



SECURITIES AND FUTURES COMMISSION

證券及期貨事務監察委員會

Consultation paper on proposed changes to the definition of “dealing in futures contracts”

27 February 2009



Forward

The Securities and Futures Commission (**Commission** or **SFC**) proposes certain amendments to the definition of “dealing in futures contracts” under Part 2 of Schedule 5 to the Securities and Futures Ordinance, Cap. 571 (**SFO**).

Market participants and interested parties are invited to submit written comments on the proposals discussed in this consultation paper or to comment on related matters that might have a significant impact upon the proposals **by no later than 31 March 2009**. Any person wishing to comment on the proposals should provide details of any organization whose views they represent.

All comments submitted will be carefully considered before the proposed amendments are finalised. A summary conclusion will be published after the end of the consultation period.

Please note that the names of the commentators and the contents of their submissions may be published on the SFC website and in other documents to be published by the SFC. In this connection, please read the Personal Information Collection Statement attached to this consultation paper.

You may not wish your name and/or submission to be published by the SFC. If this is the case, please state that you wish your name and/or submission to be withheld from publication when you make your submission.

Written comments may be sent

by mail to: Supervision of Markets Division
 Securities and Futures Commission
 8th Floor, Chater House
 8 Connaught Road Central
 Hong Kong

by fax to: (852) 2521 7917

by on-line submission: <http://www.sfc.hk/sfc/html/EN/speeches/consult/consult.html> (or, enter into the subsection “Consultation Papers and Conclusions” under the section “Speeches, Publications & Consultations” on the Commission’s website at <http://www.sfc.hk>)

by e-mail to: DealinginFutures@sfc.hk

Additional copies of the consultation paper may be obtained from the above address of the Commission. A copy of this paper can also be found on the Commission website at <http://www.sfc.hk>.

Supervision of Markets Division
Securities and Futures Commission
Hong Kong

27 February 2009



Personal information collection statement

1. This Personal Information Collection Statement (**PICS**) is made in accordance with the guidelines issued by the Privacy Commissioner for Personal Data. The PICS sets out the purposes for which your Personal Data¹ will be used following collection, what you are agreeing to with respect to the SFC's use of your Personal Data and your rights under the Personal Data (Privacy) Ordinance, Cap 486 (**PDPO**).

Purpose of collection

2. The Personal Data provided in your submission to the SFC in response to this Consultation Paper may be used by the SFC for one or more of the following purposes:
 - to administer the relevant provisions² and codes and guidelines published pursuant to the powers vested in the SFC;
 - in performing the SFC's statutory functions under the relevant provisions;
 - for research and statistical purposes;
 - for other purposes permitted by law.

Transfer of personal data

3. Personal Data may be disclosed by the SFC to members of the public in Hong Kong and elsewhere, as part of the public consultation on this Consultation Paper. The names of persons who submit comments on this Consultation Paper together with the whole or part of their submission may be disclosed to members of the public. This will be done by publishing this information on the SFC website and in documents to be published by the SFC during the consultation period or at its conclusion.

Access to data

4. You have the right to request access to and correction of your Personal Data in accordance with the provisions of the PDPO. Your right of access includes the right to obtain a copy of your Personal Data provided in your submission on this Consultation Paper. The SFC has the right to charge a reasonable fee for processing any data access request.

Retention

5. Personal Data provided to the SFC in response to this Consultation Paper will be retained for such period as may be necessary for the proper discharge of the SFC's functions.

¹ Personal Data means personal data as defined in the Personal Data (Privacy) Ordinance.

² Defined in Schedule 1 of the SFO to mean provisions of the SFO and subsidiary legislation made under it; and provisions of Parts II and XII of the Companies Ordinance (Cap. 32) so far as those Parts relate directly or indirectly, to the performance of functions relating to: prospectuses; the purchase by a corporation of its own shares; a corporation giving financial assistance for the acquisition of its own shares etc.



Enquiries

6. Any enquiries regarding the Personal Data provided in your submission on this Consultation Paper, or requests for access to Personal Data or correction of Personal Data, should be addressed in writing to:

The Data Privacy Officer
The Securities and Futures Commission
8/F Chater House
8 Connaught Road Central
Hong Kong

A copy of the Privacy Policy Statement adopted by the SFC is available upon request.



Consultation paper on proposed changes to the definition of “dealing in futures contracts” under Part 2 of Schedule 5 to the Securities and Futures Ordinance

This consultation paper seeks views on a proposal to amend the definition of “dealing in futures contracts” so that overseas participants of a Hong Kong-based futures market do not need to be licensed with the SFC provided certain preconditions are met.

Reasons for the proposal

1. Globalisation and advances in technology have made it possible for market players to become participants of a market³ and access that market from a remote location, i.e. without establishing a physical presence in the same jurisdiction.
2. Such remote participation is an attractive option for overseas market players who may be interested in participating in a particular market but have been discouraged by the costs associated with establishing a local presence. From the market’s perspective, increased participation by overseas market players is also beneficial because it has the potential to enlarge its investor base, increase its liquidity and facilitate its growth. Not surprisingly therefore, a number of markets already accept remote participants.
3. However, remote participation can also raise regulatory and commercial concerns. In particular, there may be concern about the effective regulation of participants who operate from overseas and have no local presence. Separately, local players conducting agency business may be concerned that remote participation will lead to increased competition from their overseas counterparts.
4. A main difficulty in implementing remote participation in Hong Kong lies with the dealing definitions under the SFO (i.e. the definitions of “dealing in securities” and “dealing in futures contracts” in Part 2 of Schedule 5). Those definitions are wide enough to include the direct placing and execution of trades on a Hong Kong-based market. It therefore catches the activities of all participants of such market, including any remote participants, meaning therefore that all participants have to be licensed by the SFC. However, the SFC is unable to grant licences to participants unless they carry out regulated activities in Hong Kong and have a place of business in Hong Kong. Effectively therefore, participants of a Hong Kong-based market cannot participate in that market from a remote location.
5. The SFC has received comments from the market suggesting that there is demand for remote participation in Hong Kong. Apart from some intermediaries, the SFC has also received comments from both Hong Kong Exchanges and Clearing Limited and Hong Kong Mercantile Exchange Limited (which is currently in the process of applying for authorization to provide automated trading services in Hong Kong). Both have indicated that they believe the facilitation of remote participation in Hong Kong would assist in enhancing liquidity, and thus the development of markets here.

³ Throughout this paper, we refer to participants of a market. “Participants” in this context refers to persons who are admitted as members or participants of that market, and who are able to trade directly on that market by virtue of such membership or participantship.



6. The SFC has however also received market comments raising concerns about facilitating remote participation, in particular concerns of the kind mentioned above (i.e. increased competition and the effective regulation of overseas participants.)
7. The SFC therefore proposes, through this consultation, to seek views on a proposed approach for introducing remote participation in the Hong Kong market. The proposed approach takes into account the concerns discussed above, and provides for a gradual approach to introducing remote participation in our markets. The key aspects of the proposal are discussed in the following section.

Q1: Do you agree that remote participation would bring benefits to Hong Kong and to the Hong Kong markets? If so, what are the potential benefits? If not, why not?

The proposal

Proposal in brief

8. In brief, the SFC proposes to amend the definition of “dealing in futures contracts” so that participants of a Hong Kong-based futures market do not need to be licensed by the SFC if the following requirements are met.

Requirements

9. First, the Hong Kong-based futures market must be operated by either –
 - (a) a company that is recognized as an exchange company under section 19(2) of the SFO, or
 - (b) a provider of automated trading services that is authorized under Part III of the SFO.
10. This requirement is perhaps fairly obvious – it is simply to ensure that the Hong Kong-based futures market is a regulated one.
11. Secondly, the participant must be a remote participant of the Hong Kong-based futures market, i.e. the participant must be restricted to accessing and executing trades on such market from outside Hong Kong. Moreover, the exemption will only apply in respect of the remote participant’s activities as remote participant.
12. This requirement is to restrict the scope of the proposal so that it applies only to remote participants, and only in respect of their activities as remote participants. The requirement would also serve to clarify what constitutes a remote participant.
13. Thirdly, the participant must not establish a place of business in Hong Kong, nor conduct any dealing activities in Hong Kong. Also, the participant must not serve Hong Kong clients, nor market their services to the public in Hong Kong.



14. These requirements are intended to ensure that local investors continue to be served by locally-based participants, and that remote participants can only serve overseas investors.
15. Fourthly, the remote participant must be regulated, or be a participant of an overseas futures market which is regulated, in their home jurisdiction by a regulator –
 - (a) that is a signatory to the IOSCO MMOU,⁴ and
 - (b) whose home jurisdiction is a member of the Financial Action Task Force on Money Laundering.⁵

(A list of these signatories and jurisdictions is at **Appendix 1**.)
16. This requirement is intended to ensure that effective regulatory action can be taken in respect of a remote participant if necessary. In this regard, because the oversight of remote participants will primarily be conducted by regulators in their home jurisdiction, it is important to ensure that they are overseen by regulators with whom we have agreements for the sharing of information and investigative assistance. It is equally important that the remote participant is operating in a jurisdiction with adequate policies to combat money laundering.
17. It will be noted that this requirement allows for two options, i.e. either the participant himself, or another (overseas) futures market of which he is also a participant, must be regulated by an acceptable overseas regulator. This is essentially to allow for the possibility that some remote participants may not be intermediaries and hence may not themselves be regulated by an overseas regulator. Many futures markets accept non-intermediaries as their members or participants, including the New York Mercantile Exchange, ICE Futures Europe, London Metal Exchange, Eurex Deutschland, and Chicago Mercantile Exchange. Such non-intermediaries are mainly proprietary trading firms (some of which may be end users of the underlying product) and market makers, and can also contribute significant liquidity to a market. We believe therefore that they should be permitted to participate in our markets as remote participants. However, there is still the concern about their effective regulation. To address this, it is proposed to limit the proposal only to non-intermediaries who are already participants of an acceptable overseas futures market so that the SFC can still obtain information and investigative assistance where necessary.
18. For completeness, we note that the current proposal will not affect the position of overseas intermediaries who are not participants of a Hong Kong-based market, who do not have a place of business in Hong Kong, and who do not serve Hong Kong clients. Such intermediaries may continue to place orders for their overseas clients through licensed intermediaries in Hong Kong without having to be licensed themselves.

⁴ The IOSCO MMOU refers to the IOSCO Multilateral Memorandum of Understanding concerning consultation and cooperation and the exchange of information. (IOSCO stands for the International Organization of Securities Commissions, the world's primary forum of international cooperation for securities regulatory agencies, and the international standard setter for securities markets.)

⁵ The Financial Action Task Force is an inter-governmental body whose purpose is the development and promotion of national and international policies to combat money laundering and terrorist financing.



Q2: Do you believe the above requirements can provide a sufficient framework for regulating remote participants in Hong Kong? If not, what additional suggestions do you consider to be useful, and why?

Gradual approach

19. It will be noted that the current proposal is only to introduce amendments to the definition of “dealing in futures contracts”. There is no proposal to introduce corresponding amendments to the definition of “dealing in securities”. This is because the SFC proposes to take a gradual approach to introducing remote participation in Hong Kong’s markets, by first introducing it in the futures market only. Based on the experience gained, the SFC will then assess whether it is appropriate to extend the same approach to the securities market. The SFC will only consider introducing a similar exemption to the securities market after conducting public consultation.
20. In this regard, it is noted that, globally, remote participation is common in futures markets. Major futures markets such as Eurex Deutschland, ICE Futures Europe, the London Metal Exchange and the New York Mercantile Exchange all accept remote participants and have done so for some years. In the case of securities exchanges, the London Stock Exchange has accepted remote participants for some time. In the region, the Australian Stock Exchange has begun accepting remote participants since 2007, and the Tokyo Stock Exchange has recently made public its intention to launch such service in March 2009.
21. Moreover, products in futures markets, in particular those related to commodities, are relatively more generic and thus likely to have a greater global appeal, whereas products in securities markets may have a more local flavour and hence a more local appeal. There may therefore naturally be a greater demand for remote participation in the futures market than the securities market.
22. Additionally, investors generally tend to be more familiar with investing in stocks than commodities. Securities markets therefore tend to be more populated (i.e. to have a larger investor population). Futures markets on the other hand, particularly commodities futures markets, tend to have a relatively smaller investor population and hence securing sufficient liquidity can be a greater challenge to the market’s continued development. There is therefore perhaps a greater need to expand the investor base in such markets, and allowing remote participation would provide a means of doing so.
23. To the extent that the introduction of remote participants in Hong Kong’s futures market could assist the development of commodities futures markets here, it would also be in line with the recommendations in the *Report of the Focus Group on Financial Services* issued in January 2007.⁶

Q3: Do you agree that a gradual approach should be taken to introducing remote participation in the Hong Kong markets? If not, what are your suggestions?

⁶ This January 2007 report was issued under the auspices of the *Economic Summit on “China’s 11th Five-Year Plan and the Development of Hong Kong”*. It noted that the Focus Group considered the development of a commodities futures market in Hong Kong to be a worth pursuing initiative.



International practice

24. For reference, we set out at **Appendix 2** a table showing the requirements for remote participation in other jurisdictions.

The proposed amendments

25. To facilitate remote participation in the futures markets along the lines discussed above, the SFC proposes to add a new paragraph (viii) to the definition of “dealing in futures contracts” under Part 2 of Schedule 5 to the SFO. The new paragraph (viii) will exempt the activities of remote participants of a Hong Kong-based futures market (which is operated by either a recognized exchange company or a provider of authorized automated trading services) subject to the following limitations –
- (a) The exemption will only apply in relation to the remote participant’s execution of trades on the Hong Kong-based futures market as a remote participant of that market. This is to limit the scope of the exemption, and hence the range of activities that do not require an SFC licence.
 - (b) The remote participant must operate from outside Hong Kong, and must not have a place of business in Hong Kong. This is to ensure that any activities performed by the remote participant are performed from outside Hong Kong.
 - (c) The remote participant must not serve Hong Kong clients (i.e. persons who are principally located in Hong Kong), nor market their services to the public in Hong Kong. This is to ensure that Hong Kong investors continue to be served by locally-based participants.
 - (d) The remote participant must be regulated, or be a participant of an overseas futures market which is regulated, in their home jurisdiction by a regulator (i) that is a signatory to the IOSCO MMOU, and (ii) whose home jurisdiction is a member of the Financial Action Task Force. This is to ensure that effective regulatory action can be taken if necessary.

Other limitations

26. It is worth noting here that apart from the above limitations – which are proposed to be incorporated in the legislation – there may be other non-statutory limitations imposed on remote participants also. Specifically, the futures market of which the remote participant is a participant will have its own rules and regulations, and these may impose additional requirements applicable only to remote participants, although these rules will have to be approved by the SFC.

Implementation

27. For completeness, it is noted that pursuant to section 142 of the SFO, amendments to Schedule 5 are made by the Financial Secretary by notice published in the Gazette. The amendment would also be subject to negative vetting by the Legislative Council.



Appendix 1

List of signatories to the IOSCO MMOU

1. Alberta Securities Commission (SC), **Alberta**
2. Australian Securities and Investments Commission (ASIC), **Australia**
3. Central Bank of Bahrain (CBB), **Bahrain, Kingdom of**
4. Banking, Finance And Insurance Commission, **Belgium**
5. Bermuda Monetary Authority, **Bermuda**
6. British Columbia Securities Commission (BCSC), **British Columbia**
7. British Virgin Islands Financial Services Commission, **British Virgin Islands**
8. China Securities Regulatory Commission, **China**
9. Czech National Bank, **Czech Republic**
10. Denmark Financial Supervisory Authority (Finanstilsynet), **Denmark**
11. Dubai Financial Services Authority (DFSA), **Dubai**
12. Financial Supervision Authority, **Finland**
13. Autorité des marchés financiers, **France**
14. Bundesanstalt für Finanzdienstleistungsaufsicht (BAFin), **Germany**
15. Hellenic Republic Capital Market Commission (CMC), **Greece**
16. Securities and Futures Commission, **Hong Kong**
17. Hungarian Financial Supervisory Authority, **Hungary**
18. Securities and Exchange Board of India (SEBI), **India**
19. Financial Supervision Commission, **Isle of Man**
20. Israel Securities Authority (ISA), **Israel**
21. Commissione Nazionale per le Società e la Borsa, **Italy**
22. Financial Services Agency (FSA), **Japan**
23. Jersey Financial Services Commission (FSC), **Jersey**
24. Jordan Securities Commission (JSC), **Jordan**
25. Lithuanian Securities Commission, **Lithuania**
26. Commission de surveillance du secteur financier, **Luxembourg**
27. Securities Commission, **Malaysia**
28. Malta Financial Services Authority (MFSA), **Malta**
29. Comisión Nacional Bancaria y de Valores (CNBV), **Mexico**
30. Conseil déontologique des valeurs mobilières (CDVM), **Morocco**
31. The Netherlands Authority for the Financial Markets (AFM), **Netherlands, The**
32. Securities Commission (SC), **New Zealand**
33. Securities and Exchange Commission (NSEC), **Nigeria**
34. The Financial Supervisory Authority of Norway (Kredittilsynet), **Norway**
35. Ontario Securities Commission (OSC), **Ontario**
36. Financial Supervision Authority, **Poland**
37. Comissão do Mercado de Valores Mobiliários (CMVM), **Portugal**
38. Autorité des marchés financiers, **Québec**
39. Romanian National Securities Commission, **Romania**
40. Monetary Authority of Singapore, **Singapore**
41. The National Bank of Slovakia, **Slovak Republic**
42. Financial Services Board (FSB), **South Africa**
43. Comisión Nacional del Mercado de Valores (CNMV), **Spain**
44. Securities and Exchange Commission, **Sri Lanka**
45. Securities and Exchange Commission of Thailand (SEC), **Thailand**
46. Capital Markets Board (CMB), **Turkey**
47. Financial Services Authority (FSA), **United Kingdom**



48. Commodity Futures Trading Commission (CFTC), **United States of America**
49. Securities and Exchange Commission (SEC), **United States of America**

List of members of FATF

1. Argentina
2. Australia
3. Austria
4. Belgium
5. Brazil
6. Canada
7. China
8. Denmark
9. European Commission
10. Finland
11. France
12. Germany
13. Greece
14. Gulf Co-operation Council
15. Hong Kong, China
16. Iceland
17. Ireland
18. Italy
19. Japan
20. Kingdom of the Netherlands*
21. Luxembourg
22. Mexico
23. New Zealand
24. Norway
25. Portugal
26. Russian Federation
27. Singapore
28. South Africa
29. Spain
30. Sweden
31. Switzerland
32. Turkey
33. United Kingdom
34. United States

* *the Kingdom of the Netherlands: the Netherlands, the Netherlands Antilles and Aruba.*



Comparison table of remote participation in other jurisdictions

	UK	USA	Australia	Singapore
Is remote participation permitted?	Yes	Yes	Yes	Yes
Can remote participants be proprietary traders?	Yes	Yes	Yes	Yes
Examples of markets that admit remote participants	ICE Futures Europe London Metal Exchange	New York Mercantile Exchange	Australian Stock Exchange	Singapore Exchange Derivatives Trading
Restrictions/ limitations as to who can become a remote participant	Exchanges must notify the FSA if they admit members from a new jurisdiction. They must also ensure there are adequate safeguards against financial crime. Additional requirements may be imposed by the exchange through its rules.	Foreign firms may participate on a US market on behalf of foreign customers without having to register with the CFTC as futures commission merchants (FCM), provided they clear their transactions through a registered FCM and, in the case of an introducing broker, they do not solicit any person in the US for trading, nor handle the customer funds of any such person, for the purpose of trading on US exchanges. Foreign firms that wish to become clearing participants must register as an FCM. Registration is not necessary for foreign firms acting only in a proprietary capacity. Additional requirements may be imposed by the exchange.	Persons located outside Australia may trade on a licensed Australian market without an Australian financial services licence, provided they – - trade for clients who they reasonably believe to be overseas clients, or - trade on their own behalf or provide service only to related bodies corporate. Additional requirements may be imposed by the exchange.	Entities applying for remote trading membership may need to be licensed if their activities constitute a regulated activity in Singapore. Additional requirements may be imposed by the exchange.