

獲取 / 放棄期權莊家執照申請之解釋說明
**Explanatory Notes for Application for Acquisition /
Surrender of Options Market Maker Permit(s)**

一般資料

General Information

1. 申請人須注意，若所呈交之申請未有附上解釋說明內所列明的所須表格及文件，香港交易及結算所有限公司（「香港交易所」）將不作處理，有關的申請將退回申請人。
Applicants should note that Hong Kong Exchanges and Clearing Limited ("HKEX") will not process applications that are not accompanied by all the required forms and documents stated in these notes and will return the applications to the applicants.
2. 申請表格可於香港交易所網址 www.hkex.com.hk 下載。
Application forms are available at the web-site of HKEX at www.hkex.com.hk.

申請獲取期權莊家執照之所須文件

Documents Required for Application for Options Market Maker Permit(s)

申請人須提交：

Applicant shall provide:-

1. 表格 OP004 (獲取/放棄期權莊家執照申請) ；
Form OP004 (Application for Acquisition / Surrender of Options Market Maker Permit(s));
2. Internal Report (請參閱附上之 Internal Report 指引) ；及
Internal Report (Please read the attached Guidelines for Internal Report); and
3. 證明其聯號為一受監管者、其信貸評級為 A-或以上 (標準普爾) 或 A3 或以上 (穆迪) 或其繳足股本不少於 HK\$100,000,000 及股東權益不少於 HK\$200,000,000 (只適用於將莊家盤登記於其聯號賬戶的申請人) 。
Documentary evidence showing that the affiliate is a regulated entity, has a credit rating of A- or above (Standard & Poors) or A3 or above (Moody's) or has a paid-up share capital and shareholders' funds of not less than HK\$100,000,000 and HK\$200,000,000 respectively (only applicable to Applicants who will book their market making positions to their affiliates).

申請放棄期權莊家執照之所須文件

Documents Required for Surrender of Options Market Maker Permit(s)

1. 表格 OP004 (獲取/放棄期權莊家執照申請) 。
Form OP004 (Application for Acquisition / Surrender of Options Market Maker Permit(s)).

Guidelines for Internal Report

Options Market Making

Introduction

In application for an Options Market Maker permit and having market making orders for its own account or for its affiliate's account, an Exchange Participant (the applicant) is required to: -

- (i) submit an internal report ("Report") giving information on the risk management policy of the company and describing the systems, controls and internal procedures that it intends to adopt or has adopted in regard to market making on the Exchange; and
- (ii) include in the Report the information on the core operations and risk management controls of both the applicant and the affiliate, where applicable, insofar as they relate to Options Market Making on the Exchange.

Areas to be covered in the Report

1. Overview of the market making business

Brief descriptions of set up of the business, its core operation systems and key personnel, including: -

- business structure and set up for the market making activities (providing details of the affiliate, where applicable);
- core operations of front and back offices for the market making activities;
- a description of the background, experience, role and responsibility of key personnel; and
- trading strategy and policy.

2. Financial standing

The applicant and the affiliate, where applicable, should have and employ effectively the resources and procedures, which are needed for the proper performance of the market making activities. The applicant should provide the following information: -

- financial information of the applicant and the affiliate, where applicable;
- controls and procedures to ensure compliance with the financial requirements of the Exchange; and
- controls and procedures to meet the settlement obligation towards the clearing houses.

3. Risk management

The framework of risk management policy and procedures of the applicant and the affiliate, where applicable, on the market making activities, specifically including the following: -

- policy and procedures for setting trading strategy, trading and position limits, and risk parameter for pricing and risk monitoring;
- market risk management to review and approve pricing models and valuation systems (including mark to market mechanism) and monitor for significant variance in the volatility;
- list of risk management reports reviewed by the management and risk management personnel and frequency of such review;
- controls and procedures in ensuring the implementation of the risk management policy and procedures of the applicant and the affiliate, where applicable; and
- controls ensuring the affiliate comply with "Requirements for a Market Making Affiliate" set out in Paragraph 2.1 of *Treatments of Market Maker Positions and Stamp Duty Exemptions* on an ongoing basis (see attachment).

4. Records

The applicant should keep and maintain sufficient trading records of the market making activities. The Report should include description of the following: -

- list of accounts and reports to be kept and the frequency of the reports (keep separate accounts for the affiliate's market maker trades, own market maker trades and affiliate's trades and own trades which are not for the purpose of market making); and
- controls in place to reconcile the executed trades and outstanding position to third party statements (such as reports from the clearing houses and the Exchange) from the reports generated by the pricing, risk monitoring and back office systems.

5. Computer and security

A description of the computer system to be used and internal security procedures, including: -

- software to be used for the pricing, risk monitoring and back office processing;
- source of the software and applicant's experience in the software. If newly self-developed software is used, details of training provided to the staff and testing of the software;
- history of major failure of the software, if appropriate; and
- the internal security procedures in place, including controls to restrict access to the computer system by password and User ID to prevent unauthorized amendment to the data and software.

The above areas are by no means exhaustive. The applicant should include any additional procedures, which they consider necessary to address the risks to which the applicant and the affiliate's assets are exposed and the liabilities that might incur.

MARKET MAKING

FOR

STOCK OPTIONS

TREATMENTS OF MARKET MAKER POSITIONS

AND

STAMP DUTY EXEMPTIONS

TABLE OF CONTENTS

1.	INTRODUCTION	1
2.	ALTERNATIVES FOR THE TREATMENT OF MARKET MAKER POSITIONS	2
2.1	Requirements for a Market Making Affiliate	2
2.2	FRR Modifications Permitted for Market Maker Portfolios	4
2.3	Internal Report	4
2.4	Applications	4
3.	OPERATION OF THE OPTIONS MARKET MAKER STAMP DUTY PROGRAMME	5
3.1	Overview	5
3.2	Reporting of Jobbing Business to the Exchange	5
3.3	The Monitoring System	5
3.4	Preparation of Contract Notes and Payment of Tax	6
3.5	The Eligibility Criteria	6
3.6	Position Reporting	6
3.7	Changes to the Rules	6
Appendix I	Requirements for Market Makers applying to hold positions in an affiliate	7
Appendix II	Arrangements for Stamping of Jobbing Business of Options Market Makers	9
Appendix III	Transactions Permitted To Be Treated As Options Market Maker Jobbing Business: Eligibility Criteria & Directives	13
Appendix IV	Order Input Requirements for Stock Options Market Makers and Options Hedging Participants	19

1. INTRODUCTION

This document covers two specific aspects of options market making which are not covered in the Rules of the Exchange.

Section 2 describes the alternative ways in which market maker positions may be treated in the books of an Options Trading Exchange Participant firm so as to reduce the inefficiencies associated with the conventional financial reporting treatment of portfolio trading positions in an Exchange Participant firm.

Section 3 explains how to make claims for exemptions from ad valorem stamp duty in respect of options market making. Appendices II and III are the documents issued by the Inland Revenue which describe the exact eligibility criteria and forms of claim submission.

Other aspects of market making are covered in the following documents:

Options Trading Rules

- Terms under which a market maker permit is granted
- Performance obligations of market makers
- Rates of discount allowed for given performance levels
- Exemptions to performance obligations
- General rules governing market making

Operational Trading Procedures

- Application, renewal and termination procedures for market maker permits
- Tariff rates for each options class

Stock Options Trading User Manual

- Overview of the system features of HKATS and DCASS available to market makers
- Trading applications and functions offered by both HKATS and DCASS

2. ALTERNATIVES FOR THE TREATMENT OF MARKET MAKER POSITIONS

The standard terms under which Options Trading Exchange Participants are granted a market maker permit require that all positions be booked in the name of the Exchange Participant firm itself, beneficially held by the Participant firm and not on behalf of any other entity. It is also assumed that the treatment of market maker positions will be in accordance with existing Rules of the Exchange and the Financial Resources Rules ("FRR").

However, the Exchange recognizes that there may be circumstances where the interests of the market would not be harmed by allowing alternatives.

There are two mutually exclusive alternatives to the standard arrangement. A Participant may choose one (but only one) of the following structures, subject to meeting certain criteria:

1. The market maker positions may be beneficially held by an affiliate of the Participant.
2. Certain modifications may be permitted to the way in which liquid capital is assessed under the Financial Resources Rules, which have the effect of optimising the capital charge.

If the Market Maker is not operating under the standard terms, he must declare which of these methods he will adopt. We will deal with the requirements separately.

2.1 Requirements for a Market Making Affiliate

If the firm holds its market maker positions in the accounts of an affiliate, then there must be only *one* such affiliate and all the Participant's market maker business at any one time must be in the name of that affiliate. It is not permitted that there be more than one market maker affiliate per Participant firm.

All proprietary trading or trading done on behalf of affiliates for the affiliate's own account which is not for the direct purpose of market making must be allocated to the P1 account (or, with the permission of the Exchange, to the A1 account).

Any affiliate which is a client for the purpose of market making activities must meet *at least one* of the following criteria.

1A. Regulated Entity

A regulated entity is one regulated by an exchange, clearing house, independent authority or commission which is acceptable to the Exchange.

The following provisions will apply to these arrangements, initially and on an ongoing basis:

- i. The Exchange must be able to verify with the appropriate regulatory body that the entity is not in breach of any of that body's rules or regulations;
- ii. Any breaches of those rules or relevant findings by the regulator must be reported to the Participant who will then report them to the Exchange;
- iii. Annual audited accounts and report submitted to the regulator (in English) for the affiliate will be given to the Exchange; and
- iv. The Exchange Participant will report immediately to the Exchange if the affiliate ceases to be subject to the oversight of the regulator.

Moreover, the Participant must ensure that the affiliate complies with all the obligations of a client as laid out in the Options Trading Rules, Operational Trading Procedures, Clearing Rules, Operational Clearing Procedures and the Rules of the Exchange with regard to premium payment, margin payment, commission etc.

or

1B. Credit Rating

The affiliate must have and must maintain a current credit rating of A- or above (Standard & Poors) or A3 or above (Moody's).

or

1C. Paid-Up Capital and Shareholders' Funds

The paid-up capital of the entity must be at least equal to the equivalent of HK\$100,000,000 *and* its shareholders' funds must be at least the equivalent of HK\$200,000,000 at all times. Annual audited accounts must be presented together with re-confirmation by an external auditor, at least once between annual audits (*viz.* six months after the annual audit is completed), that the paid-up capital and the shareholders' funds exceed these levels. In addition, monthly financial statements are required to be submitted to demonstrate compliance with the Working Capital requirement specified under Rule 614F of the Option Trading Rules of the Stock Exchange. See Appendix I for details.

or

1D. Others

Other exemptions may be sought for special cases but it is not envisaged that exemptions will be granted other than in exceptional circumstances.

2.2 FRR Modifications Permitted for Market Maker Portfolios

Those firms which elect for market making in the Participant firm's own account (i.e. not in the name of an affiliate) and which wish to apply for a modification to the calculation of liquid capital should notify the Exchange that they wish to apply to the SFC for modifications under the FRR for their market maker positions.

2.3 Internal Report

The Participant should also prepare a brief report giving information on the risk management policy of the company and describing the systems, controls and internal procedures that it intends to adopt or has adopted in regard to options market making on the Exchange. The purpose of this report is to give the Exchange and, where applicable, the SFC an overview of the operations so as to understand better the context in which market making is carried out.

The report, to be submitted at the time of application, can be in a free format but at a minimum should provide an account of the risk management policy and the systems, internal controls and procedures which are established for executing the policy. There should also be an account of the organisation structure and details of the personnel who are responsible for risk management within the operation and, where applicable, within affiliated or associated companies who are involved in the execution of SEHK Traded Options business.

2.4 Applications

Participants who wish to apply for market making should write in the first instance to:

Hong Kong Exchanges and Clearing Ltd
6/F, Two Exchange Square
8 Connaught Place, Central
Hong Kong
Attn: Participant Admission

3. OPERATION OF THE OPTIONS MARKET MAKER STAMP DUTY PROGRAMME

3.1 Overview

Participants who are Options Market Makers are able to claim exemptions from the ad valorem rate of stamp duty on those share transactions in the underlying market which are pursuant to their options market making business. Stamp Duty on such transactions is at a flat rate of \$5 per transaction. These transactions are known as “jobbing business”.

For a transaction to be recognised as jobbing business, it must be recorded in OTP-C and satisfy the eligibility criteria laid down by the Inland Revenue. The Participant must report such transactions to the Exchange in order to avoid paying stamp duty at the full rate.

A monitoring system is operated by the Exchange which automatically calculates the maximum amount of stock transactions which are eligible in respect of a single day's trading and compares this to the actual claims made that day. If the claimed amount exceeds the limits set by the Exchange, the Participant and the Inland Revenue will be informed.

The Exchange will assist the Inland Revenue in determining the cause of the breach and whether or not a valid reason exists for the breach. A breach may be a criminal offence if the Inland Revenue feels that the act was deliberate tax evasion. It will also be considered a disciplinary offence under the Exchange Rules.

3.2 Reporting of Jobbing Business to the Exchange

Any Participant wishing to claim jobbing business must do so by reporting the eligible transactions (which must have already been recorded in OTP-C) to the Exchange no later than 10.15 a.m. on T+1. The Participant is required to upload and submit a trade file of Form SD-4 (SD-4 Trade File) via the Electronic Communication Portal ("ECP") for jobbing business reporting. The name of the SD-4 Trade File submitted via the ECP shall follow the convention of SD4_XXXX_YYMMDD.txt where XXXX is the 4-digit Exchange Participant Firm ID with a leading zero and YYMMDD is the trade date of Form SD-4.

3.3 The Monitoring System

The DCASS system extracts the relevant option positions of each separate options market maker and determines the maximum extent of what may be claimed as jobbing business each day. This information in respect of each options market maker's portfolio is calculated nightly and made available in raw data form through DCASS.

Separately, the actual claims made in respect of each day's trading are compared to the eligible amount and if there is an apparent breach, this will be reported to the Participant and the Inland Revenue as soon as possible (in practice, no later than T+2).

3.4 Preparation of Contract Notes and Payment of Tax

Stamp Duty for jobbing business will *not* be paid via the Exchange. It must be paid directly to the Inland Revenue in accordance with their procedures. See Appendix II, *Arrangements for Stamping of Jobbing Business for Options Market Makers*.

The payment of outstanding stamp duty underpaid due to negligence or deliberate evasion will be the responsibility of the Participant and the Participant will deal directly with the Inland Revenue.

3.5 The Eligibility Criteria

Jobbing business must satisfy the eligibility criteria. Please see Appendix III, *Transactions Permitted to be Treated as Options Market Maker Jobbing Business: Eligibility Criteria & Directives*.

3.6 Position Reporting

Market makers are also required to maintain a daily record of their closing balances in regard to the stock positions which are claimed as hedges. This could consist partially of positions which were created via transactions on which stamp duty was in fact paid. This record should be available for inspection on demand by the Exchange or the IRD so that a reconciliation can be carried out, if necessary.

Participants do not need to report the stock position daily but they will need to ensure that they maintain accurate records.

The Inland Revenue requires quarterly reports to be made. Details are in their paper, *Arrangements for Stamping of Jobbing Business for Options Market Makers* (see Appendix II).

3.7 Changes to the Rules

The *Rules of the Exchange*, incorporating the *Options Trading Rules* require that Participants only claim as jobbing business transactions which are legitimately pursuant to their options market making business. The rules also stipulate that market makers must keep a record of their daily closing stock position in regard to their options portfolio together with details of any movements intra-day.

1. Requirements for Market Makers applying to hold positions in an affiliate

Certification of Paid-Up Capital and Shareholders' Funds of an Affiliate

For an affiliate holding market maker positions under the criteria that its paid-up capital and shareholders' funds must be not less than the equivalent of HK\$100 million and HK\$200 million respectively at all times, it must submit to the Exchange the following documents :-

- (1) its annual audited accounts not later than four months following the year end date; and
- (2) its half-yearly management accounts which must at least contain the balance sheet, profit and loss accounts and the full notes to the accounts. The management accounts should be certified by the external auditors in accordance with section 2 below and should be submitted within 2 months following the period end date.

2. Terms of reference for the External Review of Management Accounts and Certification of Paid-up Capital and Shareholders' Funds

This report should be based on the management accounts of the company as at 6 months after the year end date. The report shall be presented to the Exchange within two months of the reporting date.

- (1) To certify that the management accounts as at the reporting date are correctly compiled from the books and records.
- (2) To review the bank reconciliations for all bank balances as at the reporting date to ensure that large and unusual reconciling items can be satisfactorily explained.
- (3) To review the subsequent settlement of receivables (including clients, brokers, group companies and others) to ensure the fairness of the provision for bad and doubtful debts, if any.
- (4) To verify the existence, ownership and valuation of securities and other assets held by the company at the reporting date.
- (5) To ensure that the management accounts disclose the following information related to any unrecorded liabilities and contingent liabilities which may not have been reflected in the management accounts as at the reporting date.
 - (a) the nature of the unrecorded liabilities or contingent liabilities; and
 - (b) an estimate of the financial effect.
- (6) To ensure that the management accounts disclose any change of accounting policies and deviation from generally accepted accounting principles which are judged material or critical in determining profit or loss for the period and in stating the financial position and changes therein.

- (7) To confirm that all material adjusting post balance sheet events have been included in the management accounts.
- (8) To ensure that the management accounts disclose the following information related to any material non-adjusting post balance sheet event :-
 - (a) the nature of the event; and
 - (b) an estimate of the financial effect.
- (9) To ensure that the management accounts disclose any off balance sheet exposure.
- (10) To obtain all the information and explanations which to the best of the auditor's knowledge and belief were necessary for the purpose of the review.

3. Risk monitoring requirements on a Market Maker Affiliate

A Market Maker Affiliate shall:

- (1) At the end of each calendar month, submit to the Exchange, through the Market Maker, (i) a monthly financial statement, setting out the Market Maker Affiliate's Working Capital (as specified under Rule 614F of the Options Trading Rules of the Stock Exchange); and (ii) the duly completed Working Capital Report (http://www.hkex.com.hk/-/media/HKEX-Market/Services/Trading/Derivatives/Market-Maker-Programmes/Market-Maker-Obligations-and-Incentives/Working_Capital_Report.xlsm), within three weeks after the end of the relevant calendar month through the Electronic Communication Platform of HKEX at <https://ecp2.hkex.com.hk/>; and
- (2) maintain a certain level of Working Capital on a daily basis, which shall be at least equal to
 - (a) One-half of the Net Risk Margin ("NRM"); or
 - (b) One-seventh of the Total Margin Requirement ("TMR"), whichever is higher, where

NRM = the sum of the Risk Margin (determined on a net basis and after offsetting any Mark-to-Market margin credit, where applicable) for the market maker account and the house account of the Options Exchange Participant.

TMR = the sum of the Total Margin Requirement for the market maker account and the house account of the Options Exchange Participant.

"Risk Margin" and "Total Margin Requirement" have the same meaning as set out in the Operational Clearing Procedures for Options Trading Exchange Participants of SEOCH.

On breaching the Working Capital requirement, the Market Maker shall report such breach to the Exchange as soon as practicable and in any event no later than 4pm on the next Business Day. The Market Maker Affiliate shall forthwith reduce its positions or increase its Working Capital within 10 Business Days.

**Arrangements for Stamping of Jobbing Business of
Options Market Makers**

Contract Notes in respect of sales or purchases of Hong Kong Stock which constitute Jobbing Business are chargeable to stamp duty under Head 2(2) of the First Schedule to the Stamp Duty Ordinance at a flat rate of \$5. The following paragraphs set out the arrangements in relation to the execution and stamping of the contract notes for Jobbing Business.

1. Contract Notes in respect of Jobbing Business

Any broker who effects any sale or purchase of Hong Kong stock which constitutes jobbing business as prescribed by the Stamp Duty (Jobbing Business)(Options Market Makers) Regulation shall forthwith make and execute a contract note for each and every matched transaction of such nature in the usual manner as required by section 19(1) of the Stamp Duty Ordinance. The contract note shall include all normal particulars of a contract note as specified in section 19(2) which are listed as follows:

- (a) whether the person effecting the sale or purchase of the Hong Kong stock is acting as principal or agent and, if as agent, the name of his principal;
- (b) the date of the transaction and of the making of the contract note;
- (c) the quantity and description of such Hong Kong stock;
- (d) the price per unit of such Hong Kong stock and the amount of the consideration; and
- (e) the date of settlement.

In addition, the contract note relating to jobbing business should bear a self-explanatory note for identification purpose as follows which can be imprinted by any reprographic method –

This transaction is a jobbing business within the meaning of the Stamp Duty (Jobbing Business) (Options Market Makers) Regulation.

Furthermore, the contract notes for transactions arising from exercise of traded options should be specified as such on the contract note by including the following sentence below the above text box: **"This is a transaction arising from the exercise of a traded option."**

In the case where a contract note is made for or is related to more than one matched transaction of jobbing business, the number of matched transactions should be shown clearly on the contract note and the contract note will be charged with stamp duty on each of the matched transactions included therein.

2. Stamping of Jobbing Business Contract Notes

Stamping should be completed not later than 2 days after the sale or purchase is effected.

(a) Stamping via the internet (www.gov.hk/estamping)

This is a 24-hour online service available at the GovHK. Stamping application can be submitted in bulk with a maximum of 5,000 contract notes at any one time without presenting the paper contract notes to the Stamp Office. The Options Market Makers can refer to the Stamping Procedures and Explanatory Notes – e-Stamping of Share Transfer Instruments [U3/SOG/PN10A] (www.ird.gov.hk/eng/pdf/sog_pn10a.pdf) issued by the Stamp Office for further details.

(b) Conventional stamping

The Options Market Makers can forward their contract notes for jobbing business to the Stamp Office for stamping on a daily basis (or if jobbing business contract notes of more than one trade day are submitted together, the contract notes for different trade days should be separately bundled) before 4:00 p.m. on normal working days. The contract notes should be submitted under cover of the following:

1. a completed "**Requisition For Revenue Stamps**" [Form IRSD20, blank form is available from the Stamp Office] as per [Annex A](#) attached;
2. a summary statement showing the aggregate information on the contract notes submitted for stamping as per [Annex B](#); and
3. a cheque drawn in favour of "The Government of the Hong Kong Special Administrative Region" or "The Government of the HKSAR" for the total amount of contract note duties (and for the penalties for late stamping where applicable) for the pile of jobbing business contract notes attached.

The stub of the Form IRSD20 imprinted with the payment particulars will be returned to the staff of the Options Market Maker who submitted the contract notes for stamping after the cheque has been collected by the shroff. The contract notes for jobbing business will be stamped and returned to the staff of the Options Market Maker on the following working day, upon presentation of the stub of the corresponding Form IRSD20.

3. Quarterly Report to be furnished by the Options Market Makers

In order to substantiate their claims for the lower rate of stamp duty on jobbing business, the Options Market Makers are required to furnish to the Stamp Office within 14 days after the end of each quarter ended 31 March, 30 June, 30 September and 31 December a report showing the following information:

- (a) The long and short positions of each series of traded options as at the last date of the quarter covered by the report;
- (b) The description of each component of the portfolio which is hedging traded options whether the component be a security, futures contract or any other type of instrument; and
- (c) The balance, whether long or short, of each component of the portfolio which is hedging traded options at the close of business of the last trade day of the quarter.



此項印花稅係由.....評計
Duty Assessed by

稅務局 印花稅署
購買印花或加蓋稅印申請表
INLAND REVENUE DEPARTMENT—STAMP OFFICE
REQUISITION FOR REVENUE STAMPS

姓名 (Name of Options Market Makers and Broker Number) Contact person: Mr X 電話號碼 Tel. No. XXXX XXXX

種類 Description	數目 No.	稅額 Rate	總額 Total
XXX Contract Notes for Jobbing Business by Options Market Makers executed on _____ Duty Payable: Jobbing transactions chargeable to stamp duty	nnnn	\$5 00	\$XXXXXXX 00

I.R.-S.D. 表格第 20 號 (12/1999)
I.R.-S.D. 20 (12/1999)

機印所示金額收訖
RECEIVED the sum here stated in printed figures.

(備註：如以支票付款，須在支票首次提交予付款銀行獲得兌現後，此收據才屬有效。)
(N.B. In the case of payment made by cheque, this receipt is valid only when the cheque is honoured on the first presentation to the drawee bank.)

姓名： (Name of Options Market Makers & Broker Number)
Name XXX Contract Notes for Jobbing Business
文件種類： for nnnn transactions dated _____
Description of Document

**Summary Statement of Jobbing Transactions
Submitted for Stamping**

Broker Firm Name: _____

Broker Firm ID: _____

Broker No.: _____

Transaction date: _____

	Hedging Transactions	Exercise Options	Total
Number of contract notes enclosed			
Number of matched transactions involved			
Aggregate Value/consideration of the transactions (\$)			

Company Chop: _____

Signature: _____

Date: _____

TRANSACTIONS PERMITTED TO BE TREATED AS OPTIONS MARKET MAKER JOBGING BUSINESS: ELIGIBILITY CRITERIA & DIRECTIVES

For a stock transaction to be subject to the stamp duty rate applicable to jobbing business under the Stamp Duty Ordinance, it is necessary that it satisfies the “eligibility criteria”. This paper describes what will constitute the eligibility criteria. Any bona fide options market maker hedging or exercise transaction performed by a Participant of the Stock Exchange of Hong Kong (“the Exchange”) which satisfies the eligibility criteria will be liable to stamp duty at the special rate applicable to jobbing business.

1. Who is eligible?

The right to claim transactions as being jobbing business will exist for all options market makers who perform such options market making functions on the Exchange in accordance with the Law, regardless of the particular internal structure or ultimate beneficial ownership of the positions resulting therefrom, provided that such market making activities are executed according to the Rules of the Exchange and the directives issued by the Exchange from time to time with regard to market maker functions.

2. The Basic Method

For options market maker hedging transactions to constitute jobbing business for the purposes of the Stamp Duty Ordinance, it is necessary that they satisfy the eligibility criteria set out in paragraphs 2.1 and 2.2 below.

2.1 Gross Limit

The transactions in the underlying stock of an option class that can be claimed by an options market maker on a business day (Day T), excluding transactions from exercise or assignment, cannot exceed the gross limit on Day T. The gross limit is determined to be the greater of:

1. the adjusted total number of gross option positions in the option class in the options market maker’s portfolio on Day T; and
2. the adjusted total number of gross option positions in the option class in the options market maker’s portfolio on the preceding business day (Day T-1), subject to the following cap:
 - (i) 1,000 lots (for Tier 1 option classes as defined in the Operational Trading Procedures) or
 - (ii) 5,000 lots (for Tier 2 & Tier 3 option classes as defined in the Operational Trading Procedures)

where the adjusted total number of gross option positions is the underlying stock equivalent (“the number of option positions” multiplied by “the contract size”) that the options market maker holds at the end of Day T or Day T-1, as the case may be, as adjusted by applying a factor of 10% to those option positions with a delta of less than 10%. The delta of each option series in which the options market maker carries a position will be solely determined by the Exchange based on its daily closing settlement prices.

See paragraph 3 for details of the delta and paragraph 7.1 for calculation example

on gross limit.

2.2 *Net Buy/Sell Limit:*

The number of net long or short transactions in the underlying stock of an option class that can be claimed by an options market maker must be within the upper and lower bounds which the options market maker can be said to require a hedge. Such upper and lower bounds are determined by the Exchange based on the delta of each option series in the option class and other details of the options market maker's portfolio as set out below.

See paragraph 3 for details of the permitted boundaries calculation and paragraph 7.2 for the calculation example.

3. **Determination of the Upper and Lower Bounds for Net Buy/Sell Limit**

The determination of the upper and lower bounds works as follows:

The delta of each option series in which the options market maker carries a position will be solely determined by the Exchange based on its daily closing settlement prices. (Delta is the "hedge ratio" i.e. the theoretical amount of stock that needs to be bought or sold to hedge a given position in an option series). The net delta of the entire portfolio will yield a single theoretical stock position that the options market maker "should" be carrying i.e. the method will show whether the options market maker, in order to hedge the portfolio, should be net long stock, short stock or carrying zero stock, if the Exchange's delta calculation was optimal.

Because the delta is only theoretical and there may be many possible views about what the correct hedge ratio should be, it is necessary to have some latitude in how far from this Exchange-determined theoretical position the options market maker should be allowed to deviate.

The options market maker will therefore be allowed to deviate from this theoretical position in accordance with the configuration of its option positions. Its portfolio will be separated into two groups consisting of its "synthetic longs" (i.e. short puts and long calls) and "synthetic shorts" (i.e. short calls and long puts).

It would be expected that synthetic longs are hedged with short stock positions and synthetic shorts are hedged with long stock positions. Therefore an additional allowance of 40% of the synthetic longs can be added to the short side of the permitted boundaries and 40% of the synthetic shorts to the long side. For the purpose of this calculation, one options contract is equal to the equivalent amount of underlying "synthetic" stock (e.g. one board lot of shares or whatever quantity is applicable to one options contract).

3.1 *Minimum upper & lower bounds*

The options market maker is allowed under the boundary conditions to be either outright long or outright short a minimum of 250 lots.

3.2 *Carrying forward of entitlements*

The closure of a particular stock position is taken into account in the calculations. The upper and lower bounds will be calculated to be the absolute maximum of the greatest upper and lower bounds calculated by the above algorithm for Day T and for the two business days prior to Day T to allow for the closure of a stock position.

4. Exercise Transactions

For the avoidance of doubt, stock transactions arising out of exercise or assignment of option positions are not included in the eligibility criteria used to determine the limit to transactions which can be claimed, as set forth in this paper. However, separate to the calculation of the limits, these stock transactions are classified as jobbing business for options market makers in that option class, and are considered to be transactions that have satisfied the eligibility criteria notwithstanding other provisions in this paper.

5. Eligibility Criteria for Jobbing Business

5.1 *Underlying Stocks*

Normally, only the stocks which are the subject of the options will be valid for jobbing business. Options market makers are nevertheless permitted to sell short a listed security (security "A") to hedge a market making position in respect of an option over listed security "B" if security "A" and security "B" belong to the same issuer.

The following is an example (others may be identified in due course):

- i. Swire "B", as a hedge for Swire "A" in the ratio 6:1 (B:A)

Warrants are not permitted to be the subject of jobbing business.

5.2 *"Pre-hedging" Not Eligible*

Only stock transactions for hedging executed options contracts arising from the market making activities of an options market maker shall qualify as jobbing business. Stock transactions for hedging an options market maker's quotes and/or options contracts which are anticipated to be executed or which may be executed do not qualify as jobbing business.

6. General Provision

At any time, an options market maker may be called upon to justify to the Exchange's satisfaction that a particular transaction that has been claimed as jobbing business was a bona fide hedge and/or was directly pursuant to its options market making activity even if it appears to comply with the eligibility criteria described in paragraphs 1 to 5. For example, a client transaction or house transaction not properly belonging to options market making activity must not be reported as jobbing business. Another example would be the execution of large gross transactions that, even though on a netted basis comply with the eligibility criteria described in paragraphs 1 to 5, do not in fact bear any relation to the options market maker's options hedging requirement.

It is important to note that compliance with the eligibility criteria described in paragraphs 1 to 5 does not necessarily qualify a transaction as jobbing business. Only those stock transactions that are directly pursuant to the bona fide hedging of transactions of an options market maker in performing its market making functions may be entitled to stamp duty at the special rate applicable to jobbing business. Besides the Stamp Office, the Exchange may in its discretion determine whether a transaction constitutes a bona fide hedge.

Any designated Exchange staff or such persons appointed by the Exchange may from time to time inspect the books, records and documents maintained by an options market maker in relation to its market making activities and jobbing business. The options market maker

shall grant or allow such designated Exchange staff or appointed persons immediate access to its premises, books, records and documents necessary for his or their inspection with or without prior notice.

The options market maker may be requested to conduct an independent review as directed by the Exchange to confirm that its jobbing transactions are directly pursuant to bona fide hedging of the transactions in performing of its market making functions. Any expenses incidental to or consequential upon an independent review or an inspection shall be borne by the options market maker.

Any transaction which, in the opinion of the Exchange, is found to be not a bona fide hedge and/or not directly pursuant to the market making activities of an options market maker will be deemed to have failed in satisfying the eligibility criteria. The Exchange will report any such transactions to the Collector of Stamp Revenue without prior notice being given to the options market maker concerned.

The Collector of Stamp Revenue may, in its absolute discretion, determine to cease the entitlement of an options market maker to the special rate stamp duty applicable to jobbing business at any time.

If, in the opinion of the Exchange, any options market maker has abused the stamp duty exemption scheme or has attempted to do so, the Exchange may revoke or suspend its market maker permit in its absolute discretion at any time without giving any reason or notice.

7. Worked Example

Here is an example of how the eligibility criteria are determined. ('+' means long; '-' means short)

7.1 Gross Limit:

Computation of adjusted total number of gross option positions in the portfolio on Day T

Assume the gross option position of option class XYZ is 11,000 contracts, where the contract size is 1 board lot of underlying shares per options contract, hence the position is equivalent to 11,000 lots of underlying shares.

Among the 11,000 options contracts:
Delta of 10,000 options contracts < 10%
Delta of 1,000 options contracts ≥10%

The adjusted total number of gross option positions on Day T = $10,000 \times 0.1 + 1,000 \times 1 = 2,000$ lots of underlying shares

Computation of adjusted total number of gross option positions in the portfolio on Day T-1

Assume the gross option position of option class XYZ is 12,000 contracts on Day T-1. The position is equivalent to 12,000 lots of underlying shares.

Among the 12,000 options contracts:
Delta of 9,000 options contracts < 10%
Delta of 3,000 options contracts ≥10%

The adjusted total number of gross option positions on Day T-1
 = $9,000 \times 0.1 + 3,000 \times 1 = 3,900$ lots of underlying shares

Assuming it is a Tier 1 option, the cap of 1,000 lots of underlying shares will be applied.

The Gross Limit of XYZ on Day T

= Greater of (adjusted total number of gross option positions on Day T, adjusted total number of gross option positions on Day T-1)
 = Greater of (2,000 lots, 1,000 lots)
 = 2,000 lots of underlying shares

7.2 Net Buy/Sell Limit:

Assumptions

Contract size is 1 board lot of underlying shares per options contract

Day T-3

Unadjusted Upper Bound (“UUB_{T-3}”) = 800 contracts

Unadjusted Lower Bound (“ULB_{T-3}”) = 0 contract

Day T-2

Unadjusted Upper Bound (“UUB_{T-2}”) = 1,000 contracts

Unadjusted Lower Bound (“ULB_{T-2}”) = 100 contracts

Day T-1

Portfolio Delta = -1,000 contracts

Synthetic Shorts = 900 contracts

Synthetic Longs = 2,000 contracts

Day T

Portfolio Delta = -500 contracts

Synthetic Shorts = 2,000 contracts

Synthetic Longs = 2,200 contracts

Day T-1

Unadjusted Upper Bound (“UUB_{T-1}”) = [(Synthetic Shorts) x 0.40 – (Portfolio Delta)] = 360 +1,000 = 1,360

Unadjusted Lower Bound (“ULB_{T-1}”) = [-(Synthetic Longs) x 0.40 – (Portfolio Delta)] = -800 +1,000 = 200

Adjusted Upper Bound = Max(UUB_{T-1}, UUB_{T-2}, UUB_{T-3}, 250) = 1,360

Adjusted Lower Bound = Min(ULB_{T-1}, ULB_{T-2}, ULB_{T-3}, -250) = -250

Day T

Unadjusted Upper Bound = [(Synthetic Shorts) x 0.40 – (Portfolio Delta)] = 800 +500 = 1,300

("UUB_T")

Unadjusted Lower Bound ("ULB_T") = [-(Synthetic Longs) x 0.40 – (Portfolio Delta)] = -880 +500 = -380

Adjusted Upper Bound = Max (UUB_T, UUB_{T-1}, UUB_{T-2}, 250) = 1,360

Adjusted Lower Bound = Min (ULB_T, ULB_{T-1}, ULB_{T-2}, -250) = -380

How much stamp exemption can be claimed for trading during Day T?

During Day T, trading in jobbing business should not exceed a net purchase of 1,610 lots of underlying shares (1,360-(-250)), which is the adjusted upper bound Day T minus the adjusted lower bound Day T-1) or a net sale of 1,740 lot of underlying shares (1,360-(-380)), which is the adjusted upper bound Day T-1 minus the adjusted lower bound Day T).

Order Input Requirements for Stock Options Market Makers and Options Hedging Participants

1. Order input formats

(i) Stock Options Market Makers and Options Hedging Participants using OCG-C/BSS

Below is a summary of the order message requirements for different fields:

Orders	“Side” 1 = Buy 2 = Sell 5 = Sell Short	“Order Restrictions” 5 = Acting as Market Maker or Specialist in Security
(A) Buy	1	N/A
(B) Long Sell	2	N/A
(C) Short Sell		
- Downtick ^{Note}	5	5
- Non-downtick	5	N/A

(ii) Stock Options Market Makers and Options Hedging Participants using OCG-C/NSTD

Below is a summary of the input formats:

Orders	“SS” Indicator
(A) Buy	N
(B) Long Sell	N
(C) Short Sell	
- Downtick ^{Note}	M
- Non-downtick	Y

2. Stock Options Market Makers and Options Hedging Participants must comply with these input requirements and other regulations set out in the Fifteenth Schedule of the Rules of the Exchange in relation to Options Hedging Short Selling.

Note:

Downtick short sell order means order at price below the best current ask price.