



SECURITIES AND
FUTURES COMMISSION
證券及期貨事務監察委員會

Consultation Conclusions on the Guidance Note on Position Limits and Large Open Position Reporting Requirements

《持倉限額及大額未平倉合約的申報規定指引》
諮詢總結

Hong Kong
March 2003

香港
2003年3月

Consultation Conclusions

A. Introduction

1. On 24 January 2003, the Securities and Futures Commission (“the SFC”) released a consultation document inviting public comments on the draft **Guidance Note on Position Limits and Large Open Position Reporting Requirements** (“the draft Guidance Note”).
2. The draft Guidance Note is intended to provide guidelines on compliance requirements of the prescribed limits and reportable position requirements as set out in the Securities and Futures (Contracts Limits and Reportable Positions) Rules (“the Rules”). It also explains the application procedures for a person wishing to hold or control excess positions and procedures for appealing against decisions of the SFC under the Rules.
3. The consultation period ended on 25 February 2003.
4. Taking into account the comments received, several amendments to the draft Guidance Note were considered appropriate. A summary of the comments received on the draft Guidance Note (“summary of comments”) is attached as Appendix 1. The revised Guidance Note is attached as Appendix 2.
5. The SFC wishes to thank those who have provided their comments in the consultation.
6. The purpose of this report is to provide an analysis of the main comments raised during the consultation process and the rationale for the Commission’s conclusions. This report should be read in conjunction with the consultation paper, the draft Guidance Note and the summary of comments.

B. Public Consultation

Background

7. Upon commencement of the Securities and Futures Ordinance on 1 April 2003, the Rules will come into effect and replace the current Securities (Exchange Traded Stock Options) Rules and the Commodities Trading (Trading Limits and Position Limits) Rules.
8. Although the Rules appear to be more detailed than the current legislation, the SFC’s intention is to provide more transparency in the Rules whilst preserving the current practice under the existing legislation.
9. The SFC appreciates that industry participants may have concerns in relation to the operation of the Rules as they are now more transparent and therefore issued the draft Guidance Note for public consultation to enable industry participants to better understand how the Rules are intended to operate.

Consultation Process

10. In addition to the press release regarding the consultation exercise which was issued on 24 January 2003, the consultation paper and the draft Rules were

also posted on the website of the SFC and distributed to all registrants through FinNet.

11. Five submissions were received. Comments varied considerably in range and depth, with some focusing on broad principles and others on points of detail and clarification.

C. The Consultation Conclusions

The following summarises the main comments received and the SFC's responses :

Prescribed limits for stock options contracts

12. Several respondents noted that the limits for stock options contracts are too restrictive.
13. The limits are prescribed under the Rules. As the Guidance Note only explains the operation of the Rules, the SFC cannot specify more relaxed limits in the Guidance Note. A relaxation of the limits can only be achieved by legislative amendment. The SFC will consider appropriate amendments.

Disaggregation of positions held by intermediaries which are not exchange participants

14. Under the Rules, the prescribed limits and reportable positions are applied separately to an exchange participant's own proprietary positions and each of its clients' positions. This ability to 'disaggregate' positions does not extend to non-exchange participant intermediaries. Several respondents commented that non-exchange participant intermediaries should also be allowed to disaggregate their own proprietary positions with client positions.
15. Like the prescribed limits, the disaggregation for exchange participants is provided for in the Rules. To enable non-exchange participants to disaggregate their positions with clients' positions, amendment of the Rules is necessary. The SFC will review this policy shortly.

Others

16. Most other comments received related to clarifications of the Guidance Note. The SFC has accepted a large number of the comments or suggestions and has made amendments to the draft Guidance Note. The table at Annex 1 summarises all the comments received and the SFC's response.

D. Effective Date

17. The Guidance Note will be effective on 1 April 2003.

Appendix 1

Draft Guidance Note on Position Limits and Large Open Position Reporting Requirements Summary of comments received and SFC's response

Item No.	Section Reference	Details of the draft Guidance Note	Respondent's Comments	SFC's Response
1.	general comment	N.A.	<p><i>HKAOB and Phillip:</i></p> <p>The reportable position limits for some stock options contracts are too small.</p>	<p>The limits are prescribed under the Securities and Futures (Contract Limits and Reportable Positions) Rules ("the Rules") which mirror the existing HKEx rule requirements. The Guidance Note merely offers guidance on the application of the Rules. A such, this issue cannot be addressed in the Guidance Note. The SFC notes the comments and will, together with HKEx, consider appropriate limits for listed stock options contracts.</p>
2.	general comment	N.A.	<p><i>Linklaters:</i></p> <p>It is suggested that the Guidance Note should provide examples of where the SFC is likely to give permissions, for example, in the case 'give-up' arrangements. . .</p> <p>The SFC should also confirm that it would not take action under the Rules against a clearing broker which, by accepting a transaction 'given-up' to it for clearing and settlement, exceeds the prescribed limit, provided that it had not knowledge of those transactions prior to them being given-up.</p>	<p>The Guidance Note has been revised accordingly.</p> <p>The Guidance Note has been revised with a diagram showing examples of the application of the Rules. The diagram provides clear examples of when action will not be taken.</p>
3.	general comment	N.A.	<p><i>Linklaters:</i></p> <p>The Rules allow an Exchange Participant to disaggregate its own positions of</p>	<p>The issue of disaggregation relates to provisions in the Rules and as such it cannot be addressed in the</p>

Item No.	Section Reference	Details of the draft Guidance Note	Respondent's Comments	SFC's Response
4.	2.6 to 2.7	Explanation of what the SFC considers to be "holding" or "controlling" a position.	<p>clients' positions. Disaggregation should apply to all intermediaries.</p> <p><i>Linklaters:</i> There is some confusion as to who "holds or controls" a position. Particular clarification is sought as to whether a 'parent' company has control over its subsidiaries by virtue of its corporate relationship.</p>	<p>Guidance Note. The SFC is aware of the comment and will review this policy shortly.</p> <p>The Guidance Note has been revised accordingly.</p>
5.	2.9	In addition to the penalties prescribed in the Rules, the exchanges may require their participants to take steps to reduce their positions.	<p><i>LS:</i> If the positions of an Exchange Participant's clients exceed the prescribed limit, it would be difficult to require the Exchange Participant to reduce positions in the relevant accounts.</p>	<p>The exchanges have powers under their rules to require their participants to close out positions under specified circumstances. The Guidance Note has been amended to clarify this.</p>
6.	4.4 and 4.5	Where multiple persons are regarded as holding or controlling one reportable position, only one report is required to be made.	<p><i>Linklaters:</i> It should be emphasized that the obligation to make the report is on each relevant holder/controller.</p> <p>It is suggested that the paragraphs (and paragraph 6.2 and 6.5) be revised so that the underlying holder/controller of a position can choose to report his position through an intermediary or exchange participant where the latter agrees to make the report on his behalf. The intermediary or exchange participant must identify on the report each person for whom the report is being made.</p>	<p>The Guidance Note has been revised accordingly.</p>

Item No.	Section Reference	Details of the draft Guidance Note	Respondent's Comments	SFC's Response
7.	4.4	Notice of a reportable position may be submitted by the intermediary, beneficial owner of the position or the person controlling or holding the position.	It should be made clear that in such a case, the exchange participant does not become responsible for any failure by the person to fulfil its own obligations under the Rules. <i>LS:</i> It is unclear which party will be penalised or responsible if none of them has submitted the notice to the recognised exchange company.	The Guidance Note has been amended to clarify this issue.
8.	4.9	Notices of reportable positions should be accompanied by the information set out in the paragraph. In relation to information about a client, intermediaries are expected to comply with the SFC's Code of Conduct and Client Identity Rule Policy.	<i>Linklaters:</i> The SFC should clarify a person who holds or controls client positions need only disclose the identity of the client pursuant to section 6(2)(b) of the Rules. The SFC should clarify that the "client" whose identity should be disclosed is the instruction originator.	The Guidance Note has been revised accordingly..
9.	4.11 to 4.12	These paragraphs explain the other reporting requirements specified by the exchanges.	<i>Linklaters:</i> The Guidance Note should not set out the requirements of the Exchange on its participants as this may confuse persons who are not exchange participants.	The SFC does not agree with the comment. If clients are aware of the requirements of the Exchange, it may be easier for exchange participants to obtain required information from their clients for the purposes of complying with the Rules.

Item No.	Section Reference	Details of the draft Guidance Note	Respondent's Comments	SFC's Response
10.	5.3	Exchange Participants are required to notify the relevant exchange in respect of reportable positions held or controlled by each of their clients.	<p><i>Linklaters:</i> The current drafting should be clarified that if a client holds a reportable position and the exchange participant also holds/controls the position, then the exchange participant must report that position (where it is holding or controlling a position for the purpose of the Rules).</p> <p>It should also be clarified that if the client holds a reportable position but only part of that position (that part not being itself reportable) is held through the Exchange Participant, the latter does not need to report anything since it is not holding/controlling the position for the purpose of the Rules.</p>	The Guidance Note has been revised to clarify the reporting obligations.
11.	5.4	All positions held by the same beneficial owner should be aggregated for reporting purposes.	<p><i>Linklaters:</i> The reference to "beneficial owner" in this paragraph (and paragraph 6.6) should be replaced with "client".</p>	The Guidance Note has been amended accordingly.
12.	6.1	A person who holds or controls positions in more than one firm should aggregate his positions for the purpose of the Rules.	<p><i>Linklaters:</i> It should be made clear that the obligation to aggregate (and report, if necessary) the positions held through multiple intermediaries is on the person holding/controlling those positions.</p>	The Guidance Note has been revised to clarify this.
13	6.12	Non exchange participants are not	<p><i>Respondent A:</i> It is unclear from section 4(4) of the Rules</p>	The issue of disaggregation relates to provisions in

Item No.	Section Reference	Details of the draft Guidance Note	Respondent's Comments	SFC's Response
		permitted to hold positions in excess of the prescribed limits except as otherwise authorised by the SFC under section 4(4) of the Rules.	<p>how a non exchange participant can obtain the exemption. A non exchange participant who merely acts as an execution or clearing agent and has no control in trading on its clients' accounts directly or indirectly should be permitted to disaggregate its clients' positions.</p> <p>It is difficult to aggregate the total position of the intermediary on a real-time basis as positions are open and close, given in and out.</p>	the Rules and as such it cannot be addressed in the Guidance Note. The SFC will review this policy shortly.

List of Respondents

Dated Received	Respondent
10 February 2003	Respondent A
25 February 2003	Phillip Securities (HK) Limited ("Phillip")
25 February 2003	The Law Society of Hong Kong ("LS")
26 February 2003	The HK Association of Online Brokers ("HKAOB")
28 February 2003	Linklaters & Alliance ("Linklaters"), submitting on behalf of Credit Suisse First Boston (Hong Kong) Limited, Goldman Sachs (Asia) L.L.C., J.P. Morgan Futures Hong Kong Limited and associates, Merrill Lynch (Asia Pacific) Limited, Morgan Stanley Dean Witter Asia Limited, and UBS Warburg Asia Limited

**Guidance Note on Position Limits
and Large Open Position Reporting Requirements**

**Hong Kong
April 2003**

Table of Contents

1. Introduction	1
2. Prescribed Limits on Futures and Stock Options Contracts	1
Prescribed limits	1
Aggregation requirements	3
Penalties	3
3. Application to Exceed Prescribed Limits	3
Authorization for excess positions by the HKFE/SEHK	4
Authorization for excess positions by the SFC	5
4. Notice of Reportable Positions	7
Reportable positions	7
Responsibilities of reporting	8
Reporting requirements	9
Other reporting requirements specified by the HKFE/SEHK	9
Penalties	10
5. Compliance by Exchange Participants	10
6. Application of the Rules to Different Entities	11
Persons holding or controlling positions at multiple firms	11
“Clients”	11
Omnibus accounts	12
Non-Exchange Participant intermediaries.....	13

1. Introduction

- 1.1. Section 35(1) of the Securities and Futures Ordinance (Cap. 571) (“SFO”) empowers the SFC to make rules to (i) prescribe limits on the number of futures contracts¹ or options contracts² that may be held or controlled by a person; and (ii) require a person holding or controlling a reportable position to notify the recognized exchange company or the SFC³.
- 1.2. The Securities and Futures (Contracts Limits and Reportable Positions) Rules (“the Rules”) have been made by the SFC under Section 35(1) of the SFO to prescribe limits and reportable positions applicable to futures contracts and stock options contracts traded on the recognized exchange company. The Rules shall come into effect when the SFO commences on 1 April 2003.
- 1.3. The Rules have been made based on the Securities (Exchange-Traded Stock Options) Rules and the Commodities Trading (Trading Limits and Position Limits) Rules which will cease operation when the SFO commences.
- 1.4. This Guidance Note is issued to help market participants better understand how the Rules are intended to operate in practice and explain compliance requirements of the Rules.
- 1.5. The Guidance Note is intended to clarify the SFC’s policy intent and positions on issues raised by the industry and does not have the force of law. The SFC will revise the Guidance Note to clarify its position in response to market developments and to reflect legislative changes in the future.

2. Prescribed Limits on Futures and Stock Options Contracts

Prescribed limits

- 2.1. Section 4(1) of the Rules imposes restrictions on the maximum number of futures contracts or stock options contracts that may be held or controlled by a person. The prescribed limits on futures contracts⁴ and stock options contracts are specified respectively in Schedule 1 and Schedule 2 of the Rules.
- 2.2. Except for the Hang Seng Index (“HSI”) futures contract, HSI options contract, Mini-HSI futures contract and Mini-HSI options contract, Schedule 1 of the Rules specifies the maximum number of futures contracts for any one contract month that may be held or controlled by a person⁵. In other words, the

¹ Section 35(1)(a)

² Section 35(1)(b)

³ Section 35(1)(c)

⁴ In accordance with Schedule 1 of the SFO, the definition of “futures contract” includes not only a futures contract but also an option on a contract made under the rules or conventions of a futures market. In other words, futures and options contracts traded on the Hong Kong Futures Exchange are referred to as “futures contracts” in the Rules.

⁵ In addition to the prescribed limit for a contract month, a limit for all contract months combined is also imposed on HIBOR futures contracts.

prescribed limits in this Schedule apply to individual contract months. *For example, the prescribed limit on a particular futures contract is 5,000 contracts for any one contract month. If a person longs 3,000 contracts of the September futures contract and longs 2,000 contracts of the October futures contract, he will not reach the prescribed limit on this contract.*

- 2.3. The prescribed limit on the HSI futures and options contracts as well as the Mini-HSI futures and options contracts are calculated on a net basis for all contract months combined⁶. The futures-equivalent positions in options contracts are added to the positions in futures contracts for purposes of determining compliance with the prescribed limit. The futures-equivalent position in an option contract is the delta value⁷ of the option contract determined by the Hong Kong Futures Exchange (“HKFE”) at the close of market on each trading day multiplied by the number of contracts held or controlled.

Example:

A person holds the following positions:

- *Long 8,000 September HSI futures contracts*
- *Short 1,000 October HSI futures contracts*
- *Long 2,500 November Mini-HSI futures contracts*
- *Long 5,000 September HSI calls with a delta value of 0.5*

Since the contract value of the Mini-HSI futures contract is one-fifth of that of the HSI futures contract, 2,500 Mini-HSI futures contracts are equivalent to 500 HSI futures contracts. The futures-equivalent positions in September HSI calls are 2,500 contracts which are obtained by multiplying the delta value (0.5) with the number of contracts held (5,000 contracts). In deciding whether the person has reached the prescribed limit of 10,000 contracts, positions in all contracts are netted, i.e. 8,000 contracts (long September HSI futures contract) minus 1,000 contracts (short October HSI futures contract) plus 500 contracts (long November Mini-HSI futures contract) plus 2,500 contracts (long September HSI calls). That means the person holds a net position of 10,000 contracts and has reached the prescribed limit.

- 2.4. Schedule 2 of the Rules specifies the maximum number of stock options contracts in any one expiry month that may be held or controlled by a person. In determining whether the prescribed limit is exceeded, all options contracts expiring in the same month including all option types (i.e., calls and puts), strike prices, long and short positions are taken into consideration. *For example, the prescribed limit on a stock options contract is 5,000 contracts in any one expiry month. If a person holds 3,000 long calls with strike price A,*

⁶ Prescribed limits are also imposed separately on the Mini-HSI futures contracts and Mini-HSI options contracts for all contract months combined.

⁷ Delta is the amount by which the price of an option will change for a corresponding change in price of the underlying market. Delta can be used to equate the directional risk of an option position with a position of similar size in the underlying market. For example, if a person holds 1,000 HSI options contracts (delta value of the contract is +0.6), he is long 600 deltas or in equivalent terms, 600 HSI futures contracts.

1,000 short calls with strike price B and 1,000 long puts with strike price C (all these calls and puts are in the same expiry month), he will reach the prescribed limit on this contract.

- 2.5. The prescribed limits in Schedule 1 and Schedule 2 are also reflected in rules of the HKFE and the Stock Exchange of Hong Kong (“SEHK”). Market participants should note that in addition to the prescribed limits, the HKFE and SEHK may impose other position limits on a particular contract, Exchange Participant or client where situations warrant such action.

Aggregation requirements

- 2.6. The prescribed limits apply to all positions held or controlled by any person including positions in any account(s) for which such person controls trading directly or indirectly. While the word “control” is not defined in the SFO or the Rules, there are circumstances where the SFC takes the view that a person is regarded as having control of positions as for example where a person is allowed to trade or dispose of the positions independently without the day-to-day direction of the ~~beneficial~~ owner of positions ~~or a person has a financial interest of more than fifty percent (50%) in an entity holding the positions.~~
- 2.7. Notwithstanding the foregoing, the SFC accepts that the prescribed limits do not apply to a person who controls positions merely by virtue of its corporate relationship (e.g. a parent company in relation to directly controls positions held by its affiliates/subsidiaries) provided that such person ~~(i) does not give its affiliates/subsidiaries any day-to-day direction with respect to trading; and (ii) does not have knowledge of or gain access to trading activities of its affiliates/subsidiaries except for the information which is reasonably necessary for the person to perform its supervisory role of a parent company.~~

Penalties

- 2.8. Except as otherwise authorized by the SFC, HKFE or SEHK (please refer to paragraphs 3.1 to 3.1~~7~~6), a person who contravenes Section 4(1) of the Rules without reasonable excuse is liable (i) on conviction on indictment to a fine of HK\$100,000 and to imprisonment for 2 years; or (ii) on summary conviction to a fine of HK\$10,000 and to imprisonment for 6 months.
- 2.9. In addition to any other powers and sanctions contained in the SFO or the Rules, the HKFE and SEHK may require an Exchange Participant carrying an account in which a position is in excess of the prescribed limit to take immediate steps to reduce the position below the prescribed limit pursuant to their rules. Where the HKFE or SEHK becomes aware that any person maintains positions in accounts with more than one Exchange Participant such that the aggregate position in all accounts exceeds the prescribed limit, the HKFE or SEHK may require any of the Exchange Participants carrying such accounts to reduce positions in the relevant accounts so that the aggregate position in all accounts will comply with the prescribed limit.

3. Application to Exceed Prescribed Limits

- 3.1. No person may hold or control futures contracts or stock options contracts in excess of the prescribed limits except as otherwise authorized by the SFC, HKFE or SEHK (as the case may be) in accordance with Sections 4(2) and 4(4) of the Rules.

Authorization for excess positions by the HKFE/SEHK

- 3.2. Section 4(2) of the Rules provides that the HKFE or SEHK may authorize a person to hold or control futures contracts or stock options contracts in excess of the prescribed limits under the situations set out in Section 4(3) of the Rules.
- 3.3. In accordance with Section 4(3), the following persons may be authorized for holding or controlling excess positions by the HKFE or SEHK:
- (i) a person registered with the SEHK for the purpose of performing market making or liquidity providing activities in respect of stock options contracts in accordance with its rules (*e.g. an Options Trading Exchange Participant holds excess positions in stock options contracts for which it is registered with the SEHK to make a market*);
 - (ii) a person registered with the HKFE for the purpose of performing market making or liquidity providing activities in respect of futures contracts in accordance with its rules (*e.g. an HKFE Participant holds excess positions in futures contracts for which it is registered with the HKFE to make a market*);
 - (iii) an issuer of securities listed under Chapter 15A of the Listing Rules who holds or controls futures contracts or stock options contracts in the course of hedging the risks of positions previously acquired in such listed securities for the purpose of performing liquidity providing activities in respect of such listed securities (*e.g. an issuer of structured products like derivative warrants and equity-linked instruments holds excess positions in futures contracts or stock options contracts to hedge the risks of positions in the structured products issued by it*); or
 - (iv) a related corporation⁸ of an issuer of securities listed under Chapter 15A of the Listing Rules, where the related corporation holds or controls futures contracts or stock options contracts in the course of hedging the risks of positions previously acquired in such listed securities for the purpose of performing liquidity providing activities in respect of such listed securities (*e.g. an associate of an issuer of structured products like derivative warrants and equity-linked instruments holds excess positions in futures contracts or stock options*

⁸ The term “related corporation” is defined in section 3 of Schedule 1 of the SFO.

contracts to hedge the risks of its positions in the structured products issued by the issuer).

- 3.4. A person who has the need to exceed the prescribed limits pursuant to Section 4(2) should make an application to the HKFE or SEHK (as the case may be) in accordance with its rules. The approval from the HKFE or SEHK must be received prior to entering into positions which exceed the limits.

Authorization for excess positions by the SFC

- 3.5. Section 4(4) of the Rules empowers the SFC to authorize a person to hold or control futures contracts or stock options contracts in excess of the prescribed limits in special circumstances. Section 4(4) is only applicable to situations falling outside Section 4(3). That is, the SFC will not accept applications which will be dealt with by the HKFE and SEHK in accordance with Section 4(3).

- 3.6. Pursuant to this section, a person may hold or control futures contracts or stock options contracts in excess of the prescribed limits if:

- (i) the person is able to satisfy the SFC that special circumstances exist which warrant the person holding or controlling excess positions (Section 4(4)(a));
- (ii) the SFC is satisfied that the excess positions would not be prejudicial to the interest of the investing public having regard to the prescribed limits and the liquidity of the futures contracts or the stock options contracts in question (Section 4(4)(b)); and
- (iii) the SFC has given the person notice in writing that it is satisfied of the matters referred to in Sections 4(4)(a) and (b) (Section 4(4)(c)).

- 3.7. An application for excess positions under Section 4(4) may be submitted by

- (i) the ~~beneficial~~ owner of the account(s) for which the authorization is sought;
- (ii) the person who has the discretion to trade for the account(s); or
- (iii) an intermediary who acts as an agent for the ~~beneficial~~ owner of the account(s).

- 3.8. The application should be made to the Enforcement Division of the SFC in writing. There is no prescribed format for the application. It can be a letter or any written document supported by reasons and/or supporting documents for the application. The application must be approved by the SFC before positions in the relevant futures contracts or stock options contracts may be increased above the prescribed limit.

- 3.9. To meet the conditions as described in Sections 4(4)(a) and (b), the SFC will normally require the applicant to provide the following information to support the application:
- (i) A description of the nature of positions held or controlled (including transactions in other related markets which are an integral part of the entire portfolio);
 - (ii) A full and complete explanation of business needs for holding or controlling excess positions;
 - (iii) An estimate of the maximum level of positions intended to be established; and
 - (iv) The estimated duration of holding or controlling the excess positions.

Depending on each individual case, the SFC may request other information as it considers necessary.

- 3.10. The SFC will determine whether the applicant shall be approved to hold or control excess positions on the basis of the information supplied, the relevant prescribed limits, the liquidity of the futures contracts or stock options contracts for which the authorization is sought and such factors as the SFC deems appropriate to ensure that the circumstances in Sections 4(4)(a) and (b) are satisfied.
- 3.11. As a guiding principle, the SFC will not grant an authorization for any excess if the circumstances in Sections 4(4)(a) and (b) are not satisfied, or if the authorization is inconsistent with the SFC's regulatory objectives in Section 4 of the SFO, in particular,
- (i) to maintain and promote the fairness, efficiency, competitiveness, transparency and orderliness of the securities and futures industry;
 - (ii) to reduce systemic risks in the securities and futures industry; or
 - (iii) to assist the Financial Secretary in maintaining the financial stability of Hong Kong by taking appropriate steps in relation to the securities and futures industry.
- 3.12. The SFC may decide to approve or deny the application or impose conditions on the authorization. A notice of decision will be provided to the applicant in writing.
- 3.13. The SFC will endeavour to notify the applicant of its decision within ten business days after all information as requested by the SFC to support the application is provided to its full satisfaction. However, since authorizations that may be granted by the SFC under Section 4(4) are special cases, it may take more time for the SFC to consider and review some particular cases. A

person who has the need to exceed the prescribed limits is advised to submit an application accompanied by the supporting information to the SFC as soon as practicable.

- 3.14. A person who has received the authorization from the SFC to hold or control an excess position within a certain period of time should submit a new application to the SFC if he wishes to continue to hold or control the excess position after the expiration date of the initial authorization. The new application should be submitted to the SFC no later than five business days prior to the expiration date of the initial authorization. If the SFC does not grant any further authorization for the excess position, the person will be required to close out the position in excess of the prescribed limit upon the expiration date of the initial authorization.
- 3.15. After an authorization is granted by the SFC, if there are any material changes in the information previously provided to the SFC, the applicant must immediately submit the updated information to the SFC. The SFC will decide if the authorization granted is still valid. Should the applicant fail to submit such information, he may not continue to rely upon the authorization granted. That is, he may be requested to close out the excess positions.
- 3.16. A person may appeal against a decision of the SFC to refuse to authorize an excess position under Section 4(4) of the Rules to the Securities and Futures Appeals Panel Tribunal (“Tribunal”) pursuant to Section 216 of the SFO⁹. An application for review of the decision must be made to the Tribunal by the person against whom the decision is made within 21 days of notice of the decision. Upon review of the decision under appeal, the Tribunal may confirm, vary or set aside the decision or substitute any other decision which the Tribunal considers more appropriate or it may remit the matter to the SFC with directions to revisit the decision. For the avoidance of doubt, before the Tribunal determines otherwise, the decision of the SFC shall remain valid and the person is required to act on the decision of the SFC.
- 3.17. As discussed in paragraph 2.7, the SFC considers that the prescribed limits do not apply to a person who controls positions merely by virtue of its corporate relationship. In view of this, if a person is permitted by the SFC to hold or control excess positions, its affiliates or holding company, which indirectly control the same positions by virtue of the corporate relationship, will not be required to seek the approval from the SFC separately to control the positions.

4. Notice of Reportable Positions

Reportable positions

⁹ As set out in Part 2 of Schedule 8 of the SFO, the Tribunal has jurisdiction over the decision made by the SFC under Section 4(4) of the Rules.

- 4.1. In order to facilitate the HKFE and SEHK in monitoring market activities, Section 6(1) of the Rules requires a person holding or controlling a reportable position to notify the recognized exchange company of that reportable position in writing.
- 4.2. Reportable positions for futures contracts and stock options contracts are specified in Schedule 1 and Schedule 2 of the Rules respectively. Similar to the prescribed limits, the reportable positions for futures contracts are calculated based on the number of contracts held or controlled for a contract month¹⁰ while the reportable positions for stock options contracts are calculated based on the number of contracts held or controlled in an expiry month.
- 4.3. The aggregation requirements as mentioned in paragraphs 2.6 and 2.7 equally apply to the reportable positions for futures contracts and stock options contracts.

Responsibilities of reporting

- 4.4. The notice of a reportable position specified in Section 6(1) may be submitted by
 - (i) the intermediary (e.g. the Exchange Participant) carrying the account of the reportable position;
 - (ii) the ~~beneficial~~ owner of the reportable position; or
 - (iii) the person controlling the reportable position.

If one of the above parties has submitted the notice of the reportable position to the Exchange, the SFC accepts that the other parties will not be required to notify the Exchange of the same reportable position under Section 6(1).

- 4.5. In other words, a person holding or controlling a reportable position can choose to submit the notice of the reportable position to the Exchange directly or through an Exchange Participant or its intermediary where the latter agrees to make the report on the person's behalf for an Exchange Participant. However, no matter which party is chosen by the person to submit the notice to the Exchange, it is the responsibility of each person holding or controlling the reportable position to fulfill its obligations under Section 6(1).
- 4.6. In the event that a person holds or controls a reportable position in accounts at more than one intermediary, the person should have the sole responsibility to notify the Exchange of the reportable position. If the person decides to submit the notice of the reportable position to the Exchange through the intermediaries, it should provide to one intermediary its total positions held at

¹⁰ The reportable positions for HSI futures contract, HSI options contract, Mini-HSI futures contract or Mini-HSI options contract are also based on the number of contracts held or controlled.

other intermediaries so that the intermediary can submit the notice of the reportable position to the Exchange on its behalf. Alternatively, the person can ask all intermediaries to separately report positions in each of the accounts to the Exchange even though positions in the individual accounts may not ~~exceed~~~~reach~~ the reportable level.

- 4.7. Similar to the prescribed limits, the SFC agrees that a person controlling a reportable position merely by virtue of its corporate relationship is not required to submit the notice of the reportable position to the Exchange.

Reporting requirements

- 4.8. In accordance with Sections 6(1)(a) and (b), the notice of reportable positions should be made within one reporting day following

- (i) the day on which the person first holds or controls the reportable positions; and
- (ii) each succeeding day on which the person continues to hold or control the reportable positions.

For the avoidance of doubt, once a person has held or controlled a reportable position, ~~it~~~~he~~ will be required to file the notice of the reportable position to the HKFE or SEHK (as the case may be) on each reporting day even though his position remains unchanged.

- 4.9. Section 6(2) of the Rules further requires that the notice of a reportable position shall be accompanied by the following information:

- (i) the number of futures contracts or stock options contracts held or controlled by the person in respect of the reportable position in each relevant contract month; and
- (ii) if the reportable position is held or controlled for a client, the identity of the client.

In respect of the information about the identity of a client, ~~intermediaries registered or licensed persons of the SFC~~ should refer to the requirements as set out in the Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission and the Client Identity Rule Policy.

- 4.10. In the stock options market, positions held by a market maker are recorded by the SEHK Options Clearing House in a segregated clearing account. Under SEHK rules, positions held by market makers in segregated clearing accounts are treated as having been reported to the SEHK. The SFC accepts that if the segregated clearing account is used exclusively to keep positions of a single market maker, the market maker will be deemed to have fulfilled the reporting requirements as stated in Sections 6(1) and 6(2) of the Rules.

Other reporting requirements specified by the HKFE/SEHK

- 4.11. The HKFE and SEHK have developed more detailed reporting requirements to facilitate their monitoring of reportable positions as required under Section 6 of the Rules. These requirements include the use of a prescribed form for reporting and the specific deadline for submission of the notice of reportable positions¹¹.
- 4.12. The HKFE and SEHK also request Exchange Participants to provide additional information other than those specified in Section 6(2) including (i) the account number, account name and identities of the ultimate **beneficial** owner and transaction originator (if the instruction in relation to a transaction is not originated by the **beneficial**-owner) of a reportable position; (ii) the nature of a reportable position (i.e. for hedging, arbitrage or trading purposes); (iii) the account type (i.e. house account, client account or market maker account); and (iv) the nature of the entity holding or controlling the reportable position (i.e. the entity is the ultimate **beneficial**-owner, transaction originator or omnibus account operator).

Penalties

- 4.13. A person who contravenes Section 6 of the Rules without reasonable excuse is liable (i) on conviction on indictment to a fine of HK\$100,000 and to imprisonment for 2 years; or (ii) on summary conviction to a fine of HK\$10,000 and to imprisonment for 6 months.

5. Compliance by Exchange Participants

- 5.1. Section 7 of the Rules provides that the prescribed limits and reportable positions apply to (i) positions in futures contracts or stock options contracts held or controlled by an Exchange Participant for its own account; and (ii) separately to positions in futures contracts or stock options contracts held or controlled by the Exchange Participant for each of its clients.
- 5.2. This section allows an Exchange Participant to disaggregate positions held for its own account and positions held for each of its clients in the application of the prescribed limits and reportable position requirements. An Exchange Participant's own positions and positions held for each of its clients are treated separately for purposes of determining compliance with the prescribed limits and reportable position requirements.
- 5.3. In respect of reportable positions, Section 7 requires Exchange Participants to notify the HKFE or SEHK (as the case may be) of reportable positions held or controlled by each of their clients. For the avoidance of doubt, if a client holds a reportable position but only part of the position (which has not

¹¹ HKFE requires Exchange Participants to submit the notice of reportable positions by 12:00 noon on the reporting day (T+1).

exceeded the reportable level) is held by the Exchange Participant, the Exchange Participant will not need to report that position to the Exchange unless it knows that the total position held by the client in other firms has exceeded the reportable level. For this purpose, ~~the~~ HKFE and SEHK have established detailed reporting requirements for Exchange Participants to submit the notice of reportable positions (please refer to paragraphs 4.11 to 4.12).

- 5.4. If an Exchange Participant is aware that a number of its client accounts are held for the same client~~beneficial owner~~, all positions of these accounts should be aggregated for reporting purposes.

6. Application of the Rules to Different Entities

Persons holding or controlling positions at multiple firms

- 6.1. If a person holds or controls positions in accounts at more than one firm, the person should have the obligation to aggregate positions ~~should be aggregated~~ for purposes of applying the prescribed limits and reportable position requirements.
- 6.2. If a person holding or controlling positions at multiple firms chooses to submit the notice of reportable positions to the Exchange through one of the firms (e.g. an Exchange Participant) where the firm agrees to submit the notice on the person's behalf, it should provide to the firm its total positions held at other firms.

Transaction originators "Clients"

- 6.3. The SFC's view is that, for the purposes of the Rules, a client~~A transaction originator~~ is the person who is ultimately responsible for originating instructions of transactions, i.e., the transaction originator. For the purpose of applying the Rules, the SFC will treat a transaction originator as the client of the intermediary or Exchange Participant if the transaction originator will be treated as a controlling person if he has the discretion to initiate transactions on behalf of the ~~beneficial~~ owner of the order/position. The most common type of transaction originator is a fund manager who manages assets of a fund at his own discretion according to the investment policy of the fund.
- 6.4. If the total positions controlled by a transaction originator (including positions belonging to different ~~beneficial~~ owners, e.g., different funds, but under his control) have ~~exceeded~~ reached the reportable level, the transaction originator will be required to notify the HKFE or SEHK (as the case may be) of such positions. As required in Section 6(2) of the Rules, the transaction originator should also provide the information about identities of each ~~beneficial~~ owner whose position has ~~exceeded~~ reached the reportable level. *For example, a fund manager is in charge of the investment of three funds, namely, Fund A, Fund B and Fund C. Currently, there are 1,000, 800 and 200 futures*

contracts held by Fund A, Fund B and Fund C respectively. If the reportable level for the futures contract is 500 contracts, the fund manager should notify the Exchange of the total positions under his control (i.e., 2,000 contracts), names of the funds in which position has ~~exceeded~~ ~~reached~~ the reportable level (i.e., Fund A and Fund B) and the positions held in these funds.

- 6.5. A transaction originator can choose to notify the HKFE or SEHK (as the case may be) of the reportable positions by himself or through its ~~the~~ intermediary (e.g. an Exchange Participant) which agrees to make the report on his behalf ~~through which his positions are held~~.
- 6.6. The prescribed limits apply to the total positions controlled by a transaction originator even if ~~beneficial~~ owners of the positions are different.
- 6.7. Where an Exchange Participant (EP1) “takes up” a position from another Exchange Participant (EP2) for a particular client for clearing and settlement of the transaction, EP1 can, according to the rules of the HKFE and SEHK (as the case may be), disaggregate the “take up” position as a client’s position (from its own position and positions of other clients) for the purposes of applying the position limits and reportable positions.
- 6.8. Appendix 1 illustrates the application of the limits to an Exchange Participant and different types of clients.

Omnibus accounts

6.7.6.9. In the case of an omnibus account, the Rules apply to the aggregate positions held in the omnibus account and to the positions held by each of the underlying clients of the omnibus account.

6.8.6.10. An omnibus account operator should inform the HKFE or SEHK (as the case may be) of the aggregate positions held in the account if they have ~~exceeded~~ ~~reached~~ the reportable level. If an underlying client of the omnibus account holds a reportable position, such reportable position should also be reported to the Exchange. An omnibus account operator can notify the Exchange of the reportable positions by itself or ask its intermediary (e.g. an Exchange Participant) carrying the account to submit the notice of reportable positions. The notice of reportable positions should be accompanied by the information about identities of the underlying clients whose position has ~~yes~~ ~~exceeded~~ ~~reached~~ the reportable level.

6.9.6.11. There are situations where an underlying client of the omnibus account is also an omnibus account, i.e., there are more than one layer of omnibus account. If the omnibus account operator in one layer has notified the Exchange of the reportable positions held by the ultimate clients ~~beneficial owners~~ including identities of each of them (either by itself or through its intermediary), the SFC accepts that the other omnibus account operators below this layer will not be required to notify the Exchange of any reportable positions held in their accounts.

Example:

Suppose that Exchange Participant A has an omnibus account B holding 1,000 long futures contracts. One of the underlying clients of omnibus account B is also an omnibus account (account C) which holds 900 long futures contracts. Positions in omnibus account C are owned by Company D (800 long futures contracts) and other small investors (a total of 100 long futures contracts).

Assume that the reportable level is 500 contracts. Exchange Participant A should inform the Exchange of the position held by the omnibus account B (i.e. 1,000 contracts). If the operator of omnibus account B has obtained the information about the ultimate ~~client beneficial owners~~ from the operator of omnibus account C and notified the Exchange of the reportable position held by Company D including its identity (the reportable position can be reported to the Exchange by the operator B itself or through the Exchange Participant A), the operator of omnibus account C will not be required to submit any notice of reportable positions to the Exchange.

6.10.6.12. The prescribed limits apply to the aggregate positions held in an omnibus account and separately to the positions held by each of the underlying clients of the omnibus account.

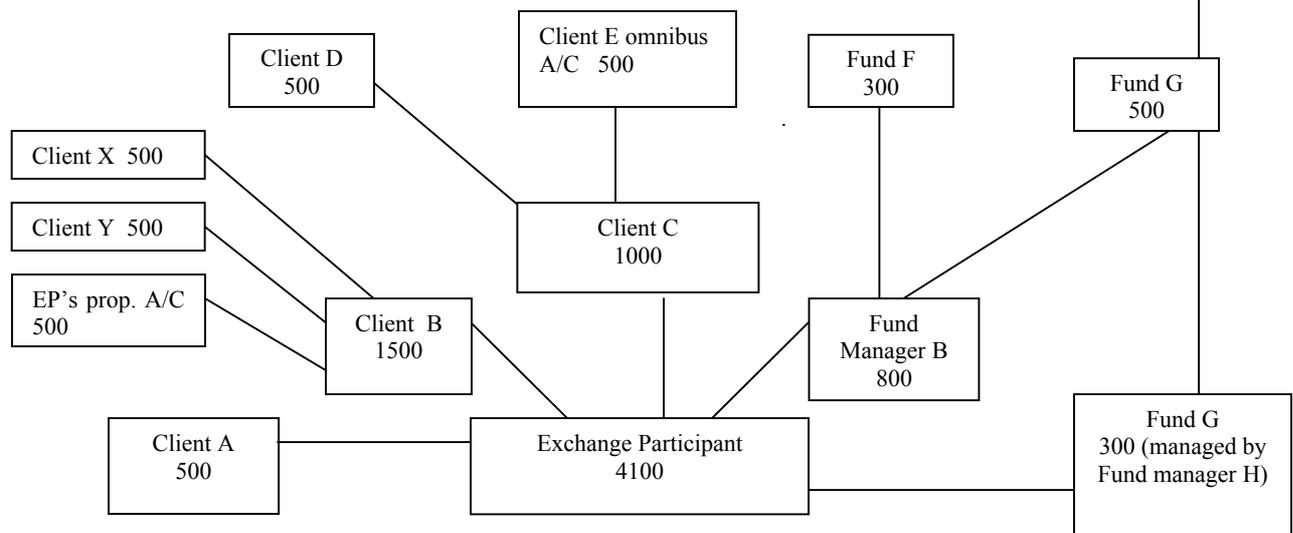
Non-Exchange Participant intermediaries

6.11.6.13. Non-Exchange Participant intermediaries carrying omnibus accounts with other intermediaries to hold client positions should refer to paragraphs 6.7 to 6.10 regarding the application of the Rules to omnibus accounts.

6.12.6.14. Even though individual clients of an intermediary do not hold positions in excess of the prescribed limits, the aggregate positions held by an intermediary may exceed the prescribed limits. Section 7 of the Rules allows an Exchange Participant to disaggregate its own positions and positions held for each of its clients in the application of the prescribed limits, but this disaggregation provision is not applicable to non-Exchange Participant intermediaries. Non-Exchange Participant intermediaries cannot hold aggregate positions in excess of the prescribed limits except as otherwise authorized by the SFC pursuant to Section 4(4).

Appendix 1

For example: Reportable Position is 450 contracts



Client A has an account with the Exchange Participant. Client A places orders directly to the Exchange Participant and the Exchange Participant books Client A's trades into Client A account. Client A is holding 500 contracts. Insofar as the limits are concerned, Client A is a client of the Exchange Participant and his position can be treated separately (i.e., disaggregated) by virtue of section 7(b) of the Rules.

The Exchange Participant has a client account under the name of Client B which it uses for booking transactions for his proprietary trading and for the trading of Clients X and Y. Client X and Client Y are clients of Client B and are also treated by the Exchange Participant as its clients. Client X and Client Y each hold 500 contracts. The Exchange Participant's proprietary position booked into the Client B account is also 500 contracts. The Client B account therefore has a total of 1500. Although Client X and Client Y's trades are booked into the client account, since they are clients of the Exchange Participant, Client X, Client Y and the Exchange Participant's proprietary position can each be treated separately (i.e., disaggregated) by virtue of section 7(b) of the Rules.

Client C is a non-exchange participant intermediary. Client C is a client of the Exchange Participant. He holds positions for Clients D and E who have 500 contracts each. Client D and E's trades are always placed with the Exchange Participant by Client C on their behalf. The Exchange Participant does not treat Clients D and E as its clients. Client E is an omnibus account. For the purposes of the Rules, the SFC does not consider that Clients D and E's trades can be treated separately as Client C is not an Exchange Participant and disaggregation is currently not allowed beyond an Exchange Participant's level.

Fund Manager B has an account with the Exchange Participant. He manages Funds F and G which hold 300 and 500 contracts respectively. Separately, Fund G has an account with the Exchange Participant. This account is managed by Fund Manager H. Fund G, through this account, holds 300 contracts. Funds F and G's trades held by Fund Manager B are executed by him. The positions cannot be treated separately as Fund Manager B is not an Exchange Participant.

Notices of Reportable Positions to be filed –

- (a) the Exchange Participant should notify the Exchange of –
- 4100 he holds in total; then 500 contracts each for its proprietary position, Client A, Client X and Client Y, 1000 contracts held by Client C, and Fund Manager B's 800 contracts.
- (b) Client B should notify the Exchange of the position of 1500 contracts which he holds for the EP's proprietary account, Client X and Y.
- (c) Client A, Client X, Client Y, Client D, Client E, should each notify the Exchange of their own positions of 500 contracts.
- (d) Client C should notify the Exchange of its aggregate position of 1000 contracts of which 500 contracts each held by Client D and Client E.
- (e) Fund Manager B should notify the Exchange of the 800 contracts he controls and that 500 contracts are for Fund G.
- (f) Fund G should notify the Exchange of its 800 contracts, 500 of which are held by Fund Manager B and 300 held by Fund Manager H.

Notwithstanding the above filing requirements, the notice of a reportable position may be submitted by the intermediary, the owner of the position or the person controlling the reportable position (see paragraph 4.4). As long as there is an arrangement in place for reporting such positions, the SFC accepts that if one of the parties has submitted the notice of reportable position, the other parties will not be required to notify the Exchange of the same reportable positions.