



**SFC**  
證監會

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

**Consultation Conclusions on the  
Securities and Futures (Contracts Limits  
and Reportable Positions)(Amendment)  
Rules 2003 and proposed amendments to  
the Guidance Note on Position Limits and  
Large Open Position Reporting  
Requirements**

《2003年證券及期貨(合約限量及須申報的持倉量)(修訂)規則》的諮詢總結  
及《持倉限額及大額未平倉合約的申報規定指引》的修訂建議

Hong Kong  
March 2004

香港  
2004年3月

## **A      Introduction**

1. On 17 September 2003, the SFC issued a consultation paper to invite public comments on the Securities and Futures (Contracts Limits and Reportable Positions)(Amendment) Rules 2003 (“the Amendment Rules”) and corresponding amendments to the Guidance Note on Position Limits and Large Open Position Reporting Requirements (“the Guidance Note”).
2. In 2002 and 2003, the SFC consulted the public on the Securities and Futures (Contracts Limits and Reportable Positions) Rules (“the Rules”) and the Guidance Note. In the course of the public consultations, industry participants commented that section 7 of the Rules (i.e., the disaggregation provision) created practical difficulties as well as an unlevel playing field.
3. Section 7 of the Rules allows an Exchange Participant to apply the reportable position limits and the prescribed limits separately to the Exchange Participant’s own account and to each of the positions which it holds or controls on behalf of its clients.
4. Pursuant to the current Rules, under the booking structure of some industry participants, client and proprietary positions would be required to be aggregated. This gives rise to practical difficulties.
5. Under section 7, an Exchange Participant is permitted to apply the limits separately to the Exchange Participant’s own account and each of its clients’ positions, whereas a non-Exchange Participant must aggregate all the positions which it holds or controls (including proprietary and client positions). Hence, non-Exchange Participants are effectively subject to a stricter limit than Exchange Participants.
6. The Amendment Rules will extend the disaggregation provision to non-Exchange Participants. The proposed changes to the Guidance Note reflect the Amendment Rules.
7. The consultation period ended on 15 October 2003. A total of 7 written submissions were received. Most respondents were supportive of the Amendment Rules and commented on new paragraph 4.14 of the Guidance Note. Appendix 1 is a summary of the comments and the SFC responses.
8. This document analyses the major comments received and explains the conclusions drawn by the SFC. This paper should be read in conjunction with the consultation document.

## **B      Summary of Comments and Conclusions**

### ***The Amendment Rules***

9. As most of the respondents were supportive of the Amendment Rules, only minor stylistic/drafting changes have been made. The Amendment Rules with marked up changes to the consultation draft are at Appendix 2.

***The Guidance Note***

10. Most respondents commented on paragraph 4.14 of the Guidance Note. Paragraph 4.14 states that to assess systemic impact of large reportable positions and to monitor concentration risks more effectively, the HKFE or SEHK may inquire into positions or transactions in other markets (including overseas markets and OTC transactions) underlying the large positions held by an Exchange Participant for itself and/or its clients or counterparties.
11. In general, the respondents felt that Exchange Participants will not be able to obtain the transaction or position information required, in particular, where the information relates to overseas or OTC transactions. Some respondents also commented that the imposition of other position limits should only be on the particular client's position and not the Exchange Participant's position.
12. The Guidance Note does not impose requirements. The purpose of the Guidance Note is to help market participants understand how the SFC considers that the Rules are intended to operate in practice and to clarify the SFC's policy and positions on issues raised by the industry.
13. Paragraph 4.14 simply repeats current SEHK and HKFE Rules which empower the SEHK and the HKFE to impose different limits where they have concerns over the risks of a particular Exchange Participant or its clients. In accordance with the SEHK/HKFE Rules, the limits can be imposed on an Exchange Participant or its clients(s) where the circumstances warrant such action.
14. The purpose of adding paragraph 4.14 to the Guidance Note is to remind Exchange Participants, other industry participants and clients that the SEHK and HKFE may request information in relation to the positions underlying those they hold and that, under the respective Rules, the information may include that relating to hedging transactions conducted in other markets. This information may help the SEHK and HKFE to assess the risks for the purpose of deciding whether different limits should be imposed.
15. As paragraph 4.14 does not add any new requirements, the SFC considers that, other than a few minor amendments, no other amendments to the Guidance Note are required. The Guidance Note is at Appendix 3. Changes to the consultation draft have been highlighted for ease of reference.

**C. Other Matters**

16. The SFC would like to thank all industry participants and other interested persons who have made valuable suggestions and comments in response to the consultation paper.

**Draft Securities and Futures (Contracts Limits and Reportable Positions) (Amendment) Rules 2003  
Proposed Revisions to the Guidance Note on Position Limits and Large Open Position Reporting  
Requirements**

**Summary of comments received and SFC's response**

<b>Item No.</b>	<b>Reference in Consultation document</b>	<b>Details</b>	<b>Respondent's Comments</b>	<b>SFC's Response</b>
1.	Not Applicable  <i>(Note : Section 4(4), S&amp;F(Contract Limits and Reportable Positions) Rules)</i>	Section 4(4) of the Rules allows the SFC to authorise a person to hold or control futures contracts or stock options contracts in excess of the prescribed limits in special circumstances.  <i>(Note : no changes to section 4(4) are proposed in the draft S&amp;F (Contract Limits and Reportable Positions) (Amendment) Rules 2003 or the relevant paragraphs in the Guidance Note)</i>	<i>Respondent A:</i> Guidance should be given as to what constitutes 'special circumstances'.	The Guidance Note explains the matters which the SFC will consider in an application under section 4(4) of the Rules. See paragraphs 3.9 and 3.11.  There is no need for further clarification as the issue of whether special circumstances exist will depend on the particular circumstances of each application.
2.	General comment	-	<i>Tung Tai, HSBC, Linklaters, HKSbA, UBS:</i> The S&F(Contracts Limits and Reportable Positions) (Amendment) Rules 2003 are welcomed.  <i>LS :</i> No comments.	-

Item No.	Reference in Consultation document	Details	Respondent's Comments	SFC's Response
3.	Para 4.14 of the Guidance Note	<p>To assess systemic impact of large positions and to monitor concentration risk more effectively, provide the required information to the HKFE or SEHK may inquire into positions/transactions in other markets underlying the large positions held by an Exchange Participant and/or its clients/counterparties. Failure to produce the information may lead to imposition of different position limits.</p>	<p><i>HSBC, HKSbA:</i> Clarification is sought on whether the imposition of other position limits will be limited to a client who refuses to provide the required information to the Exchange Participant only and not on the overall positions carried by the Exchange Participant.</p> <p>The imposition of other position limits should be on the particular client only.</p> <p><i>LS:</i> No comments.</p> <p><i>Linklaters:</i> Underlying clients may be reluctant to tell intermediaries whether they or their respective clients entered into the HSI futures positions to hedge OTC transactions.</p> <p>The respondent queries whether the HKFE or SEHK has power to inquire into transactions on overseas futures market and/or overseas OTC markets.</p> <p><i>UBS:</i> Concern that the GN has not clearly set out the extent of the OTC positions that may be disclosed by clients. Clients will not disclose their trading/hedging</p>	<p>The Guidance Note does not provide requirements. It simply explains the SFC's position on how it considers requirements should be met.</p> <p>Paragraph 4.14 of the Guidance Note simply repeats existing SEHK and HKFE Rules which enable the SEHK/HKFE to require information from Exchange Participants and their clients and impose different limits where the Exchange Participant fails to comply with such requests.</p> <p>The purpose of paragraph 4.14 is to remind Exchange Participants and the clients that the SEHK and HKFE may request information in relation to the positions underlying those which they hold and that, under the respective Rules, the information may include that relating to hedging transactions conducted in other markets.</p> <p>As paragraph 4.14 does not add any new requirements, the SFC believes that no amendments to the paragraph are required.</p>

<b>Item No.</b>	<b>Reference in Consultation document</b>	<b>Details</b>	<b>Respondent's Comments</b>	<b>SFC's Response</b>
			activities in relation to their HSI futures and options positions to Exchange Participants.	

List of Respondents

<b>Dated Received</b>	<b>Respondent</b>
24 Sept 2003	Respondent A
6 Oct 2003	Vincent Lee, Tung Tai Securities Co. Ltd, Tung Tai Futures Ltd, Tung Tai assets Management Ltd (“Tung Tai”)
14 Oct 2003	HSBC Broking Securities (Asia) Limited (“HSBC”)
15 Oct 2003	The Law Society of Hong Kong (“LS”)
15 Oct 2003	Linklaters & Alliance (“Linklaters”), submitting on behalf of CSFB, Goldman Sachs, JP Morgan, Merrill Lynch and Morgan Stanley.
22 Oct 2003	Hong Kong Stockbrokers Association (“HKSbA”)
30 Oct 2003	UBS

**SECURITIES AND FUTURES (CONTRACTS LIMITS AND REPORTABLE POSITIONS) (AMENDMENT) RULES ~~2003~~2004**

(Made by the Securities and Futures Commission under section 35(1) of the Securities and Futures Ordinance (Cap. 571), and in relation to rules made under section 35(1)(e) of that Ordinance, after consultation with the Financial Secretary)

**1. Commencement**

These Rules shall come into operation on ~~1~~30 April 2004.

**2. Notice of reportable positions**

Section 6(2)(b) ~~of the Securities and Futures (Contracts Limits and Reportable Positions) Rules (Cap. 571 sub. leg. Y)~~ is repealed and the following substituted ~~with~~

“(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.”

**3. ~~Compliance by certain persons who are agents~~Section substituted**

Section 7 is repealed and the following substituted ~~with~~ –

**“7. Compliance by certain persons ~~who are agents~~**

(1) In their application to a person ~~(the “agent”)~~ holding or controlling futures contracts or stock options contracts for any other ~~another~~ person ~~(the “principal”)~~, the prescribed limits and reportable positions apply

separately to any futures contracts or stock options contracts held or controlled by the agentfirst person -

- (a) for his own account; and
- (b) for each principalother person.

(2) For the purposes of subsection (1), a person shall not be regarded as an agent in relation to holding or controlling futures contracts or stock options contracts he holds or controls for a principal another person if he has discretion in relation to those futures contracts or stock options contracts.

(3) For the purposes of subsection (2), an agent has a person shall be regarded as having discretion in relation to the futures contracts or stock options contracts he holds or controls for a principal 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 principalother person, whether the authorization is pursuant to a written agreement, power of attorney or otherwise; and
- (b) such authorization enables the agentfirst person to make specific acquisitions or disposals without requiring further consent or instruction from the principalother person".

Chairman,  
Securities and Futures Commission

[ ] 20032004

### Explanatory Note

These Rules are made by the Securities and Futures Commission under section 35(1) of the Securities and Futures Ordinance (Cap. 571). They provide that the prescribed limits and reportable positions are applied apply separately to futures contracts or stock options contracts held or controlled in by a person's s for his own

account and positions contracts held or controlled by such person for another person. They The Rules also require the person holding or controlling a reportable position for another person to notify the recognized exchange company concerned of the identity of the other person and the numbers of contracts held or controlled for such person.

## 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 have been~~ made by the SFC under Section 35(1) of the SFO to prescribe limits and reportable positions applicable to futures contracts and stock options contracts traded on the recognized exchange company. ~~The Rules shall come into effect when the SFO commences on 1 April 2003.~~  
~~1.3. The Rules have been made based on the Securities (Exchange Traded Stock Options) Rules and the Commodities Trading (Trading Limits and Position Limits) Rules which will cease operation when the SFO commences.~~  
~~1.4.1.3. 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.~~  
~~1.5.1.4. The Guidance Note is intended to clarify the SFC’s policy intent and positions on issues raised by the industry and does not have the force of law. The SFC will revise the Guidance Note to clarify its position in response to market developments and to reflect legislative changes in the future.~~

### 2. Prescribed Limits on Futures and Stock Options Contracts

#### *Prescribed limits*

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

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

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

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

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

contract month **or series** that may be held or controlled by a person<sup>5</sup>. In other words, the prescribed limits in this Schedule apply to individual contract months **or options series**. *For example, the prescribed limit on a particular futures contract is 5,000 contracts for any one contract month. If a person longs 3,000 contracts of the September futures contract and longs 2,000 contracts of the October futures contract, he will not reach the prescribed limit on this contract.*

- 2.3. The prescribed limit on the HSI futures and options contracts as well as the Mini-HSI futures and options contracts are calculated on a net basis for all contract months combined<sup>6</sup>. The futures-equivalent positions in options contracts are added to the positions in futures contracts for purposes of determining compliance with the prescribed limit. The futures-equivalent position in an option contract is the delta value<sup>67</sup> of the option contract determined by the Hong Kong Futures Exchange (“HKFE”) at the close of market on each trading day multiplied by the number of contracts held or controlled.

Example:

A person holds the following positions:

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

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

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

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

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

<sup>67</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.

*example, the prescribed limit on a stock options contract is 5,000 contracts in any one expiry month. If a person holds 3,000 long calls with strike price A, 1,000 short calls with strike price B and 1,000 long puts with strike price C (all these calls and puts are in the same expiry month), he will reach the prescribed limit on this contract.*

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

#### ***Aggregation requirements***

- 2.6. The prescribed limits apply to all positions held or controlled by any person including positions held by the person for his own account and positions belonging to other persons but under the control of such person in any account(s) for which such person controls trading directly or indirectly. While the word “control” is not defined in the SFO or the Rules, there are circumstances where the SFC takes the view that a person is regarded as having control of positions as for example where a person is allowed to exercise discretion<sup>7</sup> to trade or dispose of the positions independently without the day-to-day direction of the owner of positions.
- 2.7. Notwithstanding the foregoing, the SFC accepts that the prescribed limits do not apply to a person who controls positions merely by virtue of its corporate relationship (e.g. a parent company in relation to positions held by its affiliates/subsidiaries) provided that such person does not give its affiliates/subsidiaries any day-to-day direction with respect to trading.

#### ***Penalties***

- 2.8. Except as otherwise authorized by the SFC, HKFE or SEHK (please refer to paragraphs 3.1 to 3.17), a person who contravenes Section 4(1) of the Rules without reasonable excuse is liable (i) on conviction on indictment to a fine of HK\$100,000 and to imprisonment for 2 years; or (ii) on summary conviction to a fine of HK\$10,000 and to imprisonment for 6 months.
- 2.9. In addition to any other powers and sanctions contained in the SFO or the Rules, the HKFE and SEHK may require an Exchange Participant carrying an account in which a position is in excess of the prescribed limit to take immediate steps to reduce the position below the prescribed limit pursuant to their rules. Where the HKFE or SEHK becomes aware that any person maintains 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. Application to Exceed Prescribed Limits**

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

#### ***Authorization for excess positions by the HKFE/SEHK***

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

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

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

*Authorization for excess positions by the SFC*

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

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

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

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

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

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

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

- (i) A description of the nature of positions held or controlled (including transactions in other related markets which are an integral part of the entire portfolio);
- (ii) A full and complete explanation of business needs for holding or controlling excess positions;
- (iii) An estimate of the maximum level of positions intended to be established; and
- (iv) The estimated duration of holding or controlling the excess positions.

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

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

- 3.14. A person who has received the authorization from the SFC to hold or control an excess position within a certain period of time should submit a new application to the SFC if he wishes to continue to hold or control the excess position after the expiration date of the initial authorization. The new application should be submitted to the SFC no later than five business days prior to the expiration date of the initial authorization. If the SFC does not grant any further authorization for the excess position, the person will be required to close out the position in excess of the prescribed limit upon the expiration date of the initial authorization.
- 3.15. After an authorization is granted by the SFC, if there are any material changes in the information previously provided to the SFC, the applicant must immediately submit the updated information to the SFC. The SFC will decide if the authorization granted is still valid. Should the applicant fail to submit such information, he may not continue to rely upon the authorization granted. That is, he may be requested to close out the excess positions.
- 3.16. A person may appeal against a decision of the SFC to refuse to authorize an excess position under Section 4(4) of the Rules to the Securities and Futures Appeals Panel Tribunal (“Tribunal”) pursuant to Section 216 of the SFO<sup>9</sup>. An application for review of the decision must be made to the Tribunal by the person against whom the decision is made within 21 days of notice of the decision. Upon review of the decision under appeal, the Tribunal may confirm, vary or set aside the decision or substitute any other decision which the Tribunal considers more appropriate or it may remit the matter to the SFC with directions to revisit the decision. For the avoidance of doubt, before the Tribunal determines otherwise, the decision of the SFC shall remain valid and the person is required to act on the decision of the SFC.
- 3.17. As discussed in paragraph 2.7, the SFC considers that the prescribed limits do not apply to a person who controls positions merely by virtue of its corporate relationship. In view of this, if a person is permitted by the SFC to hold or control excess positions, its affiliates or holding company, which indirectly control the same positions by virtue of the corporate relationship, will not be required to seek the approval from the SFC separately to control the positions.

#### **4. Notice of Reportable Positions**

##### ***Reportable positions***

- 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

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

calculated based on the number of contracts held or controlled for a contract month<sup>10</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 equally apply to the reportable positions for futures contracts and stock options contracts.

***Responsibilities of reporting***

- 4.4. The notice of a reportable position specified in Section 6(1) may be submitted by

- (i) a person the intermediary (e.g. the Exchange Participant) acting as an agent for the principal to carrying the account of the reportable position; or
- (ii) the person acting as principal for owner of the reportable position; or
- (iii) the person controlling the reportable position.

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

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

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<sup>10</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.

### ***Reporting requirements***

- 4.8. In accordance with Sections 6(1)(a) and (b), the notice of reportable positions should be made within one reporting day following
- (i) the day on which the person first holds or controls the reportable positions; and
  - (ii) each succeeding day on which the person continues to hold or control the reportable positions.

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

- 4.9. Section 6(2) of the Rules further requires that the notice of a reportable position shall be accompanied by the following information:
- (i) the number of futures contracts or stock options contracts held or controlled by the person in respect of the reportable position in each relevant contract month; and
  - (ii) where if the reportable position is held or controlled for another person (e.g. a client), the identity of the that person and the number of futures contracts or stock options contracts held or controlled for such person  
client in respect of the reportable position in each relevant contract month.

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

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

- 4.11. Appendix 1 provides examples to illustrate the application of the prescribed limits and reportable positions.

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

- 4.11.4.12. 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>11</sup>.

4.12.4.13. The HKFE and SEHK also request Exchange Participants to provide additional information other than those specified in Section 6(2) such as including (i) the account number, account name and identityies of the ultimate owner and transaction originator (if the instruction in relation to a transaction is not originated by the owner) 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); and (iv) the nature of the entity holding or controlling the reportable position (i.e. the entity is the ultimate owner, transaction originator or omnibus account operator). 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***

4.13.4.15. 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/Exchange Participants**

5.1. Section 7 of the Rules enables a person (the "agent") who holds or controls futures contracts or stock options contracts for other persons (the "principals") 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 principals except where the person agent has discretion over the positions held or controlled by him for the other persons the principals. In other words, a person can disaggregate his own position and the positions he holds or controls for each of the other persons his principals 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 the principals. A typical example of such person is an Exchange Participant or a person providing intermediary services to its clients. provides that the prescribed limits and reportable positions apply to (i) positions in futures contracts or stock options contracts held or controlled by an Exchange

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

~~Participant for its own account; and (ii) separately to positions in futures contracts or stock options contracts held or controlled by the Exchange Participant for each of its clients.~~

5.2. 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 ~~a principal if~~

- (i) 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 principal~~, whether the authorization is pursuant to a written agreement, power of attorney or otherwise; and
- (ii) such authorization enables him to make specific acquisitions or disposals without requiring further consent or instruction from the ~~other person principal~~

and in such case, he will not be regarded as holding or controlling the position for the other person ~~an agent~~ 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).

This section allows an Exchange Participant to disaggregate positions held for its own account and positions held for each of its clients in the application of the prescribed limits and reportable position requirements. An Exchange Participant's own positions and positions held for each of its clients are treated separately for purposes of determining compliance with the prescribed limits and reportable position requirements.

5.3. 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.*

~~5.3. In respect of reportable positions, Section 7 requires Exchange Participants to notify the HKFE or SEHK (as the case may be) of reportable positions held or controlled by each of their clients. For the avoidance of doubt, if a client holds a reportable position but only part of the position (which has not exceeded the reportable level) is held by the Exchange Participant, the Exchange Participant will not need to report that position to the Exchange unless it knows that the total position held by the client in other firms has exceeded the reportable level. The HKFE and SEHK have established detailed reporting requirements for Exchange Participants to submit the notice of reportable positions (please refer to paragraphs 4.11 to 4.12).~~

~~5.4.5.5. If a person is an Exchange Participant is aware that a number of its client accounts are held for the same person-client, all positions in or of these accounts should not be treated separately. They should be aggregated for purposes of determining compliance with the Rules reporting purposes.~~

~~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 “Clients”**

6.3.6.4. The SFC’s view is that, for the purposes of the Rules, a client is the person who is ultimately responsible for originating instructions of transactions, i.e., the transaction originator. For the purpose of applying the Rules, the SFC will treat a transaction originator as the client of the intermediary or Exchange Participant if the transaction originator has the discretion to initiate transactions on behalf of the owner of the order/position. 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, 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.

6.4.6.5. If the total positions controlled by a transaction originator (including positions belonging to different principalseowners, 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 owner whose positions haves 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.*

6.5.6.6. 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 intermediary (e.g. an Exchange Participant) which agrees to make the report on his behalf.

6.6.6.7. The prescribed limits apply to the total positions controlled by a transaction originator even if owners of the positions are held for different principals.

6.7. Where an Exchange Participant (EP1) “takes up” a position from another Exchange Participant (EP2) for a particular client for clearing and settlement of the transaction, EP1 can, according to the rules of the HKFE and SEHK (as the case may be), disaggregate the “take up” position as a client’s position (from its own position and positions of other clients) for the purposes of applying the position limits and reportable positions.

~~6.8. Appendix 1 illustrates the application of the limits to an Exchange Participant and different types of clients.~~

### *Omnibus accounts*

~~6.9.6.8.~~ In the case of an omnibus account, the Rules apply separately to the aggregate positions held in the omnibus account and 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.

~~6.10.6.9.~~ An omnibus account operator should inform the HKFE or SEHK (as the case may be) of the aggregate positions held in the account if they have exceeded the reportable level. 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 should also be reported to the Exchange. An omnibus account operator can notify the Exchange of the reportable positions by itself or ask its agent intermediary (e.g. an Exchange Participant) carrying the account to submit the notice of reportable positions. The notice of reportable positions should be accompanied by the information about identities of the underlying clients whose positions have exceeded the reportable level.

~~6.11.6.10.~~ 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 intermediary), the SFC accepts that the other omnibus account operators below this layer will not be required to notify the Exchange of any reportable positions held in their accounts.

#### Example:

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

*Assume that the reportable level is 500 contracts. Exchange Participant A should inform the Exchange of the position held by the omnibus account B (i.e. 1,000 contracts). If the operator of omnibus account B has obtained the information about the ultimate client 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.*

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

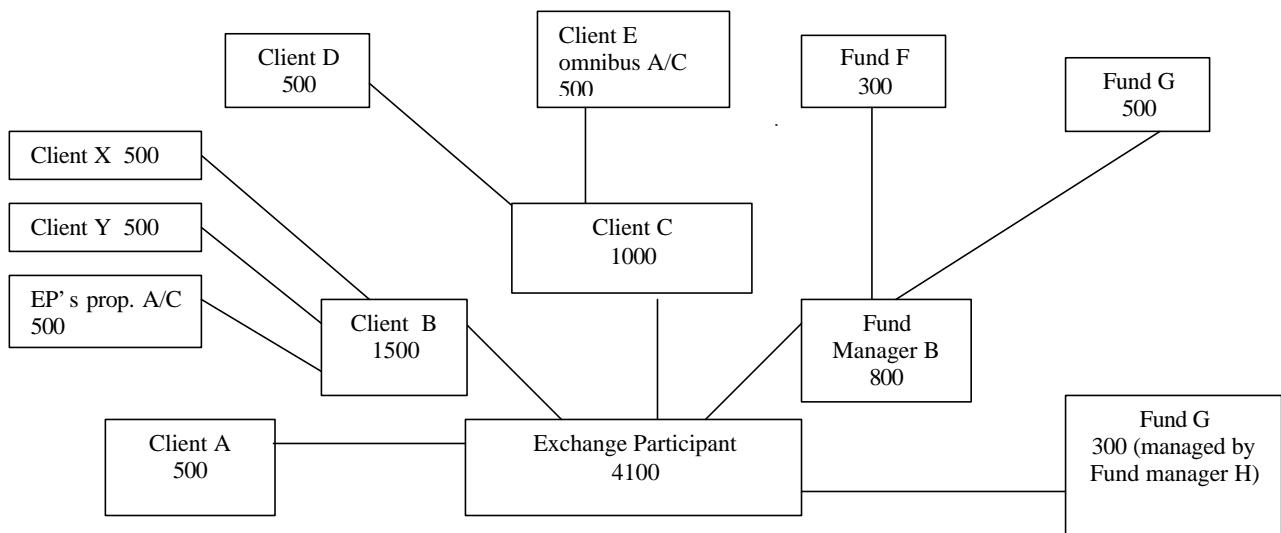
#### *Non-Exchange Participant intermediaries*

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

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

## **Appendix 1**

*For example: Reportable Position is 450 contracts*



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

The Exchange Participant has a client account under the name of **Client B** which it uses for booking transactions for his **proprietary trading** and for the trading of **Clients X and Y**.

**Client X** and **Client Y** are clients of Client B and are also treated by the Exchange Participant as its clients. Client X and Client Y each hold 500 contracts. The Exchange Participant's

proprietary position booked into the Client B account is also 500 contracts. The Client B account therefore has a total of 1500. Provided that the Exchange Participant does not have discretion over ~~Although~~ Client X's and Client Y's positions, trades are booked into the client account, since they are clients of the Exchange Participant. Client X, Client Y and the Exchange Participant's proprietary position can each be treated separately (i.e., disaggregated) by virtue of section 7(b) of the Rules.

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

#### **Notices of Reportable Positions to be filed –**

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

Notwithstanding the above filing requirements, the notice of a reportable position may be submitted by the agent intermediary, the owner of the position or the person acting as principal controlling the reportable position (see paragraph 4.4). As long as there is an arrangement in place for reporting such positions, the SFC accepts that if one of the parties

has submitted the notice of reportable position, the other parties will not be required to notify the Exchange of the same reportable positions.