
Financial Resources Rules Liquid Capital Computation

Part 1

Requirements generally applicable to Advisers

Leo Lam

Senior Manager of Intermediaries Supervision



Advisers' major liquid assets and ranking liabilities

Major liquid assets include cash, bank deposits, accrued interest / fees / commissions, house investments (securities, futures and options etc.)

Major ranking liabilities are balance sheet liabilities under GAAP and risk adjustments in respect of house positions and off-balance sheet exposures



Cash & interest etc. as liquid assets

- Beneficially owned cash, bank deposits (time deposit maturity not > 6 months) and accrued interests on time deposits [s.20]
- Fees / commissions arising from regulated activities [s.35]
 - accruals which will be first due for payment or billing within next 3 months
 - which have been due/billed and outstanding for not more than 1 month
- Sundry liquid assets, e.g. dividend receivable, accrued bond interests, tax reserve certificates, prepaid operating expenses up to 3 months etc.

House Investments

- Listed securities, debt securities and others investments
- futures and options



Securities and others investments

[Schedule 2]

- Accept all listed shares, specified exchange listed warrants and recognized exchange listed ELIs
- Debt Securities (if no published market price, accept quotations from 2 market makers, or 2 banks, securities dealers outside Hong Kong or licensed corporations, who customarily deal in such debt securities (except CDs)) [s.9]
- Recognized unit trust / mutual funds, gold, physical commodities

Securities and others investments - liquid assets calculation

- **Market Value * – Haircut Amount [s.27]**
 - Lower haircut percentage if stratified according to stock indices [Table 1 Schedule 2]
 - Haircut percentage halved for amount paid for securities subscription [s.35(f)]
-
- * Zero value for listed securities which have been suspended from trading for at least 3 business days / debt securities for which no quotation is available [s.9]



Haircut Amount / Haircut Percentage

$$\text{Haircut Amount} = \text{MV} \times \text{Haircut Percentage}$$

Haircut Percentage (see Schedule 2)

e.g.: constituents of the HSI - 15%
 constituents of the HSHKMidCapI - 20%
 all other HK listed shares - 30%

Debt securities - Sum of the percentages in
Table 4 and Table 5 of Schedule 2

Amount receivable from securities dealers [s.23]

- on a transaction-by-transaction basis

If securities are sold on a cash-against-delivery basis-

- a) Admit in full if ageing not exceeding 2 weeks
- b) Ageing >2weeks but < 1 month, cap at MV of the securities
- c) Fully write off if ageing of 1 month or above

If securities are sold on a free delivery basis-

- a) If the clearing system of the exchange settles on this basis, admit in full if ageing not exceeding 2 weeks
- b) Otherwise, only admit balance which has not been overdue



Liquid assets arising from Futures/Options trading

- Long position in options traded on specified exchange
 - admit **60%** of market value as liquid assets [s.31]
(zero value for other options)
- Margin deposit placed with the following parties admitted as liquid assets
 - recognized clearing houses, futures or options clearing houses of specified exchanges, their clearing participants and HK securities dealers and futures dealers [s.28, 29]

Balance sheet liabilities as ranking liabilities [s.53]

All liabilities

e.g.: overdraft, loans, accrued interest / expenses, account payables, tax payable (less any related prepaid tax), provision made for contingent liabilities / floating losses in respect of open positions

But do not include:

- approved subordinated loan
- Non- current portion (repayable beyond 12 months) of mortgage loan that is secured by beneficially owned office premises (capped at the net realizable value of that property)

Ranking liabilities arising from concentrated proprietary positions

If the net market value (NMV) of any single item of securities or investments equals 25% or more of required liquid capital (RLC), shall include in ranking liabilities

- **5% of the NMV**, if NMV is 25 to 50% of RLC
- **10% of the NMV**, if NMV is = or > 51% of RLC

Ranking liabilities arising from short positions in securities / investments

- General : $(MV^* + \text{Haircut Amount})$ [s.43]
- If not specified in Schedule 2 / holding $> 5\%$ market capitalisation of that securities / listed shares or listed warrants which have been suspended from trading for at least 3 business days: $(MV^* \times 2)$
- * Last closing price of listed securities which have been suspended from trading for at least 3 business days / face value of debt securities in respect of which no quotations are available [s.9]

Ranking liabilities arising from Futures/Options positions

Futures contracts

- Include in ranking liabilities the margin requirement amount [s.40(4)]

Options contracts

- If traded on specified exchange, include the margin requirement amount [s.40(4)]
- Otherwise, include the highest amount below [s.40(11) & (12)]
 - 200% of MV
 - 200% of in-the-money amount
 - 200% of the margin requirement amount.

Ranking liabilities arising from other off-balance sheet exposures

- Net underwriting commitment [s.47]
- Floating losses on off-exchange traded derivatives [s.48]
- Interest rate swap agreement [s.49 + Table 1 Schedule 4]
- Foreign exchange agreement [s.50 + Table 2 Schedule 4]
- 10% of guarantee / financial commitment [s.52(1)(a)]
- Net liabilities of subsidiary [s.52(1)(b)]
- 5% of net position in each foreign currency [s.52(1)(d)]
- Note issuance and revolving underwriting facility [s.52(1)(e) + Schedule 5]

Net position in foreign currency

[s.52(1)(d)]

“Net position” in a foreign currency means the difference between -

- (a) the value of beneficially owned assets (other than fixed assets) which are denominated in the foreign currency + the amount of the foreign currency to be purchased under any outstanding contract
- (b) the amount of on-balance sheet liabilities (other than excluded liabilities) which are denominated in such foreign currency + the amount of such foreign currency to be sold under any outstanding contract

“excluded liabilities”

Means amounts payable to clients in respect of client money held in :

- segregated account / account separate from the house bank account with an authorized financial institution
- account separate from the house bank account with an approved bank incorporated outside Hong Kong
- segregated account with a recognized clearing house

Illustrative example 1