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Rules and Procedures of HKFE Clearing Corporation Limited

PREFACE

Risk Management

HKCC has a number of powers which it uses to assist in the risk management process. These include:-

(g) in respect of Physical Delivery Contracts, the power to require an HKCC Participant to provide evidence of its holding of such amount of the underlying commodity or instrument as may be required to satisfy its settlement obligations and the power to require a Non-delivery HKCC Participant to close out and/or transfer any open positions by such time as shall be specified by the Clearing House from time to time, where applicable;

(h) in the event that an HKCC Participant fails to satisfy its delivery obligations in the settlement of a Physical Delivery Contract, the power to borrow, execute a buy-in to purchase the underlying commodity or instrument and/or make payment of Cash Compensation on behalf of the HKCC Participant, where applicable;

CHAPTER I

INTERPRETATION

Definitions

101. In these Rules, the definitions contained in the Exchange Rules (as hereinafter defined) shall where the context permits be incorporated herein by reference and the following expressions shall, unless the context otherwise requires, bear the following meanings:-

"Contract"	means an F/O Contract concluded by an HKCC Participant or a Non-Clearing Participant on any Market operated by the Exchange pursuant to the Exchange Rules or, as the context requires, a new contract arising pursuant to the provisions of Rule 308A(e), 309, 313 or 408(a);
"Physically Settled Options on Futures Contract"	means an Option Contract which is a Physical Delivery Contract and whose underlying is a Futures Contract;

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CHAPTER III

REGISTRATION, CLEARING, RISK

Timing of registration

308A. (d) Notwithstanding any provisions to the contrary in the Exchange Rules, these Rules or the Clearing House Procedures, the Clearing House shall have absolute discretion to determine the acceptance or refusal for registering and clearing any Contract executed through HKATS or otherwise. The Clearing House shall give notice to the Exchange and to the relevant HKCC Participants of any decision to refuse to register and clear any Contract. Any such refusal by the Clearing House shall not affect any then existing open positions in the relevant Exchange Contract, which shall continue to be subject to these Rules and the Clearing House Procedures.

(e) In respect of Contracts which are not executed through HKATS but which arise from the exercise of Physically Settled Options on Futures Contracts, the registration of such Contracts shall occur immediately upon the exercise of the Physically Settled Options on Futures Contracts as described in section 2A.5 of the Clearing House Procedures.

Legal effect of registration

309. After registration of every Contract (other than a Contract registered pursuant to Rule 308A(e)), the registered Contract shall be novated and there shall arise two separate Contracts:-

(a) one of them subsisting between the HKCC Participant registered as the Buyer of the Contract and the Clearing House in lieu of the original counterparty to such HKCC Participant; and

(b) the other of them subsisting between the HKCC Participant registered as the Seller of the Contract and the Clearing House in lieu of the original counterparty to such HKCC Participant,

each of these two separate Contracts being identical to the registered Contract except as to the parties thereto and except as provided in Rules 310 and 311 so that the obligations and rights of the parties to the two new Contracts shall entirely supersede and replace the obligations and rights of the parties to the novated Contract and (in particular) so that the Clearing House shall be bound by the terms of such new Contracts as principal.

After registration of every Contract arising from the exercise by an HKCC Participant of a Physically Settled Options on Futures Contract pursuant to Rule 308A(e), the HKCC Participant and the Clearing House shall continue to be bound by the terms of the Contract as principal, and for the avoidance of doubt, such Contract shall be a market contract for the purposes of the Securities and Futures Ordinance (Cap 571 of the Laws of Hong Kong).

309A. In respect of Contracts in Physically Settled Metal Futures Contracts which have been novated to the Clearing House pursuant to Rule 309 and which have the same Final Settlement Day, following:

For the avoidance of doubt, a Re-novated Contract shall be a market contract for the purposes of the Securities and Futures Ordinance (Cap 571 of the Laws of Hong Kong).

310. The obligations of the Clearing House to HKCC Participants under a Contract registered pursuant to Rule 308A(e) or arising pursuant to Rule 309 and for the time being extant shall be limited exclusively to:-

Terms of Contracts where the Clearing House is counterparty

311. Each Contract registered pursuant to Rule 308A(e) or arising pursuant to Rule 309 shall incorporate the following terms:-

(a) the Clearing House shall have no liability for any brokerage, commission or levy;

CHAPTER IV

CLEARING HOUSE MARGIN, VARIATION ADJUSTMENT, COVER FOR MARGIN AND ACCOUNTS

Clearing House margin

402. (d) The Clearing House shall determine the level of Clearing House margin required from each HKCC Participant with regard to open positions from Contracts registered pursuant to Rule 308A(e) or arising pursuant to Rule 309 using a risk based algorithm or such other methods as may be set from time to time in the Clearing House Procedures. So far as practicable the Clearing House shall make available on request the method used to HKCC Participants and the Commission. The Clearing House will inform the Commission and HKCC Participants of any changes to the margin methodology or prevailing margin rates.

Variation adjustment

410. The Clearing House shall calculate margin requirements and variation adjustments at least once on every Business Day inrespect of:-

(b) every Physical Delivery Contract until the earliest of (i) the date on which that Contract is closed out; (ii) the date on which that Contract is settled, or in the case of a Physically Settled Options on Futures Contract, the date on which that Contract expires or is exercised; or (iii) in the case of a Physical Delivery Contract where the settlement obligations of HKCC Participants to HKCC will complete at or before 9:15 a.m. on the Final Settlement Day, the Business Day immediately preceding the Final Settlement Day, or in the case of any other Physical Delivery Contract, the Final Settlement Day.

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CHAPTER V

LIMITS AND DEFAULTS

Events of default

509. Any of the following events or circumstances shall constitute an event of default upon its occurrence or if the Clearing House in its absolute discretion determines that it has occurred:

(f) an HKCC Participant defaults in any of its delivery or payment obligations in relation to the settlement of a Physical Delivery Contract including, without limitation, the payment of any Cash Compensation and non-delivery charge;

CHAPTER VI

CASH SETTLEMENT, DELIVERY AND EXCHANGE OF FUTURES

Cash Settled Contracts and Physical Delivery Contracts

601. (b) Physical Delivery Contracts that are Futures Contracts shall be settled by delivery of the underlying commodity or instrument by their Sellers and the payment of cash by their Buyers, Physical Delivery Contracts (other than Physically Settled Options on Futures Contracts) that are Put Options shall be settled by delivery of the underlying commodity or instrument by their holders and the payment of cash by their writers, and Physical Delivery Contracts (other than Physically Settled Options on Futures Contracts) that are Call Options shall be settled by delivery of the underlying commodity or instrument by their writers and the payment of cash by their holders.

(c) In respect of Physically Settled Options on Futures Contracts, any Futures Contracts arising from the exercise of such Physically Settled Options on Futures Contracts shall be settled as Cash Settled Contracts by payment of cash in the Settlement Currency.

Assignment process

603. After Market close on the last trading day of a Physical Delivery Contract (other than a deliverable Currency Futures Contract, a deliverable Currency Option Contract or a Physically Settled Options on Futures Contract), the Clearing House will allocate all short positions in such Contract to long positions in such Contract by an assignment process set forth in the Clearing House Procedures. In respect of a Physical Delivery Contract which is Physically Settled Metal Futures Contract, any outstanding open position in the relevant spot month Physically Settled Metal Futures Contract held by any HKCC Participant will be included in the Matching Process pursuant to section 2A.3.2.1(c) of the Clearing House Procedures. Each Physical Delivery Participant acknowledges and accepts that they may be matched, through the Matching Process, with a Non-delivery HKCC Participant. In such circumstances, the Physical Delivery Participant will receive a payment of Cash Compensation instead of completing the sale or purchase of, and delivering or taking delivery of, Deliverable Metal, as the case may be. The Physical Delivery Participant accepts and acknowledges such risk, and shall have no claim against the Clearing House, the relevant Non-delivery HKCC Participant or any other person resulting from it receiving payment of Cash Compensation instead of delivering or taking delivery of Deliverable Metal, as the case may be.

Failure to comply with delivery and/or payment obligations

607. In the event that an HKCC Participant ("defaulting selling HKCC Participant") fails to comply with its delivery obligations under the settlement of a Physical Delivery Contract by the prescribed time in accordance with the Exchange Rules, these Rules and the Clearing House Procedures, the Clearing House reserves the right at any time:

607A. In the event that an HKCC Participant ("defaulting buying HKCC Participant") fails to comply with its payment obligations under the settlement of a Physical Delivery Contract by the prescribed time in accordance with the Exchange Rules, these Rules and the Clearing House Procedures, the Clearing House reserves the right at any time:

Rights of the Clearing House against an HKCC Participant under a Physical Delivery Contract

611. In addition to any other rights the Clearing House may have under these Rules:-

(a) where the Clearing House has an obligation to deliver the underlying commodity or instrument to the buying HKCC Participant in relation to a Physical Delivery Contract (other than a Physically Settled Metal Futures Contract or a Physically Settled Options on Futures Contract), the Clearing House may, in lieu of delivering the underlying commodity or instrument in whole or in part, make compensation to the buying HKCC Participant notwithstanding that such underlying commodity or instrument may be available in the market. The Chairman shall exercise his powers under this Rule 611(a) only in circumstances when the Chairman considers in his reasonable opinion that the underlying commodity or instrument is not freely available in the market. The money compensation shall be in such amount and in such currency or currencies (whether in the Settlement Currency, the Currency of the Contract or otherwise) as the Chairman considers, in consultation with the Commission, to be fair and reasonable having regard to all the circumstances of the case. The Chairman's decision on the amount of payment is final and there shall be no appeal for any reason;

CHAPTER VII

THE RESERVE FUND AND LOSS DISTRIBUTION PROCESS

General

701. (a) The Clearing House shall establish a fund to provide resources to assist the Clearing House in meeting its obligations under Contracts registered pursuant to Rule 308A(e) or arising pursuant to Rule 309 or Rule 313. That fund shall constitute the Reserve Fund which shall be used only if the Clearing House is unable to meet its liabilities under Contracts by reason of defaults by HKCC Participants and shall be used only in accordance with the following Rules.

Payments out of Reserve Fund

708. (aa) The Clearing House may apply any amounts standing to the credit of the Reserve Fund as a short-term source of liquid funds to meet any immediate obligations under Contracts registered pursuant to Rule 308A(e) or arising pursuant to Rule 309 or Rule 313 on a temporary basis, regardless of the order of priority set out in Rule 706.

APPENDIX A

Fees

Description	Amount[1]
Settlement Fees (Futures), Exercise Fees and Assignment Fees (Options)	
<u>Equity index products</u>	
HSI Futures Options	10.00/Lot
HSCEI Futures Options	3.50/Lot

1 *Unless otherwise specified, the amounts listed in this appendix are in HK dollars*

APPENDIX B

<u>T+1 Session Cutoff Time</u>

Products	Time
<u>Equity Index Products</u>	
HSI Futures Options	3:00 a.m.
HSCEI Futures Options	3:00 a.m.

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CLEARING HOUSE PROCEDURES FOR FUTURES/OPTIONS CONTRACTS TRADED ON THE AUTOMATED TRADING SYSTEM OF THE EXCHANGE ("HKATS")

Chapter 1 Registration Procedures

1.1 Trade Capture and Registration

Trade details of a Contract executed on HKATS are electronically transmitted from HKATS to the Clearing House once they have been validated, matched and recorded in the Transaction Register of the system. Unless otherwise specified in the Exchange Rules, the Clearing House Rules or these Clearing House Procedures, the Contract will be immediately registered with the Clearing House upon the recording of such Contract in accordance with the Exchange Rules. Notwithstanding the foregoing, any such Contract registered with the Clearing House during the T+1 Session on a Business Day shall for the purposes of clearing and settlement, be treated as a trade executed by the relevant HKCC Participant on the next Business Day, unless otherwise specified in the Clearing House Rules or these Clearing House Procedures.

In respect of Contracts which are not executed on HKATS but which arise from the exercise of Physically Settled Options on Futures Contracts, the registration of such Contracts shall occur immediately upon the exercise of the Physically Settled Options on Futures Contracts as described in section 2A.5 of these Clearing House Procedures.

Chapter 2 Clearing and Settlement Procedures

2.2 Clearing House Margin

2.2.3 Components of Net Margining

2.2.3.1 Risk Array

PRiME evaluates the maximum likely loss of a portfolio under the same Combined Commodity* that may reasonably occur over one trading day under a set of risk scenarios. The specific set of risk scenarios are defined in terms of (a) the Price Scan Range, which is how much the price of the underlying instrument is expected to change over one trading day, and (b) the Volatility Scan Range, which is how much the volatility of that underlying price is expected to change over one trading day. The result of the calculation for each risk scenario, viz. the amount by which the portfolio will gain or lose value over one trading day under that risk scenario, is called the Risk Array value for that scenario.

**A Combined Commodity refers to a set of Futures/Options Contracts with the same underlying commodity and the same Currency of the Contract. For this purpose, a Physically Settled Options on Futures Contract and its underlying Futures Contract shall be considered to have the same underlying commodity if such underlying Futures Contract is a Stock Index Futures Contract.*

2.2.6 Clearing House Margin for Different Types of Clearing Accounts in DCASS

2.2.6.3 Client Offset Claim Account

For positions within the same Combined Commodity, offset positions are claimed on a one-to-one basis except those relating to the offset of positions in the (1) HSI Futures/Options, HSIF Option, Weekly HSI Option and Mini-HSI Futures/Options Contracts or (2) HSCEI Futures/Options, HSCEIF Option, Weekly HSCEI Option and Mini-HSCEI Futures/Options Contracts, which are claimed on the basis of (1) one HSI Futures/Options Contract, one HSIF Option Contract or one Weekly HSI Option Contract against a maximum of five Mini-HSI Futures/Options Contracts or (2) one HSCEI Futures/Options Contract, one HSCEIF Option Contract or one Weekly HSCEI Option Contract against a maximum of five Mini-HSCEI Futures/Options Contracts, as the case may be.

Chapter 2A Settlement of Physical Delivery Contracts

(1) Physical Delivery Contracts that are Futures Contracts shall be settled by delivery of the underlying commodity or instrument by the Sellers of such Contracts and by payment of cash by the Buyers of such Contracts, (2) Physical Delivery Contracts (other than Physically Settled Options on Futures Contracts) that are Put Options shall be settled by delivery of the underlying commodity or instrument by their holders and the payment of cash by their writers, and (3) Physical Delivery Contracts (other than Physically Settled Options on Futures Contracts) that are Call Options shall be settled by delivery of the underlying commodity or instrument by their writers and the payment of cash by their holders, in accordance with the Exchange Rules, the Clearing House Rules and these Clearing House Procedures. Physically Settled Options on Futures Contracts shall be exercised in accordance with section 2A.5 below and any Futures Contracts arising from the exercise of such Physically Settled Options on Futures Contracts shall be settled as Cash Settled Contracts by payment of cash in the Settlement Currency.

2A.5 Physically Settled Options on Futures Contracts

After trading of the spot month Physically Settled Options on Futures Contract ceases on the Expiry Day or at such other times as may be specified by the Exchange from time to time, the Exchange in conjunction with the Clearing House will announce the Official Settlement Price of the Physically Settled Options on Futures Contract.

If, on the Expiry Day, the Strike Price of a Call Option of a holder is less than the Official Settlement Price, the Call Option shall be deemed to be exercised by the holder automatically. No overriding instructions would be accepted. Upon exercise, the holder of the Call Option will be assigned a long position in the underlying Futures Contract with the same Contract Month and with a price which is equal to the Strike Price of the Call Option. If the Strike Price of the Call Option is greater than, or

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equal to, the Official Settlement Price, then the Call Option of the holder shall be deemed to have expired worthless.

If, on the Expiry Day, the Strike Price of a Call Option of a writer is less than the Official Settlement Price, the writer of the Call Option will be assigned a short position in the underlying Futures Contract with the same Contract Month and with a price which is equal to the Strike Price of the Call Option. If the Strike Price of the Call Option is greater than, or equal to, the Official Settlement Price, then the Call Option shall be deemed to have expired worthless and the writer shall have no further obligation in respect of that Call Option.

If, on the Expiry Day, the Strike Price of a Put Option of a holder is greater than the Official Settlement Price, the Put Option shall be deemed to be exercised by the holder automatically. No overriding instructions would be accepted. Upon exercise, the holder of the Put Option will be assigned a short position in the underlying Futures Contract with the same Contract Month and with a price which is equal to the Strike Price of the Put Option. If the Strike Price of the Put Option is less than, or equal to, the Official Settlement Price, then the Put Option of the holder shall be deemed to have expired worthless.

If, on the Expiry Day, the Strike Price of a Put Option of a writer is greater than the Official Settlement Price, the writer will be assigned a long position in the underlying Futures Contract with the same Contract Month and with a price which is equal to the Strike Price of the Put Option. If the Strike Price is less than, or equal to, the Official Settlement Price, then the Put Option shall be deemed to have expired worthless and the writer shall have no further obligation in respect of that Put Option.

All underlying Futures Contract positions arising from the exercise of a Physically Settled Options on Futures Contract as mentioned above will be marked to market on the same Business Day in which the Official Settlement Price of the Physically Settled Options on Futures Contract is announced.