

## **IV. DUTIES AND OBLIGATIONS OF SEOCH PARTICIPANTS**

### **8. SETTLEMENT AND DELIVERY IN RESPECT OF STOCK TRANSACTIONS**

#### **8.1 Overview**

Immediately upon the valid exercise of an OCH Contract and assignment of that OCH Contract pursuant to the Clearing Rules, there shall arise stock transactions for the purchase and sale of underlying securities between SEOCH and the SEOCH Participant party to that OCH Contract and upon the terms of the Standard Contract. This Chapter describes the procedures for the settlement of delivery obligations under the validly exercised OCH Contracts.

For the purposes of these Procedures, the stock transactions arising from the exercise and assignment process and the stock positions resulting therefrom are referred to as exercised options trades and pending stock positions respectively.

##### **8.1.1 Repealed**

##### **8.1.2 Repealed**

##### **8.1.3 Repealed**

#### **8.2 Determination of Trade Day for Exercised Options Trades**

Under normal circumstances, the exercise day (i.e., the day on which the exercise request is validly effected whether manually by a SEOCH Participant or automatically by DCASS pursuant to the Clearing Rules) is regarded as the trade day (T) for the resulting exercised options trades.

#### **8.3 Timing for Settlement of Exercised Options Trades**

All exercised options trades are due for settlement on the second Settlement Day immediately following the trade day, i.e., on a T+2 basis.

SEOCH Participants should note that results of assignments of OCH Contracts are available only after the completion of the day end processing on the exercise day, which will be after the close of the underlying Exchange cash market. Until then, SEOCH Participants having short call positions should be aware of the assignment. Since the exercise day is the trade day (T) of the resulting exercised options trades, it may not be possible for a SEOCH Participant to settle its delivery obligations on T+2 by acquiring the underlying securities in the underlying cash market on T+1. SEOCH Participants may need to have stock borrowing or other arrangements in place to effect timely delivery on T+2.

##### **8.3.1 Repealed**

##### **8.3.2 Repealed**

##### **8.3.2.1 Repealed**

##### **8.3.2.2 Repealed**

## **8.4 Methods for Settlement of Stock Delivery Obligations**

Under normal circumstances, SEOCH would not use securities collateral provided by a SEOCH Participant to settle its delivery obligations. However, for Specific Securities Collateral covering short call positions, whether recorded in the SEOCH Participant's House, Market Maker or Individual or Omnibus Client Account, SEOCH will deem such Specific Securities Collateral to be used for settlement of the SEOCH Participant's delivery obligations arising from assignment of the short calls.

Except as aforementioned, stock delivery obligations arising from exercise and assignment of options positions are settled via CCASS under the Continuous Net Settlement (CNS) System in the same manner as other transactions in respect of an Eligible Security effected on exercise day in the underlying cash market of the Exchange. However, SEOCH may, at its discretion, isolate certain exercised options trades relating to one or more SEOCH Participants from settlement under the CNS System. Such isolated exercised options trades will be settled under the Isolated Trade (IT) System.

Procedures regarding settlement under the CNS System, the IT System or by Specific Securities Collateral are described in paragraphs 8.7, 8.8 and 8.9 respectively.

### **8.4.1 Repealed**

### **8.4.2 Repealed**

## **8.5 Records of Exercised Options Trades and Pending Stock Positions**

Particulars of each exercised options trade and the resulting pending stock positions are detailed in a report generated by DCASS after the day end processing on the exercise day (i.e., T). SEOCH Participants can also enquire about exercise and assignment information via DCASS.

After the day end processing on the exercise day (i.e., T), particulars of the resulting pending stock positions will be transferred to CCASS for settlement on T+2. An entry in the Final Clearing Statement (FCS) issued by HKSCC to the SEOCH Participant or the CCASS GCP, where applicable, on T+1 is confirmation of acceptance by HKSCC that an exercised options trade will be settled under the CNS or IT System. SEOCH Participants can also enquire about the particulars of exercised options trades to be settled by Specific Securities Collateral provided to SEOCH via DCASS.

## **8.6 Margin Settlement of Pending Stock Positions**

### **8.6.1 Pending Stock Positions to be Settled via CCASS under the CNS System**

#### **8.6.1.1 Marks, Margin and Concentration Collateral Settlement through HKSCC**

For SEOCH's margin computation purposes only, pending stock positions to be settled via CCASS under the CNS System will be deemed as settled once such positions are reported in the Provisional Clearing Statement (PCS) on T as positions to be settled under the CNS System. Such pending stock positions will be subject to Marks, Margin and Concentration Collateral requirements of HKSCC pursuant to the HKSCC Rules and the SEOCH Participant or the CCASS GCP, where applicable, will be responsible for the settlement of such Marks, Margin and Concentration Collateral in its capacity as a CCASS Clearing Participant. Therefore no margin will be required by SEOCH on such pending stock positions.

#### **8.6.1.2 Marks, Margin and Concentration Collateral Settlement through SEOCH**

Notwithstanding the above, a SEOCH Participant which will be settling its delivery obligations in CCASS itself (in its capacity as a CCASS Clearing Participant) may arrange with SEOCH to collect and pay, through a designated House CCMS Collateral Account of the SEOCH Participant in SEOCH, Marks, Margin and Concentration Collateral demanded by HKSCC on T in respect of

pending stock positions to be settled via CCASS under the CNS System. In this case, to the extent any excess cash collateral balance standing to the credit of such designated House CCMS Collateral Account is not sufficient to settle the Marks, Margin and Concentration Collateral requirement of HKSCC, a demand will be made on T through SEOCH's money settlement process according to 9.3.1A.

On T+1, SEOCH will, on behalf of the SEOCH Participant, effect a transfer from the SEOCH Participant's designated House CCMS Collateral Account to HKSCC's CCMS Collateral Account of an amount which is required to settle the obligation of the SEOCH Participant (in its capacity as a CCASS Clearing Participant) to pay Marks, Margin and Concentration Collateral demanded by HKSCC in respect of such pending stock positions. The amount to be transferred would comprise excess cash collateral balance that would have been available for withdrawal by the SEOCH Participant had no arrangement been made with SEOCH for it to pay Marks, Margin and Concentration Collateral on its behalf and any amount demanded by SEOCH for this purpose as mentioned above. No transfer will be made if there are insufficient funds in the designated House CCMS Collateral Account of the SEOCH Participant for this purpose or if the pending stock positions are not accepted by HKSCC for settlement under the CNS System. Upon such transfer being effected, any obligation of SEOCH to release to the SEOCH Participant any amount so transferred shall be discharged.

For the avoidance of doubt, SEOCH will not arrange to collect or pay Marks, Margin and Concentration Collateral with any SEOCH Participant which settles its delivery obligations through a CCASS GCP.

#### **8.6.1.3 CCMS Collateral Account Designation for Marks, Margin and Concentration Collateral Collection**

Where a SEOCH Participant opts for SEOCH to collect and pay Marks, Margin and Concentration Collateral of pending stock positions to be settled in CCASS under the CNS System through its designated House CCMS Collateral Account in SEOCH, such SEOCH Participant shall submit a request to SEOCH by such time, in such manner and using such form as may be specified by SEOCH from time to time. Any request received by SEOCH before the specified time on a Business Day shall become effective on the next Business Day. Notwithstanding the foregoing, SEOCH reserves the right to accept or reject any request made at its sole discretion.

#### **8.6.1A Pending Stock Positions to be Settled via CCASS under the IT System**

Pending stock positions to be settled under the IT System will be margined by SEOCH until full settlement by delivery of the underlying securities. SEOCH will inform SEOCH Participants about the margin requirement, if any, and such margin would be settled via the money settlement process of SEOCH.

#### **8.6.2 Pending Stock Positions to be Settled by Specific Securities Collateral**

For covered pending stock positions of a SEOCH Participant, SEOCH would normally deem those Specific Securities Collateral covering such stock positions to be used for the settlement of the SEOCH Participant's delivery obligations and hence no margin is required. SEOCH Participants should note that, since SEOCH has no information as to the allocation of exercised options trades amongst clients of a SEOCH Participant, the covered securities collateral allocation algorithm will differ for the various accounts in DCASS.

For the House, Market Maker and Individual Client Accounts, DCASS assumes pending short stock positions resulting from assignment of short call positions have higher priority, i.e., any Specific Securities Collateral will first be allocated to cover pending short stock positions which have arisen from the assignment of short calls and the balance, if any, allocated to cover open short call options positions.

For the Omnibus Client Account in DCASS, any Specific Securities Collateral will first be allocated to cover open or expiring short call options positions and any balance left will then be allocated to cover short pending stock positions resulting from assignment of the short calls. If the quantity of Specific Securities Collateral is not sufficient to cover the SEOCH Participant's open or expiring short call options positions, the short pending stock positions resulting from assignment would become naked, and the Specific Securities Collateral will not be used for the settlement of its delivery obligations.

## **8.7 Settlement via CCASS under the CNS System**

Exercised options trades to be settled under the CNS System are regarded as if they were trades in the cash market which had been effected on the same day as the day of exercise (i.e. T), for the purpose of the HKSCC Rules.

SEOCH will send to HKSCC all the particulars of each such exercised options trade, on a trade by trade basis (i.e. no netting and with SEOCH as the counter party to each such trade) upon completion of the day end processing on T. On T+1, if the SEOCH Participant has arranged for SEOCH to collect and pay Marks, Margin and Concentration Collateral in respect of pending stock positions arising from the exercised options trades from its designated House CCMS Collateral Account, SEOCH will transfer to HKSCC an amount which is required to settle the Marks, Margin and Concentration Collateral demanded by HKSCC in respect of these pending stock positions pursuant to the HKSCC Rules, such that these exercised options trades can be settled under the CNS System.

Upon confirmation of acceptance for settlement under the CNS System as recorded in the FCS issued by HKSCC on T+1, all exercised options trades will be netted with all other trades executed in the cash market on T by the SEOCH Participant or the CCASS GCP, where applicable, and settled under the CNS System in accordance with the HKSCC Rules. SEOCH will deem such exercised options trades settled after acceptance of such trades are confirmed by HKSCC for settlement under the CNS System on T+1.

## **8.8 Settlement via CCASS under the IT System**

SEOCH may exercise its discretion and determine that certain exercised options trades should be settled under the IT System. Under such circumstances, the affected SEOCH Participant will be notified of the decision as soon as practicable. In any case, an entry in the FCS issued by HKSCC indicating the exercised options trades are to be settled under the IT System will serve as the final confirmation of such a decision. Upon confirmation of any exercised options trades to be settled under the IT System, the relevant SEOCH Participants with stock delivery obligations must change the payment method of such exercised options trades from DVP to FOP basis as soon as possible. For any SEOCH Participant which settles its delivery obligations via a CCASS GCP, it must have a pre-established arrangement with its CCASS GCP to facilitate such change in a timely manner.

Stock settlement of these exercised options trades under the IT System will be handled via CCASS, whilst money settlement of the related Settlement Amount will be effected through the SEOCH money settlement process. Settlement procedures where the SEOCH Participant is the Buyer are described under 8.8.1 and where the SEOCH Participant is the Seller, under 8.8.2 below.

### **8.8.1 Settlement where the SEOCH Participant is the Buyer under the IT System**

SEOCH will collect the related Settlement Amount from a SEOCH Participant by debiting the required cash amount from that SEOCH Participant's cash balance recorded in its CCMS Collateral Account on T+1. If the balance as shown in that SEOCH Participant's CCMS Collateral Account is insufficient, any deficit will be collected by SEOCH through the SEOCH Participant's bank account maintained with the Designated Bank or Settlement Bank on T+2 not later than 9:15 a.m.

Upon confirmation of full settlement of the Settlement Amount, SEOCH will use its best endeavour to deliver the underlying securities to the Stock Account in CCASS maintained by that SEOCH

Participant or the CCASS GCP, where applicable, during one of the four batch settlement runs on T+2 or thereafter as soon as practicable.

## **8.8.2 Settlement where the SEOCH Participant is the Seller under the IT System**

### **8.8.2.1 Settlement Process**

As soon as being notified of any exercised options trades to be settled under the IT System, the affected SEOCH Participant must change or have arrangement in place to change the payment method of such exercised options trades to an FOP basis via CCASS before the first batch run on T+2 and settle the stock delivery obligations via CCASS on T+2. Upon receipt of the underlying securities in full settlement of the pending stock positions, SEOCH will credit the related Settlement Amount to the SEOCH Participant's CCMS Collateral Account on T+2 for same day value.

If the SEOCH Participant or the CCASS GCP, where applicable, can deliver the required underlying securities by DI before 11:00 a.m. and has submitted a cash withdrawal request before the cash withdrawal request cut off time (i.e. 11:00 a.m.), SEOCH will, upon confirmation of stock settlement, process the cash withdrawal for same day value.

### **8.8.2.2 Late Stock Delivery by the SEOCH Participant under the IT System**

If the SEOCH Participant or the CCASS GCP, where applicable, fails to deliver stock to SEOCH on T+2, SEOCH will immediately initiate any necessary actions against the SEOCH Participant or the CCASS GCP, where applicable, which include but are not limited to requesting the late-delivering SEOCH Participant to buy in, requesting other Exchange Participants to perform the buy in on behalf of the late-delivering SEOCH Participant and/or the taking of disciplinary actions pursuant to the Clearing Rules. Any costs associated with the buy-in will be borne by the late-delivering SEOCH Participant.

If there are entitlements attached to the overdue stock positions which cannot be settled prior to the book-close day of the relevant event which gives rise to the entitlement, SEOCH will claim the entitlement back directly from the late delivering SEOCH Participant. Any costs or expenses incurred by SEOCH as a result of recovering the entitlement will be charged to the late delivering SEOCH Participant. The procedures below describe the processing of entitlements relating to late deliveries:

#### **i) Cash Dividend**

SEOCH will debit the cash dividend amount from the CCMS Collateral Account of the late delivering SEOCH Participant on the first Business Day of the book-close period. The cash dividend amount will be credited to the receiving SEOCH Participant's CCMS Collateral Account on the payable date by the issuer.

#### **ii) Stock Dividend, Bonus shares, Rights Issue**

For entitlements in the form other than cash, such as stock dividend or bonus shares, the late delivering SEOCH Participant will be required to provide to SEOCH, cash margin in an amount computed by SEOCH on the entitlements on a daily basis, until such time that the entitlement due is settled. Such margin call will be issued and settled in the same manner as an intraday margin call starting from the first Business Day of the book - close period.

If the late delivering SEOCH Participant fails to settle the entitlement due by the time specified by SEOCH, SEOCH will require such SEOCH Participant to purchase the entitlements on the first Business Day on which such entitlements are available for dealing.

If the late delivering SEOCH Participant fails to purchase the entitlement on the first Business Day as aforementioned, SEOCH will on the next Business Day, purchase such entitlement for the account of such SEOCH Participant; and all relevant costs and expenses will be charged to such SEOCH Participant.

**8.8.2.3 Partial Delivery by the SEOCH Participant under the IT System**

Normally SEOCH will not accept partial delivery. In cases where SEOCH determines at its absolute discretion to accept partial delivery, the entire pending stock position will be regarded as unsettled and will hence be margined accordingly until stock delivery obligations relating to that pending stock position are settled in full. The related Settlement Amount will be credited to that SEOCH Participant's CCMS Collateral Account maintained with SEOCH only upon receipt of all the underlying securities in full settlement of the pending stock position.

**8.9 Settlement by Specific Securities Collateral****8.9.1 Withdrawal of Specific Securities Collateral**

All covered pending stock positions of a SEOCH Participant are deemed to be settled by Specific Securities Collateral already provided to SEOCH. The relevant underlying stock quantity will be automatically transferred from the Specific Securities Collateral balance of the SEOCH Participant's CCMS Collateral Account (maintained under these Procedures and the Clearing Rules) to:

- i. the SEOCH Participant's CCMS Collateral Account maintained with HKSCC; or
- ii. the CCASS GCP's CCMS Collateral Account maintained with HKSCC if the SEOCH Participant settles its delivery obligation through a CCASS GCP

as Specific Securities Collateral. SEOCH Participants should note that whether such collateral will be used for settlement of the relevant pending stock positions is subject to the netting result of the trades (including the trades of the cash market) to be settled under the CNS System on T+2.

Specific Securities Collateral covering expiring short call positions which have not been assigned will be automatically de-covered after the day end processing on the expiry day. If a SEOCH Participant wishes to use such securities collateral for settlement of its delivery obligations, it could withdraw such securities collateral in accordance with the procedures detailed under 7.2.2.

**8.9.2 Repealed****8.9.3 Payment of Settlement Amount**

The Settlement Amount in respect of the quantity of pending stock positions settled by Specific Securities Collateral will be effected through CCASS on T+2.

**8.9.4 Repealed****8.10 Settlement of Odd Lots and Fractional Shares Resulting from Exercise of Adjusted Contracts after Capital Adjustment**

Unless otherwise expressly specified by SEOCH, the size of an option contract will generally be one board lot of the underlying shares, and SEOCH Participants will be able to settle exercised options trades in whole board lots.

However, as a result of capital adjustment to the underlying shares, SEOCH may adjust the contract size, with the result that SEOCH Participants may need to settle odd lots or fractional shares (see Chapter 14 – Capital Adjustments) on exercise. The settlement method of odd lots and fractional shares are described below.

**8.10.1 Settlement of Odd Lots**

Odd lots resulting from exercise of adjusted contracts will be settled by physical delivery of shares.

SEPOCH Participants will be required to settle the delivery of shares via CCASS, under the standard procedures in CCASS, or as prescribed by SEPOCH from time to time.

**8.10.2 Settlement of Fractional Shares**

The normal procedures for settlement on exercise will not apply to fractional shares, since CCASS is only able to settle whole shares. Fractional shares of each adjusted options contract exercised will be settled in cash. i.e. SEPOCH will assume the buying SEPOCH Participant (which exercised a call or assigned a put) has disposed of the fractional shares whilst the delivering SEPOCH Participant (which exercised a put or assigned a call) has purchased the fractional shares at the fixing price as determined by SEPOCH. Under normal circumstances, the fixing price will be the market closing price of the underlying stock in the cash market on the day of exercise. The cash settlement amount will be recorded in the CCMS Collateral Account of the relevant SEPOCH Participant on the day of exercise.

The cash settlement amount is calculated on the exercise day by multiplying the share fraction by the difference between the strike price and the fixing price of the underlying stock as determined by SEPOCH. Under normal circumstances, the fixing price will be the market closing price of the underlying stock in the cash market on that day.

For example, the contract size for XYZ call option at a strike of HK\$110.50 is 533.33 shares after capital adjustment. If 5 contracts are being exercised on a day when the underlying market closes at HK\$120.50, the settlement amount for the fractional shares will be computed as follows:

Cash Amount for fractional shares:

$$0.33 * 5 * (\text{HK\$}110.50 - \text{HK\$}120.50) = -\text{HK\$}16.50$$

The above cash amount will be credited to the buying SEPOCH Participant's CCMS Collateral Account and debited to the delivering SEPOCH Participant's CCMS Collateral Account i.e. the buying SEPOCH Participant will receive and the delivering SEPOCH Participant will pay HK\$16.50.

**8.11 CCASS Fees Apply**

Since after exercise and assignment, an option contract is transformed into a stock trade, stock settlement fees will be charged by CCASS on the stock transactions. Therefore, SEPOCH Participants are expected to pay the same kind of CCASS fees as they are now being charged for stock transactions executed in the cash market.

**8.12 Stamp Duty and Levies**

Each exercise or assignment will become an individual stock trade for the calculation of stamp duty and levies. These exercised/assigned trades will be reported to the Stock Exchange's automatic order matching and execution system and the associated stamp duty and levies will be collected through the same mechanism currently applicable to normal trades in the underlying market.