



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

**A Consultation Paper on proposed amendments to the Securities and Futures (Contracts Limits and Reportable Positions) Rules and proposed corresponding amendments to the Guidance Note on Position Limits and Large Open Position Reporting Requirements**

**Hong Kong  
May 2007**

## Introduction

1. This consultation document invites public comments on proposed amendments to the Securities and Futures (Contracts Limits and Reportable Positions) Rules (“**Rules**”) and proposed corresponding amendments to the Guidance Note on Position Limits and Large Open Position Reporting Requirements (“**Guidance Note**”), as set out in Appendix 1 and Appendix 2 respectively.
2. The proposed amendments are to empower the SFC to authorize Exchange Participants (or their affiliates) to exceed the prescribed limits for Hang Seng Index futures and options contracts and Hang Seng China Enterprises Index futures and options contracts where the prescribed limits are not enough to enable them to serve their clients’ needs.
3. The proposed amendments form stage two of a two-stage proposal. The first stage consisted of adjusting the position limits for Hang Seng China Enterprises Index futures and options contracts. Amendments to implement that adjustment came into effect on 30 March 2007.
4. The SFC has used the FinNet communication network to send copies of this consultation document to all intermediaries. In addition, the public may obtain copies of this consultation document free of charge at the SFC’s office and on the SFC’s Internet website at <http://www.sfc.hk>.
5. The SFC invites interested parties to submit written comments on the proposed amendments by no later than 18 June 2007. Any person wishing to comment should provide details of any organization whose views they represent. In addition, persons suggesting alternative approaches are encouraged to submit proposed text to be incorporated into the Rules and/or the Guidance Note.
6. 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.
7. You may not wish your name to be published by the SFC. If this is the case, please state that you wish your name to be withheld from publication when you make your submission.
8. Comments may be submitted as follows:

By mail to: SFC (LOP Rules and Guidance Note)  
8/F, Chater House  
8 Connaught Road  
Central, Hong Kong

Attn: Supervision of Markets Division

By fax to: (852) 25217917

By on-line submission at: <http://www.sfc.hk>

By e-mail submission to: [LOPRulesandGuidanceConsult@sfc.hk](mailto:LOPRulesandGuidanceConsult@sfc.hk)

## **The Proposal**

### *Background*

9. Under section 35(1) of the Securities and Futures Ordinance (“**SFO**”), the SFC may prescribe limits and reportable positions on futures contracts and options contracts. These are then set out in the Securities and Futures (Contracts Limits and Reportable Positions) Rules 2003 (“**Rules**”).
10. Prescribed limits and reportable positions are used as tools for the monitoring and management of risks in our futures markets. Prescribed limits help prevent the build up of excessive and over-concentrated positions which may pose a threat to the orderly functioning and financial stability of our markets. At the same time however, these limits also place constraints on the open positions that brokers and their clients may take in the futures markets. It is necessary therefore to strike an appropriate balance between the two.

### *Concerns about existing prescribed limits*

11. Global derivative markets have been undergoing significant changes in recent years, and competition among derivative exchanges has continued to accelerate regionally and globally. Increasingly therefore, leading derivative exchanges are offering competing products outside their national boundaries.
12. Meanwhile concerns have also been raised that the existing position limits for Hang Seng China Enterprises Index futures and options contracts (“**H-share contracts**”) and Hang Seng Index futures and options contracts (“**HSI contracts**”) are not adequate to cope with market growth, and that this is causing some market participants to shift part of their positions to the over-the-counter (“**OTC**”) and overseas markets. There is also concern that our existing position limits may be impeding the growth of Hong Kong’s derivatives market.

### *Market needs*

13. Earlier market feedback and analysis of the positions then held in the market had indicated the following.
  - (1) The then position limits for H-share contracts (i.e. prior to 30 March 2007)<sup>1</sup> were not sufficient to cope with the sharp growth in the H-share market.

There has been growing interest in H-share companies over the last few

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<sup>1</sup> The position limit for H-share contracts was raised on 30 March 2007 when the Securities and Futures (Contracts Limits and Reportable Positions) (Amendment) Rules 2007 came into effect – see paragraph 15 below.)

years. The market capitalization and average daily turnover of H-shares have thus increased substantially. This strong growth has in turn accelerated the development of related derivatives markets (ie the H-share index futures and options markets) with the result that the position limits in these markets had become insufficient.

- (2) Although the existing position limits were adequate for most market participants to meet their business needs, for some the limits for HSI contracts and H-share contracts were considered low.

Some Exchange Participants are unable to meet their full business needs within the existing position limits. They need to hold larger proprietary positions, particularly in HSI contracts and H-share contracts. These larger positions are needed mainly to provide client facilitation services<sup>2</sup>.

### *The proposal*

14. In view of the above, the SFC believes it is necessary to adjust the prescribed limits for HSI contracts and H-share contracts. A two-stage approach has been proposed in this regard.
15. The first stage – which has now been implemented – involved adjusting the prescribed limits for H-share contracts. Specifically, the previous limit of 6,000 contracts per futures contract month or options contracts series was combined to form a single aggregate delta limit of 12,000 applicable to all futures contract months and options series combined. This adjustment was implemented by amending Schedule 1 to the Securities and Futures (Contracts Limits and Reportable Positions) Rules. The amendment came into effect on 30 March 2007.
16. The second stage – which is the subject of this consultation – involves introducing legislative amendments that will allow the SFC to authorize a person to exceed the limits prescribed in the legislation on a case-by-case basis. The SFC's power to grant authorizations will however be subject to several limitations.
  - (1) The SFC will only be able to authorize an Exchange Participant or its affiliate (ie another company within the same group of companies as the Exchange Participant) to exceed the prescribed limit. Earlier market feedback and our analysis had indicated that it was mainly the Exchange Participants that needed to exceed the existing prescribed limits in order to serve their clients – see paragraph 13 above.

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<sup>2</sup> Client facilitation refers to the process whereby a broker helps clients to execute orders that cannot be executed directly on the exchange. For example, the client's order may be a unique one whose terms do not match those of the standardised contracts offered on the exchange. The broker may take positions, as principal, to meet the client's order and then cover its trade (outstanding positions) on the exchange. The broker usually maintains market neutrality in these client facilitation transactions. In this example, the exchange transactions are treated as the broker's proprietary positions even though they were in fact executed to facilitate the trading needs of clients.

- (2) The SFC will only be able to authorize excesses of up to 50% of the limit prescribed in the legislation. Moreover, this upper limit is a per group limit, ie it applies to the aggregate excess positions of all companies within the same group. Although the SFC recognizes that there are market participants who have a genuine business need for excess positions, the fact remains that the build up of excessive and over-concentrated positions have the potential to affect market stability. The SFC therefore believes that a cautious approach should be taken when designing any mechanism to relax the prescribed limits. Accordingly, a per group limit is set at this stage. The SFC will however keep this aspect of the proposal under review as experienced of authorizing excesses is gained.
  - (3) The SFC will only be able to authorize excesses in respect of contracts that are specified. At this stage, it is proposed that only HSI contracts and H-share contracts will be specified. Market feedback had indicated that it was these contracts that market participants needed higher position limits in order to better serve their clients – see paragraph 13 above.
17. Additionally, the SFC will only be able to authorize excesses if certain preconditions are met. These are as follows.
  - (1) The excess position must be needed for a “relevant business need”. In other words, it must be needed for client facilitation purposes, i.e. to conduct hedging and/or arbitrage activities to facilitate the provision of services to clients. This is to ensure that excess positions are not used for purely proprietary trading, but to enable an exchange participant or its affiliate to serve its clients.
  - (2) The Exchange Participant must have adequate financial capability to cover the potential risks arising from any authorized excess position. It must also have effective internal control procedures and risk management systems to manage such risks. These requirements are necessary because the SFC will normally look to the Exchange Participant (which is the regulated entity) within the group to ensure that the excess positions are properly used and any resultant risks properly managed. It will also expect the Exchange Participant to carry the relevant trades. In other words, if any member within the group is authorized to hold excess positions in a particular futures or options contract, the SFC will normally expect all its holdings (i.e. not just the excess positions) in that contract to be acquired and disposed of through an account carried by the Exchange Participant. Its financial status, and internal control and risk management systems are therefore crucial.
  - (3) The SFC must be satisfied that the excess position will not be prejudicial to the interest of the investing public. In considering this, the SFC will take into account the prescribed limit and the liquidity of the futures contracts or stock options contracts in question.

*Benefits of the proposal*

18. We believe the proposal can bring a number of benefits.
- (1) It can encourage market participants to establish their positions on Hong Kong Exchanges and Clearing Ltd's derivative market. This will result in greater transparency and consequently enable the SFC to better assess the potential implications on market stability.
  - (2) It can facilitate Hong Kong becoming a risk management centre for the Mainland. Hong Kong is currently the premier capital-raising centre for Mainland enterprises. To build on this strength, we need to provide cost-effective and highly liquid derivative products for market participants to manage the risks of H-shares and other Mainland related securities. The proposed changes will help achieve this.
  - (3) Many overseas exchanges are keen to develop derivative products on Mainland-related equities. Some have already introduced similar products to compete with our futures contracts. The current proposal can help enhance the liquidity of our market, thereby further strengthening its leading position.

*Amendments needed*

19. The above proposal will necessitate amendments to the Securities and Futures (Contracts Limits and Reportable Positions) Rules ("**Rules**") and the Guidance Note on Position Limits and Large Open Position Reporting Requirements ("**Guidance Note**"). The proposed amendments are discussed at greater length below.

**Proposed amendments to the Rules**

20. The proposed amendments to the Rules are set out in the draft Securities and Futures (Contracts Limits and Reportable Positions) (Amendment) Rules 2007 at Appendix 1. The changes are incorporated in section 4 of the Rules and essentially provide as follows.

*Subsection (4)(a)*

21. The existing subsection (4)(a) already empowers the SFC to authorize a person to exceed the prescribed limits for any futures contract or options contract but only if it can be shown that there are special circumstances warranting the excess position. The need for special circumstances suggests that there must be something special or unique about the situation. The current proposal however does not envisage that the applicant may be facing a unique or special situation – the need for excess positions to serve clients need cannot be construed as a special circumstance. It is necessary therefore to amend the legislation to provide for a new category of authorization by the SFC.

22. Accordingly, the existing subsection 4(a) is redrafted to cater for two different categories of authorization.
- (1) subsection 4(4)(a)(i) – which is the existing category of authorization – deals with authorizations needed to meet “special circumstances”; and
  - (2) subsection 4(4)(a)(ii) – which is the proposed new category and the subject of this paper – deals with authorizations needed to meet a “relevant business need”.

*Subsection (5)*

23. New subsection (5) merely reiterates the existing conditions for granting authorizations to meet “special circumstances”. There is no substantial change from the existing criteria.

*Subsections (6) to (9)*

24. New subsections (6), (7) and (8) set out the ambit of the SFC’s power to grant authorizations to meet a “relevant business need”. They incorporate the limitations and preconditions discussed in paragraphs 16 and 17 above.
25. New subsection (9) is intended to avoid overlap between the powers of the SFC and those of the Stock Exchange of Hong Kong Ltd (“SEHK”) or Hong Kong Futures Exchange Ltd (“HKFE”) in authorizing excess positions. Accordingly, if an application is one that may be dealt with by the SEHK or HKFE, it cannot be considered by the SFC.

*Subsections (10) to (12)*

26. Subsection (10) deals with the validity of authorizations, imposition of conditions and withdrawals.
27. Subsection (11) sets out key definitions.
28. Subsection (12) clarifies that any notice in the Gazette specifying futures contract or options contract as “specified contracts” for the purposes of the Rules will not be subsidiary legislation.

*Appellate jurisdiction*

29. It is worth noting that a refusal by the SFC to authorize excess positions may be appealed against to the Securities and Futures Appeals Tribunal (“SFAT”) by virtue of section 217 of the SFO and item 78 under Division 1 of Part 2 of Schedule 8 to the SFO. Decisions relating to the imposition or variation of conditions or to the withdrawal of authorizations may not be appealed against to the SFAT.

*Fees*

30. The SFC does not currently propose to impose any application fee for considering applications for authorization to hold excess positions, whether under subsection 4(5) or subsection 4(6). However, this issue will be kept under review, and fees may be imposed in future if considered necessary or appropriate. The imposition of fees will in any event require further amendments to the Rules.

**Proposed amendments to the Guidance Note**

31. The above proposal will necessitate amendments to the Guidance Note, which has been issued to help industry participants better understand how the Rules are intended to operate. The proposal will of course necessitate changes to the Guidance Note. These are set out in Appendix 2 and marked up for easy reference.
32. The proposed amendments are self-explanatory and reflect the proposed amendments to the Rules discussed above.



## **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 Data<sup>3</sup> 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 provisions<sup>4</sup> 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.

### **Enquiries**

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<sup>3</sup> Personal Data means personal data as defined in the Personal Data (Privacy) Ordinance.

<sup>4</sup> 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.

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.**

## Appendix 1

Proposed amendments to the Securities and Futures (Contracts Limits  
and Reportable Positions) Rules

**SECURITIES AND FUTURES (CONTRACTS  
LIMITS AND REPORTABLE POSITIONS)  
(AMENDMENT) (NO. 2) RULES 2007**

(Made by the Securities and Futures Commission under section 35(1)(a)  
and (b) of the Securities and Futures Ordinance (Cap. 571))

**1. Commencement**

These Rules shall come into operation on [       ] 2007.

**2. Restrictions on number of contracts held or controlled**

Section 4(4) of the Securities and Futures (Contracts Limits and Reportable Positions) Rules (Cap. 571 sub. leg. Y) is repealed and the following substituted –

“(4) A person may hold or control a futures contract or stock options contract in excess of the prescribed limit if –

- (a) the person –
  - (i) is authorized under subsection (5) to hold or control such excess; or
  - (ii) is authorized under subsection (6) to hold or control such excess;
- (b) the Commission is satisfied that the excess would not be prejudicial to the interest of the investing public having regard to the prescribed limit and the liquidity of the futures contract or stock options contract in question; and
- (c) the Commission has given the person notice in writing that it is satisfied –
  - (i) where paragraph (a)(i) applies, of the matters referred to in paragraph (b) and subsection (5); or
  - (ii) where paragraph (a)(ii) applies, of the matters referred to in paragraph (b) and subsection (8)(a), (b) and (c).

(5) The Commission may authorize a person, other than a person who may be authorized under subsection (3), to hold or control a futures contract or stock options contract in excess of the prescribed limit if the Commission is satisfied that there are special circumstances which warrant the person holding or controlling such excess.

(6) Subject to subsections (7), (8) and (9), the Commission may authorize an exchange participant or an affiliate of an exchange participant to hold or control a specified contract in excess of the prescribed limit by up to 50%.

(7) The Commission shall not authorize more than one member of a group of companies to hold or control a specified contract in excess of the prescribed limit if such authorization would result in the excess positions, in aggregate, of all members of that group of companies exceeding the prescribed limit by more than 50%.

(8) The Commission shall not authorize an exchange participant or an affiliate of an exchange participant to hold or control a specified contract in excess of the prescribed limit unless the exchange participant satisfies the Commission that –

- (a) the exchange participant or the affiliate (as the case may be) has a relevant business need for the excess for which authorization is sought;
- (b) the exchange participant or, if the Commission considers appropriate, the affiliate has adequate financial capability to cover the potential risks arising from such excess; and
- (c) the exchange participant has effective internal control procedures and risk management systems to manage the potential risks arising from such excess.

(9) The Commission shall not grant an authorization under subsection (6) if the excess for which authorization is sought may be authorized under the rules of the recognized exchange company concerned as referred to in subsection (2).

(10) An authorization granted under subsection (5) or (6) –

- (a) subject to paragraph (b), shall be valid for such period as the Commission may specify in the notice given under subsection (4)(c);
- (b) may be withdrawn by the Commission, at any time, by at least 7 days' notice in writing to the person authorized and, where the person authorized is an affiliate of an exchange participant, also to the exchange participant; and
- (c) shall be subject to such reasonable conditions as the Commission may specify in the notice given under subsection (4)(c) and the Commission may, at any time, by notice in writing to the person authorized and, where the person authorized is an affiliate of an exchange participant, also to the exchange participant, amend or revoke any such condition or impose new conditions as may be reasonable in the circumstances.

(11) In this section –  
“adequate financial capability” ( ), in relation to an exchange participant or an affiliate of an exchange participant, means such exchange participant or affiliate or his holding company having –  
    (a) a net asset value of not less than \$2 billion as set out in its latest audited financial statements; or  
    (b) a qualifying credit rating;  
“affiliate” ( ), in relation to an exchange participant, means any corporation belonging to the same group of companies as the exchange participant;  
“relevant business need” ( ), in relation to an exchange participant or an affiliate of an exchange participant, means a business need that requires such exchange participant or affiliate to engage in hedging or arbitrage activities to facilitate the provision of services to his clients;  
“specified contract” ( ) means any futures contract or stock options contract that is specified by the Commission by notice published in the Gazette for the purposes of these Rules.

(12) A notice referred to in the definition of “specified contract” in subsection (11) is not subsidiary legislation.”.

Martin WHEATLEY  
Chief Executive Officer,  
Securities and Futures Commission

2007

### **Explanatory Note**

Section 4 of the Securities and Futures (Contracts Limits and Reportable Positions) Rules (Cap. 571 sub. leg. Y) (the “principal Rules”) prohibits a person (except an authorized person) from holding or controlling a futures contract or stock options contract in excess of the prescribed limit.

2. The purpose of these Rules is to amend section 4 of the principal Rules to provide that the Securities and Futures Commission (the “Commission”) may authorize an exchange participant or its affiliate to hold or control a specified contract in excess of the prescribed limit up to a 50% ceiling if the Commission is satisfied that there is a business need for the excess and that the exchange participant has adequate financial capability and effective

internal control procedures and risk management systems to manage the potential risks arising from such excess.

## Appendix 2

Proposed amendments to the Guidance Note on Position Limits  
and Large Open Position Reporting Requirements



## GUIDANCE NOTE ON POSITION LIMITS AND LARGE OPEN POSITION REPORTING REQUIREMENTS

### 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 contracts<sup>1</sup> or options contracts<sup>2</sup> 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 SFC<sup>3</sup>.
- 1.2. The Securities and Futures (Contracts Limits and Reportable Positions) Rules (“the Rules”) were 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.
- 1.3. 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.
- 1.4. 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 contracts<sup>4</sup> 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 index futures and index options contract~~, Schedule 1 of the Rules specifies the maximum number of futures contracts for any one contract month or series that may be held or controlled by a person. In other words, the prescribed limits in this Schedule apply to individual contract months or options series. *For example, the prescribed limit on ~~a particular~~ any stock futures contract is 5,000 contracts for any one contract month. If a person longs 3,000 contracts of the September futures*

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<sup>1</sup> Section 35(1)(a)

<sup>2</sup> Section 35(1)(b)

<sup>3</sup> Section 35(1)(c)

<sup>4</sup> 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.

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 index~~ futures and ~~index~~ options contracts ~~as well as the Mini HSI futures and options contracts~~ are calculated on a net basis for all contract months combined<sup>5</sup>. 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 options contract is the delta value<sup>6</sup> of the options 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) by 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 market direction<sup>7</sup> for all expiry months combined 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 any stock options contract is 50,000 contracts in any one expiry month market direction. If a person holds 30,000 long calls ~~with strike price in month A~~, 10,000 short calls ~~with strike price in month B~~ and 10,000 long puts ~~with strike price in~~

<sup>5</sup> ~~Prescribed limits are also imposed separately on the Mini HSI futures contracts and Mini HSI options contracts for all contract months combined.~~

<sup>6</sup> 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.

<sup>7</sup> Long calls and short puts are in the same market direction; and short calls and long puts are in the same market direction.

month C (all these calls and puts are in the same expiry month), he will reach the prescribed limit on this contract for the short market direction, but will still be able to hold 20,000 more contracts for the long market direction. (The position in the long market direction is 30,000 contracts (i.e. 30,000 long calls) and the position in the short market direction is 50,000 contracts (i.e. 10,000 short calls plus 40,000 long puts).)

- 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***

(This section should be read in conjunction with paragraph 5 below on Compliance by Agents.)

- 2.6. The prescribed limits apply to all positions held or controlled by any person including positions held by the person for his own account and positions belonging to other persons but under the control of such person. 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 exercise discretion<sup>8</sup> to trade or dispose of the positions independently without the day-to-day direction of the owner of 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 positions held by its affiliates/subsidiaries) provided that such person does not give its affiliates/subsidiaries any day-to-day direction with respect to trading.

***Penalties***

- 2.8. Except as otherwise authorized by the SFC, HKFE or SEHK (please refer to paragraphs 3 below 3.1 to 3.17), 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—holds or controls 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

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<sup>8</sup> Section 7(3) of the Rules explains the situations in which a person is considered to have discretion to trade or dispose of positions independently.

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~~ Authorization 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) ~~of the Rules, or by the SFC in accordance with and~~ Section 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~~ if the person is one of those described 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 to hold or control excess positions:

~~(i)~~ (1) 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)~~ (2) 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)~~ (3) 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)~~ (4) a related corporation<sup>9</sup> 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

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<sup>9</sup> The term “related corporation” is defined in ~~s~~Section 3 of Schedule 1 of the SFO.

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 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~~ if special circumstances exist, or if the person has a relevant business need. Section 4(4) is however only applicable to situations falling outside Section 4(3). That is, the SFC will not accept applications which ~~will~~ may be dealt with by the HKFE ~~and~~ or SEHK in accordance with Section 4(3)<sup>10</sup>.

- 3.6. Pursuant to ~~this~~ Section 4(4), a person may hold or control futures contracts or stock options contracts in excess of the prescribed limits if:

~~(i)(1)~~ 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))the person is authorized to do so pursuant to either under Section 4(5) or 4(6) (Section 4(4)(a));

~~(ii)(2)~~ 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)(3)~~ 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) and 4(5) or 4(8) (Section 4(4)(c)).

***Authorization under Section 4(5) – in “special circumstances”***

- 3.7. An authorization under Section 4(5) may only be granted:

(1) to a person who is not one of those described in Section 4(3); and

(2) where such person can show that there are special circumstances which warrant his holding or controlling the excess positions in question.

- 3.8. The phrase “special circumstances” is not defined in the SFO. However, the SFC considers that the reference to “special” implies that the circumstances should normally be unique or unusual (i.e. out of the ordinary) in some way.

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<sup>10</sup> This is embodied in Section 4(9).

*Authorization under Section 4(6) – for a “relevant business need”*

3.9. An authorization under Section 4(6) may only be granted:

- (1) to an Exchange Participant or an affiliate of an Exchange Participant; and
- (2) where such person has a relevant business need for the excess positions in question.

3.10. The phrase “relevant business need” is defined in Section 4(11) and essentially means a need to engage in hedging and/or arbitrage activities as a result of providing client facilitation services. The definition is designed to ensure that excess positions are sought and authorized only for the purposes of helping Exchange Participants and their affiliates to better serve their clients, and not for purely proprietary trading. For instance, a client wants to buy a large number of futures contracts, but is concerned that the purchase will push up market prices materially and thus increase his execution prices. The Exchange Participant can facilitate this client to buy the futures contracts by selling the contracts to the client as principal over-the-counter (OTC) and then buying the futures contracts in the exchange market throughout the day to minimize the impact on market prices and to cover the OTC position established for the client. In this case, the futures contracts traded on the exchange are the proprietary positions of the Exchange Participant resulting from client facilitation activities.

3.11. The SFC’s power to grant authorizations under Section 4(6) is restricted in a number of ways. In particular:

- (1) The authorization may only be granted to persons who belong to a group of companies that includes an Exchange Participant (including the Exchange Participant) (Sections 4(4)(a)(ii) and 4(6)). This is because Exchange Participants and their affiliates generally have a greater need for holding excess positions to provide client facilitation services. In addition, Exchange Participants are licensed corporations under the SFO and therefore the SFC can better assess whether they would have the capabilities to hold excess positions and manage the resultant risks.
- (2) The authorization may only be granted in respect of futures contracts or stock options contracts that have been specified by the SFC by notice in the Gazette (Sections 4(6) and 4(11)). Such notice is not subsidiary legislation (Section 4(12)). The SFC will, from time to time, review the list of specified contracts based on market demand.
- (3) The SFC will only be able to authorize excesses of up to 50% of the prescribed limit (Section 4(6)). Moreover, this upper limit is a per group limit, i.e. it applies to the aggregate excess positions of all companies within the same group (Section 4(7)).

Example:

There are 3 members in a particular group of companies and the prescribed limit for a particular futures contract is 10,000. Assuming they each hold and control contracts independently of each other (i.e. no issue of aggregation – as discussed in paragraph 2.6 above – arises because none of the group members controls contracts held by any of the others, nor holds contracts controlled by any of the others):

▪ The maximum that the members in the group may in aggregate be authorized to hold or control is 35,000 calculated as follows:  
 $(3 \times 10,000) + 5,000 = 35,000$

▪ Subject to the above, the maximum that any one member in the group may be authorized to hold or control is 15,000 calculated as follows:

$$\underline{10,000 + 5,000}$$

However, once this 15,000 maximum is held or controlled, no other member in the same group may hold or control any excess positions.

It follows therefore that:

▪ The maximum possible excess position per group (i.e. 5,000 in the above example) does not change no matter how many members there are within the group.

▪ The maximum possible excess position of a single person does not change no matter how many members there are within the group – but once a person holds this maximum possible excess, no other person in the same group may hold or control any excess positions in the same contract.

3.12. Additionally, the SFC may only authorize excess positions under Section 4(6) if the Exchange Participant in question has –

(1) adequate financial capability to cover the potential risks arising from any authorized excess position (Section 4(8)(b)); and

(2) effective internal control procedures and risk management systems to manage such risks (Section 4(8)(c)).

This is irrespective of whether the person authorized is the Exchange Participant or one of its affiliates.

3.13. The SFC will normally look to the Exchange Participant to ensure that excess positions are properly used and any resultant risks properly managed, as that is the regulated entity within the group. Consequently, the SFC will expect a single entity within the group (normally the Exchange Participant, as that is the regulated entity) to carry the relevant positions. In other words, if any member within a group (including the Exchange Participant) is authorized to hold excess positions in a particular futures or options contract, the SFC will



normally expect all of such person's holdings in that contract (i.e. not just the excess positions) to be acquired and disposed of through an account carried by the Exchange Participant. These requirements, together with those described in paragraph 3.12(1) above will facilitate the SFC monitoring compliance with the prescribed limits and any authorized excesses.

**Application process for authorizations by the SFC**

3.7.3.14. An application for authorization from the SFC to hold excess positions ~~under Section 4(4)~~ may be submitted by the following persons:

(1) where authorization is sought under Section 4(5), either:

(i)(a) the person acting as principal for the account(s) for which the authorization is sought; or

(ii)(b) a person who acts as an agent for the principal; and

(2) where authorization is sought under Section 4(6), the Exchange Participant concerned.

3.8.3.15. The application should be made in writing to the Enforcement Supervision of Markets Division of the SFC ~~in writing.~~

3.16. 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.

3.9.3.17. ~~To meet the conditions as described in Sections 4(4)(a) and (b),~~ The SFC will normally require the applicant to provide at least the following information ~~to~~ in support of the application:

(i)(1) 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)(2) A full and complete explanation of ~~the business~~ needs for holding or controlling excess positions and (in the case of an application for authorization under Section 4(6)) how the excess positions will be used to support the business of the relevant Exchange Participant and (if applicable) the affiliate; and such explanation to include;

(a) the nature and size of the positions established, or to be established, in connection with the excess position for which authorization is sought (“related positions”), and on which market (e.g. OTC market, overseas exchange markets) such positions have been, or will be, executed;



~~(iii)(b)~~ An estimate of the maximum level of the excess positions intended to be established; and

~~(iv)(c)~~ The estimated duration of holding or controlling the excess positions;

(3) in the case of an application for authorization under Section 4(6), details of:

(a) the relevant Exchange Participant's and (if applicable) the affiliate's financial position, such information to be sufficient to demonstrate that the Exchange Participant or affiliate has adequate financial capability to cover the potential risks arising from the excess position<sup>11</sup>, and should normally include at least its latest annual audited accounts and information on its credit rating (if any);

(b) the relevant Exchange Participant's internal control procedures and risk management systems, such information to be sufficient to demonstrate that the Exchange Participant has effective internal control procedures and risk management systems to manage the potential risks arising from the excess position<sup>12</sup>, and should normally include at least the following:

(i) a brief summary of the risk management policies and procedures that will be adopted to monitor and address the key risks connected with the excess position (such as market risk, concentration risk, etc), including:

▪ the counterparty due diligence process that the Exchange Participant or its affiliate (as the case may be) will use when assessing the counterparty risk of clients who are, or will be, provided client facilitation services by the Exchange Participant or its affiliate in relation to the excess position held or controlled by it

▪ the contingency measures that will be applied to minimize the impact of a default by the counterparties, including the procedures for dealing with the excess position in the event of such default

<sup>11</sup> This is required by Section 4(8)(b). The term "adequate financial capability" is defined in Section 4(11), i.e. the person or its holding company should have a net asset value of not less than HK\$2 billion as set out in its latest audited financial statements or a qualifying credit rating (defined in Part 5 of Schedule 1 of the SFO).

<sup>12</sup> This is required by Section 4(8)(c).

- the techniques that will be used to measure, monitor, control and reduce various types of risks arising as a result of the excess position and the related position
- (ii) a brief summary of the internal control procedures that will be put in place to ensure implementation of the risk management policies and procedures mentioned in the preceding sub-paragraph (i).

Depending on the facts and circumstances of each individual case, the SFC may also request other information as it considers necessary. The SFC may also have regard to any information or material in its possession which it considers relevant.

3.12.3.18. The SFC will determine ~~whether the applicant shall be approved an application~~ 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 other factors as the SFC deems appropriate ~~to ensure that the circumstances in Sections 4(4)(a) and (b) are satisfied.~~

3.13.3.19. As a guiding principle, the SFC will not grant an authorization for any excess if the ~~circumstances in Sections 4(4)(a) and (b)~~ relevant preconditions<sup>13</sup> are not satisfied, or if the authorization is inconsistent with the SFC's regulatory objectives in Section 4 of the SFO, in particular:

~~(i)~~ (1) to maintain and promote the fairness, efficiency, competitiveness, transparency and orderliness of the securities and futures industry;

~~(ii)~~ (2) to reduce systemic risks in the securities and futures industry; or

~~(iii)~~ (3) 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.

3.14.3.20. The SFC may decide to approve or deny the application or impose conditions on the authorization. Conditions imposed on an authorization may be varied or revoked subsequently. New conditions may also be imposed (Section 4(10)(c)). A notice of decision will be provided to the applicant in writing (Section 4(4)(c)).

3.24.3.21. The SFC will endeavour to notify the applicant of its decision within ~~ten business days~~ four weeks 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(45) are special cases, it may take more time for the SFC to consider and review some

<sup>13</sup> Relevant preconditions here refers to (in relation to an application under Section 4(5)), the limitations and other matters described in Sections 4(4)(b) and 4(5); and (in relation to an application under Section 4(6)), the limitations and other matters described in Sections 4(4)(b), 4(6), 4(7) and 4(8).

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.

**Validity and renewal of authorizations by the SFC**

~~3.14.3.22.~~ A person who has ~~received the authorization from~~ been authorized by the SFC ~~to hold or control an excess position within a certain period of time under Section 4(5) or 4(6)~~ 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~~ ten 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.~~

**Withdrawal of authorizations by the SFC**

~~3.23.~~ The SFC may at any time withdraw an authorization granted under Section 4(5) or 4(6) by giving at least seven days' notice to the person (Section 4(10)(b)). Upon a withdrawal coming into effect, the authorization will cease to apply.

~~3.24.~~ In determining the effective date of a withdrawal, the SFC will consider:

- ~~(1)~~ whether any excess positions are already held or controlled and if so, whether they are within the limits of the authorization previously granted;
- ~~(2)~~ when the relevant contracts are due to expire;
- ~~(3)~~ whether the withdrawal may be delayed until the time of such expiry taking into account the reasons for the withdrawal.

~~3.25.~~ As a guiding principle, the SFC will not normally consider withdrawing an authorization unless it believes:

- ~~(1)~~ one or more of the relevant preconditions<sup>14</sup> cease to exist;
- ~~(2)~~ the authorization ceases to be consistent with the SFC's regulatory objectives in Section 4 of the SFO; or

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<sup>14</sup> See footnote 13 above.

- (3) one or more of the conditions attached to the authorization have failed to be met and adequate steps have not been taken, or cannot be taken, to rectify the failure and avoid similar failures in future.

### Appeals

~~3.16.3.26.~~ A person may appeal against a decision of the SFC to refuse to authorize an excess position under Section 4(45) or 4(6) of the Rules to the Securities and Futures Appeals ~~Panel~~-Tribunal (“Tribunal”) pursuant to Section 216 of the SFO<sup>15</sup> (Section 4(4)(c) and item 78 under Division 1 of Part 2 of Schedule 8 of the SFO). 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~~ in accordance with the decision of the SFC.

### Positions held or controlled indirectly by virtue of corporate relationship

~~3.17.3.27.~~ As discussed in paragraph ~~2.72.7~~ above, 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 (including any or holding company), which indirectly controls the same positions by virtue only 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*

- 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 month<sup>16</sup> or series while the reportable positions for stock options contracts are calculated based on the number of contracts held or controlled in an expiry month.

<sup>15</sup> ~~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.~~

<sup>16</sup> 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.

- 4.3. The aggregation requirements as mentioned in paragraphs [2.6-2.6](#) and [2.7-2.7](#) above 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:

[\(i\)\(1\)](#) a person (e.g. the Exchange Participant) acting as an agent for the principal to carry the account of the reportable position; or

[\(ii\)\(2\)](#) the person acting as principal for 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 agent where the latter agrees to make the report on the person's behalf. 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 agent, 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 agents, it should provide to one agent its total positions held at other agents so that the agent can submit the notice of the reportable position to the Exchange on its behalf. Alternatively, the person can ask all agents to separately report positions in each of the accounts to the Exchange even though positions in the individual accounts may not exceed 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:

[\(i\)\(1\)](#) the day on which the person first holds or controls the reportable positions; and

[\(ii\)\(2\)](#) 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 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)~~(1) 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)~~(2) where the reportable position is held or controlled for another person (e.g. a client), the identity of that person and the number of futures contracts or stock options contracts held or controlled for such person in respect of the reportable position in each relevant contract month.

In respect of the information about the identity of a client, the requirements are 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.
- 4.11. Appendix 1 provides examples to illustrate the application of the prescribed limits and reportable positions.

***Other reporting requirements specified by the HKFE/SEHK***

- 4.12. 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 positions<sup>17</sup>.
- 4.13. The HKFE and SEHK also request Exchange Participants to provide additional information other than those specified in Section 6(2) such as (i) the account number, account name and identity of the transaction originator of a reportable position; (ii) the nature of a reportable position (i.e. for hedging, arbitrage or trading purposes); and (iii) the account type (i.e. house account, client account or market maker account). Exchange Participants should refer to the relevant position reporting procedures prescribed by the HKFE or SEHK for details.

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<sup>17</sup> HKFE requires Exchange Participants to submit the notice of reportable positions by 12:00 noon on the reporting day (T+1).

- 4.14. In order to assess the systemic impact of large reportable positions on the market and monitor concentration risk more effectively, the HKFE and SEHK may make enquiries into transactions/positions in other markets (e.g. OTC market) underlying the reportable positions held by Exchange Participants. For this reason, Exchange Participants may be requested by the HKFE or SEHK to obtain details of such transactions/positions from the clients or their counterparties. Failure to provide such information to the HKFE or SEHK could lead to the imposition of position limits other than the prescribed limits according to the HKFE or SEHK rules.

***Penalties***

- 4.15. 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 Agents**

- 5.1. Section 7 of the Rules enables a person who holds or controls futures contracts or stock options contracts for other persons to apply the prescribed limits and reportable positions separately to his own position and to each of the positions he holds or controls for other persons except where the person has discretion over the positions held or controlled by him for the other persons. In other words, a person can disaggregate his own position and the positions he holds or controls for each of the other persons in the application of prescribed limits and reportable positions provided that he does not have discretion over the positions held or controlled for the other persons. A typical example of such person is an Exchange Participant or a person providing intermediary services to its clients.
- 5.2. In accordance with Sections 7(2) and (3) of the Rules, a person will be considered to have discretion in relation to a position he holds or controls for another person if:

(i)(1) he may originate orders to acquire or dispose of any position in futures contracts or stock options contracts under a general authorization from the other person, whether the authorization is pursuant to a written agreement, power of attorney or otherwise; and

(ii)(2) such authorization enables him to make specific acquisitions or disposals without requiring further consent or instruction from the other person.

and in such case, he will not be regarded as holding or controlling the position for the other person for the purpose of applying the disaggregation provision to this position.

Examples of such person include a fund manager controlling positions for his funds and a trader managing discretionary accounts. However, it does not

include a trader with a short-term discretion from his client to manage an order (e.g. if a client leaves an order to buy or sell futures contracts at any price within a specified range, the agent will not be regarded as having discretion) or a firm initiating orders to close out a position held for its client for risk control purposes (e.g. the client has defaulted on his payment to the firm).

- 5.3. If a person has discretion over positions held with him for other persons, all these positions should be aggregated with his own position in the application of the prescribed limits and reportable positions.
- 5.4. *For example, an agent holds 400, 3,000, and 8,000 futures contracts for Clients A, B and C respectively. Client A is a discretionary account operated by the agent. The agent also holds 200 futures contracts for his own account. Since the agent has discretion over the position held for Client A, the agent's own position and Client A's position should be aggregated in the application of the prescribed limits and reportable positions. Assume that the reportable level is 500 contracts and the prescribed limit is 10,000 contracts. The agent should notify the Exchange of each of the reportable positions held with him (i.e. 600 contracts held by its own account and Client A, 3,000 contracts held by Client B and 8,000 contracts held by Client C) and identities of the persons. Since these reportable positions are within the prescribed limit, the agent fully complies with the Rules.*
- 5.5. If a person is aware that a number of its client accounts are held for the same person, all positions in these accounts should not be treated separately. They should be aggregated for purposes of determining compliance with the Rules.
- 5.6. There are situations where a person holds or controls positions for the other person who is acting as agent. In accordance with the Client Identity Rule Policy, a person holding or controlling positions for an agent should find out who are the ultimate clients and obtain the client identity information from the agent. As an agent is allowed to disaggregate positions held for his clients, his total positions may exceed the prescribed limits even though each of the client positions is within the limits. The SFC accepts that a person is in compliance with the prescribed limits in respect of the positions held for an agent provided that he has obtained the client identity information to determine that the agent is allowed to hold excess positions in accordance with the Rules. If the person is not able to obtain the client identity information to decide whether the agent complies with the prescribed limits (e.g., the agent does not want to disclose the information for commercial reasons), the person should not apply the disaggregation provision to this agent account (i.e., all positions held by the agent should be aggregated in applying the prescribed limits).

## **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 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.
- 6.3. For the avoidance of doubt, if a person holds a reportable position but only part of the position (which has not exceeded the reportable level) is held by a firm, the firm will not need to report that position to the Exchange unless it knows that the total position held by the person in other firms has exceeded the reportable level.

***Transaction originators***

- 6.4. A transaction originator is a person who is ultimately responsible for originating instructions for transactions on behalf of the other person. 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. As explained in paragraph [5.25.2 above](#), since the transaction originator has discretion in relation to positions he holds or controls for his principals, he is not allowed to disaggregate the positions held or controlled for each of the principals for the purpose of applying the Rules.
- 6.5. If the total positions controlled by a transaction originator (including positions belonging to different principals, e.g., different funds, but under his control) have exceeded 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 of his principals whose positions have exceeded 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 the reportable level (i.e., Fund A and Fund B) and the positions held in these funds.*
- 6.6. 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 agent (e.g. an Exchange Participant) which agrees to make the report on his behalf.
- 6.7. The prescribed limits apply to the total positions controlled by a transaction originator even if the positions are held for different principals.

***Omnibus accounts***

- 6.8. In the case of an omnibus account, the Rules apply separately to the positions held by each of the underlying clients of the omnibus account except where the omnibus account operator has discretion over the positions. For this reason, positions held by different underlying clients should not be netted off

for purposes of calculating and reporting reportable positions or determining compliance with the prescribed limits.

- 6.9. -If an underlying client of the omnibus account holds or controls a reportable position, the omnibus account operator should inform the HKFE or SEHK (as the case may be) of such reportable position. An omnibus account operator can notify the Exchange of the reportable positions by itself or ask its agent (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 positions have exceeded the reportable level.
- 6.10. 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 including identities of each of them (either by itself or through its agent), 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:

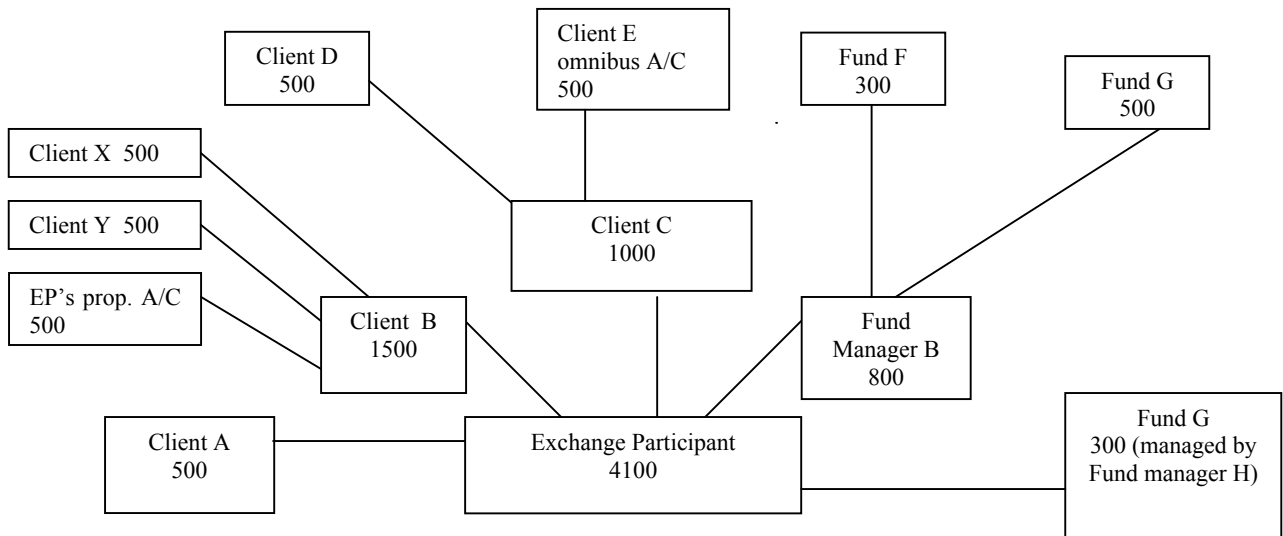
*Suppose that Exchange Participant A has an omnibus account B holding 1,000 long futures contracts. One of the underlying clients of omnibus account B is also an omnibus account (account C) which holds 900 long futures contracts. Positions in omnibus account C are owned by Company D (800 long futures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

- 6.11. Where the omnibus account operator has discretion over positions held with it, it should aggregate such positions with its own position in the application of the prescribed limits.

## Appendix 1

For example: Reportable Position is 450 contracts



**Client A** has an account with the Exchange Participant which contains 500 contracts.

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 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. Provided that the Exchange Participant does not have discretion over Client X's and Client Y's positions, Client X, Client Y and the Exchange Participant's proprietary position can each be treated separately (i.e., disaggregated) by virtue of [Section 7](#) of the Rules.

**Client C** is a non-exchange participant agent. He holds positions for Clients D and E who have 500 contracts each. Client E is an omnibus account. Provided that Client C does not have discretion over Client D's and Client E's positions, positions held for Clients D and E can be treated separately. In respect of the omnibus account itself, if the operator of Client E does not have discretion over positions in the account, it can apply disaggregation to the positions held for each of the underlying clients.

**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 held for Funds F and G cannot be treated separately as Fund Manager B has discretion over these positions.

### Notices of Reportable Positions to be filed –

(a) the Exchange Participant should notify the Exchange of –

- 500 contracts each for its proprietary position and Client A, 1500 contracts held by Client B, 1000 contracts held by Client C, and 800 contracts held by Fund Manager B.

- (b) Client B should notify the Exchange of 500 contracts each held by 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 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 agent or the person acting as principal (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.