

Updating Your Study Manual

Instructions for Inserting Version 1.8

The followings serve as the instructions for updating **Topic 7: Securities, Options and Futures** of Study Manual 1 for the Licensing Examination for Securities and Futures Intermediaries. Please be reminded that only the updated sections are provided for downloading. You may replace the relevant sections with this updated version for the study manual you possess.

Instructions:

1. Download and print out the following pages.
 2. **Remove** pages 7-7 to 7-8 and **Insert** new pages 7-7 to 7-8.
 3. **Remove** pages 7-11 to 7-12 and **Insert** new pages 7-11 to 7-12.
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The Hong Kong Exchanges and Clearing Ltd. ('HKEx')

- 2.11 HKEx is a company listed on SEHK (see below) and is an exchange controller as defined in the SFO. HKEx controls and has as subsidiaries various exchanges and clearing houses in Hong Kong.
- 2.12 As noted earlier, HKEx is responsible for ensuring an orderly and fair market in securities and futures contracts and other matters (refer paragraph 4.3 and 4.6, topic 1 for other responsibilities). Rules and regulations have been made for these purposes by the Exchanges and clearing houses and these may be referred to if detailed information is required.
- 2.13 HKEx regulates listed companies, trading on the exchanges and the related clearing and settlement functions. The regulation of intermediaries engaged in trading on the exchanges and their relationships with each other and their clients are principally directly regulated by the SFC. Accordingly although the operating and other rules can be extensive, the regulatory aspects of the operations of the HKEx group are limited in their scope.

Exchanges, trading systems and clearing houses

- 2.14 It will be helpful to a newcomer to the Hong Kong exchanges to introduce the various entities. The details of how they are structured and how trading, clearing and settlement are conducted will not be dealt in this manual except to the minimal extent necessary to help understand the regulatory implications.
- 2.15 There are currently two exchanges:
- The Stock Exchange of Hong Kong Limited ('SEHK') which provides for trading in securities as defined earlier on two Boards, the Main Board and a secondary board, the Growth Enterprise Market ('GEM'), and in options on underlying securities also traded on the Main Board; and
 - The Hong Kong Futures Exchange Limited ('HKFE') which provides for trading in futures contracts principally financial futures.
- 2.16 These were independent until 6 March 2000 when they were made subsidiaries of HKEx under a scheme of arrangement. They continued to retain their trading and settlement structures. Their operations are governed by separate sets of Rules.

Trading systems

- 2.17 The third generation of the Automatic Order Matching and Execution System ('AMS/3') is the trading system currently used by SEHK. The AMS/3 system architecture allows for a direct interface between brokers' own systems and AMS/3 and eventually to straight through processing of

client orders. AMS/3 processes equities, debt instruments, unit trusts, exchange traded funds and warrants.

- 2.18 The Hong Kong Futures Automated Trading System ('HKATS') is an electronic screen based trading system used for trading in HKFE products as well as traded options which are SEHK products.
- 2.19 Options trading and clearing is conducted through the HKATS and clears through Derivatives and Clearing and Settlement System ('DCASS').

Clearing and settlement systems

- 2.20 There are 3 clearing houses:
- the Hong Kong Securities Clearing **Company** Limited ('HKSCC') which was an independent corporation and the clearing house for the 'cash business' of SEHK;
 - the SEHK Options Clearing House Limited ('SEOCH'), a wholly owned subsidiary of SEHK, which clears the traded options business of SEHK; and
 - the HKFE Clearing Corporation Limited ('HKCC'), a subsidiary of HKFE which clears the futures business of HKFE.
- 2.21 Under the March 2000 arrangements, HKSCC also became a subsidiary of HKEx. No further rearrangement was necessary for the other two clearing houses as they were already subsidiaries of SEHK and HKFE and automatically had HKEx as their ultimate holding company.
- 2.22 The Central Clearing and Settlement System ('CCASS') is operated by HKSCC for securities transactions on SEHK. HKEx introduced in April 2004 the DCASS. DCASS provides a common platform for the clearing and settlement of all derivatives products traded on the HKEx markets, including index futures and options, single stock futures and options.

Participants

- 2.23 There are a number of groups of 'Participants' within the structure of the various exchanges and clearing houses. Membership of HKEx is distinct from access to the trading facilities of SEHK and HKFE and access to the settlement facilities of HKSCC, SEOCH and HKCC. Because of the separation of ownership and the right to trade, membership is no longer needed to trade on the exchanges or to clear the trades.
- 2.24 Instead, those who wish to trade through the exchanges ('exchange participants') are required to hold trading rights and register with SEHK as (SEHK) Exchange Participants, or with the HKFE as (HKFE) Exchange

Closing price calculation

- 2.32 To avoid a situation in which the closing price is controlled by the price of the last transaction, AMS/3 takes the median figure of the five nominal prices recorded in the last minute of a trading day as the closing price of a security. From 3.59 p.m. onwards, the system records the nominal price of a security every 15 seconds. Five nominal prices will be collected for each security. The nominal price is calculated on the basis of the bid price, the ask price and the last trading price. This procedure minimises the chance of any manipulation of the closing price.

Direct business

- 2.33 Direct business means business transacted by an exchange participant (or dealing partnership), which acts for both the buyer and the seller, whether as principal or agent. Direct business must be conducted under several rules including the inputting of details of such transactions within 15 minutes of concluding the transaction.

Transaction Costs

- 2.34 The following are costs to an investor of buying and selling securities on SEHK. The SEHK as well as the SFC will monitor the correctness of the charges.

Brokerage (Commission)

- 2.35 HKEx has abolished minimum commissions chargeable on transactions on the SEHK with effect from 1 April, 2003. The brokerage of IPO transactions is currently set at 1% of the subscription.

Transaction Levy and Investor Compensation Levy

- 2.36 The SEHK charges two levies on the value of each purchase or sale of securities as follows (both the buyer and seller shall pay each of the two levies):
- A Transaction Levy of 0.005% which is passed on to the SFC for use in funding its operations; and
 - An Investor Compensation Levy of 0.002% which is used to fund the Investor Compensation Fund established by the SFC.

There is no Transaction Levy nor Investor Compensation Levy on SEHK traded options, pilot program and market making trades in designated Exchange Traded Funds.

Trading fee

- 2.37 A trading fee of 0.005% per side of the consideration of a transaction is payable to the SEHK. There is no trading fee on SEHK traded options, pilot program and market making trades in designated Exchange Traded Funds.

Trading tariff

- 2.38 A trading tariff of HK\$0.50 is payable to the SEHK on each and every purchase or sale transaction.

Ad valorem stamp duty

- 2.39 An ad valorem stamp duty is levied on each transaction at the rate of **0.1% (rounded up to the nearest dollar) on the value of the transaction, on both the buyer and the seller.**

Transfer deed stamp duty

- 2.40 Independent of the quantity of shares traded, the Government levies a transfer deed stamp duty of HK\$5, payable by the registered holder of the share certificate(s), i.e. the seller, on each new transfer deed.

Transfer fee

- 2.41 Independent of the quantity of shares traded, the registrar of each listed company levies a transfer fee of HK\$2.5 per share certificate from the registered holder, i.e. the buyer, for each new certificate issued.
- 2.42 No charges are levied by the HKSCC on investors if they settle with brokers or custodians outside the CCASS. However, brokers or custodians have to pay fees for use of the clearing, settlement, custody and nominee services offered by HKSCC. The decision on whether to pass these fees on to investors will be totally at the discretion of the brokers or custodians.

Regulated Short Selling on the SEHK

- 2.43 Regulated short selling is defined in Schedule 1, SFO and in the Eleventh Schedule of the SEHK Rules to mean the sale of a security in respect of which the seller or a person, for whose benefit or on whose behalf the sale is made, has a presently exercisable and unconditional right to vest the security in the purchaser by virtue of having:
- under a securities borrowing and lending agreement (see paragraphs 2.46 to 2.51 below):
 - borrowed the securities; or
 - obtained a confirmation from the counterparty to the agreement that the counterparty has the security available to lend to him;
 - a title to another security which is convertible into or exchangeable for the security to which the sale relates;
 - an option to acquire the security to which the sale relates;