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[online version](http://www.charltonslaw.com/amendments-to-the-definitions-of-specified-stock-and-futures-exchanges-and-proposed-amendments-to-the-securities-and-futures-financial-resources-rules/)

# Amendments To The Definitions Of Specified Stock And Futures Exchanges Effective 18 July 2012 And Proposed Amendments To The Securities And Futures (Financial Resources) Rules

## 1. Amendments To The Definitions Of Specified Stock And Futures Exchanges Effective 18 July 2012

### Introduction

Amendments to the definitions of specified Futures Exchanges (**SFEs**) and specified Stock Exchanges (**SSEs**) in Parts 2 and 3 to Schedule 1 of the Securities and Futures Ordinance (**SFO**) took effect on 18 July 2012. The amendments followed the SFC’s release of its Consultation Conclusions on Proposed Amendments to Specified Stock and Futures Exchanges (**Conclusions**) on 11 May 2012 and the Securities and Futures Ordinance (Amendment of Schedule 1) Notice 2012 on 25 April 2012. The principal amendments are:

* updates to exchanges which reflect renaming and restructuring, and
* addition of exchanges from emerging markets.

The SFO and its subsidiary legislation refer to SFEs and/or SSEs in relation to:

* licensing of regulated activities;
* disclosure of interests obligations;
* recognised counterparty status, and
* securities’ price stabilising period.

The Inland Revenue Ordinance (**IRO**) refers to them in relation to tax breaks. The Trustee Ordinance, Gambling Ordinance, Occupational Retirement Schemes Ordinance and Mass Transit Railway Ordinance also refer to them.

This newsletter sets out the amendments to the SFO, their key implications under the SFO and IRO.

A copy of the notice amending Schedule 1 SFO can be viewed [here](http://www.sfc.hk/web/EN/pdf/laws/sfo/20/L.N.%2094%20of%202012%20(Eng).pdf) ([Archived copy](L.N._94_of_2012_(Eng).pdf)).

### New Exchanges In The SFO

Seven futures exchanges from Brazil, China and India have been added to Part 2 to Schedule 1 of the SFO:

* BM&FBOVESPA S.A. – Bolsa de Valores, Mercadorias e Futuros;
* China Financial Futures Exchange;
* Dalian Commodity Exchange;
* Shanghai Futures Exchange;
* Zhengzhou Commodity Exchange;
* Multi Commodity Exchange of India Limited, and
* National Commodity & Derivatives Exchange Limited.

Two stock exchanges from India have been added to Part 3.

* BSE Limited, and
* National Stock Exchange of India Limited.

### Updated Exchanges In The SFO

#### Updated Futures Exchanges

The following futures exchanges in Part 2 of Schedule 1 to the SFO have been updated.

ASX Limited

formerly Australian Stock Exchange

Australian Securities Exchange Limited

formerly Sydney Futures Exchange, Ltd.

Board of Trade of the City of Chicago, Inc.

formerly Chicago Board of Trade

Chicago Board Options Exchange, Incorporated

formerly Chicago Board Options Exchange

Commodity Exchange, Inc.

formerly Commodity Exchange, Inc. (New York)

Eurex Frankfurt AG and Eurex Zürich AG

formerly Eurex

Euronext Amsterdam N.V.

formerly Euronext Amsterdam

Euronext Paris S.A.

formerly Marche a Terme International de France and Marche des Options Negociables de Paris

ICE Futures Canada, Inc.

formerly Winnipeg Commodities Exchange Inc.

ICE Futures U.S., Inc.

formerly New York Cotton Exchange, Inc. and New York Futures Exchange

Korea Exchange, Inc.

formerly Korea Stock Exchange

LIFFE Administration and Management

formerly London International Financial Futures and Options Exchange

Montréal Exchange Inc.

formerly Bourse de Montreal Inc.

NASDAQ OMX PHLX LLC

formerly Philadelphia Stock Exchange

NASDAQ OMX Stockholm AB

formerly Stockholmsborsen

New York Mercantile Exchange, Inc.

formerly New York Mercantile Exchange

New Zealand Futures and Options Exchange Limited

formerly New Zealand Futures and Options Exchange

NYSE Arca, Inc.

formerly Pacific Exchange

Osaka Securities Exchange Co., Ltd.

formerly Osaka Securities Exchange

The London Metal Exchange Limited

formerly London Metal Exchange

Tokyo Financial Exchange Inc.

formerly Tokyo International Financial Futures Exchange

Tokyo Grain Exchange Inc.

formerly Tokyo Grain Exchange

Tokyo Stock Exchange, Inc.

formerly Tokyo Stock Exchange

#### Updated Stock Exchanges

The following stock exchanges in Part 3 of Schedule 1 to the SFO have been updated.

ASX Limited

formerly Australian Stock Exchange

Bursa Malaysia Securities Berhad

formerly Kuala Lumpur Stock Exchange

Deutsche Börse AG

formerly Deutsche Borse AG

Euronext Amsterdam N.V.

formerly Euronext Amsterdam

Euronext Brussels S.A./N.V.

formerly Euronext Brussels

Euronext Paris S.A.

formerly Euronext Paris

Korea Exchange, Inc.

formerly Korea Stock Exchange

London Stock Exchange plc

formerly London Stock Exchange

Montréal Exchange Inc.

formerly Bourse de Montreal Inc.

Nagoya Stock Exchange, Inc.

formerly Nagoya Stock Exchange

NASDAQ OMX Copenhagen A/S

formerly Copenhagen Stock Exchange

NASDAQ OMX Helsinki Ltd

formerly Helsinki Exchanges

NASDAQ OMX Stockholm AB

formerly Stockholmsborsen

New York Stock Exchange LLC

formerly New York Stock Exchange

NYSE Amex LLC

formerly American Stock Exchange

NZX Limited

formerly New Zealand Stock Exchange

Osaka Securities Exchange Co., Ltd.

formerly Osaka Securities Exchange

Oslo Børs ASA

formerly Olso Bors

SIX Swiss Exchange AG

formerly SWX Swiss Exchange

Tokyo Stock Exchange, Inc.

formerly Tokyo Stock Exchange

TSX Inc.

formerly Toronto Stock Exchange

Wiener Börse AG

formerly Wiener Borse AG

### Matters Affected

#### Exemption from Regulation of Leveraged Foreign Exchange Trading

Part 1 of Schedule 5 to the SFO lists nine types of regulated activity. They include:

* Type 1: dealing in securities;
* Type 2: dealing in futures contracts, and
* Type 3: leveraged foreign exchange trading.

Under the SFO, a licence or registration from the SFC is generally required to carry out each regulated activity. The definition of leveraged foreign exchange trading exempts from the licensing/registration requirement acts in connection with:

* a transaction executed on a SSE by or through a person licensed or registered for dealing in securities or wholly incidental to such a transaction; and
* a contract executed on a SFE by or through a person licensed or registered for dealing in futures contracts or wholly incidental to such a contract.

Type 3 trading by a Type 1 or Type 2 licensee on a SSE or SFE is thus exempted from Type 3 licensing requirements.

#### Exemption of Individuals from Local Regulatory Framework Paper

The SFC assesses individuals seeking to engage in regulated activities. The addition of exchanges extends recognition of competence to applicants with experience in emerging markets. Under Section 6(a) of Appendix E to the SFC Guidelines on Competence, individuals who demonstrate substantial experience, such as eight years in a market with a SFE or SSE, may obtain conditional exemption from sitting the local regulatory framework paper.

#### Exemption from Disclosure of Interests Obligations

Part XV of the SFO imposes obligations on corporate insiders to disclose their shareholdings in listed corporations. The disclosure obligation extends to interests under equity derivatives. Section 308(1) stipulates that equity derivatives include rights, options or interests in underlying shares. Hence, holders, writers and issuers of equity derivatives are taken to be interested in underlying shares and must disclose such interest. Sections 308(5) to (7) provide an exemption from disclosure for basket derivatives where the basket comprises at least five shares listed on an SSE provided that no one share accounts for more than 30% of the value of the total basket.

Section 326(4) relaxes the duty of disclosure under Section 310 for listed corporations, including those listed on an SSE or their wholly owned subsidiary. It exempts them from disclosing the name and address of any person whose directions or instructions they, or their directors, are accustomed or obliged to follow.

#### Recognised Counterparty Status

Under Section 3(a) to (b) of the Securities and Futures (Recognised Counterparty) Rules:

* a corporation licensed for dealing in futures contracts, or
* equivalent corporation,

which deals in currency futures contracts on a SFE, is a recognised counterparty. An equivalent corporation has equivalent, regulated dealings in eight jurisdictions specified in Schedule 1 to the Rules.

Under Part 1 of Schedule 1 to the SFO, a recognised counterparty is not a client of a corporation licensed for leveraged foreign exchange trading. Trading corporations are relieved from client-related obligations. For example, the Securities and Futures (Client Money) Rules do not apply. They do not have to pay recognised counterparties’ monies into a segregated account.

Accounting and compliance are affected. For example, pursuant to Section 34(1) of the FRR, trading corporations must factor amounts receivable from and cash deposited with a recognized counterparty into their liquid assets.

#### Commencement of Securities Price Stabilising Period

A stock’s stabilising period is determined in accordance with Section 2(1) of the Securities and Futures (Price Stabilizing) Rules. When a stock starts trading on an overseas SSE, its stabilising period commences. Stabilising action may only be taken during this period.

#### Exemption of Offshore Funds from Profits Tax

The addition of exchanges extends tax breaks to offshore funds trading futures on them. The Revenue (Profits Tax Exemption for Offshore Funds) Ordinance in 2006 inserted the relevant provisions in the IRO. Pursuant to Sections 20AB and 20AC of the IRO, offshore funds are exempt from tax chargeable on profits from futures contracts, retrospectively from the year of assessment 1996-97 onwards. Futures contracts are defined in Schedule 16 to include:

* a contract or option on a contract listed or traded on the Hong Kong Futures Exchange; and
* any other contract for differences listed on an SSE or traded on an SFE.

Derivatives popular with offshore funds, such as cash-settled commodity futures and index-based contracts, fall within the wide ambit of contracts for differences.

The Conclusions anticipate that Hong Kong’s development as an international finance centre in general and an asset management centre in particular would thus be facilitated. Hong Kong would potentially attract more investment from offshore funds. Benefits include increased market liquidity and higher employment in downstream service sectors.

## 2. Proposed Amendments To The Securities And Futures (Financial Resources) Rules (FRR)

### Introduction

The SFC published a consultation paper on proposed amendments to the Securities and Futures (Financial Resources) Rules (**Consultation Paper**) in May 2011. The proposed amendments would update the list of exchanges specified (**Specified Exchanges**) in Schedule 3 for which the FRR prescribe treatments for assets and liabilities arising from, or in relation to, dealings in futures and options contracts traded on those exchanges. For example, amounts receivable from and cash deposited with a clearing house of a Specified Exchange in respect of futures or options contracts trading can be included as liquid assets. Specified Exchanges are also mentioned in Schedule 2 in relation to haircut percentages for shares. The key proposals are:

* updates to exchanges, and
* addition of exchanges with increased trading.

The SFC currently grants FRR modifications to licensed corporations dealing in futures or options products that are traded on certain exchanges which are not specified in the FRR on an individual firm basis in order to alleviate their FRR compliance burden. These modifications are published on the SFC website for the reference of other licensed corporations. The proposed amendments to the FRR are intended to reduce compliance costs and facilitate market development.

The consultation conclusions on these proposals have not yet been published.

### New Exchanges in the FRR

The four new exchanges would be:

* Hong Kong Mercantile Exchange Limited;
* Taiwan Futures Exchange Corporation;
* Thailand Futures Exchange Public Company Limited, and
* Tokyo Commodity Exchange, Inc.

None are specified in the SFO.

### Updated Exchanges in the FRR

Updates to specified exchanges would largely mirror those in the SFO with the following exceptions.

* Bursa Malaysia Derivatives Berhad is specified in the FRR, but not the SFO. It was formerly Malaysian Derivatives Exchange Berhad.
* London Stock Exchange plc – SEAQ International is deleted from Schedule 2 of the FRR. SEAQ International was never specified in the SFO.
* Chicago Mercantile, Inc. is specified in Schedule 3 to the FRR, whereas it remains Chicago Mercantile Inc. in the SFO.
* Osaka Securities Exchange Co., Ltd.– JASDAQ is mentioned in Schedule 2 of the FRR, whereas the SFO does not mention JASDAQ as a subsidiary or otherwise.

Japanese Association of Securities Dealers Automated Quotations was updated as Jasdaq Securities Exchange Inc – JASDAQ in the Conclusions, then deleted from the SFO. This is attributable to the merger between OSE and JASDAQ in April 2010. OSE now operates both JASDAQ and NEO. It recently announced a merger with the Tokyo Stock Exchange, which will be dissolved. The SFC has indicated that it will not be updating the SFO frequently to reflect such changes. However, the merger may be reflected in forthcoming consultation conclusions.

This newsletter provides a summary only of the Consultation Paper’s proposals. The Consultation Paper and Notice on the SFO are available on the SFC’s website [here](http://www.sfc.hk/edistributionWeb/gateway/EN/consultation/openFile?refNo=11CP2) ([see archive](openFile.pdf)) and [here](http://www.sfc.hk/web/EN/pdf/laws/sub-leg/N/Relevant%20LN/LN%2029%20of%202011.pdf) ([see archive](LN_29_of_2011.pdf)) respectively.

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