



PAST QUESTIONS AND ANSWERS (December 2006)

PAPER 3

REGULATION OF DERIVATIVES

of

The Licensing Examination
for Securities and Futures Intermediaries

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Methodology of Developing Questions

Our Institute is committed to providing questions of the highest quality.

Our current examination structure has been benchmarked against those in both developed and emerging markets such as UK, US, Australia, Singapore, Malaysia and China. The syllabuses, study materials, training guides and questions were designed by international consultants specializing in financial education.

The Licensing Examination has been approved by the Academic and Accreditation Advisory Committee of the Securities and Futures Commission (SFC) as recognized industry qualification and local regulatory framework paper for meeting the competence requirements of the SFC.

External consultants are appointed to develop new questions according to specified criteria approved by our Examinations Committee. The aim of these criteria is to ensure that the candidates have thorough understanding of the manuals by testing them at different cognitive levels such as recall, comprehension, application, analysis and evaluation on predetermined weightings of each topic. The new questions are reviewed by reviewers who are market practitioners, legal and compliance professionals, and academics to ensure that the knowledge tested is covered in the study manuals, and that the standard of the questions is appropriate and consistent throughout.

To maintain their quality, the questions undergo frequent reviews and revisions internally which take into account, among others, the average correctness of the questions (i.e., the percentage of candidates in the examination who correctly answer the questions) and candidates' comments, if any, following each examination. In addition to the quality assurance being imposed on the questions, external assessors who are market practitioners, legal and compliance professionals, and academics, are engaged to conduct regular reviews. There are also periodic comprehensive reviews by external consultants on the manuals and questions.

The study manuals and their subsequent updates are the only source of materials for the setting of the questions, so that candidates need to study only those manuals and updates to prepare for the examinations.

It is estimated that the study manuals will require 6 to 11 hours of study time per topic, depending on which paper it is. Candidates may need to spend more or less time, depending on their work experience and background. They are advised to use the Learning Outcomes for each topic as a key to the way they study the materials in each topic, and unless explicitly stated, they could be tested on any aspect of the syllabus.

**Please attempt ALL 40 questions in this question book.
All questions carry EQUAL MARKS.**

<1>.

Participants from which **ONE** of the following countries are **NOT** entitled to remote access to Hong Kong Automated Trading System (HKATS)?

- A Australia.
- B Japan.
- C United Kingdom.
- D The United States of America.

<2>.

Which **ONE** of the following statements about futures clearing is **CORRECT**?

- A The HKFE Clearing Corporation Limited (HKCC) is partly owned by the Hong Kong Securities Clearing Company Limited (HKSCC).
- B HKCC clears all options as well as futures.
- C HKCC clears futures contracts for all futures intermediaries.
- D HKCC is open only to participants of the Hong Kong Futures Exchange (HKFE).

<3>.

Which **ONE** of the following statements about short selling of Hong Kong Futures Exchange (HKFE) market makers is **INCORRECT**?

- A Short sales may be made on any security that underlies a futures contract on an index.
- B Short sales may be made on any listed security which has the same underlying as the contract they are hedging.
- C Short sales may be made on any listed security that underlies a single stock futures contract.
- D Short sales may apply to pre-hedging activities.

<4>.

Under the Securities and Futures Ordinance (SFO), an intermediary is restricted from making an unsolicited call, without the express invitation of the recipient, to which **ONE** of the following persons?

- A A solicitor acting in his professional capacity.
- B An unregistered institution.
- C A professional investor.
- D An existing client.

<5>.

Which of the following statements about the futures trading system (HKATS – Hong Kong Automated Trading System) are **CORRECT**?

- I Direct access to HKATS is available to all Approved Institutional Investors in Hong Kong.
 - II Direct access to HKATS is available to Stock Exchange of Hong Kong (SEHK) options trading participants.
 - III Remote access to HKATS is permitted to overseas-incorporated companies trading futures contracts for their own account and regulated by the domestic regulatory authority which has a Memorandum of Understanding with the Securities and Futures Commission (SFC).
 - IV Remote access to HKATS is available to approved traders on the Tokyo International Financial Futures Exchange (TIFFE).
- A I and II only
 - B I and IV only
 - C II and III only
 - D I, II and III only

<6>.

Which of the following statements are **CORRECT**?

- I Hong Kong Exchanges and Clearing Limited (HKEx) is responsible for the front line prudential regulation of exchange participants.
 - II Securities and Futures Commission (SFC) is responsible for regulating the general conduct of exchange participants.
 - III HKEx undertakes management of its own business risk.
 - IV HKEx enforces its own trading, clearing and settlement rules.
- A I and II only
 - B I, II and III only
 - C I, III and IV only
 - D II, III and IV only

<7>.

Under the Securities and Futures Ordinance (SFO), licensed individuals are required to report to the Securities and Futures Commission (SFC) when which **ONE** of the following situations changes?

- A The status of their membership in an overseas Securities Institute.
- B The status of their membership of an overseas stock exchange or futures exchange.
- C The status of their membership of an overseas sports association.
- D The status of any authorisation by a community organisation outside Hong Kong.

<8>.

Under Schedule 1, Securities and Futures Ordinance (SFO), which of the following statements are **CORRECT** in defining a futures contract?

- I A forward contract or an option on a forward contract made under the rules or conventions between two consenting counterparties.
 - II Interests, rights or property which is interests, rights or property, or is of a class or description of interests, rights or property prescribed by notice under Section 392 of SFO as being regarded as futures contracts in accordance with the terms of the notice.
 - III An option contract for settlement on a future date made under the rules of a recognised securities exchange whereby delivery of the contract is to be settled in equity shares.
 - IV A contract or an option on a contract made under the rules or conventions of a futures market.
- A I and II only
 - B II and IV only
 - C III and IV only
 - D I, II and IV only

<9>.

Under the Securities and Futures (Financial Resources) Rules, which **ONE** of the following statements about share capital is **INCORRECT**?

- A The minimum paid-up capital requirement for an intermediary carrying out Type 2 (dealing in futures contracts) regulated activity is HKD5 million.
- B The minimum paid-up capital requirement for an intermediary carrying out Type 5 (advising on futures contracts) regulated activity is HKD5 million.
- C The minimum paid-up capital requirement for an intermediary carrying out both Type 2 (dealing in futures contracts) regulated activity and Type 5 (advising on futures contracts) regulated activity is HKD5 million.
- D The minimum paid-up capital requirement for an intermediary carrying out both Type 2 (dealing in futures contracts) regulated activity and Type 5 (advising on futures contracts) regulated activity is HKD10 million.

<10>.

A person does **NOT** need a Type 2 licence (dealing in futures contracts) from the Securities and Futures Commission (SFC) under which of the following circumstances?

- I When he is licensed for Type 9 regulated activity (asset management) and deals in futures contracts solely for the purpose of his asset management activity.
 - II When offering to make an agreement with another person to dispose of a futures contract.
 - III When attempting to induce another person to offer to enter into a futures contract.
 - IV When dealing as a principal off-exchange with a professional investor.
- A I and III only
 - B I and IV only
 - C II and III only
 - D II, III and IV only

<11>.

Under the Securities and Futures Ordinance (SFO), what would be the further penalty on summary conviction for a continuing offence for a person holding himself out as performing any function in relation to a regulated activity without holding an appropriate licence?

- A A fine of HKD2,000 per day for every day during which the offence continues.
- B A fine of HKD20,000 per day for every day during which the offence continues.
- C A fine of HKD10,000 per day for every day during which the offence continues.
- D A fine of HKD100,000 per day for every day during which the offence continues.

<12>.

Corporation XYZ wishes to acquire shares of Intermediary JKL equivalent to 15% of the voting power of JKL. Which of the following statements are **CORRECT**?

- I JKL must notify the Securities and Futures Commission (SFC).
 - II JKL sponsors XYZ during its approval process.
 - III XYZ must be approved as fit and proper by the SFC.
 - IV If XYZ fails to get approval from the SFC before becoming a substantial shareholder, it may be committing an offence under the Securities and Futures Ordinance (SFO).
- A I and IV only
 - B II and III only
 - C I, III and IV only
 - D II, III and IV only

<13>.

Which **ONE** of the following statements about responsible officers for Type 2 (dealing in futures contracts) regulated activity is **CORRECT**?

- A The Hong Kong Futures Exchange (HKFE) has the power to suspend a responsible officer of any one of its trading participants.
- B A responsible officer must be an executive director of the licensed corporation.
- C One responsible officer must be available at all times to supervise the business of the regulated activity.
- D A responsible officer has no legal liability in the event that his negligence causes a licensed corporation to be in breach of the Securities and Futures Ordinance (SFO).

<14>.

Which of the following statements about client money are **CORRECT**?

- I Under the Securities and Futures (Client Money) Rules, cash held on deposit for a non-regulated activity is excluded.
 - II Under the Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission, the potential risks associated with money held overseas must be explained to the client.
 - III Under the Securities and Futures (Client Money) Rules, money held in the client's own bank account where the intermediary has authority to operate it for settlement purposes is covered.
 - IV Under the Securities and Futures (Client Money) Rules, cash received by the associated entity of the licensed corporation is covered.
- A I and IV only
 - B II and III only
 - C II and IV only
 - D I, II and IV only

<15>.

Under the Securities and Futures (Client Securities) Rules, which of the following may receive clients' assets in Hong Kong on behalf of an intermediary?

- I An associated entity of the intermediary.
 - II An authorised financial institution.
 - III A custodian approved by the Securities and Futures Commission (SFC).
 - IV Another intermediary with whom client collateral is deposited under financial accommodation arrangements.
- A I and IV only
 - B II and III only
 - C II and IV only
 - D I, II, III and IV

<16>.

Under the Securities and Futures (Client Money) Rules, which of the following statements are **CORRECT**?

- I Amounts that are to be handled according to a client's standing authority need not be deposited into a segregated account.
 - II All amounts received in Hong Kong or overseas for a client's dealing in futures contracts are subject to the rules.
 - III Interest arising from client money is subject to the rules.
 - IV Money to be used for margin purposes within the next three days need not be segregated.
- A I and II only
 - B I and III only
 - C II and III only
 - D III and IV only

<17>.

Under the Securities and Futures (Client Securities) Rules or the Securities and Futures (Client Money) Rules, an intermediary has a duty to report any non-compliance to the Securities and Futures Commission (SFC). What is the time limit for such reporting?

- A Immediately it is discovered.
- B Within one business day.
- C Within 48 hours.
- D Within one week.

<18>.

Under the Securities and Futures (Client Securities) Rules, when an intermediary receives no objection from a private customer to the renewal of his standing authority for client securities, the intermediary **MUST** within what time period after the expiry date issue a written confirmation?

- A 2 working days.
- B 1 week.
- C 10 working days.
- D 1 month.

<19>.

What is the amount of the maximum fine for a breach of the Securities and Futures (Client Money) Rules with intent to defraud, on summary conviction?

- A HKD50,000 and imprisonment for 3 years.
- B HKD500,000 and imprisonment for 1 year.
- C HKD1,000,000 and imprisonment for 7 years.
- D HKD5,000,000 and imprisonment for 2 years.

<20>.

Under the Securities and Futures Ordinance (SFO), which **ONE** of the following types of transactions **CANNOT** be part of a “false trading” charge?

- A Futures contracts traded on a recognised London exchange.
- B Options on futures contracts traded on an Automated Trading System authorised by the Securities and Futures Commission (SFC).
- C Forward contracts traded between two licensed counterparties in an over-the-counter transaction.
- D Listed warrants traded under the rules of the Stock Exchange of Hong Kong (SEHK).

<21>.

Which **ONE** of the following statements about telephone usage is **INCORRECT**?

- A Orders received over land-line telephones should be recorded and kept for a minimum of 3 months.
- B Orders received over mobile phones must immediately be recorded manually or on the central telephone recording system.
- C According to the Securities and Futures Commission (SFC) Rules, orders cannot be received over a mobile phone.
- D Intermediaries may forbid the usage of mobile phones for any reasons on their premises.

<22>.

Under the Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission, in the event that the net equity in a discretionary account of a client (who trades futures and options) falls by more than 50% in a specified period or less, the intermediary is required to notify the client. What is the specified period?

- A 3 days.
- B 4 days.
- C 5 days.
- D 6 days.

<23>.

Under Part XIII of the Securities and Futures Ordinance (SFO), which **ONE** of the following activities is **NOT** considered an offence of “market misconduct”?

- A False trading.
- B Insider dealing.
- C Covered short selling.
- D Stock market manipulation.

<24>.

Under the Securities and Futures Ordinance (SFO) on disclosure of interests, the current notifiable percentage level is set at 5%. There is then a continuing duty to disclose when the notifiable interests (including those with potential positions resulting from held derivatives) results in a change of percentage level equivalent to or more than the “specified percentage level”. What is the “specified percentage level” ?

- A 0.1%.
- B 0.5%.
- C 1%.
- D 5%.

<25>.

Which **ONE** of the following practices is **NOT** required when an intermediary is providing services to a client in derivative products?

- A To make sure that the client understands the nature and risks of derivative products.
- B To ascertain the client’s appetite for risk.
- C To ascertain the client’s financial ability to absorb losses.
- D To ensure that the client understands all the Hong Kong Futures Exchange (HKFE) Trading System rules.

<26>.

Under Part XIV of the Securities and Futures Ordinance (SFO), what is the maximum penalty if convicted on indictment for the offence of insider dealing?

- A HKD1 million and imprisonment for 3 years.
- B HKD1 million and imprisonment for 10 years.
- C HKD10 million and imprisonment for 3 years.
- D HKD10 million and imprisonment for 10 years.

<27>.

With respect to contract notes for non-professional investors, under the Securities and Futures (Contract Notes, Statements of Account and Receipts) Rules, which of the following statements are **CORRECT**?

- I The contract note must be issued on the same business day.
 - II Contract notes can be consolidated with the daily statement of account.
 - III Information regarding futures contracts entered into on the same day can be consolidated into one contract note.
 - IV The client can choose to receive all contract notes at the month end.
- A I and IV only
 - B II and III only
 - C II, III and IV only
 - D I, II, III and IV

<28>.

Under the Securities and Futures (Contract Notes, Statements of Account and Receipts) Rules, to whom may an intermediary **NOT** pass a client's contract note?

- A The client himself.
- B The client's solicitor.
- C An officer of the intermediary.
- D The client's accountant.

<29>.

Under the Securities and Futures (Contract Notes, Statements of Account and Receipts) Rules, which **ONE** of the following items is **NOT** required on a confirmation note for a futures contract transaction?

- A Price per unit or average price if the client so requests.
- B The nature of the dealing and the name of any agent involved in either dealing or the clearing.
- C The theoretical fair price of the contract.
- D The name and description of the futures contract to enable it to be identified.

<30>.

Under the Securities and Futures (Contract Notes, Statements of Account and Receipts) Rules, what is the time limit within which a client can request a copy of a past statement of account?

- A 6 months.
- B 1 year.
- C 2 years.
- D 5 years.

<31>.

Under the Securities and Futures (Contract Notes, Statements of Account and Receipts) Rules, which of the following details must a daily statement of account contain for clients trading in futures contracts?

- I The amount of margin excess or margin shortfall as at the end of that day.
 - II Details of all income credited to and charges levied against the account during that day.
 - III All settlement values at the expiration dates of each futures contract.
 - IV All floating profits and floating losses as at the end of that day.
- A I, II and III only
 - B I, II and IV only
 - C I, III and IV only
 - D II, III and IV only

<32>.

Under the Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission, which of the following records are intermediaries licensed to deal in futures contracts required to maintain?

- I The amount of variation adjustment and interest rate cash adjustment collected or required to be collected from clients.
 - II Particulars of all open positions of the intermediary and of each of its clients.
 - III The amount of margin deposited or required to be deposited by each client.
 - IV The cost of carry for every completed futures transaction.
- A I, II and III only
 - B I, II and IV only
 - C I, III and IV only
 - D II, III and IV only

<33>.

Under the Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission, intermediaries in the futures market must maintain separate client ledger accounts for three categories of business. Which **ONE** of the following categories is **NOT** a recognised requirement?

- A All Hong Kong Futures Exchange (HKFE) trades.
- B All HKFE unmatched trades.
- C All non-HKFE trades.
- D All trades which are not futures and options business of that client.

<34>.

Under the HKFE Clearing Corporation (HKCC) Rules, what is the “minimum volume threshold” for a block trade in HIBOR futures?

- A 20.
- B 80.
- C 100.
- D 200.

<35>.

Which of the following statements about bank guarantees for the HKFE Clearing Corporation Limited (HKCC) are **CORRECT**?

- I The HKCC will accept guarantees from any authorised institution.
- II The HKCC has the discretion to accept a guarantee from a bank which is the holding company of the HKCC participant.
- III The HKCC participant must give at least one bank business day’s notice of its intention to use a bank guarantee.
- IV The HKCC has the right to determine the amount of an HKCC participant’s margin liability which may be covered by guarantees.

- A I and II only
- B II and III only
- C II and IV only
- D III and IV only

<36>.

Under the Rules of the Hong Kong Futures Exchange (HKFE), the trading entitlement “for his own account only” is **MOST** applicable to which **ONE** of the following exchange participant types?

- A Broker.
- B Futures Commission Merchant.
- C Merchant Trader.
- D Trader.

<37>.

Under the HKFE Clearing Corporation (HKCC) Rules, which **ONE** of the following conditions is **NOT** an initial requirement for applicants for Clearing House Participants?

- A To satisfy the minimum capital requirements.
- B To have agreed in writing to abide by the HKCC Rules.
- C To operate under the same name as it is registered as an exchange participant.
- D To demonstrate its previous experience as a clearing agent.

<38>.

Under the HKFE Clearing Corporation (HKCC) Rules, what do the initials SPAN stand for in relation to its margin system?

- A Standard and Poors Analytical Network.
- B Standard Portfolio Analysis of Risk.
- C Stock Product Analysis of Notional values.
- D Swedish Proprietary Analytical Network.

<39>.

Which **ONE** of the following is an exchange where many of its traded products are forwards rather than futures contracts?

- A MATIF, France.
- B OM, Sweden.
- C The Singapore Exchange.
- D The Sydney Futures Exchange.

<40>.

The Ministry of Finance is the futures regulator of which **ONE** of the following countries?

- A Australia.
- B Germany.
- C Japan.
- D United Kingdom.

~End of the Examination Paper~

Answers

| Question No. | Answer | Question No. | Answer |
|---------------------|---------------|---------------------|---------------|
| 1 | B | 21 | C |
| 2 | D | 22 | A |
| 3 | D | 23 | C |
| 4 | B | 24 | C |
| 5 | C | 25 | D |
| 6 | D | 26 | D |
| 7 | B | 27 | B |
| 8 | B | 28 | C |
| 9 | D | 29 | C |
| 10 | B | 30 | C |
| 11 | A | 31 | B |
| 12 | C | 32 | A |
| 13 | C | 33 | B |
| 14 | D | 34 | B |
| 15 | D | 35 | D |
| 16 | B | 36 | D |
| 17 | B | 37 | D |
| 18 | B | 38 | B |
| 19 | B | 39 | B |
| 20 | C | 40 | C |