Chapter 5： Client Services Support

5.1 House Accounts

Each Options Trading Exchange Participant will be assigned a house account in HKATS, specifically designated as “P1”, to hold all proprietary trades.

If an Options Trading Exchange Participant is a Market Maker, it will be assigned a Market Maker account, designated as “M1” in its House Account in HKATS (See Chapter 4).

House positions are maintained on a net basis (i.e. either the position is net long or net short exclusively) in DCASS. For margin calculation purposes, positions in a Market Maker’s Market Maker Account in DCASS (other than that of a designated trader or an NCP) will be propagated to its House Account in DCASS and margined together by SEOCH on a net basis. The *Operational Clearing Procedures* set out the details.

5.2 Client Account

Each Options Trading Exchange Participant with client business will be assigned a Client Account in HKATS, specifically designated as “A1”, to hold all client trades.

Positions arising from such Client Account will be maintained in DCASS in the Options Trading Exchange Participant or its designated GCP’s Omnibus Client Account, Individual Client Accounts or Client Offset Claim Accounts.

Where the Options Trading Exchange Participant trades options for an Options Broker Exchange Participant, it is required to open with SEOCH two accounts in DCASS for that Options Broker Exchange Participant -- one Individual Client Account for the recording of positions from trades executed by it for the Options Broker Exchange Participant, and one Omnibus Client Account for the recording on an omnibus basis of positions from trades executed for clients of that Options Broker Exchange Participant. The Options Trading Exchange Participant may also open a Client Offset Claim Account for the Options Broker Exchange Participant in DCASS for the recording of positions from trades executed for clients of the Options Broker Exchange Participant which are eligible for margin offset.

The Options Broker Exchange Participant has to inform the Options Trading Exchange Participant whether the order placed is for its client account or for its proprietary account.

Positions in the Omnibus Client Account in DCASS are maintained and margined on a gross basis. Positions in an Individual Client Account will be maintained and margined on a net basis if such positions belong to one client only. Positions in a Client Offset Claim Account will be maintained on a gross basis but margined on a net basis. See the *Operational Clearing Procedures* for details.

5.3 Give-Up and Take-Up

A SEOCH Participant can upon request of its client transfer a trade to another SEOCH Participant, provided that the recipient SEOCH Participant is willing to accept the trade and that it has entered into a Clearing Agreement, an Options Client Agreement or an Options Broking Agreement with the client who has requested for the transfer. The transfer is performed with commands specifically provided by DCASS for this purpose, and is referred to as a give-up (and its acceptance is known as a take-up). The *Operational Clearing Procedures* describe the details.

5.4 Margining

Margin Call

A margin call occurs when the margin requirement for a SEOCH Participant or a client exceeds the collateral value the SEOCH Participant or the client has currently deposited for margin purposes. The margin amount to be called will be the difference between the current margin requirement and the current collateral value deposited.

SEOCH determines the margin requirement for each SEOCH Participant by using the Portfolio Risk Margining System ("PRiME"). A SEOCH Participant must pay the margin in accordance with the *Operational Clearing Procedures*. A non-clearing Options Trading Exchange Participant (NCP) will not be margined directly by SEOCH. The General Clearing Participant (GCP) clearing for an NCP will collect margin from the NCP.

Client Margin refers to the margin due from a client to an Options Exchange Participant, or from an NCP to its GCP.

Client Margin is calculated by the Options Exchange Participant. SEOCH does not calculate individual client margin for an Options Exchange Participant.

The minimum client margin that must be collected is the amount that is stated in Appendix H.

Options Exchange Participants can have the PRiME calculation algorithm as part of their back office systems to simulate exactly the calculation of SEOCH.

5.5 Notification of Client Margin

Options Trading Rules require that an Options Exchange Participant notify each of its clients as soon as possible of the margin amount due in respect of outstanding positions.

The notification can take the form of a telephone call (preferably taped), or sent by fax to a pre-arranged number, or by hand-delivery, or as stated in the client agreement.

Therefore, Options Exchange Participants should ensure that they know where their clients can be reached. Alternatively, adequate collateral should be posted by the client in advance if it is believed there may be difficulties contacting the client for any prolonged period.

If a client cannot be notified in any of the above ways of his margin requirements and his collateral kept with the Options Exchange Participant is inadequate to cover the margin requirements, the Options Exchange Participant should assume that the client is about to default.

If a client's collateral is sufficient to cover the margin, there is no obligation on the Options Exchange Participant to notify the client of his margin requirements on an urgent basis but the Options Exchange Participant is still required to notify the client of the new margin requirement.

5.6 Collection of Client Margin

Options Trading Rules stipulate when client margin should be collected.

If sufficient collateral is not collected when due, the Options Trading Exchange Participant must notify the Exchange immediately via such form as may be prescribed by the Exchange from time to time, and may take any steps as defined in Options Trading Rule 431 in respect of the defaulting client position.

The PRiME calculation algorithm is there to protect the Options Exchange Participant from suffering a final loss in liquidating a defaulting client position. If in doubt, an Options Exchange Participant is advised to collect sufficient margin up front before the order is executed.

5.7 Entry and Adjustment of Exercise Requests

A client can instruct his Options Exchange Participant to exercise a long position. The instruction can take the form of telephone, fax, letter or whatever means are laid down in the Client Agreement. Before the end of the Post-Trading Period subject also to the Client Agreement, a client can also give instructions to his Options Exchange Participant to reverse or modify an exercise instruction given earlier the same day.

An Options Broker Exchange Participant or an Options Trading Exchange Participant that is an NCP may, upon request of its clients, request its Options Trading Exchange Participant or designated GCP, as the case may be, to input exercise requests for its clients. Normally, an Options Trading Exchange Participant shall input, or, if it is an NCP, shall request its designated GCP to input, its exercise requests through DCASS in respect of each and every contract it wishes to exercise. DCASS will not automatically generate exercise requests in respect of in-the-money contracts on behalf of SEOCH Participants except on an expiry day.

On an expiry day, DCASS will automatically generate exercise requests in respect of all open long positions in expiring contracts which meet the exercise criterion prescribed (i) by the relevant SEOCH Participant; or (ii) if no such exercise criterion is prescribed by the SEOCH Participant, by SEOCH. SEOCH Participants can elect to deny such automatically generated exercise requests via DCASS at any time prior to the System Input Cutoff Time on the expiry day. For the purposes of the *Options Clearing Rules* and the *Operational Clearing Procedures*, exercise requests automatically generated by DCASS, if not so denied, are deemed as exercise requests input by SEOCH Participants and shall be binding and irrevocable. Please refer to the *Operational Clearing Procedures* for more details.

Options Exchange Participants should ensure their clients are aware that there is a possibility that their open long positions could be automatically exercised unless elected otherwise. Options Exchange Participants and their clients should note that on an expiry day, all open long positions expiring on that expiry day will expire worthless unless these positions have been exercised, either by exercise requests automatically generated by DCASS or via manual input of exercise requests by the Options Trading Exchange Participant or, if it is an NCP, by its designated GCP. Therefore an Options Exchange Participant shall ensure that it obtains timely instructions from its clients in respect of exercise of Options Contracts.

Instructions relating to exercise, exercise adjustment or the denying of an automatic exercise instruction on client or house positions must be entered before the System Input Cutoff Time on the expiry day in order to be processed.

NCPs will not have access to screens for entry of exercise requests and adjustments and must therefore instruct their designated GCPs to enter exercised requests and adjustments on their behalf. The *Operational Clearing Procedures* set out the details.

If an out-of-the-money client position is to be exercised, the Exchange advises the SEOCH Participant to obtain written exercise instructions from the client before input.

5.8 Settlement of Client Premium

Settlement of premium between a SEOCH Participant and SEOCH is described in the *Operational Clearing Procedures*.

DCASS calculates the premium payable and receivable as soon as a trade is done in HKATS and transmitted to DCASS. DCASS does not carry premium details at the individual client level and the Options Trading Exchange Participant must calculate such amounts in their back office system.

The *Options Trading Rules* requires that client premium be collected in cash promptly. The following are considered by the Exchange as cash settlement of client premium:

- cash receipt
- bank account transfer
- a cheque drawn on a bank, not post-dated

If the client has a net premium due from his Options Exchange Participant, the Options Exchange Participant should pay the client on the same day promptly, unless that premium is used to set off other liabilities that the same client has with the Options Exchange Participant.

5.9 Position Limit and Reporting Level

Subject to *Options Trading Rule 436A*, limits are imposed on the open positions any single party (Options Exchange Participant or client) can carry at any one time. Reporting levels, in excess of which a party (Options Exchange Participant or client) is required to report to the Exchange, are also prescribed. Without prejudice to the powers of the Exchange under *Options Trading Rules 435 and 439*, the position limits[Note 1] currently applicable are classified into 5 levels, namely 250,000, 200,000, 150,000, 100,000 and 50,000 open contracts per option class in any one market direction for all expiries combined. The applicable level of position limit is determined by reference to the methodology set out in 5.9A below. Reporting level[Note 2] for all option classes is 1,000 open contracts per option class per expiry.

Notes:

1. *Position Limit* – this represents the maximum number of open contracts a single party can hold for any option class in any one market direction for all expiries combined (N.B. long calls/short puts combined are in one direction and short calls/long puts combined are in another direction).

   Example A, if the limit is 50,000 and an Options Exchange Participant is long a total of 47,000 calls and short 3,000 puts in all the expiry months (and expiry weeks if applicable) of the same option class, it has reached the limit, but if it is long 47,000 calls and long 3,000 puts, it has not.

   Example B, if the limit is 150,000 and an Options Exchange Participant is long a total of 135,000 calls and 15,000 puts and short a total of 10,000 puts and 132,000 calls in all the expiry months (and expiry weeks if applicable) of the same option class, it has not reached the limit, since the positions in one market direction will be 145,000 contracts (long 135,000 calls and short 10,000 puts) and 147,000 contracts (short 132,000 calls and long 15,000 puts).

   A Market Maker or an Options Exchange Participant which is, or is holding positions for, a person specified under section 4A of the Securities and Futures (Contracts Limits and Reportable Positions) Rules may hold positions in excess of the limit prescribed by the Commission under the Securities and Futures (Contracts Limits and Reportable Positions) Rules provided that it is authorized to do so by the Exchange under 5.12 below.

2. *Reporting level* – this is the number of open contracts in any one single expiry month (or week if applicable) of an option class, including all types, strike prices, long and short positions in excess of which a position shall be reported to the Exchange. Where positions exceeding this level are held for a client, the Options Exchange Participant must notify the Exchange of the client's identity. Positions arising from market making activities that are held by Market Makers in their Market Maker Accounts are treated as having been reported to the Exchange.

5.9A Methodology for Setting the Position Limit

The position limit is set based on the contract-equivalent number and shall be calculated by reference to the market capitalization and liquidity of the underlying stock relating to that particular stock options contract.

Contract-equivalent number (X)	Position limit
250,000 contracts ≤ X	250,000 contracts
200,000 ≤ X < 250,000 contracts	200,000 contracts
150,000 ≤ X < 200,000 contracts	150,000 contracts
100,000 ≤ X < 150,000 contracts	100,000 contracts
X < 100,000 contracts	50,000 contracts

X = 5% of the outstanding shares divided by the contract size subject to the provisions set out below:

(i) if 5% of the outstanding shares is less than 25% of the stock's turnover for the previous six months (the "25% Threshold"), X shall be deemed to be equal to the 25% Threshold divided by the contract size subject to (iii) below;

(ii) if 5% of the outstanding shares is greater than 33% of the stock's turnover for the previous six months (the "33% Threshold"), X shall be deemed to be equal to the 33% Threshold divided by the contract size subject to (iii) below; and

(iii) if X as calculated above is more than the Liquidity Threshold divided by the contract size, it shall be deemed to be equal to the Liquidity Threshold divided by the contract size. "Liquidity Threshold" means 6.7% of the stock's turnover in the previous six months.

The Liquidity Threshold could be revised from time to time as deemed appropriate by the Exchange.

The position limits will be reviewed regularly on an annual basis to adjust for any substantial changes due to market development. The formula above will be applied to all option classes at the end of November each year, and if revisions are required, the updated position limits will be announced in December in the same year, and they will take effect on the first business day of April in the next calendar year.

Following a corporate action which results in a material change in the value of an underlying stock, the Exchange may consider adjusting the contract size of the affected stock option to substantively maintain its notional value. The decision as to whether or not an adjustment will be made to the terms of an options contract and the nature of that adjustment will be announced no later than the tenth trading day after the company announcement of the relevant corporate actions is made.

5.10 Responsibility of Reporting Excess in Reporting Level

1. If the Options Exchange Participant is aware that a number of its client accounts are held for the same beneficial owner, all open positions of these accounts shall be aggregated.

2. [Repealed]

3. Options Exchange Participants shall inform their clients of the reporting requirements and the responsibilities of reporting set out in 5.9 and in the Securities and Futures (Contracts Limits and Reportable Positions) Rules and related guidance notes issued by the Commission.

4. Where a client's positions are in excess of the reporting level, he may choose to report the positions to the Exchange directly or through an Options Exchange Participant. Where positions are held by a client with more than one Options Exchange Participant and notwithstanding that positions separately held by each of these Options Exchange Participants for the client may not have exceeded the reporting level, the client may instruct any of these Options Exchange

Participants to report positions he holds to the Exchange on his behalf such that the total number of positions reported shall represent the total number of positions held by the client in excess of the reporting level.

5.11 Reporting Excess in Reporting Level

1. [Repealed]

2. [Repealed]

3. Any Options Exchange Participant holding positions in excess of the reporting level for its own account or for any client shall file a written report with the Exchange using such form as may be prescribed by the Exchange from time to time, no later than 12:00 noon of the next business day after the positions are opened or accumulated, and continue to file a report for as long as the Options Exchange Participant holds positions in excess of the reporting level.

Example
The reporting level for CKH is 1,000 contracts. A client buys 1,100 September CKH calls on Day 1. These positions will have to be reported by no later than 12:00 noon of Day 2. However, the client does not need to file a written report on or before Day 2 if he sells 150 September CKH calls on Day 1, thereby reducing his positions to below the reporting level.
So long as the client holds more than 1,000 September CKH calls on Day 2 or succeeding days, he will need to report his positions daily even though his positions remain unchanged.

5.12 Increasing a Position Limit

Subject to *Options Trading Rules 436A and 436B*, an Options Exchange Participant or a client may request the Exchange to increase the position limit imposed by the Exchange or, in the case of a person specified under section 4A of the Securities and Futures (Contracts Limits and Reportable Positions) Rules, to authorize it to hold positions in excess of the limit prescribed by the Commission thereunder (the "Commission's prescribed limit"). Where applicable, an Options Exchange Participant (if it is not a SEOCH Participant) or a client may also submit a request to increase the position limit imposed on behalf of the SEOCH Participant which clears its trades together with its own request. Such requests shall be made in writing to the Exchange. The Options Exchange Participant or its client or the person that made the request may be required to justify the increase of the limit imposed by the Exchange or the holding of positions in excess of the Commission's prescribed limit. The Exchange may at its absolute discretion grant or refuse the request. Approval from the Exchange must be received prior to entering into positions which exceed the position limit imposed by the Exchange or the Commission's prescribed limit. In the event that approval to hold or control excess position limit is granted by the Exchange under s4A of the Securities and Futures (Contracts Limits and Reportable Positions) Rules in respect of any option class, the Options Exchange Participant or client shall appoint only one SEOCH Participant to hold its positions in such option class.