

Leveraged Foreign Exchange Trader's Responsible Officer Examination
Syllabus, Suggested Study Hours and Reference Readings

The Securities and Futures Ordinance (SFO), operative on 1st April 2003, covers ten regulated activities including leveraged foreign exchange trading. For examination purpose, only the sections in the SFO and subsidiary legislation relevant and related to Type 3 regulated activity, namely, leveraged foreign exchange trading will be tested.

Candidates are expected to have an in-depth knowledge of the ordinance, subsidiary legislation, regulations and compliance requirements in carrying out the duties of a responsible officer/officer of a leveraged foreign exchange trader.

I. Paper 1 - Syllabus and Suggested Study Hours

Topics	Suggested Study Hours
1. Regulatory Framework	
A. <u>Regulators</u>	
<ul style="list-style-type: none"> - Securities and Futures Commission (SFC) <ul style="list-style-type: none"> ▪ Regulatory Objectives of the SFC ▪ Organization and Functions of the SFC ▪ Powers and Corporate Governance of SFC ▪ Scope of Regulation ▪ The Securities and Futures Appeals Tribunal ▪ Leveraged Foreign Exchange Trading Arbitration Panel ▪ Market Misconduct Tribunal 	2
<ul style="list-style-type: none"> - Hong Kong Monetary Authority (HKMA) <ul style="list-style-type: none"> ▪ Functions and Objectives of the HKMA ▪ Role of HKMA in the Regulation of Leveraged Foreign Exchange Trading ▪ Registered Institutions 	0.5
B. <u>Relevant Ordinance and Subsidiary Legislation</u>	
<ul style="list-style-type: none"> - The Securities and Futures Ordinance (SFO) (CAP 571) <ul style="list-style-type: none"> ▪ Background and Scope of SFO ▪ Activities Regulated under SFO ▪ Meaning of Leveraged Foreign Exchange Trading 	2
<ul style="list-style-type: none"> - Subsidiary Legislation <ul style="list-style-type: none"> ▪ Cap 571A Securities and Futures (Unsolicited Calls – Exclusion) Rules ▪ Cap 571B Securities and Futures (Recognized Counterparty) Rules ▪ Cap 571E Securities and Futures (Leveraged Foreign Exchange Trading – Exemption) Rules ▪ Cap 571F Securities and Futures (Leveraged Foreign Exchange Trading) (Arbitration) Rules 	4.5

Topics	Suggested Study Hours
<ul style="list-style-type: none"> ▪ Cap 571H Securities and Futures (Client Securities) Rules ▪ Cap 571I Securities and Futures (Client Money) Rules ▪ Cap 571J Securities and Futures (Associated Entities – Notice) Rules ▪ Cap 571N Securities and Futures (Financial Resources) Rules ▪ Cap 571O Securities and Futures (Keeping of Records) Rules ▪ Cap 571P Securities and Futures (Accounts and Audit) Rules ▪ Cap 571Q Securities and Futures (Contract Notes, Statements of Account and Receipts) Rules ▪ Cap 571S Securities and Futures (Licensing and Registration) (Information) Rules ▪ Cap 571U Securities and Futures (Miscellaneous) Rules ▪ Cap 571AF Securities and Futures (Fees) Rules 	
<p>2. Regulation on Business Activities and Standards</p> <p>A. <u>Licensing of Intermediaries</u></p> <ul style="list-style-type: none"> - Fitness and Properness <ul style="list-style-type: none"> ▪ Who Needs to be Comply with the “Fit and Proper” Guidelines ▪ Determination of “Fit and Proper” for an Individual and a Corporation ▪ Continuing requirement - Competence Requirement <ul style="list-style-type: none"> ▪ Application and Interpretation ▪ Fitness and Properness ▪ Assessment of Competence for Responsible Officer ▪ Test of Competence for Responsible Officer - Financial Resource Rules <ul style="list-style-type: none"> ▪ Paid-up Share Capital Requirement ▪ Liquid Capital Requirement ▪ Notification Requirements ▪ Non-Compliance and Penalty <p>B. <u>Continuing Obligations of Licensed Persons</u></p> <ul style="list-style-type: none"> - Code of Conduct <ul style="list-style-type: none"> ▪ General Principles ▪ Risk Disclosure Statement ▪ Additional Requirements for Licensed Persons Engaging in Leveraged Foreign Exchange Trading <ul style="list-style-type: none"> ○ General Conduct of Business Requirements ○ Specific Guidelines 	<p>1</p> <p>2</p> <p>1</p> <p>4</p>

Topics	Suggested Study Hours
<ul style="list-style-type: none"> - Continuous Professional Training (CPT) <ul style="list-style-type: none"> ▪ Objectives of CPT ▪ CPT Requirements – Obligations of Corporations ▪ CPT Requirements – Obligations of Individuals ▪ Practical Issues ▪ Consequences of Non-Compliance 	0.5
<ul style="list-style-type: none"> - Prevention of Money Laundering and Terrorist Financing <ul style="list-style-type: none"> ▪ Nature and Stages of Money Laundering ▪ Terrorist Financing ▪ Relevant and Related Legislation ▪ Policies and Procedures Expected of Licensed Corporations 	1.5
<ul style="list-style-type: none"> - Client Identity Rule Policy <ul style="list-style-type: none"> ▪ Nature and Enforcement of the Rule ▪ Timing of Provision of Information ▪ Manner in Which Information is Provided ▪ Disciplinary Proceedings 	1
<ul style="list-style-type: none"> - Disciplinary Fining Guidelines <ul style="list-style-type: none"> ▪ General Considerations of Seriousness of Conduct ▪ Specific Considerations 	0.5
<ul style="list-style-type: none"> - Compliance with the Securities and Futures (Client Securities) Rules and the Securities and Futures (Client Money) Rules 	0.5
<ul style="list-style-type: none"> - Management, Supervision and Internal Control Guidelines <ul style="list-style-type: none"> ▪ Management and Supervision ▪ Segregation of Duties and Functions ▪ Personnel and Training ▪ Information Management ▪ Compliance ▪ Audit ▪ Operational Controls ▪ Risk Management 	1.5
<ul style="list-style-type: none"> - Measures for Augmenting the Accountability of Senior Management <ul style="list-style-type: none"> ▪ Meaning of Senior Management ▪ Managers-In-Charge of Core Functions ▪ Submission of Management Structure Information 	0.5

II. Paper 1 - Reference Readings

1. Suggested Reading:

Leveraged Foreign Exchange Trading Examination Study Manual, Institute of Professional Education And Knowledge of Vocational Training Council, May 2018.
(HK\$250 per copy)

2. Further Readings:

- (1) *Licensing Handbook*, Securities and Futures Commission, Hong Kong (April 2017).
- (2) *Securities and Futures Ordinance and Subsidiary Legislation*, Laws of Hong Kong.
- (3) *Fit and Proper Guidelines*, Securities and Futures Commission, Hong Kong (October 2013).
- (4) *Guidelines on Competence and Appendix C*, Securities and Futures Commission, Hong Kong (March 2003, June 2011).
- (5) *Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission*, Securities and Futures Commission, Hong Kong (Aug 2018).
- (6) *Guidelines on Continuous Professional Training*, Securities and Futures Commission, Hong Kong (March 2003).
- (7) *Guideline on Anti-Money Laundering and Counter-Terrorist Financing*, Securities and Futures Commission, Hong Kong (March 2018).
- (8) *Prevention of Money Laundering and Terrorist Financing Guideline issued by the Securities and Futures Commission for Associated Entities*, Securities and Futures Commission, Hong Kong (August 2018).
- (9) *SFC Disciplinary Fining Guidelines*, Securities and Futures Commission, Hong Kong (August 2018).
- (10) *Securities and Futures Commission, Hong Kong*, Available at: <http://www.sfc.hk/>.
- (11) *The Hong Kong Monetary Authority*, Available at: <http://www.hkma.gov.hk/>.

Note: All the above Code and Guidelines may be downloaded from the Website of the Securities and Futures Commission at: <http://www.sfc.hk/web/EN/rules-and-standards/codes-and-guidelines/>.

III. Paper 1 - Sample Examination Questions

1. Which of the following are recommended with respect to the segregation of duties?
 - I. Policy formulation, supervisory and other internal or advisory functions should effectively be segregated from line operational duties.
 - II. Sales, dealing, accounting and settlement are effectively segregated.
 - III. Compliance and internal audit function are effectively segregated from and independent of the operational and related supervisory functions, and report directly to Management.
 - A. I & II only
 - B. II & III only
 - C. I & III only
 - D. All of the above
2. According to the Securities and Futures (Contract Notes, Statements of Account and Receipt) Rules, after a trade is executed for a client, the intermediary should provide the contract note to the client
 - A. No later than the end of the day of entering into the relevant contract.
 - B. No later than the end of next business day after entering into the relevant contract.
 - C. No later than the end of the second business day after entering into the relevant contract.
 - D. No later than the end of the seventh business day after entering into the relevant contract.
3. In considering whether a person is fit and proper to be licensed as a leveraged foreign exchange trader or a trader's representative, the Securities and Futures Commission takes into account the person's:
 - I. financial status
 - II. educational or other qualifications or experience
 - III. ability to perform efficiently, honestly and fairly
 - IV. reputation, character, financial integrity and reliability
 - A. I, III & IV only
 - B. II, III & IV only
 - C. I, II & IV only
 - D. All of the above

4. According to the Securities and Future (Financial Resources) Rules, a licensed corporation carrying on Type 3 regulated activity, namely leveraged foreign exchange trading, other than an approved introducing agent, shall at all times maintain liquid capital not less than
- A. HK\$15,000,000.
 - B. HK\$20,000,000.
 - C. HK\$25,000,000.
 - D. HK\$30,000,000.
5. The general principle regarding responsibility of senior management stipulated in the Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission states that
- I. The senior management of a registered person should bear primary responsibility for ensuring the maintenance of appropriate standards of conduct and adherence to proper procedures by the firm.
 - II. Senior management of a registered person should properly manage the risks associated with the business of the registered person, including performing periodic evaluation of its risk management processes.
 - III. Owing to the complexity of leveraged foreign exchange trading, senior management may not understand the nature of the business of the registered person, its internal control procedures or its policies on the assumption of risk, they should delegate their responsibilities to subordinates.
 - IV. Senior management should clearly understand the extent of their own authorities and responsibilities.
- A. I, II & III only
 - B. II, III & IV only
 - C. I, II & IV only
 - D. I, III & IV only

Suggested Answers:

1. D 2. C 3. D 4. D 5. C

IV. Paper 2 - Syllabus and Suggested Study Hours

Topics	Suggested Study Hours
1. Risk Management	
A. <u>Definition and Types of Risk</u> <ul style="list-style-type: none"> - Market Risk - Credit and Counterparty Risk - Liquidity Risk - Operational Risk - Other Risks 	4
B. <u>The Risk Management Process</u> <ul style="list-style-type: none"> - Risk Policy and Strategy <ul style="list-style-type: none"> ▪ Senior Management Oversight - Identification of Risk - Measurement of Risk <ul style="list-style-type: none"> ▪ Sensitivity Approach ▪ Scenario Analysis ▪ Value at Risk Approach ▪ Risk on House Positions - Control and Management of Risk <ul style="list-style-type: none"> ▪ Market Risk <ul style="list-style-type: none"> ○ Open Position Limits ○ Risk Diversification and Hedging FX Exposure ▪ Credit and Counterparty Risk <ul style="list-style-type: none"> ○ Margining, Intra-day and Overnight Margin ○ Margin Calculation ○ Mark to Market ○ Margin Call ○ Liquidation of Position ▪ Operational Risk <ul style="list-style-type: none"> ○ Deal Processing ○ Internal Control Framework ○ People Management ○ Information System 	12
C. <u>Risk Management System</u> <ul style="list-style-type: none"> - The Essentials of Risk Management System - Management Reporting - Enterprise Wide Risk Management System 	4

Topics	Suggested Study Hours
2. Financial Markets	
A. <u>Foreign Exchange Markets</u> <ul style="list-style-type: none"> - Evolution of Foreign Exchange Market - Fixed, Floating and Linked Exchange Rate Systems - Hong Kong Exchange Rate System - Spot FX Market <ul style="list-style-type: none"> ▪ Market Mechanism ▪ The Eurocurrency Market ▪ Currency Appreciation and Depreciation ▪ Exchange Rate Theory <ul style="list-style-type: none"> ○ Purchasing Power Parity ○ International Fisher Effect ○ Monetary Model ○ Forward Rate as Unbiased Predictor of Future Spot Rate ▪ Determinants of Exchange Rates <ul style="list-style-type: none"> ○ Macroeconomic and Microeconomic Environment ○ Government Fiscal and Monetary Policies ○ Foreign Exchange Intervention ○ Exchange Controls ▪ Forward FX Market <ul style="list-style-type: none"> ○ Forward Outright Quotation ○ FX Swap ○ Determination of Forward Swap Points ○ Non-Deliverable Forward Contract 	8
B. <u>Money Markets</u> <ul style="list-style-type: none"> - Euro-deposit versus Domestic Deposit Market - Hong Kong Interbank Money Market - Linkage between Foreign Exchange and Money Markets <ul style="list-style-type: none"> ▪ Arbitrage between Swap and Interest Rates 	2
C. <u>Fixed Income Markets</u> <ul style="list-style-type: none"> - What are bonds? - Bond Features - Bond Valuation - Bond Pricing Theorems - Hong Kong Exchange Fund Bills and Notes - Linkage between Foreign Exchange and Fixed Income Markets 	4

Topics	Suggested Study Hours
D. <u>Equity Markets</u> <ul style="list-style-type: none"> - Type of Equity Securities - Market Structure - Trading Mechanism - Hong Kong Exchanges and Clearing Limited - Exchange Rate Risk in Foreign Equity Investment 	4
E. <u>Futures and Options Markets</u> <ul style="list-style-type: none"> - Hong Kong Futures and Options Markets - Currency Futures <ul style="list-style-type: none"> ▪ Using Currency Futures to Hedge FX Positions - Currency Options <ul style="list-style-type: none"> ▪ Option Terminology ▪ Holder versus Writer ▪ Put versus Call ▪ Underlying Asset ▪ Strike Price and Moneyness ▪ Intrinsic Value and Time Value of Option Premium ▪ European versus American Style Options ▪ Exercise an Option - Using Currency Options for Trading and Hedging 	8

V. **Paper 2 - Reference Readings**

1. Suggested Reading:

Leveraged Foreign Exchange Trading Examination Study Manual, Institute of Professional Education And Knowledge of Vocational Training Council, May 2018.
(HK\$250 per copy)

2. Further Readings:

- (1) DeRosa, David F., *Foreign exchange operations: master trading agreements, settlement, and collateral*, Wiley finance series.
- (2) *An Introduction to Foreign Exchange and Money Markets*, The Reuters Financial Training Series, John Wiley & Sons (Asia) Pte Ltd.
- (3) Walmsley, Julian, *The Foreign Exchange and Money Markets Guide*, John Wiley & Sons, Inc.
- (4) Roth, Paul, *Mastering Foreign Exchange and Money Market: A Step-by-Step Guide to the Products, Applications and Risks*, Financial Times Pitman Publishing.
- (5) Murphy, John, *Technical Analysis of the Financial Markets: A Comprehensive Guide to Trading Methods and Applications*, New York Institute of Finance.
- (6) Smithson, Charles W., *Managing Financial Risk: A Guide to Derivative Products, Financial Engineering and Value Maximization*, 3rd Edition, Irwin Library of Investment and Finance, McGraw Hill.
- (7) *An Introduction to Bond Markets*, The Reuters Financial Training Series, John Wiley & Sons (Asia) Pte. Ltd.
- (8) *An Introduction to Derivatives*, The Reuters Financial Training Series, John Wiley & Sons (Asia) Pte. Ltd.

VI. Paper 2 - Sample Examination Questions

1. What best describes credit risk?
 - A. The risk that a deal is settled incorrectly.
 - B. The risk that an asset might lose value due to price fluctuation.
 - C. The risk of being unable to obtain funds to meet commitments.
 - D. The risk that the counterparty fails to perform its obligations under the contract.
2. Which of the following is **NOT** recommended?
 - A. Representatives should be responsible for confirming and settlement of trades with their own clients in order to improve efficiency.
 - B. Senior management involvement in setting risk policies.
 - C. Periodic review of the internal risk management system.
 - D. Establishment of a comprehensive framework of limits to control overall foreign exchange exposure.
3. A foreign exchange open position has a 1-day 95% confidence level Value at Risk of \$100,000. Which of the following is the correct interpretation of the above statement?
 - A. The position has a 95% chance of losing more than \$100,000.
 - B. The position has a 95% chance of losing at least \$100,000.
 - C. The position has a 95% chance of losing no more than \$100,000.
 - D. The position has a maximum loss of \$100,000.
4. A counterparty is quoting

Spot USD/JPY	119.60-65
Spot USD/HKD	7.7995-00
3 months USD/JPY swap	90-85
3 months USD/HKD swap	30-35

At what rate this counterparty buys JPY against HKD 3 months forward?

 - A. 0.065741
 - B. 0.065678
 - C. 0.064759
 - D. 0.064751
5. If an investor is thinking of buying an at-the-money (ATM) call or selling an ATM put on a currency as he is bullish on this currency, what is FALSE about the difference on the two strategies?
 - A. The buyer of the option pays a premium while the seller of the option receives a premium.
 - B. Both option strategies are suitable for the bullish view.
 - C. Breakeven price for the long ATM call is lower than that of short ATM put.
 - D. Long call strategy's loss is limited to the premium paid while short put strategy has substantial loss potential.

Suggested Answers:

1. D 2. A 3. C 4. B 5. C