



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

**Consultation Conclusions on Proposed Enhancements  
to the Position Limit Regime and Associated  
Amendments to the Securities and Futures (Contracts  
Limits and Reportable Positions) Rules and the  
Guidance Note on Position Limits and Large Open  
Position Reporting Requirements**

21 March 2017

## Table of Contents

<b>Executive Summary</b>	<b>1</b>
<b>Comments Received and Our Responses</b>	<b>2</b>
<b>I. Client Facilitation Excess Position Limit</b>	<b>2</b>
<b>II. ETF Market Maker Excess Position Limit</b>	<b>4</b>
<b>III. Index Arbitrage Activity Excess Position Limit</b>	<b>4</b>
<b>IV. Asset Manager Excess Position Limit</b>	<b>5</b>
<b>V. Stock Options Contracts Position Limit</b>	<b>6</b>
<b>VI. Proposed Amendments to the CLRP Rules and the         Guidance Note</b>	<b>6</b>
<b>Conclusions and Way Forward</b>	<b>7</b>
<b>Appendix A – List of Respondents</b>	
<b>Appendix B – Revised Securities and Futures (Contracts Limits and Reportable Positions) Rules (Cap 571Y)</b>	
<b>Appendix C – Revised Guidance Note on Position Limits and Large Open Position Reporting Requirements</b>	

## Executive Summary

1. On 20 September 2016, the Securities and Futures Commission (SFC) issued a public consultation proposing a number of enhancements to the position limit regime (Consultation Paper). The SFC sought comments on these policy proposals and modifications to the Securities and Futures (Contracts Limits and Reportable Positions) Rules (CLRP Rules) to reflect the proposed enhancements.
2. During the consultation period, which ended on 21 November 2016, the SFC received 10 written submissions from various market participants and professional bodies. The list of respondents is set out in Appendix A, and their comments (unless requested to be withheld from publication) can be viewed on the SFC's website.
3. This paper sets out the SFC's conclusions and responses to the comments received as well as the way forward after taking the public feedback into account. This conclusions paper should be read in conjunction with the corresponding Consultation Paper.
4. In general, most respondents were supportive of the proposals to enhance the position limit regime, although a number of them suggested that the SFC should consider relaxing some requirements and criteria for the proposed excess position limits.
5. After carefully considering the comments received, the SFC is of the view that the proposals in the Consultation Paper are appropriate for the Hong Kong market and will proceed accordingly. However, in response to market feedback, the SFC has decided to lower the assets under management (AUM) requirement applicable to the proposed Asset Manager Excess Position Limit from \$100 billion to \$80 billion.
6. There were no substantive comments on the amendments to the CLRP Rules as proposed in the Consultation Paper. The SFC will make corresponding changes to the CLRP Rules to reflect the lower AUM requirement. The SFC will also take the opportunity to add statutory position limits and large open position reporting requirements for a number of new futures contracts to Schedule 1 to the CLRP Rules. These amendments are routine amendments to the CLRP Rules related to new futures and options contracts launched by Hong Kong Exchanges and Clearing Limited (HKEX).
7. The SFC is planning to submit the proposed amendments to the Legislative Council for negative vetting before the end of March 2017. Subject to the legislative process, we expect the amended CLRP Rules to become effective on 1 June 2017.

## Comments Received and Our Responses

### I. Client Facilitation Excess Position Limit

8. In the Consultation Paper, the SFC proposed to raise the cap on the excess position limit that may be granted under the existing Client Facilitation Excess Position Limit from 50% to 300% and to tighten the adequate financial capability requirement by increasing the net asset value (NAV) requirement from \$2 billion to \$5 billion. The majority of the respondents supported the proposal to increase the cap to 300% and considered that the proposed increase in the NAV requirement is consistent with market growth.

#### Cap on the Excess Position Limit

##### *Public comments*

9. One respondent commented that the SFC should consider granting an excess limit of 300% to all successful applicants rather than treating it as an upper limit. The respondent was also of the view that the proposed 300% cap is still very conservative compared to other markets. Another respondent commented that setting a constant upper cap on the excess position limit makes it too rigid to cater for future changes and the SFC should consider future needs in determining the cap.

##### *The SFC's response*

10. We would like to reiterate that our purpose in raising the cap on the excess position limit is to facilitate the use of exchange-traded contracts by market participants to meet their business needs, but we are also mindful of potential risks associated with increased positions. Rather than authorizing the use of the upper limit by all successful applicants, it is important to consider the actual need of each applicant on a case-by-case basis and to determine the level of excess position after taking relevant factors into account, including prevailing market conditions. Furthermore, it is worth noting that, as mentioned in our Consultation Paper, our analysis of Hang Seng Index (HSI) and Hang Seng China Enterprises Index (HHI) futures and options markets showed that the existing position limit should be sufficient to meet the business needs of the majority of market participants. Thus, we believe the six-fold increment to 300% should be sufficient. Furthermore, the SFC will conduct ongoing reviews in the future to consider if there is a need for any further changes.

#### Tightening the "Adequate Financial Capability" Requirement

##### *Public comments*

11. We received support from respondents to tighten the "adequate financial capability" requirement, but views varied on how it should be tightened. One respondent suggested setting a lower minimum financial requirement and increasing it on a case-by-case basis. Some respondents commented that a scaled financial requirement should be implemented in accordance with the actual excess position limits granted by the SFC.

##### *The SFC's response*

12. As explained in the Consultation Paper, we are of the view that the "adequate financial capability" requirement should be kept simple to minimise any compliance burden. Thus, we believe the minimum NAV requirement of \$5 billion is appropriate. It is also important

for us to ensure that all applicants have reached a sufficient business scale and have sufficient resources to manage the risks of the excess positions granted.

### Transitional arrangements for the “Adequate Financial Capability” Requirement

#### *Public comments*

13. One respondent enquired about the transitional arrangements for existing applicants in relation to the tightening of the “adequate financial capability” requirement.

#### *The SFC’s response*

14. In formulating the proposed requirement, we reviewed its potential impact on all existing applicants. Based on available information, our assessment indicated that the proposal should not have any adverse impact on existing applicants as they all are able to meet the new “adequate financial capability” requirement. Prior to the implementation of the proposal, the SFC will continue to monitor the situation and hold discussions with existing applicants if needed.

### Further clarification of client facilitation and the assessment criteria

#### *Public comments*

15. One respondent commented that the SFC should provide more clarity on the definition of client facilitation as well as the application process, whilst another respondent considered that the application assessment criteria and process are not sufficiently clear and transparent.

#### *The SFC’s response*

16. The term “client facilitation” is broadly defined as catering for different business needs and arrangements that require an Exchange Participant (or its affiliate) to engage in hedging activities to facilitate the provision of services to its clients. This is set out in section 3 of the existing Guidance Note on Position Limits and Large Open Position Reporting Requirements (Guidance Note) which includes an example to explain client facilitation. We revised the Guidance Note to set out the application process and required documents for each type of excess position limit. As is our current practice, the SFC encourages potential applicants to contact us should they have any questions about the application process or requirements.

### Introduction of Hedging Exemptions

#### *Public comments*

17. There was a comment that the SFC should consider introducing hedging exemptions similar to those offered in overseas markets to encourage and promote bona fide risk management activities.

#### *The SFC’s response*

18. We would like to explain that the existing Client Facilitation Excess Limit and the new proposed excess limits are intended to provide a mechanism for market participants to use exchange-traded futures and options to hedge their relevant business activities. Based on our previous engagement with market participants, we consider that the proposed excess limits will be able to meet their hedging needs. At this stage, we do not consider it necessary to introduce a blanket hedging exemption.

## **II. ETF Market Maker Excess Position Limit**

### *Public comments*

19. Respondents were supportive of the proposed exchange traded fund (ETF) Market Maker Excess Position Limit, where an ETF market maker or liquidity provider may be authorized by the relevant recognized exchange company to hold or control futures or stock options contracts in excess of the statutory prescribed limit for hedging purposes.
20. One respondent commented that there should be some requirements or guidance on the eligibility of ETF market makers and liquidity providers so as to avoid abuse or misuse. The respondent noted that while some ETF market makers make a market for more than 100 ETFs, others may make a market for only one ETF. Therefore not all ETF market makers have the same needs and capabilities for handling excess positions.

### *The SFC's response*

21. We would like to clarify that the proposed ETF Market Maker Excess Position Limit will be applicable mainly to market makers for ETFs tracking the HSI or HHI. Other ETF market makers will not be eligible for the proposed excess position limit. In addition, similar to existing provisions for other market makers or liquidity providers, the relevant recognized exchange company will have appropriate rules and guidelines in place to monitor potential abuse or misuse by ETF market makers.

## **III. Index Arbitrage Activity Excess Position Limit**

### *Public comments*

22. Respondents generally supported the proposed Index Arbitrage Activity Excess Position Limit and agreed to the proposed definition of "index arbitrage". Two respondents who requested anonymity suggested some changes to the proposed definition. We reviewed their suggestions but consider that the definition need not be revised.
23. Respondents were mostly supportive of the proposed eligibility criteria for the Index Arbitrage Excess Position Limit applicable to an Exchange Participant or its affiliate. However, one respondent was concerned about potential abuse by applicants, as monitoring of index arbitrage activities might be difficult, and suggested that the SFC should issue further guidance to ensure that the excess position limit granted will be used solely for index arbitrage activities. The respondent was also of the view that a segregated account should be established solely for index arbitrage activities in order to facilitate the monitoring of positions by regulators and Exchange Participants.

### *The SFC's response*

24. We agree that both the SFC and the applicant should have the ability to distinguish and monitor the use of excess position limits for index arbitrage activities. We therefore propose that as part of the SFC's assessment of the applicant's internal control procedures, we would expect the applicant to have a standalone trading desk/book to conduct its index arbitrage activities.
25. In light of the comments received, we studied a number of index arbitrage manipulation cases, including in overseas markets. We noted that in some cases, the firms

established additional proprietary positions to take advantage of the price movements caused by the unwinding of index arbitrage positions. To further address the risk of misuse or abuse, the SFC will take into consideration whether the applicant has in place a Chinese wall (or equivalent internal control measures) between its index arbitrage trading desk and other trading desks. To detect and prevent potential misuse or abuse, we will also ask the applicant to demonstrate, to the satisfaction of the SFC, the effectiveness of its internal controls and compliance monitoring process.

26. Accordingly, we amended paragraph 3.25 of the Guidance Note to reflect the additional requirements proposed above.

#### **IV. Asset Manager Excess Position Limit**

##### *Public comments*

27. All respondents agreed with the proposal to introduce an Asset Manager Excess Position Limit, and one respondent was of the view that the proposal will promote Hong Kong as an asset management centre.
28. Most respondents were supportive of the proposed eligibility requirements for the Asset Manager Excess Limit. However, a number of respondents raised concerns about the proposed AUM requirement of \$100 billion. These concerns largely fall into two areas: i) the rationale for setting this requirement; and ii) that the requirement is much higher than the AUM size of many asset managers, particularly hedge fund managers. We also received a comment suggesting the eligibility criteria be expanded to allow not only entities licensed or registered for Type 9 regulated activity but also all equivalent regulated entities in overseas jurisdictions.

##### *The SFC's response*

29. We would like to further explain the rationale for setting the AUM requirement. We estimated that on average, the aggregate notional value of statutory position limits for HSI futures and options as well as HHI futures and options contracts amounted to \$16 billion from 1 July 2015 to 30 June 2016. As mentioned in the Consultation Paper, the proposed Asset Manager Excess Position Limit is intended to facilitate portfolio management. We therefore expected that asset managers who sought to apply for excess position limits would invest only a part of their funds in futures and options contracts. Based on various estimates, we made the assumption that the majority of large asset managers would invest 10% to 20% of their portfolio value in derivatives products. Therefore, an asset manager with an AUM ranging from \$80 to \$160 billion could reach the statutory position limits and need to seek an excess position limit. It is on this basis that we proposed to set the AUM requirement at the lower end of the range, ie, \$100 billion. In view of respondents' requests to lower the AUM requirement, the SFC is agreeable to lowering the proposed AUM requirement to \$80 billion.
30. As to the comments that many smaller-sized asset managers (as measured by AUM) would be excluded from the proposed excess position limit, we noted that according to the SFC's Fund Management Activities Survey, the fund size of asset managers in Hong Kong averaged \$17 billion in 2014 and \$15 billion in 2015. Given the small average fund size relative to the notional value of the statutory position limits, the SFC is of the view that the current position limits should be sufficient to cater for the needs of smaller-sized asset managers.

31. It is important for the SFC to have a direct regulatory handle on the utilisation of excess position limits. We are therefore of the view that it would not be appropriate to expand the eligibility criteria for the proposed excess position limit to cover equivalent regulated entities in overseas jurisdictions.

## **V. Stock Options Contracts Position Limit**

### *Public comments*

32. All respondents were supportive of the proposed increase in the statutory position limit for stock options to facilitate market development. Most respondents also supported the proposal to increase the statutory position limit from 50,000 to 150,000 contracts. However, one respondent expressed the view that the single limit of 150,000 contracts is inconsistent with HKEX's proposed three-tier position limits (ie, 50,000, 100,000 and 150,000 contracts), and that this might create unnecessary confusion as well as administrative burdens for exchange participants and market makers.

### *The SFC's response*

33. As we explained in the Consultation Paper, the proposal to increase the statutory position limit to 150,000 contracts is intended to facilitate the implementation of HKEX's proposed three-tier position limit model, which will re-assign the position limit tier levels for stock option contracts based on a pre-determined formula on a regular or an ad-hoc basis. If the statutory position limit for stock options were to be set at three tiers, corresponding to those proposed by HKEX, then future new tier levels assigned by HKEX as a result of its regular or ad-hoc reviews could not be implemented until after the completion of legislative amendments to the CLRP Rules. For this reason, the SFC considers it appropriate to maintain the proposed increase in the statutory position limit of stock options contracts to 150,000. The proposal is also consistent with the existing approach for the statutory position limit for stock options.

## **VI. Proposed Amendments to the CLRP Rules and the Guidance Note**

34. No substantive comments were received on the proposed amendments to the CLRP Rules. Apart from a change to reflect the revised AUM requirement and a few editorial changes, we will adopt the amendments to the CLRP Rules as proposed. Also, a few minor changes will be made to existing definitions of some terms used in the CLRP Rules for the purpose of clarity; these changes do not affect the substantive content of the definitions<sup>1</sup>. Moreover, the SFC is taking this opportunity to add the statutory position limits and large open position reporting requirements for a number of new futures contracts into Schedule 1 to the CLRP Rules. For details, please refer to items 5, 13, 18, 19 and 20 in Schedule 1. The SFC is also making a few minor drafting amendments to the descriptions of futures contracts referred to in items 4, 5 and 9 in Schedule 1 so that the descriptions in Schedule 1 are consistent. These amendments are not related to the consultation but are part of the regular amendments to the CLRP Rules made by the

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<sup>1</sup> The definitions of "adequate financial capability" and "specified contract" in Section 2(1) are amended.



SFC in relation to new futures and options contracts launched by HKEX and for housekeeping purposes.

35. Similarly, we also did not receive any substantive comments on proposed changes to the Guidance Note. Therefore, we will adopt the changes as proposed along with the additional provisions for assessing an applicant's internal control procedures for the Index Arbitrage Activity Excess Position Limit as discussed above.

## **Conclusions and Way Forward**

36. After considering all comments and suggestions, the SFC concludes that the proposals as set out in the Consultation Paper will be adopted, with the exception of the AUM requirement applicable to the Asset Manager Excess Position Limit, which will be lowered from \$100 billion to \$80 billion.
37. The SFC is planning to submit the proposed amendments to the CLRP Rules to the Legislative Council for negative vetting before the end of March 2017. Subject to the legislative process, we expect the amended CLRP Rules to become effective on 1 June 2017.

### List of Respondents

(in alphabetical order)

1. CompliancePlus Consulting Limited
2. Futures Industry Association
3. Hong Kong Investment Funds Association
4. I-Access Investors Limited
5. Simmons & Simmons on behalf of itself and Samsung Asset Management (Hong Kong) Limited
6. The Law Society of Hong Kong
7. Anonymous – two respondents requested not to publish their identities
8. Anonymous – two respondents requested not to publish their identities and contents of their submissions

**Revised Securities and Futures (Contracts Limits and Reportable Positions) Rules (Cap 571Y)**



## Securities and Futures (Contracts Limits and Reportable Positions) Rules

(Cap 571, section 35(1))

1 (Omitted as spent)

### 2 Interpretation

(1) In these Rules, unless the context otherwise requires—

**adequate financial capability** (充足財政能力), in relation to an exchange participant or an affiliate of an exchange participant, means any one of the exchange participant, the affiliate or their holding company, has—

- (a) a net asset value of not less than \$5 billion as set out in its latest audited financial statements; or
- (b) a qualifying credit rating;

**affiliate** (聯屬公司), in relation to an exchange participant, means any corporation belonging to the same group of companies as the exchange participant;

**constitutive documents** (組成文件), in relation to a collective investment scheme, means the principal documents governing the establishment of the scheme;

**exchange traded fund** (交易所買賣基金) means an open-ended collective investment scheme the shares or units of which are listed or traded on a recognized stock market;

**Listing Rules** (《上市規則》) means the Rules Governing the Listing of Securities on the Stock Exchange of Hong Kong Limited made by the Stock Exchange Company;

**offering document** (要約文件), in relation to a collective investment scheme, means a document—

- (a) inviting participation in the scheme by prospective shareholders or prospective unit holders of the scheme; and
- (b) containing information relating to the establishment or administration of the scheme)

**open-ended collective investment scheme** (開放式集體投資計劃) means a collective investment scheme the shares or units of which may be repurchased or redeemed at the request of any of its shareholders or unit holders—

- (a) at a price calculated wholly or mainly by reference to the net asset value of the scheme; and
- (b) in accordance with the frequency for repurchase or redemption, requirements and procedures set out in the offering document or constitutive documents of the scheme;

**prescribed limit** (訂明上限), in relation to a futures contract or a stock options contract, means the limit on the number of contracts prescribed for it under section 5;

**reportable position** (須申報的持倉量) means an open position in futures contracts or stock options contracts the number of which is—



- (a) in the case of a futures contract specified in column 2 of Schedule 1, in excess of that specified opposite to it in column 4 of that Schedule; and
- (b) in the case of a stock options contract specified in column 2 of Schedule 2, in excess of that specified opposite to it in column 4 of that Schedule;

**specified contract** (指明合約) means any of the following futures contracts—

- (a) Hang Seng Index futures contracts and options contracts;
- (b) Hang Seng China Enterprises Index futures contracts and options contracts;

**specified percentage** (指明百分率) means 300%.

- (2) For the purposes of these Rules, a reference to control, in relation to futures contracts or stock options contracts, shall be construed as a reference to control of such futures contracts or stock options contracts, either directly or indirectly.

### **3 Application**

These Rules apply to futures contracts and stock options contracts that are traded through the facilities of a recognized exchange company in accordance with the rules of the recognized exchange company.

### **4 Restrictions on number of contracts held or controlled**

- (1) No person, other than a person referred to in subsections (2) and (3), may hold or control futures contracts or stock options contracts in excess of the prescribed limit.
- (2) A person specified in section 4A may be authorized under the rules of the recognized exchange company concerned to hold or control futures contracts or stock options contracts in excess of the prescribed limit.
- (3) A person may hold or control a futures contract or stock options contract in excess of the prescribed limit if the person is authorized by the Commission to do so under section 4B, 4C, 4D or 4E.
- (4) The Commission may, under section 4B, 4C, 4D or 4E, authorize a person to hold or control a futures contract or stock options contract in excess of the prescribed limit—
  - (a) except in circumstances where holding or controlling 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);
  - (b) only if 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) by giving the person a notice of authorization in writing.
- (5) An authorization granted under section 4B, 4C, 4D or 4E—
  - (a) subject to paragraph (b), is valid for the period (if any) that the Commission may specify in the notice of authorization given under subsection (4)(c);



- (b) may be withdrawn by the Commission, at any time, by at least 5 business 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) is subject to any reasonable conditions that the Commission may specify in the notice of authorization given under subsection (4)(c) and the Commission may, at any time, by at least 5 business 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, amend or revoke any condition or impose new conditions as may be reasonable in the circumstances.

#### **4A Authorization under rules of recognized exchange company to hold or control contracts in excess of prescribed limit**

A person who may be authorized for the purposes of section 4(2) is—

- (a) a person registered with the Futures Exchange Company for the purpose of performing market making or liquidity providing activities in respect of futures contracts in accordance with its rules;
- (b) a person registered with the Stock Exchange Company for the purpose of performing market making or liquidity providing activities, in accordance with its rules—
  - (i) in respect of stock options contracts; or
  - (ii) in respect of exchange traded funds, where the person holds or controls futures contracts or stock options contracts in the course of hedging the risks arising from performing market making or liquidity providing activities;
- (c) 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; or
- (d) a related corporation 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.

#### **4B Authorization by Commission to hold or control contracts in excess of prescribed limit in special circumstances**

Subject to section 4(4)(a) and (b), the Commission may authorize a person 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 the excess.



**4C Authorization by Commission to hold or control contracts in excess of prescribed limit for purposes of facilitating provision of services to clients**

- (1) Subject to subsection (2) and section 4(4)(a) and (b), 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 the specified percentage.
- (2) The Commission must 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 holding or controlling the excess for which authorization is sought;
  - (b) either the exchange participant or the affiliate has adequate financial capability to cover the potential risks arising from the excess; and
  - (c) the exchange participant has effective internal control procedures and risk management systems to manage the potential risks arising from the excess.
- (3) In this section—

**relevant business need** (相關業務需要), in relation to an exchange participant or an affiliate of an exchange participant, means a business need that requires the exchange participant or the affiliate to engage in hedging activities to facilitate the provision of services to its clients.

**4D Authorization by Commission to hold or control contracts in excess of prescribed limit for purposes of index arbitrage activity**

- (1) Subject to subsection (2) and section 4(4)(a) and (b), 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 the specified percentage.
- (2) The Commission must 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) engages in index arbitrage activities, and will, if authorization is granted, hold or control the excess for the purposes of those activities;
  - (b) either the exchange participant or the affiliate has adequate financial capability to cover the potential risks arising from the excess; and
  - (c) the exchange participant has effective internal control procedures and risk management systems to manage the potential risks arising from the excess.
- (3) In this section—

**index arbitrage** (指數套戩), in relation to an exchange participant or an affiliate of an exchange participant, means a trading strategy engaged in by the exchange participant or the affiliate—

- (a) involving—



- (i) the purchase (or sale) of a stock index futures contract; or
  - (ii) the purchase (or sale) of a stock index call options contract together with the sale (or purchase) of a stock index put options contract, where both contracts have the same underlying index, expiry date and strike price;
- (b) in conjunction with the sale (or purchase) of some or all of the stocks comprised in the underlying basket of stocks used to compile the index underlying the stock index futures contract or the stock index options contracts; and
  - (c) with a view to securing a profit from any difference in price between the stocks and the futures contract or the options contracts.

#### **4E Authorization by Commission for asset manager to hold or control contracts in excess of prescribed limit for purposes of asset management activity**

- (1) Subject to subsection (2) and section 4(4)(a) and (b), the Commission may authorize a person referred to in subsection (3) to hold or control a specified contract in excess of the prescribed limit by up to the specified percentage.
- (2) The Commission must not authorize a person referred to in subsection (3) to hold or control a specified contract in excess of the prescribed limit unless the person satisfies the Commission that—
  - (a) the person has a need for holding or controlling the excess for which authorization is sought, for the purposes of the asset management activity for which the person is licensed or registered; and
  - (b) the person has effective internal control procedures and risk management systems to manage the potential risks arising from the excess.
- (3) Subsection (1) applies to a person that—
  - (a) is a licensed corporation that is licensed for, or a registered institution that is registered for, Type 9 regulated activity; and
  - (b) in the course of that regulated activity, manages assets having a total value of not less than \$80 billion.

#### **5 Prescribed limits**

For the purposes of section 4(1), the limit on the number of contracts that may be held or controlled is—

- (a) in the case of a futures contract specified in column 2 of Schedule 1, that specified opposite to it in column 3 of that Schedule; and
- (b) in the case of a stock options contract specified in column 2 of Schedule 2, that specified opposite to it in column 3 of that Schedule.

#### **6 Notice of reportable positions**

- (1) Any person who holds or controls a reportable position shall lodge a notice in writing of that reportable position with the recognized exchange company concerned within one business day following—





- (a) the day on which the person first holds or controls that reportable position; and
  - (b) each succeeding day on which the person continues to hold or control that reportable position.
- (2) A notice referred to in subsection (1) shall be accompanied by the following information—
- (a) 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
  - (b) if the reportable position is held or controlled for another person—
    - (i) the identity of that person; and
    - (ii) 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.

## **7 Compliance by certain persons**

- (1) In their application to a person holding or controlling futures contracts or stock options contracts for any other person, the prescribed limits and reportable positions apply separately to any futures contracts or stock options contracts held or controlled by the first person—
- (a) for his own account; and
  - (b) for each other person.
- (2) For the purposes of subsection (1), a person shall not be regarded as holding or controlling futures contracts or stock options contracts for another person if he has discretion in relation to those futures contracts or stock options contracts.
- (3) For the purposes of subsection (2), a person shall be regarded as having discretion in relation to futures contracts or stock options contracts he holds or controls for another person if—
- (a) he may originate orders to acquire or dispose of any of the 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
  - (b) such authorization enables the first person to make specific acquisitions or disposals without requiring further consent or instruction from the other person.

## **8 Penalties**

Any person who, without reasonable excuse, fails to comply with section 4(1) or 6 commits an offence and is liable—

- (a) on conviction on indictment to a fine at level 6 and to imprisonment for 2 years; or
- (b) on summary conviction to a fine at level 3 and to imprisonment for 6 months.



## Schedule 1

### Prescribed Limit and Reporting Level for Futures Contracts

[sections 2(1) & 5(a)]

Item	Futures contract	Prescribed limit	Reporting level
1.	Stock futures contracts on shares listed on a stock market operated by the Stock Exchange Company	5000 open contracts for any one contract month	1000 open contracts for any one contract month
2.	Three-Month Hong Kong Interbank Offered Rate futures contract	Nil	1000 open contracts for any one contract month; 4000 open contracts for all contract months
3.	One-Month Hong Kong Interbank Offered Rate futures contract	Nil	1000 open contracts for any one contract month; 4000 open contracts for all contract months
4.	Hang Seng Index futures contract and options contract, and Mini-Hang Seng Index futures contract and options contract	10000 long or short position delta limit for all contract months combined, provided that the position delta for the Mini-Hang Seng Index futures contracts or Mini-Hang Seng Index options contracts must not at any time exceed 2000 long or short for all contract months combined	500 open Hang Seng Index futures contracts for any one contract month; 500 open Hang Seng Index options contracts for any one series; 2500 open Mini-Hang Seng Index futures contracts for any one contract month and 2500 open Mini-Hang Seng Index options contracts for any one series
5.	Hang Seng China Enterprises Index futures contract and options contract, and Mini-Hang Seng China Enterprises Index futures contract and options contract	12000 long or short position delta limit for all contract months combined, provided that the position delta for the Mini-Hang Seng China Enterprises Index futures contracts or Mini-Hang Seng China Enterprises Index options contracts must not at any time exceed 2400 long or short for all	500 open Hang Seng China Enterprises Index futures contracts for any one contract month; 500 open Hang Seng China Enterprises Index options contracts for any one series; 2500 open Mini-Hang Seng China Enterprises Index futures contracts for any one contract month and 2500 open Mini-Hang Seng China



		contract months combined	Enterprises Index options contracts for any one series
6.	Hang Seng China H-Financials Index futures contract	10000 long or short position delta limit for all contract months combined	500 open contracts for any one contract month
7.	Gold futures contract	Nil	500 open contracts for any one contract month
8.	Three Year Exchange Fund Note (EFN) futures contract	5000 open contracts for any one contract month except that the limit for the spot month contract during the last 6 trading days is 1000 open contracts	1000 open contracts for any one contract month except that the reportable position for the spot month contract during the last 6 trading days is 200 open contracts
9.	FTSE/Xinhua China 25 Index futures contract and options contract	6000 long or short position delta limit for all contract months combined	500 open FTSE/Xinhua China 25 Index futures contracts for any one contract month and 500 open FTSE/Xinhua China 25 Index options contracts for any one series
10.	HSI Dividend Point Index futures contract	Nil	1000 open contracts for any one contract month
11.	HSCEI Dividend Point Index futures contract	Nil	1000 open contracts for any one contract month
12.	HSI Volatility Index futures contract	10000 open contracts for any one contract month	1000 open contracts for any one contract month
13.	US Dollar vs Renminbi (Hong Kong) futures contract and options contract, and Renminbi (Hong Kong) vs US Dollar futures contract	8000 long or short position delta limit for all contract months combined, provided that the position delta for the spot month US Dollar vs Renminbi (Hong Kong) futures contracts and the spot month US Dollar vs Renminbi (Hong Kong) options contracts combined during the last 5 trading	500 open US Dollar vs Renminbi (Hong Kong) futures contracts for any one contract month; 500 open US Dollar vs Renminbi (Hong Kong) options contracts for any one series and 500 open Renminbi (Hong Kong) vs US Dollar futures contracts for



		days must not exceed 2 000 long or short	any one contract month
14.	London Copper Mini futures contract	50000 net long or short contracts for all contract months combined	500 open contracts for any one contract month
15.	London Aluminium Mini futures contract	25000 net long or short contracts for all contract months combined	500 open contracts for any one contract month
16.	London Zinc Mini futures contract	25000 net long or short contracts for all contract months combined	500 open contracts for any one contract month
17.	Stock futures contracts on shares or units of exchange traded funds	5000 open contracts for any one contract month	1000 open contracts for any one contract month
18.	London Nickel Mini futures contract	50000 net long or short contracts for all contract months combined	500 open contracts for any one contract month
19.	London Lead Mini futures contract	25000 net long or short contracts for all contract months combined	500 open contracts for any one contract month
20.	London Tin Mini futures contract	15000 net long or short contracts for all contract months combined	500 open contracts for any one contract month

## Schedule: 2

### Prescribed Limit and Reporting Level for Stock Options Contracts

[sections 2(1) & 5(b)]

Item	Stock options contract	Prescribed limit	Reporting level
1.	Stock options contracts on shares listed on a stock market operated by the Stock Exchange Company	150000 open contracts per option class in any one market direction for all expiry months combined	1000 open contracts per option class per expiry month
2.	Stock options contracts on shares or units of exchange traded funds	150000 open contracts per option class in any one market direction for all expiry months combined	1000 open contracts per option class per expiry month

**Revised 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 position 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 index futures and index options contracts,~~ 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 any stock 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.*

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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.



- 2.3. The prescribed limits on certain futures contracts such as stock index futures and stock index options contracts, currency futures contracts and commodity futures contracts are calculated on a net basis for all contract months combined. The Moreover, for stock index futures and stock index options contracts with the same underlying index, as well as currency futures and currency options contracts with the same underlying currency pair, the futures-equivalent positions in options contracts are added to the positions in futures contracts for purposes of determining compliance with the prescribed limits. The futures-equivalent position in an options contract is the delta value<sup>5</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>6</sup> for all expiry months combined that may be held or controlled by a person. *For example, the prescribed limit on any stock options contract is ~~50~~150,000 contracts in any one market direction. If a person holds 30,000 long calls in month A, ~~10~~100,000 short calls in month B and ~~40~~50,000 long puts in month C, he will reach the prescribed limit on this contract for the short market direction, but will still be able to hold ~~20~~120,000 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*

<sup>5</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>6</sup> Long calls and short puts are in the same market direction; and short calls and long puts are in the same market direction.



market direction is ~~50~~150,000 contracts (i.e. ~~10~~100,000 short calls plus ~~40~~50,000 long puts.)

- 2.5. In general, ~~T~~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>7</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 paragraph 3 below), 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 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 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.

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<sup>7</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.





### 3. 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 HKFE or SEHK (as the case may be) in accordance with Section 4(2) of the Rules, or by the SFC in accordance with 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 if the person is one of those described in Section ~~4(3)~~4A of the Rules.

3.3. In accordance with Section ~~4(3)~~4A, the following persons may be authorized by the HKFE or SEHK to hold or control excess positions:

- (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 (i) in respect of stock options contracts (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) or (ii) in respect of exchange traded funds where the person holds or controls futures contracts or stock options contracts in the course of hedging the risks arising from performing market making or liquidity providing activities;
- (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);
- (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
- (4) a related corporation<sup>8</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 respect of such listed securities (e.g. an associate of an issuer of structured products like derivative warrants and equity-linked instruments holds excess

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<sup>8</sup> The term “related corporation” is defined in Section 3 of Schedule 1 of the SFO.



*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~~provides that the SFC ~~may~~to authorize a person to hold or control futures contracts or stock options contracts in excess of the prescribed limits if (i) special circumstances exist; (Section 4B); or if the person (ii) has a relevant business need; (Section 4C); (iii) carries out index arbitrage activity (Section 4D); or (iv) is an asset manager that meets the specified criteria (Section 4E). Section 4(4) is however only applicable to situations falling outside Section 4(~~3~~2). That is, the SFC will not accept applications which may be dealt with by the HKFE or SEHK in accordance with Section 4(~~3~~2).

- 3.6. Pursuant to Section 4(4), the SFC may authorize a person ~~may~~to hold or control futures contracts or stock options contracts in excess of the prescribed limits under Section 4B, 4C, 4D or 4E by giving the person a notice of authorization if:

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

(1) — the person is not one of those described in Section 4A; and

(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;~~

~~(3) — the SFC has given the person notice in writing that it is satisfied of the matters referred to in Sections 4(4)(b) and either 4(5) or 4(7) (Section 4(4)(c)).~~

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

- 3.7. An authorization under Section ~~4(5)~~4B may only be granted where such person can show that there are special circumstances which warrant his holding or controlling the excess positions in question:

~~(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.~~

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<sup>9</sup> This is embodied in Sections 4(5) and 4(8).



- 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. So, for example, requiring excess positions to serve a regular business need would not be regarded as constituting special circumstances.

**Authorization under Section 4(6) — for a “relevant business need” 4C – for purposes of facilitating provision of services to clients**

- 3.9. An authorization under Section ~~4(6)~~4C 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(10)~~4C(3) and essentially means a need to engage in hedging activities as a result of providing client facilitation services (i.e. services to facilitate client transactions – whether conducted on exchange or off exchange, and in futures or options contracts or other products). 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~~may 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.

**Authorization under Section 4D – for purposes of index arbitrage activity**

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

- ~~3.11. The~~An authorization under Section 4D may only be granted:

- (1) to an Exchange Participant or an affiliate of an Exchange Participant; and
- (2) where such person engages in index arbitrage activities and will hold or control the excess for the purposes of those activities.

- ~~3.12. The phrase “index arbitrage” is defined in Section 4D(3) to mean a trading strategy engaged in by the person-~~

- (a) involving (i) the purchase or sale of a stock index futures contract (*the futures contract*); or (ii) the purchase (or sale) of a stock index call options contract together with the sale (or



- purchase) of a stock index put options contract, where both contracts have the same underlying index, expiry date and strike price (*the options contracts*);
- (b) in conjunction with the sale or purchase of some or all of the stocks comprised in the underlying basket of stocks (*the stocks*) used to compile the index underlying the futures contract or the options contracts; and
- (c) with a view to securing a profit from any difference in price between the stocks and the futures contract or the options contracts.

The SFC accepts that “the stocks” do not necessarily include all the components stocks of the underlying index of the futures or options contracts, the SFC however expects the applicant to demonstrate that the tracking error of the stocks is immaterial.

- (4) 3.13. The SFC may grant authorizations under Sections 4C and 4D to an Exchange Participant or persons who belong to a group of companies that includes an Exchange Participant ~~(including the Exchange Participant) (Sections 4(6) and 4(10))~~. 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 are specified contracts (Sections 4(6) and 4(10)). 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 the specified percentage (Section 4(6) and 4(10)). The SFC will, from time to time, review the specified percentage based on market need.~~

*Example:*

~~*There are 3 members in a particular group of companies and the prescribed limit for a particular futures contract is 10,000. Assuming the specified percentage is 50% and that each group member holds and controls 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 any member in the group may be authorized to hold or control is 15,000 calculated as follows:  
 $10,000 + (50\% \times 10,000) = 15,000$*~~
- ~~▪ *The maximum that the group would in aggregate be authorized to hold or control is 45,000 calculated as follows:*~~



$$15,000 \times 3 = 45,000$$

~~3.14~~ 3.14 The SFC will determine the size of excess positions to be authorized for an applicant on a case by case basis after taking into consideration various factors including the prevailing market situation. It should be noted ~~however~~ that although the upper limit set by the specified percentage is a per applicant upper limit, the SFC will ~~also~~ take into account any excess positions already authorized to other members within the same group as the applicant ~~when considering whether the requirements of Section 4(4)(b) have been satisfied.~~ Under Section 4(4)(b), the SFC may authorise the excess sought only if it 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.

~~3.12.~~ 3.15 Additionally, the SFC may only authorize excess positions under ~~Section 4(6)~~ Sections 4C and 4D if –

- (1) the Exchange Participant or affiliate in question has adequate financial capability to cover the potential risks arising from any authorized excess position ~~(Section 4(7)(b));~~; and
- (2) the Exchange Participant in question has effective internal control procedures and risk management systems to manage such risks ~~(Section 4(7)(e)).~~

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

~~3.13.~~ 3.16 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~~ specified contract<sup>10</sup>, the SFC will normally expect all of such person's holdings in that contract (i.e. not just the excess positions) to be held through an account carried by the Exchange Participant. Additionally, if the group Exchange Participant is not a clearing participant (of a recognized clearing house), positions must be carried through both the group Exchange Participant and a general clearing participant (of a recognized clearing house) appointed by the group Exchange Participant. The following further points should be noted also –

- (1) Positions can be carried through any affiliate, but must be carried through the group Exchange Participant at the Exchange level. Hence, if an affiliate is not an Exchange Participant but the group wants the positions to be carried through that affiliate, then the positions must be

<sup>10</sup> The term “specified contract” is defined in the Rules.



carried through both the group Exchange Participant (at the Exchange level) and that affiliate.

~~(4)(2)~~ It is not necessary for execution (ie, acquisitions and disposals) to be conducted through the group Exchange Participant. Accordingly, any execution broker may be used (including the group Exchange Participant).

The above requirements, ~~together with those described in paragraph 3.12(1) above~~ will facilitate the SFC in monitoring compliance with the prescribed limits and any authorized excesses.

*Authorization under Section 4E – for purposes of asset management activity*

3.17. An authorization under Section 4E may only be granted:

- (1) to an intermediary that is (i) licensed or registered for Type 9 regulated activity under the SFO (asset manager); and (ii) manages assets having a total value (AUM) of not less than HK\$ 80 billion;
- (2) where such asset manager needs excess positions to facilitate its asset management activity; and
- (3) the asset manager has effective internal control procedures and risk management systems to manage the potential risks arising from the excess.

3.18. For the purposes of Section 4E, the AUM of an asset manager is determined as follows:

- (1) in the case that the applicant is a Licensed Corporation (LC) under the SFO, it is the “Total aggregate net value of assets under management” figure reported in its latest filing to the SFC under the Securities and Futures (Financial Resources) Rules; and
- (2) in the case that the applicant is a Registered Institution under the SFO, the applicant is to use the figure reported under its asset management activity in its latest filing to the Hong Kong Monetary Authority under section 63 of the Banking Ordinance on securities related activities. This figure is to be used as the basis for further adjustment by the applicant to arrive at an adjusted figure equivalent to the “Total aggregate net value of assets under management” figure mentioned in sub-paragraph (1) above.

3.19. The SFC is mindful that any excess positions granted should commensurate with the asset manager’s business need. Under Section 4(4)(b), the SFC may authorise the excess sought only if it 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. In this regard, the SFC in determining the size of the excess position



to be granted to an asset manager under Section 4E will take into account the following: –

- (1) investment mandates and size of all the funds managed by the asset manager; and
- (2) the investment strategies of the asset manager.

3.14.

*Application process for authorizations by the SFC*

3.15-3.20. An application for authorization from the SFC to hold excess positions may be submitted by the following persons:

- (1) where authorization is sought under Section ~~4(5)~~4B, either:
  - (a) the person acting as principal for the account(s) for which the authorization is sought; or
  - (b) a person who acts as an agent for the principal; ~~and~~
- (2) where authorization is sought under Sections 4C and 4D, the Exchange Participant concerned; and
- ~~(2)~~(3) where authorization is sought under Section ~~4(6)~~4E, the ~~Exchange Participant~~asset manager concerned.

3.16-3.21. In the case of an authorization sought under ~~Section 4(6)~~Sections 4C and 4D, although the application must be submitted by the Exchange Participant concerned, the SFC will not dictate which members of its group should take the excess positions and hence need authorization. However, where any member of a group is authorized to hold or control excess positions in respect of a particular contract, the SFC will normally expect all of its holdings in that contract (~~ie i.e.~~ not just the excess positions) to be carried through the Exchange Participant. It follows therefore that the Exchange Participant will in any event need to be authorized under ~~section 4(6)~~Sections 4C and 4D of the Rules.

3.17-3.22. ~~All~~The applications to the SFC should be made in writing to the Supervision of Markets Division of the SFC. Applications may be made on the basis of an immediate ~~client request~~need, or in advance in anticipation of ~~clients'~~ prospective needs based on past experience.

3.18-3.23. 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.

3.19-3.24. ~~The~~In the case of an application for authorization under Section 4C, the SFC will ~~normally~~ require the applicant to provide ~~at least~~ the following information ~~in support of the application:-~~:



~~(1)(a)~~ 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);

~~(2)(b)~~ a full and complete explanation of the 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 positions for which authorization is sought ~~(“related positions”)~~,<sup>2</sup> and on which market (e.g. OTC market, overseas exchange markets) such positions have been, or will be, executed;

~~(b)~~•            an estimate of the maximum level of the excess positions intended to be established;

~~(c)~~•            the estimated duration of holding or controlling the excess positions;<sup>2</sup>

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

~~(c)~~ details of the relevant Exchange Participant’s and (if applicable) the affiliate’s or their holding company’s financial position, such information to be sufficient to demonstrate that the Exchange Participant or affiliate ~~has or their holding company meets the adequate financial capability requirement to cover the potential risks arising from the excess position~~<sup>11</sup>; and should normally include at least its latest annual audited ~~accounts~~ financial statements ~~and/or~~ information on its credit rating (if any);

~~(a)(d)~~ details of 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 positions<sup>12</sup>, and should normally include at least the following:

<sup>11</sup> This is required by Section 4(7)(b). The term “adequate financial capability” is defined in Section 4(10), 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(7)(c).





- (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 positions (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 positions 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 positions in the event of such default
  - *the techniques that will be used to measure, monitor, control and reduce various types of risks* arising as a result of the excess positions 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).

3.25. In the case of an application for authorization under Section 4D, the SFC will require the applicant to provide the following information:

(a) the index arbitrage trading strategy and the relevant positions, which include:

- a description of how index arbitrage activities are conducted, or will be conducted, in connection with the excess positions for which authorization is sought;
- a description of the current nature and size of the positions related to the index arbitrage trading strategy in question (including positions in other related markets which are an integral part of the index arbitrage portfolio);
- the methodology adopted to determine the underlying stocks involved in the index arbitrage portfolio and their relative weighting of the entire portfolio;
- the timing of execution in the stock market and the relevant stock index derivatives market;
- an estimate of the maximum level of the excess positions intended to be established;



- an estimate of the duration of holding or controlling the excess positions;
  - the circumstances under which the index arbitrage portfolio will be unwound and the detailed unwinding strategy and process.
- (b) the monitoring process to ensure that the excess positions sought are executed according to the strategy described above;
- (c) information to demonstrate that the trading desk/book for index arbitrage activities is standalone;
- (d) details of the internal control measures and compliance monitoring process to prevent and detect potential misuse or abuse of the excess positions which should include a Chinese Wall (or equivalent internal control measures) in place between the index arbitrage trading desk and other trading desks;
- (e) details of the relevant Exchange Participant's and (if applicable) the affiliate's or their holding company's financial position, such information to be sufficient to demonstrate that the Exchange Participant or affiliate or their holding company meets the adequate financial capability requirement and should normally include at least its latest annual audited financial statements or information on this credit rating (if any);
- (f) details of the relevant Exchange Participant's internal control procedures and risk management systems 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, 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, tracking error etc.). The summary should cover the techniques that will be used to measure, monitor, control and reduce various types of risks arising as a result of the excess positions and the related position; and
  - (ii) a brief summary of the internal control procedures that will be put in place to ensure the implementation of the risk management policies and procedures mentioned in the preceding sub-paragraph (i).

3.26. In the case of an application for authorization under Section 4E, the SFC will require the applicant to provide the following information:



- (a) a summary of the investment objectives and characteristics of each of the funds under its management and a description of the nature of positions held or controlled by each of the funds (including investments in other related markets which are an integral part of the entire portfolio);
- (b) a full and complete explanation of the needs for holding or controlling excess positions and how the excess positions will be used for asset management purposes;
- (c) an estimate of the maximum level of the excess positions intended to be established for each of the funds;
- (d) the relevant asset manager's internal control procedures and risk management systems to demonstrate that the asset manager has effective internal control procedures and risk management systems to manage the potential risks arising from the excess position, 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.). The summary should cover the techniques that will be used to measure, monitor, control and reduce various types of risks arising as a result of the excess positions and the related position; and
  - (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).
- (e) information showing that the applicant's total assets under management is not less than HK\$80 billion:
  - (i) For licensed corporations, the latest filing made by the applicant to the SFC under the Securities and Futures (Financial Resources) Rules which contains a "Total aggregate net value of assets under management" figure.
  - (ii) For registered institutions, the latest filing made by the applicant to the Hong Kong Monetary Authority under section 63 of the Banking Ordinance on securities related activities should be used as the basis for further adjustment by the applicant to arrive at a figure equivalent to the "Total aggregate net value of assets under management" figure mentioned in (i).

*Other considerations for authorization*



~~3.27.~~ 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.

~~3.20-~~ ~~3.28.~~ The SFC will determine 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.

~~3.21-~~ ~~3.29.~~ As a guiding principle, the SFC will not grant an authorization for any excess if the relevant preconditions<sup>13</sup> set out in the Rules are not satisfied, or if the authorization is inconsistent with the SFC's regulatory objectives in Section 4 of the SFO, in particular:

- (1) to maintain and promote the fairness, efficiency, competitiveness, transparency and orderliness of the securities and futures industry;
- (2) to reduce systemic risks in the securities and futures industry; or
- (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.

~~3.22-~~ ~~3.30.~~ 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 on at least five business days' notice. New conditions may also be imposed (Section 4(~~95~~)(c)). —A notice of decision/authorization will be provided to the applicant in writing (Section 4(4)(c)).

~~3.23-~~ ~~3.31.~~ The SFC will endeavour to notify the applicant of its decision within 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(5)~~4B 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.

*Use and evidencing use of excess positions*

~~3.24-~~ ~~3.32.~~ Excess positions authorized under Section 4C must be used to hold positions that facilitate client transactions. However, the SFC will not require that they be used in relation to a particular client transaction, or a particular client. Similarly, the SFC will not impose any limitation on the order in which

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<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) and 4(7).~~



excess positions are used. Example 1 in Appendix 1 further illustrates how excess positions may be used.

3.33. The SFC will expect Exchange Participants/their affiliates to evidence the use of their excess positions. To this end, the SFC will expect authorized Exchange Participants/affiliates to submit regular reports confirming:

- (1) the amount of excess used, the
- (2) the type of clients involved, and a
- (3) a general description of the nature of the client transactions including their notional and market values. Exchange participants/affiliates will need to provide an
- (4) an overall description of the positions they have taken, but not details in relation to each client on an individual basis.

3.34. Excess positions authorized under Section 4D must be used solely for index arbitrage activities. Please refer to example 2 in Appendix 1 which illustrates how excess positions may be used for index arbitrage activities. The SFC will expect Exchange Participants/their affiliates to evidence the use of their excess positions. To this end, the SFC will expect authorized Exchange Participants/affiliates to submit regular reports confirming:

- (1) the amount of excess used;
- (2) a general description of the size of the stock index derivatives positions used for index arbitrage activities;
- (3) details of the stock portfolio established; and
- (4) the daily risk position of the entire index arbitrage portfolio containing the stock index derivatives positions and the stock positions

3.35. Excess positions authorized under Section 4E must be used for asset management purposes. The SFC will expect asset managers to evidence the use of excess positions. To this end, the SFC will expect the asset manager authorized to submit regular reports providing details of the following:

- The amount of excess used for each of the funds under its management;
- The total number of futures positions held by each of the funds under its management; and
- The notional value of futures positions as a percentage relative to the fund size for each of the funds under its management

3.25-3.36. The SFC will normally require reports mentioned above to be submitted quarterly within two weeks of the end of the relevant quarter. However, more frequent or additional reporting requirements may be required in individual cases as necessary.

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

3.26-3.37. A person who has been authorized by the SFC under Section 4(5)4B, 4C, 4D or 4(6)4E should submit a new application to the SFC if he wishes to continue to hold or control the excess positions after the expiration date of the initial authorization. The new application should be submitted to the SFC no



later than ~~ten business days~~ two months prior to the expiration date of the initial authorization. If the SFC does not grant any further authorization for the excess positions, the person will be required to close out the position in excess of the prescribed limit upon the expiration date of the initial authorization.

#### *Withdrawal of authorizations by the SFC*

3.27-3.38. The SFC may at any time withdraw an authorization granted under Section ~~4(5)4B, 4C, 4D~~ or ~~4(6)4E~~ by giving at least five business days' notice to the person (Section 4(~~95~~)(b)). Upon a withdrawal coming into effect, the authorization will cease to apply.

3.28-3.39. 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.

3.29-3.40. 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> set out in the Rules in respect of the authorization in question cease to exist;
- (2) the authorization ceases to be consistent with the SFC's regulatory objectives in Section 4 of the SFO; or
- (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*

3.30-3.41. A person may appeal against a decision of the SFC to refuse to authorize ~~an~~ excess positions under Section ~~4(5)4B, 4C, 4D~~ or ~~4(6)4E~~ of the Rules to the Securities and Futures Appeals Tribunal ("**Tribunal**") pursuant to Section 216 of the SFO (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 in accordance with the decision of the SFC.

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<sup>14</sup> See footnote 12 above.



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

~~3.31.3.42.~~ As discussed in paragraph 2.7 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 holding company), which indirectly controls the same positions by virtue only of the corporate relationship, will not be required to seek 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>15</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.
- 4.3. The aggregation requirements as mentioned in paragraphs 2.6 and 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:
  - (1) a person (e.g. the Exchange Participant) acting as an agent for the principal to carry the account of the reportable position; or
  - (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

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~~<sup>15</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.~~



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:
  - (1) the day on which the person first holds or controls the reportable positions; and
  - (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:
  - (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
  - (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 2 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>16</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.
- 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

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<sup>16</sup> HKFE requires Exchange Participants to submit the notice of reportable positions by 12:00 noon on the reporting day (T+1).



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:

- (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
- (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 5.2 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

### Examples illustrating the use of excess positions

#### Example 1:

~~Assume a firm already holds 5,000~~firm's proprietary trading desk has a position of HSI futures contracts ~~for proprietary trading purposes~~equivalent to 9,000 position delta, and ~~that its sales desk wants to facilitate clients' trades resulting in the use of about 530,000~~ HSI futures contracts for ~~clients' hedging purpose~~. Assume also that the specified percentage ~~for HSI futures contracts~~ is ~~50~~ 300%. Can the firm apply for excess?

- Yes, it can apply for excess of up to ~~5,000 contracts~~. ~~(See also the Note below.)~~30,000 contracts. However, the size of excess positions authorized for an applicant will be determined on a case by case basis after taking into consideration various factors such as the prevailing market situation.

#### Example 2:

~~Assume a firm holds 10,000 HSI futures contracts for hedging client-driven transactions. Assume also that the specified percentage for HSI futures contracts is 50%. Can the firm can still apply for excess?~~

- ~~Yes, it can apply for~~ If an excess of up to 5,000 contracts. ~~(See also the Note below.)~~

#### Example 3:

~~Assume a firm's existing client facilitation business has used a position delta equivalent to 9,000 HSI futures contracts, and that its proprietary trading desk wishes to trade 6,000 HSI futures contracts. Assume also that the specified percentage is 50%. Can the firm apply for excess?~~

- ~~Yes, it can apply for excess of up to 5,000 contracts~~. ~~(See also the Note below.)~~

~~**Note:** In each of the above 3 examples, if an excess of 530,000 contracts is authorized, the firm's limit will increase to 1540,000 contracts. In each case~~

- The firm can use up to 10,000 contracts for proprietary trading purposes and any remaining balance for client facilitation purposes. The firm may therefore also use the entire 1540,000 limit for client facilitation purposes if it holds no proprietary trading position.
- The SFC is not concerned as to the order in which the limit is consumed (ie whether the limit is first used to acquire contracts for client facilitation purposes and then for proprietary trading purposes or vice versa). It is however concerned to ensure that any holdings over 10,000 contracts are held only for client facilitation purposes – ie that holdings for proprietary trading purposes do not exceed the statutorily prescribed limit ~~(ie 10,000 contracts in the above examples)~~.

#### Example 4:

~~Assume the facts as stated in Example 3, and that the SFC has authorized an excess of 5,000 contracts. Assume also that the firm's client facilitation position then fluctuates, from time to time, between 3,000 and 128,000 position delta. Will the authorized excess be automatically withdrawn or otherwise affected simply because of the fluctuation?~~



- ~~▪ No, the authorized excess will not be automatically withdrawn or invalidated just because the client facilitation position falls below 3,000 (or any other amount).~~
- ~~▪ Authorizations for excess will usually be granted for a specified period of time and the excess authorized may be used at any time during that period unless withdrawn. The SFC will normally only consider withdrawing an authorization in the circumstances listed in paragraph 3.29 of this Guidance Note. It will not consider withdrawing an authorization simply because of fluctuations in use.~~

Example 2:

Assume a firm already holds a short position in HSI futures contract equivalent to 8,000 position delta for its proprietary trading business, and that it wishes to hold another 30,000 position delta for its index arbitrage activities in the same short direction. Assume that the specified percentage is 300%. Can the firm apply for excess?

- Yes, it can apply for excess of up to 30,000 contracts. However, the size of excess positions authorized for an applicant will be determined on a case by case basis after taking into consideration various factors such as the prevailing market situation.

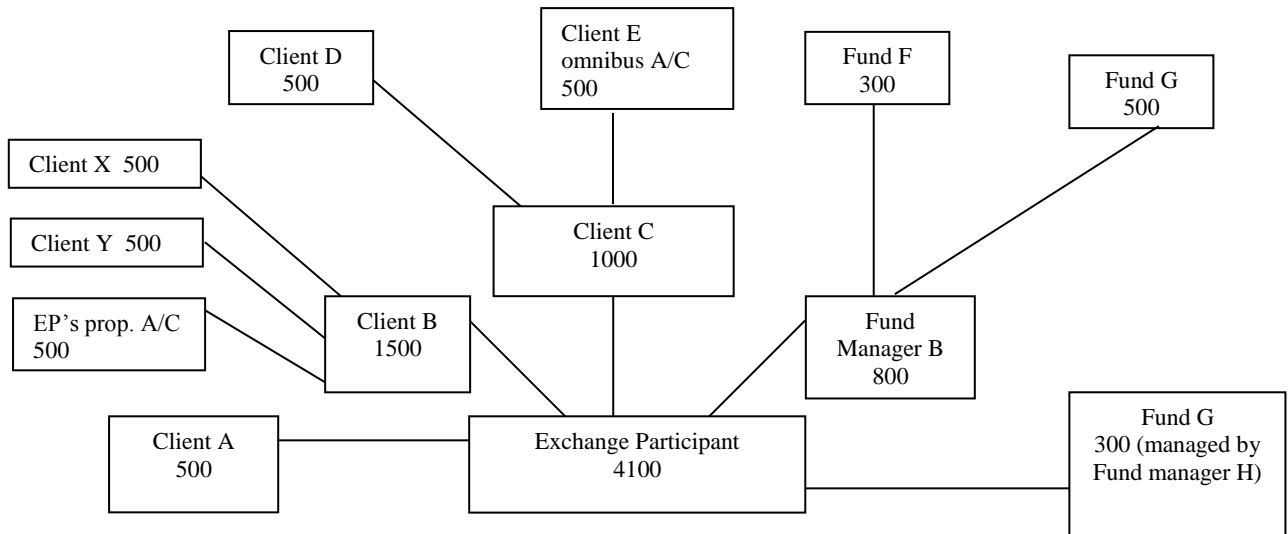
If an excess of 30,000 contracts is authorized, the firm's limit will increase to 40,000 contracts—

- The firm can use up to 10,000 contracts for its proprietary trading business (not including index arbitrage activities) and any remaining balance for its index arbitrage activities. The firm may therefore also use the entire 40,000 limit for its index arbitrage activities if it holds no other proprietary trading position.



## Appendix 2

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.