

# I. INTRODUCTION TO OPERATIONAL CLEARING PROCEDURES

## 1. INTRODUCTION

### 1.1 Functions of SEOCH

SEOCH will accept for clearing, and act as a counterparty to, every options contract validly concluded on the Exchange. As a counterparty, SEOCH will be responsible for premium settlement and contract performance.

As a result of its contractual obligations, SEOCH will perform risk management functions on a daily basis. Such functions include determining the appropriate margin to be collected. In addition, SEOCH monitors the size of the Reserve Fund on a regular basis and will request SEOCH Participants to top-up their contributions if necessary.

Furthermore SEOCH will carry out surveillance functions, review position ratios and/or position limits and implement appropriate risk management measures to control and minimise the risk of SEOCH in its role as the counterparty to options contracts traded on the Exchange.

### 1.2 [Repealed]

### 1.3 SEOCH Participants

SEOCH will maintain a register of its Participants in accordance with the Clearing Rules.

There are two categories of SEOCH Participanship:

A **Direct Clearing Participant (DCP)** is entitled to clear options contracts traded in HKATS on the instructions, in its capacity as an Options Trading Exchange Participant, of its clients, as well as trades for its own account.

A **General Clearing Participant (GCP)** is entitled to clear options contracts traded in HKATS on the instructions, in its capacity as an Options Trading Exchange Participant, of its clients, as well as trades for its own account. In addition, a GCP is entitled to clear options contracts on behalf of other Options Trading Exchange Participants with whom it has entered into a Clearing Agreement.

An Options Trading Exchange Participant which is not a SEOCH Participant is referred to as a **Non-Clearing Options Trading Participant (NCP)**. An NCP cannot clear trades on its own, but has to rely on a GCP to clear on its behalf.

### 1.4 Principal to Principal Relationship Between SEOCH and SEOCH Participants

As provided in the Clearing Rules, a SEOCH Participant is in a principal to principal relationship with SEOCH for settlement and contract performance in respect of each and every options contract recorded or cleared in the name of that SEOCH Participant, regardless of whether the subject options contract is executed on its behalf or on its clients' behalf or is executed by another Options Trading Exchange Participant and given up to it for clearing. There is no relationship between SEOCH and clients of a SEOCH Participant, nor between SEOCH and an NCP.

The creation or maintenance of separate accounts by SEOCH for SEOCH Participants is only for the purpose of assisting SEOCH Participants in keeping separate records of their clients' trading in Exchange Traded Options Business. It shall not in any way detract from or otherwise affect the capacity and principal to principal relationship between the SEOCH Participant and SEOCH in respect of each and every OCH Contract. Nor shall it give rise to any trust or other equitable interest of any kind in respect of any money or other property standing to the credit of any such separate accounts.

## **1.5 Types of Accounts Maintained in DCASS and CCMS for SEOCH Participants**

### **1.5.1 DCASS Accounts**

SEOCH maintains for each SEOCH Participant different types of clearing accounts in DCASS. These accounts are registered under the name of the SEOCH Participant and are identified as the SEOCH Participant's (1) House Account, (2) Omnibus Client Account, (3) Individual Client Account, (4) Client Offset Claim Account, (5) Market Maker Account, (6) Daily Account, (7) APT Account, and (8) Sink Account.

#### *House Account*

The House Account is for the recording of a SEOCH Participant's proprietary trades and positions. Positions in the House Account are maintained on a net basis and margined, together with positions propagated from any Market Maker Account, on a net basis.

#### *Omnibus Client Account*

The Omnibus Client Account is for the recording, on an omnibus basis, of trades and positions of clients of a SEOCH Participant. Positions in the Omnibus Client Account are maintained and margined on a gross basis.

#### *Individual Client Account*

In order to facilitate net margining on positions of a SEOCH Participant's client, SEOCH (upon the request of a SEOCH Participant) may in its absolute discretion establish and maintain one or more Individual Client Accounts for the SEOCH Participant. SEOCH may prescribe a maximum number of Individual Client Accounts for a SEOCH Participant. The Individual Client Account is for the recording, on an individual client basis, of trades and positions of a client of a SEOCH Participant. Positions in an Individual Client Account are maintained and margined on a net basis. SEOCH Participants shall ensure that all trades and positions maintained in an Individual Client Account belong to one client only and such trades and positions are not held by a client of a SEOCH Participant operating an omnibus account. SEOCH Participants shall submit to SEOCH an application for the opening, maintenance and termination of Individual Client Accounts in such manner and using such form as may be prescribed by SEOCH from time to time. SEOCH may in its absolute discretion accept or reject the opening of any account and any maintenance request. The Individual Client Account is to facilitate separate position keeping in order to achieve net margin calculation for SEOCH Participants but should not be treated as recognising any trust or other equitable interest arising from such Individual Client Account.

#### *Client Offset Claim Account*

Upon the request of a SEOCH Participant, SEOCH may, in its absolute discretion, establish and maintain one or more Client Offset Claim Accounts for the SEOCH Participant. The Client Offset Claim Account is for the recording of eligible short positions of individual clients of a SEOCH Participant which are of an offset nature only. No long positions are permitted. Positions in each portfolio for an offset claim must belong to the same client (please refer to 9.3.1.2) and no positions of a client may be allocated to the Client Offset Claim Account except with the client's prior consent. Positions in the Client Offset Claim Account are maintained on a gross basis but margined on a net

basis. SEOCH Participants shall ensure that all positions maintained in the Client Offset Claim Account for margin offset can be reconciled with their internal records. SEOCH Participants shall submit to SEOCH an application for the opening, maintenance and termination of Client Offset Claim Accounts in such manner and using such form as may be prescribed by SEOCH from time to time. SEOCH may in its absolute discretion accept or reject the opening of any account and any maintenance request. The Client Offset Claim Account is to facilitate separate position keeping in order to achieve net margin calculation for SEOCH Participants but should not be treated as recognising any trust or other equitable interest arising from such Client Offset Claim Account.

#### *Market Maker Account*

The Market Maker Account is for the recording of trades and positions of a SEOCH Participant arising from its market making activities. Separate Market Maker Accounts may also be opened and maintained for designated traders of the SEOCH Participant and NCPs of the SEOCH Participant which are Market Makers. Positions in a Market Maker Account are maintained and margined on a net basis. Other than positions in the Market Maker Account of a designated trader, which will be margined separately, and other than positions in the Market Maker Account of an NCP of a SEOCH Participant, which will be propagated to the relevant Individual Client Account of the SEOCH Participant maintained for such NCP as if they were positions in such account for margin calculation purposes, positions in the Market Maker Account of a SEOCH Participant will be propagated to its House Account as if they were the positions in its House Account for margin calculation purposes.

#### *Daily Account*

The Daily Account serves as an account to which trades can be transferred on a temporary basis for average price trade calculation or other purposes prescribed by SEOCH from time to time. Trades and positions in the Daily Account are treated for all purposes as trades and positions belonging to the House Account with the exception that positions recorded in the Daily Account on any Business Day will be maintained on a gross basis prior to the System Input Cutoff Time on each Business Day. A SEOCH Participant shall transfer all trades in its Daily Account to its other accounts in DCASS (other than the Sink Account) prior to the System Input Cutoff Time. Any trades and positions remaining in the Daily Account after the System Input Cutoff Time will be automatically transferred to the Sink Account of the SEOCH Participant.

#### *APT Account*

The APT Account serves as an account to which a selected group of trades can be transferred on a temporary basis for the purpose of performing average price trade calculation. No positions will be recorded or maintained in the APT Account.

#### *Sink Account*

The Sink Account is for the recording of trades and positions automatically transferred from the Daily Account. Trades and positions in the Sink Account are treated for all purposes as trades and positions belonging to the House Account with the exception that positions in the Sink Account will be maintained and margined on a gross basis, separate from the House Account. A SEOCH Participant shall transfer all trades and positions in its Sink Account to its other accounts in DCASS (other than the Daily Account).

### **1.5.2 CCMS Accounts**

Transactions of a SEOCH Participant with SEOCH in respect of any delivery or redelivery of collateral, whether cash or non-cash, and settlement of its stock delivery obligation resulting from exercise or assignment of options contracts are collectively referred to as “collateral movement” and “stock settlement” transactions respectively for the purpose of this section.

CCMS Collateral Accounts are held in the name of a SEOCH Participant for the recording of collateral movement and stock settlement transactions between that SEOCH Participant and SEOCH. There are no CCMS Collateral Accounts held in the name of an NCP as all collateral movement and stock settlement transactions relating to options contracts traded by that NCP will be effected by the GCP that cleared those options trades on behalf of that NCP.

All cash and non-cash collateral provided by a SEOCH Participant to SEOCH will be recorded in the SEOCH Participant's CCMS Collateral Account. Collateral kept in the CCMS Collateral Account may comprise (a) cash; (b) approved securities available as General Collateral, To-be-Released collateral or Specific Securities Collateral for covering short call positions; (c) Exchange Fund Bills and Notes; and (d) such other types of collateral as may from time to time be accepted by SEOCH for crediting to the CCMS Collateral Account.

SEOCH maintains for each SEOCH Participant different types of clearing accounts in CCMS for recording collateral movement transactions between that SEOCH Participant and SEOCH. Collateral in the CCMS Collateral Account may be designated for house positions or client positions by a SEOCH Participant via its CCMS terminal. These accounts are identified as the SEOCH Participant's (1) House CCMS Collateral Account; and (2) Client CCMS Collateral Account. Each of these accounts is mapped with one or more position accounts of the SEOCH Participant in DCASS. For the purposes of these Procedures and the Clearing Rules, the terms House CCMS Collateral Account and Client CCMS Collateral Account will be used and the term CCMS Collateral Account will mean both House CCMS Collateral Account and Client CCMS Collateral Account unless otherwise specified or the context requires otherwise. In the case of a GCP, all collateral movements effected by that GCP in relation to positions cleared by that GCP for an NCP will be recorded in its Client CCMS Collateral Account on an omnibus basis.

## 1.6 Segregation of Accounts

For the purpose of assisting SEOCH Participants in keeping separate records of options contracts transacted on behalf of their clients, SEOCH will:

- i. calculate the following on a SEOCH Participant's house positions (i.e., those recorded in that SEOCH Participant's House Account, Market Maker Accounts, Daily Account and Sink Account) and its client positions (i.e., those recorded in that SEOCH Participant's Omnibus Client Account, Client Offset Claim Accounts and Individual Client Accounts) separately:
  - (a) the margin requirements;
  - (b) the amount of MTM Flow Adjustment in the Loss Distribution Process;
  - (c) the amount of Termination Value Payable and Termination Value Receivable in the contract termination process;
  - (d) the amount of Limited Recourse Interim CP Payables, Limited Recourse Final CP Payables and Limited Recourse CP Receivables in a Clearing Service Termination Event; and
  - (e) the amount of SEOCH Default Interim CP Payables, SEOCH Default Final CP Payables and SEOCH Default CP Receivables pursuant to Section 20.1 of the Operational Clearing Procedures.
- ii. regard the various types of collateral designated in the House CCMS Collateral Account independent of those designated in its Client CCMS Collateral Account when determining the following in respect of a SEOCH Participant:
  - (a) the amount of margin to be payable;
  - (b) the amount required from or due to that SEOCH Participant in respect of Premium and Settlement Amount;
  - (c) delivery obligations arising from the exercise or assignment of OCH contracts;

- (d) the value of SEOCH Collateral provided by that SEOCH Participant;
- (e) whether SEOCH Collateral provided by the SEOCH Participant is adequate;
- (f) whether SEOCH Collateral provided by the SEOCH Participant should be redelivered to it.
- (g) the amount of MTM Flow Adjustment in the Loss Distribution Process;
- (h) the amount of Termination Value Payable and Termination Value Receivable in the contract termination process;
- (i) the amount of Limited Recourse Interim CP Payables, Limited Recourse Final CP Payables and Limited Recourse CP Receivables in a Clearing Service Termination Event; and
- (j) the amount of SEOCH Default Interim CP Payables, SEOCH Default Final CP Payables and SEOCH Default CP Receivables pursuant to Section 20.1 of the Operational Clearing Procedures.

## **1.7 Separate DCASS Accounts for Designated Traders**

A Market Maker may apply to SEOCH for using the enhanced accounting services of opening and keeping a separate Market Maker Account for each of its designated traders.

A designated trader means a trader designated by a Market Maker to perform the market making obligations in the name and on behalf of that Market Maker in option class(es) specified by that Market Maker. In addition to the market making activities, trades in other option class(es) may be conducted by a designated trader for his own account.

SEOCH may in its absolute discretion, reject any applications by a Market Maker to open and maintain a Market Maker Account and/or other accounts for a designated trader without giving any reason. SEOCH may, from time to time in its absolute discretion impose conditions on the opening and maintaining of these accounts for designated traders of a Market Maker.

### **1.7.1 Market Maker Accounts for Designated Traders**

Upon opening of a Market Maker Account for a designated trader, all provisions of the Second Schedule of the Options Trading Rules shall apply to the named designated trader individually as if he was the Market Maker himself. The Market Maker shall be fully responsible for the conduct and performance of its designated trader.

For the purpose of the calculation of margin requirement, cash and stock settlement obligations, each Market Maker Account and/or other accounts opened for a designated trader of a SEOCH Participant will be treated separately as a portfolio on its own and totally independent of the positions of that SEOCH Participant recorded in its other accounts. All liabilities or settlement obligations arising from trades or positions of a designated trader will be settled through the SEOCH Participant's House CCMS Collateral Account.

### **1.7.2 Account Opening and Subsequent Maintenance Procedures**

A Market Maker shall submit to SEOCH an application for the opening of a Market Maker Account and/or other accounts for each designated trader and the subsequent maintenance thereof viz., cancellation of account, addition or deletion of class(es) which the designated trader is permitted to make market in such manner and using such form as may be prescribed by SEOCH from time to time.

### 1.7.3 Terms and Conditions

SEOCH shall have the absolute discretion to approve applications for opening and maintaining a Market Maker Account for a designated trader and such approval shall be subject to such terms and conditions as SEOCH may prescribe from time to time. SEOCH shall have the right to terminate a Market Maker Account and/or other accounts of any designated trader at any time without prior notice to the Market Maker.

General terms applicable to all Market Maker Accounts for designated traders include but are not limited to:

- i. The Market Maker must be a holder of at least one current Market Maker permit and the designated trader must be an Authorized User registered with the Exchange pursuant to the Options Trading Rules. A Market Maker must inform SEOCH of any changes to the options classes which its designated trader is permitted to make market.
- ii. SEOCH will set up for each designated trader a Market Maker Account for recording trades of the designated trader. A Market Maker shall ensure that each Market Maker Account will be used to record the activities of only one designated trader and not any other activities of any other trader or the Market Maker transacted on an omnibus basis.
- iii. The Market Maker shall be liable for discount claw-back in respect of each and every designated trader who has failed to meet the performance target as laid down in the Second Schedule of the Options Trading Rules.
- iv. Each designated trader account will be valid for one year from the date of approval of application by the Market Maker. Upon expiration, the Market Maker may re-apply again.

### 1.7.4 Termination of Services by SEOCH

SEOCH may at any time terminate the service of keeping a separate Market Maker Account for a designated trader in respect of his market making activities in one or more option classes if:

- i. the designated trader has failed for a consecutive two months to meet at least 50% of the performance target as laid down in the Second Schedule of the Options Trading Rules; or
- ii. the Market Maker permit to make a market expires or is revoked by the Exchange; or
- iii. the Market Maker submits to SEOCH an application to terminate a Market Maker Account in such manner and using such form as may be prescribed by SEOCH from time to time; or
- iv. the Market Maker ceases to be an Options Trading Exchange Participant; or
- v. the designated trader ceases to be an Authorized User.

Upon termination, open positions, if any, of the designated trader will be transferred to the Market Maker or other Account of the Market Maker as appropriate.

### 1.8 DCASS Account in respect of Options Broker Exchange Participants' Transactions Carried by a SEOCH Participant

Pursuant to Options Trading Rules 401A(1) & (5), no Options Trading Exchange Participant shall accept instruction from an Options Broker Exchange Participant ("OBEP") in relation to the transaction of any Exchange Traded Options Business for the account of the clients of that OBEP unless and until the Options Trading Exchange Participant is a Direct Clearing Participant or GCP of SEOCH and it has opened separate accounts in DCASS with SEOCH in respect of the transactions cleared by it for the OBEP.

For the purposes of this section 1.8, the SEOCH Participant that is required to open and maintain separate accounts in DCASS for an OBEP is referred to as the "carrying SEOCH Participant" and an account opened and maintained for that purpose an "OBEP Individual Client Account" respectively.

#### **1.8.1 No Relationship between SEOCH and OBEP**

To avoid all doubt, an OBEP has no relationship with SEOCH irrespective that SEOCH may from an OBEP Individual Client Account identify the relevant OBEP.

For margin calculation and assignment purposes, transactions recorded in an OBEP Individual Client Account will be regarded as a portfolio separate from other transactions recorded in the other accounts of the carrying SEOCH Participant. All money and / or stock settlement obligations arising from transactions recorded in an OBEP Individual Client Account will be settled through the carrying SEOCH Participant's Client CCMS Collateral Account.

The carrying SEOCH Participant must notify SEOCH the identity of the OBEP for whom an OBEP Individual Client Account is maintained. It is the responsibility of the carrying SEOCH Participant to ensure that each and every transaction in respect of an OBEP must be properly recorded in the OBEP Individual Client Account designated for that OBEP and that except for transactions in respect of that OBEP, no other transactions shall be recorded in that account.

#### **1.8.2 Structure and Operation of OBEP Individual Client Accounts**

For position recording purposes, two OBEP Individual Client Accounts may be maintained in DCASS for an OBEP, one Individual Client Account for the recording of positions from trades executed by the carrying SEOCH Participant for the OBEP's own proprietary account and one Omnibus Client Account for the recording on an omnibus basis of positions from trades executed for clients of the OBEP.

The carrying SEOCH Participant can, after execution of a trade, allocate the trade directly into the relevant OBEP Individual Client Account of the OBEP via DCASS.

Position and various trading and clearing reports / information generated by DCASS in respect of an OBEP Individual Client Account will only be available to the carrying SEOCH Participant.

#### **1.8.3 OBEP's subject to Long Only Restrictions**

All short positions recorded in an OBEP Individual Client Account designated for an OBEP which is subject to the Long-Only restriction pursuant to Rule 207 of the Options Trading Rules must be closed out immediately after the short positions are created or detected. Unless the carrying SEOCH Participant closes out or transfers the short positions to its Omnibus Client Account before 5:00 p.m. of the Business Day on which the short positions are created or detected, SEOCH will transfer all short positions detected in the OBEP Individual Client Account designated for an OBEP to the carrying SEOCH Participant's Omnibus Client Account.

#### **1.8.4 Application for OBEP Individual Client Accounts**

A SEOCH Participant shall submit to SEOCH an application for the opening of an OBEP Individual Client Account in such manner and using such form as may be prescribed by SEOCH from time to time. It will be within the absolute discretion of SEOCH to decide whether to open and maintain an OBEP Individual Client Account for an OBEP, and all OBEP Individual Client Accounts shall be governed by the terms and conditions as the SEOCH Board may prescribe from time to time.

#### **1.8.5 Termination of OBEP Individual Client Accounts**

SEOCH may at any time terminate an OBEP Individual Client Account for a SEOCH Participant if:

- i. the carrying SEOCH Participant notifies SEOCH of the termination of a particular OBEP Individual Client Account in such manner and using such form as may be prescribed by SEOCH from time to time provided that there are no open positions in the OBEP Individual Client Account to be terminated in such manner and using such form. If there are any open positions, the carrying SEOCH Participant must provide to SEOCH a plan of how to close out such open positions and the plan must be acceptable to SEOCH before it will process the termination; or
- ii. the OBEP ceases to be an OBEP of the Exchange; or
- iii. the carrying SEOCH Participant ceases to be a SEOCH Participant; or
- iv. if SEOCH considers it appropriate to do so; or
- v. upon SEOCH terminating this service completely.