

## CHAPTER 7

### DEFAULT PROCEDURES

#### Default

701. In these Clearing Rules, an “event of default” shall mean any event or circumstance which leads SEOCH to determine that a SEOCH Participant is or appears to be unable, or likely to become unable, to meet its obligations under one or more Contracts to which it is party. Without prejudice to the generality of the foregoing, SEOCH may take the occurrence of any one or more of the following events or circumstances as sufficient grounds for determining that a SEOCH Participant is or appears to be unable, or likely to become unable, so to meet such obligations:-

- (1) failure by a SEOCH Participant to pay Premium when due;
- (2) failure by a SEOCH Participant to deliver SEOCH Collateral in respect of margin when due;
- (3) failure by a SEOCH Participant to pay all SEOCH Collateral in respect of its Reserve Fund Contributions or its Replenishment Contribution when due and to maintain the value of its SEOCH Collateral delivered in respect of its Reserve Fund Contributions so it is at least equal to its Reserve Fund Requirement;
- (4) failure by a SEOCH Participant to pay any fees, charges, levies or other amounts when due;
- (5) failure by a SEOCH Participant to duly perform or comply with any of its delivery obligations when due;
- (6) where a SEOCH Participant is unable to pay its debts as they fall due or any resolution is passed, or order made, for the winding-up of a SEOCH Participant or any steps are taken by, or proceedings instituted against, a SEOCH Participant seeking to render it insolvent or seeking liquidation, winding-up, reorganisation, dissolution, protection or relief from, or composition of, its debts or any receiver, liquidator or other similar official is appointed in respect of the whole or any substantial part of the assets of a SEOCH Participant;
- (7) failure by a SEOCH Participant to comply with any provision of the Financial Resources Rules or any financial resources requirement prescribed by SEOCH, any position limits pursuant to Clearing Rules 624 to 630 (inclusive) or any exercise limits pursuant to Clearing Rule 631 for the time being in effect;
- (8) where a SEOCH Participant makes any false return to SEOCH or knowingly or carelessly provides any information or makes any statement which is untrue or misleading to SEOCH, the Exchange, or a recognized exchange controller which is the controller of SEOCH;
- (9) failure by a SEOCH Participant which is also a CCASS Clearing Participant to meet any obligation to HKSCC or, if it is also an HKCC Participant, HKCC when due;
- (9a) failure by a SEOCH Participant to have a valid, binding and effective CCASS Clearing Agreement with another CCASS GCP in respect of the delivery obligation where the CCASS GCP of the SEOCH Participant is declared as a defaulter or suspended by HKSCC;

- (10) failure by a SEOCH Participant, in its capacity as an Options Trading Exchange Participant, to comply with any provision of the Options Trading Rules and, as a result of such failure, any restriction on its ability to enter into Options Contracts is imposed by the Exchange;
- (11) failure by a SEOCH Participant, within any required time period, to take any action required by SEOCH to ensure compliance with these Clearing Rules;
- (12) where the Exchange determines that an event of default has occurred in relation to a SEOCH Participant under the Options Trading Rules or an event of incapacity under the Exchange Rules, or, if the SEOCH Participant is also an HKCC Participant, where HKCC determines that an event of default has occurred in relation to the SEOCH Participant in its capacity as an HKCC Participant under the HKCC Rules; or
- (13) where SEOCH becomes aware of circumstances affecting a client, associate or affiliate of a SEOCH Participant which might, in the opinion of SEOCH, result in that SEOCH Participant being unable to meet any of its obligations in relation to its Exchange Traded Options Business.

A SEOCH Participant shall immediately give notice to SEOCH if it is, or if it suspects that it is likely to become, unable to meet its obligations under one or more Contracts to which it is party.

702. Notwithstanding the provisions of Chapter 8 of these Clearing Rules, if SEOCH in its absolute discretion determines that an event of default has occurred in respect of a SEOCH Participant, SEOCH may take such steps including, without limitation, those set out in Clearing Rule 703, as in the circumstances appear to it, in its absolute discretion, best calculated:-

- (1) to discharge the Defaulting SEOCH Participant's rights, obligations and liabilities under or in respect of one or more or all OCH Contracts to which that SEOCH Participant is party;
- (2) to minimise losses or the potential for losses to SEOCH as a result of the default of that SEOCH Participant; or
- (3) to complete the process set out in Clearing Rule 705.

703. Steps which may be taken by SEOCH in relation to a Defaulting, suspended or resigning SEOCH Participant, without the need for any prior notice to or consent of that SEOCH Participant, include:-

- (1) to limit (on such terms as it shall think fit), suspend or terminate access, in conjunction with the Exchange, of that SEOCH Participant to the Options Clearing System;
- (2) to direct that SEOCH Participant or to act on its behalf, to close any Contracts to which that SEOCH Participant is party;
- (2a) to direct that SEOCH Participant or to act on its behalf, to sell any Contracts to which that SEOCH Participant is party by auction and/or private arrangement on-market or off-market;
- (3) to direct that SEOCH Participant or to act on its behalf, to discharge any delivery obligations of that SEOCH Participant;

- (4) to direct that SEOCH Participant or to act on its behalf, to exercise any OCH Contract to which that SEOCH Participant is party;
- (5) to direct that SEOCH Participant to give-up, or to do so on its behalf, any OCH Contract to which that SEOCH Participant is party to another SEOCH Participant who agrees to accept such give-up and cause to be paid or transferred any SEOCH Collateral in respect of margin for such OCH Contract to that other SEOCH Participant;
- (6) to direct that SEOCH Participant or to act on its behalf, to make or procure the making of any OCH Contracts to which that SEOCH Participant will be party via auction and/or private arrangement, including, without limitation, any OCH Contracts for the purpose of hedging risk to which that SEOCH Participant is exposed;
- (7) to direct that SEOCH Participant or to act on its behalf, to make or procure the making of any contract for the sale, purchase, acquisition or other disposition of any securities, futures contracts or commodities on an exchange or otherwise;
- (8) without prior written notice to that SEOCH Participant and without having to obtain from that SEOCH Participant or any other person any power of attorney, consent or document, to sell or otherwise realize any non-cash SEOCH Collateral provided by that SEOCH Participant to SEOCH or held by any third party on behalf of SEOCH and to do such acts and things and execute such documents as SEOCH may consider necessary or expedient for such purpose;
- (9) without prejudice to any other right of SEOCH, to take such action as SEOCH may consider necessary for its own protection in the name and at the expense of that SEOCH Participant with regard to any OCH Contract to which that SEOCH Participant is a party;
- (10) subject to Clearing Rule 707, to apply any funds standing to the credit of that SEOCH Participant (including, but not limited to, any Premium, SEOCH Collateral in respect of margin or any Reserve Fund Contributions, the proceeds realised from the closing of long open positions, the proceeds realised from the liquidation of non-cash SEOCH Collateral, the proceeds of the sale of any securities in relation to delivery obligations or funds received under a financial instrument) for the purpose of discharging that SEOCH Participant's obligations in respect of any OCH Contracts to which it is party;
- (11) to effect without entering into any further Contracts, the closing by means of set off of any pair of long and short open positions which exist in the same quantity in respect of the same option series (i) within or between any of the SEOCH Participant's House Account, Market Maker Account, Daily Account and Sink Account; (ii) within any of its Individual Client Account(s); and (iii) other than long open positions in respect of which Premium has been fully paid, within any of its Omnibus Client Account(s) or between any of its Omnibus Client Account(s) and Client Offset Claim Account(s) in DCASS;
- (12) to direct that SEOCH Participant to submit for approval to SEOCH a plan for the orderly winding down of its Exchange Traded Options Business;
- (13) to take any step which in the circumstances is open to SEOCH under the Options Trading Rules; and
- (14) to take any other step calculated by SEOCH to complete the process set out in Clearing Rule 705,

any action taken by SEOCH under this Clearing Rule will be undertaken at what SEOCH determines to be the best prevailing price and terms available in its own discretion (but taking into account that SEOCH may need to act promptly and provided that SEOCH shall have no liability if it acts in good faith).

703A. Upon the occurrence of an event of default under Clearing Rule 701, the Chairman of the SEOCH Board may declare the SEOCH Participant to be a Defaulter.

704. Without prejudice to Clearing Rule 703, following a determination of an event of default in respect of a SEOCH Participant, a SEOCH Participant may lodge an appeal in respect of any such determination, in which case, SEOCH will supply to the SEOCH Participant in written form an account of its reasons for such determination.

705. If SEOCH determines, in its absolute discretion, that an event of default has occurred and that it is necessary or appropriate to take action against a Defaulting SEOCH Participant in relation to all OCH Contracts to which that SEOCH Participant is party, SEOCH may complete the following process:-

- (1) there shall be brought into account all sums payable by or to the Defaulting SEOCH Participant pursuant to these Clearing Rules;
- (2) the sums so payable shall be aggregated or set off so as to produce a net sum or, where required by Clearing Rule 705, two net sums;
- (3) such net sum, or each such net sum:-
  - (a) if payable by the Defaulting SEOCH Participant to SEOCH, shall be set off against any SEOCH Collateral provided by that SEOCH Participant (or any other property the subject of a market charge) so as to produce a further net sum payable by or to that SEOCH Participant to SEOCH; or
  - (b) if payable by SEOCH to the Defaulting SEOCH Participant, SEOCH will redeliver SEOCH Collateral or property which is subject to a market charge so as to produce a further net sum; and
- (4) SEOCH shall certify the sum or each sum finally payable by the Defaulting or resigning SEOCH Participant to SEOCH or by SEOCH to that SEOCH Participant, or the fact that no sum is finally payable by either party to the other, such certificate to be conclusive as to the discharge of that SEOCH Participant's rights and liabilities in respect of the OCH Contracts to which it relates.

Upon the completion of the process in this Clearing Rule, SEOCH will make a report as required by the Securities and Futures Ordinance.

## **General**

706. SEOCH shall not have a lien or other interest in long open positions in respect of which Premium has been fully paid and which are held in DCASS in (i) an Omnibus Client Account or (ii) an Individual Client Account which only contains long positions in respect of which Premium has been fully paid. The authority of SEOCH under these Rules in relation to Contracts comprised in such long open positions and the proceeds of their sale will not generally be used to set off liabilities in respect of short open positions in, or liabilities arising from, the same account or any other accounts maintained by the SEOCH Participant in DCASS.

707. Any amount standing to the credit of the House Account of a SEOCH Participant may be applied by SEOCH to set off any liabilities of that SEOCH Participant to SEOCH.

708. SEOCH may appoint any person to take or assist it in taking any step under these Clearing Rules and to complete or assist it in completing the process set out in Clearing Rules 703 and 705. SEOCH may at any time consult with any person, and act in reliance upon advice received, in relation to any action it takes.
709. Without prejudice to the right of SEOCH to take any step, including any of those specified in Clearing Rule 703, SEOCH may, upon determining that an event of default has occurred, issue a cautionary notice to the Defaulting SEOCH Participant including such directions and requirements to be complied with by the Defaulting SEOCH Participant within such time period as SEOCH may think fit.
710. The exercise by SEOCH of any of its rights under these Clearing Rules is without prejudice to and shall not preclude SEOCH from exercising any other rights (including the right to take disciplinary action) in respect of any default by a SEOCH Participant. Furthermore, no delay or omission on the part of SEOCH in exercising any right, power or remedy shall impair such right, power or remedy or operate as any kind of waiver.
711. A receiver, liquidator or other similar official appointed in respect of a SEOCH Participant must comply with any directions given by SEOCH (or by any person appointed by SEOCH) pursuant to these Clearing Rules.
712. If one or more SEOCH Participants fail to meet their delivery obligations and, in so doing, prevent SEOCH from meeting its delivery obligations, SEOCH may borrow or buy securities (although it is under no obligation to do so) or borrow funds in order to meet delivery obligations under any OCH Contract. Any direct or indirect costs incurred by SEOCH in acquiring securities or borrowing of funds will be debited to the account of the SEOCH Participants whose failure to meet their delivery obligations, in the view of SEOCH, necessitated the acquisition of those securities or borrowing funds by SEOCH. SEOCH may demand immediate payment by the SEOCH Participant in respect of such costs in addition to requiring prompt delivery or payment of the outstanding securities or funds pertaining to the OCH Contract.

### **Indemnity**

713. A SEOCH Participant shall indemnify SEOCH, the Exchange and a recognized exchange controller which is the controller of SEOCH and keep SEOCH, the Exchange and a recognized exchange controller which is the controller of SEOCH indemnified from and against any loss, cost (including cost of enforcement), interests, liability (including any tax or other fiscal liability), claim or damage which SEOCH, the Exchange and a recognized exchange controller which is the controller of SEOCH incur or suffer, directly or indirectly, as a consequence of the use of the Options System by that SEOCH Participant or any default by that SEOCH Participant, whether or not SEOCH takes any steps pursuant to Clearing Rule 703 or any other steps under these Clearing Rules.

### **GCP Obligations on Default, Resignation or other Relevant Circumstances**

714. If SEOCH determines that a default has occurred in respect of a GCP, or where a GCP has resigned pursuant to these Clearing Rules, or where any Clearing Agreements entered into by a GCP with NCPs are deemed to be terminated under Clearing Rule 434A(3), SEOCH may direct that GCP to contact as soon as possible NCPs with whom it has entered into Clearing Agreements, with a view to determining what action, having regard to the default or resignation or other relevant circumstances, those NCPs would like to take in relation to NCP Contracts to which they are party.

715. Where any NCP contacted by a GCP pursuant to Clearing Rule 714 has instructed the GCP to exercise, close or allow the expiration of any NCP Contracts or to give-up any NCP Contracts to another GCP, the GCP shall immediately notify SEOCH of such instructions. SEOCH may authorise or direct the GCP to exercise, close, or allow the expiration of any such NCP Contracts or to request the acceptance of another GCP to a give-up of such NCP Contracts.
716. A GCP to whom NCP Contracts and OCH Contracts are given-up pursuant to Clearing Rule 715 shall, as soon as practicable, enter into a Clearing Agreement in such form or containing such provisions as may from time to time be required by SEOCH with that NCP.
717. Clearing Rules 714 to 716 (inclusive) shall be without prejudice to the actions SEOCH may take pursuant to Clearing Rule 703.

### **Suspension of SEOCH Participantship**

718. SEOCH may suspend the SEOCH Participantship of a Defaulting SEOCH Participant on such terms and for such period as SEOCH may think fit. SEOCH may also suspend the SEOCH Participantship of any SEOCH Participant which is in violation of these Clearing Rules.

Where a SEOCH Participant is suspended:-

- (1) all monies due to SEOCH shall remain due and payable by the SEOCH Participant as if it had not been suspended;
  - (2) unless otherwise directed by SEOCH, all the rights and privileges of SEOCH Participantship shall be suspended in relation to that SEOCH Participant and the access of that SEOCH Participant to the trading and clearing functions of the Options System shall, in conjunction with the Exchange, be suspended;
  - (3) the suspension shall not in any way affect the validity or enforceability of any Contract or other agreement or arrangement to which that SEOCH Participant was party prior to the suspension;
  - (4) SEOCH may take such action pursuant to these Clearing Rules as it, in its absolute discretion, sees fit;
  - (5) a suspended SEOCH Participant shall continue to be bound by these Clearing Rules until such time as it receives notice of termination of its SEOCH Participantship; and
  - (6) notice of suspension of the SEOCH Participantship of any SEOCH Participant will be given by SEOCH as soon as possible to all SEOCH Participants, the Exchange, HKSCC and the Commission.
- 718A. The Head of Cash and Derivatives Clearing of HKEX may suspend the SEOCH Participantship of a SEOCH Participant if, in its capacity as an Exchange Participant, it voluntarily suspends its Exchange Participantship or is suspended from Exchange Participantship or accessing the System provided he has first obtained the approval of the Chairman of the SEOCH Board which may be given orally or in writing.

## **Expulsion**

719. Where a SEOCH Participant is expelled:-

- (1) all monies due to SEOCH shall remain due and payable by the SEOCH Participant as if it had not been expelled; and
- (2) all of the rights and privileges of SEOCH Participantship shall be extinguished in relation to that SEOCH Participant and the access of that SEOCH Participant to the Options System shall, in conjunction with the Exchange, be terminated.

720. Notice of expulsion of any SEOCH Participant will be given by SEOCH as soon as practicable to all other SEOCH Participants, to the Exchange, to HKSCC and to the Commission.

721. No SEOCH Participant who has been expelled from SEOCH Participantship shall be eligible for re-admission, unless otherwise agreed by the SEOCH Board in its absolute discretion.

## **Return of Reserve Fund Contributions of an Expelled or Resigning SEOCH Participant**

722. SEOCH will return to an expelled or resigning SEOCH Participant any SEOCH Collateral standing to its credit in respect of its Reserve Fund Contributions 2 months after the effective date of termination of that SEOCH Participant's SEOCH Participantship. SEOCH may:-

- (1) deduct any amount in respect of which it is indemnified by an expelled or resigning SEOCH Participant pursuant to these Clearing Rules;
- (2) deduct an amount determined by the SEOCH Board to be adequate to satisfy any outstanding contingent liabilities of an expelled or resigning SEOCH Participant;
- (3) deduct any amount of the Initial Contribution or Variable Contribution of an expelled or resigning SEOCH Participant which has been applied towards any payment in accordance with Clearing Rule 413; and
- (4) include any monies recovered from Defaulters that have been credited to the Reserve Fund as an expelled or resigning SEOCH Participant's Initial Contribution or Variable Contribution under Clearing Rule 414, as determined on the effective date of termination of its SEOCH Participantship by SEOCH.

723. To the extent that resources of the Reserve Fund in excess of the value of an expelled SEOCH Participant's SEOCH Collateral in respect of Reserve Fund Contributions are applied in discharging the rights and liabilities under any OCH Contracts to which it was party, SEOCH may recover in full the amount so applied from that SEOCH Participant as a debt due to SEOCH from it.

## **Default Procedures Prevail**

724. The Clearing Rules contained in this Chapter are without prejudice to, but in the case of any conflict take precedence over, any other provision of these Clearing Rules, the Operational Clearing Procedures, the Options Trading Rules, Operational Trading Procedures, the Exchange Rules or the terms and conditions of any Contract.