

## **7. COLLATERAL**

SEPOCH may accept cash and non-cash assets as SEPOCH Collateral for margin purposes and for making Variable Contributions to the Reserve Fund in such form and manner, and in the case of non-cash assets and cash denominated in a currency other than the Settlement Currency, up to such limit as may be approved by the SEPOCH Board from time to time. Where the Settlement Currency of a Contract is not the same as the Currency of the Contract, the margin payable on such Contract will be converted by SEPOCH from the Currency of the Contract into the Settlement Currency at the exchange rate determined by SEPOCH as soon as practicable after the margin arose from such source and on such basis as it shall consider appropriate. Unless otherwise determined by the SEPOCH Board, the amount of cash in the Settlement Currency covering the margin requirement for each CCMS Collateral Account of a SEPOCH Participant shall not fall below the minimum level prescribed by the SEPOCH Board. Normally, a SEPOCH Participant's margin requirements will first be satisfied by cash in the Settlement Currency, then cash in any other currency from time to time approved by the SEPOCH Board (see Appendix H for the current list of approved currencies) and then by any non-cash collateral credited to the SEPOCH Participant's CCMS Collateral Account, or any other order of application as prescribed by the SEPOCH Board from time to time. In relation to Variable Contributions to the Reserve Fund where cash and non-cash collateral may be used, the order of application of such collaterals may be in any order as prescribed by the SEPOCH Board from time to time.

SEPOCH may accept the transfer of non-cash collateral directly from a SEPOCH Participant's clients provided that details of such transfer are provided by the SEPOCH Participant in advance. SEPOCH will update the SEPOCH Participant's CCMS Collateral Account upon the transfer of such non-cash collateral.

This chapter sets out the procedures for handling non-cash collateral. For the processing of cash collateral, refer to Chapter 10 - Money Settlement.

Collateral management, including cash and non-cash collateral of SEPOCH Participants, is handled by CCMS. For a detailed description of the collateral management functions in CCMS, please refer to the *CCMS Terminal User Guide*.

Any SEPOCH Participant using non cash collateral in settlement of the SEPOCH Participant's margin requirement will be subject to an accommodation charge at a rate or rates as prescribed by the SEPOCH Board from time to time on the amount of margin requirement which is settled by non-cash collateral (see Appendix I).

Each SEPOCH Participant shall be liable for all disbursements and expenses that may be incurred by SEPOCH in respect of or incidental to its acceptance of non-cash collateral from the SEPOCH Participant, including its redelivery or delivery of non-cash collateral and related sums to the SEPOCH Participant.

### **7.1 Repealed**

### **7.2 Securities Collateral**

SEPOCH may, subject to the provisions below, accept securities designated by the SEPOCH Board as acceptable General Collateral or Specific Securities Collateral (i.e. "the underlying") for the purpose of meeting in part or in whole the margin requirement of a SEPOCH Participant. Securities may be accepted as General Collateral and/or Specific Securities Collateral in respect of a SEPOCH Participant's House CCMS Collateral Account, provided always that the SEPOCH Board shall have the sole and absolute discretion to determine the maximum amount of a SEPOCH Participant's margin requirements that may be satisfied in the form of securities. For the Client CCMS Collateral Account, securities collateral will be accepted for Specific Securities Collateral purpose only.

SEPOCH has the final discretion in deciding whether and how much of a particular issue of securities to accept as General Collateral from a particular SEPOCH participant. SEPOCH reserves the right to modify the list of approved securities at any time and determine the maximum amount of securities that may be accepted from an issuer. Notwithstanding the foregoing, SEPOCH will not accept, as General Collateral, any securities issued by an issuer which holds or controls (whether directly or indirectly) 20 percent or more of the issued shares or voting power of a SEPOCH Participant or which, in SEPOCH's absolute opinion, is closely associated with or related to the SEPOCH Participant.

SEPOCH will not accept securities collateral in physical scrips. Deposit and withdrawal of securities collateral will be effected by transfers of shares representing the securities collateral as book entries between any one of the Stock Accounts of the SEPOCH Participant or the CCASS GCP, where applicable, in CCASS other than the Stock Collateral Control Account and the SEPOCH Participant's CCMS Collateral Account.

Please refer to HKSCC Rules for the daily cut-off time for submission of securities deposit/withdrawal request via CCMS.

A SEPOCH Participant which intends to lodge securities for collateral purposes must execute a valid "Deed of Charge" which governs SEPOCH's fixed charge on such securities collateral and such other documents as may be required by SEPOCH. For the avoidance of doubt, any EFBN provided by a SEPOCH Participant to SEPOCH shall be transferred outright to SEPOCH and will not form the subject matter of such "Deed of Charge". The standard form Deed of Charge is available from SEPOCH upon request. SEPOCH will not accept a SEPOCH Participant's securities collateral if such documents are not in place. Securities collateral credited to a SEPOCH Participant's CCMS Collateral Account will not be allowed to be used except as provided for under the Clearing Rules or these Operational Clearing Procedures, or transferred or withdrawn by the SEPOCH Participant unless with the express permission of SEPOCH.

### **7.2.1 Deposit of Securities Collateral**

A SEPOCH Participant or the CCASS GCP with which a SEPOCH Participant has entered into a CCASS Clearing Agreement, must input a transfer instruction via a CCASS terminal to transfer securities from one of its Stock Accounts in CCASS other than the Stock Collateral Control Account to the SEPOCH Participant's CCMS Collateral Account. Upon successful transfer, the Stock Collateral Control Account of the SEPOCH Participant or the CCASS GCP, where applicable, in CCASS and the CCMS Collateral Account of the SEPOCH Participant will be updated automatically and the securities balance in the CCMS Collateral Account of the SEPOCH Participant will be immediately made available for use as securities collateral of the SEPOCH Participant.

To allocate the securities collateral to specifically cover particular short call positions, the SEPOCH Participant must input appropriate cover call requests via DCASS. Upon verifying the availability of excess securities collateral in the CCMS Collateral Account, the relevant short call positions that are being covered will be excluded from calculation of margin requirements. Cover call requests can be input before the System Input Cutoff Time on a Business Day. Cover call requests are effected real time provided there are excess available securities. Otherwise, they will be rejected by DCASS. Rejected cover call requests will be purged from DCASS during the day end processing.

### **7.2.2 Withdrawal of Securities Collateral**

Any SEPOCH Participant that wishes to withdraw securities collateral should check the current securities collateral balance in its CCMS Collateral Account. A securities collateral withdrawal request will be accepted only to the extent that the value of the General Collateral in the CCMS Collateral Account exceeds the SEPOCH Participant's current margin requirement. A SEPOCH Participant's securities withdrawal request will be rejected if the value of the General Collateral in its CCMS Collateral Account does not exceed its current margin requirement.

Upon verifying the availability of excess securities collateral in its CCMS Collateral Account, the SEOCH Participant may withdraw securities held in its CCMS Collateral Account by inputting a transfer instruction via a CCASS terminal to transfer securities from the SEOCH Participant's CCMS Collateral Account to one of the Stock Accounts in CCASS maintained by that SEOCH Participant or the CCASS GCP, where applicable, other than the Stock Collateral Control Account.

In addition, if the securities collateral to be withdrawn have been assigned as Specific Securities Collateral to cover particular series, the relevant SEOCH Participant must de-cover that particular series via DCASS on the Business Day before the day the SEOCH Participant intends to withdraw such securities collateral. Upon settlement of the SEOCH Participant's money obligations the next morning, the SEOCH Participant will be able to effect the withdrawal via a CCASS terminal.

### **7.2.3 Revaluation of Securities Collateral**

Acceptable underlying securities allocated as Specific Securities Collateral to cover short call positions will provide full margin relief for short call positions which are being covered.

Securities collateral in CCMS Collateral Accounts will be marked to market at least once daily, based on the closing prices or prevailing market prices at the time of revaluation. "Haircuts" may be applied which discount the value of the securities collateral for the purpose of collateral valuation. The haircut rates will be determined by SEOCH at its absolute discretion.

### **7.2.4 Securities Collateral Coverage Assignment**

All securities collateral designated for SEOCH in CCMS will be allocated as General Collateral by default. It is the responsibility of the SEOCH Participant to input cover requests via DCASS to allocate securities collateral as Specific Securities Collateral in CCMS. This function is available before the System Input Cutoff Time. The SEOCH Participant should check the balance of the securities collateral available as either General Collateral or To-be-Released collateral in its CCMS Collateral Account and ensure that it is sufficient for covering short call positions before effecting the cover requests via DCASS.

A SEOCH Participant can input a cover call request via DCASS for a quantity of the underlying securities collateral in its House or Client CCMS Collateral Account to cover an open short call position in a particular series in its DCASS House, Market Maker, Individual or Omnibus Client Account, as the case may be. No cover call request however, shall be input to cover any open short call positions in the Client Offset Claim Account. The cover call request will be confirmed via DCASS if the quantity of underlying securities available in its CCMS Collateral Account is sufficient and upon confirmation, such underlying securities will be used as Specific Securities Collateral in CCMS. Short call positions covered by Specific Securities Collateral will not be marginable. For the allocation algorithm of covered securities collateral in covering particular series, please see 8.6.2.

### **7.2.5 Securities Collateral De-cover**

Similarly, SEOCH Participants can de-cover any covered short call position via DCASS. Any de-cover request will trigger the allocation of securities collateral to be de-covered from Specific Securities Collateral to To-be-Released collateral in a SEOCH Participant's CCMS Collateral Account. To-be-Released collateral can neither be withdrawn by a SEOCH Participant nor be used to meet margin requirement, but will have priority over General Securities Collateral in covering other options series in the relevant DCASS account. All To-be-Released collateral are DCASS account specific and will be released as General Collateral in the SEOCH Participant's CCMS Collateral Account after day-end processing and settlement of next day margin call, if any.

## **7.3 CCASS and CCMS Fees**

SEPOCH will generally charge a SEPOCH Participant for any CCASS or CCMS fees it incurs in relation to any CCASS or CCMS transaction specific to that particular SEPOCH Participant in relation to collateral movement as detailed in the tariff schedule in Appendix G to these Procedures.

## **7.4 Exchange Fund Bills/Notes**

Exchange Fund Bills/Notes (EFBN) refers to the debt instruments issued for the account of the Exchange Fund of Hong Kong. SEPOCH may, subject to the provisions set out below, accept these EFBN as General Collateral for the purpose of meeting in part but not in whole, the margin obligations of a SEPOCH Participant in respect of its house or client positions. The SEPOCH Board shall have the sole and absolute discretion to determine the maximum amount of a SEPOCH Participant's margin obligations that may be satisfied in the form of EFBN.

SEPOCH may also, subject to the provisions set out below, accept EFBN for the purpose of meeting in part or in whole the Variable Contribution of a SEPOCH Participant to the Reserve Fund. The SEPOCH Board shall have the sole and absolute discretion to determine the maximum amount of a SEPOCH Participant's Variable Contribution that may be satisfied in the form of EFBN.

SEPOCH is a Recognised Dealer (RD) appointed by the Hong Kong Monetary Authority (HKMA) under the Exchange Fund Bill/Note programmes and all transfers of EFBN must be effected as book entries via the Exchange Fund Bills and Notes Clearing and Settlement System (EFCS) between the account of SEPOCH and that of the SEPOCH Participant or its client. In case the SEPOCH Participant or its client is not a RD, the SEPOCH Participant must give instructions to the RD with whom the EFBN are held to effect the transfer on its behalf.

### **7.4.1 Use of EFBN**

Any SEPOCH Participant wishing to use EFBN to meet its margin or Variable Contribution requirements shall, in writing or by other means acceptable to SEPOCH, notify SEPOCH of its intention before 11:00 a.m. Such notification must include the specific purpose for which EFBN are being transferred. At the same time, the SEPOCH Participant shall instruct its RD to transfer EFBN on a Free of Payment ("FOP") basis to SEPOCH's account with HKMA. A SEPOCH Participant may also meet its margin requirement in respect of client positions through the transfer of EFBN directly from the SEPOCH Participant's clients provided that the SEPOCH Participant notifies SEPOCH of the details of such transfer in advance. The SEPOCH Participant shall instruct its clients or their RDs to transfer EFBN on an FOP basis to SEPOCH's account with HKMA and any such EFBN so transferred shall be considered to be delivered by the SEPOCH Participant. In the event that any such transfer fails to be made with the result that the SEPOCH Participant fails to meet any margin requirement, the SEPOCH Participant shall remain liable to SEPOCH in respect of such requirement and will be placed in default under the Clearing Rules.

SEPOCH will update the SEPOCH Participant's CCMS Collateral Account and accept EFBN as cover for margin or Variable Contribution requirements for the quantity of EFBN transferred only upon confirmation of receipt of the relevant EFBN in the account that SEPOCH maintained in the EFCS. To receive same-day credit for EFBN, the SEPOCH Participant must transfer EFBN to SEPOCH's account with HKMA by such transfer cutoff time as may from time to time be specified by HKMA.

### **7.4.2 Redelivery of EFBN**

Any SEPOCH Participant that wishes to request for the redelivery of EFBN collateral should check its current balance of EFBN via a CCMS terminal. A redelivery request will be accepted only if and to the extent that there is excess collateral in its CCMS Collateral Account to satisfy the request. SEPOCH Participants shall provide replacement collateral before submitting any EFBN redelivery requests if there is insufficient collateral in their CCMS Collateral Accounts.

A SEOCH Participant shall, in writing or by other means acceptable to SEOCH, notify SEOCH of an EFBN redelivery request before 11:00 a.m. and, if the conditions in the preceding paragraph are satisfied, such EFBN will be debited from the SEOCH Participant's CCMS Collateral Account and no longer be used to settle the SEOCH Participant's margin requirement and/or to satisfy the requirement of the Variable Contribution of that SEOCH Participant as determined under the procedure described in 11.2.2. SEOCH, upon allowing such redelivery request, will initiate instructions to HKMA to transfer EFBN on an FOP basis to the account of the SEOCH Participant, or on the express instructions of the SEOCH Participant, to such other account as it may specify provided that the SEOCH Participant provides confirmation to SEOCH that the holder of such account is a client of the SEOCH Participant. The SEOCH Participant should instruct its or, as the case may be, its client's RD to settle the transfer on that day. Any EFBN so transferred by SEOCH to an account specified by the SEOCH Participant shall be deemed to have been transferred to the SEOCH Participant insofar as the satisfaction of any liability of SEOCH towards the SEOCH Participant is concerned.

#### **7.4.3 Interest Payment of EFBN**

Where interest is paid to SEOCH in relation to EFBN which are the subject of cover for margin or Variable Contribution requirement provided by a SEOCH Participant, SEOCH will pay to the SEOCH Participant by crediting the relevant CCMS Collateral Account of the SEOCH Participant on the same Business Day, a sum equivalent to the amount of such interest, less any withholding tax that may be required to be deducted pursuant to any applicable tax laws and regulations and/or net of any Withholding Tax (whether withheld by SEOCH or any other parties). SEOCH will have no obligation to gross-up any such interest payment or to pay any additional amount as a result of such deduction or Withholding Tax. Without prejudice to the foregoing, to the extent required by the Tax Information Exchange Framework, SEOCH shall be entitled to deduct or withhold Withholding Tax (whether withheld by SEOCH or any other parties) from any payment of interest money (or payment of any other income) received by SEOCH in relation to the EFBN to a SEOCH Participant (or from any other payment made by SEOCH to a SEOCH Participant) and shall have no obligation to gross-up any such payment or to pay any additional amount as a result of such Withholding Tax.

#### **7.4.4 Maturity Redemption of EFBN**

Where redemption money is paid to SEOCH upon maturity of any EFBN which is the subject of cover for margin or Variable Contribution requirement provided by a SEOCH Participant, unless otherwise notified to the contrary by SEOCH, SEOCH will pay to the SEOCH Participant, by crediting the relevant CCMS Collateral Account of the SEOCH Participant on the Business Day following maturity of the EFBN, a sum equivalent to the amount of such redemption money, less any withholding tax that may be required to be deducted pursuant to any applicable tax laws and regulations and/or net of any Withholding Tax (whether withheld by SEOCH or any other parties). SEOCH will have no obligation to gross-up any such redemption money or to pay any additional amount as a result of such deduction or Withholding Tax. Without prejudice to the foregoing, to the extent required by the Tax Information Exchange Framework, SEOCH shall be entitled to deduct or withhold Withholding Tax (whether withheld by SEOCH or any other parties) from any payment of redemption money (or payment of any other income) received by SEOCH in relation to the EFBN to a SEOCH Participant (or from any other payment made by SEOCH to a SEOCH Participant) and shall have no obligation to gross-up any such payment or to pay any additional amount as a result of such Withholding Tax. SEOCH will, on the same day, debit the matured EFBN from the CCMS Collateral Account of the SEOCH Participant.

#### **7.4.5 Revaluation of EFBN**

EFBN recorded in the CCMS Collateral Account will be marked to market based on the closing value or the market value of the EFBN at a specified time published by the HKMA at the close of each Business Day. "Haircuts" may be applied which discount the value of the EFBN collateral for the purpose of margin call and Variable Contribution calculation. The haircut rates will be determined by SEOCH at its absolute discretion.