

SECTION 2: QUESTIONS FOR RESPONSE

Please indicate your views by providing comments as appropriate. Where there is insufficient space, please use additional sheets of paper as necessary.

HKEx's Proposal 1: Revise HKEx Stress Testing Assumptions

Questions

1. Do you support the proposed revision of the Price Movement assumptions in stress testing?

☒ Yes

☐ No

Please provide reasons for your response and include any other suggestions or comments you may have on this question:

*We generally support the proposed revision of the Price Movement assumptions in stress testing which is in line with the international IOCSO standards.*_____

2. Do you support the proposed revision of the Counterparty Default assumption in stress testing?

☒ Yes

☐ No

Please provide reasons for your response and include any other suggestions or comments you may have on this question:

*We generally support the proposed revision of the Counterparty Default assumption in stress testing in line with the international IOCSO standards.*_____

HKEx's Proposal 2: Introduce Margining and Dynamic Guarantee Fund in HKSCC

Questions

3. Do you agree with the proposed margining arrangements at HKSCC?

☐ Yes

☐ No

Please provide reasons for your response and include any other suggestions or comments you may have on this question:

Neutral view.

4. Do you agree with the proposed Dynamic GF model at HKSCC?

☐ Yes

☒ No

Please provide reasons for your response and include any other suggestions or comments you may have on this question:

We do not agree with the proposed shortened time to settle Guarantee Fund contribution payment from current seven (7) days to three (3) business days. Please refer to our comment letter for details.

HKEx's Proposal 3: Revise HKCC Reserve Fund Calculation

Questions

5. Do you support the proposed revisions to the HKCC Collateral assumption?

☒ Yes

☐ No

Please provide reasons for your response and include any other suggestions or comments you may have on this question:

We generally support the proposed revisions in Price Movement and Counterparty Default to the HKCC Stress Testing Assumptions which are in line with the international IOCSO standards.

6. Do you support the use of HKCC Contingent Advance in relieving burden of CPs?

☒ Yes

☐ No

Please provide reasons for your response and include any other suggestions or comments you may have on this question:

We support the use of HKCC Contingent Advance in relieving burden of CPs.

Questions

7. What is your view on allowing RF contribution to be counted as liquid capital? Will this help your company in terms of reducing liquid capital funding burden?

We strongly suggest that Guarantee Fund or Reserve Fund should be counted as liquid capital under the FRR to reduce our funding burden. Please refer to our comment letter for details.

HKEx's Proposal 4: Revise SEOCH Reserve Fund Calculation

Questions

8. Do you support the proposed revisions to the SEOCH Collateral assumption?

☒ Yes

☐ No

Please provide reasons for your response and include any other suggestions or comments you may have on this question:

We generally support the proposed revisions in Price Movement and Counterparty Default to the SEOCH Stress Testing Assumptions which are in line with the international IOCSO standards.



Corporate Communications Department
Hong Kong Exchanges and Clearing Limited
12th Floor, One International Finance Centre
1 Harbour View Street
Central
Hong Kong

Dear Sirs,

Re: Consultation Paper on HKEx Clearing House Risk Management Reform Measures

Newedge Financial Hong Kong Limited (“**NFHKL**”) and Newedge Broker Hong Kong Limited (“**NBHKL**”) are licensed firms regulated by Securities and Futures Commission. NFHKL is a Trading Participant of HKFE / SEHK and a Clearing Participant of HKCC, SEOCH and HKSCC, whilst NBHKL is a Trading Participant of HKFE and a Clearing Participant of HKCC and SEOCH. NFHKL, which continually is ranked as one of the top brokers on the HKFE in terms of execution and clearing volume, is a subsidiary of Newedge.

Newedge, which is one of the world's largest brokerage organizations, offers its customers clearing and execution facilities across multiple asset classes including futures, securities (fixed income and equities), options, FX and various OTC instruments.¹ Newedge maintains offices in over 15 countries, and is a member of over 85 exchanges worldwide. As of June 2011, Newedge had an estimated global market share in listed derivatives of 11% (clearing) and 11.9% (execution), and over Euro 50.8 billion of client assets on deposit. Newedge’s primary function is that of a broker; *i.e.*, to execute and clear customer transactions across multiple asset classes on an agency basis. Consequently, Newedge has very little proprietary trading, and generally will only hedge in connection with the facilitation of customer orders.

Newedge appreciates this opportunity to comment on the HKEx’s public consultation (“**Consultation Paper**”) relating to the risk management reform measures for its clearing houses including HKSCC, HKCC and SEOCH. Newedge has been active over the years, both in Asia and elsewhere, in working with regulators to develop rules and regulations designed to strengthen our financial markets. Given our broad experience across asset classes, we feel we are strongly positioned to provide such input and, as noted, welcome the opportunity to do so.

We generally support HKEx’s proposal to improve on managing the risk of counterparty loss arising from its Clearing Participant’s default. We enclose a completed Questionnaire on HKEx Clearing House Risk Management Reform Measures for your review and consideration. In addition, we would like to draw HKEx’s attention to the following matters for its further consideration.

¹ "Newedge" refers to Newedge Group, a 50%-50% joint venture between Credit Agricole Corporate and Investment Bank (formerly Calyon) and Societe Generale, headquartered in Paris, France, and all of its worldwide branches, subsidiaries and other units.

Comment 1 - Guarantee Fund or Reserve Fund should be included as liquid assets for the purpose of calculating FRR or Clearing Participants would be at risk to meet SFC and HKEx requirements

On the basis of the example mentioned in the Consultation Paper, paragraph 92, the implementation of the proposed measures would increase Clearing Participants' share of Reserve Fund by 30%. The significant increase (if requested) would immediately put pressure on Clearing Participants' liquid capital and funding arrangement.

As Guarantee Fund or Reserve Fund is currently excluded as liquid assets for the purpose of calculating FRR, an increase on Clearing Participants' share of Reserve Fund would reduce its liquid assets which in turn, would impact on their abilities to comply with FRR requirements and may cause potential capital issue on Clearing Participants. This in turn will affect Clearing Participants' Capital Based Position Limited with the different Clearing Houses as the calculation of CBPL is premised on the Clearing Participants' FRR.

The aggregate effect on the Clearing Participants of the above means that Clearing Participants would be put at risk of meeting HKEx and SFC requirements. We have all seen the ramifications of the collapse of Lehman Brothers and where Clearing Participants/licensed corporations' financial status was called into question. We believe that this is something HKEx, regulators, the industry and the public at large would like to avoid.

To this end, we respectfully submit that the risk could be addressed by having contributions made by Clearing Participants included in the calculation of its liquid assets for the purpose of calculating FRR under Cap 571N section 28.

Comment 2 - Types of collaterals acceptable to meet Guarantee Fund and Reserve Fund contribution payment should be expanded

We also suggest that the types of collaterals acceptable to HKEx for Clearing Participants to meet their Guarantee Fund and Reserve Fund contribution requirement be expanded. As noted above, currently HKSCC will only accept cash, bank guarantees or Exchange Fund Bills notes (subject to its prior approval apart from cash) from Clearing Participants; no other form of collaterals is accepted. We suggest that other forms of collaterals such as US Treasury Bills, JGB bonds or similar should be included and be accepted by HKEx for the purpose of meeting the fund contribution requirement. We believe that this would assist the concern raised under Comment 3 below.

Comment 3 - Re Proposal 2: Time to settle Guarantee Fund contribution payment should remain as seven (7) business days

Under Proposal 2, it is proposed that the time for Clearing Participants to settle Guarantee Fund contribution payment be shortened from the current seven (7) business days to three (3) business days. The proposed reduction of settlement time would place Clearing Participants at risk of failing to meet such obligations for reasons beyond their control.

The Consultation Paper states that there will be no change to the acceptable forms of Guarantee Fund contributions (see paragraph 78). Accordingly, except for the minimum cash contributions required for the Fixed Guarantee Fund, Clearing Participants can meet their remaining Guarantee Fund contribution requirements (Fixed or Dynamic Guarantee Fund) either in cash or bank

guarantee, subject to HKSCC bank guarantee acceptance policy. Currently, HKSCC will accept no other forms of collaterals for this purpose.

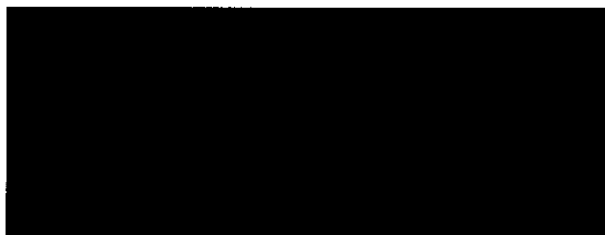
Our experience has been that relevant banks takes up to three (3) days to renew an existing bank guarantee and up to seven (7) days if they were asked to issue a fresh guarantee in favour of HKSCC. We understand that each of the relevant banks may issue bank guarantee up to the maximum limit set by HKEx. They are not, however, obliged to issue guarantee up to such maximum limit. In practice, they would take into consideration of other factors as they consider appropriate, such as their own risk appetite and potential exposure as well as market conditions.

If the settlement time is shortened as proposed, we are concerned that licensed corporations would be exposed to the risk of not being able to meet their Guarantee Fund contribution obligations in time for reasons beyond their control. At times when the market is particularly volatile and may be suffering a downturn, banks would take a more conservative approach and take longer time to consider requests from Clearing Participants for guarantees.

CONCLUSION

To sum up, we respectfully submit that contributions made by licensed corporations to Guarantee Fund and/or Reserve Fund should be included as their liquid assets, type of collaterals to meet Guarantee Fund and Reserve Fund contributions should be expanded and HKEx should continue to allow its Clearing Participants to meet their Guarantee Fund contribution obligations within seven (7) business days, such that the interest of the public at large is better protected. Indeed, it is our respectful submission that Clearing Participants of all three Clearing Houses should be allowed seven (7) business days to meet their payment obligations.

Yours sincerely,

A large black rectangular redaction box covering the signature and name of the sender.

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