



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

**Consultation conclusions paper:  
Proposed amendments to allow remote participants  
in the futures market**

10 July 2009



## Introduction

1. On 27 February 2009, the Securities and Futures Commission (**SFC**) issued a consultation paper (**Consultation Paper**) inviting comments on proposed amendments to the definition of “dealing in futures contracts” under Part 2 of Schedule 5 to the Securities and Futures Ordinance, Cap. 571 (**SFO**).
2. The proposed amendments sought to facilitate remote participation in Hong Kong-based futures markets by allowing overseas participants to participate in that market without an SFC licence provided certain preconditions were met.
3. The consultation period ended on 31 March 2009 and 16 written submissions were received from different market participants. Respondents had mixed views about the proposal. Concerns raised revolved around the following three main areas:
  - (a) General economic issues – respondents were concerned that brokers in Hong Kong would face increased competition and that this would be particularly harsh given the current economic conditions,
  - (b) Enforcement and regulation issues – respondents were concerned about the regulation of remote participants being left to overseas regulators and that this may result in remote participants being subject to less stringent standards, and
  - (c) Risk management issues – respondents noted that the Consultation Paper did not discuss how risk management issues relating to the clearing of remote participants’ trades would be dealt with, and were concerned that there should be clarity in this regard before remote participation is adopted in Hong Kong.
4. The comments and concerns raised, together with the SFC’s response to these, are discussed in greater detail below. A list of the respondents who sent in submissions is at **Appendix A** to this paper, and the full text of the submissions can be viewed at the SFC’s website at [www.sfc.hk](http://www.sfc.hk).

## Comments received and the SFC’s response

5. A total of 16 respondents submitted written comments to the Consultation Paper.
6. There were mixed views regarding the proposal to introduce remote participants in the Hong Kong futures markets. Some respondents supported the proposal and agreed that it would bring benefits to Hong Kong and its markets, while others disagreed noting it would adversely affect local employment and economic conditions, and result in unequal regulatory treatment as between locally based and remote participants.
7. Many respondents however – including both supporters and non-supporters of the proposal – emphasised the need to first address certain risk management issues concerning the clearing of remote participants’ trades before progressing the proposal further.



## General economic issues

8. Six respondents raised concerns about increased competition from overseas participants and adverse impact on the local job market. Two respondents however expressly disagreed with concerns about increased competition, and noted that competition had repeatedly proven to be the most effective factor in improving a business, its processes, products and services.
9. The SFC appreciates the concern raised. However, as mentioned in the Consultation Paper, we believe the proposal also has the potential to enlarge the investor base of our futures markets, increase liquidity and facilitate growth. These can bring new opportunities for Hong Kong and its markets and people. Moreover, a key aspect of the proposal is that remote participants can only serve overseas investors. Local investors will therefore continue to be served by locally-based participants.
10. Four respondents also noted that the proposal might persuade some institutional investors, who have already established a presence in Hong Kong, to close their operations here and become remote participants instead. This would adversely affect both Hong Kong's economy and its development as an international financial centre.
11. The SFC considers that any such decision is likely to be based on a range of considerations rather than just one single factor. For example, firms may be less inclined to move their operations if they have an established client base in Hong Kong or the region, or if they wish to operate their business in the place where the exchange is located. In addition, new clearing firms may be set up in Hong Kong, or existing ones may expand their operations, in order to provide services to remote participants. This could, to some extent, offset any potential negative impact.

## Enforcement and regulation issues

12. Four respondents raised concerns about unequal regulatory treatment as a result of local participants and remote participants being subject to different laws and regulations, as well as different customs and practices. Two respondents however expressly noted that the proposal should not raise regulatory concerns as the proposed changes would permit market participation by persons who were already regulated by a signatory to the Multilateral Memorandum of Understanding Concerning Consultation and Cooperation and the Exchange of Information of the International Organization of Securities Commissions (IOSCO MMOU).
13. The SFC notes the concerns about unequal regulatory treatment. The SFC recognizes that the regulatory treatment of remote participants can never be identical to that of local firms as the two will always be subject to rules and regulations of different jurisdictions, even though both jurisdictions may be signatories to the IOSCO MMOU. The SFC will therefore further consider what additional regulatory measures can be put in place to address concerns about the regulation of remote participants.
14. One respondent noted that the proposal may not attract overseas firms that are proprietary in nature as the requirement to be regulated overseas would result in additional cost and burden. The SFC however considers that this would be a matter of cost-benefit analysis for the firm in question.
15. Two respondents raised concerns about the proposal encouraging speculative activities by overseas participants. The SFC does not agree that the proposal would encourage



speculative activities given the safeguards incorporated including in particular the requirement for compliance with internationally recognized and accepted standards and regulations. To the extent that the concern relates to increased misconduct or criminal activity in our markets, it is worth noting that the Hong Kong laws and regulations in this regard (such as those relating to market manipulation, position limits and large open positions reporting, etc) would in any event apply. The SFC will however further consider if additional measures can be put in place to further address concerns in this regard.

## **Risk management issues**

16. Seven respondents raised various concerns about the clearing of trades executed by remote participants and related risk management issues. They were concerned that the proposal did not provide enough information on how remote participants' trades would be cleared and how risks arising from their positions would be managed. They felt these matters needed to be clarified and properly addressed before remote participation was introduced in Hong Kong.
17. Several respondents gave suggestions as to how the risk management issues should be addressed. These included requiring remote participants to clear their trades through a Hong Kong based clearing member, and requiring market operators to provide risk management tools which would allow clearing members to monitor trades executed by their remote participant clients and take action where necessary.
18. The SFC notes the concerns raised in relation to the risk management of remote participants' positions. As regards how remote participants should clear their trades, we understand that many exchanges require remote participants to clear their trades through clearing firms. A similar approach could be adopted in Hong Kong as there is already a model in place that could be built upon. Specifically, clearing firms in Hong Kong (known as general clearing participants) are currently allowed to provide clearing services to non-clearing firms and should therefore have already established appropriate risk control procedures to deal with risks arising from positions held by non-clearing firms. Since the position of remote participants would be analogous to that of non-clearing firms, we believe that a similar risk management model could be applied, i.e. the clearing firms could be responsible for managing the risks of remote participants' positions, and the clearing house could be responsible for managing the risks of the clearing firms.
19. The above said, the SFC acknowledges also that at present, non-clearing firms in Hong Kong represent only a small portion of market activities. If remote participants are admitted to our markets, they may become significant players in our market. Moreover, the associated risks may be different from those presented by existing non-clearing firms. As a result, clearing firms who clear trades of remote participants could face greater risks than they do now. The SFC agrees that risk controls should be adequate to deal with risks arising from remote participants and their clearing firms, and therefore considers that a more detailed study of the risk management issues is needed before the proposed amendments can be progressed.

## **Others**

20. A few other concerns were raised. In particular, three respondents raised concerns about the timing of the proposal given the current financial crisis. The SFC notes this concern.



21. In addition, one respondent questioned whether it was necessary or advisable to introduce legislative amendment to facilitate remote participation in Hong Kong, and suggested that amendments to exchange rules may be more appropriate. The SFC notes this suggestion and will consider it further as this matter progresses.

## **Conclusion and way forward**

22. As mentioned above, the SFC considers that a more detailed study of the risk management issues is needed before the remote participation proposal can be further considered. The SFC will discuss this aspect of the proposal further with relevant market participants and futures markets operators, to seek their views on how best to take this matter forward. The SFC will also further consider if additional regulatory measures can be put in place to further address concerns about the regulation of remote participants.
23. The SFC would also like to take this opportunity to thank all respondents who have sent in submissions to this consultation exercise for their time, effort and contribution.



## Appendix A

### List of respondents

(in alphabetical order)

1. Anonymous
2. Anonymous
3. Anonymous
4. Anonymous
5. Anonymous
6. Fortis Clearing (Futures) Hong Kong Limited & Fortis Clearing (Options) Hong Kong Limited
7. Hong Kong Securities and Futures Industry Staff Union
8. The Securities Professionals Association
9. Hong Kong Stockbrokers Association Ltd
10. HSBC Broking Futures (Asia) Limited
11. J.P. Morgan Broking (Hong Kong) Limited
12. Kingsway Financial Services Group Limited
13. Newedge Financial Hong Kong Limited
14. Quam Securities Company Limited
15. RBS Global Banking & Markets
16. Roctec Futures Trading Co., Ltd