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

Consultation Conclusions on the Draft Securities and Futures (Leveraged Foreign Exchange Trading – Exemption) Rules

證券及期貨(槓桿式外匯交易 — 豁免)規則》草擬本諮詢文件總結

Hong Kong
July 2002

香港
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INTRODUCTION

1. On 5 June 2002, the Securities and Futures Commission ("SFC") published a Consultation Document on the Draft Securities and Futures (Leveraged Foreign Exchange Trading - Exemption) Rules ("Consultation Document"). The consultation period ended on 26 June 2002.

2. The draft Rules prescribe, for the purposes of the definition of "leveraged foreign exchange trading" in Part 2 of Schedule 5 to the Securities and Futures Ordinance, that certain acts performed by any person belonging to three qualifying classes are to be excluded from the definition. The three classes are:

   - corporations that carry on any form of leveraged foreign exchange trading but whose principal business is not in leveraged foreign exchange spot transactions or the average principal amount in such transactions is not less than $7.8 million, and the corporation or its sole holding corporation or partnership has a qualifying credit rating;

   - licensed persons who are performing an act in connection with the sale, purchase or transfer of currency warrants that are listed or are to be listed, and clients of the licensed persons undertaking such transactions through the licensed persons; and

   - issuers of such currency warrants and corporations belonging to the same group of companies as the issuers who are undertaking the above transactions through licensed persons, or undertaking intra-group purchases, sales or transfers of such currency warrants.

3. The first qualifying class replicates that of the existing Foreign Exchange Trading (Exemption) Rules prescribed under the Leveraged Foreign Exchange Trading Ordinance, while the latter qualifying classes constitute a new policy initiative. The aim is to facilitate the development of the listed currency warrant market by removing unnecessary technical obstacles, while not compromising investor protection.

CONSULTATION EXERCISE

4. A press release regarding the consultation exercise was issued on 5 June 2002. The Consultation Document and the draft Rules were posted on the SFC's website and distributed to all licensed firms through the FinNet.

5. Two submissions were received, one each from Messrs Allen and Overy, and Messrs Linklaters. These have been posted on the SFC's website. Two other market practitioners have also informally commented on the draft Rules.

CONSULTATION CONCLUSIONS

6. Messrs Allen and Overy expressed support for the addition of the two new qualifying classes, while Messrs Linklaters commented on specific provisions of the Rules. A summary of the comments from the two firms as well as the SFC's responses are set out in the Attachment. The other two practitioners believed that the exemptions provided in the draft Rules had addressed the concerns of the market in the listed currency warrant area.

7. In view of the comments received during the consultation exercise, the SFC concludes that no material changes to the draft Rules are required.

FINAL NOTE

8. The SFC would like to thank Messrs Allen and Overy, Messrs Linklaters and the industry participants for their comments in response to the Consultation Document.

Attachment

Summary of comments received on the Draft
Securities and Futures (Leveraged Foreign Exchange Trading - Exemption) Rules

	Section Reference	Details of the Rules	Respondent's Comments	SFC's Responses
1	Rule 3 (Exemption under paragraph (xiii) of the definition of "leveraged foreign exchange trading" in Part 2 of Schedule 5 to the SF Ordinance)	This Rule prescribes, for the purposes of the SF Ordinance, "foreign exchange trading" and "leveraged foreign exchange trading" do not include any act performed for or in connection with a contract or arrangement or a proposed contract or arrangement by any person belonging to the three classes specified in Rules 4, 5 and 6.	[Linklaters] The classes referred to in this Rule should be alternatives, therefore, we suggest that the word "or" appears at the end of (a) and (b).	We will add the word "or" to Rule 3 to ensure further clarity. (Please note that the reference to section 174(1) of the SF Ordinance on cold calling activities has been removed. There is no policy change. This carve-out is not necessary as the draft Rules should not affect the operation of section 174(1) of the SF Ordinance.)
2	Rule 4 (Qualifying class 1)	Qualifying class 1 refers to corporations whose principal business is not in leveraged foreign exchange spot transactions or the average principal amount in such transactions is not less than $7.8 million, and the corporations or their sole holding corporations or partnerships have a qualifying credit rating.	[Linklaters] According to paragraph 7 of the Consultation Paper, the exemption applies if the corporation's principal business is not in leveraged foreign exchange spot transactions provided the average principal amount of each transaction meets a threshold test and there is a qualifying credit rating. However, Rule 4 states that a corporation must meet the qualifying credit rating and either its principal business is not in leveraged foreign exchange spot transactions or the average principal amount of each transaction meets a threshold test. We assume that the position in the Rules is the one to be followed.	Yes, this qualifying class refers to corporations whose principal business is not in leveraged foreign exchange spot transactions or the average principal amount in such transactions is not less than $7.8 million, and the corporations or their sole holding corporations or partnerships have a qualifying credit rating.

	Section	Details of the Rules	Respondent's Comments	SFC's Responses
			[Linklaters] There is no definition in the draft Rules of "leveraged foreign exchange spot transactions".	This term is not defined in the current Leveraged Foreign Exchange (Exemption) Rules prescribed under the Leveraged foreign Exchange Trading Ordinance ("LFETO"). The SFC takes the view that in the interests of simplicity, such a definition should not be added to the Rules. The term is well understood by the market, and that this arrangement has worked well for the past 7 years.
			[Linklaters] The requirement to annually notify the SFC that a corporation satisfies the exemption conditions has become a condition of being able to rely on the exemption from the definition of leveraged foreign exchange trading (LFET). This means that if a corporation inadvertently fails to notify the SFC within 4 months after the end of its financial year, but continues to carry on LFET, it will have committed a criminal offence. This appears unduly harsh.	The SFC is of the view that the notification requirement is not unduly harsh as the corporations concerned have a four-month period to make the notification. Moreover, the SFC has a practice of issuing reminders to existing exempt corporations reminding them of the notification requirements prior to their respective annual due dates. A failure to file an annual notice is not a criminal offence under the draft Rules. The failure simply means that the exemption will no longer be available.

	Section Reference	Details of the Rules	Respondent's Comments	SFC's Responses
3	Rules 5 and 6 (Qualifying classes 2 and 3)	Qualifying class 2 refers to licensed persons who perform an act for or in connection with the sale, purchase or transfer of currency warrants that are listed or are to be listed, and clients of the licensed persons undertaking such transactions through the licensed persons. Qualifying class 3 refers to issuers of such currency warrants and corporations belonging to the same group of companies as the issuers who undertake the above transactions through licensed persons, or undertaking intra-group purchases, sales or transfers of such currency warrants.	[Allen & Overy] Issuers of Hong Kong listed warrants have previously been hampered in the issuing of currency warrants in the Hong Kong market due to uncertainty as to whether these types of warrants are technically caught by the current legislation, particularly in respect of any pre-listing activity in the currency warrants. By exempting any act in connection with the purchase, sale and transfer of listed currency warrants from the definition of leveraged foreign exchange trading, the current uncertainty will be removed and will give issuers of derivative warrants more flexibility to bring these products to the market. I would therefore support the addition of the two new qualifying classes relating to currency warrants. I am assuming that the new Rules are intended to cover any pre-listing grey market activity in the currency warrants as well as any post-listing activity. [Linklaters] Although the SFC has accepted in the past that there is an argument that currency warrants are "securities" and therefore do not fall within the provisions of the Leveraged Foreign Exchange Trading Ordinance, as the SFC has now specifically excluded "listed currency warrants" from the definition of LFET, this exemption should also be extended to non-listed currency warrants and currency warrants listed on exchanges other than the Hong Kong Stock Exchange.	The assumption is correct in the context. "Listed currency warrants" has been defined in Rule 2 to include a currency warrant that is listed, and not listed but is reasonably foreseeable that it will be listed within a period of 14 days from the date that the warrant is first offered for sale. While the SFC has accepted in the past that certain currency warrants may constitute "securities", the SFC does not accept that all currency warrants are necessarily "securities" and therefore do not fall within the provisions of the LFETO. It may be noted that section 2(2) of the LFETO provides that "foreign exchange trading" and "leveraged foreign exchange trading" exclude, amongst others, any act performed for or in connection with a contract or an arrangement or a proposed contract or arrangement that is a transaction

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				executed on a recognized stock exchange by or through a registered securities dealer. We do not agree that the exemption should be extended to non-listed currency warrants out of investor protection concerns. To so extend may unnecessarily enlarge the scope of exemption. As regards currency warrants listed on exchanges other than the Hong Kong Stock Exchange, it may be noted that such an exemption is already provided for in the SF Ordinance. In Schedule 5 of the SF Ordinance, the definition for foreign exchange trading excludes, among others, any act performed for or in connection with any contract or arrangement or a proposed contract or arrangement that is a transaction executed on a specified stock exchange (or futures exchange) by or through a licensed person. The exclusions proposed under the draft Rules essentially aim to supplement these exemptions and cover transactions in currency warrants that are to be listed, and transactions in listed currency warrants that are carried out during non-exchange trading hours through licensed persons.
			[Linklaters] As there are no filing requirements for qualifying classes 2 and 3, we assume this means that entities satisfying the requirements in Rules 5 and 6 would be automatically exempt.	The assumption is correct. There are no filing requirements for qualifying classes 2 and 3.

	Section Reference	Details of the Rules	Respondent's Comments	SFC's Responses
4	General	Transitional arrangements.	[Linklaters] What happens to institutions that are currently exempt under the Leveraged Foreign Exchange Trading (Exemption) Rules? We assume that they would continue to be regarded as exempt until they are required to renew the exemption, rather than have to reapply under the draft Rules.	The assumption is correct. Section 91 of Schedule 10 to the SF Ordinance provides that any document or information given or served to the SFC under any provision of an Ordinance repealed by the SF Ordinance shall be deemed to have been served under any provision in the SF Ordinance. We take the view that section 91 covers the notification requirements imposed on existing exempt institutions.

List of Respondents

Date received	Respondent
25 June 2002	Allen and Overy
28 June 2002	Linklaters (on behalf of 2 firms)