

## Chapter 2

### Membership

#### 2.1 Membership Application Process

##### 2.1.1 Application Form

An Applicant must complete OTC Clear's membership application form (the "**Application Form**"), which can be found on the HKEX website or obtained directly from OTC Clear's office. The Application Form together with the supplementary documents (please see section 2.1.2) should be submitted to OTC Clear for its review.

OTC Clear reserves the right to amend the form of the Application Form from time to time.

For further information, please contact OTC Clear at:

OTCMembership@hkex.com.hk

##### 2.1.2 Document Checklist for Membership Assessment (One-Off)

Each Applicant is required to submit the documents listed in the Application Form to OTC Clear for membership assessment purpose. Applicants should contact OTC Clear at OTCMembership@hkex.com.hk in case of any queries relating to the nature or contents of the documents required to be submitted to OTC Clear for membership assessment purpose.

In respect of any documents to be submitted to OTC Clear that are not written in the English language, Applicants shall provide OTC Clear with copies of English translations for the same, with any translation costs to be borne by the relevant Applicant. All English translation shall be prepared by translators acceptable to OTC Clear and certified by such translators to the effect that the English translation accurately and completely reflects the contents of the document in its original language.

##### 2.1.3 Inspection and Site Visit

An on-site inspection may be required for membership assessment purpose. An on-site inspection will be mandatory for any Applicant that has not been a clearing member of any over-the-counter central clearing counterparty of international repute for a continuous period of 5 years before the date of its application to OTC Clear. Applicants should make themselves available for inspection provided that OTC Clear has given 28 calendar days' written notice prior to the proposed inspection date, or such other notice period as OTC Clear and the relevant Applicant may otherwise agree.

OTC Clear will provide an Applicant with details of the area to be inspected in the inspection notice, for example, OTC Clear may inspect an Applicant's risk management systems and other systems.

##### 2.1.4 Review and Assessment Process

OTC Clear will collect and review information provided by each Applicant for the purpose of assessing its membership eligibility. The processing of an application will vary from case to case, but it is expected that the application review process should generally be completed within two months from the date OTC Clear is in receipt of all required documents and information.

##### 2.1.5 Approval of Application

Once the application review process has been completed by OTC Clear, the application will be approved or rejected by the OTC Clear Board, in consultation with the Risk Management Committee (provided that such committee has been constituted).

Pursuant to Clearing Rule 308, the OTC Clear Board may, in consultation with the Risk Management Committee (provided that such committee has been constituted), also approve an application in principle subject to the Applicant's fulfilment of conditions set by the OTC Clear Board. Upon receipt of the conditional approval, the Clearing Member may submit Original Transactions and Original Northbound Transactions for registration by OTC Clear, provided that Clearing Rule 308 shall apply if a Clearing Member fails to fulfil the conditions within the specific time.

The OTC Clear Board's decision will be final and Applicants will be given written notice of approval or rejection. A failed Applicant may request OTC Clear to provide reasons for rejection of its application for Membership.

In accordance with Clearing Rule 405, Membership may not be assigned, transferred or sold without the prior written approval of OTC Clear Board.

#### **2.1.6 Execution of Membership Agreement and Initial Contribution to the Rates and Guarantee Fund**

An Applicant's Membership will only become effective if OTC Clear has received the following:

- (i) two copies of the Membership Agreement signed by the authorized signatory(ies) of the Applicant; and
- (ii) such Applicant's initial contribution to the Rates and FX Guarantee Fund, as determined pursuant to section 6.1.1 of these Clearing Procedures, to be delivered to OTC Clear within the time period set out in Clearing Rule 1504.

#### **2.1.7 Designated Person**

A Designated Person may submit Original Transactions and Original Northbound Transactions for registration on behalf, and in the name, of its Clearing Member pursuant to the provisions of Chapter 7 of the Clearing Rules.

#### **2.1.8 Additional Documents Required and Membership Requirements in respect of Non-Hong Kong Incorporated Persons**

Where a Licensed Corporation or an Authorized Institution with jurisdiction of incorporation outside Hong Kong, or a Remotely Regulated Entity (a "**Non-Hong Kong Incorporated Person**") applies to become a Clearing Member, OTC Clear may require such Non-Hong Kong Incorporated Person to demonstrate in its application the ability to satisfy the obligations of a Clearing Member (including but not limited to those set out in Clearing Rule 401(4)), and to provide legal opinions on, among others, the enforceability of OTC Clear's rights under the Clearing Documentation against such Non-Hong Kong Incorporated Person if it were a Clearing Member in respect of the jurisdiction of incorporation of such Non-Hong Kong Incorporated Person.

OTC Clear may, at its discretion, apply more stringent on-going risk monitoring to Non-Hong Kong Incorporated Persons and require such persons to implement sufficient outsourcing arrangements to be able to participate in fire drills and support the Default Management Process upon the occurrence of a DMP Event.

## **2.2 Future Categories of Membership**

Pursuant to Clearing Rule 301, OTC Clear may, after consultation with the Risk Management Committee, establish one or more categories of membership in the future. OTC Clear will notify the Clearing Members of any new category(ies) of membership established, and provide details of the same.

## **2.3 Clearing Members' On-going Requirements and Obligations**

OTC Clear's requirements in respect of Clearing Members are designed to ensure Clearing Members have sufficient financial resources and the relevant infrastructure for submission of Original Transactions and Original Northbound Transactions for registration as Contracts with OTC Clear.

### **2.3.1 Capital Requirement**

With respect to each Clearing Member, in addition to maintaining Capital in an amount not less than the Minimum Capital Requirement applicable to it set out in Clearing Rules 403 and 404, it shall also:

- (i) maintain Capital in an amount not less than its Rates and FX Liability;
- (ii) maintain Capital in an amount not less than its Expected Uncollateralized Loss as determined in accordance with section 6.1.1 of these Clearing Procedures; and
- (iii) on any day, maintain Capital in an amount such that the value of its CM Funded Contribution Amount (determined on such day as if it was a Rates and FX Contribution Determination Date) is less than 20% of the then total amount of its Capital.

### **2.3.2 Operational Requirement**

OTC Clear requires each Clearing Member to have operational capabilities to perform trade affirmation, contract settlement, portfolio valuation, portfolio reporting and system linkage with an Approved Trade Registration System. Please refer to section 3.2 of these Clearing Procedures for general information relating to such Approved Trade Registration System.

### **2.3.3 Risk Management Requirement**

Pursuant to Clearing Rule 401(9)(c), OTC Clear requires all Clearing Members to have established adequate risk management systems that are applied appropriately. This will include having risk management policies and procedures in place to ensure different aspects of risk are properly managed. Each Clearing Member's risk management systems, policies and procedures shall include, without limitation, the following:

#### **(i) Market and Credit Risk Management**

Each Clearing Member must have adequate risk policies and procedures in place to manage market and credit risk exposures of its trading portfolios submitted for registration with OTC Clear. Unless with the prior written approval from OTC Clear, a Clearing Member shall, as part of its risk management policies and procedures, set appropriate limits on the aggregate risk exposure of its House Position Account and (if it provides Client Clearing Services) on the risk exposure of each of its Client Position Accounts by utilizing the House Account Limit and/or Client Account Limit as described further in section 4.6.1 of these Clearing Procedures.

#### **(ii) Default Management Process Participation**

Clearing Members shall cooperate with OTC Clear in implementing the Default Management Process, including but not limited to:

- (a) participating in regular drills/tests (as set out in Clearing Rule 401(19));
- (b) providing market access for Hedging (as set out in Chapter 18 of the Clearing Rules and sections 8.2 and 8.5 of these Clearing Procedures); and
- (c) bidding in one or more Auctions during the Default Management Process (as set out in Chapter 19 of the Clearing Rules and section 8.6 of these Clearing Procedures).

- (iii) Client Risk Management (only applicable to Clearing Members who provide Client Clearing Services)

A Clearing Member that provides Client Clearing Services must have adequate risk policies and procedures to mitigate, monitor and control client credit risk as well as fulfil the requirements as stipulated in the Membership Application Form.

- (iv) Margin

A Clearing Member must deliver Collateral to satisfy its Margin requirements. Please refer to Chapter 12 of the Clearing Rules and Chapter 4 of these Clearing Procedures for details.

- (v) Rates and FX Guarantee Fund and Rates and FX Assessments

A Clearing Member must deliver Collateral to OTC Clear in respect of its CM Funded Contribution Amount, as calculated and demanded by OTC Clear, taking into account any applicable Collateral Haircuts on a monthly basis or at such other times as required pursuant to Clearing Rule 1503. A request by OTC Clear to deliver additional Collateral in respect of a Clearing Member's CM Funded Contribution Amount shall be satisfied by the relevant Clearing Member within 1 OTC Clear Business Day from the date such request is delivered to the Clearing Member.

In addition to the CM Funded Contribution Amount, a Clearing Member may be required to pay in cash its CM Unfunded Contribution Amount. More details can be found in Clearing Rules 1506 and 1507 and Chapter 6 of these Clearing Procedures.

#### **2.3.4 Outsourcing**

Each Clearing Member must have the ability to perform its operational and risk management functions (including participating in fire drills and in the Default Management Process) as required under the Clearing Documentation. To the extent that a Clearing Member wishes to have part or all of its operational and risk management functions performed by one or more of its Affiliates, such Clearing Member must have received written approval from OTC Clear to that effect prior to outsourcing or delegating such functions to the relevant Affiliate(s). OTC Clear will withhold its approval if a Clearing Member is seeking to outsource all of its risk management functions to its Affiliate who is also its Client. A Clearing Member who has outsourced part or all of its operational and risk management functions to its Affiliate(s) shall remain responsible to OTC Clear for the performance of all such functions pursuant to the Clearing Documentation. OTC Clear may revoke any approval in relation to the outsourcing or delegation of operational and risk management functions of a Clearing Member by providing such Clearing Member with written notice revoking the relevant approval. For the avoidance of doubt, a Clearing Member may not outsource its operational and risk management functions to any person other than its Affiliates.

#### **2.3.5 On-going Reporting Requirement**

A Clearing Member shall satisfy its obligations to provide OTC Clear with all relevant information as set out in Clearing Rules 401(13), 501, 503 and 504.

### **2.4 Client Clearing**

A Clearing Member may apply to provide Client Clearing Services by completing part B of the Application Form.

## 2.5 Changes to conditions of Membership

Any request to change any condition(s) of Membership, including but not limited to the type(s) of Contracts that a Clearing Member may submit for registration or whether it may provide Client Clearing Services, must be submitted to OTC Clear in writing.

Upon receipt of such request, OTC Clear may, at its discretion, require additional information or documents from such Clearing Member, conduct on-site inspection of such Clearing Member, or require such Clearing Member to submit a new Application Form. After assessing such request, OTC Clear will notify the Clearing Member in writing whether any requested change to condition(s) of Membership is approved or rejected.

## 2.6 Notification

- (i) In accordance with Clearing Rule 501(3), each Clearing Member is required to provide notification to OTC Clear for the events and changes specified below, within the periods specified herein:

Subject to OTC Clear's approval	any addition or removal of a Designated Person attached to a Clearing Member
At least 10 OTC Clear Business Days prior to the relevant event	any change in the settlement instructions by a Clearing Member
At least two OTC Clear Business Days prior to the relevant event	any of the following: (i) where practicable, any registration of new Contracts, or de-registration of existing Contracts from the House Position Account or any Client Position Account(s) of a Clearing Member that will or is expected to result in the Initial Margin requirement relating to such House Position Account or Client Position Account(s) meeting or exceeding a certain percentage threshold designated, and notified, by OTC Clear from time to time. The initial percentage threshold relevant for this purpose is set as 20%; or (ii) any change in the names or contact details of the persons designated by the Clearing Member in the Application Form as responsible officers for handling operational and risk matters.
Immediate notice by telephone and followed by notice in writing as soon as reasonably practicable	(i) any transfer, change or cessation of a Clearing Member's business which has a material effect on the Clearing Member's over-the-counter derivatives trading business. A "material effect" on the Clearing Member's OTC derivatives trading business will be deemed to have occurred if any transfer, change or cessation of a Clearing Member's business leads to: (ii) - the Initial Margin requirement relating to the House Position Account or the Client Position Account(s) of such Clearing Member meeting or exceeding a certain percentage threshold designated and notified by OTC

	<p>Clear from time to time. The initial percentage threshold relevant for this purpose is 20%; and</p> <ul style="list-style-type: none"> <li>- the value of such change is in excess of the Rates and FX Minimum Contribution Amount; or</li> </ul> <p>(iii) de-registration of all Contracts recorded in the name of the Clearing Member (please refer to section 3.6 of these Clearing Procedures).</p>
<p>Within 7 OTC Clear Business Days after the occurrence of the relevant event</p>	<p>any change in any of the following in relation to the Clearing Member:</p> <ul style="list-style-type: none"> <li>(i) the legal or business name;</li> <li>(ii) the registered office address provided by the Clearing Member and stated on the Application Form;</li> <li>(iii) any chief executive or equivalent;</li> <li>(iv) share capital; or</li> <li>(v) auditor.</li> </ul>

(ii) In addition to the matters set out in sub-paragraph (i) above, each Clearing Member is also required to provide notification to OTC Clear for the events and changes specified below, within the periods specified herein:

<p>As soon as the relevant event is identified</p>	<ul style="list-style-type: none"> <li>(i) any action, proceeding or investigation instituted against the Clearing Member by or on behalf of any Governmental Authority, self-regulatory organization, other regulatory authority exercising any disciplinary functions to which the Clearing Member is subject or any Clearing Organization to which the Clearing Member is a member; or</li> <li>(ii) any action, proceeding or investigation instituted against any member of the board of directors, chief executive officer, chief financial officer or chief operations officer (or its equivalent) of the Clearing Member by or on behalf of any Governmental Authority, self-regulatory organization, other regulatory authority exercising any disciplinary functions to which the Clearing Member is subject or any Clearing Organization to which the Clearing Member is a member.</li> </ul>
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The above lists are not intended to be exhaustive and a Clearing Member is expected to notify OTC Clear of any matter set out in Clearing Rule 501 in writing without delay, provided that any materially adverse or time sensitive changes that may affect a Clearing Member's eligibility to continue as a Clearing Member shall be notified to OTC Clear by telephone promptly and followed by notice in writing as soon as reasonably practicable.

**2.7 Audit, Inspection or System Tests**

Pursuant to Clearing Rule 401(18), officers or employees of OTC Clear or such persons appointed by OTC Clear may:

- (i) from time to time inspect and copy the statements, books, records, accounts and other documents maintained by a Clearing Member relating to Contracts; and/or
- (ii) conduct audits or system tests of each Clearing Member's operations related to its business with OTC Clear. Audit and system tests shall be conducted during business hours, and it is expected that, under normal circumstances, there will not be more than two audits being conducted within the same year with respect to a Clearing Member.

In addition, OTC Clear will conduct an on-site inspection of each Clearing Member at least once every 3 years.

A Clearing Member shall provide or allow relevant officers or employees or appointed persons of OTC Clear access to its premises, systems, statements, books, records, accounts and other documents necessary to discharging their duty for the purpose of carrying out the audit or system tests. A Clearing Member shall be entitled to deny entry to a representative of OTC Clear for the purpose of audit or system tests if it has reasonable grounds to believe any such representatives are conflicted in their role as an inspector or auditor, and has, in OTC Clear's reasonable determination, provided sufficient evidence to OTC Clear to substantiate such alleged conflict of interest.

Any costs and expenses reasonably incurred as a result of an inspection (including an on-site inspection) or audit or system test directed by OTC Clear under Clearing Rule 401(18) shall be borne by the Clearing Member concerned. OTC Clear will obtain at least two independent quotes for any such inspection or audit or system test.

If, upon the completion of an inspection or audit, OTC Clear is of the view that modifications are necessary to a Clearing Member's business activities, in whole or in part, such Clearing Member shall enter into good faith discussions with OTC Clear as to the necessary extent of any modifications and the timescale within which such Clearing Member will make such modifications.

## **2.8 Suspension, Termination and Resignation**

Membership may be suspended by OTC Clear in accordance with Chapter 6 of the Clearing Rules or terminated by OTC Clear in accordance with Clearing Rule 1311 or 1405.

A Clearing Member may resign from its Membership by giving written notice to OTC Clear in accordance with Clearing Rules 604 to 612.

## **2.9 Capped Liability Period**

In connection with Clearing Rules 609 and 1544, the following diagram illustrates how a Clearing Member's Maximum Current Liability is determined in respect of each Capped Liability Period:

- (i) if there is a single DMP Event (i.e. no other DMP Event has occurred in the period 20 OTC Clear Business Days prior or after such DMP Event), then the Capped Liability Period is the period from the declaration of such DMP Event to the 20th OTC Clear Business Day after such declaration; or
- (ii) if there are multiple DMP Events occurring in close succession and each of them occurred within 20 OTC Clear Business Days of another DMP Event, then the Capped Liability Period is the period from declaration of the first DMP Event (i.e. no other DMP Event has occurred within 20 OTC Clear Business Days prior to such DMP Event) to the 20th OTC Clear Business Day after the last of such declared DMP Event.

