

LEGISLATIVE COUNCIL BRIEF

Securities and Futures Ordinance (Cap. 571)

SECURITIES AND FUTURES (RECOGNIZED COUNTERPARTY) RULES

INTRODUCTION

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

BACKGROUND

The SFO

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

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

THE PROPOSALS

Major policy considerations

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

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

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

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

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

THE RULES

¹ Leveraged foreign exchange trading.

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

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

PUBLIC CONSULTATION

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

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

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

FINANCIAL AND STAFFING IMPLICATIONS

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

COMMENCEMENT DATE

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

PUBLICITY

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

ENQUIRIES

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

The Securities and Futures Commission
25 November 2002