a basket of gold.

53ZZF. Market risk charges for positions in gold

- (1) Subject to subsection (2), an SMRA-LC must, in respect of its net position in each of the following matters, include in its ranking liabilities an amount equal to the market value of the net position, multiplied by the product of 8% and the scaling factor 1.2—
 - (a) a category of gold;
 - (b) a basket of gold.
- (2) An SMRA-LC, in calculating its net position in a category of gold or basket of gold for subsection (1), must exclude a controlled asset position in that category.
- (3) Subject to subsection (4), an SMRA-LC must, in respect of each controlled asset position in a category of gold or basket of gold, include in its ranking liabilities an amount that is equal to the market value of the position, multiplied by the product of 8% and the scaling factor 1.2.
- (4) The total amount to be included under subsection (3) in respect of an SMRA-LC's controlled asset positions in a category of gold or basket of gold that are opposite to the SMRA-LC's net long or short position in that category or basket calculated for subsection (1) is to be reduced, down to zero at most, by the amount included in the SMRA-LC's ranking liabilities under subsection (1) in respect of the net position.

Division 6—Foreign and notional currency risk

53ZZG. Application of Division to positions in foreign and notional currencies

- (1) Subject to subsections (2) and (3) and sections 53ZZP(6) and 53ZZR(4), this Division applies to an SMRA-LC in relation to the following positions—
 - (a) its spot position in a foreign currency arising from an asset or liability under section 9E(1)(a);
 - (b) its spot position in a foreign currency arising from a foreign exchange agreement under section 9E(1)(b);
 - (c) its spot or notional position in a foreign currency arising from a specified leveraged foreign exchange contract under section 9E(1)(c);
 - (d) its notional position in a foreign currency arising from a guarantee or instrument under section 9E(3);
 - (e) its notional position in a foreign currency arising from a common derivative under section 9D(1), 9E(4) and (5); and

- (f) its notional position in a notional currency arising from a common derivative under section 9E(4).
- (2) This Division does not apply to an SMRA-LC in relation to its position in a foreign currency arising from—
 - (a) a fixed asset; or
 - (b) its long spot position in an illiquid investment.
- (3) An SMRA-LC may exclude any of the following positions from the application of this Division—
 - (a) a spot position in a foreign currency arising from an asset that is not included in its liquid assets;
 - (b) a notional position in a foreign currency arising from its position in a category of equity, debt security or commodity, a basket of equities, debt securities or commodities, or an index that has such a basket underlying it, if—
 - (i) the SMRA-LC holds a net long position in that category, basket or index; and
 - (ii) the haircut percentage or specific risk percentage applicable to the net long position (as the case may be) is 100%.

53ZZH. Market risk charges for positions in foreign currencies

- (1) Subject to subsection (4), an SMRA-LC must, in respect of all of its net positions in foreign currencies other than non-freely floating foreign currencies, include in its ranking liabilities an amount equal to the higher of the following amounts, multiplied by the product of 8% and the scaling factor 1.2—
 - (a) the sum of the market values of all of its net long positions; and
 - (b) the sum of the market values of all of its net short positions.
- (2) Subject to subsection (4), an SMRA-LC must, in respect of its onshore net position and offshore net position in a non-freely floating foreign currency, include in its ranking liabilities an amount equal to—
 - (a) if it has only an onshore net position in the currency or an offshore net position in the currency—the market value of the position, multiplied by the product of 8% and the scaling factor 1.2; or
 - (b) if it has both an onshore net position in the currency and an offshore net position in the currency, and—
 - (i) if the positions are both net long positions or net short positions—the sum of the market values of the positions, multiplied by the product of 8% and the scaling factor 1.2; or
 - (ii) if subparagraph (i) does not apply, the sum of—
 - (A) the market value of the lower of its onshore net position in the currency and its offshore net position in the currency, multiplied by 1.5%; and
 - (B) the absolute value of the difference between the market values of its onshore net position in the currency and its offshore net position in the currency, multiplied by the product of 8% and the scaling factor 1.2.
- (3) Subject to subsection (4), an SMRA-LC must, in respect of its net position in a notional currency, include in its ranking liabilities an amount equal to the market value of the net position, multiplied by the product of 8% and the scaling factor 1.2.
- (4) An SMRA-LC, in calculating its net position in a foreign currency or notional currency for subsection (1), (2) or (3), must exclude a controlled asset position in that currency.

- (5) Subject to subsection (6), an SMRA-LC must, in respect of each controlled asset position in a foreign currency or notional currency, include in its ranking liabilities an amount that is equal to the market value of the position, multiplied by the product of 8% and the scaling factor 1.2.
- (6) The total amount to be included under subsection (5) in respect of an SMRA-LC's controlled asset positions in a foreign currency or notional currency that are opposite-to-net positions is to be reduced, down to zero at most, by—
 - (a) where the positions are in a foreign currency other than a non-freely floating foreign currency and the market value of the SMRA-LC's net position in that currency is included in the higher of the amounts referred to in subsection (1)(a) and (b)—the market value of the SMRA-LC's net position in that currency, multiplied by the product of 8% and the scaling factor 1.2;
 - (b) where the positions are in a non-freely floating foreign currency and—
 - (i) the opposite-to-net positions are onshore positions—
 - (A) if an amount is included in the SMRA-LC's ranking liabilities under subsection (2)(a) in respect of the SMRA-LC's onshore net position in that currency—that amount; or
 - (B) if an amount is included in the SMRA-LC's ranking liabilities under subsection (2)(b) and the market value of the SMRA-LC's onshore net position in that currency is higher than the market value of the SMRA-LC's offshore net position in that currency—the market value of the SMRA-LC's onshore net position in that currency, multiplied by the product of 8% and the scaling factor 1.2; or
 - (ii) the opposite-to-net positions are offshore positions—
 - (A) if an amount is included in the SMRA-LC's ranking liabilities under subsection (2)(a) in respect of the SMRA-LC's offshore net position in that currency—that amount; or
 - (B) if an amount is included in the SMRA-LC's ranking liabilities under subsection (2)(b) and the market value of the SMRA-LC's offshore net position in that currency is higher than the market value of the SMRA-LC's onshore net position in that currency—the market value of the SMRA-LC's offshore net position in that currency, multiplied by the product of 8% and the scaling factor 1.2; or
 - (c) where the positions are in a notional currency—the amount included in the SMRA-LC's ranking liabilities under subsection (3) in respect of the SMRA-LC's net position in that currency.
- (7) In subsection (6), an SMRA-LC's controlled asset position in a foreign currency or notional currency is an **opposite-to-net position** () if—
 - (a) where the position is in a foreign currency other than a non-freely floating currency—the position is opposite to the SMRA-LC's net long or short position in that currency calculated for subsection (1);
 - (b) where the currency is a non-freely floating currency—
 - (i) the position is an onshore position and is opposite to the SMRA-LC's onshore net long or short position in that currency calculated for subsection (2); or
 - (ii) the position is an offshore position and is opposite to the SMRA-LC's offshore net long or short position in that currency calculated for subsection (2); or

- (c) where the position is in a notional currency—the position is opposite to the SMRA-LC's net long or short position in that currency calculated for subsection (3).
- (8) In this section—
 - (a) an SMRA-LC's position in a non-freely floating currency is—
 - (i) if the position is required by the home authority of the currency to be valued or settled at the permitted rate—an **onshore position**; or
 - (ii) if the position is not required by the home authority of the currency to be valued or settled at the permitted rate—an **offshore position**;
 - (b) a reference to an SMRA-LC's—
 - (i) **onshore net position** () in a non-freely floating currency is a reference to the SMRA-LC's net position in the currency that is constituted only by onshore positions; or
 - (ii) **offshore net position** () in a non-freely floating currency is a reference to the SMRA-LC's net position in the currency that is constituted only by offshore positions; and
 - (c) an SMRA-LC is regarded as not having an onshore net position or offshore net position in a non-freely floating currency if the size of the position is zero.

Division 7—Continuous options contracts risk

53ZZI. Interpretation

In this Division—

applicable continuous options contract (), in relation to an SMRA-LC, means a continuous options contract in which the SMRA-LC holds a position to which this Division applies;

continuous options contract () means an options contract that has—

- (a) a gamma which is mathematically a continuous function of the price, value or level of its underlying subject matter; and
- (b) a vega which is mathematically a continuous function of its implied volatility;

delta (), in relation to an options contract, means an estimate of the rate of change in the value of the contract due to changes in the price, value or level of the underlying subject matter of the contract;

delta-plus approach () means the approach set out in section 53ZZL;

gamma (), in relation to an options contract, means an estimate of the rate of change in the delta of the contract due to changes in the price, value or level of the underlying subject matter of the contract;

illiquid underlying investment () means—

- (a) an illiquid investment;
- (b) a basket constituted only by illiquid investments; or
- (c) an index that has a basket referred to in paragraph (b) underlying it;

reference underlying (), in relation to a continuous options contract, means—

- (a) subject to paragraph (b)—the underlying subject matter of the options contract;
- (b) if the underlying subject matter of the options contract is a contract (**underlying contract**)—the underlying subject matter of the underlying contract;

simplified approach () means the approach set out in section 53ZZP;

vega (), in relation to an options contract, means an estimate, expressed as a monetary value, of the rate of change in the value of the contract due to changes in the volatility of the price, value or level of the underlying subject matter of the contract.

53ZZJ. Application of Division to positions in continuous options contracts

- (1) Subject to subsection (2) and section 53ZZR(4), this Division applies to an SMRA-LC in relation to its position in a common derivative that is in the form of a continuous options contract.
- (2) This Division does not apply to an SMRA-LC in relation to a position (or the part of the position) that forms one side of a pair of matched positions under subsection (3).
- (3) The following pair of an SMRA-LC's positions must be treated, to the extent that the sizes of the positions are equal, as a pair of matched positions—
 - (a) a long position in a common derivative that is in the form of a continuous options contract; and
 - (b) a short position in another common derivative that is in the form of a continuous options contract that is identical to the contract referred to in paragraph (a).

53ZZK. Market risk charges for positions in continuous options contracts

An SMRA-LC must, in respect of each of its positions in common derivatives that are in the form of continuous options contracts, comply with one of the following approaches—

- (a) the delta-plus approach;
- (b) the simplified approach;
- (c) if approved by the Commission under section 58(5)(o), any other approach, in accordance with the conditions of the approval.

53ZZL. Delta-plus approach

An SMRA-LC must, for each applicable continuous options contract—

- (a) in respect of delta risk—calculate the delta-weighted size of its notional position in each underlying subject matter of the options contract by multiplying the size of the position by the delta of the options contract;
- (b) in respect of gamma risk—comply with section 53ZZM; and
- (c) in respect of vega risk—comply with section 53ZZN.

53ZZM. Gamma risk

- (1) An SMRA-LC must calculate the gamma impact of each applicable continuous options contract using Formula 31—

Formula 31

Calculation of gamma impact of continuous options contract

$$\text{Gamma impact} = 0.5 \times G \times (\text{MV} \times \text{RW})^2 \times \text{SF}$$

where—

- G** is the gamma of the options contract;
- MV** is the market value of the SMRA-LC's notional position in the underlying subject matter of the options contract;
- RW** is, where the reference underlying of the options contract is—

- (a) a debt security, a basket of debt securities or a debt security index—the general risk percentage applicable to that security, basket or index; or
 - (b) any other matter—the market risk percentage applicable to that matter; and
- SF is—
 - (a) where paragraph (a) of RW applies—1.3; or
 - (b) where paragraph (b) of RW applies—the scaling factor applicable to the market risk percentage applicable to that matter.
- (2) An SMRA-LC must, for all applicable continuous options contracts the reference underlyings of which are illiquid underlying investments, include in its ranking liabilities the absolute value of the sum of all gamma impacts of the contracts that are negative.
- (3) An SMRA-LC must, for all applicable continuous options contracts having the same reference underlying, or same category of reference underlying, (other than a contract falling within subsection (2))—
 - (a) calculate the net gamma impact of all of the contracts by offsetting the gamma impacts of the contracts; and
 - (b) if the net gamma impact is negative—include in its ranking liabilities the absolute value of the net gamma impact.
- (4) An SMRA-LC must, for each applicable continuous options contract (other than a contract falling within subsection (2) or (3)) the gamma impact of which is negative, include in its ranking liabilities the absolute value of the gamma impact.

53ZZN. Vega risk

- (1) An SMRA-LC must calculate the vega impact of each applicable continuous options contract using Formula 32.

Formula 32

Calculation of vega impact of continuous options contract

$$\text{vega impact} = 0.25 \times V \times \text{vol} \times \text{SF}$$

where—

- V is the vega of the contract;
 - vol is the volatility (expressed as a number of percentage points) of the price or level of the underlying subject matter of the options contract; and
 - SF is the scaling factor applicable to the market risk percentage applicable to the reference underlying of the options contract.
- (2) An SMRA-LC must, for all applicable continuous options contracts the reference underlyings of which are illiquid underlying investments, include in its ranking liabilities the sum of the absolute values of all vega impacts of the contracts.
 - (3) An SMRA-LC must, for all applicable continuous options contracts having the same reference underlying, or same category of reference underlying, (other than a contract falling within subsection (2))—
 - (a) calculate the net vega impact of all of the contracts by offsetting the vega impacts of the contracts; and

- (b) include in its ranking liabilities the absolute value of the net vega impact.
- (4) An SMRA-LC must, for each applicable continuous options contract (other than a contract falling within subsection (2) or (3)), include in its ranking liabilities the absolute value of the vega impact of the contract.

53ZZO. Continuous options contracts having the same category of reference underlying

For the purposes of sections 53ZZM and 53ZZN, a reference to applicable continuous options contracts having the same category of reference underlying is a reference to—

- (a) applicable continuous options contracts the reference underlyings of which are debt securities, baskets of debt securities or debt security indexes where the notional positions in the debt securities, baskets or indexes (as applicable) arising from the contracts are—
 - (i) denominated in the same currency; and
 - (ii) allocated to the same time band set out in column 2 of Table 5 in Schedule 9 under section 53ZZA(5);
- (b) applicable continuous options contracts the reference underlyings of which are interest rates where the notional positions in SRF securities arising from the contracts are—
 - (i) denominated in the same currency; and
 - (ii) allocated to the same time band set out in column 2 of Table 5 in Schedule 9 under section 53ZZA(5);
- (c) applicable continuous options contracts the reference underlyings of which are to be treated as the same category under section 9G(1)(a), (2)(a), (3)(a) or (4)(a); or
- (d) applicable continuous options contracts the reference underlyings of which are the same currency pair.

53ZZP. Simplified approach

- (1) An SMRA-LC may elect to comply with the simplified approach instead of the delta-plus approach if all applicable continuous options contracts are options contracts that—
 - (a) it has purchased and not written; and
 - (b) do not have an underlying subject matter that is a contract.
- (2) An SMRA-LC must, for each applicable continuous options contract in which it holds a long position (except a long position that forms one side of a pair of matched positions under subsection (3)), include in its ranking liabilities an amount that is equal to the lower of—
 - (a) the market value of the options contract; and
 - (b) the market value of its notional position in the underlying subject matter of the options contract, multiplied by the product of—
 - (i) the market risk percentage applicable to the underlying subject matter; and
 - (ii) the scaling factor applicable to that percentage.
- (3) Subject to subsection (4), each of the following pairs of an SMRA-LC's positions must be treated, to the extent that the sizes of the positions are equal, as a pair of matched positions—
 - (a) a pair of—

- (i) a long notional position (**position A**) in an underlying subject matter (other than an illiquid underlying investment) of an applicable continuous options contract that is a call continuous options contract; and
 - (ii) a short spot position (**position B**) in that underlying subject matter that hedges position A;
- (b) a pair of—
 - (i) a long notional position (**position C**) in an underlying subject matter (other than an illiquid underlying investment) of an applicable continuous options contract that is a put continuous options contract; and
 - (ii) a long spot position (**position D**) in that underlying subject matter that hedges position C.
- (4) Subsection (3) applies to an SMRA-LC only if position A or position C (as applicable) comprises the SMRA-LC's entire long notional position in the underlying subject matter of the applicable continuous options contract.
- (5) An SMRA-LC must, in respect of each pair of matched positions referred to in subsection (3)(a) or (b), include in its ranking liabilities an amount that is equal to the higher of—
 - (a) zero; and
 - (b) the market value of position B or position D (as applicable), multiplied by the product of the market risk percentage applicable to the underlying subject matter of the options contract and the scaling factor applicable to that percentage, less—
 - (i) if the options contract has a residual maturity of 6 months or less—the in-the-money amount (if any) of the options contract; or
 - (ii) if the options contract has a residual maturity of more than 6 months and—
 - (A) it is practicable for the SMRA-LC to identify the forward price of the underlying subject matter of the options contract—the in-the-money amount of the options contract calculated as if, in the definition of **in-the-money amount** in section 2(1), variable "M" represents the forward price of the underlying subject matter; or
 - (B) sub-subparagraph (A) does not apply to the SMRA-LC—zero.
- (6) An SMRA-LC must treat Division 2, 3, 4, 5 or 6 (as applicable) as not applying to it in relation to—
 - (a) its notional position in the underlying subject matter of an applicable continuous options contract falling within subsection (2); and
 - (b) its position in the underlying subject matter of an applicable continuous options contract falling within subsection (3).

Division 8—Uncommon derivatives risk

53ZZQ. Interpretation

In this Division—

opening margin (), in relation to an SMRA-LC's position or group of positions, means assets posted as security in respect of the position or positions against any credit risk exposure that could arise from future changes in the value of the position or positions during the time it takes to close out and replace the position or positions in the event of default;

reference underlying (), in relation to an uncommon derivative, means—

- (a) subject to paragraph (b)—the underlying subject matter of the uncommon derivative;
- (b) if the underlying subject matter of the uncommon derivative is a derivative instrument (***underlying derivative***)—the underlying subject matter of the underlying derivative.

53ZZR. Market risk charge for positions in certain cleared uncommon derivatives

- (1) This section applies to an SMRA-LC in relation to the following positions in respect of which the conditions specified in subsection (2) are satisfied—
 - (a) its long spot position or short spot position in 1 uncommon derivative;
 - (b) its long spot positions or short spot positions (or both) in 2 or more uncommon derivatives;
 - (c) its long spot positions or short spot positions (or both) in—
 - (i) one or more uncommon derivatives; and
 - (ii) one or more common derivatives.
- (2) The conditions specified for subsection (1) are that—
 - (a) the derivative or derivatives are subject to clearing and settlement by any of the following persons—
 - (i) a specified exchange;
 - (ii) a clearing house of a specified exchange;
 - (iii) a regulated CCP; and
 - (b) an amount of opening margin in respect of the position or positions has been set by one or more of the following persons—
 - (i) the specified exchange;
 - (ii) the clearing house;
 - (iii) the regulated CCP;
 - (iv) one or more persons who provide any clearing and settlement service in the clearing and settlement referred to in paragraph (a).
- (3) An SMRA-LC must, in respect of each position, or group of positions, referred to in subsection (1), include in its ranking liabilities the highest of the amounts of opening margin set by the persons referred to in subsection (2)(b).
- (4) An SMRA-LC must treat Division 2, 3, 4, 5, 6 or 7 (as applicable) as not applying to it in relation to—
 - (a) its spot position in a common derivative referred to in subsection (1)(c)(ii); and
 - (b) its position in any other matter arising from such a spot position.

53ZZS. Market risk charge for positions in other uncommon derivatives

- (1) An SMRA-LC must, in respect of its long spot position or short spot position in an uncommon derivative, except a position (or a position within a portfolio of positions) to which section 53ZZR applies, include in its ranking liabilities—
 - (a) an amount, not exceeding the maximum possible loss of the position, that is the highest of the amounts specified in subsection (2) when calculated on a transaction-by-transaction basis; or
 - (b) with the Commission's approval in writing under section 58(5)(p), an amount that is calculated in accordance with the conditions of the approval.
- (2) The amounts specified for subsection (1)(a) are—

- (a) the higher of the fair value and the market value of the position in the uncommon derivative;
- (b) subject to subsection (3), if one or more amounts of opening margin have been set in respect of the position in the uncommon derivative—the highest of the amounts of opening margin;
- (c) if the uncommon derivative is in the form of a call or put options contract—the in-the-money amount of the options contract;
- (d) if the uncommon derivative—
 - (i) has 1 reference underlying—the higher of—
 - (A) the product of—
 - (I) the market risk percentage applicable to the reference underlying; and
 - (II) the higher of the fair value and the market value of the SMRA-LC's notional position in the reference underlying; and
 - (B) the product of—
 - (I) the market risk percentage applicable to the reference underlying; and
 - (II) the notional principal (if any) of the reference underlying; or
 - (ii) has 2 or more reference underlyings—the higher of—
 - (A) the sum, for the SMRA-LC's notional positions in the reference underlyings, of the product of—
 - (I) the market risk percentage applicable to a particular reference underlying; and
 - (II) the higher of the fair value and the market value of the SMRA-LC's notional position in that reference underlying; and
 - (B) the sum, for the SMRA-LC's notional positions in the reference underlyings, of the product of—
 - (I) the market risk percentage applicable to a particular reference underlying; and
 - (II) the notional principal (if any) of that reference underlying.
- (3) Subsection (2)(b) does not apply to an amount of opening margin set in respect of a portfolio of positions to which the position in the uncommon derivative belongs.

Division 9—Concentration risk

53ZZT. Market risk charges for concentrated positions

- (1) An SMRA-LC must, in respect of its positions in a matter specified below, include in its ranking liabilities an amount specified in subsection (2) if the absolute value of the overall market value of such positions in that matter, as calculated in accordance with subsection (3) or (5), is equal to 25% or more of its required liquid capital—
 - (a) a category of equity;
 - (b) a category of debt security;
 - (c) a category of commodity; or
 - (d) an unspecified reference underlying.
- (2) The amount to be included in an SMRA-LC's ranking liabilities under subsection (1) is, where the absolute value of the overall market value of the positions is equal to—

- (a) 25% or more but less than 51% of the SMRA-LC's required liquid capital—5% of such absolute value; or
 - (b) 51% or more of the SMRA-LC's required liquid capital—10% of such absolute value.
- (3) An SMRA-LC must calculate the overall market value of its positions in a category of equity, category of debt security or category of commodity as the sum of—
 - (a) the sum of the market values of its long notional positions and its short notional positions in that category arising from uncommon derivatives; and
 - (b) where the category—
 - (i) is an illiquid investment—the sum of the market values of its short positions in that category, excluding—
 - (A) any short notional position in that category arising from an uncommon derivative; and
 - (B) for a category of equity or category of debt security only—any short position in that category (or the part of any such position) that can be settled by a long position in that category; or
 - (ii) is not an illiquid investment—subject to subsection (4)—
 - (A) for a category of equity—the market value of the SMRA-LC's net position in that category as calculated for section 53ZF(1);
 - (B) for a category of debt security—the market value of the SMRA-LC's net position in that category as calculated for section 53ZU(1)(b); or
 - (C) for a category of commodity—the market value of the SMRA-LC's net position in that category as calculated for section 53ZZC(2)(a).
- (4) For subsection (3)(b)(ii), if an SMRA-LC's position in a category of equity, debt security or commodity is, by virtue of section 53ZZP(6), excluded from the calculation of the SMRA-LC's net position in that category for section 53ZF(1), 53ZU(1)(b) or 53ZZC(2)(a) (as applicable) (**Division 2, 3 or 4 net position**)—
 - (a) that position is nevertheless to be included in the calculation of the SMRA-LC's net position in that category for subsection (3)(b)(ii)(A), (B) or (C) (as applicable) (**Division 9 net position**); and
 - (b) the SMRA-LC is to use the market value of the Division 9 net position (instead of the market value of the Division 2, 3 or 4 net position) in its calculation of the overall market value of its positions in that category under subsection (3).
- (5) An SMRA-LC must calculate the overall market value of its positions in an unspecified reference underlying as the sum of—
 - (a) the difference between the sum of the market values of its long notional positions and the sum of the market values of its short notional positions in the unspecified reference underlying arising from uncommon derivatives that are in the forms of any of the following—
 - (i) a futures contract;
 - (ii) a forward contract;
 - (iii) a swap;
 - (iv) a contract for differences; and
 - (b) the sum of the market values of its long and short notional positions in the unspecified reference underlying arising from uncommon derivatives that are in the forms of instruments other than those referred to in paragraph (a).

(6) In this section—

unspecified reference underlying () means a reference underlying (as defined by section 53ZZQ) of an uncommon derivative that falls within item 24 of Table 1 in Schedule 9.

Part 5

Miscellaneous

54. Licensed corporations to notify Commission of failure to comply with these Rules

- (1) Where a licensed corporation notifies the Commission—
 - (a) under section 146(1) of the Ordinance that it is unable to maintain, or to ascertain whether it maintains, financial resources in accordance with the specified amount requirements that apply to it; or
 - (b) under section 146(3) of the Ordinance that it is unable to comply with, or to ascertain whether it complies with, all or any of the requirements of these Rules, other than the specified amount requirements,
 it must include in the notice—
 - (c) full details of the matter and the reason therefor; and
 - (d) full details of any steps it is taking, has taken or proposes to take to redress the inability.
- (2) The Commission may, where a licensed corporation gives notice to the Commission under section 146(1) and (3) of the Ordinance, request the licensed corporation to provide, in such form and within such time as the Commission may specify, such additional information and document as the Commission may require in connection with the matter, whereupon the licensed corporation must comply with the request accordingly.
- (3) For the purposes of this section and section 144 of the Ordinance, ***specified amount requirements*** (指明數額規定), in relation to a licensed corporation, means the applicable requirements specified in section 4 and—
 - (a) the requirement to maintain paid-up share capital in the amount required under section 5; ~~and~~
 - ~~(ab) the requirement to maintain tangible capital in the amount required under section 5A; and~~
 - (b) the requirement to maintain liquid capital not less than its required liquid capital under section 6.

55. Licensed corporations to notify Commission of circumstances relating to financial resources and trading activities and to submit returns in certain cases

- (1) A licensed corporation must notify the Commission in writing as soon as reasonably practicable and in any event within ~~one business day of becoming~~ **1 business day after the date on which it becomes** aware of any of the following matters—
 - ~~(aa) its tangible capital falls below 120% of the amount it is required to maintain under section 5A(1);~~
 - ~~(aab) its tangible capital falls below 50% of the tangible capital stated in its last return submitted to the Commission under section 56(3A);~~
 - (a) its liquid capital falls below 120% of its required liquid capital;
 - (b) a required liquid capital deficit occurs, but the licensed corporation is regarded as having complied with section 6(1) by virtue of section 6(3);
 - (c) its liquid capital falls below 50% of the liquid capital stated in its last return submitted to the Commission under section 56(1) or (3);

- (d) any information contained in any of its previous returns submitted to the Commission pursuant to these Rules has become false or misleading in a material particular;
 - (e) the aggregate of the amounts it has drawn down on any loan, advance, credit facility or other financial accommodation provided to it by banks exceeds the aggregate of the credit limits thereof;
 - (f) it has been or will be unable, for 3 consecutive business days, to meet in whole or in part any calls or demands for payment or repayment (as the case may be), from any of its lenders, credit providers or financial accommodation providers;
 - (g) any of its lenders or any person who has provided credit or financial accommodation to it has exercised, or has informed it that he will exercise, the right to liquidate security provided by it to him in order to reduce its liability or indebtedness to him under any outstanding loan, advance, credit facility balance or other financial accommodation provided to it by him;
 - (h) *(Repealed)*
 - (i) the aggregate of the maximum amounts that can be drawn down against it under any guarantee, indemnity or any other similar financial commitment provided by it—
 - (i) exceeds \$5,000,000; or
 - (ii) would, if deducted from its liquid capital, cause its liquid capital to fall below 120% of its required liquid capital;
 - (j) the aggregate of amounts of any outstanding claim made in writing by it or against it (whether disputed or not) exceeds or is likely to exceed \$5,000,000;
 - (k) the aggregate of amounts of any outstanding claim made in writing by it or against it (whether disputed or not) would, if deducted from its liquid capital, cause its liquid capital to fall below 120% of its required liquid capital;
 - (l) any claim is made by it under any professional indemnity or other insurance policy that it is required to maintain under any rules made under section 116(5) of the Ordinance or the rules or conventions of any exchange or clearing house;
 - (m) any financial commitment, including a guarantee, is provided for it in favour of an exchange or a clearing house, by a corporation which is a member of a group of companies of which it is a member.
- (2) Where a licensed corporation notifies the Commission of any matter under subsection (1), it must—
- (a) include in the notice full details of the matter and the reason therefor; ~~and~~
 - (ab) in the case of a notification under subsection (1)(aa) or (aab), include in the notice full details of any steps it is taking, has taken or proposes to take to prevent its tangible capital from falling below the amount it is required to maintain under section 5A(1); and
 - (b) in the case of a notification under subsection (1)(a), (b), (c), (e), (f) or (g), include in the notice full details of any steps it is taking, has taken or proposes to take to prevent its liquid capital from falling below its required liquid capital or to improve its liquidity.
 - (c)-(d) *(Repealed)*
- (2A) A licensed corporation that is a party to a profit or loss sharing agreement must, within 1 business day after the date on which it enters into the agreement—
- (a) submit a copy of the agreement to the Commission; and

- (b) notify the Commission in writing of—
 - (i) the purpose of the agreement;
 - (ii) the reason why it entered into the agreement; and
 - (iii) the measures it adopts to prevent its liquid capital from falling below 120% of its required liquid capital in case any specified liability arises under the agreement.
- (2B) A licensed corporation that is a party to a profit or loss sharing agreement must, within 1 business day after the date on which it becomes aware of any of the following matters, notify the Commission in writing of that matter—
 - (a) it is unable to maintain measures to prevent its liquid capital from falling below 120% of its required liquid capital in case any specified liability arises under the agreement;
 - (b) its liquid capital falls below—
 - (i) 150% of its required liquid capital; or
 - (ii) any other percentage of its required liquid capital that is notified to it in writing by the Commission.
- (2C) A licensed corporation that notifies the Commission of any matter under subsection (2B) must include in the notice—
 - (a) full details of the matter and the reason for the matter; and
 - (b) full details of any steps it is taking, has taken or proposes to take to prevent its liquid capital from falling below its required liquid capital or to improve its liquidity.
- ~~(3) Where a licensed corporation has, prior to the commencement of these Rules, entered into any position in an off-exchange traded derivative contract other than—~~
 - ~~(a) an options contract written by it on its own account;~~
 - ~~(b) an interest rate swap agreement; and~~
 - ~~(c) a foreign exchange agreement,~~~~of which it has not notified the Commission prior to the commencement of these Rules, it must within one business day of the commencement of these Rules notify the Commission in writing of the details of such position.~~
- ~~(4) Where a licensed corporation intends to enter into any position in an off-exchange traded derivative contract other than—~~
 - ~~(a) an unlisted options contract written by it on its own account;~~
 - ~~(b) an interest rate swap agreement; and~~
 - ~~(c) a foreign exchange agreement,~~~~it must notify the Commission in writing of the details of the position it intends to enter into at least 10 business days before entering into the position.~~
- (5) Where a licensed corporation intends to change any of its accounting principles in a way that may materially affect the liquid capital, ~~or~~ paid-up share capital ~~or~~ tangible capital that it maintains or is required to maintain under Part 3, for the purposes of section 3(2), it must notify the Commission in writing of the details of, and the reasons for, the intended change not less than 5 business days prior to effecting the change.
- (6) A BMRA-LC must comply with subsection (8) if—
 - (a) it is required under section 48B(1) or 48E(1) to include in its ranking liabilities an amount in respect of a position in an OTCD product, or a miscellaneous derivative, that is an uncommon derivative (**specified amount**); and

- (b) the maximum possible loss of the position exceeds the specified amount.
- (7) An SMRA-LC must comply with subsection (8) if—
 - (a) it is required under section 53ZZS(1) to include in its ranking liabilities an amount in respect of a position in an uncommon derivative (***specified amount***); and
 - (b) the maximum possible loss of the position exceeds the specified amount.
- (8) A licensed corporation to which subsection (6) or (7) applies must, within 1 business day after the date on which it enters into the position referred to in that subsection, notify the Commission in writing of—
 - (a) the details of the position, including the terms and conditions of, and the names of the counterparties to, the derivative to which the position relates;
 - (b) the details of the structure (including underlying subject matters) and risks of the derivative; and
 - (c) how the licensed corporation manages the risks.
- (9) If an approved BOCCRA-LC or approved BMRA-LC becomes aware that any of its OTCD activity levels that are counted for basic approach approval as at a reference date within the meaning of section 56(4A)(a) has exceeded the applicable threshold, it must, within 1 business day after the date on which it becomes so aware, notify the Commission in writing and include in the notice—
 - (a) the amount of the OTCD activity level concerned as at the reference date; and
 - (b) the difference between that amount and the applicable threshold.
- (10) A licensed corporation must comply with subsection (11), until this subsection ceases to apply to it under subsection (13), once—
 - (a) it is required under section 53P(1) or 53Q(1) to include in its ranking liabilities an amount specified in that section; or
 - (b) the Commission is satisfied that it is prudent to require the licensed corporation to do so, taking into account risks associated with the licensed corporation, and so requires the licensed corporation by notice in writing.
- (11) A licensed corporation to which subsection (10) applies must, within the period of time specified in subsection (12), submit to the Commission—
 - (a) a notification setting out the results of a stress test on its liquidity, which must be based on assumptions that are sufficient to reflect the liquidity risks associated with the licensed corporation during a period of stress in its liquidity;
 - (b) if the Commission so requires the licensed corporation in writing—a plan setting out the emergency funding support for meeting the licensed corporation's liquidity needs, which must be sufficient taking into account the results of the stress test, together with documents evidencing the emergency funding support; and
 - (c) if, after a requirement has been made under paragraph (b), any drawdown is made on the emergency funding—a notification setting out—
 - (i) the event triggering the drawdown;
 - (ii) the effect of the event on the licensed corporation's financial position and liquidity;
 - (iii) the date, amount and sources of the drawdown; and
 - (iv) the licensed corporation's estimation of the period of time its financial position and liquidity will continue to be affected by the event.
- (12) The period of time specified for subsection (11) is—

- (a) for a notification under subsection (11)(a)—3 weeks after the end of every month starting from the month in which the requirement referred to in subsection (10)(a) or (b) arises;
 - (b) for a plan and documents required by the Commission under subsection (11)(b)—the period specified by the Commission in the requirement; and
 - (c) for a notification under subsection (11)(c)—1 business day after the date of the drawdown.
- (13) Subsection (10) ceases to apply to a licensed corporation if—
 - (a) the Commission is satisfied, on reasonable grounds, that it is prudent to allow the licensed corporation to cease complying with subsection (11), taking into account risks associated with the licensed corporation, and so allows the licensed corporation by notice in writing; or
 - (b) for a licensed corporation falling within subsection (10)(a)—
 - (i) the requirement referred to in that subsection has ceased to apply to it for 3 consecutive months; and
 - (ii) the licensed corporation declares to that effect to the Commission by notice in writing.
- (14) A licensed corporation opting for reduced capital requirements under section 6A(1) must, within 1 business day after the date on which it makes the option (**starting date**), notify the Commission in writing and include in the notice—
 - (a) the amount of each of its OTCD activity levels that are counted for reduced capital requirements as at a date specified in the notice (**initial reference date**), which must be not more than 1 month before the starting date;
 - (b) the difference between each such amount and the applicable threshold; and
 - (c) a statement declaring—
 - (i) that as at the initial reference date, none of its OTCD activity levels that are counted for reduced capital requirements exceeds the applicable threshold;
 - (ii) that it has started to opt for reduced capital requirements; and
 - (iii) the starting date.
- (15) If a licensed corporation opting for reduced capital requirements becomes aware that any of its OTCD activity levels that are counted for reduced capital requirements as at a reference date within the meaning of section 56(4B)(a) has exceeded the applicable threshold, the licensed corporation must, within 1 business day after the date on which it becomes so aware, notify the Commission in writing and include in the notice—
 - (a) the amount of the OTCD activity level concerned as at the reference date; and
 - (b) the difference between that amount and the applicable threshold.
- (16) A licensed corporation that, for the purposes of section 6A(2)(b)(i), withdraws its option for reduced capital requirements must, within 1 business day after the date on which it withdraws the option (**cessation date**), notify the Commission in writing and include in the notice a statement declaring—
 - (a) that it has ceased to opt for reduced capital requirements; and
 - (b) the cessation date.
- (17) In this section—

profit or loss sharing agreement (), in relation to a licensed corporation, means an agreement under which the licensed corporation is or may be liable to—

- (a) pay (otherwise than as a dividend) a portion or all of a profit made by it (whether specifically identified in the agreement or not) to any person;
- (b) bear a portion or all of a loss made by another person (whether specifically identified in the agreement or not); or
- (c) pay (otherwise than as a dividend) a portion or all of a profit made by another person (whether specifically identified in the agreement or not) that the licensed corporation received pursuant to the agreement to any person;

specified liability (), in relation to a profit or loss sharing agreement entered into by a licensed corporation, means any liability of the licensed corporation under the agreement that is referred to in the definition of **profit or loss sharing agreement** in this subsection.

56. Licensed corporations to submit returns to Commission

- (1) Subject to subsections (4) and (4C), a licensed corporation licensed for one or more of the following—
 - (a) Type 1 regulated activity;
 - (b) Type 2 regulated activity;
 - (c) Type 3 regulated activity;
 - (d) Type 4 regulated activity, and it is not subject to the specified licensing condition;
 - (e) Type 5 regulated activity, and it is not subject to the specified licensing condition;
 - (f) Type 6 regulated activity, and it is not subject to the specified licensing condition;
 - (g) Type 7 regulated activity;
 - (h) Type 8 regulated activity;
 - (i) Type 9 regulated activity, and it is not subject to the specified licensing condition;
 - (ia) Type 10 regulated activity, and it is not subject to the specified licensing condition;
 - (iab) Type 11 regulated activity, and it is not subject to either or both of—
 - (i) the specified licensing condition; and
 - (ii) the no dealing licensing condition;
 - (iac) Type 12 regulated activity;
 - (ib) Type 13 regulated activity,
 must, in respect of each month at the end of which it remains licensed, submit to the Commission, in the specified manner ~~specified in subsection (5)~~ and no later than 3 weeks after the end of the month concerned, a return ~~which is in the form specified by the Commission under section 402 of the Ordinance and that is duly signed in the manner specified in subsection (6)~~, and includes—
 - (j) its liquid capital computation, as at the end of the month;
 - (k) its required liquid capital computation, as at the end of the month;
 - (l) a summary of bank loans, advances, credit facilities and other financial accommodation available to it, as at the end of the month;
 - (m) an analysis of its margin clients, as at the end of the month;
 - (n) an analysis of collateral received from its margin clients, as at the end of the month;
 - (o) an analysis of its rolling balance cash clients, as at the end of the month;
 - (p) an analysis of its profit and loss account;

- (q) other than a licensed corporation licensed for Type 13 regulated activity in relation to the carrying on by it of Type 13 regulated activity, an analysis of its client assets, as at the end of the month;
 - (r) where it is licensed for Type 3 regulated activity, an analysis of its foreign currency positions, as at the end of the month; ~~and~~
 - (s) where it is licensed for Type 13 regulated activity, an analysis of relevant CIS property received or held by it for any relevant CIS arising from the carrying on of Type 13 regulated activity, as at the end of the month; ~~and~~
 - (t) ~~an analysis of its proprietary derivative positions, as at the end of the month.~~
- (2) Subject to subsections (4) ~~and (4C)~~, a licensed corporation to which subsection (1) applies must, in respect of each period of 3 months at the end of which it remains licensed, being such period in a year ending at the end of the month of March, June, September or December, respectively, submit to the Commission, in the ~~specified manner specified in subsection (5)~~ and no later than 3 weeks after the end of the period concerned, a return ~~which is in the form specified by the Commission under section 402 of the Ordinance and that is duly signed in the manner specified in subsection (6)~~, and includes—
- (a) an analysis of its clientele, as at the end of the 3 month period;
 - ~~(b) an analysis of its proprietary derivative positions, as at the end of the 3 month period;~~
 - (c) where it is licensed for Type 3 regulated activity, an analysis of its recognized counterparties, as at the end of the 3 month period; and
 - ~~(d) where it is licensed for Type 9 regulated activity,~~ an analysis of the assets under its management, as at the end of the 3 month period.
- (3) Subject to subsections (4) ~~and (4C)~~, a licensed corporation which is licensed solely for one or more of the following—
- (a) Type 4 regulated activity;
 - (b) Type 5 regulated activity;
 - (c) Type 6 regulated activity;
 - (d) Type 9 regulated activity;
 - (da) Type 10 regulated activity;
 - ~~(db) Type 11 regulated activity,~~
- and subject to the specified licensing condition ~~and, for a licensed corporation licensed for Type 11 regulated activity, the no dealing licensing condition~~, must, in respect of each period of 6 months at the end of which it remains licensed, being such period in a year ending at the end of the month of June or December, respectively, submit to the Commission, in the ~~specified manner specified in subsection (5)~~ and no later than 3 weeks after the end of the period concerned, a return ~~which is in the form specified by the Commission under section 402 of the Ordinance and that is duly signed in the manner specified in subsection (6)~~, and includes—
- (e) its liquid capital computation, as at the end of the 6 month period;
 - (f) its required liquid capital computation, as at the end of the 6 month period;
 - (g) an analysis of its profit and loss account;
 - (h) an analysis of its clientele, as at the end of the 6 month period; and
 - ~~(i) where it is licensed for Type 9 regulated activity,~~ an analysis of the assets under its management, as at the end of the 6 month period.

- (3A) Subject to subsections (4) and (4C), a licensed corporation to which section 5A applies must, in respect of each month at the end of which it remains licensed, submit to the Commission, in the specified manner and no later than 3 weeks after the end of the month concerned, a return that is duly signed and includes its tangible capital computation, as at the end of the month.
- (4) A licensed corporation may elect to submit the return required under—
- (a) subsection (1) ~~or (3A)~~, in respect of periods of not less than 28 days but not more than 35 days, each ending not more than 7 days before or after the end of a month;
 - (b) subsection (2), in respect of periods of 3 months each ending not more than 7 days before or after the end of March, June, September or December in a year;
 - (c) subsection (3), in respect of periods of 6 months each ending not more than 7 days before or after the end of June or December in a year,
- determined by it on a basis according to which the ending date of each period so determined is predictable, and where it so elects and submits the return concerned, it is deemed to have submitted the return concerned in respect of the period required under subsection (1), (2), ~~or (3)~~ **or (3A)** (as the case may be).
- (4A) An approved BOCCRA-LC or approved BMRA-LC must, in respect of each period of 6 months at the end of which its approval as such remains in effect, being such period in a year ending at the end of June or December respectively, submit to the Commission, in the specified manner and within 1 month after the end of the period concerned, a return that is duly signed and includes—
- (a) the amount of each of its OTCD activity levels that are counted for basic approach approval as at the date specified in the return (**reference date**), which must be—
 - (i) for a return submitted within 1 month after the end of June of a year—30 June of that year; and
 - (ii) for a return submitted within 1 month after the end of December of a year—31 December of that year; and
 - (b) the difference between each such amount and the applicable threshold.
- (4B) A licensed corporation opting for reduced capital requirements must, in respect of each period of 6 months at the end of which its election remains in effect, being such period in a year ending at the end of June or December respectively, submit to the Commission, in the specified manner and within 1 month after the end of the period concerned, a return that is duly signed and includes—
- (a) the amount of each of its OTCD activity levels that are counted for reduced capital requirements as at the date specified in the return (**reference date**), which must be—
 - (i) for a return submitted within 1 month after the end of June of a year—30 June of that year; and
 - (ii) for a return submitted within 1 month after the end of December of a year—31 December of that year; and
 - (b) the difference between each such amount and the applicable threshold.
- (4C) A licensed corporation to which an approval under section 58(5B)(b)(ii) applies is not required to include in a return referred to in this section any particulars to which the approval relates.
- (5) For the purposes of this section, a licensed corporation must submit a return referred to in this section to the Commission electronically by means of an online

communication system approved by the Commission under section 58(7) for the purposes of this subsection.

(6) For the purposes of this section—

- (a) a return referred to in this section must be signed on behalf of the licensed corporation concerned by a responsible officer of the licensed corporation or another officer of the licensed corporation approved by the Commission under section 58(5)(e) for the purposes of this section, by way of attachment to the return of the digital signature or electronic signature of the responsible officer or other officer; and
- (b) the signature referred to in paragraph (a) must—
 - (i) in the case of a digital signature, be supported by a recognized certificate, generated within the validity of that certificate and used in accordance with the terms of that certificate; or
 - (ii) in the case of an electronic signature, be authenticated in accordance with such directions and instructions for the use of the online communication system concerned as are published by the Commission under section 58(8).

(6A) For the purposes of subsection (6)(b)(i), a digital signature is taken to be supported by a recognized certificate if it is taken to be supported by that certificate under section 2(2) of the Electronic Transactions Ordinance (Cap. 553).

(7) In this section—

digital signature (數碼簽署) has the meaning assigned to it by section 2(1) of the Electronic Transactions Ordinance (Cap. 553);

duly signed () means signed in the manner specified in subsection (6);

electronic signature (電子簽署) has the meaning assigned to it by section 2(1) of the Electronic Transactions Ordinance (Cap. 553);

recognized certificate (認可證書) has the meaning assigned to it by section 2(1) of the Electronic Transactions Ordinance (Cap. 553);

rolling balance cash client (滾存結餘現金客戶) means a client of a licensed corporation in respect of whom the amounts receivable from, and amounts payable to, him by the licensed corporation arising from the purchase and sale of securities on a cash-against-delivery basis by the licensed corporation for him may be ~~set-off~~ **offset** by the licensed corporation under section ~~24(3)~~ **21(2)**;

specified manner () means the manner specified in subsection (5);

within the validity of that certificate (在該證書的有效期內) has the meaning assigned to it by section 6(2) of the Electronic Transactions Ordinance (Cap. 553).

57. Licensed corporations to provide information

The Commission may at any time, by notice in writing, request a licensed corporation to provide it within the time and in the manner specified in the notice with such information, including any record or document, as it may specify in the notice relating to the financial resources or trading activities of the licensed corporation, whereupon the licensed corporation must comply with the request accordingly.

58. Approvals

- (1) For the purposes of these Rules, the Commission may, whether or not on application in writing and payment of the fee prescribed in the Securities and Futures (Fees) Rules (Cap. 571 sub. leg. AF), approve a person as—

- (a) an approved bank incorporated outside Hong Kong, where the person is a bank which is incorporated under the law or other authority of any jurisdiction outside Hong Kong;
 - (b) an approved credit rating agency; ~~or~~
 - (c) an approved securities borrowing and lending counterparty; ~~;~~
 - (d) an approved OTCD central counterparty; or
 - (e) an approved repurchase central counterparty.
- (2) Where the Commission approves a person under subsection (1), it must as soon as reasonably practicable—
- (a) publish in such manner as it considers appropriate the name of the person approved; and
 - (b) in the case of a person approved under subsection (1)(b), specify the ratings issued by the person as being equivalent to a specified rating issued by Moody's Investors Service, Standard & Poor's Corporation or Fitch Ratings.
- (3) A person ~~may be approved under subsection (1)(c) must be a person whose only if~~ the person's activities or objects include the provision of services for interposing himself in a securities borrowing and lending agreement as the counterparty to both the borrower and the lender, including administering any security deposited with him in connection with the agreement and registration and settlement of the agreement.
- (3A) A person may be approved under subsection (1)(d) or (e) only if—
- (a) the person's activities or objects include acting as—
 - (i) for an approval under subsection (1)(d)—a central counterparty for the clearing and settlement of OTCD transactions; or
 - (ii) for an approval under subsection (1)(e)—a central counterparty for the clearing and settlement of repurchase transactions; and
 - (b) the person is, in that capacity, subject to regulation by an authority or regulatory organization (whether in Hong Kong or elsewhere).
- (4) The Commission may, on application in writing and payment of the fee prescribed in the Securities and Futures (Fees) Rules (Cap. 571 sub. leg. AF), approve a licensed corporation for the purposes of these Rules as an approved introducing agent where the licensed corporation satisfies the Commission that—
- (a) where—
 - (i) it is licensed solely for Type 1 regulated activity, it conducts no business other than—
 - (A) communicating offers to effect dealings in securities to an exchange participant of a recognized exchange company or a specified exchange, in the names of the persons from whom those offers are received; and
 - (B) introducing persons to an exchange participant of a recognized exchange company or a specified exchange, in order that they may—
 - (I) effect dealings in securities; or
 - (II) make offers to deal in securities;
 - (ii) it is licensed solely for Type 2 regulated activity, it conducts no business other than—
 - (A) communicating offers to effect dealings in futures contracts or unlisted options contracts to an exchange participant of a recognized

- exchange company or a specified exchange, in the names of the persons from whom those offers are received; and
 - (B) introducing persons to an exchange participant of a recognized exchange company or a specified exchange, in order that they may—
 - (I) effect dealings in futures contracts or unlisted options contracts; or
 - (II) make offers to deal in futures contracts or unlisted options contracts;
 - (iii) it is licensed solely for Type 3 regulated activity, it conducts no business other than—
 - (A) communicating offers to effect **trading in specified** leveraged foreign exchange trading to a recognized counterparty in the names of the persons from whom those offers are received; and
 - (B) introducing persons to a recognized counterparty in order that they may—
 - (I) effect trading in **specified** leveraged foreign exchange contracts; or
 - (II) make offers to trade in **specified** leveraged foreign exchange contracts; or
 - (iv) it is—
 - (A) licensed for one or more of the following—
 - (I) Type 1 regulated activity;
 - (II) Type 2 regulated activity;
 - (III) Type 3 regulated activity; or
 - (B) licensed for one or more of the regulated activities referred to in sub-subparagraph (A) and one or more of the following—
 - (I) Type 4 regulated activity, and it is subject to the specified licensing condition;
 - (II) Type 5 regulated activity, and it is subject to the specified licensing condition;
 - (III) Type 6 regulated activity, and it is subject to the specified licensing condition,

and not licensed for any regulated activity other than as described in sub-subparagraphs (A) and (B), and in relation to any one or more of the regulated activities referred to in sub-subparagraph (A) for which it is licensed, it conducts no business other than that described in subparagraph (i), (ii) or (iii);
 - (b) in connection with the offers communicated or the persons so introduced, it will not incur any liability to any person except for its own negligence, wilful default or fraud; and
 - (c) it does not hold client assets.
- (4A) **In subsection (4), a reference to dealing in securities, futures contracts or unlisted options contracts does not include dealing in one or more of the following—**
- (a) **OTCD securities;**
 - (b) **OTCD futures contracts;**
 - (c) **OTCD unlisted options contracts.**

- (4B) The Commission may, on application in writing and payment of the fee prescribed in the Securities and Futures (Fees) Rules (Cap. 571 sub. leg. AF), approve—
- (a) as an approved SOCCRA-LC, a licensed corporation the default approach for which is BOCCRA within the meaning of section 2EF(5)(b);
 - (b) as an approved SMRA-LC, a licensed corporation the default approach for which is BMRA within the meaning of section 2EF(5)(b);
 - (c) as an approved BOCCRA-LC, a licensed corporation the default approach for which is SOCCRA within the meaning of section 2EF(5)(a); and
 - (d) as an approved BMRA-LC, a licensed corporation the default approach for which is SMRA within the meaning of section 2EF(5)(a).
- (4C) A licensed corporation may be approved under subsection (4B)(c) or (d) only if none of its OTCD activity levels that are counted for basic approach approval exceeds the applicable thresholds.
- (5) The Commission may, on application in writing by a licensed corporation and payment of the fee prescribed in the Securities and Futures (Fees) Rules (Cap. 571 sub. leg. AF), approve—
- (a) as approved redeemable shares, any redeemable shares issued by the licensed corporation;
 - (b) as an approved subordinated loan, any subordinated loan obtained by the licensed corporation;
 - (c) as an approved standby subordinated loan facility, any standby subordinated loan facility obtained by the licensed corporation;
 - (ca) for the purposes of paragraph (b) of the definition of **affiliate** in section 2EE(4), any entity as an approved affiliate of the licensed corporation;
 - (cb) for the purposes of section 2N(1)(b)(i)(B), an instrument as being an uncommon derivative;
 - (cc) for the purposes of section 2N(1)(b)(ii), a derivative instrument as not being an uncommon derivative;
 - (cd) for the purposes of section 2N(1)(c)(i)(B), an instrument as being a miscellaneous derivative;
 - (ce) for the purposes of section 2N(1)(c)(ii), a derivative instrument as not being a miscellaneous derivative;
 - (cf) for the purposes of section 2N(2)(a)(i)(C), an instrument as being a common commodity derivative;
 - (cg) for the purposes of section 2N(2)(a)(ii), a derivative instrument as not being a common commodity derivative;
 - (ch) for the purposes of section 2N(2)(b)(i)(C), an instrument as being a common debt security derivative;
 - (ci) for the purposes of section 2N(2)(b)(ii)(B), a derivative instrument as not being a common debt security derivative;
 - (cj) for the purposes of section 2N(2)(c)(i)(C), an instrument as being a common equity derivative;
 - (ck) for the purposes of section 2N(2)(c)(ii), a derivative instrument as not being a common equity derivative;
 - (cl) for the purposes of section 2N(2)(d)(i)(C), an instrument as being a common exchange rate derivative;

- (cm) for the purposes of section 2N(2)(d)(ii), a derivative instrument as not being a common exchange rate derivative;
- (cn) for the purposes of section 2N(2)(e)(i)(C), an instrument as being a common gold derivative;
- (co) for the purposes of section 2N(2)(e)(ii), a derivative instrument as not being a common gold derivative;
- (cp) for the purposes of section 2N(2)(f)(i)(C), an instrument as being a common interest rate derivative;
- (cq) for the purposes of section 2N(2)(f)(ii), a derivative instrument as not being a common interest rate derivative;
- (cr) for the purposes of section 2N(2)(g)(i)(C), an instrument as being a common credit derivative;
- (cs) for the purposes of section 2N(2)(g)(ii), a derivative instrument as not being a common credit derivative;
- (d) for the purposes of section 3(3), the adoption by the licensed corporation of an accounting principle other than one of those referred to in section 3(1)(a);
- (e) for the purposes of section 56(6), an officer of the licensed corporation to sign a return;
- (f) for the purposes of section 41(1)(a)(v), a foreign currency;
- (g) for the purposes of section 59(1)(a), the withdrawal of an election made by the licensed corporation under any provision of these Rules;
- (h) ~~the calculation of the haircut percentage applicable to an underlying basket of securities as in~~ relation to a basket of securities, the adoption of the weighted average of the haircut percentages applicable to each of the securities ~~which~~ that constitute the basket as the weighted average haircut percentage applicable to the basket;—
- ~~— (i) for special debt securities which fall within the description set out in item 1(b)(iii) or 2(a)(ii) in column 2 of Table 6 in Schedule 2; or~~
- ~~— (ii) for specified securities which fall within the description set out in item 2(b) or 3(a)(vii) in column 2 of Table 7 in Schedule 2; and~~
- (ha) in relation to a basket of debt securities—
 - (i) the adoption of the weighted average of the specific risk percentages applicable to each of the debt securities that constitute the basket as the weighted average specific risk percentage applicable to the basket; and
 - (ii) the adoption of the weighted average of the general risk percentages applicable to each of the debt securities that constitute the basket as the weighted average general risk percentage applicable to the basket;
- (hb) in relation to a basket of commodities, the adoption of the weighted average of the market risk percentages applicable to each of the commodities that constitute the basket as the weighted average market risk percentage applicable to the basket;
- (i) for the purposes of section 11(7), the ~~setting-off~~ offsetting by the licensed corporation of amounts receivable (except amounts receivable referred to in section 23(1)(f)) by it from, and amounts payable by it to, a general clearing participant of HKSCC which arise from transactions in securities that are cleared for it or its clients by the participant with HKSCC;

- (j) for the purposes of section 48B(1)(b), the inclusion of an amount in an BMRA-LC's ranking liabilities instead of the amount mentioned in section 48B(1)(a);
 - (k) for the purposes of section 48E(1)(b), the inclusion of an amount in an BMRA-LC's ranking liabilities instead of the amount mentioned in section 48E(1)(a);
 - (l) for the purposes of section 53H(2)(b), the use of a method for calculating the amount of a share of an asset posted as security;
 - (m) for the purposes of section 53I(2)(b), the use of a method for calculating the amount of a share of an asset posted as security;
 - (n) for the purposes of paragraph (h) of the definition of **specified equity index** in section 53ZD(1), an equity index as a specified equity index;
 - (o) for the purposes of section 53ZZK(c), the compliance with an approach in respect of each of an SMRC-LC's positions in common derivatives that are in the form of continuous options contracts; and
 - (p) for the purposes of section 53ZZS(1)(b), the inclusion of an amount in an SMRA-LC's ranking liabilities instead of the amount mentioned in section 53ZZS(1)(a).
- (5A) An entity may be approved under subsection (5)(ca) as an approved affiliate of a licensed corporation only if the entity is—
- (a) in a relationship with the licensed corporation that is, in the Commission's opinion, comparable to being in the same group of companies; and
 - (b) licensed, registered or authorized by an authority or regulatory organization in a comparable jurisdiction for a Type 9-equivalent activity within the meaning of section 2EE(4).
- (5B) The Commission may, on application in writing by a licensed corporation, approve—
- (a) for the purposes of section 53A(1), the adoption by the licensed corporation of an alternative approach; and
 - (b) in connection with an approval under paragraph (a)—
 - (i) for the purposes of section 7(2), the accounting by the licensed corporation for any of its assets, liabilities and transactions on an alternative basis; and
 - (ii) for the purposes of section 56(4C), the omission by the licensed corporation of any particulars in a return under section 56.
- (5C) The Commission may give an approval under subsection (5B)(a) to a licensed corporation only if—
- (a) the Commission has had regard to guidelines published under section 399 of the Ordinance in relation to such approvals when giving the approval;
 - (b) the Commission is satisfied that—
 - (i) it would be unreasonable or unduly burdensome for the licensed corporation to comply with the provision to which the approval relates without the approval; or
 - (ii) the holding company of the licensed corporation applies in full or a substantial part of the methodologies set out in the prevailing banking supervisory standards issued by the Basel Committee in calculating the financial resources of the holding company on a consolidated basis, which covers the holding company and licensed corporation, in accordance with the requirements imposed or enforced by a comparable regulator; and

- (c) the Commission is satisfied that—
 - (i) it is prudent to give the approval taking into account the risks associated with the licensed corporation; and
 - (ii) the approval will not prejudice the interest of the investing public.
- (5D) The Commission may give an approval under subsection (5B)(b) to a licensed corporation only if—
 - (a) the Commission is satisfied that, in view of the adoption of an alternative approach by the licensed corporation as approved under subsection (5B)(a), it would be unreasonable or unduly burdensome for the licensed corporation to comply with the provision to which the approval relates without the approval; and
 - (b) the Commission is satisfied that—
 - (i) it is prudent to give the approval taking into account the risks associated with the licensed corporation; and
 - (ii) the approval will not prejudice the interest of the investing public.
- (5E) The Commission may, on application in writing by a licensed corporation, approve, for the purposes of section 14(4) of Schedule 6, the change of the licensed corporation's selection of SCRA's for a portfolio.
- (6) An approval granted under subsection (1), (4), (4B), ~~or~~ (5), (5B) or (5E) is subject to such reasonable conditions as the Commission may impose, and the Commission may at any time revoke the approval or amend or revoke any such condition or impose new conditions as may be reasonable in the circumstances.
- (7) The Commission may, for the purposes of section 56(5), approve an online communication system.
- (8) Where the Commission approves an online communication system under subsection (7), it must as soon as reasonably practicable publish directions and instructions for the use of that system in such manner as it considers appropriate.
- (9) An approval granted under subsection (1), (4), (4B), (5), (5B), (5E) or (7) remains in force—
 - (a) where a period of validity of the approval is specified in the notice of approval, until the expiry of the period; or
 - (b) where no such period is specified, until revoked by the Commission by notice in writing.
- (10) In this section—

comparable regulator (), in relation to the holding company of a licensed corporation, means an authority or regulatory organization that, in the Commission's opinion, performs a function involving the imposition or enforcement of requirements relating to the financial resources of banks or persons carrying on activities similar to any regulated activity.

59. Withdrawal of **and objection to** elections made under these Rules

- (1) A licensed corporation ~~which that~~ makes an election under any provision of these Rules is bound by the election until ~~such time as—~~
 - (a) if the Commission approves the withdrawal of the election under section 58(5)(g)—the date specified in the approval; or
 - (b) if the Commission objects to the election under subsection (2)—the date on which the objection takes effect.

- (2) For the purposes of subsection (1)(b), the Commission may, by notice in writing served on a licensed corporation that makes an election referred to in subsection (1), object to the election if the Commission is satisfied that it is prudent to do so taking into account risks associated with the licensed corporation.
- (3) An objection under subsection (2) to an election takes effect on the later of—
 - (a) the date on which the notice of objection is served; and
 - (b) the date specified in the notice.

60. Transitional

- (1) *(Omitted as expired)*
- (2) *(Omitted as spent)*
- (3) Notwithstanding section 1 and subject to subsection (5), section 5 does not apply in respect of—
 - (a) a partnership deemed under section 27 of Part 1 of Schedule 10 to the Ordinance to be a licensed corporation; or
 - (b) an individual deemed under section 30 of Part 1 of Schedule 10 to the Ordinance to be a licensed corporation,
 provided that—
 - (c) in the case of a partnership, the aggregate of amounts maintained in all partners' capital accounts; or
 - (d) in the case of an individual, the amount maintained in his capital account, is not less than the amount of paid-up share capital required of a licensed corporation under section 5, until such time as the specified decision referred to, in the case of a partnership, in section 53(1)(b) of Part 1 of Schedule 10 to the Ordinance or, in the case of an individual, in section 53(1)(c) of Part 1 of Schedule 10 to the Ordinance, takes effect.
- (4) For the purposes of these Rules, a transaction executed by—
 - (a) a partnership deemed under section 27 of Part 1 of Schedule 10 to the Ordinance to be a licensed corporation, for the account of a partner of the partnership; and
 - (b) an individual deemed under section 30 of Part 1 of Schedule 10 to the Ordinance to be a licensed corporation, for his own account,
 shall be treated as a transaction executed by it or him (as the case may be) for a client.
- (5) Notwithstanding section 1 and subject to subsection (6), these Rules do not apply in respect of—
 - (a) a partnership deemed under section 27 of Part 1 of Schedule 10 to the Ordinance to be a licensed corporation;
 - (b) an individual deemed under section 30 of Part 1 of Schedule 10 to the Ordinance to be a licensed corporation; or
 - (c) a licensed corporation,
 which is licensed solely for one or more of the following—
 - (d) Type 4 regulated activity;
 - (e) Type 5 regulated activity;
 - (f) Type 6 regulated activity;
 - (g) Type 9 regulated activity,

provided that it or he (as the case may be) maintains net tangible assets in an amount of not less than \$500,000.

- (6) Subsection (5) shall expire at the expiration of 6 months from the commencement of these Rules.
- (6A) Where a licensed corporation is licensed immediately prior to 1 October 2006 for Type 1 or Type 8 regulated activity, for the period from 1 October 2006 to 30 September 2007, the reference in section 42(2) to 80% shall be construed as a reference to 65%.
- (6B) Schedule 10 sets out transitional provisions that have effect for the purposes of the amendments to these Rules made by the Securities and Futures (Financial Resources) (Amendment) Rules.

(7) In this section—

capital account (資本帳) means an account in which the amount of capital injected into the business of a partnership or sole-proprietorship is kept;

net tangible assets (有形資產淨值), in relation to a person referred to in subsection (5)(a), (b) or (c), means the person's total assets less—

- (a) the person's intangible assets, including goodwill, copyrights, patents and licences; and
 - (b) the person's total liabilities (after excluding any approved subordinated loan provided to the person).
-

Schedule 1

[ss. 2, &-5, 5A & Sch. 10]

Financial Resources Requirements

1. Minimum paid-up share capital

- (1) The minimum amount of paid-up share capital applicable to a licensed corporation to which section 5 applies is, subject to subsection (2), the highest of those amounts specified in column 3 of Table 1 opposite—
- (a) any of the regulated activities specified in column 2 of that Table for which the licensed corporation is licensed; and
 - (b) where any further description is set out for a regulated activity for which the licensed corporation is licensed—any of the applicable descriptions.
- (2) If the licensed corporation is an approved standardized approach LC or approved latest Basel LC that is, or is treated as, an RCCP-cleared OTCD dealer, the minimum amount of paid-up share capital applicable to it is the higher of—
- (a) the amount applicable to it under subsection (1); and
 - (b) \$30,000,000.

Table 1

Paid-up Share Capital

Column 1 Item	Column 2 Regulated activity	Column 3 Minimum amount of paid-up share capital
1.	Type 1—	
	(a) in the case where the licensed corporation in question provides securities margin financing	\$10,000,000
	(ab) where the licensed corporation is a non-RA11 OTCD dealer that—	
	(i) is an RCCP-cleared OTCD dealer or asset management group central OTCD dealer	\$30,000,000
	(ii) does not fall within subparagraph (i), and is an OTCD inter-dealer broker	\$60,000,000
	(b) in any other case	\$5,000,000
2.	Type 2—	\$5,000,000
	(a) where the licensed corporation is a non-RA11 OTCD dealer that—	
	(i) is an RCCP-cleared OTCD dealer or asset management group central OTCD dealer	\$30,000,000
	(ii) does not fall within subparagraph (i), and	\$60,000,000

	is an OTCD inter-dealer broker	
	(b) in any other case	\$5,000,000
3.	Type 3—	
	(a) in the case where the licensed corporation in question is an approved introducing agent	\$5,000,000
	(ab) where the licensed corporation is a non-RA11 OTCD dealer that—	
	(i) is an RCCP-cleared OTCD dealer or asset management group central OTCD dealer	\$30,000,000
	(ii) does not fall within subparagraph (i), and is an OTCD inter-dealer broker	\$60,000,000
	(b) in any other case	\$30,000,000
4.	Type 4	\$5,000,000
5.	Type 5	\$5,000,000
6.	Type 6—	
	(a) in the case where the licensed corporation in question is not subject to the no sponsor work licensing condition	\$10,000,000
	(b) in any other case	\$5,000,000
7.	Type 7	\$5,000,000
8.	Type 8	\$10,000,000
9.	Type 9	\$5,000,000
10.	Type 10	\$5,000,000
11.	Type 11—	
	(a) where the licensed corporation is not an RA11 dealer	\$5,000,000
	(b) where the licensed corporation is an RA11 dealer that—	
	(i) is an RCCP-cleared OTCD dealer or asset management group central OTCD dealer	\$30,000,000
	(ii) does not fall within subparagraph (i), and is an OTCD inter-dealer broker	\$60,000,000
12.	Type 12	\$5,000,000

13. Type 13

\$10,000,000

2. Minimum tangible capital

The minimum amount of tangible capital applicable to a licensed corporation to which section 5A applies is the highest of those amounts specified in column 3 of Table 1A opposite any of the descriptions set out in column 2 of that Table that apply to the licensed corporation.

Table 1A**Tangible Capital**

Column 1 Item	Column 2 Description	Column 3 Minimum amount of tangible capital
1.	A licensed corporation that falls within section 5A(2)(a), (b) or (f)—	
	(a) where it is opting for reduced capital requirements	\$500,000,000
	(b) where it is not opting for reduced capital requirements	\$1,000,000,000
2.	A licensed corporation that falls within section 5A(2)(c)	\$1,000,000,000
3.	A licensed corporation that falls within section 5A(2)(d)	\$2,000,000,000
4.	A licensed corporation that falls within section 5A(2)(e)—	
	(a) where it is opting for reduced capital requirements	\$1,000,000,000
	(b) where it is not opting for reduced capital requirements	\$2,000,000,000
5.	A licensed corporation that falls within section 5A(2)(g)	\$2,000,000,000

3. Minimum amount of required liquid capital

- (1) The minimum amount of required liquid capital applicable to a licensed corporation is, subject to subsections (2) and (3), the highest of those amounts specified in column 3 of Table 2 opposite—
 - (a) any of the regulated activities specified in column 2 of that Table for which the licensed corporation is licensed; and
 - (b) where any further description is set out for a regulated activity for which the licensed corporation is licensed—any of the applicable descriptions.
- (2) If the licensed corporation is an approved standardized approach LC or approved latest Basel LC, the minimum amount of required liquid capital applicable to it is the higher of—

- (a) the amount applicable to it under subsection (1); and
- (b) the following amount—
 - (i) for an approved standardized approach LC or approved latest Basel LC that is, or is treated as, an RCCP-cleared OTCD dealer—\$15,000,000; or
 - (ii) for any other approved standardized approach LC or approved latest Basel LC—
 - (A) if it is opting for reduced capital requirements—\$78,000,000; or
 - (B) if it is not opting for reduced capital requirements—\$156,000,000.
- (3) If the licensed corporation is an approved internal model LC, the minimum amount of required liquid capital applicable to it is the higher of—
 - (a) the amount applicable to it under subsection (1) or (2); and
 - (b) \$156,000,000.

Table 2

Required Liquid Capital

Column 1 Item	Column 2 Regulated activity	Column 3 Minimum amount of required liquid capital
1.	Type 1—	
(a)	in the case where the licensed corporation in question is an approved introducing agent or trader	\$500,000
(ab)	where the licensed corporation is a non-RA11 OTCD dealer that—	
(i)	is an RCCP-cleared OTCD dealer or asset management group central OTCD dealer	\$15,000,000
(ii)	does not fall within subparagraph (i), and is an OTCD inter-dealer broker	\$30,000,000
(ac)	where the licensed corporation is a non-RA11 OTCD dealer that does not fall within paragraph (ab)(i) or (ii), and—	
(i)	is opting for reduced capital requirements	\$78,000,000
(ii)	is not opting for reduced capital requirements	\$156,000,000
(b)	in any other case	\$3,000,000
2.	Type 2—	
(a)	in the case where the licensed corporation in question is an approved introducing agent, futures non-clearing dealer or trader	\$500,000
(ab)	where the licensed corporation is a non-RA11 OTCD dealer that—	

	(i) is an RCCP-cleared OTCD dealer or asset management group central OTCD dealer	\$15,000,000
	(ii) does not fall within subparagraph (i), and is an OTCD inter-dealer broker	\$30,000,000
	(ac) where the licensed corporation is a non-RA11 OTCD dealer that does not fall within paragraph (ab)(i) or (ii), and—	
	(i) is opting for reduced capital requirements	\$78,000,000
	(ii) is not opting for reduced capital requirements	\$156,000,000
	(b) in any other case	\$3,000,000
3.	Type 3—	
	(a) in the case where the licensed corporation in question is an approved introducing agent	\$3,000,000
	(ab) where the licensed corporation is a non-RA11 OTCD dealer that—	
	(i) is an RCCP-cleared OTCD dealer or asset management group central OTCD dealer	\$15,000,000
	(ii) does not fall within subparagraph (i), and is an OTCD inter-dealer broker	\$30,000,000
	(ac) where the licensed corporation is a non-RA11 OTCD dealer that does not fall within paragraph (ab)(i) or (ii), and—	
	(i) is opting for reduced capital requirements	\$78,000,000
	(ii) is not opting for reduced capital requirements	\$156,000,000
	(b) in any other case	\$15,000,000
4.	Type 4—	
	(a) in the case where the licensed corporation in question is subject to the specified licensing condition	\$100,000
	(b) in any other case	\$3,000,000
5.	Type 5—	
	(a) in the case where the licensed corporation in question is subject to the specified licensing condition	\$100,000
	(b) in any other case	\$3,000,000
6.	Type 6—	
	(a) in the case where the licensed corporation in question is subject to the specified licensing	\$100,000

	condition	
	(b) in any other case	\$3,000,000
7.	Type 7—	\$3,000,000
	(a) where the licensed corporation is an RA7 service provider for OTCD trading	\$156,000,000
	(b) where the licensed corporation is an RA7 service provider for OTCD clearing	\$390,000,000
	(c) in any other case	\$3,000,000
8.	Type 8	\$3,000,000
9.	Type 9—	
	(a) in the case where the licensed corporation in question is subject to the specified licensing condition	\$100,000
	(b) in any other case	\$3,000,000
10.	Type 10—	
	(a) in the case where the licensed corporation in question is subject to the specified licensing condition	\$100,000
	(b) in any other case	\$3,000,000
11.	Type 11—	
	(a) where the licensed corporation is not an RA11 dealer, and—	
	(i) is subject to the specified licensing condition	\$100,000
	(ii) is not subject to the specified licensing condition	\$3,000,000
	(b) where the licensed corporation is an RA11 dealer that—	
	(i) is an RCCP-cleared OTCD dealer or asset management group central OTCD dealer	\$15,000,000
	(ii) does not fall within subparagraph (i), and is an OTCD inter-dealer broker	\$30,000,000
	(c) where the licensed corporation is an RA11 dealer that does not fall within paragraph (b), and—	
	(i) is opting for reduced capital requirements	\$78,000,000
	(ii) is not opting for reduced capital requirements	\$156,000,000
12.	Type 12—	
	(a) where the licensed corporation is a specified RA12 LC	\$3,000,000

(b) where the licensed corporation does not fall within paragraph (a), and—

(i) is opting for reduced capital requirements \$195,000,000

(ii) is not opting for reduced capital requirements \$390,000,000

13. Type 13 \$3,000,000

Schedule 2

[ss. 2, 2C, ~~2E~~ & 582N & 9C]

Haircut Percentages

Table 1

Haircut Percentages for Listed Shares or Listed Depositary Receipts

Column 1	Column 2	Column 3
Item	Description	Haircut percentage %
1.	Except for the purpose of calculating the haircut amount under section 22(1)(b)(i), shares or depositary receipts which are listed on a recognized stock market—	
	(a) being a constituent of the Hang Seng Index	15
	(b) not being a constituent of the Hang Seng Index but being a constituent of the Hang Seng Composite LargeCap Index	20
	(c) not being a constituent of the Hang Seng Index or the Hang Seng Composite LargeCap Index	30
2.	Shares or depositary receipts which are listed on a specified exchange in the United Kingdom—	
	(a) other than shares or depositary receipts which are listed on London Stock Exchange plc – SEAQ—	
	(i) being a constituent of the FTSE 100 Index	15
	(ii) not being a constituent of the FTSE 100 Index	20
	(b) being shares or depositary receipts which are listed on London Stock Exchange plc – SEAQ	30
3.	Shares or depositary receipts which are listed on a specified exchange in the United States of America—	
	(a) other than shares or depositary receipts which are listed on the NASDAQ Stock Market LLC – NASDAQ Global Market or the NASDAQ Stock Market LLC – NASDAQ Global Select Market—	
	(i) being a constituent of the S&P 500 Index	15
	(ii) not being a constituent of the S&P 500 Index	20
	(b) being shares or depositary receipts which are listed on the NASDAQ Stock Market LLC – NASDAQ Global Market or the NASDAQ Stock Market LLC – NASDAQ Global Select Market	30

Column 1	Column 2	Column 3
Item	Description	Haircut percentage %
4.	Shares or depositary receipts which are listed on a specified exchange in Japan—	
	(a) other than shares or depositary receipts which are listed on the Tokyo Stock Exchange, Inc. – JASDAQ—	
	(i) being a constituent of the Nikkei Stock Average	15
	(ii) not being a constituent of the Nikkei Stock Average	20
	(b) being shares or depositary receipts which are listed on the Tokyo Stock Exchange, Inc. – JASDAQ	30
5.	Shares or depositary receipts which are listed on a specified exchange specified in Part 1 of Schedule 3, other than an exchange in the United Kingdom, the United States of America or Japan—	
	(a) being a constituent of the Euro Stoxx 50 Index	15
	(b) not being a constituent of the Euro Stoxx 50 Index	20
6.	Shares or depositary receipts which are listed on a specified exchange specified in Part 2 of Schedule 3—	30
	(a) being a constituent of the MSCI China A 50 Connect Index	15
	(b) being a constituent of the FTSE China A50 Index	15
	(c) not being a constituent of an index referred to in paragraph (a) or (b) but being a constituent of the CSI 300 Index	20
	(d) not being a constituent of an index referred to in paragraph (a), (b) or (c)	30
7.	Shares or depositary receipts which are listed on a stock exchange (other than an exchange referred to in item 1, 2, 3, 4, 5 or 6) which is a member of the World Federation of Exchanges	50
8.	Shares or depositary receipts which are listed on a stock exchange not referred to in item 1, 2, 3, 4, 5, 6 or 7	75

Table 1A

Haircut Percentages for Shares **or Depositary Receipts Listed in Hong Kong for Purpose of Calculating Haircut Amount under Section 22(1)(b)(i)**

Column 1	Column 2	Column 3
Item	Description	Haircut percentage %
1.	For the purpose of calculating the haircut amount under section 22(1)(b)(i), shares or depositary receipts which are listed on a recognized stock market—	
	(a) being a constituent of the Hang Seng Index	15
	(b) not being a constituent of the Hang Seng Index but being a constituent of the Hang Seng Composite LargeCap Index	20
	(c) not being a constituent of the Hang Seng Index or the Hang Seng Composite LargeCap Index but being a constituent of the MSCI Hong Kong Index or the MSCI China Index	30
	(d) not being a constituent of the Hang Seng Index, the Hang Seng Composite LargeCap Index, the MSCI Hong Kong Index or the MSCI China Index but being a constituent of the Hang Seng Composite Index	30
	(e) not being a constituent of an index referred to in paragraph (a), (b), (c) or (d)—	
	(i) for a licensed corporation which does not repledge securities collateral	30
	(ii) for a licensed corporation which repledges securities collateral	60

Table 2*(Repealed)***Table 3***(Repealed)***Table 4**

**Haircut Percentages for Qualifying Debt Securities,
by Issuer or Guarantor, etc.**

Column 1	Column 2	Column 3
Tier	Description	Haircut percentage %
1.	Where the issuer or guarantor of the qualifying debt securities—	0
	(a) is the Central People's Government of the	

Column 1	Column 2	Column 3
Tier	Description	Haircut percentage %
	(i) Moody's Investors Service at Aa, A or Prime-2; (ii) Standard & Poor's Corporation at AA, A or A-2; or (iii) Fitch Ratings at AA, A or F2; or (b) where the issuer of the qualifying debt securities is the Hong Kong Mortgage Corporation (a) the qualifying debt securities— <ul style="list-style-type: none"> (i) fall within paragraph (a)(iv) or (v) of the definition of qualifying debt securities in section 2(1) by virtue of a rating by— <ul style="list-style-type: none"> (A) Moody's Investors Service at A1, A2, A3 or P-2; (B) Standard & Poor's Corporation at A+, A, A- or A-2; or (C) Fitch Ratings at A+, A, A- or F2; or (ii) are issued by the Hong Kong Mortgage Corporation; and (b) the qualifying debt securities are— <ul style="list-style-type: none"> (i) not securitization issues; 2 (ii) securitization issues (other than re-securitization issues); or 21.84 (iii) re-securitization issues 27.3 (c) <i>(Repealed)</i>	
4.	To the extent not already covered in Tier 1, Tier 2 or Tier 3, where the issuer of the qualifying debt securities has an issue or issues currently rated by— (a) Moody's Investors Service at Baa or Prime-3; (b) Standard & Poor's Corporation at BBB or A-3; or (c) Fitch Ratings at BBB or F3 (a) the qualifying debt securities fall within paragraph (a)(iv) of the definition of qualifying debt securities in section 2(1) by virtue of a rating by— <ul style="list-style-type: none"> (i) Moody's Investors Service at Baa1, Baa2, Baa3 or P-3; (ii) Standard & Poor's Corporation at BBB+, BBB, BBB- or A-3; or (iii) Fitch Ratings at BBB+, BBB, BBB- or F3; and (b) the qualifying debt securities are—	5

Column 1	Column 2	Column 3
Tier	Description	Haircut percentage %
	(i) not securitization issues;	5
	(ii) securitization issues (other than re-securitization issues); or	43.68
	(iii) re-securitization issues	54.6

Table 5

Haircut Percentages for Qualifying Debt Securities, by Remaining Term to Maturity

Notes:

- In this Table—
category 1 qualifying debt securities (第1類合資格債務證券) means qualifying debt securities having a fixed rate coupon or a floating rate coupon, except qualifying debt securities having no maturity date or a remaining term to maturity exceeding 30 years;
category 2 qualifying debt securities (第2類合資格債務證券) means qualifying debt securities that do not fall within category 1 qualifying debt securities.
- In this Table, qualifying debt securities are regarded as having a fixed rate coupon if interest—
 - is payable periodically throughout the term of the securities; and
 - is calculated by reference to a predetermined fixed interest rate that does not change during the term of the securities.
- In this Table, qualifying debt securities are regarded as having a floating rate coupon if interest—
 - is payable periodically throughout the term of the securities; and
 - is calculated by reference to a variable interest rate that is reset periodically to equate to the level of a money market or interbank reference interest rate that is widely quoted and is predetermined to apply throughout the term of the securities, plus or minus a predetermined specified rate (if any) that does not change during the term of the securities.

Column 1	Column 2	Column 3
Remaining term to maturity	Category 1 qualifying debt securities Haircut percentage %	Category 2 qualifying debt securities Haircut percentage %
(a) Less than 6 months	1	1
(b) 6 months to less than 3 years	3	3

	Column 1	Column 2	Column 3
		Category 1 qualifying debt securities	Category 2 qualifying debt securities
		Haircut percentage	Haircut percentage
	Remaining term to maturity	%	%
(c)	3 years to less than 5 years	4	5
(d)	5 years to less than 10 years	7	10
(e)	10 years or more, or infinite	10	22

Table 6

Haircut Percentages for Special Debt Securities

Notes:

- In this Table, the following terms have the meaning given by section 2F(2)—
 - permitted interest rate** (許可利率);
 - permitted securities** (許可證券);
 - permitted underlying asset** (許可相關資產);
 - permitted underlying type of rate or index** (屬許可類別的相關比率或指數);
 - tradable commodity index** (流通商品指數);
 - tradable currency exchange rate index** (流通貨幣匯率指數);
 - tradable securities index** (流通證券指數).
- In this Table—

category 1 special debt securities (第1類特別債務證券) means special debt securities having a fixed rate coupon or a floating rate coupon, except special debt securities having no maturity date or a remaining term to maturity exceeding 30 years;

category 2 special debt securities (第2類特別債務證券) means special debt securities that do not fall within category 1 special debt securities.
- For the purposes of the definition of **category 1 special debt securities** in Note 2, special debt securities are regarded as having—
 - a fixed rate coupon if interest—
 - is payable periodically throughout the term of the securities; and
 - is calculated by reference to a predetermined fixed interest rate that does not change during the term of the securities; or
 - a floating rate coupon if interest—
 - is payable periodically throughout the term of the securities; and
 - is calculated by reference to a variable interest rate that is reset periodically to equate to the level of a money market or interbank reference interest rate that is widely quoted and is predetermined to apply throughout the term of the

securities, plus or minus a predetermined specified rate (if any) that does not change during the term of the securities.

4. In this Table—

P, in relation to special debt securities referred to in item 1(b)(i), 2(b) or 3 of this Table, means the percentage calculated in accordance with the following formula—

$$P = A + B$$

where—

“A” is the percentage specified in column 3 of Table 4 opposite a description set out in Tier 1, 3 or 4 in column 2 of Table 4 of an issuer or guarantor of qualifying debt securities, being a description which is applicable to—

- (a) for special debt securities referred to in item 1(b)(i) of this Table—the rating given by Moody’s Investors Service, Standard & Poor’s Corporation or Fitch Ratings to the applicable jurisdiction referred to in the definition of **permitted interest rate** in section 2F(2); or
- (b) for special debt securities referred to in item 2(b) or 3 of this Table—the issuer or guarantor of the special debt securities; and

“B” is—

- (a) for special debt securities referred to in item 1(b)(i) of this Table—the percentage specified in column 2 of Table 5 opposite the description of a remaining term to maturity of qualifying debt securities set out in column 1 of Table 5 which would, if the description was of the tenor of an interest rate, apply to the permitted interest rate underlying the special debt securities;
- (b) for special debt securities referred to in item 2(b) of this Table—the percentage specified in the following column of Table 5 opposite the description of a remaining term to maturity of qualifying debt securities set out in column 1 of Table 5 which would, if the description was of the remaining term to maturity of special debt securities, apply to the remaining term to maturity of the special debt securities—
 - (i) if the special debt securities are category 1 special debt securities—column 2; or
 - (ii) if the special debt securities are category 2 special debt securities—column 3; or
- (c) for special debt securities referred to in item 3 of this Table—the percentage specified in column 3 of Table 5 opposite the description of a remaining term to maturity of qualifying debt securities set out in column 1 of Table 5 which would, if the description was of the remaining term to maturity of special debt securities, apply to the remaining term to maturity of the special debt securities.

Column 1	Column 2	Column 3
Item	Description	Haircut percentage
1.	Special debt securities being a structured note, where—	
	(a) the permitted underlying asset is—	
	(i) permitted securities	the percentage applicable to the permitted securities

Column 1	Column 2	Column 3
Item	Description	Haircut percentage
	(ii) a tradable commodity	40%
(b)	the permitted underlying type of rate or index is a single type of—	
	(i) permitted interest rate	P
	(ii) currency exchange rate or tradable currency exchange rate index	5%
	(iii) tradable securities index	the highest of the haircut percentages applicable to each of the permitted securities which constitute the basket underlying the index, or the weighted average percentage applicable to the index basket as calculated in accordance with an approval granted under section 58(5)(h)(i)
	(iv) tradable commodity index	40%
2.	Special debt securities being specified convertible debt securities or a specified bond, where—	
	(a) the market value is more than the par value or nominal value, where—	
	(i) the underlying asset-subject matter is shares	the percentage applicable to the underlying shares
	(ii) the underlying asset-subject matter is a basket of shares	the highest of the haircut percentages applicable to each of the shares which constitute the basket, or the weighted average haircut percentage applicable to the basket as calculated in accordance with an approval granted under section 58(5)(h)(i)
	(b) the market value is equal to, or less than, the par value or nominal value	P

Column 1	Column 2	Column 3
Item	Description	Haircut percentage
3.	Special debt securities being non-interest bearing debt securities	105% of P

Table 7

Haircut Percentages for Specified Securities

Column 1	Column 2	Column 3
Item	Description	Haircut percentage
1.	Warrants listed on a specified exchange	100%
2.	Equity-linked instruments, where—	
	(a) the underlying asset-subject matter is an equity	the percentage applicable to the underlying equity
	(b) the underlying asset-subject matter is a basket of equities, or the underlying index is calculated by reference to a basket of equities or an equity index	the highest of the haircut percentages applicable to each of the equities which that constitute the basket (or the basket underlying the index) , or the weighted average haircut percentage applicable to the basket or index as calculated in accordance with an approval granted under section 58(5)(h)(ii)
3.	Units in a unit trust or shares in a mutual fund (<i>fund</i>) which is an authorized fund, a recognized jurisdiction fund or a specified exchange traded fund, where the fund has features or characteristics that—	
	(a) satisfy the descriptions in the UT Code for—	
	—(i) warrant funds	40%
	—(ii) futures and options funds	40%
	(iii) hedge funds	40%
	(iv) structured funds	40%
	(v) funds that invest extensively in financial	40%

Column 1	Column 2	Column 3
Item	Description	Haircut percentage
	derivative instruments	
(vi)	money market and cash management funds	5%
(vii)	unlisted index funds and index tracking exchange traded funds , but only if the fund tracks an equity index or a debt security index (being an index that is calculated by reference to a basket of equities) or a debt securities index (being an index that is calculated by reference to a basket of debt securities)	the highest of the haircut percentages applicable to each of the equities or debt securities which that constitute the basket underlying the index, or the weighted average haircut percentage applicable to the index basket as calculated in accordance with an approval granted under section 58(5)(h)(ii)
(viii)	closed-ended funds	30%
(b)	satisfy the descriptions in the Code on Real Estate Investment Trusts published by the Commission under section 399 of the Ordinance for a REIT	30%
(c)	fall within more than one of the descriptions set out in paragraph (a) or (b)	the highest of the haircut percentages applicable to each of the descriptions
(d)	do not fall within any of the descriptions set out in paragraph (a), (b) or (c)	20%

Table 8

Haircut Percentages for Specified Investments

Column 1	Column 2	Column 3
Item	Description	Haircut percentage %
1.	Gold coin or gold bullion	10
2.	Interests in a collective investment scheme which—	10
	(a) falls within the meaning of paragraph (b) of the definition of collective investment scheme in section 1 of Part 1 of Schedule 1 to the Ordinance; and	
	(b) is authorized by the Commission under section 104	

Column 1	Column 2	Column 3
Item	Description	Haircut percentage %

of the Ordinance

Note—

Paragraph (a) refers to arrangements for the purchase of gold coins or gold bullion, as described in item 1 of the Schedule to the Securities and Futures (Collective Investment Schemes) Notice (Cap. 571 sub. leg. M).

3.	A tradable commodity	40
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Table 9**Haircut Percentages for Illiquid and Miscellaneous Investments**

Column 1	Column 2	Column 3
Item	Description	Haircut percentage %
1.	Illiquid investments	100
2.	Miscellaneous investments	100

Schedule 3

[s. 2 & Sch. 2]

Specified Exchanges**Part 1**

ASX Limited
Australian Securities Exchange Limited
Board of Trade of the City of Chicago, Inc.
Borsa Italiana S.p.A.
Cboe Exchange, Inc.
Chicago Mercantile Exchange, Inc.
Commodity Exchange, Inc.
Deutsche Börse AG
Eurex Frankfurt AG
Eurex Zürich AG
Euronext Amsterdam N.V.
Euronext Brussels S.A./N.V.
Euronext Paris S.A.
European Energy Exchange AG
Guangzhou Futures Exchange
Hong Kong Futures Exchange Limited
ICE Futures Canada, Inc.
ICE Futures Europe
ICE Futures U.S., Inc.
Korea Exchange, Inc.
London Stock Exchange plc
Montréal Exchange Inc.
Nagoya Stock Exchange, Inc.
NASDAQ Copenhagen A/S
NASDAQ Helsinki Ltd
NASDAQ PHLX LLC
NASDAQ Stockholm AB
New York Mercantile Exchange, Inc.
New York Stock Exchange LLC
NYSE American LLC
NYSE Arca, Inc.
NZX Limited
Osaka Dojima Commodity Exchange
Osaka Exchange, Inc.

Oslo Børs ASA
 SIX Swiss Exchange Ltd.
 Sociedad Rectora de la Bolsa de Valores de Madrid, S.A., Sociedad Unipersonal
 Société de la Bourse de Luxembourg S.A.
 The London Metal Exchange Limited
 The NASDAQ Stock Market LLC – NASDAQ Global Market
 The NASDAQ Stock Market LLC – NASDAQ Global Select Market
 The Stock Exchange of Hong Kong Limited
 Tokyo Commodity Exchange, Inc.
 Tokyo Financial Exchange Inc.
 Tokyo Stock Exchange, Inc.
 TSX Inc.
 Wiener Börse AG

Part 2

B3 S.A. – Brasil, Bolsa, Balcão
 BSE Limited
 Bursa Malaysia Derivatives Berhad
 Bursa Malaysia Securities Berhad
 China Financial Futures Exchange
 Dalian Commodity Exchange
 Hochiminh Stock Exchange
 Indonesia Stock Exchange
 MIAX Futures Exchange, LLC
 National Stock Exchange of India Limited
 Shanghai Futures Exchange
 Shanghai International Energy Exchange Co., LTD
 Shanghai Stock Exchange
 Shenzhen Stock Exchange
 Singapore Exchange Derivatives Trading Limited
 Singapore Exchange Securities Trading Limited
 Taiwan Stock Exchange Corporation
 Thailand Futures Exchange Public Company Limited
 The Philippine Stock Exchange, Inc.
 The Saudi Exchange
 The Stock Exchange of Thailand
 The Taiwan Futures Exchange Corporation
 Zhengzhou Commodity Exchange

Schedule 4

[~~ss. 49 & 50~~]

Financial Commitments

~~Table 1~~~~Interest Rate Swap Agreements~~

Item	Remaining term to maturity	Percentage
		%
1.	Less than 3 months	0
2.	3 months or more but less than 1 year	0.05
3.	1 year or more but less than 2 years	0.1
4.	Each year in addition to the period referred to in item 3	0.1

Table 2

Foreign Exchange Agreements

Item	Description	Percentage
1.	The counterparty of the foreign exchange agreement is an authorized financial institution or an approved bank incorporated outside Hong Kong and the remaining term to maturity is—	
	(a) less than 3 business days	0%
	(b) 3 business days or more but less than 1 year	0.2%
	(c) 1 year or more	0.5% where the remaining term to maturity of the agreement is less than 2 years, plus 0.3% for each additional full year after 1 year, subject to a maximum of 5%
2.	The counterparty of the foreign exchange agreement is a person other than a person referred to in item 1 and the remaining term to maturity is—	
	(a) less than 3 business days	0%
	(b) 3 business days or more	5%

Schedule 5

[s. 52]

Note Issuance and Revolving Underwriting Facilities

Item	Remaining term to maturity	Percentage %
1.	Less than 1 year	1
2.	1 year or more but less than 5 years	2.5
3.	5 years or more	5

Schedule 6

[ss. 2, 53D, 53K, 53N, 53S, 53V,
53Z & 58]

Credit Quality Grades for Credit Assessment Ratings and Risk Weights

Part 1

Interpretation

1. Interpretation

(1) In this Schedule—

Basel-covered bank () means—

- (a) an authorized institution (as defined by section 2(1) of the Banking Ordinance (Cap. 155)); or
- (b) a bank that is authorized (however described) to carry on business by a banking supervisory authority in a jurisdiction outside Hong Kong (**supervisory authority**) and is subject to the comparable supervisory arrangements in that jurisdiction, except such a bank—
 - (i) the authorization of which to carry on business is for the time being suspended; or
 - (ii) that, in the opinion of the Commission, is not adequately supervised by the supervisory authority;

Basel-covered securities firm () means a corporation (other than a licensed corporation or a Basel-covered bank) that is authorized (however described) by an ordinary member of the International Organization of Securities Commissions in a jurisdiction outside Hong Kong (**supervisory authority**) to engage in an activity that, if carried on in Hong Kong, would constitute a regulated activity, and is subject to the comparable supervisory arrangements in that jurisdiction, except such a corporation—

- (a) the authorization of which to carry on such activity is for the time being suspended; or
- (b) that, in the opinion of the Commission, is not adequately supervised by the supervisory authority;

comparable supervisory arrangements (), in relation to a jurisdiction outside Hong Kong, means supervisory arrangements imposed by a supervisory authority in that jurisdiction or under the law of that jurisdiction—

- (a) that regulate the maintenance of adequate capital to support business activities of banks or corporations within the meaning of the definition of **Basel-covered securities firm**; and
- (b) that are comparable to the standards set out in the document entitled “International Convergence of Capital Measurement and Capital Standards—A Revised Framework (Comprehensive Version)” published by the Basel Committee in June 2006 or any standards subsequently published by the Basel Committee for prudential regulation of banks;

domestic currency exposure () means an exposure of a licensed corporation to the Government or any other JAA that is—

- (a) denominated—
 - (i) for an exposure to the Government—in Hong Kong dollars; or
 - (ii) for an exposure to any other JAA—in the local currency of the JAA; and
- (b) funded by liabilities of the licensed corporation in that currency;

entity () includes a person;

Hong Kong public sector entity () means an entity specified in Part 1 of Schedule 1 to the Banking (Capital) Rules (Cap. 155 sub. leg. L);

JAA () means—

- (a) in relation to Hong Kong—the Government; or
- (b) in relation to a jurisdiction outside Hong Kong—
 - (i) the relevant government of the jurisdiction;
 - (ii) the central bank of the jurisdiction; or
 - (iii) an authority of the jurisdiction that is treated as equivalent to the relevant government or central bank of the jurisdiction for allocating risk weights under the comparable supervisory arrangements in the jurisdiction;

Note—

JAA stands for jurisdiction administration authority.

JAA-equivalent non-Hong Kong public sector entity () means a non-Hong Kong public sector entity that is treated as equivalent to a JAA of the relevant jurisdiction of the entity for allocating risk weights under the comparable supervisory arrangements in the relevant jurisdiction;

local currency () means—

- (a) in relation to a jurisdiction—the currency issued by the relevant government, the central bank, the monetary authority or an authorized note-issuing bank of that jurisdiction;
- (b) in relation to an obligor—the currency within the meaning of paragraph (a) of the relevant jurisdiction of the obligor;

local JAA ()—see section 19 of this Schedule;

long-term SCRA issue specific rating () means an SCRA issue specific rating that is a long-term credit assessment rating;

miscellaneous entity () means any entity except—

- (a) a JAA;
- (b) a Hong Kong public sector entity or non-Hong Kong public sector entity;
- (c) a qualifying financial institution;
- (d) a relevant international organization; or
- (e) a multilateral body;

multilateral body () means—

- (a) a multilateral development bank; or
- (b) an entity (other than a multilateral development bank)—
 - (i) that is established by a group of countries to provide financing and professional advice for economic and social development projects;
 - (ii) that has—
 - (A) a large membership of JAAs;
 - (B) its own independent legal and operational status; and

(C) a mandate similar to the mandates of multilateral development banks; and

(iii) a considerable number of the owners of which are also the owners of multilateral development banks;

multilateral development bank () has the meaning given by section 2(1) of the Banking Ordinance (Cap. 155);

non-Hong Kong public sector entity () means an entity incorporated in a jurisdiction outside Hong Kong (other than a JAA of that jurisdiction) which Basel-covered banks carrying on business in that jurisdiction are, under the comparable supervisory arrangements in that jurisdiction, required or permitted to treat as a public sector entity for the purposes of allocating risk weights to exposures to the entity;

obligor () means—

- (a) for an exposure of a licensed corporation arising from—
 - (i) an OTCD transaction in respect of which the licensed corporation is required to include an amount under a provision in Division 2, 3 or 5 of Part 4A of these Rules—the counterparty or clearing client (within the meaning of that provision) in relation to the transaction; or
 - (ii) a repo-style transaction in respect of which the licensed corporation is required to include an amount under section 53R—the counterparty (within the meaning of section 53S(3)(d)) in relation to the transaction;
- (b) for an exposure of a licensed corporation arising from a guarantee—the guarantor under the guarantee;
- (c) for an exposure of a licensed corporation arising from a credit risk swap under which the licensed corporation is the protection buyer—the protection seller under the swap; or
- (d) in relation to any other exposure of a licensed corporation, means a person who has the primary obligation to repay, pay or otherwise settle the exposure;

qualifying financial institution () means—

- (a) a Basel-covered bank;
- (b) a licensed corporation;
- (c) a Basel-covered securities firm; or
- (d) an authorized insurer, or a designated insurance holding company, within the meaning of the Insurance Ordinance (Cap. 41);

reference debt (), in relation to an entity, means a debt obligation issued or undertaken by the entity;

relevant international organization () has the meaning given by section 2(1) of the Banking (Capital) Rules (Cap 155 sub. leg. L);

relevant jurisdiction (), in relation to an entity, means—

- (a) if the entity is not an individual—the jurisdiction in which it is incorporated; or
- (b) if the entity is an individual—the jurisdiction in which he or she is ordinarily resident;

relevant original maturity (), in relation to an exposure of a licensed corporation, means—

- (a) if the exposure arises from—
 - (i) an OTCD transaction effected by the licensed corporation that does not form part of an OTCD netting set; or

- (ii) an asset posted as security by the licensed corporation in respect of an OTCD transaction referred to in subparagraph (i),
the original maturity of the transaction;
- (b) if the exposure arises from—
 - (i) OTCD transactions effected by the licensed corporation that constitute an OTCD netting set; or
 - (ii) an asset posted as security by the licensed corporation in respect of OTCD transactions referred to in subparagraph (i),
the longest of the original maturities of the transactions;
- (c) if the exposure arises from—
 - (i) a repo-style transaction entered into by the licensed corporation that does not form part of a repo-style netting set; or
 - (ii) an asset posted as security by the licensed corporation in respect of a repo-style transaction referred to in subparagraph (i),
the original maturity of the transaction; or
- (d) if the exposure arises from—
 - (i) repo-style transactions entered into by the licensed corporation that constitute a repo-style netting set; or
 - (ii) an asset posted as security by the licensed corporation in respect of repo-style transactions referred to in subparagraph (i),
the longest of the original maturities of the transactions;

SCRA () means—

- (a) Moody's Investors Service;
- (b) Standard & Poor's Corporation;
- (c) Fitch Ratings; or
- (d) an approved credit rating agency;

Note—

SCRA stands for specified credit rating agency.

SCRA issue specific rating (), in relation to an exposure or a reference debt of an entity, means a short-term or long-term SCRA rating that is assigned to the exposure or reference debt;

SCRA issuer rating (), in relation to an entity, means a long-term SCRA rating that is assigned to the entity;

SCRA rating () means a credit assessment rating that is assigned to an exposure, a reference debt of an entity or an entity by an SCRA, and is for the time being not withdrawn or suspended by that SCRA;

short-term SCRA issue specific rating () means an SCRA issue specific rating that is a short-term credit assessment rating.

- (2) For the purposes of the definitions of **JAA** and **local currency** in subsection (1), in relation to a jurisdiction outside Hong Kong that—
 - (a) is a part of a country and issues its own local currency—
 - (i) a reference to the relevant government is a reference to the government that has the power to issue that currency; and
 - (ii) (to avoid doubt) a reference to the jurisdiction is not to be construed as a reference to the country;

- (b) is a part of a country and does not issue its own local currency—
 - (i) a reference to the relevant government is a reference to the central government of the country; and
 - (ii) a reference to the jurisdiction is a reference to the country; or
 - (c) is a country—a reference to the relevant government is a reference to the central government of the country.
- (3) For the purposes of this Schedule, an entity (**former**) is treated as equivalent to another entity (**latter**) for allocating risk weights under the comparable supervisory arrangements in a jurisdiction outside Hong Kong if Basel-covered banks carrying on business in that jurisdiction are required or permitted, under the comparable supervisory arrangements in that jurisdiction, to allocate to an exposure to the former the same risk weight as that which would be allocated to an exposure to the latter.
- (4) In applying this Schedule for the allocation of a risk weight to an exposure arising from an eligible guarantee for the purposes of Formula 28 in section 53Y, a reference to an OTCD transaction in this Schedule includes a guarantee.

2. Credit quality grades applicable to SCRA ratings

For the purposes of these Rules, the **credit quality grade** () applicable to an SCRA rating is—

- (a) for an SCRA issuer rating or a long-term SCRA issue specific rating—the grade specified in column 1 of Table 1 opposite the applicable description of the rating specified in column 2, 3 or 4 of the Table; or
- (b) for a short-term SCRA issue specific rating—the grade specified in column 1 of Table 2 opposite the applicable description of the rating specified in column 2, 3 or 4 of the Table.

Table 1

Credit quality grades for SCRA issuer ratings or long-term SCRA issue specific ratings

Column 1	Column 2	Column 3	Column 4
Credit quality grade	SCRA issuer ratings or long-term SCRA issue specific ratings assigned by Standard & Poor's Corporation	SCRA issuer ratings or long-term SCRA issue specific ratings assigned by Moody's Investors Service	SCRA issuer ratings or long-term SCRA issue specific ratings assigned by Fitch Ratings
1	AAA AA+ AA AA-	Aaa Aa1 Aa2 Aa3	AAA AA+ AA AA-
2	A+ A A-	A1 A2 A3	A+ A A-
3	BBB+ BBB	Baa1 Baa2	BBB+ BBB

Column 1	Column 2	Column 3	Column 4
	BBB-	Baa3	BBB-
4	BB+ BB BB-	Ba1 Ba2 Ba3	BB+ BB BB-
5	B+ B B-	B1 B2 B3	B+ B B-
6	CCC+ CCC CCC- CC C D	Caa1 Caa2 Caa3 Ca C	CCC CC C D

Table 2**Credit quality grades for short-term SCRA issue specific ratings**

Column 1	Column 2	Column 3	Column 4
Credit quality grade	Short-term SCRA issue specific ratings assigned by Standard & Poor's Corporation	Short-term SCRA issue specific ratings assigned by Moody's Investors Service	Short-term SCRA issue specific ratings assigned by Fitch Ratings
1	A-1+ A-1	P-1	F1+ F1
2	A-2	P-2	F2
3	A-3	P-3	F3
4	B B-1 B-2 B-3 C D	NP	B C D

Part 2**Allocation of risk weights to exposures****3. Requirements for allocating risk weights to exposures**

A licensed corporation that is required to allocate a risk weight to an exposure must—

- (a) allocate a risk weight to the exposure in accordance with this Part; and

- (b) in so far as the risk weight is to be allocated or a credit quality grade is to be determined by reference to an SCRA rating, comply with the requirements relating to the use of SCRA ratings specified in Part 3 of this Schedule.

4. Allocation of risk weights to exposures based on obligors

- (1) A licensed corporation must allocate a risk weight to an exposure in accordance with the section applicable in relation to the obligor in respect of the exposure, as follows—
- (a) for an exposure to a JAA—section 5 of this Schedule;
 - (b) for an exposure to a Hong Kong public sector entity or non-Hong Kong public sector entity—section 6 of this Schedule;
 - (c) for an exposure to a relevant international organization—section 7 of this Schedule;
 - (d) for an exposure to a multilateral body—section 8 of this Schedule;
 - (e) for an exposure to a qualifying financial institution—section 9 of this Schedule;
 - (f) for an exposure to a miscellaneous entity—section 10 of this Schedule.
- (2) Subsection (1) and sections 5, 6, 7, 8, 9 and 10 of this Schedule are subject to sections 11 and 12 of this Schedule.

5. JAA exposures

- (1) A licensed corporation must allocate a risk weight to an exposure to a JAA in accordance with this section.
- (2) A licensed corporation may allocate a risk weight of 0% to an exposure that is a domestic currency exposure to the Government (including an exposure to the Exchange Fund established by the Exchange Fund Ordinance (Cap. 66)).
- (3) Subject to subsections (2) and (4), a licensed corporation must allocate to an exposure to a JAA the following risk weight—
- (a) if the exposure has a long-term SCRA issue specific rating—the risk weight specified in column 2 of Table 3 opposite the credit quality grade applicable to the rating set out in column 1 of the Table; or
 - (b) if the exposure does not have a long-term SCRA issue specific rating, and—
 - (i) the JAA has an SCRA issuer rating or a reference debt of the JAA has a long-term SCRA issue specific rating—the risk weight specified in column 2 of Table 3 opposite the credit quality grade applicable to the rating set out in column 1 of the Table; or
 - (ii) subparagraph (i) does not apply—100%.

Table 3

Risk weights for JAA exposures

Column 1 Credit quality grade	Column 2 Risk weight
1	0%
2	20%
3	50%
4	100%

5	100%
6	150%

- (4) If the exposure referred to in subsection (3) is a domestic currency exposure to a JAA, and Basel-covered banks carrying on business in the jurisdiction of the JAA are permitted or required, under the comparable supervisory arrangements in that jurisdiction, to allocate a risk weight to the exposure that is lower than the risk weight that would be allocated under subsection (3), the licensed corporation may allocate the lower risk weight to the exposure.

6. Hong Kong public sector entity or non-Hong Kong public sector entity exposures

- (1) A licensed corporation must allocate a risk weight to an exposure to a Hong Kong public sector entity or non-Hong Kong public sector entity in accordance with this section.
- (2) For an exposure to a Hong Kong public sector entity, a licensed corporation must allocate the following risk weight—
- (a) if the Government has an SCRA issuer rating and the credit quality grade applicable to the rating is—
 - (i) 1—20%;
 - (ii) 2—50%;
 - (iii) 3, 4 or 5—100%; or
 - (iv) 6—150%; or
 - (b) if the Government does not have an SCRA issuer rating—100%.
- (3) For an exposure to a non-Hong Kong public sector entity, a licensed corporation must allocate the following risk weight—
- (a) if the entity's local JAA has an SCRA issuer rating, and—
 - (i) the entity is a JAA-equivalent non-Hong Kong public sector entity, and the credit quality grade applicable to the rating is—
 - (A) 1—0%;
 - (B) 2—20%;
 - (C) 3—50%;
 - (D) 4 or 5—100%; or
 - (E) 6—150%; or
 - (ii) the entity is not a JAA-equivalent non-Hong Kong public sector entity, and the credit quality grade applicable to the rating is—
 - (A) 1—20%;
 - (B) 2—50%;
 - (C) 3, 4 or 5—100%; or
 - (D) 6—150%; or
 - (b) if the entity's local JAA does not have an SCRA issuer rating—100%.

7. Relevant international organization exposures

A licensed corporation must allocate a risk weight of 0% to an exposure to a relevant international organization.

8. Multilateral body exposures

- (1) A licensed corporation must allocate a risk weight to an exposure to a multilateral body in accordance with this section.
- (2) Subject to subsection (3), a licensed corporation must allocate to an exposure to a multilateral body the following risk weight—
 - (a) if the exposure has a long-term SCRA issue specific rating—the risk weight specified in column 2 of Table 4 opposite the credit quality grade applicable to the rating set out in column 1 of the Table; or
 - (b) if the exposure does not have a long-term SCRA issue specific rating, and—
 - (i) the multilateral body has an SCRA issuer rating or a reference debt of the multilateral body has a long-term SCRA issue specific rating—the risk weight specified in column 2 of Table 4 opposite the credit quality grade applicable to the rating set out in column 1 of the Table; or
 - (ii) subparagraph (i) does not apply—50%.

Table 4

Risk weights for multilateral body exposures

Column 1 Credit quality grade	Column 2 Risk weight
1	20%
2	30%
3	50%
4	100%
5	100%
6	150%

- (3) A licensed corporation may allocate a risk weight of 0% to an exposure to a multilateral development bank if—
 - (a) the bank has an SCRA issuer rating; and
 - (b) the credit quality grade applicable to the rating is 1.

9. Qualifying financial institution exposures

- (1) A licensed corporation must allocate a risk weight to an exposure to a qualifying financial institution in accordance with this section.
- (2) For an exposure to a qualifying financial institution that has an SCRA issue specific rating, a licensed corporation must allocate the following risk weight to the exposure—
 - (a) if the exposure has a short-term SCRA issue specific rating—the risk weight specified in column 2 of Table 5 opposite the credit quality grade applicable to the rating set out in column 1 of the Table;

Table 5

Risk weights for qualifying financial institution exposures with short-term SCRA issue specific ratings

Column 1 Credit quality grade	Column 2 Risk weight
1	20%
2	50%
3	100%
4	150%

- (b) if the exposure has a long-term SCRA issue specific rating and—
- (i) the exposure is a general exposure—the risk weight specified in column 2 of Table 6 opposite the credit quality grade applicable to the rating set out in column 1 of the Table; or
 - (ii) the exposure is a 3 months' exposure—(subject to subsection (3)) the risk weight specified in column 3 of Table 6 opposite the credit quality grade applicable to the rating set out in column 1 of the Table.

Table 6

Risk weights for qualifying financial institution exposures with long-term SCRA issue specific ratings

Column 1 Credit quality grade	Column 2 Risk weight for general exposure	Column 3 Risk weight for 3 months' exposure (other than an exposure with a short-term SCRA issue specific rating)
1	20%	20%
2	30%	20%
3	50%	20%
4	100%	50%
5	100%	50%
6	150%	150%

- (3) Subsection (2)(b)(ii) does not apply to a 3 months' exposure if the exposure also has a short-term SCRA issue specific rating.
- (4) Unless subsection (5), (6) or (7) applies, for an exposure to a qualifying financial institution that does not have an SCRA issue specific rating, if the institution has an SCRA issuer rating or a reference debt of the institution has a long-term SCRA issue specific rating, the licensed corporation must allocate to the exposure—
- (a) if the exposure is a general exposure—the risk weight specified in column 2 of Table 6 opposite the credit quality grade applicable to the SCRA issuer rating or the long-term SCRA issue specific rating (as the case may be) set out in column 1 of the Table; or
 - (b) if the exposure is a 3 months' exposure—the risk weight specified in column 3 of Table 6 opposite the credit quality grade applicable to the SCRA issuer rating or the long-term SCRA issue specific rating (as the case may be) set out in column 1 of the Table.
- (5) The licensed corporation must allocate a risk weight of 150% to an exposure falling within subsection (4) if—

- (a) a reference debt of the qualifying financial institution concerned has a short-term SCRA issue specific rating; and
 - (b) the risk weight that would be allocated to the reference debt based on the short-term SCRA issue specific rating in accordance with subsection (2)(a) (as if the reference debt were an exposure) is 150%.
- (6) Unless subsection (5) applies, a licensed corporation must allocate a risk weight of 100% to a general exposure falling within subsection (4)(a) if—
 - (a) the relevant original maturity of the exposure is equal to, or shorter than, 1 year;
 - (b) the risk weight that would be allocated to the exposure in accordance with subsection (4)(a) is 50% or less; and
 - (c) a reference debt of the qualifying financial institution concerned has a short-term SCRA issue specific rating, and the risk weight that would be allocated to the reference debt based on the short-term SCRA issue specific rating in accordance with subsection (2)(a) (as if the reference debt were an exposure) is 50% or 100%.
- (7) Unless subsection (5) applies, and subject to subsection (8), in respect of a 3 month's exposure falling within subsection (4)(b) (**subject exposure**), if—
 - (a) a reference debt of the qualifying financial institution concerned has a short-term SCRA issue specific rating; and
 - (b) the risk weight that would be allocated to the reference debt based on the short-term SCRA issue specific rating in accordance with subsection (2)(a) (as if the reference debt were an exposure) (**relevant risk weight**) is higher than the risk weight allocated to the subject exposure in accordance with subsection (4)(b),

the licensed corporation must allocate the relevant risk weight to the subject exposure.
- (8) If, in respect of the subject exposure, there are 2 or more reference debts falling within subsection (7)(b) and the relevant risk weights in respect of those reference debts are different, the licensed corporation must allocate the highest of those relevant risk weights to the subject exposure.
- (9) For an exposure to a qualifying financial institution that does not have an SCRA issue specific rating, if subsections (4), (5), (6) and (7) do not apply to the exposure, the licensed corporation must allocate the following risk weight to the exposure—
 - (a) if the exposure is not a specified exposure, and—
 - (i) is a 3 months' exposure—50%; or
 - (ii) is a general exposure—75%; or
 - (b) if the exposure is a specified exposure—the higher of the risk weights set out in subparagraphs (i) and (ii) (or, if they are the same, that same risk weight)—
 - (i) the risk weight that the licensed corporation would allocate to a senior and unsecured exposure to the local JAA of the qualifying financial institution (other than a domestic currency exposure) in accordance with section 5 of this Schedule;
 - (ii) the following risk weight—
 - (A) if the exposure is a 3 months' exposure—50%; or
 - (B) if the exposure is a general exposure—75%.
- (10) In this section—

3 months' exposure () means an exposure of a licensed corporation to a qualifying financial institution arising from one or more OTCD transactions effected by the licensed corporation or one or more repo-style transactions entered into by the licensed corporation, or from an asset posted as security by the licensed corporation in respect of such transaction or transactions, where—

- (a) the relevant original maturity of the exposure is not more than 3 months; and
- (b) the licensed corporation does not expect or anticipate to roll over—
 - (i) if there is only 1 such transaction—the transaction at the expiry of the original maturity of the transaction; or
 - (ii) if there are 2 or more such transactions—any of those transactions at the expiry of the original maturity of the transaction;

general exposure () means an exposure of a licensed corporation to a qualifying financial institution that is not a 3 months' exposure;

specified exposure () means an exposure of a licensed corporation to a qualifying financial institution that—

- (a) is not denominated in the local currency of the institution; or
- (b) is booked in a branch of the institution in a jurisdiction (***jurisdiction concerned***) other than the relevant jurisdiction of the institution, and is not denominated in the local currency of the jurisdiction concerned.

10. Miscellaneous entity exposures

- (1) A licensed corporation must allocate a risk weight to an exposure to a miscellaneous entity in accordance with this section.
- (2) For an exposure to a miscellaneous entity that has an SCRA issue specific rating, a licensed corporation must allocate the following risk weight to the exposure—
 - (a) if the exposure has a short-term SCRA issue specific rating—the risk weight specified in column 2 of Table 7 opposite the credit quality grade applicable to the rating set out in column 1 of the Table;

Table 7

Risk weights for miscellaneous entity exposures with short-term SCRA issue specific ratings

Column 1	Column 2
Credit quality grade	Risk weight for exposure with short-term SCRA issue specific rating
1	20%
2	50%
3	100%
4	150%

- (b) if the exposure has a long-term SCRA issue specific rating—the risk weight specified in column 2 of Table 8 opposite the credit quality grade applicable to the rating set out in column 1 of the Table.

Table 8

**Risk weights for miscellaneous entity exposures with long-term SCRA
issue specific ratings**

Column 1 Credit quality grade	Column 2 Risk-weight
1	20%
2	50%
3	75%
4	100%
5	150%
6	150%

- (3) Unless subsection (4) or (5) applies, for an exposure to a miscellaneous entity that does not have an SCRA issue specific rating, if the entity has an SCRA issuer rating or a reference debt of the institution has a long-term SCRA issue specific rating, the licensed corporation must allocate to the exposure the risk weight specified in column 2 of Table 8 opposite the credit quality grade applicable to the rating set out in column 1 of the Table.
- (4) The licensed corporation must allocate a risk weight of 150% to an exposure falling within subsection (3) if—
- (a) a reference debt of the miscellaneous entity concerned has a short-term SCRA issue specific rating; and
 - (b) the risk weight that would be allocated to the reference debt based on the short-term SCRA issue specific rating in accordance with subsection (2)(a) (as if the reference debt were an exposure) is 150%.
- (5) Unless subsection (4) applies, a licensed corporation must allocate a risk weight of 100% to an exposure falling within subsection (3) if—
- (a) the relevant original maturity of the exposure is equal to, or shorter than, 1 year;
 - (b) the risk weight that would be allocated to the exposure in accordance with subsection (3) is 50% or less; and
 - (c) the risk weight that would be allocated to the reference debt based on the short-term SCRA issue specific rating in accordance with subsection (2)(a) (as if the reference debt were an exposure) is 50% or 100%.
- (6) For an exposure to a miscellaneous entity that does not have an SCRA issue specific rating, if subsections (3), (4) and (5) do not apply to the exposure, the licensed corporation must allocate a risk weight of 100% to the exposure.

11. Allocation of risk weights to exposures arising from regulated CCP-cleared OTCD transactions

- (1) A licensed corporation that is a clearing participant of a regulated CCP must allocate a risk-weight of 2% to an exposure to the regulated CCP arising from a covered OTCD transaction that is—
- (a) effected by the licensed corporation; and
 - (b) entered into by the regulated CCP.
- (2) A licensed corporation that is a clearing client of a clearing participant of a regulated CCP may allocate the risk weight specified in subsection (3) to an exposure to the clearing participant arising from the following transaction that is centrally cleared by the regulated CCP—

- (a) a covered OTCD transaction (**type A transaction**) that is—
 - (i) effected by the licensed corporation; and
 - (ii) entered into by the clearing participant (as its clearing intermediary); or
 - (b) a covered OTCD transaction (**type B transaction**) that is—
 - (i) effected by the licensed corporation through the clearing participant (as its clearing intermediary); and
 - (ii) entered into by the regulated CCP.
- (3) The risk weight specified for the purposes of subsection (2) is—
- (a) 2% if all the applicable conditions specified in subsection (4) are met; or
 - (b) 4% if all the applicable conditions specified in subsection (4) are met except to the extent that those conditions relate to the matter specified in—
 - (i) for a type A transaction—subsection (4)(a)(iii) or (b)(iii); or
 - (ii) for a type B transaction—subsection (4)(a)(iii) or (c)(iii).
- (4) The conditions specified for subsection (3) are that—
- (a) the type A transaction or type B transaction (as the case may be) from which the exposure arises (**subject transaction**) and any asset posted to the clearing participant as security in respect of the subject transaction are distinguished and segregated, at the level of the clearing participant, from the transactions and assets (being posted as security) of the clearing participant or other clearing clients of the clearing participant, and as a result of such distinction and segregation the licensed corporation will not suffer from any losses due to—
 - (i) the default or insolvency of the clearing participant;
 - (ii) the default or insolvency of the clearing participant's other clearing clients; and
 - (iii) the joint default or joint insolvency of the clearing participant and any of its other clearing clients;
 - (b) if the subject transaction is a type A transaction—the CCP transaction in respect of the subject transaction and any asset posted to the regulated CCP as security in respect of that CCP transaction are distinguished and segregated, at the level of the regulated CCP, from the transactions and assets (being posted as security) of the clearing participant or other clearing clients of the clearing participant, and as a result of such distinction and segregation the licensed corporation will not suffer from any losses due to—
 - (i) the default or insolvency of the clearing participant;
 - (ii) the default or insolvency of the clearing participant's other clearing clients; and
 - (iii) the joint default or joint insolvency of the clearing participant and any of its other clearing clients;
 - (c) if the subject transaction is a type B transaction—the subject transaction and any asset posted to the regulated CCP as security in respect of the subject transaction are distinguished and segregated, at the level of the regulated CCP, from the transactions and assets (being posted as security) of the clearing participant or other clearing clients of the clearing participant, and as a result of such distinction and segregation the licensed corporation will not suffer from any losses due to—
 - (i) the default or insolvency of the clearing participant;

- (ii) the default or insolvency of the clearing participant's other clearing clients; and
 - (iii) the joint default or joint insolvency of the clearing participant and any of its other clearing clients;
 - (d) in the event of the insolvency of the clearing participant, there must be no legal impediment (which does not include the obtaining of a court order to which the licensed corporation is entitled) to the transfer of any asset posted by the licensed corporation as security to—
 - (i) one or more other clearing participants of the regulated CCP;
 - (ii) the licensed corporation; or
 - (iii) the licensed corporation's nominee;
 - (e) the licensed corporation—
 - (i) has conducted a sufficient legal review and has a well-founded basis to conclude that, in the event of any legal challenge, the relevant arbiter would find that—
 - (A) if the subject transaction is a type A transaction—the arrangements described in paragraphs (a) and (b); or
 - (B) if the subject transaction is a type B transaction—the arrangements described in paragraphs (a) and (c),
 are legal, valid, binding and enforceable under the laws of the jurisdictions relevant to the arrangements; and
 - (ii) undertakes such further review as necessary to ensure the continuing enforceability of the arrangements; and
 - (f) laws, regulations, rules, contractual or administrative arrangements applicable to or binding the licensed corporation, the clearing participant or the regulated CCP facilitate, in the event of the default or insolvency of the clearing participant, the transfer of the positions of the licensed corporation (or its clearing client) relating to the subject transaction, and of the corresponding asset posted as security (if any), to another clearing participant of the regulated CCP, and in such circumstances, those positions and asset will be transferred at market value unless the licensed corporation requests to close out the positions at market value.
- (5) A licensed corporation that is a clearing client of a clearing client (**relevant clearing client**) of a clearing participant of a regulated CCP may allocate the risk weight specified in subsection (6) to an exposure to the relevant clearing client arising from the following transaction that is centrally cleared by the regulated CCP—
- (a) a covered OTCD transaction (**type C transaction**) that is—
 - (i) effected by the licensed corporation; and
 - (ii) entered into by the relevant clearing client (as its clearing intermediary);
 - (b) a covered OTCD transaction (**type D transaction**) that is—
 - (i) effected by the licensed corporation through the relevant clearing client (as its clearing intermediary); and
 - (ii) entered into by the clearing participant; or
 - (c) a covered OTCD transaction (**type E transaction**) that is—
 - (i) effected by the licensed corporation through the relevant clearing client (as the licensed corporation's clearing intermediary) and the clearing

- participant (as the clearing intermediary of the licensed corporation or the relevant clearing client); and
- (ii) entered into by the regulated CCP.
- (6) The risk weight specified for the purposes of subsection (5) is—
- (a) 2% if all the applicable conditions specified in subsection (7) are met; or
 - (b) 4% if all the applicable conditions specified in subsection (7) are met except to the extent that those conditions relate to the matter specified in—
 - (i) for a type C transaction—subsection (7)(a)(iii), (b)(iii) or (c)(iii);
 - (ii) for a type D transaction—subsection (7)(a)(iii), (d)(iii) or (e)(iii); or
 - (iii) for a type E transaction—subsection (7)(a)(iii), (d)(iii) or (f)(iii).
- (7) The conditions specified for subsection (6) are that—
- (a) the type C transaction, type D transaction or type E transaction (as the case may be) from which the exposure arises (**subject transaction**) and any asset posted to the relevant clearing client as security in respect of the subject transaction are distinguished and segregated, at the level of the relevant clearing client, from the transactions and assets (being posted as security) of the relevant clearing client or other clearing clients of the relevant clearing client, and as a result of such distinction and segregation the licensed corporation will not suffer from any losses due to—
 - (i) the default or insolvency of the relevant clearing client;
 - (ii) the default or insolvency of the relevant clearing client's other clearing clients; and
 - (iii) the joint default or joint insolvency of the relevant clearing client and any of its other clearing clients;
 - (b) if the subject transaction is a type C transaction—the transaction entered into between the relevant clearing client and the clearing participant or the regulated CCP (as the case may be) as part of the clearing and settlement process to which the subject transaction relates (**offsetting transaction**) and any asset posted to the clearing participant as security in respect of the offsetting transaction are distinguished and segregated, at the level of the clearing participant, from the transactions and assets (being posted as security) of the clearing participant or other clearing clients of the clearing participant, and as a result of such distinction and segregation the licensed corporation will not suffer from any losses due to—
 - (i) the default or insolvency of the clearing participant;
 - (ii) the default or insolvency of the clearing participant's other clearing clients; and
 - (iii) the joint default or joint insolvency of the clearing participant and any of its other clearing clients;
 - (c) if the subject transaction is a type C transaction—the CCP transaction in respect of the subject transaction and any asset posted to the regulated CCP as security in respect of that CCP transaction are distinguished and segregated, at the level of the regulated CCP, from the transactions and assets (being posted as security) of the clearing participant or other clearing clients of the clearing participant, and as a result of such distinction and segregation the licensed corporation will not suffer from any losses due to—
 - (i) the default or insolvency of the clearing participant;

- (ii) the default or insolvency of the clearing participant's other clearing clients; and
 - (iii) the joint default or joint insolvency of the clearing participant and any of its other clearing clients;
- (d) if the subject transaction is a type D transaction or type E transaction—the subject transaction and any asset posted to the clearing participant as security in respect of the subject transaction are distinguished and segregated, at the level of the clearing participant, from the transactions and assets (being posted as security) of the clearing participant or other clearing clients of the clearing participant, and as a result of such distinction and segregation the licensed corporation will not suffer from any losses due to—
 - (i) the default or insolvency of the clearing participant;
 - (ii) the default or insolvency of the clearing participant's other clearing clients; and
 - (iii) the joint default or joint insolvency of the clearing participant and any of its other clearing clients;
- (e) if the subject transaction is a type D transaction—the CCP transaction in respect of the subject transaction and any asset posted to the regulated CCP as security in respect of that CCP transaction are distinguished and segregated, at the level of the regulated CCP, from the transactions and assets (being posted as security) of the clearing participant or other clearing clients of the clearing participant, and as a result of such distinction and segregation the licensed corporation will not suffer from any losses due to—
 - (i) the default or insolvency of the clearing participant;
 - (ii) the default or insolvency of the clearing participant's other clearing clients; and
 - (iii) the joint default or joint insolvency of the clearing participant and any of its other clearing clients;
- (f) if the subject transaction is a type E transaction—the subject transaction and any asset posted to the regulated CCP as security in respect of the subject transaction are distinguished and segregated, at the level of the regulated CCP, from the transactions and assets (being posted as security) of the clearing participant or other clearing clients of the clearing participant, and as a result of that distinction and segregation the licensed corporation will not suffer from any losses due to—
 - (i) the default or insolvency of the clearing participant;
 - (ii) the default or insolvency of the clearing participant's other clearing clients; and
 - (iii) the joint default or joint insolvency of the clearing participant and any of its other clearing clients;
- (g) in the event of the insolvency of the relevant clearing client or the clearing participant (or both), there must be no legal impediment (which does not include the obtaining of a court order to which the licensed corporation is entitled) to the transfer of the asset posted by the licensed corporation as security to—
 - (i) one or more other clearing clients of the clearing participant;
 - (ii) one or more other clearing participants of the regulated CCP;
 - (iii) the licensed corporation; or
 - (iv) the licensed corporation's nominee;

- (h) the licensed corporation—
 - (i) has conducted a sufficient legal review and has a well-founded basis to conclude that, in the event of any legal challenge, the relevant arbiter would find that—
 - (A) if the subject transaction is a type C transaction—the arrangements described in paragraphs (a), (b) and (c);
 - (B) if the subject transaction is a type D transaction—the arrangements described in paragraphs (a), (d) and (e); or
 - (C) if the subject transaction is a type E transaction—the arrangements described in paragraphs (a), (d) and (f),
 are legal, valid, binding and enforceable under the relevant laws of the jurisdictions relevant to the arrangements; and
 - (ii) undertakes such further review as necessary to ensure the continuing enforceability of the arrangements; and
 - (i) laws, regulations, rules, contractual or administrative arrangements applicable to or binding the licensed corporation, the clearing participant or the regulated CCP facilitate—
 - (i) in the event of the default or insolvency of the relevant clearing client—the transfer of the positions of the licensed corporation (or its clearing client) relating to the subject transaction, and of the corresponding asset posted as security (if any), to another clearing client of the clearing participant, any clearing client of another clearing participant of the regulated CCP or any clearing participant of the regulated CCP, and in such circumstances, those positions and asset will be transferred at market value unless the licensed corporation requests to close out the positions at market value; and
 - (ii) in the event of the default or insolvency of the clearing participant—the transfer of—
 - (A) the positions of the licensed corporation (or its clearing client) relating to the subject transaction;
 - (B) if the subject transaction is a type C transaction—the relevant clearing client's positions relating to the offsetting transaction;
 - (C) if the subject transaction is a type C transaction or type D transaction—the clearing participant's positions relating to the CCP transaction in respect of the subject transaction; and
 - (D) the corresponding asset posted as security in respect of the transactions mentioned in sub-subparagraphs (A), (B) and (C) (if applicable),
 to another clearing participant of the regulated CCP at market value, and in such circumstances, those positions and asset will be transferred unless the licensed corporation requests to close out the positions at market value.
- (8) If a central counterparty ceases to be a regulated CCP, a licensed corporation may, for a period of not more than 3 months commencing on the date of the cessation, continue to allocate risk weights to its exposures in accordance with this section as if the cessation had not occurred unless, before the expiry of the period, the Commission by written notice requires the licensed corporation not to do so.
- (9) To avoid doubt, a reference in this section to a covered OTCD transaction from which the licensed corporation's exposure arises is a reference to such a transaction whether or not it forms part of an OTCD netting set.

(10) This section is subject to section 12 of this Schedule.

(11) In this section—

covered OTCD transaction () has the meaning given by section 53J(6).

12. Allocation of risk weights to exposures arising from OTCD transactions ended with past due or with parties in default

A licensed corporation must allocate a risk weight of 1250% to—

- (a) an exposure arising from an OTCD transaction effected by it that is a transaction ended with past due (within the meaning of section 53E(1)) and does not form part of an OTCD netting set;
- (b) an exposure arising from an OTCD transaction effected by it with a party in default (within the meaning of section 53E(2)) that does not form part of an OTCD netting set; or
- (c) an exposure arising from OTCD transactions effected by it with a party in default (within the meaning of section 53E(2)) that constitute an OTCD netting set.

Part 3

Requirements relating to use of credit assessment ratings

13. Credit assessment ratings must be used in accordance with this Part

- (1) A licensed corporation must comply with the requirements specified in this Part in identifying—
 - (a) the SCRA the SCRA ratings issued by which are to be used; and
 - (b) the SCRA ratings to be used,
 for allocating risk weights to its exposures under Part 2 of this Schedule.
- (2) A licensed corporation must comply with sections 14 and 15 of this Schedule in using SCRA ratings for the purposes of section 19 of this Schedule.
- (3) To avoid doubt, if a provision under this Part has the effect of requiring a licensed corporation to use SCRA ratings of a certain description (however described), either generally or for particular purposes, the provision is to be construed as requiring a licensed corporation to have regard only to SCRA ratings of that description in all relevant respects in determining the allocation of risk weights under this Schedule, either generally or for those particular purposes.

14. SCRA must be nominated for portfolios of exposures

- (1) A licensed corporation must, in respect of each of its portfolios of exposures referred in subsection (2), select one or more SCRA the SCRA ratings issued by which are to be used by it in allocating risk weights to its exposures within the portfolio.
- (2) The portfolios specified for subsection (1) are—
 - (a) exposures to JAAs;
 - (b) exposures to Hong Kong public sector entities or non-Hong Kong public sector entities;
 - (c) exposures to multilateral bodies;
 - (d) exposures to qualifying financial institutions;
 - (e) exposures to miscellaneous entities.

- (3) In selecting SCRA ratings for a portfolio, the licensed corporation must, having regard to the relevant obligors in respect of the exposures in the portfolio and to the geographical regions where those exposures arise or may require to be enforced, reasonably believe that the SCRA ratings issue a range of credit assessment ratings which taken collectively provide reasonable coverage for the portfolio.
- (4) The licensed corporation must, as soon as practicable and no later than 1 week after selecting SCRA ratings for a portfolio, give the Commission notice in writing of the names of the SCRA ratings it has selected for the portfolio. The licensed corporation must not change the selection unless the change has been approved in writing by the Commission under section 58(5E).
- (5) A reference in this Schedule to an SCRA rating, in relation to an exposure of a licensed corporation or a reference debt of an entity, is a reference to a rating issued by an SCRA selected under this section for the portfolio to which the exposure or reference debt relates.

15. Requirement to use only solicited SCRA ratings

A licensed corporation must only use an SCRA rating that is a solicited rating.

16. SCRA rating must take into account all amounts

In allocating a risk weight to an exposure, a licensed corporation must only use an SCRA rating that takes into account the credit risk associated with all amounts (including principal and interest) owed to the licensed corporation.

17. SCRA issue specific rating must be for outstanding debt obligation

A licensed corporation must not use an SCRA issue specific rating that is assigned to a debt obligation that has ceased to be outstanding.

18. Currencies to which SCRA ratings relate

In allocating a risk weight to an exposure to an obligor that does not have an SCRA issue specific rating, a licensed corporation—

- (a) if the exposure is denominated in a currency (**relevant currency**) that is not the obligor's local currency—
 - (i) (subject to subparagraph (ii)) must only use an SCRA rating applicable to the relevant currency; or
 - (ii) if the exposure is guaranteed by a multilateral development bank against the risk of the obligor not being able to repay the exposure to the licensed corporation due to exchange controls of the relevant jurisdiction of the obligor—may use an SCRA rating applicable to the obligor's local currency; or
- (b) if the exposure is denominated in the obligor's local currency—
 - (i) (subject to subparagraph (ii)) must only use an SCRA rating applicable to the local currency; or
 - (ii) if no SCRA rating described in subparagraph (i) is available, and an SCRA issuer rating applicable to a currency other than the local currency is available—may use such an SCRA issuer rating.

19. Determination of local JAA and the use of its SCRA issuer ratings

- (1) A licensed corporation must comply with this section in identifying—

- (a) the JAA of the relevant jurisdiction of an obligor that is regarded as the local JAA in respect of the obligor; or
 - (b) the SCRA issuer rating of the local JAA that is to be used, for allocating a risk weight to an exposure to the obligor (**relevant exposure**) under Part 2 of this Schedule.
- (2) For the purposes of subsection (3)—
 - (a) if the relevant exposure is denominated in a currency (**relevant currency**) that is not the obligor's local currency—the licensed corporation must only use an SCRA issuer rating applicable to the relevant currency; or
 - (b) if the relevant exposure is denominated in the obligor's local currency—
 - (i) (subject to subparagraph (ii)) must only use an SCRA issuer rating applicable to the local currency; or
 - (ii) if no SCRA issuer rating described in subparagraph (i) is available, and an SCRA issuer rating applicable to a currency other than the local currency is available—may use such an SCRA issuer rating.
- (3) For the purposes of subsections (4) and (5)—
 - (a) if a JAA of the relevant jurisdiction of the obligor has only 1 SCRA issuer rating falling within subsection (2)—that rating is regarded as the relevant SCRA issuer rating of the JAA; or
 - (b) if a JAA of the relevant jurisdiction of the obligor has 2 or more SCRA issuer ratings falling within subsection (2), and using the ratings would result in allocating, in accordance with section 5 of this Schedule—
 - (i) the same risk weight to an exposure to the JAA—any of the ratings is regarded as the relevant SCRA issuer rating of the JAA; or
 - (ii) different risk weights to an exposure to the JAA—the rating (or any of the ratings) the use of which would result in allocating the second lowest risk weight among those risk weights is regarded as the relevant SCRA issuer rating of the JAA.
- (4) For the purpose of this Schedule, the following JAA is regarded as the local JAA in respect of the obligor—
 - (a) if the relevant jurisdiction of the obligor has only 1 JAA—the JAA; or
 - (b) if the relevant jurisdiction of the obligor has 2 or more JAAs—
 - (i) if none of the JAAs has an SCRA issuer rating falling within subsection (2)—any of the JAAs;
 - (ii) if only 1 of the JAAs has an SCRA issuer rating falling within subsection (2)—the JAA;
 - (iii) if among the JAAs, 2 or more of them (**those JAAs**) have SCRA issuer ratings falling within subsection (2), and using the relevant SCRA issuer ratings of those JAAs would result in allocating, in accordance with section 5 of this Schedule—
 - (A) the same risk weight to exposures to those JAAs—any of those JAAs; or
 - (B) different risk weights to exposures to those JAAs—the JAA that has the relevant SCRA issuer rating the use of which would result in allocating the highest risk weight among those risk weights (or, if there are 2 or more such JAAs, any of them).

- (5) For the purpose of this Schedule, the licensed corporation, in allocating a risk weight to the relevant exposure on the basis of an SCRA issuer rating of the local JAA of the obligor, must use the relevant SCRA issuer rating of the local JAA.

20. Use of SCRA issue specific ratings of exposure

- (1) In allocating a risk weight to an exposure that has an SCRA issue specific rating, a licensed corporation must use—
- (a) if the exposure has only 1 SCRA issue specific rating—that rating; or
 - (b) if the exposure has 2 or more SCRA issue specific ratings and using the ratings would result in allocating different risk weights to the exposure—the rating (or any of the ratings) the use of which would result in allocating the second lowest risk weight among those risk weights to the exposure.
- (2) In allocating a risk weight to a reference debt based on a short-term SCRA issue specific rating of the reference debt for the purposes of section 9(5), (6) or (7) or 10(4) or (5) of this Schedule, subsection (1) applies as if a reference to an exposure in that subsection were a reference to a reference debt.

21. Use of SCRA issuer ratings and long-term SCRA issue specific ratings of reference debts

- (1) If an obligor has one or more SCRA issuer ratings or one or more reference debts that have long-term SCRA issue specific ratings (or both), the following subsections apply in relation to the licensed corporation's compliance with a specified requirement for allocating a risk weight to a relevant exposure—
- (a) if the obligor does not have an SCRA issuer rating, but has one or more reference debts that have long-term SCRA issue specific ratings—subsections (2), (3), (4) and (5);
 - (b) if the obligor has one or more SCRA issuer ratings, but does not have a reference debt that has a long-term SCRA issue specific rating—subsections (6) and (7); or
 - (c) if the obligor has one or more SCRA issuer ratings, and has one or more reference debts that have long-term SCRA issue specific ratings—subsections (8) and (9).
- (2) Subject to subsections (3), (4) and (5), where the obligor does not have an SCRA issuer rating, and a reference debt of the obligor has a long-term SCRA issue specific rating—
- (a) the licensed corporation must use the long-term SCRA issue specific rating for the purposes of the specified requirement if—
 - (i) the relevant exposure ranks equally with, or is subordinated in respect of payment or repayment to, the reference debt; and
 - (ii) such use results in allocating a risk weight that is equal to or higher than the risk weight that would be allocated on the basis that the obligor has neither an SCRA issuer rating nor a reference debt having a long-term SCRA issue specific rating;
 - (b) the licensed corporation must use the long-term SCRA issue specific rating for the purposes of the specified requirement if—
 - (i) the relevant exposure ranks equally with, or senior in respect of payment or repayment to, the reference debt; and
 - (ii) such use results in allocating a risk weight that is lower than the risk weight that would be allocated on the basis that the obligor has neither an SCRA

- issuer rating nor a reference debt having a long-term SCRA issue specific rating; or
- (c) if neither paragraph (a) nor paragraph (b) applies in relation to the relevant exposure—the obligor is treated, for the purposes of the specified requirement, as having neither an SCRA issuer rating nor a reference debt that has a long-term SCRA issue specific rating, and accordingly the specified requirement does not apply to the licensed corporation in relation to the relevant exposure.
- (3) Subject to subsections (4) and (5), if a reference debt of the obligor—
- (a) has only 1 long-term SCRA issue specific rating the use of which can satisfy the requirement in subsection (2)(a) or (b) (as the case may be) (**qualified rating**), the qualified rating must be used for the purposes of the specified requirement; or
 - (b) has 2 or more qualified ratings—
 - (i) if using those qualified ratings for the purposes of the specified requirement would result in allocating the same risk weight to the relevant exposure—any of those qualified ratings may be used for the purposes of specified requirement; or
 - (ii) if using those qualified ratings for the purposes of the specified requirement would result in allocating different risk weights to the relevant exposure—the qualified rating (or any of the qualified ratings) the use of which would result in allocating the second lowest risk weight among those risk weights must be used for the purposes of the specified requirement.
- (4) If there are 2 or more reference debts of the obligor, and using the long-term SCRA issue specific rating (determined in accordance with subsection (3)) of each of those reference debts can satisfy the requirement in subsection (2)(a) (those ratings are collectively referred to as **relevant ratings**)—
- (a) if using the relevant ratings for the purposes of the specified requirement would result in allocating the same risk weight to the relevant exposure—any of the relevant ratings may be used for the purposes of the specified requirement; or
 - (b) if using the relevant ratings for the purposes of the specified requirement would result in allocating different risk weights to the relevant exposure—the relevant rating (or any of the relevant ratings) the use of which would result in allocating the highest risk weight among those risk weights must be used for the purposes of the specified requirement.
- (5) If there are 2 or more reference debts of the obligor, and using the long-term SCRA issue specific rating (determined in accordance with subsection (3)) of each of those reference debts can satisfy the requirement in subsection (2)(b) (those ratings are collectively referred to as **relevant ratings**), any of the relevant ratings may be used for the purposes of the specified requirement.
- (6) Subject to subsection (7), where the obligor has an SCRA issuer rating but does not have a reference debt that has a long-term SCRA issue specific rating—
- (a) the licensed corporation must use the SCRA issuer rating for the purposes of the specified requirement if—
 - (i) the SCRA issuer rating only applies to unsecured obligations of the obligor as an issuer that are not subordinated to any other exposures to the obligor (**obligor's unsecured obligations**);
 - (ii) the relevant exposure ranks equally with, or is subordinated to, the obligor's unsecured obligations; and

- (iii) such use results in allocating a risk weight that is equal to, or higher than, the risk weight that would be allocated on the basis that the obligor has neither an SCRA issuer rating nor a reference debt having a long-term SCRA issue specific rating;
 - (b) the licensed corporation must use the SCRA issuer rating for the purposes of the specified requirement if—
 - (i) the SCRA issuer rating only applies to the obligor's unsecured obligations;
 - (ii) the relevant exposure is not subordinated to the obligor's unsecured obligations; and
 - (iii) such use results in allocating a risk weight that is lower than the risk weight that would be allocated on the basis that the obligor has neither an SCRA issuer rating nor a reference debt having a long term SCRA issue specific rating; or
 - (c) if neither paragraph (a) nor paragraph (b) applies in relation to the relevant exposure—the obligor is treated, for the purposes of the specified requirement, as having neither an SCRA issuer rating nor a reference debt that has a long-term SCRA issue specific rating, and accordingly the specified requirement does not apply to the licensed corporation in relation to the relevant exposure.
- (7) If the obligor—
- (a) has only 1 SCRA issuer rating the use of which can satisfy the requirement in subsection (6)(a) or (b) (as the case may be) (**qualified rating**), the qualified rating must be used for the purposes of the specified requirement; or
 - (b) has 2 or more qualified ratings—
 - (i) if using those qualified ratings for the purposes of the specified requirement would result in allocating the same risk weight to the relevant exposure—any of those qualified ratings may be used for the purposes of the specified requirement; or
 - (ii) if using those qualified ratings for the purposes of the specified requirement would result in allocating different risk weights to the relevant exposure—the qualified rating (or any of the qualified ratings) the use of which would result in allocating the second lowest risk weight among those risk weights must be used for the purposes of the specified requirement.
- (8) If the obligor has one or more reference debts that have long-term SCRA issue specific ratings and has one or more SCRA issuer ratings—
- (a) if applying subsection (2)(a) (read together with subsections (3) and (4)) in relation to the one or more reference debts, as if the obligor did not have an SCRA issuer rating, would result in using a particular long-term SCRA issue specific rating (**rating A**) for the purposes of the specified requirement—subject to paragraph (c), the licensed corporation must use rating A for the purposes of the specified requirement;
 - (b) if applying subsection (6)(a) (read together with subsection (7)) in relation to the one or more SCRA issuer ratings, as if the obligor did not have a reference debt that had a long-term SCRA issue specific rating, would result in using a particular SCRA issuer rating (**rating B**) for the purposes of the specified requirement—subject to paragraph (c), the licensed corporation must use rating B for the purposes of the specified requirement;
 - (c) if paragraph (a) and paragraph (b) both apply, and using rating A and rating B for the purposes of the specified requirement would result in—

- (i) allocating the same risk weight to the relevant exposure—the licensed corporation may use either rating A or rating B for the purposes of the specified requirement; or
 - (ii) allocating different risk weights to the relevant exposure—the licensed corporation must use, for the purposes of the specified requirement, whichever of rating A and rating B the use of which would result in allocating a higher risk weight; or
 - (d) if neither paragraph (a) nor paragraph (b) applies—the obligor is treated, for the purposes of the specified requirement, as having neither an SCRA issuer rating nor a reference debt that has a long-term SCRA issue specific rating, and accordingly the specified requirement does not apply to the licensed corporation in relation to the relevant exposure.
- (9) If the obligor has one or more reference debts that have long-term SCRA issue specific ratings and has one or more SCRA issuer ratings—
- (a) if applying subsection (2)(b) (read together with subsections (3) and (5)) in relation to the one or more reference debts, as if the obligor did not have an SCRA issuer rating, would result in using a particular long-term SCRA issue specific rating (**rating C**) for the purposes of the specified requirement—subject to paragraph (c), the licensed corporation must use rating C for the purposes of the specified requirement;
 - (b) if applying subsection (6)(b) (read together with subsection (7)) in relation to the one or more SCRA issuer ratings, as if the obligor did not have a reference debt that had a long-term SCRA issue specific rating, would result in using a particular SCRA issuer rating (**rating D**) for the purposes of the specified requirement—subject to paragraph (c), the licensed corporation must use rating D for the purposes of the specified requirement;
 - (c) if paragraph (a) and paragraph (b) both apply—the licensed corporation may use either rating C or rating D for the purposes of the specified requirement; or
 - (d) if neither paragraph (a) nor paragraph (b) applies—the obligor is treated, for the purposes of the specified requirement, as having neither an SCRA issuer rating nor a reference debt that has a long-term SCRA issue specific rating, and accordingly the specified requirement does not apply to the licensed corporation in relation to the relevant exposure.
- (10) In this section—
- relevant exposure** () means a licensed corporation's exposure to—
- (a) a JAA;
 - (b) a multilateral body;
 - (c) a qualifying financial institution; or
 - (d) a miscellaneous entity;
- specified requirement** () means the requirement to allocate a risk weight to a relevant exposure to an obligor on the basis of an SCRA issuer rating of the obligor or a long-term SCRA issue specific rating of a reference debt of the obligor under—
- (a) if the obligor is a JAA—section 5(3)(b)(i) of this Schedule;
 - (b) if the obligor is a multilateral body—section 8(2)(b)(i) of this Schedule;
 - (c) if the obligor is a qualifying financial institution—section 9(4) of this Schedule; or
 - (d) if the obligor is a miscellaneous entity—section 10(3) of this Schedule.

Schedule 7

[s. 2]

Volatility Adjustment Percentages

1. Calculation of volatility adjustment percentage

A licensed corporation must calculate the volatility adjustment percentage applicable to an asset or a currency mismatch by—

- (a) assigning to it—
 - (i) for an asset—the percentage specified in column 3 of the Table opposite the applicable description of the asset set out in column 2 of the Table; or
 - (ii) for a currency mismatch—8%; and
- (b) adjusting each percentage referred to in paragraph (a) using the Formula.

Formula

Calculation of volatility adjustment percentage

$$H = H_{10} \times \sqrt{\frac{N_R + (T_M - 1)}{10}}$$

where—

- H_{10} is the percentage referred to in paragraph (a)(i) in respect of the asset or paragraph (a)(ii) in respect of the currency mismatch (as the case may be);
- N_R is the number of business days between each regular remargining or each regular revaluation (for example, if the regular remargining or regular revaluation takes place every business day, N_R is 1);
- T_M is the number of days in the minimum holding period in respect of the asset or currency mismatch determined under section 2 of this Schedule.

Table

Percentages applicable to assets

Column 1	Column 2	Column 3
Item	Description of asset	Percentage
1.	Cash	0%
2.	Gold coin or gold bullion	15%
3.	Certificates of deposits issued by an authorized financial institution or an approved bank incorporated outside Hong Kong	The haircut percentage applicable to the certificates of deposits
4.	Listed shares	The haircut percentage applicable to the listed shares
5.	Units in a unit trust or shares in a mutual fund	The haircut percentage applicable to the units or

Column 1	Column 2	Column 3
Item	Description of asset	Percentage
		shares
6.	Debt securities (including convertible bonds) with an SCRA issue specific rating the applicable credit quality grade of which is 1, 2 or 3	The haircut percentage applicable to the debt securities
7.	An asset that falls within more than one of the descriptions in items 2, 3, 4, 5 and 6	The percentage specified in this column opposite any of the descriptions, as elected by a licensed corporation
8.	<p>In respect of one or more OTCD transactions effected by the licensed corporation, an asset (except one falling within a description in item 1, 2, 3, 4, 5 or 6) that—</p> <p>(a) is posted as security in respect of the transactions, which are centrally cleared by a regulated CCP, and that is acceptable as security for the transactions under the rules of the regulated CCP; or</p> <p>(b) is posted as security in respect of the transactions, which are subject to mandatory margining requirements under the Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission published by the Commission under section 169 and 399 of the Ordinance, and that is prescribed in the Code as being acceptable for satisfying the mandatory margining requirements,</p> <p>and—</p> <p>(i) is a tradable commodity;</p> <p>(ii) is an equity-linked instrument falling within any of the descriptions set out in item 2 in column 2 of Table 7 of Schedule 2; or</p> <p>(iii) is any interest in a collective investment scheme which—</p> <p>(A) falls within the meaning of paragraph (b) of the definition of collective investment scheme in section 1 of Part 1 of Schedule 1 to the Ordinance; and</p> <p>(B) is authorized by the Commission under section 104 of the Ordinance</p> <p>Note— Subparagraph (iii)(A) refers to arrangements for the</p>	<p>15%</p> <p>The percentage specified in item 2 in column 3 of Table 7 of Schedule 2 opposite the applicable description of the equity-linked instrument</p> <p>15%</p>

Column 1	Column 2	Column 3
Item	Description of asset	Percentage
	purchase of gold coins or gold bullion, as described in item 1 of the Schedule to the Securities and Futures (Collective Investment Schemes) Notice (Cap. 571 sub. leg. M).	
9.	<p>In respect of one or more repo-style transactions entered into by the licensed corporation, an asset (except one falling within a description in item 1, 2, 3, 4, 5 or 6) that—</p> <p>(a) is a tradable commodity;</p> <p>(b) is an equity-linked instrument falling within any of the descriptions set out in item 2 in column 2 of Table 7 of Schedule 2; or</p> <p>(c) is any interest in a collective investment scheme which—</p> <p>(i) falls within the meaning of paragraph (b) of the definition of collective investment scheme in section 1 of Part 1 of Schedule 1 to the Ordinance; and</p> <p>(ii) is authorized by the Commission under section 104 of the Ordinance</p> <p>Note—</p> <p>Paragraph (c)(i) refers to arrangements for the purchase of gold coins or gold bullion, as described in item 1 of the Schedule to the Securities and Futures (Collective Investment Schemes) Notice (Cap. 571 sub. leg. M).</p>	<p>15%</p> <p>The percentage specified in item 2 in column 3 of Table 7 of Schedule 2 opposite the applicable description of the equity-linked instrument</p> <p>15%</p>
10.	An asset that does not fall within the description in any other item of this Table	100%

2. Minimum holding periods

- (1) Subject to subsection (4), if the relevant transactions in respect of the subject asset or subject currency mismatch are not covered by a netting agreement, the minimum holding period in respect of the subject asset or subject currency mismatch is—
 - (a) unless paragraph (c) applies, if the relevant transactions are OTCD transactions—10 days;
 - (b) unless paragraph (d) applies, if the relevant transactions are repo-style transactions—5 days;
 - (c) if the relevant transactions are OTCD transactions, and any of them satisfies any of the following conditions—
 - (i) the asset posted as security in respect of the transaction is an illiquid asset;
 - (ii) the underlying subject matter of the OTC derivative product concerned is an illiquid asset;

- (iii) the transaction is not marked to market every business day, or the fair value of the transaction is determined by a model using inputs that are not observable in the market;
 - (iv) the transaction cannot be easily replaced—
20 days; or
- (d) if the relevant transactions are repo-style transactions, and any of them satisfies any of the following conditions—
 - (i) the RST exposure or RST collateral in respect of the transaction is an illiquid asset;
 - (ii) the transaction cannot be easily replaced—
20 days.
- (2) Subject to subsection (5), if the relevant transactions in respect of the subject asset or subject currency mismatch are covered by a netting agreement, the minimum holding period in respect of the subject asset or subject currency mismatch is—
 - (a) unless paragraph (d) or (e) applies, if the netting agreement covers OTCD transactions (regardless of whether it also covers other transactions)—10 days;
 - (b) unless paragraph (d) or (e) applies, if the netting agreement covers repo-style transactions only—5 days;
 - (c) unless paragraph (d) or (e) applies, if the netting agreement covers repo-style transactions and other transactions—10 days;
 - (d) if, at any point in time during the quarter immediately before the current quarter, the netting agreement covered more than 5 000 transactions (excluding any transaction giving rise to the licensed corporation's exposure to a regulated CCP)—20 days; or
 - (e) if the netting agreement covers—
 - (i) an OTCD transaction that satisfies any of the following conditions—
 - (A) the asset posted as security in respect of the transaction is an illiquid asset;
 - (B) the underlying subject matter of the OTC derivative product concerned is an illiquid asset;
 - (C) the transaction cannot be easily replaced;
 - (ii) a repo-style transaction that satisfies any of the following conditions—
 - (A) the RST exposure or RST collateral in respect of the transaction is an illiquid asset;
 - (B) the transaction cannot be easily replaced;
 - (iii) a transaction in a derivative instrument that is not marked to market every business day or the fair value of which is determined by a model using inputs that are not observable in the market; or
 - (iv) a transaction (other than an OTCD transaction or repo-style transaction) that satisfies any of the following conditions—
 - (A) the asset posted as security in respect of the transaction is an illiquid asset;
 - (B) the value of the transaction is determined by reference to an illiquid asset;
 - (C) the transaction cannot be easily replaced—

20 days.

(3) For the purposes of subsections (1)(c) and (d) and (2)(e)—

- (a) subject to paragraphs (b) and (c), a licensed corporation must determine whether an asset is illiquid or a transaction is one that cannot be easily replaced in the context of stressed market conditions characterized by the absence of continuously active markets where a person could, within less than 3 business days, obtain multiple price quotations that would not move the market or represent a price reflecting—
 - (i) for an asset—a market discount; or
 - (ii) for a transaction—a market premium;
- (b) a licensed corporation must regard a transaction as being one that cannot be easily replaced if it would not be able to replace the transaction should the counterparty to the transaction exit the market precipitously; and
- (c) a licensed corporation must regard an asset as an illiquid asset if the asset is not marked to market every business day or the fair value of the asset is determined by a model using inputs that are not observable in the market.

(4) If—

- (a) subsection (1) applies for the purpose of determining the minimum holding period in respect of the subject asset or subject currency mismatch, and the minimum holding period so determined is a certain number of days (***specified number of days***); and
- (b) during the period of 2 quarters immediately before the current quarter, there were margin call disputes concerning any one or more relevant transactions in respect of the subject asset or subject currency mismatch (***relevant disputes***), and the time taken to resolve each of at least 3 relevant disputes exceeded the specified number of days,

the minimum holding period in respect of the subject asset or subject currency mismatch is, in the current quarter and the next following quarter, double the specified number of days.

(5) If—

- (a) subsection (2) applies for the purpose of determining the minimum holding period in respect of the subject asset or subject currency mismatch, and the minimum holding period so determined is a certain number of days (***specified number of days***); and
- (b) during the period of 2 quarters immediately before the current quarter, there were margin call disputes concerning any one or more transactions covered by the netting agreement referred to in that subsection (regardless of whether they are the relevant transactions referred to in that subsection) (***relevant disputes***), and the time taken to resolve each of at least 3 relevant disputes exceeded the specified number of days,

the minimum holding period in respect of the subject asset or subject currency mismatch is, in the current quarter and the next following quarter, double the specified number of days.

(6) In this section—

quarter () means a period of 3 consecutive calendar months ending on the last day of March, June, September or December in any year;

relevant transactions () means—

- (a) in relation to the subject asset—either or both of the following—

- (i) one or more OTCD transactions in respect of which the subject asset is posted as security;
- (ii) one or more repo-style transactions in respect of which the subject asset is the RST exposure or RST collateral; or
- (b) in relation to the subject currency mismatch—one or more OTCD transactions or repo-style transactions (or both) to which the subject currency mismatch relates;

RST collateral () has the meaning given by section 53R(5);

RST exposure () has the meaning given by section 53R(5);

subject asset () means an asset for which a volatility adjustment percentage is calculated under section 1 of this Schedule;

subject currency mismatch () means a currency mismatch for which a volatility adjustment percentage is calculated under section 1 of this Schedule.

Schedule 8

[s. 2]

Calculation of PFE amount and net PFE amount

1. Interpretation

In this Schedule—

PFE percentage () in relation to an OTCD transaction, means the PFE percentage applicable to the transaction as determined in accordance with section 4 of this Schedule;

specified swap () means a common credit derivative in the form of a credit default swap;

subject product () in relation to an OTCD transaction, means the OTC derivative product that is the subject of the transaction.

2. Calculation of PFE amount of OTCD transaction

- (1) Subject to other provisions of this section, the PFE amount of an OTCD transaction is—
 - (a) if 1 PFE percentage is applicable to the transaction—the amount equal to the notional principal of the underlying subject matter of the subject product of the transaction, multiplied by the PFE percentage; or
 - (b) if 2 or more PFE percentages are applicable to the transaction because there are 2 or more underlying subject matters of the subject product of the transaction—the highest of the amount determined in accordance with paragraph (a) in respect of each of those underlying subject matters.
- (2) If the subject product of an OTCD transaction is an uncommon derivative falling within section 53ZZR(1), the PFE amount of the transaction is equal to the amount calculated under section 53ZZR(3) in respect of the licensed corporation's position in the uncommon derivative for inclusion in the licensed corporation's ranking liabilities.
- (3) If the subject product of an OTCD transaction is an uncommon derivative falling within section 53ZZS(1), the PFE amount of the transaction is equal to the amount calculated under that section in respect of the licensed corporation's position in the uncommon derivative for inclusion in the licensed corporation's ranking liabilities.
- (4) In applying section 53ZZR or 53ZZS for the purposes of subsection (2) or (3)—
 - (a) a licensed corporation that is not a SMRA-LC is to be treated as if it were a SMRA-LC;
 - (b) the licensed corporation's position (not being a long spot position or short spot position) in the uncommon derivative is to be treated as if it were the licensed corporation's long spot position or short spot position in the uncommon derivative; and
 - (c) if the OTCD transaction is an intermediary transaction (agency clearing) effected by the licensed corporation for its clearing client—the clearing client's position in the uncommon derivative is to be treated as if it were the licensed corporation's long spot position or short spot position in the uncommon derivative.
- (5) If the subject product of an OTCD transaction is a specified swap under which the licensed corporation is the protection seller, the PFE amount of the transaction is not to exceed the total amount of premia that are not yet paid, under the swap, by the protection buyer under the swap to the licensed corporation.

- (6) However, subsection (5) does not apply in relation to the determination of a PFE amount for the purpose of calculating an OTCD floor initial margin amount for calculating an OTCD variable amount.
- (7) If—
 - (a) the subject product of an OTCD transaction is a specified swap;
 - (b) the transaction is an intermediary transaction (agency clearing) effected by the licensed corporation for its clearing client; and
 - (c) the clearing client is the protection seller under the swap,
 the PFE amount of the transaction is not to exceed the total amount of premia that are not yet paid, under the swap, by the protection buyer under the swap to the clearing client.
- (8) However, subsection (7) does not apply in relation to the determination of a PFE amount for the purpose of calculating an OTCD floor initial margin amount—
 - (a) for calculating an OTCD variable amount; or
 - (b) for the purposes of Formula 15 in section 53L(1).
- (9) If—
 - (a) the subject product of an OTCD transaction is a specified swap;
 - (b) the transaction is an intermediary transaction (agency clearing) effected by the licensed corporation for its clearing client; and
 - (c) the clearing client is the protection buyer under the swap,
 the PFE amount of the transaction, determined for the purpose of calculating an OTCD floor initial margin amount for the purposes of Formula 15 in section 53L(1), is not to exceed the total amount of premia that are not yet paid by the clearing client to the licensed corporation.
- (10) For an OTCD transaction that has 2 or more exchanges of principal, subsection (1)(a) applies as if the reference to the notional principal of the underlying subject matter in that subsection were a reference to an amount equal to the number of exchanges remaining to be made under the transaction multiplied by the notional principal of the underlying subject matter.
- (11) If the Commission is satisfied that calculating the PFE amount of a particular OTCD transaction, or any OTCD transaction belonging to a class of OTCD transactions, in accordance with subsection (1)(b) would result in significantly underestimating the PFE amount of the transaction, the Commission may, by a written notice to a licensed corporation, require the licensed corporation to calculate the PFE amount of the transaction in accordance with the method specified in the notice.
- (12) A licensed corporation must comply with a notice given to it under subsection (11).
- (13) Despite other provisions of this section, the PFE amount of an OTCD transaction that has been closed or terminated is zero.

3. Calculation of net PFE amount of OTCD netting set

- (1) The net PFE amount of an OTCD netting set is the amount calculated using the following formula—

$$PFE_{\text{Net}} = 0.4 \times PFE_{\text{Gross}} + 0.6 \times NGR \times PFE_{\text{Gross}}$$

where—

- PFE_{Gross} is, subject to subsections (2), (3) and (4), the sum of the PFE amounts of all of the OTCD transactions constituting the OTCD netting set as calculated under section 2 of this Schedule;
- NGR is the net-to-gross ratio, which is—
- (a) if no election is made under subsection (6)—
 - (i) the ratio of the net market value of the OTCD netting set to the total positive market value of the OTCD netting set; or
 - (ii) if the total positive market value of the OTCD netting set is zero—zero; or
 - (b) if an election is made under subsection (6)—
 - (i) the ratio of the sum of the net market values of all OTCD netting sets effected by the licensed corporation to the sum of the total positive market values of such OTCD netting sets; or
 - (ii) if the sum of the total positive market values of such OTCD netting sets is zero—zero.
- (2) For calculating PFE_{Gross} in the formula in subsection (1), subsection (3) applies in relation to 2 or more forward foreign exchange contracts (or similar contracts in respect of each of which the notional principal of the underlying subject matter is equivalent to the amount of currency to be exchanged under the contract on a date in the future) included in an eligible netting agreement (**relevant contracts**) if—
- (a) the currency exchanges under all of the relevant contracts will take place on the same date in the future; and
 - (b) either or both of the following conditions are met in respect of each of the relevant contracts—
 - (i) the currency to be delivered under the contract is the same as the currency to be received under one or more of the other relevant contracts;
 - (ii) the currency to be received under the contract is the same as the currency to be delivered under one or more of the other relevant contracts.
- (3) If this subsection applies—
- (a) the relevant contracts may be treated as if they were one or more contracts (**deemed contracts**);
 - (b) the notional principal of the underlying subject matter of each deemed contract is equal to the net receipt or payment in a particular currency to be exchanged under 2 or more relevant contracts; and
 - (c) the net receipt or payment in that currency is to be calculated by netting the amounts of that currency to be exchanged under those 2 or more relevant contracts.
- (4) For calculating PFE_{Gross} in the formula in subsection (1), if—
- (a) the subject products of 2 or more OTCD transactions forming part of the OTCD netting set are uncommon derivatives; and
 - (b) the licensed corporation's positions in the uncommon derivatives constitute a portfolio falling within section 53ZZR(1),
- the sum of the PFE amounts of those transactions is equal to the amount calculated under section 53ZZR(3) in respect of the portfolio for inclusion in the licensed corporation's ranking liabilities.
- (5) In applying section 53ZZR for the purposes of subsection (4)—

- (a) a licensed corporation that is not a SMRA-LC is to be treated as if it were a SMRA-LC;
 - (b) the licensed corporation's position (not being a long spot position or short spot position) in the uncommon derivative is to be treated as if it were the licensed corporation's long spot position or short spot position in the uncommon derivative; and
 - (c) if the OTCD transaction is an intermediary transaction (agency clearing) effected by the licensed corporation for its clearing client—the clearing client's position in the uncommon derivative is to be treated as if it were the licensed corporation's long spot position or short spot position in the uncommon derivative.
- (6) For calculating NGR in the formula in subsection (1), the licensed corporation may elect to obtain the net-to-gross ratio by applying paragraph (b) of the description of NGR.
- (7) In the description of NGR in the formula in subsection (1)—
- net market value** (), in relation to an OTCD netting set, means—
- (a) if the sum of the market values (whether positive or negative) of all the OTCD transactions constituting the OTCD netting set is a positive number—that sum; or
 - (b) in any other case—zero;
- total positive market value** (), in relation to an OTCD netting set, means—
- (a) if only 1 OTCD transaction forming part of the OTCD netting set has a positive market value—that value;
 - (b) if 2 or more OTCD transactions forming part of the OTCD netting set have positive market values—the sum of those values; or
 - (c) in any other case—zero.

4. PFE percentages

- (1) Subject to other provisions of this section, the PFE percentage applicable to an OTCD transaction falling within a description specified in an item in column 2 of the Table (**Table item**) is specified in column 3 of the Table opposite that Table item.

Table

PFE Percentages for OTCD Transactions

Column 1	Column 2	Column 3
Item	Description of OTCD transaction	PFE percentage
1.	An OTCD transaction the subject product of which is a common exchange rate derivative	4%
2.	An OTCD transaction the subject product of which is a common interest rate derivative, with a residual maturity of—	
	(a) 1 year or less;	0.5%
	(b) more than 1 year but not more than 5 years; or	2%

Column 1	Column 2	Column 3
Item	Description of OTCD transaction	PFE percentage
	(c) more than 5 years	4%
3.	<p>An OTCD transaction the subject product of which is a common debt security derivative or common credit derivative (other than one falling within item 13, 14 or 15)—</p> <p>(a) that references a single entity being an entity that has an SCRA issuer rating the applicable credit quality grade of which is 1, 2 or 3, a relevant international organization or a multilateral development bank; or</p> <p>(b) that references a single-name debt security that has an SCRA issue specific rating the applicable credit quality grade of which is 1, 2 or 3, or that is issued by a relevant international organization or a multilateral development bank,</p> <p>with a residual maturity of—</p> <p>(i) 1 year or less;</p> <p>(ii) more than 1 year but not more than 5 years; or</p> <p>(iii) more than 5 years</p>	<p>0.5%</p> <p>2.5%</p> <p>4.5%</p>
4.	<p>An OTCD transaction the subject product of which is a common debt security derivative or common credit derivative (other than one falling within item 13, 14 or 15) that references an investment grade index, with a residual maturity of—</p> <p>(a) 1 year or less;</p> <p>(b) more than 1 year but not more than 5 years; or</p> <p>(c) more than 5 years</p>	<p>0.5%</p> <p>2.5%</p> <p>4.5%</p>
5.	<p>An OTCD transaction the subject product of which is a common debt security derivative or common credit derivative (other than one falling within item 13, 14 or 15)—</p> <p>(a) that references a single entity that has an SCRA issuer rating the applicable credit quality grade of which is 4 or 5; or</p> <p>(b) that references a single-name debt security that has an SCRA issue specific rating the applicable credit quality grade of which is 4 or 5,</p>	

Column 1	Column 2	Column 3
Item	Description of OTCD transaction	PFE percentage
	with a residual maturity of— (i) 1 year or less; (ii) more than 1 year but not more than 5 years; or (iii) more than 5 years	1.5% 7% 12.5%
6.	An OTCD transaction the subject product of which is a common debt security derivative or common credit derivative (other than one falling within item 13, 14 or 15)— (a) that references a single entity that does not have an SCRA issuer rating; or (b) that references a single-name debt security that does not have an SCRA issue specific rating, with a residual maturity of— (i) 1 year or less; (ii) more than 1 year but not more than 5 years; or (iii) more than 5 years	1.5% 7% 12.5%
7.	An OTCD transaction the subject product of which is a common debt security derivative or common credit derivative (other than one falling within item 13, 14 or 15) that references an index (other than an investment grade index), with a residual maturity of— (a) 1 year or less; (b) more than 1 year but not more than 5 years; or (c) more than 5 years	1.5% 7% 12.5%
8.	An OTCD transaction the subject product of which is a common debt security derivative or common credit derivative (other than one falling within item 13, 14 or 15)—	
	(a) that references a single entity that has an SCRA issuer rating the applicable credit quality grade of which is 6; or (b) that references a single-name debt security that has an SCRA issue specific rating the applicable credit quality grade of which is 6, with a residual maturity of—	

Column 1	Column 2	Column 3
Item	Description of OTCD transaction	PFE percentage
	(i) 1 year or less;	6%
	(ii) more than 1 year but not more than 5 years; or	26.5%
	(iii) more than 5 years	47%
9.	An OTCD transaction the subject product of which is a common equity derivative, where the underlying subject matter of the common equity derivative is— (a) a liquid equity investment (as defined by section 53ZD(1)); or (b) an illiquid equity investment (as defined by section 53ZD(1))	the haircut percentage, highest of the haircut percentages or weighted average haircut percentage applicable to the liquid equity investment for calculating an amount for inclusion in the ranking liabilities of an SMRA-LC under section 53ZF(1) 100%
10.	An OTCD transaction the subject product of which is a common gold derivative or an OTC derivative product relating to silver or platinum	18%
11.	An OTCD transaction the subject product of which is an OTC derivative product relating to electricity	40%
12.	An OTCD transaction the subject product of which is an OTC derivative product relating to other tradable commodities	18%
13.	Subject to subsection (5), an OTCD transaction the subject product of which is a specified swap— (a) under which the licensed corporation is the protection seller; and (b) that is not subject to close-out upon the insolvency of the protection buyer under the swap while the reference entity is still solvent	0%
14.	Subject to subsection (6), an intermediary transaction (agency clearing) effected by a licensed corporation for its clearing client the subject product of which is a specified	0%

Column 1	Column 2	Column 3
Item	Description of OTCD transaction	PFE percentage
	<p>swap—</p> <p>(a) under which the clearing client is the protection seller; and</p> <p>(b) that is not subject to close-out upon the insolvency of the protection buyer under the swap while the reference entity is still solvent</p>	
15.	<p>Subject to subsection (7), an intermediary transaction (agency clearing) effected by a licensed corporation for its clearing client the subject product of which is a specified swap—</p> <p>(a) under which the clearing client is the protection buyer; and</p> <p>(b) that is not subject to close-out upon the insolvency of the protection buyer under the swap while the reference entity is still solvent</p>	0%
16.	<p>An OTCD transaction the subject product of which is a common derivative that meets any of the following descriptions—</p> <p>(a) the percentage applicable to the underlying subject matter of the common derivative for calculating, under Part 4B, an amount for inclusion in the ranking liabilities of an SMRA-LC is 100%;</p> <p>(b) the haircut percentage applicable to the underlying subject matter of the common derivative is 100%;</p> <p>(c) the underlying subject matter of the common derivative is an asset that the licensed corporation is not required or permitted to include in its liquid assets under these Rules;</p> <p>(d) the underlying subject matter of the common derivative is an asset that must be valued at nil under these Rules</p>	100%
17.	An OTCD transaction not falling within any other item of this Table	40%

- (2) For subsection (1), if an OTCD transaction falls within 2 or more Table items because—

- (a) those Table items make references to an SCRA issuer rating of an entity or an SCRA issue specific rating of a debt security (or both); and
 - (b) there are 2 or more ratings falling within paragraph (a),

the licensed corporation may treat the transaction as falling within any one of those Table items.
- (3) In this section (except subsection (4)(a)), in relation to an OTC derivative product under which, on specified payment dates, outstanding exposures are settled and the terms of the product are reset so that the market value of the product is zero, a reference to the residual maturity of the product is to be treated as if it were a reference to the period until the next specified payment date.
- (4) For an OTCD transaction falling within the description specified in item 2 in column 2 of the Table, if the subject product of the transaction—
 - (a) has a residual maturity of more than 1 year; and
 - (b) is, by virtue of subsection (3), treated as if it had a residual maturity of 1 year or less,

the PFE percentage applicable to the transaction is 2%.
- (5) Item 13 of the Table does not apply in relation to the determination of a PFE amount for the purpose of calculating an OTCD floor initial margin amount for calculating an OTCD variable amount.
- (6) Item 14 of the Table applies only in relation to—
 - (a) the determination of a PFE amount for the purposes of Formula 5 in section 53J(1) or Formula 11 in section 53K(1);
 - (b) the determination of a net PFE amount for the purposes of Formula 7 in section 53J(3) or Formula 13 in section 53K(2); and
 - (c) the determination of a PFE amount for the purpose of calculating an OTCD floor initial margin amount for the purposes of Formula 17 in section 53M(1).
- (7) Item 15 of the Table applies only in relation to the determination of a PFE amount for the purpose of calculating an OTCD floor initial margin amount for the purposes of Formula 15 in section 53L(1).
- (8) In applying—
 - (a) section 53ZF(1) for the purposes of item 9 of the Table; or
 - (b) Part 4B for the purposes of item 16 of the Table,

a licensed corporation that is not a SMRA-LC is to be treated as if it were a SMRA-LC.
- (9) If the subject product of an OTCD transaction falling within a Table item is a common interest rate derivative that references the value of another OTC derivative product in the form of a common interest rate derivative (***underlying product***), then, for determining the PFE percentage applicable to the transaction, a reference in the Table item to the residual maturity of the subject product is to be treated as if it were a reference to the period from the current date to the maturity date of the underlying product.
- (10) If the subject product of an OTCD transaction falling within a Table item is a common debt security derivative or common credit derivative that references the value of either of the following (***underlying product***)—
 - (a) another OTC derivative product in the form of a common debt security derivative or common credit derivative;
 - (b) a debt security,

for determining the PFE percentage applicable to the transaction, a reference in the Table item to the residual maturity of the subject product is to be treated as if it were a reference to the period from the current date to the maturity date of the underlying product.

- (11) The PFE percentage applicable to an OTCD transaction as determined under this section (apart from this subsection) must be adjusted by multiplying the percentage by—
- (a) if the subject product of the transaction is a single-currency floating rate against floating rate interest rate swap—0.5; or
 - (b) if the transaction is a volatility transaction—5.

- (12) In this section—

investment grade index () means an index where the minimum SCRA rating specified by the index service provider concerned for the purpose of determining whether an entity is eligible for being included in the index is a rating the applicable credit quality grade of which is 1, 2 or 3;

OTC derivative product relating to electricity () means an OTC derivative product the underlying subject matter of which is—

- (a) a tradable commodity being electricity;
- (b) a basket of tradable commodities being electricity; or
- (c) an index on tradable commodities being electricity;

OTC derivative product relating to other tradable commodities () means an OTC derivative product the underlying subject matter of which is—

- (a) any tradable commodity other than electricity, silver and platinum; or
- (b) a basket of tradable commodities mentioned in paragraph (a); or
- (c) an index on tradable commodities mentioned in paragraph (a);

OTC derivative product relating to silver or platinum () means an OTC derivative product the underlying subject matter of which is—

- (a) a tradable commodity being silver or platinum;
- (b) a basket of tradable commodities being silver or platinum; or
- (c) an index on tradable commodities being silver or platinum;

reference entity () in relation to a specified swap, means the entity on whose credit status the swap is based;

volatility transaction () means an OTCD transaction the payment under which is determined by reference to a measure of the volatility (historical or implied) of an underlying subject matter and the measure is explicitly specified in the terms and conditions of the transaction.

Schedule 9

[ss. 2, 53ZZA, 53ZZO & 53ZZT]

Market Risk Percentage, Specific Risk Percentage and General Risk Percentage

Part 1

Market Risk Percentage

1. Market risk percentage

- (1) Subject to subsections (2) and (3), the market risk percentage applicable to a specified matter is—
 - (a) for a specified matter in relation to an SMRA-LC—the percentage specified in column 3 of Table 1 opposite the applicable description of that matter set out in column 2 of that Table; or
 - (b) for a specified matter in relation to a BMRA-LC—the percentage specified in column 3 of Table 2 opposite the applicable description of that matter set out in column 2 of that Table.
- (2) If, for a specified matter that falls within a description set out in column 2 of Table 1 or 2, more than 1 alternative percentage is specified in column 3 of that Table opposite that description, the SMRA-LC or BMRA-LC may use any of the percentages so specified as the market risk percentage applicable to the specified matter.
- (3) If the specified matter is a reference underlying referred to in section 53ZZS, 48B or 48E and is denominated in a foreign currency, the market risk percentage applicable to the specified matter is—
 - (a) where the percentage specified in column 3 of Table 1 or 2 (as applicable under subsections (1) and (2)) is less than 100%—the sum of 8% and that percentage;
 - (b) where the percentage specified in column 3 of Table 1 or 2 (as applicable under subsections (1) and (2)) is 100% and SMRA-LC or BMRA-LC's notional position in the specified matter is a short position—108%; or
 - (c) where the percentage specified in column 3 of Table 1 or 2 (as applicable under subsections (1) and (2)) is 100% and SMRA-LC or BMRA-LC's notional position in the specified matter is a long position—100%.
- (4) In this section (including Tables 1 and 2)—

liquid equity investment () has the meaning given by section 53ZD(1);

specified matter () means—

- (a) in relation to an SMRA-LC—
 - (i) any securities or specified investment referred to in section 52(1A)(a) or (c);
 - (ii) a reference underlying or underlying subject matter of an applicable continuous options contract referred to in section 53ZZM, 53ZZN or 53ZZP;
 - (iii) a reference underlying of an uncommon derivative referred to in section 53ZZS; or
- (b) in relation to a BMRA-LC—
 - (i) a reference underlying of an OTCD product referred to in section 48B; or

- (ii) a reference underlying of a miscellaneous derivative referred to in section 48E.

Table 1

SMRA-LC

Column 1	Column 2	Column 3	Column 4
Item	Description	Percentage	Scaling factor
1.	A category of equity that is a liquid equity investment	The haircut percentage applicable to equities of that category of equity	1
2.	A basket of equities that is a liquid equity investment	Either of— (a) the highest of the haircut percentages applicable to each of the equities that constitute the basket or (b) the weighted average haircut percentage applicable to the basket	1
3.	An equity index that is a liquid equity investment	Either of— (a) the highest of the haircut percentages applicable to each of the equities that constitute the basket of equities underlying the index or (b) the weighted average haircut percentage applicable to the index	1
4.	(a) A category of gold (b) A basket of gold	8%	1.2
5.	(a) A category of commodity that is a tradable commodity (b) A basket of commodities that is	15%	1.9

Column 1	Column 2	Column 3	Column 4
Item	Description	Percentage	Scaling factor
	constituted only by tradable commodities (c) A commodity index that has a basket of commodities referred to in paragraph (b) underlying it		
6.	A basket of commodities that is constituted by both tradable commodities and non-tradable commodities	Either of— (a) 100% or (b) the weighted average market risk percentage applicable to the basket	1 1.9
7.	A commodity index that has a basket of commodities referred to in item 6 underlying it	Either of— (a) 100% or (b) the weighted average market risk percentage applicable to the index	1 1.9
8.	(a) A category of debt security that is a marketable debt security for which the applicable specific risk percentage is 100% (b) A basket of debt securities that is constituted only by marketable debt securities referred to in paragraph (a) (c) A debt security index that has a basket of debt securities referred to in paragraph (b) underlying it	100%	1
9.	(a) A basket of debt	100%	1

Column 1	Column 2	Column 3	Column 4
Item	Description	Percentage	Scaling factor
	<p>securities that is constituted only by marketable debt securities referred to in item 8(a) and debt securities that are illiquid investments</p> <p>(b) A debt security index that has a basket of debt securities referred to in paragraph (a) underlying it</p>		
10.	A basket of debt securities other than a basket referred to in item 8(b), 9(a), 13 or 22(b)	<p>Either of—</p> <p>(a) 100%</p> <p>or</p> <p>(b) the sum of—</p> <p>(i) the weighted average specific risk percentage applicable to the basket; and</p> <p>(ii) the general risk percentage applicable to the basket</p>	<p>1</p> <p>1.3</p>
11.	A debt security index that has a basket of debt securities referred to in item 10 underlying it	<p>Either of—</p> <p>(a) 100%</p> <p>or</p> <p>(b) the sum of—</p> <p>(i) the weighted average specific risk percentage applicable to the index; and</p> <p>(ii) the general risk percentage applicable to the index</p>	<p>1</p> <p>1.3</p>

Column 1	Column 2	Column 3	Column 4
Item	Description	Percentage	Scaling factor
12.	A category of debt security that is a marketable debt security for which the applicable specific risk percentage is a percentage other than 100%	The sum of— (a) the specific risk percentage applicable to the category of debt security; and (b) the general risk percentage applicable to the category of debt security	1.3
13.	A basket of debt securities that is constituted only by marketable debt securities referred to in item 12	The sum of— (a) the highest of the specific risk percentages applicable to each of the categories of debt security that constitute the basket, or the weighted average specific risk percentage applicable to the basket; and (b) the general risk percentage applicable to the basket	1.3
14.	A debt security index that has a basket of debt securities referred to in item 13 underlying it.	The sum of— (a) the highest of the specific risk percentages applicable to each of the categories of debt security that constitute the basket of debt securities underlying it, or the weighted average specific risk percentage applicable to the index; and (b) the general risk percentage applicable to the	1.3

Column 1	Column 2	Column 3	Column 4
Item	Description	Percentage	Scaling factor
		index	
15.	A foreign currency	8%	1.2
16.	A basket of currencies	8%	1.2
17.	A currency exchange rate	8%	1.2
18.	A basket of currency exchange rates	8%	1.2
19.	A currency exchange rate index	8%	1.2
20.	An interest rate	The general risk percentage applicable to the rate	1.3
21.	2 or more interest rates	The general risk percentage applicable to the interest rate that has the longest tenor	1.3
22.	(a) An illiquid investment (b) A basket that is constituted only by illiquid investments (c) An index that has a basket of illiquid investments referred to in paragraph (b) underlying it	100%	1
23.	(a) A miscellaneous investment that is not a marketable debt security (b) A basket that is constituted only by miscellaneous investments referred to in paragraph (a) (c) An index that has a basket of miscellaneous investments referred to in paragraph (b) underlying it	100%	1

Column 1	Column 2	Column 3	Column 4
Item	Description	Percentage	Scaling factor
24.	A matter that does not fall within any of the above items	30%	1

Table 2

BMRA-LC

Column 1	Column 2	Column 3
Item	Description	Percentage
1.	A category of equity that is a liquid equity investment	The haircut percentage applicable to the category of equity
2.	A basket of equities that is a liquid equity investment	Either of— (a) the highest of the haircut percentages applicable to each of the equities that constitute the basket or (b) the weighted average haircut percentage applicable to the basket
3.	An equity index that is a liquid equity investment	Either of— (a) the highest of the haircut percentages applicable to each of the equities that constitute the basket of equities underlying the index or (b) the weighted average haircut percentage applicable to the index
4.	(a) A category of gold (b) A basket of gold	10%
5.	(a) A category of commodity that is a tradable commodity (b) A basket of commodities that is constituted only by tradable commodities (c) A commodity index that has a basket of commodities referred	40%

Column 1	Column 2	Column 3
Item	Description	Percentage
	to in paragraph (b) underlying it	
6.	A basket of commodities that is constituted by both tradable commodities and non-tradable commodities	Either of— (a) 100% or (b) the weighted average market risk percentage applicable to the basket
7.	A commodity index that has a basket of commodities referred to in item 6 underlying it	Either of— (a) 100% or (b) the weighted average market risk percentage applicable to the index
8.	A category of debt security that is a marketable debt security	The haircut percentage applicable to the category of debt security
9.	A basket of debt securities other than a basket referred to in item 18(b)	Either of— (a) the highest of the haircut percentages applicable to each of the categories of debt securities that constitute the basket or (b) the weighted average haircut percentage applicable to the basket
10.	A debt security index that has a basket of debt securities referred to in item 9 underlying it	Either of— (a) the highest of the haircut percentages applicable to each of the categories of debt security that constitute the basket of debt securities underlying the index or (b) the weighted average haircut percentage applicable to the index
11.	A foreign currency	5%
12.	A basket of currencies	5%
13.	A currency exchange rate	5%
14.	A basket of currency exchange rates	5%
15.	A currency exchange rate index	5%
16.	An interest rate	The percentage specified in column 2 of Table 5 in Schedule 2

Column 1	Column 2	Column 3
Item	Description	Percentage
		opposite the description set out in column 1 of that Table that would, if the description was of the tenor of an interest rate, apply to the interest rate
17.	2 or more interest rates	The percentage specified in column 2 of Table 5 in Schedule 2 opposite the description set out in column 1 of that Table that would, if the description was of the tenor of an interest rate, apply to the interest rate that has the longest tenor
18.	(a) An illiquid investment (b) A basket that is constituted only by illiquid investments (c) An index that has a basket of illiquid investments referred to in paragraph (b) underlying it	100%
19.	(a) A miscellaneous investment that is not a marketable debt security (b) A basket that is constituted only by miscellaneous investments referred to in paragraph (a) (c) An index that has a basket of miscellaneous investments referred to in paragraph (b) underlying it.	100%
20.	A matter not falling within in any of the items above	30%

Part 2

Specific Risk Percentage

2. Specific risk percentage—marketable debt securities (other than securitization issues)

- (1) The specific risk percentage applicable to a marketable debt security (other than a securitization issue) is, where the debt security falls within a class specified in column 2 of Table 3 and a description (if any) specified in column 3 of that Table opposite that class, the percentage specified in column 4 of that Table opposite that class and that description (if any).

Table 3

Specific risk percentages applicable to marketable debt securities (other than securitization issues)

Column 1	Column 2	Column 3	Column 4	Column 5
Item	Class	Description	Specific risk percentage	Scaling factor
1.	Debt securities issued by any of the following (<i>issuer</i>)— (a) a JAA; (b) a relevant international organization; (c) a JAA-equivalent non-Hong Kong public sector entity	The credit quality grade of the SCRA issuer rating of the issuer is 1	0%	1
		The credit quality grade of the SCRA issuer rating of the issuer is 2 or 3, and the residual maturity of the debt securities is—		
		(a) 6 months or less;	0.25%	1.3
		(b) more than 6 months but not more than 24 months; or	1%	1.3
		(c) more than 24 months	1.6%	1.3
		The credit quality grade of the SCRA issuer rating of the issuer is 4, 5 or 6 (or the debt securities are unrated), and the initial issuance size of the debt securities is—		
		(a) not less than \$1 billion;	15%	1
		(b) less than \$1 billion but not less than \$750 million;	20%	1
		(c) less than \$750 million but not less than \$500 million;	25%	1
		(d) less than \$500 million but not less than \$200 million; or	50%	1
		(e) less than \$200 million	100%	1
2.	Any of the following— (a) debt securities	The residual maturity of the debt securities is—		

Column 1	Column 2	Column 3	Column 4	Column 5
Item	Class	Description	Specific risk percentage	Scaling factor
	issued by a multilateral body; (b) debt securities issued by a Hong Kong public sector entity or non-Hong Kong public sector entity (other than a JAA-equivalent non-Hong Kong public sector entity) described in subsection (3); (c) debt securities (other than those falling within paragraph (a) or (b) or item 1) that have at least 2 SCRA issue specific ratings, issued by different SCRA, the credit quality grade of each of which is 1, 2 or 3	(a) 6 months or less; (b) more than 6 months but not more 24 months; or (c) more than 24 months	0.25% 1% 1.6%	1.3 1.3 1.3
3.	Debt securities (other than those falling within item 1 or 2) that are issued by— (a) a Hong Kong public sector entity or non-Hong Kong public sector entity; or (b) an entity the equities of which are listed on a specified exchange	The initial issuance size of the debt securities is— (a) not less than \$1 billion; (b) less than \$1 billion but not less than \$750 million; (c) less than \$750 million but not less than \$500 million; (d) less than \$500 million but not less than \$200 million; or (e) less than \$200 million	15% 20% 25% 50% 100%	1 1 1 1 1
4.	Debt securities that do		100%	1

Column 1	Column 2	Column 3	Column 4	Column 5
Item	Class	Description	Specific risk percentage	Scaling factor
	not fall within item 1, 2 or 3			

- (2) For the purposes of item 1 of Table 3, in respect of debt securities issued by a JAA, relevant international organization or JAA-equivalent non-Hong Kong public sector entity (*issuer*)—
- if the issuer has only 1 SCRA issuer rating—the rating must be used;
 - if the issuer has 2 SCRA issuer ratings—
 - if using the ratings would result in allocating the same specific risk percentage to the debt securities—any of the ratings may be used; or
 - if using the ratings would result in allocating different specific risk percentages to the debt securities—the rating the use of which would result in allocating the higher of the percentages must be used;
 - if the issuer has more than 2 SCRA issuer ratings—
 - if using the ratings would result in allocating the same specific risk percentage to the debt securities—any of the ratings may be used; or
 - if using the ratings would result in allocating different specific risk percentages to the debt securities, and, among those percentages, the 2 lowest (**2 lowest percentages**) are—
 - the same—any of the ratings the use of which would result in allocating that same percentage may be used; or
 - different—the rating (or any of the ratings) the use of which would result in allocating the higher of the 2 lowest percentages must be used; or
 - if the issuer does not have a SCRA issuer rating—the debt securities are treated as unrated.
- (3) Debt securities issued by a Hong Kong public sector entity or non-Hong Kong public sector entity (other than a JAA-equivalent non-Hong Kong public sector entity) fall within paragraph (b) of the description specified in item 2 in column 2 of Table 3 if—
- the jurisdiction in which the entity is incorporated has 1 JAA that has an SCRA issuer rating, and the credit quality grade of the SCRA issuer rating of that JAA (determined in accordance with subsection (4)) is 1 or 2; or
 - that jurisdiction has 2 or more JAAs that have SCRA issuer ratings, and the credit quality grade of the SCRA issuer rating of each of those JAAs (determined in accordance with subsection (4)) is 1 or 2.
- (4) For the purposes of subsection (3)—
- if the JAA has only 1 SCRA issuer rating—the rating must be used;
 - if the JAA has 2 SCRA issuer ratings—
 - if using the ratings would result in allocating the same specific risk percentage to the debt securities—any of the ratings may be used; or
 - if using the ratings would result in allocating different specific risk percentages to the debt securities—the rating the use of which would result in allocating the higher of the percentages must be used; or

- (c) if the JAA has more than 2 SCRA issuer ratings—
- (i) if using the ratings would result in allocating the same specific risk percentage to the debt securities—any of the ratings may be used; or
 - (ii) if using the ratings would result in allocating different specific risk percentages to the debt securities, and, among those percentages, the 2 lowest (**2 lowest percentages**) are—
 - (A) the same—any of the ratings the use of which would result in allocating that same percentage may be used; or
 - (B) different—the rating (or any of the ratings) the use of which would result in allocating the higher of the 2 lowest percentages must be used.

3. Specific risk percentage—marketable debt securities that are securitization issues

- (1) The specific risk percentage applicable to a marketable debt security that is a securitization issue is, where the debt security falls within a class specified in column 2 of Table 4 and a description specified in column 3 of that Table opposite that class, the percentage specified in column 4 of that Table opposite that class and that description.

Table 4

Specific risk percentages applicable to marketable debt securities that are securitization issues

Column 1	Column 2	Column 3	Column 4	Column 5
Item	Class	Description	Specific risk percentage	Scaling factor
1.	Debt securities that are securitization issues (other than re-securitization issues)	The credit quality grade of the long-term SCRA issue specific rating of the debt securities is—		
		(a) 1;	11.2%	1.3
		(b) 2;	16.8%	1.3
		(c) 3; or	33.6%	1.3
		(d) 4, 5 or 6.	100%	1
		The credit quality grade of the short-term SCRA issue specific rating of the debt securities is—		
		(a) 1;	1.2%	1.3
		(b) 2;	4%	1.3

Column 1	Column 2	Column 3	Column 4	Column 5
Item	Class	Description	Specific risk percentage	Scaling factor
		(c) 3; or (d) 4.	8% 100%	1.3 1
		The debt securities are unrated.	100%	1
2.	Debt securities that are re-securitization issues	The credit quality grade of the long-term SCRA issue specific rating of the debt securities is— (a) 1; (b) 2; (c) 3; or (d) 4, 5 or 6.	14% 21% 42% 100%	1.3 1.3 1.3 1
		The credit quality grade of the short-term SCRA issue specific rating of the debt securities is— (a) 1; (b) 2; (c) 3; or (d) 4.	1.5% 5% 10% 100%	1.3 1.3 1.3 1
		The debt securities are unrated.	100%	1

- (2) Subject to subsections (4) and (7), for the purposes of Table 4 in subsection (1)—
- (a) if the debt securities have one or more long-term SCRA issue specific ratings, but do not have a short-term SCRA issue specific rating—the specific risk percentage must be allocated in accordance with subsection (3) based on the long-term SCRA issue specific ratings;
 - (b) if the debt securities have one or more short-term SCRA issue specific ratings, but do not have a long-term SCRA issue specific rating—the specific risk percentage must be allocated in accordance with subsection (3) based on the short-term SCRA issue specific ratings;
 - (c) if the debt securities have one or more long-term SCRA issue specific ratings and one or more short-term SCRA issue specific ratings, and applying subsection (3) in relation to the long-term SCRA issue specific ratings and the short-term SCRA issue specific ratings respectively would result in allocating—

- (i) the same specific risk percentage—that percentage is the specific risk percentage in respect of the debt securities; or
 - (ii) different specific risk percentages—the higher of those percentages is the specific risk percentage in respect of the debt securities; or
- (d) if the debt securities have neither a long-term SCRA issue specific rating nor a short-term SCRA issue specific rating—the specific risk percentage must be allocated on the basis the debt securities are unrated.
- (3) Subject to subsections (2), (4) and (7), for the purposes of allocating a specific risk percentage to the debt securities in accordance with Table 4 in subsection (1) based on one or more long-term SCRA issue specific ratings or one or more short-term SCRA issue specific ratings (as the case requires) (**relevant SCRA ratings**)—
 - (a) if the debt securities have only 1 relevant SCRA rating—the rating must be used;
 - (b) if the debt securities have 2 relevant SCRA ratings—
 - (i) if using the ratings would result in allocating the same specific risk percentage to the debt securities—any of the ratings may be used; or
 - (ii) if using the ratings would result in allocating different specific risk percentages to the debt securities—the rating the use of which would result in allocating the higher of the percentages must be used; or
 - (c) if the debt securities have more than 2 relevant SCRA ratings—
 - (i) if using the ratings would result in allocating the same specific risk percentage to the debt securities—any of the ratings may be used; or
 - (ii) if using the ratings would result in allocating different specific risk percentages to the debt securities, and, among those percentages, the 2 lowest (**2 lowest percentages**) are—
 - (A) the same—any of the ratings the use of which would result in allocating that same percentage may be used; or
 - (B) different—the rating (or any of the ratings) the use of which would result in allocating the higher of the 2 lowest percentages must be used.
- (4) If an SCRA, in assigning an SCRA issue specific rating to debt securities that are securitization issues, has taken into account the credit risk mitigating effect of a guarantee provided to a person (**guaranteed party**) as credit protection in respect of the underlying exposures of the relevant securitization transaction (**guaranteed underlying exposures**), an SMRA-LC must disregard that rating for the purpose of determining the specific risk percentage in respect of the debt securities under this section unless—
 - (a) the guarantee is provided by an eligible credit protection provider (as defined by section 53S(1)); and
 - (b) the requirements specified in subsection (5) are satisfied.
- (5) The requirements specified for subsection (4)(b) are that—
 - (a) the guarantee must give the guaranteed party a direct claim against the guarantor;
 - (b) the credit protection provided by the guarantee must relate to specific underlying exposures, or the entire pool of the underlying exposures, of the relevant securitization transaction;
 - (c) the extent of the credit protection provided by the guarantee must be clearly documented and defined, including the undertaking of the guarantor to make

payment in specified circumstances relating to the guaranteed underlying exposures;

- (d) there must not be any term in the guarantee that would allow the guarantor to terminate the guarantee unilaterally or that would increase the effective cost of the credit protection provided by the guarantee as a result of the deteriorating credit quality of the guaranteed underlying exposures, except a term permitting termination in the event of a failure by the guaranteed party to pay sums due from it under the terms of the guarantee;
 - (e) there must not be any term in the guarantee that could operate to prevent the guarantor from being obliged to pay out promptly in the event that the obligor in respect of the guaranteed underlying exposures defaults in making any payments due to the guaranteed party in respect of the guaranteed underlying exposures;
 - (f) the guarantor must not have recourse to the guaranteed party for any losses suffered by the guarantor as a result of the guarantor being obliged to make any payment to the guaranteed party under the terms of the guarantee;
 - (g) the guaranteed party must have the right to receive payment from the guarantor without having to take legal action in order to pursue the obligor in respect of the guaranteed underlying exposures for payment; and
 - (h) there must not be a material positive correlation between the credit quality of the guarantor and the credit quality of the obligor in respect of the guaranteed underlying exposures, unless the guarantor is a specified guarantor.
- (6) For the purposes of subsection (5)(h), a guarantor is a specified guarantor if—
- (a) where it has 1 SCRA issuer rating—the applicable credit quality grade of the rating is 1, 2 or 3; or
 - (b) where it has 2 or more SCRA issuer ratings—the applicable credit quality grade of each of those ratings is 1, 2 or 3.
- (7) If an SCRA assigns an SCRA issue specific rating to debt securities that are securitization issues wholly or partly based on unfunded support (including a liquidity facility or credit enhancement) provided by an SMRA-LC, the SMRA-LC must disregard that rating for the purpose of determining the specific risk percentage in respect of the debt securities under this section.
- (8) In this section—

obligor (), in relation to an exposure, means a person who has the primary obligation to repay, pay or otherwise settle the exposure;

relevant securitization transaction () means—

- (a) in relation to securitization issues (other than re-securitization issues)—the securitization transaction to which the securitization issues relate; or
- (b) in relation to re-securitization issues—the re-securitization transaction to which the re-securitization issues relate.

Part 3

General Risk Percentage

4. General risk percentage

- (1) The general risk percentage applicable to the following matter is—

- (a) for a debt security—the percentage specified in column 5 of Table 5 opposite the applicable description of that security specified in column 3 or 4 of that Table;
- (b) for a basket of debt securities—
 - (i) the highest of the general risk percentages applicable to each of the debt securities that constitute the basket; or
 - (ii) whichever of the following is applicable—
 - (A) if the weighted average general risk percentage applicable to the basket coincides with a percentage specified in column 5 of Table 5—that percentage; or
 - (B) if the weighted average percentage applicable to the basket falls between 2 adjacent percentages specified in column 5 of Table 5—the higher of those 2 percentages;
- (c) for a debt security index—
 - (i) the highest of the general risk percentages applicable to each of the debt securities that constitute the basket underlying the index; or
 - (ii) whichever of the following is applicable—
 - (A) if the weighted average general risk percentage applicable to the index coincides with a percentage specified in column 5 of Table 5—that percentage; or
 - (B) if the weighted average percentage applicable to the index falls between 2 adjacent percentages specified in column 5 of Table 5—the higher of those 2 percentages;
- (d) for an SRF security—the percentage specified in column 5 of Table 5 opposite the applicable description of that SRF security specified in column 3 or 4 of that Table; or
- (e) for an interest rate—the percentage specified in column 5 of Table 5 opposite the applicable description of that interest rate specified in column 3 or 4 of that Table.

Table 5**General risk percentages**

Column 1	Column 2	Column 3	Column 4	Column 5
Zone	Time band	Debt security, SRF security or interest rate that— (a) belongs to group A; and (b) has a specified duration falling into a description below	Debt security, SRF security or interest rate that— (a) belongs to group B; and (b) has a specified duration falling into a description below	Percentage

Column 1	Column 2	Column 3	Column 4	Column 5
Zone	Time band	Debt security, SRF security or interest rate that— (a) belongs to group A; and (b) has a specified duration falling into a description below	Debt security, SRF security or interest rate that— (a) belongs to group B; and (b) has a specified duration falling into a description below	Percentage
1	1	≤1 month	≤1 month	0%
	2	>1 ≤ 3 months	>1 ≤ 3 months	0.20%
	3	>3 ≤ 6 months	>3 ≤ 6 months	0.40%
	4	>6 ≤ 12 months	>6 ≤ 12 months	0.70%
2	5	>1 ≤ 2 years	>1 ≤ 1.9 years	1.25%
	6	>2 ≤ 3 years	>1.9 ≤ 2.8 years	1.75%
	7	>3 ≤ 4 years	>2.8 ≤ 3.6 years	2.25%
3	8	>4 ≤ 5 years	>3.6 ≤ 4.3 years	2.75%
	9	>5 ≤ 7 years	>4.3 ≤ 5.7 years	3.25%
	10	>7 ≤ 10 years	>5.7 ≤ 7.3 years	3.75%
	11	>10 ≤ 15 years	>7.3 ≤ 9.3 years	4.50%
	12	>15 ≤ 20 years	>9.3 ≤ 10.6 years	5.25%
	13	>20 years	>10.6 ≤ 12 years	6.00%
	14		>12 ≤ 20 years	8.00%
	15		>20 years	12.5%

(2) In Table 5—

- (a) a debt security, SRF security or interest belongs to group A if—
 - (i) for a debt security or SRF security—it has a coupon of 3% or more per annum; or
 - (ii) for an interest rate—its current level is at 3% or more per annum;
- (b) a debt security, SRF security or interest belongs to group B if—
 - (i) for a debt security or SRF security—it has a coupon of less than 3% per annum; or
 - (ii) for an interest rate—its current level is at less than 3% per annum; and
- (c) **specified duration** () means—
 - (i) in relation to a debt security or SRF security, means the residual maturity of that security;
 - (ii) in relation to an interest rate, means the sum of—
 - (A) the tenor of the interest rate; and
 - (B) the residual maturity of the continuous options contract or uncommon derivative of which the interest rate is a reference underlying.

Schedule 10

[s. 60]

Transitional Arrangements for Securities and Futures (Financial Resources) (Amendment) Rules

1. Interpretation of Schedule 10

In this Schedule—

deemed RA7 OTCD service provider () means a corporation that—

- (a) is deemed under section 33(2) or (3) of Schedule 11 to the Ordinance to be licensed for Type 7 regulated activity; and
- (b) is an RA7 service provider for OTCD trading or RA7 service provider for OTCD clearing;

deemed RA11 dealer () means a corporation that—

- (a) is deemed under section 3(1) or (2) of Schedule 11 to the Ordinance to be licensed for Type 11 regulated activity; and
- (b) is an RA11 dealer;

deemed RA12 LC () means a corporation that is deemed under section 3(1) or (2) of Schedule 11 to the Ordinance to be licensed for Type 12 regulated activity;

first transitional period () means the period of 6 months beginning on the material date;

material date () means the commencement date as defined by section 1(1) of Schedule 11 to the Ordinance;

pre-existing non-RA11 OTCD dealer () means a non-RA11 OTCD dealer that, for a period of at least 2 years immediately before the material date, has been carrying on a business in acts that—

- (a) during that period, constituted Type 1, Type 2 or Type 3 regulated activity, for which it was licensed; and
- (b) would have fallen within paragraph (b) of the definition of **non-RA11 OTCD dealer** in section 2(1) if the acts were carried out on and from the material date;

pre-existing RA7 OTCD service provider () means an RA7 service provider for OTCD trading or RA7 service provider for OTCD clearing that, for a period of at least 2 years immediately before the material date—

- (a) has been licensed for Type 7 regulated activity; and
- (b) has been providing either or both of the following services—
 - (i) services that would have fallen within paragraph (b) of the definition of **RA7 service provider for OTCD trading** in section 2(1) if the services were provided on and from the material date;
 - (ii) services that would have fallen within paragraph (b) of the definition of **RA7 service provider for OTCD clearing** in section 2(1) if the services were provided on and from the material date;

second transitional period () means the period of 6 months immediately after the first transitional period.

2. First transitional period—certain licensed corporations deemed not to be non-RA11 OTCD dealer

- (1) Subject to subsection (3), subsection (2) applies to a non-RA11 OTCD dealer (**covered non-RA11 OTCD dealer**) that, immediately before the material date, has been carrying on a business in acts that—
 - (a) before the material date, constituted Type 1, Type 2 or Type 3 regulated activity, for which it was licensed; and
 - (b) would have fallen within paragraph (b) of the definition of **non-RA11 OTCD dealer** in section 2(1) if the acts were carried out on and from the material date.
- (2) During the first transitional period, these Rules apply to a covered non-RA11 OTCD dealer as if it were a licensed corporation that is not a non-RA11 OTCD dealer.
- (3) Subsection (2) does not apply to a covered non-RA11 OTCD dealer if it makes an election to disapply that subsection.

3. First transitional period—certain licensed corporations deemed not to be RA7 service provider for OTCD trading or RA7 service provider for OTCD clearing

- (1) Subject to subsection (3), subsection (2) applies to an RA7 service provider for OTCD trading or RA7 service provider for OTCD clearing (**covered corporation**) that, immediately before the material date—
 - (a) has been licensed for Type 7 regulated activity; and
 - (b) has been providing either or both of the following services—
 - (i) services that would have fallen within paragraph (b) of the definition of **RA7 service provider for OTCD trading** in section 2(1) if the services were provided on and from the material date;
 - (ii) services that would have fallen within paragraph (b) of the definition of **RA7 service provider for OTCD clearing** in section 2(1) if the services were provided on and from the material date.
- (2) During the first transitional period, these Rules apply to a covered corporation as if it were a licensed corporation licensed for Type 7 regulated activity that is neither an RA7 service provider for OTCD trading nor an RA7 service provider for OTCD clearing.
- (3) Subsection (2) does not apply to a covered corporation if it makes an election to disapply that subsection.

4. Second transitional period—certain licensed corporations deemed to be BOCCRA-LC or BMRA-LC

- (1) Subject to subsection (3), subsection (2) applies to any of the following licensed corporations (**covered corporation**)—
 - (a) a pre-existing non-RA11 OTCD dealer;
 - (b) a pre-existing RA7 OTCD service provider;
 - (c) a deemed RA7 OTCD service provider;
 - (d) a deemed RA11 dealer;
 - (e) a deemed RA12 LC.
- (2) During the second transitional period, these Rules apply to a covered corporation—
 - (a) if it is not a BOCCRA-LC—as if it were a BOCCRA-LC; and
 - (b) if it is not a BMRA-LC—as if it were a BMRA-LC.
- (3) Subsection (2) does not apply to a covered corporation if it—

- (a) makes an election under section 7(1) of this Schedule; or
- (b) is an approved standardized approach LC.

5. Second transitional period—reduced minimum amount of required liquid capital for certain licensed corporations

- (1) Subject to subsection (3), subsection (2) applies to any of the following licensed corporations (**covered corporation**)—
 - (a) a pre-existing non-RA11 OTCD dealer (except a specified OTCD dealer);
 - (b) a pre-existing RA7 OTCD service provider;
 - (c) a deemed RA7 OTCD service provider;
 - (d) a deemed RA11 dealer (except a specified OTCD dealer);
 - (e) a deemed RA12 RA LC (except a specified RA12 LC).
- (2) During the second transitional period, Table 2 of Schedule 1 applies in relation to a covered corporation as if an amount applicable to the covered corporation specified in the following item or items in column 3 of that Table were reduced by 50%—
 - (a) in the case of subsection (1)(a)—items 1, 2 and 3;
 - (b) in the case of subsection (1)(b) or (c)—item 7;
 - (c) in the case of subsection (1)(d)—item 11; or
 - (d) in the case of subsection (1)(e)—item 12.
- (3) Subsection (2) does not apply to a covered corporation if it—
 - (a) makes an election under section 7(1) of this Schedule; or
 - (b) is an approved internal model LC.

6. Second transitional period—reduced minimum amount of tangible capital for certain licensed corporations

- (1) Subject to subsection (3), subsection (2) applies to any of the following licensed corporations (**covered corporation**)—
 - (a) a pre-existing non-RA11 OTCD dealer (except a specified OTCD dealer);
 - (b) a pre-existing RA7 OTCD service provider;
 - (c) a deemed RA7 OTCD service provider;
 - (d) a deemed RA11 dealer (except a specified OTCD dealer);
 - (e) a deemed RA12 LC.
- (2) During the second transitional period, Table 1A of Schedule 1 applies in relation to a covered corporation as if an amount applicable to the covered corporation specified in the following item or items in column 3 of that Table were reduced by 50%—
 - (a) in the case of subsection (1)(a) or (d)—item 1;
 - (b) in the case of subsection (1)(b) or (c)—items 2 and 3; or
 - (c) in the case of subsection (1)(e)—item 4.
- (3) Subsection (2) does not apply to a covered corporation if it—
 - (a) makes an election under section 7(1) of this Schedule; or
 - (b) is an approved internal model LC.

7. Second transitional period—election for disapplying certain provisions

- (1) A licensed corporation—

- (a) to which 1 specified provision applies may elect to disapply the specified provision; or
- (b) to which 2 or more specified provisions apply may elect to disapply all (but not only some) of the specified provisions.

(2) In this section—

specified provision () means—

- (a) section 4(2)(a) of this Schedule;
- (b) section 4(2)(b) of this Schedule;
- (c) section 5(2) of this Schedule; or
- (d) section 6(2) of this Schedule.

8. Notification of pre-existing profit or loss sharing agreement or pre-existing position

- (1) For the purposes of section 55(2A), if the licensed corporation entered into the profit or loss sharing agreement before the date on which that section comes into operation (***commencement date***), the licensed corporation must comply with that section within 1 business day after the commencement date instead of the date on which it enters into the agreement.
- (2) For the purposes of section 55(8), if the licensed corporation entered into the position mentioned in that section before the date on which that section comes into operation (***commencement date***), the licensed corporation must comply with that section within 1 business day after the commencement date instead of the date on which it enters into the position.

Guidelines for Internal Models Approach for FRR Market Risk Charges Calculation

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1 Introduction

- 1.1 Under section 58(5B)(a) of the Securities and Futures (Financial Resources) Rules (FRR), the Securities and Futures Commission (the SFC) may, on application in writing by a licensed corporation (LC), approve the adoption by the LC of an alternative approach to calculate one or more amounts in respect of the market risks of one or more positions of the LC in instruments or assets held by it for its own account (market risk charges¹). Pursuant to section 58(5C)(a) of the FRR, when giving an approval under section 58(5B)(a) of the FRR, the SFC must, among other matters, have had regard to guidelines published under section 399 of the Securities and Futures Ordinance (SFO) in relation to such approval.
- 1.2 The SFC may², pursuant to section 58(5B)(a) of the FRR, give approval to an LC permitting it to calculate market risk charges based on risk measures generated by one or more internal market risk measurement models (IMA models) for in-scope market risks³, provided that the LC satisfies the SFC, among other matters, that it has, and will consistently, maintain high risk management standards and accurately measure the in-scope market risks having regard to the requirements in these guidelines. An approval granted under section 58(5B)(a) of the FRR for this purpose is referred to as an internal models approach approval (IMA approval) in these guidelines.
- 1.3 These guidelines, which are published by the SFC under section 399 of the SFO, aim to provide guidance on IMA approval application requirements and summarise the major approval criteria which, among other matters, the SFC will have regard to when considering an application.
- 1.4 The requirements specified in these guidelines are the minimum standards required of an IMA approval applicant and are not meant to be exhaustive. These requirements, such as the qualitative requirements and quantitative requirements set out in Sections 3 and 4 respectively, are benchmarked to “*Revisions to the Basel II market risk framework*” issued by the Basel Committee on Banking Supervision on 31 December 2010. The SFC will take into account, among other things, the applicant’s compliance with these requirements in granting IMA approval.
- 1.5 Where the SFC grants an IMA approval to an LC, it will issue a letter (IMA approval letter) to the LC setting out, among other matters, the scope of the approval in terms of
- (a) the categories of positions held for the LC’s own account that are covered by the approval (in-scope positions); and
 - (b) in respect of each category of in-scope positions, the categories of market risks (as enumerated in paragraph 4.6) arising from that category of in-scope positions (such market risks are referred to as “in-scope market risks”, and such categories of market risks are referred to as “in-scope market risk categories”).
- 1.6 An LC to which the SFC has granted an IMA approval (an IM-LC) must calculate market risk charges
- (a) for market risks falling within in-scope market risk categories – in accordance with

¹ The calculation of market risk charge is not limited to using the alternative approach.

² The exercise of approval power is further subject to any other contemporary policy or regulatory consideration that the SFC may have.

³ The term “in-scope market risks” is defined in paragraph 1.5(b).

paragraph 4.1; and

- (b) for market risks arising from positions held for the LC's own account which fall outside in-scope market risk categories (out-of-scope market risks) – in accordance with the applicable FRR provisions subject to such variation as the SFC may specify in the IMA approval letter pursuant to section 58(5B)(b)(i) of the FRR.
- 1.7 The intensity of review and amount of time required for assessing an application will be affected by many factors, including but not limited to the applicant's readiness, the scope and complexity of the application, and the SFC's resources and priority. Applicants are encouraged to assess their readiness in advance and allow ample amount of time for the application.

Application for IMA approval

- 1.8 An LC which intends to make an IMA application should communicate in writing the intention to its case officer in the SFC's Intermediaries Division. The SFC will schedule an initial discussion with the LC for the latter to introduce its proposals, including its intended in-scope positions, in-scope market risk categories (such positions and market risk categories are referred to as "proposed in-scope positions" and "proposed in-scope market risk categories" respectively) and internal models.
- 1.9 Subsequent to the initial discussion, if the LC decides to apply for an IMA approval, the SFC will request the LC to
- (a) carry out an assessment of its readiness to comply with the General Criteria⁴, Qualitative Standards⁵ and Quantitative Standards⁶ set out in these guidelines and the requirements set out in the General Principles for Model Risk Management (MRMGP) and provide necessary information for the SFC's consideration. The request for information will be in the form of the Information Request List for Internal Models Approach for FRR Market Risk Charges Calculation attached in Annex F, subject to changes that the SFC considers fit in the circumstances; and
 - (b) submit the information within a reasonable period of time to the SFC.
- 1.10 The SFC may, at any stage of an application, suggest the LC, at its own cost, engage a competent external reviewer to independently assess the LC's readiness and compliance with the requirements specified in these guidelines.
- 1.11 IMA applications should be submitted in writing to the SFC. The application should
- (a) specify the
 - (i) proposed in-scope positions, and
 - (ii) proposed in-scope market risk categories; and
 - (b) be accompanied by a written report of the detailed results of the self-assessment and the information required under 1.9(b).
- 1.12 At this stage, the SFC will not consider application for IMA approval for market risk charges relating to securitization or correlation trading portfolios. Such positions should be treated in accordance with the relevant provisions in the FRR. The SFC will regularly

⁴ Please refer to Section 2 for details.

⁵ Please refer to Section 3 for details.

⁶ Please refer to Section 4 for details.

revisit its position with reference to contemporary circumstances and international trend.

Review and approval by the SFC

1.13 The SFC will consider all relevant circumstances, including but not limited to the following, when reviewing an application:

- (a) the results of the applicant's self-assessment and all information on hand;
- (b) the applicant's abilities to build (where applicable), maintain and improve its IMA models and related systems on an ongoing basis and ensure continuing appropriateness and prudence of its market risk management;
- (c) any approval granted to the applicant's parent or affiliated company for the use of the IMA models or similar models in the calculation of requirements relating to financial resources of that company by an authority, in Hong Kong or elsewhere, which
 - (i) in the opinion of the SFC performs a function which involves the imposition of requirements relating to financial resources of persons carrying on activities similar to any regulated activity for which the applicant is licensed, and
 - (ii) applies standards similar to those set out in these guidelines in its approval;
- (d) the applicant's past FRR compliance record; and
- (e) any other factors that the SFC deems relevant to the application.

1.14 The SFC may counter-propose a scope for the approval that is different from the LC's proposal if it considers that this is prudent and appropriate in the circumstances. If an agreement cannot be reached on the scope of the IMA approval, the SFC may consider rejecting the application.

1.15 For ensuring the General Criteria, Qualitative Standards and Quantitative Standards set out in these guidelines and the MRMGP will be complied with, an applicant may be required to perform initial monitoring and live testing of the performance of its IMA models and related systems over such period of time as may be specified by the SFC in writing.

1.16 An IMA approval shall be subject to such reasonable conditions as the SFC may impose, and the SFC may at any time amend or revoke any such condition or impose new conditions as may be reasonable in the circumstances⁷.

⁷ Section 58(6) of the FRR.

2 General Criteria

2.1 An IM-LC must comply with the following general criteria:

- (a) it shall maintain at all times its tangible capital not less than the amount it is required to maintain under section 5A of the FRR;
- (b) it should maintain sufficient excess liquid capital (ELC) for covering the illiquidity risks referred to in paragraph 2.3 and the risks-not-in-IMA model referred to in paragraph E.5 of Annex E;
- (c) its risk management system is conceptually sound and is implemented with integrity;
- (d) it has satisfied the SFC, and shall satisfy upon request by the SFC, that it has sufficient number of staff in Hong Kong who have adequate product knowledge in the in-scope positions and skills in operating and maintaining the IMA models and any supporting models;
- (e) the IMA models and supporting models have a proven track record of reasonable accuracy in measuring the in-scope market risks;
- (f) it shall regularly conduct stress tests in accordance with the requirements in paragraph 3.9(e) and Annex D; and
- (g) it shall, upon request by the SFC, provide the relevant supporting information evidencing compliance with the requirements in these guidelines.

2.2 In addition to these general criteria, the LC must comply with the Qualitative Standards and Quantitative Standards set out in Sections 3 and 4 respectively, as well as the MRMGP.

2.3 An IM-LC should identify, measure, monitor, manage and report any illiquidity risks arising from in-scope positions that are illiquid, concentrated, or one-way if such risks are not covered or are not adequately covered, by the IMA models. In particular,

- (a) the LC should maintain an inventory of all such illiquidity risks which should at least identify, for each illiquidity risk, the business owner, the risk manager, the risk measurement methodology, and the estimated profit and loss impact;
- (b) the related risk measurement methodology should be adequately documented and subject to independent review; and
- (c) the inventory should be regularly reviewed, challenged and approved by the LC's senior management (or a committee with delegated authority).

3 Qualitative Standards

- 3.1 The valuation methodologies used by an IM-LC's IMA models may differ from those used to calculate trading outcomes. However, the LC's IMA models should provide a reasonably accurate assessment of the risks arising from in-scope positions.
- 3.2 An IM-LC's IMA models should be closely integrated into the LC's daily risk management process. Model outputs should be used in the process of planning, monitoring and controlling the LC's market risk profile. In particular, the models should be used in conjunction with market risk limits. In this regard, limits should be related to the models in a manner that is consistent over time and well-understood by both traders and senior management.

Board and senior management oversight

- 3.3 An IM-LC's board of directors and senior management should actively oversee the risk control process and regard risk control as an essential aspect of the business to which significant resources need to be devoted.
- 3.4 An IM-LC's board may delegate day-to-day market risk management functions and authority to the senior management or management committees. However, the board remains ultimately accountable for the continuing effectiveness of the LC's market risk management system⁸, and should ensure that the committees or personnel with delegated authority have the required expertise, resources and authority, and are subject to proper checks and balances, to enable them to effectively discharge their functions.
- 3.5 An IM-LC's board should ensure that appropriate supervisory and reporting arrangements are in place to allow the LC to have sufficient oversight of all risk management activities and control processes performed by its parent or affiliated company on its behalf.
- 3.6 An IM-LC's board should possess an adequate level of understanding of the LC's trading and market risk management activities and key assumptions and limitations of its IMA models. The board should ensure that there is a sufficient level of competence and expertise on market risk management and the LC's IMA models across different levels and functions.
- 3.7 An IM-LC's board should approve all fundamental aspects of its market risk management system. The IM-LC's senior management (or a committee with delegated authority) should approve all key elements of, and any material changes to, its market risk management system.
- 3.8 An IM-LC's board and senior management (or a committee with delegated authority) should approve and update the LC's risk appetite or tolerance and the associated market risk limits at least annually.

Market risk management framework and controls

⁸ Market risk management system means the methods, models, processes, controls, data collection, and information technology systems used for identifying, measuring, monitoring and managing market risk.

- 3.9 An IM-LC should have an independent risk control unit that is responsible for the design and implementation of its market risk management system and complies with the following minimum requirements.
- (a) This unit should be independent of business trading units and should report directly to senior management of the LC. Furthermore, the unit should be adequately represented on management committees responsible for decisions which may impact market risk profile or activities of the LC.
 - (b) This unit should propose a comprehensive set of market risk limits, which should be aligned with the LC's business goals and risk appetite, for approval by the board and senior management (or a committee with delegated authority). It should review and take appropriate actions on limit excesses according to the LC's market risk policies and procedures.
 - (c) This unit should produce and analyse daily reports on the outputs of the LC's IMA models, including an evaluation of the relationship between measures of risk exposure and trading limits. These daily reports should be reviewed by management with sufficient seniority and authority to enforce both reductions of positions taken by individual traders and reductions of the LC's overall risk exposure.
 - (d) This unit should implement a regular back-testing programme in accordance with Annex A.
 - (e) This unit should perform stress testing on the LC's market risk exposures in accordance with Annex D.
- 3.10 An IM-LC should have an independent control unit that conducts model validation, revalidation and periodic review of the LC's IMA models and any supporting models in accordance with the MRMGP.
- 3.11 An IM-LC should have a policy and a process in place to ensure that every new product is reviewed and approved before the LC engages in trading activities related to the product. In the product review and approval process, the LC should consider any market risk implication, including the use of valuation models, the calibration of model parameters, the introduction of new methodologies for risk measurement, impacts on the LC's risk profile and financial resources adequacy. Furthermore, based on the review, the LC should implement risk control measures on the new product, such as risk limits and trading restrictions in terms of maturities, underlyings, or counterparties.
- 3.12 An IM-LC should have comprehensive product control policy and fair value policy, and establish adequate procedures to ensure compliance with these policies. In particular, the LC should
- (a) have an independent product control unit that reports directly to senior management to ensure these policies are complied with;
 - (b) have reliable processes to explain profit and loss (P&L) arising from its trading, including new trades review, P&L Greeks attribution, P&L analysis and commentary;
 - (c) have adequate systems and controls to generate reliable valuations;
 - (d) keep clear documentation on valuation methodologies and valuation adjustments, including any assumptions made; and
 - (e) perform independent price verification at least on a monthly basis or such higher frequency as the market conditions and the LC's trading activity may call for, with clear

documentation on material price variance or material P&L impact due to price variance.

- 3.13 An IM-LC's market risk management system must be adequately documented. Such documentation should describe the basic principles of the market risk management system and provide an explanation of the empirical techniques used to measure market risk. Moreover, such documentation must be kept up-to-date and should be periodically reviewed and signed off by senior management (or a committee with delegated authority).
- 3.14 An IM-LC should have a robust risk data architecture and information technology infrastructure to support its daily market risk management activities. Specifically, the LC should comply with the following requirements:
- (a) the LC's information technology system should be able to support its use of IMA models and any supporting models;
 - (b) the LC should have a process to ensure the completeness, integrity, accuracy and timeliness of all data fed into its IMA models and any supporting models; and
 - (c) the LC should only employ manual processes in limited situations, provided that effective controls are in place. All manual processes should be fully documented, including an explanation of the appropriateness of the manual workarounds, a description of potential impact on the related market risk management activities, and actions to reduce the potential impact.
- 3.15 An IM-LC should have policies in place to address all aspects of market risk management, including risk identification, measurement, mitigation, and monitoring. These policies should be proposed by the risk control unit and approved by the board and senior management (or a committee with delegated authority). The LC should ensure that these policies are reviewed on a regular basis and any change or exception is approved by the board and senior management (or a committee with delegated authority).
- 3.16 An IM-LC should establish procedures to effectively implement its market risk management policies referred to in paragraph 3.15 and have a systematic process for monitoring and ensuring compliance with these policies and procedures.
- 3.17 An IM-LC should have an established practice of effective management of intra-day trading risk commensurate with the scale, complexity, and frequency of the LC's intra-day trading activities.

Internal audit

- 3.18 An IM-LC should, as part of its regular internal audit activities, conduct independent review of its market risk management processes, at least annually. The scope of the independent review must include both the activities of the business trading units and the activities of the independent control units referred to in paragraphs 3.9 and 3.10. The independent review must be sufficiently detailed to determine which trading desks are impacted by any failing. The reviews should assess, at a minimum:
- (a) the adequacy of the documentation of the market risk management systems and processes;
 - (b) the organisation and function of the independent control units referred to in paragraphs 3.9 and 3.10;

- (c) the integration of market risk measures into daily risk management;
- (d) the approval processes for valuation models and valuation systems used by front- and back-office;
- (e) the validation of any significant change in the risk measurement processes;
- (f) the scope of market risks captured by the IMA models;
- (g) the integrity of the management information system;
- (h) the accuracy and completeness of position data;
- (i) the verification of consistency, timeliness, independency, and reliability of data sources used in the IMA models and any supporting models;
- (j) the accuracy and appropriateness of volatility, correlation and other assumptions applied by the IMA models;
- (k) the accuracy of valuation and risk transformation calculations;
- (l) the effectiveness of back-testing (see paragraph 3.9(d) and Annex A) and model validation (see MRMGP) carried out to verify the model's accuracy; and
- (m) the compliance with relevant internal control processes (including monitoring of market risk, model risk, illiquidity risks and risks-not-in-IMA model) with their respective policies and procedures.

4 Quantitative Standards

Calculation of capital charges

- 4.1 An IM-LC must calculate and include in its ranking liabilities the market risk charge for in-scope market risks as the sum of –
- (a) value-at-risk (VaR) capital charge (VaR capital charge),
 - (b) stressed VaR capital charge (SVaR capital charge), and
 - (c) incremental risk⁹ measure (IRC) capital charge (IRC capital charge).
- 4.2 An IM-LC must calculate its VaR capital charge as the higher of
- (a) the previous trading day's VaR; and
 - (b) the average of the daily VaRs over the preceding 60 trading days, multiplied by a multiplier specified by the SFC in writing.
- 4.3 An IM-LC must calculate its SVaR capital charge as the higher of
- (a) the last available SVaR; and
 - (b) the average of the SVaRs over the preceding 60 trading days, multiplied by a multiplier specified by the SFC in writing.
- 4.4 The SFC may specify different multipliers for calculation of VaR capital charge and SVaR capital charge. In specifying a multiplier, the SFC will apply the following approach
- (a) the multiplier will be subject to an absolute minimum of 3;
 - (b) a plus factor will be added to the multiplier based on the results of Regulatory Back-testing performed in accordance with Annex A; and
 - (c) an additional plus factor may be added to the multiplier based on the SFC's assessment of the LC's fulfilment of the Qualitative Standards set out in Section 3 or other consideration.
- 4.5 An IM-LC must calculate the IRC capital charge by multiplying a scaling factor, which is 1 or such other value specified by the SFC in writing, to the higher of
- (a) the last available IRC; and
 - (b) the average of the IRCs over the preceding 12 weeks.

Specification and treatment of market risk factors

- 4.6 An IM-LC must specify for in-scope market risks falling into each risk category set out in (a) to (e) below an adequate set of market risk factors for incorporation into its IMA models. The granularity of the risk factors should be proportionate to the complexity of the LC's in-scope positions and trading strategies.
- (a) General interest rate risk (detailed requirements in paragraph 4.9)

⁹ Please see paragraph 4.15 for the meaning of incremental risk.

- (b) Specific interest rate risk¹⁰ (detailed requirements in paragraphs 4.13 to 4.15)
 - (c) Foreign exchange risk (detailed requirements in paragraph 4.10)
 - (d) Equity risk, including general equity risk (detailed requirements in paragraph 4.11) and specific equity risk¹¹ (detailed requirements in paragraphs 4.13 to 4.14)
 - (e) Commodity risk (detailed requirements in paragraph 4.12)
- 4.7 An IM-LC should identify, measure, monitor, and manage any part of in-scope market risks that are not included or are not properly included in its VaR or SVaR models in accordance with Annex E.
- 4.8 An IM-LC must incorporate factors that are deemed relevant for pricing of its in-scope positions as market risk factors into its IMA models. Where a market risk factor is incorporated into a valuation model but not in the IMA models, the LC should justify this omission to the satisfaction of the SFC.
- 4.9 For the purpose of modelling general interest rate risk of in-scope market risks falling into general interest rate risk category, an IM-LC must specify interest rate risk factors that comply with the following requirements.
- (a) There must be a set of interest rate risk factors (by currency) corresponding to the interest rates whose movements the LC's in-scope positions are sensitive to.
 - (b) The yield curve should be modelled using a generally accepted approach. The yield curve must be divided into various maturity segments in order to capture variation in the volatility of rates along the yield curve. For material exposures to interest rate movements in major currencies and markets, the LC should model the yield curve using a minimum of six risk factors¹². The number of risk factors used should be driven by the nature and complexity of the LC's in-scope positions and trading strategies.
 - (c) There must be separate risk factors to capture spread or basis risks.
- 4.10 For the purpose of modelling foreign exchange risk of in-scope market risks falling into foreign exchange risk category, an IM-LC must specify risk factors corresponding to each foreign currency (which may include gold) in which the LC's in-scope positions are denominated. Since the liquid capital of the LC is expressed in the LC's reporting currency, any net position denominated in a foreign currency will expose the LC to foreign exchange risk. Thus, there must be risk factors corresponding to the exchange rate between the LC's reporting currency and each foreign currency to which the LC has significant exposure.
- 4.11 For the purpose of modelling general equity risk of in-scope market risks falling into general equity risk category, an IM-LC must specify equity risk factors corresponding to each equity market in which the LC holds in-scope positions. Risk factors based on sector or industry indices may also be considered for general equity risk purpose where appropriate.
- 4.12 For the purpose of modelling commodity risk of in-scope market risks falling into

¹⁰ Specific interest rate risk refers to the risk of losses of portfolio value owing to factors relating to individual issuers of debt securities.

¹¹ Specific equity risk refers to the risk of losses of portfolio value owing to factors relating to individual issuers of equities.

¹² One risk factor typically corresponds to one maturity segment of the yield curve.

commodity risk category, an IM-LC must specify commodities risk factors corresponding to each commodity market in which the LC holds in-scope positions. If the LC has limited positions in commodity-based instruments relative to other in-scope positions, a straightforward specification of risk factors, e.g. one risk factor for each commodity price to which the LC is exposed, would be acceptable.

4.13 An IM-LC must comply with the following requirements in specifying market risk factors for specific risks¹³.

- (a) For the purpose of modelling specific interest rate risk of in-scope market risks falling into specific interest rate risk category, an IM-LC must specify specific interest rate risk factors corresponding to each instrument with debt issuer exposure, including debt securities and debt-related derivatives, in which it holds in-scope positions.
- (b) For the purpose of modelling specific equity risk of in-scope market risks falling into specific equity risk category, an IM-LC must specify specific equity risk factors corresponding to each instrument with equity issuer exposure, including equities and equity-related derivatives, in which it holds in-scope positions.

4.14 An IM-LC should ensure that its modelling of specific risks captures all material components of price risk and is responsive to changes in market conditions and compositions of portfolios. In particular, the model must

- (a) explain the historical price variation in the LC's portfolios;
- (b) be sensitive to the magnitude of and the changes in composition of concentrated positions;
- (c) be robust to an adverse environment;
- (d) capture name-related basis risk;
- (e) capture event risk, namely market risk which arises from events other than market-wide shocks resulting in large changes in prices; and
- (f) be validated through back-testing (see paragraphs A.9 to A.11 in Annex A for back-testing requirements).

4.15 An IM-LC must, for its in-scope positions subject to specific interest rate risk, have sufficient risk factors to adequately capture default and credit migration risks that are incremental to the risks captured by the VaR and SVaR (incremental risks).

4.16 An IM-LC's IMA models must accurately capture risks arising from the non-linear price characteristics of option positions or positions with embedded optionality. The IMA models should capture the sensitivity of market risk exposure to volatility, and if applicable, the volatility should be modelled across both strike and tenor.

4.17 An IM-LC's IMA models must adequately capture risks arising from positions that are sensitive to correlation risk or basis risk (e.g. between credit default swaps and bonds).

4.18 An IM-LC must conservatively assess the risk arising from less liquid positions and positions with limited price transparency under realistic market scenarios.

4.19 An IM-LC may use proxies only when available data are insufficient or are not reflective of the true volatility of a position or portfolio. The LC should ensure that any proxies used

¹³ Specific risks refer to specific interest rate risk or specific equity risk.

have an appropriate track record for their representation of the position.

4.20 An IM-LC may recognise empirical correlations within broad risk factor categories^{14,15} or across broad risk factor categories¹⁶. In either case, the methodology for estimating correlations should be sound and implemented with integrity.

Calculation of VaR, SVaR and IRC

4.21 An IM-LC's calculation of VaR must comply with the following requirements.

- (a) Calculation should be performed daily.
- (b) Apply a 99%, one-tailed confidence level.
- (c) Assume a 10-day holding period.
- (d) Use an effective historical observation period of at least one year, except where a shorter period is required by the SFC or justified by a significant increase in price volatility.
- (e) Update data set at least monthly, with flexibility and capability for more frequent updates.

4.22 An IM-LC's calculation of SVaR must comply with the requirements set out in Annex B.

4.23 An IM-LC's calculation of IRC must comply with the requirements set out in Annex C.

¹⁴ Broad risk factor categories refer to interest rate, foreign exchange, equity, and commodity risk factor categories. Each category includes corresponding volatility risk factors.

¹⁵ An example of recognising empirical correlation within a broad risk category would be between two interest rate risk factors.

¹⁶ An example of recognising empirical correlation across broad risk factor categories would be between one interest rate risk factor and one foreign exchange rate risk factor.

5 Post-approval Requirements

- 5.1 If an IM-LC becomes aware of non-compliance with any requirement in these guidelines or condition set out in the IMA approval letter, the LC must
- (a) Notify the SFC in writing of the non-compliance as soon as reasonably practicable and in any case no later than one business day after becoming aware of the non-compliance;
 - (b) assess the impact of the non-compliance and submit the assessment results to the SFC as soon as reasonably practicable;
 - (c) propose an action plan to remedy the non-compliance and interim compensating measures, and submit the plan in writing to the SFC as soon as reasonably practicable; and
 - (d) implement the interim compensating measures and action plan promptly.
- 5.2 An IM-LC should seek the SFC's prior written consent before making any significant change to its IMA models or to any related model, system, internal control and oversight that may materially impact the accuracy and quality of the outputs of its IMA models.
- 5.3 An IM-LC should submit the inventory of illiquidity risks mentioned in paragraph 2.3(a) to the SFC on a quarterly or such other basis as may be specified in the IMA approval letter.
- 5.4 An IM-LC's Manager-In-Charge for Overall Management Oversight and Manager-In-Charge for Risk Management should each provide, on an annual basis as specified in the IMA approval letter, an attestation that the LC complies with all the applicable requirements in these guidelines and all the conditions in the IMA approval letter during the year.
- 5.5 The SFC may take into account market conditions and other circumstances in its supervision of IM-LCs and take supervisory measures on individual IM-LC according to the LC's circumstances. The supervisory measures may include, but are not limited to, amending the IMA approval (such as raising the multipliers mentioned in paragraph 4.4, excluding any position from in-scope positions, etc), revoking the IMA approval, and taking any other actions proportionate to the risks associated with the LC and its IMA models.
- 5.6 An IM-LC will be required to submit information periodically to the SFC for monitoring purposes. The information required may include the types of reports and information listed in Annex G. Submission frequency is generally on a monthly or quarterly basis, depending on the report nature and subject to changes according to individual circumstances and market conditions. Exact reporting requirements, frequencies and timelines for individual IM-LCs will be determined by the SFC and specified in the letter of approval.

Annex A Back-testing

A.1 An IM-LC should establish a back-testing framework to govern the comparison of its trading outcomes with model-generated risk measures regularly to gauge the accuracy and reliability of its VaR and SVaR models. This annex sets out the requirements for IM-LC's back-testing framework.

A.2 An IM-LC should

- conduct Regulatory Back-testing in accordance with the specification set out in paragraphs A.3 to A.8;
- conduct Specific Risk Back-testing in accordance with the specification set out in paragraphs A.9 to A.11;
- conduct Internal Back-testing in accordance with the specification set out in paragraphs A.12 to A.14; and
- comply with the reporting requirements set out in paragraphs A.16 to A.17.

Regulatory Back-testing requirements

A.3 As mentioned in paragraph 4.4(b), the results of Regulatory Back-testing will inform the determination of multipliers. An IM-LC should conduct Regulatory Back-testing according to the following requirements.

- (a) The trading outcomes used in back-testing should be based on the hypothetical changes in portfolio values which would occur if positions were to remain unchanged over the holding period and exclude fees, commissions, and net interest income (hypothetical P&L).
- (b) The risk metric examined in back-testing should be VaR with a 99%, one-tailed confidence level and a one-day holding period, i.e. calculated in accordance with the requirements in paragraph 4.21 except that the assumed holding period is one day instead of 10 days.
- (c) The back-testing should be conducted on a daily basis using 250 previously observed trading outcomes.

A.4 An IM-LC should count the number of back-testing exceptions¹⁷ in the previous 250 trading days and classify accordingly its results into three zones:

- (a) if back-testing results produce 4 or fewer exceptions, they correspond to the Green Zone;
- (b) if back-testing results produce more than 4 but less than 10 exceptions, they correspond to the Yellow Zone;
- (c) if back-testing results produce 10 exceptions or more, they correspond to the Red Zone.

A.5 If an IM-LC's back-testing results correspond to the Yellow Zone or the Red Zone, it should add a plus factor to the multipliers in its calculation of the market risk charge for

¹⁷ A back-testing exception occurs when an IM-LC's trading outcome exceeds the corresponding VaR.

in-scope market risks according to the following table, unless the SFC requires the LC to apply a different plus factor as a supervisory measure based on the assessment of the LC's back-testing results.

Number of exceptions	Plus factor	Traffic light zone
4 or fewer	0.00	Green
5	0.40	Yellow
6	0.50	
7	0.65	
8	0.75	
9	0.85	
10 or more	1.00	Red

- A.6 When the value of plus factor changes as a consequence of a change in the number of exceptions generated by the daily back-testing, the multipliers should be updated based on the new value of plus factor and applied within one business day after the LC becomes aware of the aforesaid daily back-testing results.
- A.7 An IM-LC should analyse all back-testing results¹⁸. The results of back-testing analysis, along with any follow-up action taken, should be clearly documented and promptly reported to senior management or a committee with delegated authority. Additionally, the LC should categorise back-testing exceptions in a meaningful way, carry out necessary investigative analysis, and take follow-up actions accordingly. For example, back-testing exceptions may be categorised according to causes, such as:
- (a) problem with the design or integrity of the model, e.g. the model does not capture the risk of the positions or volatilities or incorrectly calculates correlations;
 - (b) the model's accuracy could be improved, e.g. the model does not measure the risk of some instruments with sufficient precision;
 - (c) the market moved in a fashion which is not anticipated in the design of the model, e.g. random chance (a very low probability event), markets moved by more than the model predicted was likely (i.e. volatility was significantly higher than expected), and markets did not move together as expected (i.e. correlations were significantly different from what was assumed by the model).
- A.8 An IM-LC should determine the plus factor to be added to a multiplier according to the back-testing results in accordance with paragraph A.5. However, in exceptional situations (such as when the market is undergoing significant stress) it may request for the SFC's written consent to ignore certain back-testing exceptions in the determination of the plus factor on reasonable grounds, for example, if it can demonstrate that its VaR and SVaR models are robust and that the back-testing exceptions in question are caused purely by outliers in market data. In support of such request, the LC should provide evidence to demonstrate an adequate model performance, which may include results of its Internal Back-testing (see paragraphs A.12 to A.14). Until the SFC gives its consent in writing, the LC should continue to apply the plus factor determined in accordance with the back-testing exceptions identified by the Regulatory Back-testing including the exceptions in question.

¹⁸ Such as exceptions, i.e. cases where a trading loss exceeds the corresponding VaR.

Specific Risk Back-testing requirements

- A.9 To assess whether specific risk is accurately captured by its VaR and SVaR models, an IM-LC should perform a separate back-testing on sub-portfolios that have specific risk exposures (Specific Risk Back-testing) to validate any specific risk estimate in the models. If the LC decomposes its in-scope positions into finer categories, it is appropriate to keep these distinctions for Specific Risk Back-testing purposes. The LC should not make changes to the sub-portfolio structure without the SFC's prior written consent.
- A.10 An IM-LC should establish a similar process as Regulatory Back-testing for conducting Specific Risk Back-testing and analysing, investigating, documenting and reporting to senior management exceptions identified. It should apply similar requirements as those set out in paragraphs A.3(b) and A.3(c) and paragraph A.7 to such back-testing. The LC should take immediate corrective actions if any issue in its model or system is identified.
- A.11 There will be a presumption that models that incorporate specific risk are unacceptable if the Specific Risk Back-testing based on 250 trading days produces 10 or more exceptions. An IM-LC with a presumed unacceptable specific risk model should take immediate action to correct the problem in the model and, in the interim, ensure that there is a sufficient amount of excess liquid capital to cover the risk not adequately captured by the model based on the Specific Risk Back-testing results.

Internal Back-testing requirements

- A.12 In addition to Regulatory Back-testing and Specific Risk Back-testing (if applicable), an IM-LC should conduct other back-testings (Internal Back-testing), such as those suggested below, to assess the validity of its VaR model and to monitor its VaR model's ongoing performance:
- (a) back-testing for longer periods¹⁹ (e.g. 3 years) to improve the power of the back-testing;
 - (b) back-testing using VaR with confidence levels other than the 99%, one-tailed confidence level required under Section 4;
 - (c) back-testing at risk factor level or sub-portfolio level;
 - (d) back-testing using specially designed hypothetical portfolios.
- A.13 An IM-LC is required by paragraph 3.17 to manage intra-day trading risk. As part of its management of such risk, it should perform back-testing using actual trading outcomes (actual P&L), i.e. without assuming constant positions over the holding period, as part of its Internal Back-testing. It should implement additional risk measures to monitor its intra-day trading risk and profit and loss impact if significant back-testing exceptions using actual P&L are observed.
- A.14 An IM-LC should establish a similar process as Regulatory Back-testing for conducting Internal Back-testing and analysing, investigating, documenting and reporting to senior management exceptions identified. It should apply similar requirements as those set out in paragraphs A.3(b) and A.3(c) and paragraph A.7 to such back-testing. The LC should take immediate corrective actions if any issue in its model or system is identified.

¹⁹ The IMA LC should consider the VaR model and market condition when selecting the length of back-testing period.

Supervisory measures for unsatisfactory back-testing results

A.15 If the SFC deems the back-testing results of an IM-LC unsatisfactory, it may take additional supervisory measures, for example, requesting more in-depth analyses of the back-testing exceptions, requiring the LC to improve its VaR and SVaR models, amending the IMA approval (such as raising the multipliers mentioned in paragraph 4.4, excluding any position from in-scope positions, etc), and taking any other actions proportionate to the risks associated with the LC and its VaR and SVaR models. In severe cases, the SFC may revoke the IMA approval.

Reporting requirements

A.16 An IM-LC must

- (a) notify the SFC of any back-testing exception of Regulatory Back-testing as soon as reasonably practicable, and in any event within one business day of becoming aware of the exception;
- (b) submit to the SFC an analysis of the back-testing exception referred to in subparagraph (a) and details of any follow-up action taken or planned within one month of the exception's occurrence; and
- (c) on a quarterly or such other basis as the SFC may require in writing, submit to the SFC a periodic report of its back-testing results analysis for Regulatory Back-testing, Specific Risk Back-testing and Internal Back-testing, including, at minimum, a summary of all back-testing exceptions identified during the period with explanation of the exceptions and follow-up actions taken, and trends of back-testing components (i.e. VaR, actual P&L and hypothetical P&L) during the period.

A.17 An IM-LC must submit to the SFC an analysis of any issue (including deficiencies) in its model or system identified by back-testing or otherwise and follow-up action taken or planned within one month of becoming aware of the issue, unless the same has been reported under A.16.

Annex B Calculation of SVaR

- B.1 The SVaR should deliver a capital charge based on a measure of VaR that would be applicable to an IM-LC's current in-scope market risks in a period of stress relevant to that portfolio. As such, the identification of the period of stress as well as the methodological consistency between VaR and SVaR are of particular importance. SVaR model is considered as a separate model for the purpose of these guidelines. This annex describes key points of consideration and sets out the SFC's expectation.
- B.2 An IM-LC's calculation of SVaR is subject to the following requirements.
- (a) Calculation should be performed at least weekly.
 - (b) Apply a 99%, one-tailed confidence level.
 - (c) Assume a 10-day holding period.
 - (d) Use a continuous 12-month period of significant financial stress relevant to the LC's in-scope market risks without weighting of historical data.
 - (e) Update data set at least monthly with flexibility and capability for more frequent updates.

Identification of stressed period

- B.3 An IM-LC should develop a methodology for identifying a 12-month stressed period relevant to its in-scope market risks. Such a methodology should not merely select the period of highest market volatility but to select a historical period that would lead to a conservative capital charge.
- B.4 An IM-LC should clearly document and consistently apply the methodology referred to in paragraph B.3. The documentation should provide motivation for and justify the use of any simplification, approximation, or expert judgement in the identification of the stressed period. Furthermore, the LC should maintain documented evidence for demonstrating the relevance of the selected stressed period to its current in-scope market risks.
- B.5 An IM-LC should establish a process to ensure, on an ongoing basis, that the selected stressed period remains relevant, including when market conditions or portfolio compositions have been subject to significant changes. The LC should review the relevance of its stressed period at least annually.
- B.6 An IM-LC should not make any change to the methodology referred to in paragraph B.3 unless it has the written consent of the SFC (i.e. any change to such a methodology is considered significant and hence subject to the SFC's written consent as per paragraph 5.2). In addition, the LC should seek the SFC's prior written consent before any change to the chosen stressed period is made based on the results of the monitoring and review process referred to in paragraph B.5 (i.e. without a methodology change).

Consistency with VaR methodology

- B.7 An IM-LC's SVaR calculation should be based on its VaR model, with specific adjustments when necessary. In particular, the LC should incorporate any risk factor included in the VaR calculation in the SVaR calculation.

- B.8 An IM-LC's SVaR calculation may diverge from its VaR calculation due to different modelling techniques between the two methodologies. For example,
- (a) the SVaR calculation should be calibrated to the 12-month stressed period on an unweighted basis, whether or not the VaR calculation employs a weighting scheme for the historical observation period;
 - (b) the SVaR calculation may involve use of proxies additional to those used in the VaR calculation; and
 - (c) the revaluation approach or configuration used in the SVaR calculation may employ techniques different than those used in the VaR calculation to appropriately capture wider shocks in risk factors that typically occur under stress scenarios.

Validation of the SVaR model

- B.9 An IM-LC should validate its SVaR model separately from its VaR model in accordance with the requirements in MRMGP. The validation should independently evaluate the methodology for selecting the stressed period. Moreover, the validation should not be based on the presumption that techniques employed and validated in the VaR model would be valid for the calculation of SVaR without further assessment.

Annex C Calculation of IRC

- C.1 An IM-LC's IRC model should capture and adequately reflect, on a continuing basis, the default risk²⁰ and credit migration risk²¹ inherent in the LC's in-scope positions that are not already captured in its VaR calculations. This annex provides general guidelines on the calculation of IRC.
- C.2 An IM-LC's calculation of IRC should be performed at least weekly and is subject to the following requirements.

Positions and risks covered by IRC

- C.3 An IM-LC should include in its IRC calculation all in-scope positions that have specific interest rate risk as their in-scope market risk (IRC-covered positions) regardless of their perceived liquidity.
- C.4 Subject to the SFC's approval, an IM-LC can choose consistently to include all listed equity and listed equity-based derivative positions of a trading desk in its IRC model if such positions are included in the LC's internal measurement and management of incremental risk at the trading desk level. Alternatively, the SFC may request the LC to include all or part of listed equity and listed equity-based derivative positions of a trading desk in its IRC model. If positions in a listed equity are included in the computation of IRC, default is deemed to occur if the related debt defaults.
- C.5 For IRC-covered positions, the IRC captures
- (a) default risk, which means the risk of direct loss due to an obligor's default as well as the risk of indirect loss that may arise from a default event; and
 - (b) credit migration risk, which means the risk of direct loss due to an internal/external rating downgrade or upgrade as well as the risk of indirect loss that may arise from a credit migration event.

IRC soundness standard

- C.6 For all IRC-covered positions, an IM-LC's IRC model should measure losses due to default and credit migration at the 99.9%, one tailed confidence level over a capital horizon of one year, taking into account the liquidity horizons applicable to individual trading positions or sets of positions. The LC should include losses caused by broader market-wide events affecting multiple issues or issuers in its model.
- C.7 For each IRC-covered position, an IM-LC's IRC model should also capture the impact of rebalancing positions at the end of their liquidity horizons so as to achieve a constant level of risk over a one-year capital horizon. The model may incorporate correlation effects among the modelled risk factors, subject to standards set forth in paragraph C.16.
- C.8 An IM-LC should develop internal modelling benchmarks to assess the overall accuracy of its IRC model.

²⁰ See paragraph C.5(a) for the meaning of default risk.

²¹ See paragraph C.5(b) for the meaning of credit migration risk.

Constant level of risk over one-year capital horizon

- C.9 An IM-LC's IRC model should be based on the assumption of a constant level of risk over the one-year capital horizon. In other words, the LC is assumed to rebalance, or roll over, its trading positions over the one-year capital horizon in a manner that maintains the initial risk level, as indicated by a metric such as VaR or the profile of exposure by credit rating and concentration. This also means incorporating the effect of replacing positions whose credit characteristics have improved or deteriorated over the liquidity horizon with positions that have risk characteristics equivalent to those that the original position had at the start of the liquidity horizon. The frequency of the assumed rebalancing must be governed by the liquidity horizon for a given position.
- C.10 Rebalancing positions does not imply that the same positions will be maintained throughout the capital horizon. However, an IM-LC may elect to use a one-year constant position assumption, as long as it does so consistently across all portfolios.

Liquidity horizon

- C.11 An IM-LC should pay particular attention to the appropriate liquidity horizon assumptions within its IRC model. The liquidity horizon represents the time required to sell the position or to hedge all material risks covered by the IRC model in a stressed market. The liquidity horizon should be measured under conservative assumptions and should be sufficiently long that the act of selling or hedging, in itself, does not materially affect market prices. The determination of the appropriate liquidity horizon for a position or set of positions may take into account the LC's internal policies relating to, for example, prudent valuation, valuation adjustments and the management of stale positions. Liquidity horizons should also reflect actual practice and experience during periods of both systematic and idiosyncratic stresses.
- C.12 An IM-LC must apply a floor of three months on the liquidity horizon for a position or a set of positions. In general, within a given product type a non-investment-grade position is expected to have a longer assumed liquidity horizon than an investment-grade position. Conservative assumptions regarding the liquidity horizon for non-investment-grade positions are warranted until further evidence is gained regarding the market's liquidity during systematic and idiosyncratic stress situations. The LC also needs to apply conservative liquidity horizon assumptions for products (regardless of rating) where secondary market liquidity is not deep, particularly during periods of financial market volatility and investor risk aversion. The application of prudent liquidity assumptions is particularly important for rapidly growing product classes that have not been tested in a downturn.
- C.13 An IM-LC may assess liquidity by position or on an aggregated basis ("buckets"). If an aggregated basis is used, the aggregation criteria should be defined in a way that meaningfully reflects differences in liquidity.
- C.14 An IM-LC should specify a longer liquidity horizon for positions that are concentrated, reflecting the longer period needed to liquidate such positions. This longer liquidity horizon for concentrated positions is necessary to provide adequate capital against two types of concentration: issuer concentration and market concentration (please also see paragraph C.18).

Correlations and diversification

- C.15 Economic and financial dependence among obligors causes a clustering of default and credit migration events. The IRC should cover the impact of correlations between default and credit migration events among obligors. Accordingly, an IM-LC's IRC model must include the impact of such clustering of default and credit migration events.
- C.16 An IM-LC should ensure that its modelling approach for correlations is appropriate for its portfolios, including the choice and weights of the systematic risk factors applied. Correlation assumptions must be supported by an analysis of objective data in a conceptually sound framework. If the LC uses a multi-period model to compute incremental risk, it should evaluate the implied annual correlations to ensure they are reasonable and in line with observed annual correlations.
- C.17 The impact of diversification between default or credit migration events and other market variables should not be reflected in IRC calculation.

Concentration

- C.18 An IM-LC's IRC model should appropriately reflect issuer and market concentrations. Thus, other things being equal, a concentrated portfolio should attract a higher capital charge than a more granular portfolio (see also paragraph C.14). Concentrations that can arise within and across product classes under stressed conditions must also be reflected.

Risk mitigation, diversification effects and basis risks

- C.19 An IM-LC may net the exposure amounts within the IRC model only when long and short positions refer to the same financial instrument. Otherwise, the LC should capture exposure amounts on a gross (i.e. non-netted) basis. Hedging or diversification effects associated with long and short positions involving different instruments or different securities of the same obligor ("intra-obligor hedges"), as well as associated with long and short positions in different issuers ("inter-obligor hedges"), may not be recognised through netting of exposure amounts. The LC may only recognise such effects by capturing and modelling separately the gross long and short positions in the different instruments or securities.
- C.20 An IM-LC should reflect significant basis risks by product, seniority in the capital structure, internal or external rating, maturity, vintage for offsetting positions as well as differences between offsetting instruments, such as different payout triggers and procedures in the IRC model.
- C.21 An IM-LC should include in its IRC model, where material, the impact of potential risks that could occur during the interval between the maturity of an instrument and the liquidity horizon if the instrument has a shorter maturity than the liquidity horizon or if a maturity longer than the liquidity horizon is not contractually assured.
- C.22 An IM-LC may recognise in its IRC model rebalancing of hedges within the liquidity horizon of the hedged positions that are typically hedged via dynamic hedging strategies if it
- (a) chooses to model rebalancing of the hedge consistently;

- (b) demonstrates that the inclusion of rebalancing results in a better risk measurement; and
 - (c) demonstrates that the markets for the hedging instruments are liquid enough to allow for this kind of rebalancing even during periods of stress.
- C.23 An IM-LC should reflect residual risks resulting from the dynamic hedging strategies referred to in paragraph C.22 in the quantification of IRC. The LC should validate its approach to capturing such residual risks to the satisfaction of the SFC.
- C.24 An IM-LC's IRC model should take into account objective data over the liquidity horizon of in-scope positions and include comparison of risk estimates for a rebalanced portfolio with that of a portfolio with fixed positions.

Optionality

- C.25 An IM-LC must reflect the impact of optionality in its IRC model. The LC's model should include the non-linear impact of options and other positions with material non-linear behaviour with respect to underlying price changes. The LC should also have due regard to the amount of model risk inherent in the valuation and estimation of price risks associated with such products.

Validation

- C.26 IRC model must be subject to ongoing model validation with reference to all the standards set out in these guidelines and the IM-LC should justify the soundness of its validation procedures to the satisfaction of the SFC. An IM-LC should comply with the validation requirements set out in MRMGP in validating its IRC model. The validation of an IRC model should include making use of stress testing, sensitivity analyses and scenario analyses to assess its qualitative and quantitative reasonableness, particularly with regard to the model's treatment of concentrations. Given the nature of the IRC soundness standard, such tests must not be limited to the range of events experienced historically.

Use Test

- C.27 This annex does not prescribe any specific modelling approach for capturing incremental risk. The modelling approach employed by an IM-LC is subject to the "use test", i.e. the modelling approach should be consistent with the LC's internal risk management methodologies for identifying, measuring, and managing default and credit migration risks. If an IM-LC's modelling approach does not meet one or more requirements for an IRC model set out in the previous paragraphs in this annex, the LC should demonstrate that the IRC calculated by its modelling approach would be at least as prudent as the IRC produced by an IRC model that fully complies with the requirements in this annex.

Annex D Stress Testing

- D.1 An IM-LC must establish and maintain a rigorous and comprehensive stress testing programme which is commensurate with the size and complexity of its business and overall level of risk exposure. The programme should provide a complementary and independent risk perspective to IMA-based market risk charge. This annex sets out the general principles governing the LC's implementation of its stress testing programme.

Stress testing as a risk management tool

- D.2 An IM-LC should implement a stress testing programme as an integral part of the overall governance and risk management framework.
- D.3 An IM-LC's stress testing programme should incorporate both market risk and liquidity aspects of market disturbances and be able to:
- (a) identify and apply plausible stress scenarios to which the LC could be exposed;
 - (b) evaluate the capacity of the LC's capital to absorb potential large losses; and
 - (c) identify steps the LC can take to reduce its risk and conserve capital.
- D.4 An IM-LC should document the approach it takes in identifying stress scenarios, carrying out the stress testing and analysing the stress test results.
- D.5 An IM-LC should perform stress tests at least monthly.
- D.6 An IM-LC's stress test results must be reviewed at least monthly by senior management (or a committee with delegated authority). An IM-LC must take into account the stress test results in its decision making at the appropriate senior management level under both stressed and normal business conditions, including policy and limit setting.
- D.7 In addition, an IM-LC's stress test results must be used in:
- (a) the LC's internal assessment of capital adequacy; and
 - (b) monitoring new products where no historical data is available.
- D.8 An IM-LC must use its stress test results as a basis for identifying vulnerabilities in its portfolios. If the stress test results reveal particular vulnerability to a given set of circumstances, the LC should take prompt steps to manage those risks appropriately (e.g. by hedging against that outcome or reducing the size of its exposures).
- D.9 In addition, an IM-LC should compare the five largest daily losses experienced during the past 250 trading days, computed on a rolling basis, with the corresponding VaRs calculated based on the outputs of the IMA models. The comparison results should be analysed, which should include quantifying any large loss that exceeds the VaR, and the number of days of the observed peak losses that have been covered by the corresponding VaRs. Proper record should be maintained for such analyses.

Stress scenario design

- D.10 The stress scenarios used in an IM-LC's stress testing programme must cover factors that can lead to extraordinary losses or gains in the LC's portfolios or make the control

of risk in those portfolios very difficult. These factors include low-probability events in all major types of risk.

- D.11 An IM-LC should design stress scenarios which it identifies as most adverse, taking into account the characteristics (including both linear and non-linear price characteristics) of its portfolios. Specifically, in designing stress scenarios, the LC should factor in illiquidity, gapping of prices, concentrated positions in relation to market turnover, one-way markets, non-linear products, deep out-of-the-money positions, jump-to-default events, significant shifts in correlation and other risks that may not be captured adequately in IMA models (e.g. recovery rate uncertainty, implied correlations, or skew risk). The shocks applied must reflect the nature of the portfolios and the time it could take to hedge out or manage risks under severe market conditions.
- D.12 In addition, an IM-LC should stress test its portfolios with past periods of significant disturbance (for example, 1997/1998 Asian Financial Crisis, the 2008 Global Financial Crisis, the 2011/2012 Euro zone crisis, and the 2020 COVID-19 pandemic), incorporating both the large price movements and the rapid drop in liquidity associated with these events.
- D.13 An IM-LC should also evaluate its portfolios' sensitivity to changes in the assumptions about volatilities and correlations. Applying this type of stress test would require an evaluation of the historical range of variation for volatilities and correlations and evaluation of the LC's current in-scope positions against the extreme values of the historical range.
- D.14 An IM-LC should also have the capability to perform ad-hoc stress testing in response to emerging risk issues, such as expectation of recession or geo-political conflicts.

Annex E Risks-not-in-IMA model

- E.1 An IM-LC is required by paragraph 4.6 to apply an adequate set of risk factors in its IMA models. However, certain market risks relating to in-scope positions may be excluded from or may not be properly measured by the LC's VaR or SVaR models due to practical reasons. Such risks are referred to as risks-not-in-VaR (RNIV) and risks-not-in-SVaR (RNISV) respectively (collectively, risks-not-in-IMA model (RNIM)) in these guidelines. This annex sets out the required treatments for these risks, including their quantification and the IM-LC's approach to addressing the potential impact of such risks on its liquid capital.
- E.2 An IM-LC should systematically identify, measure and document any RNIM and justify its exclusion from its VaR and SVaR models. The LC should review the appropriateness of the exclusion at least quarterly. The LC should improve its VaR and SVaR models to include these risks where practicable.
- E.3 An IM-LC should monitor RNIM individually and in aggregate and prudently manage RNIM.
- E.4 An IM-LC should measure RNIV and RNISV on a standalone basis at least on a monthly basis, in an appropriate way according to the following principles.
- (a) The measurement of RNIM should make use of observable market data where this is appropriate and practicable.
 - (b) If relevant observable market data are available, the LC may quantify RNIV and RNISV using statistical measures reflecting a loss at a 99% one-tailed confidence level with a 10-day holding period. The stressed period used for measuring RNISV should be the same as the period used for calibrating the SVaR model.
 - (c) If observable market data are not available or the statistical measures specified in subparagraph (b) are not appropriate measures for a RNIV or RNISV, other appropriate approach should be used to quantify the risk (such RNIV and RNISV are referred to as "Residual RNIV" and "Residual RNISV" respectively and collectively, "Residual RNIM"). The measurement should at least be equal to the highest of the losses projected by stress tests conducted on stress scenarios which are applicable to the risk factor and take into account the liquidity of the risk factor. If the measurement of Residual RNIM makes use of approximations or expert judgments, the basis should be adequately justified and documented.
 - (d) The measurement methodologies of RNIM (other than those that cannot be classified as models) should be independently validated on an ongoing basis according to the requirements in MRMGP.
- E.5 Although the market risk charges set out in paragraph 4.1 do not include a market risk charge for RNIM, an IM-LC should monitor the potential impacts of RNIM on its excess liquid capital, which should be calculated in accordance with subparagraphs (a), (b) and (c) below, and be prepared to cover such risks with its own funds²²:
- (a) RNIV potential ELC impact, which is calculated as the multiplier used in the calculation of VaR capital charge under paragraph 4.4, multiplied by the higher of
 - (i) the average of the measurements of RNIV, other than Residual RNIM, quantified in accordance with paragraph E.4(b) in the preceding three

²² Such as share capital or subordinated loans.

- calendar months; and
 - (ii) the latest measurement of RNIV, other than Residual RNIM, quantified in accordance with paragraph E.4(b);
 - (b) RNISV potential ELC impact, which is calculated as the multiplier used in the calculation of SVaR capital charge under paragraph 4.4, multiplied by the higher of
 - (i) the average of the measurements of RNISV, other than Residual RNIM, quantified in accordance with paragraph E.4(b) in the preceding three calendar months; and
 - (ii) the latest measurement of RNISV, other than Residual RNIM, quantified in accordance with paragraph E.4(b); and
 - (c) Residual RNIM potential ELC impact, which is calculated as the higher of
 - (i) the average of the measurements of Residual RNIM in the preceding three calendar months; and
 - (ii) the latest measurement of Residual RNIM.
- E.6 The SFC may by notice in writing require an IM-LC to maintain at all times an ELC which is not less than the sum of the IM-LC's RNIV potential ELC impact, RNISV potential ELC impact and Residual RNIM potential ELC impact.

Reporting requirements

- E.7 An IM-LC should report in writing on its RNIM to its senior management (or a committee with delegated authority) at least quarterly or on such other basis as the SFC may require in writing. The report should include the potential ELC impacts of RNIM calculated in accordance with paragraph E.5 and the progress of any improvement made or being made to the LC's IMA models to cover RNIM. The LC must submit a copy of the report to the SFC at the same time.

Annex F Information Request List for Internal Models Approach for FRR Market Risk Charges Calculation

Submission instructions

A Licensed Corporation (LC) applying to the Securities and Futures Commission (the SFC) for approval to use internal models approach for market risk (IMA) is required to

- (a) carry out an assessment of its readiness to comply with the requirements set out in the SFC's Guidelines for Internal Models Approach for FRR Market Risk Charges Calculation (IMA Guidelines) and the requirements set out in the General Principles for Model Risk Management (MRMGP) (self-assessment). The self-assessment must be tailored to the circumstances of the LC and conducted against each relevant requirement in the IMA Guidelines and MRMGP. The assessment must clearly identify areas of potential non-compliance and outline the nature, materiality, and planned remediation of the issues. The results of the self-assessment must be adequately supported by evidence and discussions; and
- (b) provide the information requested in paragraphs F.1 to F.11.

When preparing the self-assessment report and responding to the information requested, the LC should note the following:

- (a) The self-assessment report should be self-contained, although cross references may be made to the information or documents submitted to avoid duplication.
- (b) When providing or discussing policies, procedures, and methodologies in the submission, please explain the associated governance controls and provide the latest relevant committee meeting minutes (where applicable).
- (c) Information provided should, where applicable, be the same as that used in the LC's day-to-day risk management or reporting to management. If any information has been specially prepared or modified for meeting the information request, please indicate clearly in the submission.

The submissions of the self-assessment and information request should be accompanied by the following attestation, which must be jointly signed by the LC's Manager-In-Charge for Overall Management Oversight and Manager-In-Charge for Risk Management:

"We confirm that in relation to [names of the internal market risk measurement models the LC is seeking SFC approval], [the LC's name] has carried out a comprehensive self-assessment of its compliance with the SFC's Guidelines for Internal Models Approach for FRR Market Risk Charges Calculation (IMA Guidelines) and the General Principles for Model Risk Management (MRMGP) and provided the information requested by the SFC in this relation.

*Based on the self-assessment, we confirm to the best of our knowledge and understanding that [there is no evidence of any aspect of the aforesaid models or the controls of [the LC's name] is materially non-compliant with the IMA Guidelines or MRMGP.] / [[the LC's name] has reported all identified areas of non-compliance with the IMA Guidelines and MRMGP in this submission and there is no evidence of any other aspect of the aforesaid models or the controls of [the LC's name] is materially non-compliant with the IMA Guidelines or MRMGP.]**

We further confirm that to the best of our knowledge and understanding, information provided in this submission is complete and accurate."

*** Please choose the applicable attestation statement**

List of abbreviations

IMA	Internal models approach for market risk
IMA Guidelines	Guidelines for Internal Models Approach for FRR Market Risk Charges Calculation
IMA models	Internal market risk measurement models
IPV	Independent price verification
IRC	Incremental risk measure
KPI	Key performance indicator
P&L	Profit and loss
VaR	Value-at-risk
SVaR	Stressed value-at-risk

Information request for IMA approval application

The information requested aims to help the SFC to understand the methodologies used by the LC to measure market risk and calculate market risk charges, as well as the business, systems and control environment for or within which these methodologies are used.

The LC should respond to each of the requests set out in paragraphs F.1 to F.11 below. In addition, the LC should provide a high level summary of the responses under each of those paragraphs to facilitate the SFC's review.

The information requests listed below are not intended to be exhaustive. LCs are encouraged to provide additional information about their business and governance that they believe would facilitate the SFC's understanding. The SFC may vary the information requests for individual LC as it thinks fit.

F.1 Business context

- F.1.1 Provide an overview of the business case for the use of IMA models in liquid capital calculation. Provide a list of the business units to be covered in the scope of the IMA application (proposed in-scope business units). Provide a summary of business or trading activities conducted by each proposed in-scope business units and the associated market risk management practices.
- F.1.2 If the LC is a subsidiary in a group subject to matrix management, describe how the LC meets the qualitative standards set out in Section 3 of the IMA Guidelines on a legal entity basis.
- F.1.3 Provide the components of the market risk charge for the proposed in-scope market risks²³ (e.g. VaR, SVaR, IRC and multipliers) both in aggregate and at the lowest possible business level, such as by business line or trading desk.
- F.1.4 Describe the use of the models by the LC. If the models are also used by any of the LC's group companies, describe any dependency or relationship between the LC and the group company in their uses of the models. Provide a list of approvals, if any, granted by other regulators on the IMA models specifying the scope of each approval.
- F.1.5 Provide an organisational chart of each proposed in-scope business unit with necessary information for understanding the roles, responsibilities, geographical locations, and reporting lines of front-office staff. Any part-time, temporary, contract, outsourced or offshore (i.e. located outside Hong Kong) staff should be clearly identified. Describe internal governance process for outsourced or offshore staff. Describe the basis on which the LC satisfies itself on the adequacy, technical skills, and practical experiences of the staff operating the business unit. Provide profiles of each key staff member.
- F.1.6 Describe any key process integral to business and trading activities that is outsourced or carried out outside Hong Kong and the monitoring of performance of such process performed by the LC. Provide samples of management information reports received for such purpose.
- F.1.7 For each business conducted by a proposed in-scope business unit, provide a summary of
 - (a) its business strategy;

²³ An LC's proposed in-scope market risk is the market risk arising from its intended positions that fall within the scope of its IMA application.

- (b) the products traded, related trading and hedging strategies and risk appetite; and
- (c) its P&L budget and past 3 years' performance, revenue and return on equity.

Additional information that is necessary for explaining the business's nature, operation, performance and risks should also be provided.

- F.1.8 Provide a list of top 20 clients (by revenue generation) of each proposed in-scope business unit.
- F.1.9 For any products which are excluded from the positions proposed to be covered by the scope of IMA application (proposed in-scope positions), provide an overview of the positions in such products, the risk management strategy for such products, and reason for excluding these positions.
- F.1.10 Provide an outline of major changes to the businesses conducted by the proposed in-scope business units, booking model or any other areas covered by paragraphs F.1 to F.11 that have been planned or are being introduced, together with a timetable.
- F.1.11 Provide a list of significant projects under consideration that are relevant to this application, such as any project on implementation of the latest Basel capital standards. For each project, briefly describe the project scope, business rationale, timeline, and dedicated resources.

F.2 IMA models

- F.2.1 Provide an organisational chart of teams involved in the development, testing, and implementation of the IMA models with necessary information for understanding the roles, responsibilities, geographical locations and reporting lines of the staff. Any part-time, temporary, or contract, outsourced or offshore staff should be clearly identified. Describe internal governance process for outsourced or offshore staff. Describe the basis on which the LC satisfies itself on the adequacy, technical skills, and practical experiences of the aforementioned staff. Provide profiles of each key staff member.
- F.2.2 Describe any key process relating to IMA models that is outsourced or carried out outside Hong Kong and the monitoring of performance of such activities performed by the LC. Provide samples of management information reports received for such purpose.
- F.2.3 Describe the governance of the development, implementation, and approval of IMA models for market risk charge calculation purposes.
- F.2.4 Describe the scope of IMA application. If the proposed in-scope positions are subject to interest rate specific risk, which would require the LC to comply with the IRC requirements, indicate whether listed equity positions and listed equity-based derivative positions are included in the IRC, and explain the basis for any such inclusion.
- F.2.5 Describe the risk factors captured by the IMA models and indicate their relationship to the risk categories set out in paragraph 4.6 of the IMA Guidelines. Indicate the materiality of existing or expected positions per risk factor (e.g. in terms of position size, VaR or other risk measures, and stress loss contribution).
- F.2.6 Provide the product documentation of each product contained in the IMA application, which should, at a minimum, explain the product's risk characteristics (e.g. path dependency), key risk factors the product is sensitive to, and valuation models used for the product. Demonstrate how the LC ensures compliance with paragraph 4.8 of the IMA Guidelines.

- F.2.7 Provide documentation demonstrating the methodologies for calculating VaR and stressed VaR comply with paragraphs 4.21 and B.2 of the IMA Guidelines. Provide documentation relating to the identification of stress period by the LC and demonstrate how it complies with Annex B of the IMA Guidelines.
- F.2.8 Provide IMA models documentation detailing
- (a) model assumptions, including statistical assumptions, of the individual and joint behaviours of modelled risk factors; and
 - (b) modelling methodologies employed for each risk factor, such as curve and surface constructions, interpolation and extrapolation, data proxy and backfilling, commodity seasonality adjustment and scenario generation.
- The documentation should include assessment and demonstration of the appropriateness of such assumptions and methodologies. It should also indicate how the appropriateness is assessed and demonstrated on an ongoing basis.
- F.2.9 Provide documentation detailing the valuation methods used in the IMA models. The valuation methods should be benchmarked against a full revaluation approach (i.e. applying the valuation model to the jointly shifted risk factors in any given scenario) to demonstrate that these methods are sufficiently reliable and accurate. The documentation should also indicate how their reliability and accuracy are assessed and demonstrated on an ongoing basis.
- F.2.10 Provide a summary of any material discrepancies between the valuation generated by the valuation models used for risk measurement and official valuation of the proposed in-scope positions in the past 12 months. The LC should explain any criteria or thresholds used to identify and assess material discrepancies, if applicable.
- F.2.11 Provide policies, processes and controls on trade bookings that do not reflect the contractual terms of the trades (e.g. approximately booked trades) in the IMA models. Explain how the additional uncertainty resulting from the use of such trade bookings is measured and monitored.
- F.2.12 Provide information on the quality of historical data and describe the treatment and the materiality of proxy market data. This may include a description of
- (a) data sources and policies, processes and controls relating to data sourcing;
 - (b) policies, processes and controls relating to verification and updating of data;
 - (c) policies, processes and controls relating to data cleansing;
 - (d) data filling techniques; and
 - (e) other policies, processes and control relating to proxy market data (including the selection of proxy market data).
- Explain how the additional uncertainty resulting from the use of proxy market data is measured and monitored.
- F.2.13 Provide a complete list of risks which are excluded from or may not be properly measured by the LC's VaR or SVaR models. The list should include the nature and materiality of such risks and the approach to identify, measure, monitor, and manage these risks in accordance with paragraph 4.7 and Annex E of the IMA Guidelines.

- F.2.14 Provide documentation of the regular process²⁴ undertaken by the LC to ensure its IMA models provide a reasonably accurate assessment of the risks of proposed in-scope positions, in addition to its back-testing and model validation processes. The documentation should contain details of the assessment methodology, including key assumptions. Provide a sample report as evidence of performance of such process.
- F.2.15 Provide an assessment of risks arising from less liquid positions. Explain how these risks are capitalised by the LC's IMA models and demonstrate compliance with paragraph 4.18 of the IMA Guidelines.
- F.2.16 If specific risk is covered by the LC's IMA application, the documentation requested in paragraphs F.1 and F.2 should cover the specific risk model components, including the IRC model, if applicable.
- F.2.17 If the LC uses alternative risk measures for risk management purposes, explain to what extent these measures meet the requirements set out in the IMA Guidelines, compare them with the regulatory market risk measures and explain any differences, and explain the reason for choosing the alternative risk measures.

F.3 Model validation

- F.3.1 Provide policy and procedure documents relating to the testing and validation of valuation models and IMA models.
- F.3.2 Provide an organisational chart of the teams involved in the testing and validation of valuation models and IMA models with necessary information for understanding the roles, responsibilities, geographical locations, and reporting lines of the staff. Any part-time, temporary, or contract, outsourced or offshore staff should be clearly identified. Describe internal governance process for outsourced or offshore staff. Describe the basis on which the LC satisfies itself on the adequacy, technical skills, and practical experiences of the aforementioned staff. Provide profiles of each key staff member.
- F.3.3 Describe any key process relating to model validation that is outsourced or carried out outside Hong Kong and the monitoring of performance of such activities performed by the LC. In particular, provide a summary of the extent to which testing and validation of valuation models and IMA models are outsourced or carried out by offshore staff. Provide samples of management information received for monitoring of performance of such activities.
- F.3.4 Provide policy and procedures documents relating to the governance of the life cycle of valuation models and IMA models.
- F.3.5 Provide a description of systems and processes for recording and monitoring the testing and validation of valuation models and IMA models.
- F.3.6 Provide a product inventory covering all in-scope products and internal definition of each product in the inventory. Provide sample term sheets of those major products (if applicable) that contribute the most to the market risk for the proposed in-scope market risks.

²⁴ For example, the process may involve comparing the P&L time series generated by valuation methods used by the IMA models with the hypothetical P&L time series, or conducting statistical tests of these time series, to ensure accuracy and reliability of its IMA models.

- F.3.7 Provide a model inventory covering all models within the scope of the IMA application, including valuation models, IMA models and supporting models, detailing each model's validation status, date of last review and model risk rating (if applicable).
- F.3.8 Provide a detailed product and valuation model inventory report as of the most recent month-end date, including the trade count, trade notional, market risk exposures, model approval status for each valuation model.
- F.3.9 Provide documentation produced by model development and validation teams for a sample of the valuation models covered in paragraph F.3.7. The sample should be selected based on the greatest materiality in terms of model uncertainty and risk and P&L expected to arise from the products covered by the sampled model. The sampled model may be different to the model covering the products on which term sheets are provided under paragraph F.3.6.
- F.3.10 Provide a complete set of the latest validation reports of the IMA models.
- F.3.11 Provide samples of reports used for managing and monitoring model risk of valuation models and IMA models.

F.4 Model implementation and use of model outputs

- F.4.1 Provide an organisational chart of the teams responsible for producing and maintaining the internal market risk measures for individual model components with necessary information for understanding the roles, responsibilities, geographical locations, and reporting lines of the staff. Any part-time, temporary, or contract, outsourced or offshore staff should be clearly identified. Describe internal governance process for outsourced or offshore staff. Describe the basis on which the LC satisfies itself on the adequacy, technical skills, and practical experiences of the aforementioned staff. Provide profiles of each key staff member.
- F.4.2 Describe any key process relating to producing and maintaining the internal market risk measures for individual model components that is outsourced or carried out outside Hong Kong and the monitoring of performance of such activities performed by the LC. Provide samples of management information reports received for such purpose.
- F.4.3 Provide a summary of all systems and data feeds connected to the IMA models, including source and pre-processing systems, cut-off times for inclusion of positions, and expected time when the data feeds become available.
- F.4.4 Provide documentation describing the main steps relating to the production of model outputs, including target times (preliminary results and final results, if relevant).
- F.4.5 Provide a description of reconciliations undertaken²⁵ by the LC that inform or ensure the completeness and accuracy of the model feeds and outputs.
- F.4.6 Provide a description of the roles played by business units (if any) in respect of risk or model results sign-off.
- F.4.7 Describe the processes and procedures of re-stating model results in case of production issues arising²⁶ and any threshold applied. Provide sample reports to walk through the processes.

²⁵ By Product Control or Operations or any other function as part of the IMA models production process or other daily process.

²⁶ Such as late, failed or corrupted feeds or late trade capture or amendments.

F.5 Back-testing

- F.5.1 Provide an organisational chart of the teams responsible for different elements of the back-testing process (e.g. for P&L production and the computation of actual and hypothetical P&L, carrying out back-testing analysis, reporting and escalating back-testing exceptions) with necessary information for understanding the roles, responsibilities, geographical locations, and reporting lines of the staff. Any part-time, temporary, or contract, outsourced or offshore staff should be clearly identified. Describe internal governance process for outsourced or offshore staff. Describe the basis on which the LC satisfies itself on the adequacy, technical skills, and practical experiences of the aforementioned staff. Provide profiles of each key staff member.
- F.5.2 Describe any key process relating to back-testing that is outsourced or carried out outside Hong Kong and the monitoring of performance of such activities performed by the LC. Provide samples of management information reports received for such purpose.
- F.5.3 Provide documentation on the processes for back-testing against actual and hypothetical P&L. This should at least include details of the systems used for back-testing, details of the computation of actual and hypothetical P&L, the granularity and frequency of back-testing analysis, back-testing reporting and escalation framework, and timescales.
- F.5.4 If the proposed in-scope positions are subject to specific risk, explain how the performance of specific risk methodologies is tested by separate back-testing on sub-portfolios that have specific risk exposures. Demonstrate the LC's compliance with paragraphs A.9 to A.11 of the IMA Guidelines. Further explain how sub-portfolios are defined and selected.
- F.5.5 If the LC conducts Internal Back-testing as set out in paragraphs A.12 to A.14 of the IMA Guidelines, provide details and examples of routine analyses of the Internal Back-testing results.
- F.5.6 Provide back-testing results for at least the past 3 months at both the aggregate level and individual trading desk level, and details of the frequency of reporting, distribution list and any other information that can evidence sound monitoring and live testing of the performance of the IMA models.
- F.5.7 Describe how back-testing results are integrated into the initial and ongoing assessment and validation of the IMA models.

F.6 Risk management

- F.6.1 Provide an organisational chart of the independent market risk control function with necessary information for understanding the roles, responsibilities, geographical locations, and reporting lines of the staff. Any part-time, temporary, contract, outsourced or offshore staff should be clearly identified. Describe internal governance process for outsourced or offshore staff. Describe the basis on which the LC satisfies itself on the adequacy, technical skills, and practical experiences of the staff performing independent market risk control function. Provide profiles of each key staff member. In addition, provide the following.
- (a) Details of key independent market risk controllers and their corresponding key risk takers in the business units.
 - (b) An overview of how remuneration (e.g. fixed and discretionary compensation) is determined for independent market risk controllers and specify who has influence

on decisions on the discretionary compensation of independent market risk controllers.

- F.6.2 Describe any key process relating to the independent market risk control function that is outsourced or carried out outside Hong Kong and the monitoring of performance of such activities performed by the LC. Provide samples of management information reports received for such purpose.
- F.6.3 Provide documentation relating to the independent market risk management framework, including the following.
- (a) Independent market risk management policy and procedures documents for identifying, measuring, reporting, and managing market risk.
 - (b) An overview of market risk appetite and limit framework. Provide an overview of how market risk appetite and limits for the LC differ from group-wide risk appetite and limits, if applicable.
 - (c) An overview of the calibration and monitoring of metrics used in the market risk limit framework (including risk limits, limit monitoring and reporting, limit exception reporting, and limit change reporting). Provide details of any types of positions that are either partially or wholly exempt from the market risk limit framework.
 - (d) Reports on the utilisation of market risk limits over the past 12 months and evidence of controls exercised on temporary or permanent limit adjustments and actions taken on limit breaches (including records of limit breach in management reporting) during that period.
 - (e) An inventory list of internal market risk reports, with explanation of their purposes, contents, target recipients and frequency of production. Please provide a sample set of these reports.
 - (f) An overview of how intra-day market risk is managed.
 - (g) Report of periodic monitoring of significant tail risks within the proposed in-scope positions, including a comparison of regulatory VaR and SVaR with alternative risk measures.
 - (h) Any booking structures (e.g. back-to-back trades) that might impede effective risk management.
- F.6.4 Provide an overview of the booking models used by the LC, including any intra-group booking practices and use of internal hedges, and explain the drivers of the arrangements. Provide supporting documentation on these arrangements.
- F.6.5 Describe the governance of the independent market risk control function and provide copies of the minutes and meeting materials of a governance meeting conducted in the past 6 months.
- F.6.6 Provide a summary of systems used by the independent market risk control function with brief descriptions of the role of each system.
- F.6.7 Provide a summary of each manual process deployed in market risk management and market risk charge calculation and describe the governance of such process.
- F.6.8 Provide an overview of the independent market risk control function's involvements in market risk-related decisions (e.g. new product approval, limit reviews, risk mitigation, methodological changes, stress testing), sample records of such involvements, and any exceptions where the independent market risk control function was excluded from decision-making.

- F.6.9 Provide an overview of the ways in which the independent market risk control function interacts with other functions (e.g. trading, middle office, product control, and internal audit) in the LC in relation to market risk management, together with examples of such interactions.
- F.6.10 Provide an overview of the independent market risk control function's involvements in other control processes (e.g. valuation control, product control, independent price verification, and internal audit) together with examples of such interactions.
- F.6.11 Describe the basis on which the LC's Manager-In-Charge for Overall Management Oversight and Manager-In-Charge for Risk Management approved the submission of the IMA application.

F.7 Stress testing

- F.7.1 Provide an overview of the governance of the LC's market risk stress testing process. This should, at a minimum, include the following.
- (a) An overview of the roles and responsibilities of the functions involved in defining stress testing scenarios.
 - (b) Documentation of policies, methodologies and procedures covering all aspects of the stress testing framework. The stress testing methodology documentation should, for each type of stress testing scenarios, set out the methods and processes of defining and calibrating the scenarios and valuing or revaluing trades, and any other consideration (e.g. risk factor granularity, risk factor inclusion and exclusion choices, severity of stressed scenarios, incorporation of liquidity constraints, idiosyncratic or sectoral shocks to concentrated positions, and hedge efficiency) and analysis required.
 - (c) Information on the governance committees responsible for overseeing stress testing at the LC and group (if applicable) levels.
 - (d) A description of the quality assurance process ensuring the integrity of stress testing results.
 - (e) An overview of the use of stress testing results in limit setting.
- F.7.2 A list of periodic stress testing analyses performed at the LC level, highlighting the time interval between the close of business date of positions and dissemination of the stress testing report.
- F.7.3 Provide the LC's internal stress testing reports and related analyses over the past 12 months.
- F.7.4 Describe the LC's capability to carry out ad hoc scenario testing and provide samples of past ad hoc scenario tests.
- F.7.5 Provide documentation on the assessment of the soundness of the stress testing framework.
- F.7.6 Provide a summary of the portfolios and products excluded from stress testing, describe their materiality and explain their exclusion.

F.8 Product control

- F.8.1 Provide an overview of the governance of the product control and finance processes relating to trading activities, which should, at a minimum, include the information required below.
- F.8.2 For processes relating to daily P&L calculation and review, provide the following information.
- (a) An overview of the governance of P&L calculation and review processes, including details of committee structures and reporting lines of the relevant staff.
 - (b) Documentation of policies and procedures for daily and monthly clean P&L and actual P&L calculations, including standards for analysis and commentary.
 - (c) Daily P&L reports (including attribution, *clean vs. total* reconciliation, *trader flash vs. final P&L* reconciliation, sign-off and commentary) for the 3 days with the largest absolute P&L in the past 3 months.
 - (d) Monthly P&L reports (including attribution, *clean vs. total* reconciliation, *trader flash vs. final* reconciliation, sign-off and commentary) for the past 3 months.
 - (e) Documentation of policies and procedures for day-one trade review (including P&L thresholds, complexity triggers, risk thresholds and commentary).
 - (f) Details of trades in the past 12 months for which a day-one P&L reserve has been set up.
- F.8.3 For processes relating to independent price verification (IPV), provide the following information.
- (a) An overview of the governance of IPV process, including details of committee structures and reporting lines of the relevant staff.
 - (b) Documentation of policies, procedures, and methodologies for the IPV process.
 - (c) Detailed IPV reports (including adjusted and un-adjusted variances, and impact of using unusual external pricing source) for the past 3 months.
- F.8.4 For processes relating to valuation adjustments specified below, provide the following information.
- (a) An overview of the governance of valuation adjustment processes for model reserves, bid-offer reserves, liquidity reserves and other trading-related reserves, including details of committee structures and reporting lines of staff.
 - (b) Documentation of policies, procedures, and methodologies for making valuation adjustments specified in subparagraph (a) and other valuation adjustments (e.g. credit valuation adjustment).
 - (c) Detailed schedules of the valuation adjustments specified in subparagraph (b) for the past 3 months.
- F.8.5 For front office control, provide the following information.
- (a) Documentation of policies and procedures for front office marking, valuation control, trader flash P&L production, and trader flash P&L sign-off.
 - (b) A set of sample management reports on *trader flash vs. final P&L* reconciliation reviewed by trading desk heads.
 - (c) Traders flash P&L reports with commentary for the 3 days with the largest absolute P&L in the past 3 months.

- (d) Details of trades which are booked and managed on spreadsheets and documentation of controls over such spreadsheets.

F.8.6 Provide the following documents:

- (a) Monthly management reports summarising information about product control and KPIs (e.g. balance sheet substantiation, reconciliations, and manual adjustments) for the past 3 months.
- (b) A list of reconciliations carried out by product control function.
- (c) Documentation of policies, procedures and controls relating to manual adjustments.
- (d) Product inventory, documentation of policies, procedures, and methodologies for approximately booked trades (including barrier shifts).

F.9 New product approval and pre-trade approval

F.9.1 Provide an overview of the governance of the new product approval process, which should, at a minimum, include the following information:

- (a) An overview of the governance of new product approval, including details of committee structure, reporting lines of the relevant staff and approval grids.
- (b) Documentation of policies and procedures on new product approval.
- (c) A list of new products (whether approved or not) that have been subject to the new product approval process in the past 12 months.

F.9.2 Provide documentation of policies and procedures for pre-trade approval (e.g. for exotic and large trades) and a sample of the relevant management information on such approval presented to management.

F.10 Operations and middle office

F.10.1 Provide an organisational chart of the operations and middle office functions with necessary information for understanding the roles, responsibilities, geographical locations, and reporting lines of the staff. Any part-time, temporary, or contract, outsourced or offshore staff should be clearly identified. Describe internal governance process for outsourced or offshore staff. Describe the basis on which the LC satisfies itself on the adequacy, technical skills, and practical experiences of the staff performing operations and middle office functions. Provide profiles of each key staff member.

F.10.2 Describe any key process relating to operations and middle office functions that is outsourced or carried out outside Hong Kong and the monitoring of performance of such activities performed by the LC. Provide samples of management information reports received for such purpose.

F.10.3 Provide an overview of the governance of the operations and middle office functions.

F.10.4 Provide an overview of the governance of the operations and middle office functions, including the reporting structures of various operational committees in which operations and middle office participate. These committees range from those participate in desk-level meetings (such as business control meetings) to those report to board and management committees (if any).

F.10.5 A description of the quality assurance process for ensuring the integrity of trade data fed into P&L and VaR calculations, which should, at a minimum, include static data

controls, account controls, inter-system reconciliations, and external reconciliations. Describe the roles of the operations and middle office functions in the process.

F.10.6 Provide the most recent management reports on internal controls submitted to board and management committees.

F.11 Internal audit

F.11.1 Provide an organisational chart of the internal audit function responsible for carrying out independent audits of the internal model and the market risk measurement and management systems and processes with necessary information for understanding the roles, responsibilities, geographical locations, and reporting lines of the staff. Any part-time, temporary, or contract, outsourced or offshore staff should be clearly identified. Describe internal governance process for outsourced or offshore staff. Describe the basis on which the LC satisfies itself on the adequacy, technical skills, and practical experiences of the staff performing internal audit function. Provide profiles of each key staff member.

F.11.2 Describe any key process relating to internal audit function that is outsourced or carried out outside Hong Kong and the monitoring of performance of such activities performed by the LC. Provide samples of management information reports received for such purpose.

F.11.3 Provide an overview of the internal audit approach and methodologies and explain how the requirements in paragraph 3.18 of the IMA Guidelines can be complied with. Provide the most recent internal audit reports and external independent review reports (if any) that covered the specified audit areas. For each report, provide a summary of the scope and methodologies of the audit or review (including any sampling method and size applied in the audit or review).

F.11.4 Provide a list of all open audit issues relevant to the IMA application, including any past due issues, reasons for delays, and their target resolution dates.

Annex G Reporting requirements for LCs granted Internal Models Approach Approval for FRR Market Risk Charges Calculation

LCs to which the SFC has granted an internal models approach approval for FRR market risk charges calculation (IM-LCs) are required to submit information periodically to the SFC for monitoring purposes. The information required may include the types of reports and information listed in this document. Submission frequency is generally on a monthly or quarterly basis, depending on report nature and subject to changes according to individual circumstances and market conditions. Exact reporting requirements, frequencies and timelines for individual IM-LCs will be determined by the SFC and specified in the letter of approval.

Monthly reports

1. Capital components report

This report should include all key components of market risk charges as of each month-end and presented in the format stipulated at the end of this document (Table 1). The report should include detailed commentaries on the movements of these components since the previous report and over the past 3 calendar months.

2. Market risk report

This is the regular market risk report that the IM-LC's senior management receives for management purposes. It should include key risk metrics, such as:

- (a) Trends²⁷ of Regulatory VaR²⁸, Regulatory SVaR²⁹, Expected Shortfall (ES)³⁰, Stressed ES³¹, Risk Management VaR³², IRC and market risk charges for in-scope market risks (IMA market risk charges) over the past 12 months
- (b) Risk measures by business line
- (c) Overview of all limit usage
- (d) Exposures to key Greeks by business line and other dimensions relevant to the key risk of business (e.g. exposures to key Greeks by country or industry)
- (e) Results of scenario analysis by business line

²⁷ The trend comparisons of Regulatory VaR vs ES and Regulatory SVaR vs Stressed ES aim to identify any significant tail risks that are not reflected in Regulatory VaR and Regulatory SVaR.

²⁸ Regulatory VaR refers to the Value-at-Risk measured over a 10-day time horizon at the 99%, one-tailed confidence level, using a one-year observation period.

²⁹ Regulatory SVaR refers to the Stressed Value-at-Risk measured over a 10-day time horizon at the 99%, one-tailed confidence level, using a one-year observation period.

³⁰ ES refers to the Expected Shortfall measured over a 10-day time horizon at the 97.5%, one-tailed confidence level, using a one-year observation period. The computation of ES should be based on the same set of data as Regulatory VaR.

³¹ Stressed ES refers to the Stressed Expected Shortfall measured over a 10-day time horizon at the 97.5%, one-tailed confidence level, using a one-year observation period. The computation of Stressed ES should be based on the same set of stressed data as Regulatory SVaR.

³² Risk Management VaR refers to the one-tailed Value-at-Risk determined using the IM-LC's internal risk parameter settings (including but not limited to holding periods / time horizons, confidence level, and the length of observation period).

- (f) Concentration risk
- (g) Risk profile of the IM-LC's portfolios
- (h) Summary of key business and trading position changes, including new activities and unwinds.
- (i) Significant positions

In the submission, the IM-LC should highlight in the report movements of key risk metrics over time with commentaries.

3. Scenario analysis report

The report should cover the evaluation of the potential impacts of various hypothetical scenarios on the IM-LC's business lines or portfolios.

Each scenario should be concisely described, including portfolio scope, selected shock sizes, and key underlying assumptions of the scenario design (e.g. the number of days expected to unwind the relevant positions or hedge market risk exposures).

Additionally, the report should explain any large movements observed in these scenario analyses.

4. Trading P&L report

The report should include both daily P&L trends since the beginning of the year and year-to-date total P&L trends broken down by year-to-date total realised P&L and year-to-date total unrealised P&L and by business line as of each month-end. The report should also include high-level commentaries to explain the P&L arising from the IM-LC's in-scope positions, particularly highlighting any significant P&L items in the reporting period.

Quarterly reports

5. Back-testing report

The number of back-testing exceptions should be reported monthly in the form of Table 1. This report should provide trends and other details of back-testing exceptions at the portfolio and sub-portfolio levels, including the following:

- (a) Analysis of the trends of daily Hypothetical P&L and Actual P&L relative to the Back-testing VaR at the LC level over the past 250 trading days.
- (b) The number of hypothetical P&L back-testing exceptions over the past 250 trading days, accompanied by a thorough analysis and detailed explanation of these exceptions.
- (c) The number of actual P&L back-testing exceptions over the past 250 trading days, accompanied by a thorough analysis and detailed explanation of these exceptions.

6. Proxy report

The report should include a concise description of and key assumptions underlying each proxy methodology employed in the IM-LC's VaR and SVaR calculations and any other relevant information, such as the market risk sensitivity of positions that use proxies, the

product type of such positions, and the materiality of VaR and SVaR that are calculated with the help of proxy data.

7. VaR and Stressed VaR reports

The report should include the following information:

- (a) Analysis of monthly SVaR-to-VaR ratios in the past 12 calendar months with commentaries on significant fluctuations.
- (b) Analysis of monthly VaR and SVaR in the past 12 calendar months, with commentaries on any significant fluctuations in the past 3 calendar months.
- (c) A quantitative justification for the selection of historical stress period that would lead to a conservative SVaR capital charge.

8. IRC report

The report should include the analysis of monthly IRC in the past 12 calendar months, with commentaries on any significant fluctuations in the past 3 calendar months.

9. RNIM report

The report should include a complete list of risks categorised as RNIM with the following information:

- (a) A description of each risk categorised as RNIV, RNISV, Residual RNIV or Residual RNISV.
- (b) An analysis of RNIV, RNISV, Residual RNIV or Residual RNISV in the past 12 calendar months with commentaries on any significant fluctuations in the past 3 calendar months.
- (c) A breakdown of excess liquid capital maintained for covering RNIV, RNISV, Residual RNIV or Residual RNISV.

In addition, the report should provide a list of valuation adjustments made on the instruments giving rise to the RNIM to account for factors that may not be fully captured by the related valuation model, specifying both the name or nature of each adjustment and the corresponding amount.

10. Summary of model changes

The summary should contain a list of all model changes that have been implemented or are planned for implementation in the last 3 calendar months. The report should, in respect of each model change, provide a concise description of the change, the impact of the change on various model outputs (such as PV, Greeks, risk measures and components of IMA market risk charges), status of the change (if it is still work-in-progress, please state the target completion date; if it has been implemented, the date of implementation), and any outstanding model-related issues together with their resolution status.

11. Summary of key changes in the market risk management policies and framework

The summary should provide a clear, concise, and comprehensive overview of the modifications, enhancements, or revisions made to the policies and framework. The relevant updated documents should be submitted with the summary.

12. Product list

The list should include information on the products that contribute to the IMA market risk charge as of the reporting date, including the asset class they fall into, product name, and total gross (i.e. no offsetting between long and short positions) notional amount of the LC's positions in each product. For each of these products, please indicate the most recent quarter in which it was traded and specify whether it is a new product.

13. Organisational chart

The organisational chart should highlight any changes of key personnel (including senior management, functional heads and their supervisors) in the firm's or group's Market Risk Department supporting the IM-LC's activities related to the in-scope positions.

14. Assessment report on valuation methodologies used by approved IMA models

The report should detail the routine process of assessing the accuracy and reliability of valuation methodologies used by IMA models, in addition to back-testing and model validation processes. For example, the report should include the comparison of hypothetical P&L and the P&L calculated using IMA models' valuation methodologies.

Other ad hoc reports

15. Additional report on material model assumptions

IM-LCs may be required to provide report on material model assumptions and accuracy of VaR calculation methodologies on a regular or ad hoc basis. For example, the SFC may require IM-LCs to submit model assumption revalidation results periodically.

Table 1

As at Date		Report in HK\$ million					
						Number of back-testing exceptions over the past 250 trading days.	
VaR	VaR	Average VaR over past 60 trading days	Multiplier for VaR (m_c)	Total Avg VaR x m_c	VaR capital charge ¹	Based on Hypothetical P&L	Based on Actual P&L
Interest Rate							
Equity							
Foreign Exchange							
Commodity							
Total*							

¹ VaR capital charge = Max [Total VaR, Total Avg VaR x m_c]

SVaR	SVaR	Average SVaR over past 12 weeks	Multiplier for SVaR (m_s)	TOTAL Avg SVaR x m_s	SVaR capital charge ²
Interest Rate					
Equity					
Foreign Exchange					
Commodity					
Total*					

² SVaR capital charge = Max [Total SVaR, Total Avg SVaR x m_s]

IRC	IRC	Average IRC over past 12 weeks	Scaling factor for IRC (s_r)	Total Avg IRC x s_r	IRC capital charge ³
Interest Rate					
Equity					

Total*					
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³ IRC capital charge = $s_r \times \text{Max} [\text{Total IRC}, \text{Total Avg IRC}]$

Note *: For VaR, SVaR and IRC, the total reported under the individual items is not necessarily equal to the sum of their respective components because of the correlation across the risk categories.

Risks-not-in-IMA model	RNIV	Average RNIV over past 3 months	Multiplier for VaR (m_c)	RNISV	Average RNISV over past 3 months	Multiplier for SVaR (m_s)	Residual RNIM	Average Residual RNIM over past 3 months	Potential ELC impact
RNIV ⁴									
RNISV ⁵									
Residual RNIM ⁶									
Total									

⁴ RNIV potential ELC impact = $m_c \times \text{Max} (\text{RNIV}, \text{Average RNIV over past 3 months})$

⁵ RNISV potential ELC impact = $m_s \times \text{Max} (\text{RNISV}, \text{Average RNISV over past 3 months})$

⁶ Residual RNIM potential ELC impact = $\text{Max} (\text{Residual RNIM}, \text{Average Residual RNIM over past 3 months})$

Market risk charges* calculated using approaches other than IMA (Note*: the market risk charges for out-of-scope market risks)	
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General Principles for Model Risk Management

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1 Introduction

- 1.1 A licensed corporation (LC) engaging in OTC derivative dealing or clearing may use models to assist it in pricing, valuation or risk management (for example, option pricing models and models for measuring risk sensitivity), and so may LCs approved to use an alternative approach to calculate capital charges under section 58(5B) of the Securities and Futures (Financial Resources) Rules (FRR)¹. The use of models inevitably exposes the users to model risk, which must be prudently managed.
- 1.2 These principles are published by the SFC under section 399 of the Securities and Futures Ordinance (SFO) to provide LCs with guidance on model risk management. These principles must be complied with by LCs that
- (a) engage in OTC derivative dealing or clearing; or
 - (b) are approved by the SFC under section 58(5B) of FRR to use an alternative approach to calculate capital charges,
- as far as reasonably practicable for models used in trading-related activities, capital charge calculation, valuation and risk management (collectively referred to in this document as *covered models*), subject to application may be customised in a manner commensurate with the size of the LC's risk exposures, level of business activities, complexity of the models and the extent of its use of the models concerned. LCs referred in subparagraphs (a) and (b) are collectively referred to in this document as *covered-LCs*.
- 1.3 Other LCs may refer to these principles for guidance in managing major financial models used in their operations.

¹ Under section 58(5B) of FRR, the Securities and Futures Commission (the SFC) may, on application in writing by an LC, approve the adoption by the LC of an alternative approach (which may involve the use of internal models or latest Basel capital standards) to calculate capital charges for market risk or counterparty credit risk.

2 Model identification and inventory

- 2.1 A covered-LC should establish a clear definition of “model”. In general, a model includes any quantitative approach which applies qualitative judgment to generate quantitative results. A model typically consists of three components, namely
- (a) an information input component, which delivers assumptions and data to the model;
 - (b) a processing component, which transforms inputs into estimates, employing economic, financial, or mathematical theories, techniques and assumptions, along with numerical implementation; and
 - (c) a reporting component, which translates the estimates into useful business information.
- 2.2 A covered-LC’s model inventory should include all covered models and establish appropriate controls on these models in accordance with these principles. A covered-LC should also establish appropriate controls on other models and quantitative approaches that are not classified as models to ensure risks associated with the implementation and use of such models or approaches are adequately understood, controlled and documented.
- 2.3 A covered-LC should maintain a complete and accurate model inventory that documents information relevant to the management of model risk for all covered models in use, under development, or decommissioned. The information for a covered model should clearly identify the model owner, model developer, model user and unit responsible for model validation, revalidation and periodic review, and should include model uses and the model’s direct or material dependencies². A designated party should be charged with maintaining a firm-wide model inventory. Any variation of a covered model in use that warrants a separate validation should be classified in the inventory as a separate model.

² For example, the model’s dependence on or use of the outputs of other models.

3 Model development and use

- 3.1 A covered-LC should exercise robust control over model development and ensure appropriate use of models both at inception and on an ongoing basis. Specifically, the LC should have standards for model design, model selection, model implementation, model performance measurement, and ongoing monitoring of model use.
- 3.2 A covered-LC should ensure that the design, theory and logic underlying a covered model are conceptually sound, appropriate for the intended use of the model, and supported by generally accepted research published by academia or industry experts and sound industry practice. The LC should compare the model results with the outcomes of alternative theories or approaches and benchmarks (if any). The LC should place particular emphasis on understanding and communicating to model users and other stakeholders the merits and limitations of a covered model under different conditions and carry out input sensitivity analyses to determine the operating boundaries of the model.
- 3.3 A covered-LC should rigorously assess the quality and relevance of data used to develop a covered model. Where adjustments are made, proxies are used, or the data are not representative of the LC's portfolio, the impact should be evaluated qualitatively and, if possible, quantitatively, justified and documented for future reference. Model users should understand the potential model limitations.
- 3.4 A covered-LC should carry out adequate testing during the model development stage to ensure that the model performs as expected for the intended use. Such testing should adopt clear criteria as the basis to measure a model's quality and select between candidate models. The testing should include verifying model accuracy, assessing potential model limitations, and evaluating robustness and stability of the model across a variety of economic and market conditions including stressed conditions. The LC should also conduct model testing for material model changes. All model testing activities should be appropriately documented.
- 3.5 A covered-LC should have a sound development process for the more judgmental and qualitative aspects of a covered model. More specifically, any judgments or model overlays that are used to modify the parameters, inputs or outputs of a covered model due to known model limitations should be appropriately understood and documented in the model development stage and be subject to independent review and challenge by model validation unit mentioned in paragraphs 4.1 to 4.9.
- 3.6 A covered-LC should ensure that covered models are implemented in information systems or environments which have been thoroughly tested for the intended model use purposes.
- 3.7 A covered-LC should ensure that model users play an integral part in the design, selection and testing of covered models. A covered-LC should challenge the methods, the underlying assumptions, and the results of the covered models, both at inception and on an ongoing basis.
- 3.8 A covered-LC should demonstrate that model uncertainties³ are adequately understood, managed, monitored and reported, both on an individual basis as well as in aggregate.

³ For the purposes of these principles, the term "model uncertainty" refers to the inherent uncertainty in the parameter estimates and outputs of models, including the uncertainty in the outputs due to model choices or inadvertent model misuse.

Where model uncertainty is mitigated by conservative adjustments, the LC should justify and document such adjustments and demonstrate that they are reasonable from a business and economic perspective.

- 3.9 A covered-LC should perform ongoing monitoring of covered models in use to assess their effectiveness and performance over time. The monitoring controls should aim to confirm that the models are appropriately implemented, used for their intended purposes and are performing as intended. Moreover, the LC should perform ongoing monitoring to evaluate whether changes in market conditions and portfolio composition necessitate adjustment, redevelopment, or replacement of the models. The frequency of the periodic monitoring should be commensurate with the nature and materiality of the models and risks, with due consideration given to model complexity.

4 Model validation, revalidation and periodic review

- 4.1 A covered-LC should undertake appropriate independent model validation to ensure sound model performance and greater understanding of model uncertainties. Material changes to covered models should also be subject to validation.
- 4.2 A covered-LC should conduct model revalidation on an ongoing basis to track known model limitations and to identify any new ones.
- 4.3 A covered-LC should conduct periodic reviews (at least annually) on each covered model to determine whether it is working as intended and whether the existing model validation and revalidation activities are sufficient or require updates, enhancements, or additional validation activities.
- 4.4 A covered-LC's model validation, revalidation and periodic review activities should address all three model components (i.e. the input component, the processing component and the reporting component, as outlined in paragraph 2.1) to ensure the covered model is suitable for its intended use and has been implemented as intended.
- 4.5 The nature, frequency and extent of validation, revalidation and periodic review activities should be commensurate with the overall use, complexity, and materiality of the model, model components, adjustments to model results or changes to a covered model.
- 4.6 A covered-LC's model validation, revalidation and periodic review activities should be conducted by the model validation unit, which must be independent of model development and model use. The model validation unit should not have a stake in the decision on whether a model should be adopted.
- 4.7 A covered-LC's model validation unit should have explicit authority to challenge model developers and model users and to ensure that any model issues and deficiencies are appropriately addressed in a timely and substantive manner.
- 4.8 A covered-LC's model validation unit should have the requisite technical knowledge, skills, and expertise. It should also possess a significant degree of familiarity with the business context in which the covered models are used.
- 4.9 A covered-LC's model validation unit should impose or recommend very tight controls or constraints in a model approval if significant deficiencies are noted in the model validation or revalidation activities. If the deficiencies are too severe to be addressed within the model framework, the model should be rejected. The process of managing identified model issues (including deficiencies) should include the tracking of the outstanding issues and should be adequately documented.

5 Governance, policies and controls

- 5.1 A covered-LC should have effective governance framework, policies, procedures and controls to manage model risk.
- 5.2 A covered-LC's board is ultimately responsible for the management of model risk and should establish a comprehensive firm-wide model risk management framework. In implementing and maintaining such framework, the LC's senior management (or a committee with delegated authority) should

- (a) establish effective policies and procedures and ensure compliance with these principles;
- (b) assign competent staff to assist them in model risk management, overseeing model development and implementation, evaluating model results, ensuring effective challenge, reviewing findings of validation, revalidation, audits and periodic reviews, and taking prompt remedial action when necessary.

Firm-wide policies should be approved by the board and reviewed on a regular basis to ensure their continued relevance.

- 5.3 A covered-LC should regulate its model risk management activities by suitable policies and procedures which should cover all aspects of the model risk management framework, including but not limited to

- (c) model definition, model development standards, model implementation and change processes, model validation, revalidation and periodic review standards, governance and challenge processes;
- (d) the prioritisation, scope and frequency of model validation, revalidation and periodic review and any other ongoing monitoring activities; and
- (e) documentation standards of all aspects of the model risk management framework.

- 5.4 A covered-LC's model risk management policies should identify the roles and responsibilities of all parties within the model risk management framework, including but not limited to

- (a) model owners, who should have accountability for model use and performance and be responsible for ensuring that covered models are appropriately developed, conceptually sound, implemented and used as intended, have undergone appropriate validation, approval, revalidation and periodic review, and are recorded and maintained in the model inventory;
- (b) model developers, who should be responsible for the design, research, development, evaluation and documentation of covered models and may be involved in model monitoring and reassessment of covered models in use;
- (c) model users, who should ensure that covered models are used consistently with the model's intended purpose and any model limitations are understood and taken into consideration when using the outputs of the model, and may be involved in ongoing model monitoring activities;
- (d) model validation unit, who should be responsible for the model validation, revalidation and periodic review activities set out in paragraphs 4.1 to 4.9;
- (e) control functions (including the model validation unit), who should have the authority

- to restrict the use of covered models and monitor any limits on model use; and
- (f) internal audit, who should assess the overall effectiveness of the model risk management framework and compliance with internal policies, and independently evaluate whether model risk management practices are comprehensive, rigorous, and effective.
- 5.5 A covered-LC should maintain adequate documentation to demonstrate that model risk assessment and management are effective. More specifically,
- (a) model development documentation should be sufficiently detailed, up-to-date, and include results of relevant tests and analyses so that parties unfamiliar with a covered model can understand from the documentation how the model operates and its limitations and key assumptions;
 - (b) model validation reports should articulate the scope of the validation and revalidation activities, assess the model development activities, record independent analyses and testing, highlight key model assumptions and limitations, and recommend any compensating controls or constraints as necessary; and
 - (c) other model risk management activities, including ongoing monitoring, periodic review, benchmarking, and outcomes analyses should be adequately documented.
- 5.6 A covered-LC should ensure that model development, validation, revalidation, or any other activities related to model risk management performed by an external party⁴ on the LC's behalf are conducted in accordance with the LC's model risk management standards. An internal staff with sufficient authority and experience in model risk management should be assigned to oversee the work delivered by the external party and address any issues identified either with model development or in model validation or revalidation.

⁴ Please refer to paragraph 6.1 for the principles of validating vendor models.

6 Use of vendor models

- 6.1 Where a covered-LC uses vendor models as covered models, the associated risks should be adequately addressed in the LC's model risk management framework. Particularly, the LC should observe the following principles.
- (a) The covered-LC should have an appropriate process for selecting vendor models which should be conceptually analogous to, and as stringent as, the process of model development. To ensure a vendor model is suitable for its use, the LC should
 - (i) obtain and understand relevant model development information that explains, at a minimum, the model components, design (including economic, financial, or mathematical theories, techniques, logics and assumptions), intended use, dependencies and limitations; and
 - (ii) obtain and evaluate model testing results to ensure the model works as intended.
 - (b) The covered-LC should obtain adequate documentation of a chosen vendor model and include the relevant information in its model inventory.
 - (c) Any customisation of a vendor model should be documented and justified as part of model validation and revalidation. The LC should conduct ongoing monitoring of performance of a vendor model based on its use of the model.
 - (d) The covered-LC should establish procedures to acquire and maintain as much in-house knowledge about a chosen vendor model as possible. The LC should also have contingency plans for scenarios where the vendor model is no longer available or supported by the vendor.
 - (e) The covered-LC should comply with the model development and use standards set out in paragraphs 3.1 to 3.9 where applicable.