

TOPIC 3 - OVERVIEW

1. GENERAL REQUIREMENTS	3.2
2. CLIENT SECURITIES	3.2
2.1 Introduction	3.2
2.2 Securities and Futures (Client Securities) Rules	3.2
2.3 Requirement for Deposit or Registration of Securities	3.3
2.4 Standing Authority	3.3
2.5 Right of Disposal	3.3
2.6 Relevance to Trading in Futures Contracts	3.4
2.7 Non-compliance	3.4
2.8 Penalties	3.4
3. CLIENT MONEY	3.4
3.1 Introduction	3.4
3.2 Securities and Futures (Client Money) Rules	3.4
3.3 Sources of Client Money	3.5
3.4 Mode of Treatment of Client Money on Receipt	3.5
3.5 Payment of Money Out of Segregated Account	3.5
3.6 Interest	3.5
3.7 Examples of Application	3.6
3.8 Non-compliance	3.6
3.9 Penalties	3.6

1. GENERAL REQUIREMENTS

- Intermediaries are called upon to handle client assets, including money, in a fiduciary capacity. The **SFC protects the assets of investors** by making rules regarding:
 - The holding of and dealing with client assets and securities collateral
 - The holding of and dealing with client money
- No person may receive or hold client assets of an intermediary in Hong Kong, unless the person is:
 - The intermediary
 - An associated entity of the intermediary
 - An excluded person
 - Any AFI
 - Another intermediary holding securities collateral
 - Any company approved by the SFC

2. CLIENT SECURITIES

2.1 Introduction

- The Client Securities Rules cover how intermediaries or their associated entities must deal with client securities and securities collateral received or held in Hong Kong

2.2 Securities and Futures (Client Securities) Rules

- The Client Securities Rules apply to client securities or securities collateral of an intermediary that are:
 - Listed on a recognized stock market (ie SEHK);
 - Interests in an SFC authorized CIS; and
 - Received or held in Hong Kong by an **intermediary (or its associated entity)** in the course of conducting a regulated activity
- The Client Securities Rules **do not apply** to securities held by an intermediary **in an account in a client's name**, set up by that client with persons other than the intermediary or its associated entity:

[Rules only apply to Hong Kong stocks held in Hong Kong received by an intermediary or associated entity in the course of conducting regulated activities]

2.3 Requirement for Deposit or Registration of Securities

- The intermediary shall, *as soon as reasonably practicable* after receiving client securities/securities collateral, deal with them as follows
 - If a deposit is to be made, it must be with
 - An AFI
 - An approved custodian
 - Another intermediary licensed for dealing in securities
 - Any deposits
 - Must be in separate segregated accounts for each category, designated as trust or client accounts
 - Which are securities collateral, may be deposited in an account in the name of the intermediary/associated entity
 - If registered, it must be in the name of:
 - The client
 - The associated entity of the intermediary
 - For securities collateral only, the intermediary itself

2.4 Standing Authority

- A written notice authorizing the intermediary/associated entity to deal with client assets in specified ways
- Effective for a period not more than 12 months (no time limit for PIs)
- May be renewed on the written request of the client for a period not more than 12 months
- May be **deemed to be renewed** by the intermediary/associated entity giving written notice at least 14 days prior to expiry reminding client of impending expiry. Deemed to be renewed on date of expiry, unless client objects
- Intermediary/associated entity must provide written confirmation of deemed renewal to client within a week of expiry date

2.5 Right of Disposal

- There are 3 basic authorities under which the intermediary/associated entity may deal with client securities/securities collateral:
 - An oral or written direction to sell or settle a sale order
 - A written direction
 - A standing authority
- The **standing authority** cannot be used by the intermediary/associated entity to:
 - Transfer client securities/securities collateral to an account of the intermediary, its associated entity or any entity which has a controlling entity relationship with the intermediary
 - Make any such transfer to any officer or employee of these entities
 - Deal with client securities/securities collateral in an unconscionable manner (Unconscionable = contrary to a sense of justice, decency or reasonableness)

2.6 Relevance to Trading in Futures Contracts

- Generally, the Client Securities Rules **allow the disposal of client securities** or securities collateral in settlement of a clients' liability to the intermediary, associated entity or a third person
- One situation where the Rules can be applied to dealing in futures contracts is the **accepting of securities collateral** from clients to cover derivative margin obligations
- **HKFE** Clearing Corporation Limited allows its participants to use cash and non-cash collateral to discharge their margin liabilities from dealing in futures contracts
- An intermediary licensed/registered for dealing in futures contracts may deposit the securities collateral with:
 - A recognised clearing house; or
 - Another intermediary licensed/registered for dealing in futures contracts as collateral for settlement obligations

2.7 Non-compliance

- Non-compliance with Rules must be notified to SFC in writing within one business day

2.8 Penalties

- A breach of the Rules with an intention to defraud can carry a maximum penalty of HK\$1m and imprisonment of 7 years

3. CLIENT MONEY

3.1 Introduction

- The Client Money Rules prescribe how **licensed corporations and their associated entities** should deal with client money received or held **in Hong Kong**

3.2 Securities and Futures (Client Money) Rules

- The Rules do **not** apply to client money that:
 - Is received or held **outside** Hong Kong
 - Is moved outside Hong Kong
 - Is held in a bank account by the client in his own name

3.3 Sources of Client Money

- Client money to be safeguarded includes all amounts received by the licensed corporation or its associated entity, from or on behalf of clients, less amounts due from the clients and any proper charges due
- Client money to be safeguarded includes:
 - amounts received from dealing in futures contracts on behalf of a client:
 - less brokerage commission
 - except settlement amounts due to be paid within two business days
 - except amounts owed by a client to a licensed corporation
 - interest arising on client money

3.4 Mode of Treatment of Client Money on Receipt

- The licensed corporation/associated entity holding client money should have **one or more segregated accounts** (designated as a trust or a client account) **maintained with an AFI** or another SFC-approved person (ie open a separate bank account)
- **Within one business day** of receiving client money, the licensed corporation/associated entity should **pay the money**:
 - Into a segregated account
 - To the client directly
 - In accordance with a written direction
 - In accordance with a standing authority

3.5 Payment of Money Out of Segregated Account

- **Money should be held in the segregated account** until payment has to be made
 - To the client
 - In accordance with a written direction
 - In accordance with a standing authority
 - To meet settlement or margin requirements
 - To meet amounts due from the client to the licensed corporation/associated entity
- Money held in a segregated account, which is discovered not to be client money, must be moved out of the account within one business day of discovery

3.6 Interest

- Interest received on client money is due to the client unless otherwise agreed in writing

3.7 Examples of Application

- A licensed corporation can **deduct an amount from cash received from a client** to settle an obligation already due (or due within two days)
- With **dividends and other income**, as long as such payments have been identified as client money, they should be deposited into a segregated account upon receipt. Thereafter the dividends/other income due to clients should be credited to their individual accounts
- When funds are received by a licensed corporation after business hours (electronically), they will be treated as received on the following business day

3.8 Non-compliance

- Non-compliance with Rules must be notified to SFC in writing within one business day

3.9 Penalties

- Failure to comply with the Client Money Rules with an intent to defraud carries a maximum sentence of a HK\$1m fine and 7 years imprisonment