

# **LEGISLATIVE COUNCIL BRIEF**

## **Securities and Futures Ordinance (Cap. 571)**

### **SECURITIES AND FUTURES (CONTRACTS LIMITS AND REPORTABLE POSITIONS) RULES**

#### **INTRODUCTION**

Pursuant to section 35(1) of the Securities and Futures Ordinance (Cap. 571) (“SFO”), the Securities and Futures Commission (SFC) has made the Securities and Futures (Contracts Limits and Reportable Positions) Rules (the Rules) at the **Annex**.

#### **BACKGROUND**

##### **The SFO**

2. The SFO was enacted in March 2002. It consolidates and modernizes ten existing ordinances governing the securities and futures markets into a composite piece of legislation to keep the regulatory regime on a par with international standards and practices. For effective regulation, the SFO has already provided flexibility in addressing changing market practices and global conditions by empowering the Chief Executive in Council, the Financial Secretary, the Chief Justice and the SFC to prescribe detailed and technical requirements as necessary by way of subsidiary legislation, to supplement the regulatory framework laid down under the primary legislation.

3. On 22 February 2002, the House Committee of the Legislative Council has established the Subcommittee on Draft Subsidiary Legislation to be made under the SFO (the Subcommittee) to study the subsidiary legislation necessary for commencing the SFO. From March 2002 to October 2002, the Subcommittee held 12 meetings and considered a total of 37 sets of draft subsidiary legislation, including the *vires* to make them.

## **THE PROPOSALS**

### **Major policy considerations**

4. The Rules are based on the Securities (Exchange – Traded Stock Options) Rules (Cap. 333 Sub. Leg. K) and the Commodities Trading (Trading Limits) Rules (Cap. 250 Sub. Leg. E). The Rules apply to exchange-traded futures contracts and stock options contracts and set out the limits on the number of specified futures contracts and stock options contracts which may be held or controlled by any person in any one contract month or expiry month respectively (the prescribed limits). The Rules seek to prevent the holding of large concentrations of futures contracts and stock options contracts by one person without the exchange companies being notified, in order to minimize systemic risks in the markets. The Rules also provide flexibility by empowering the relevant exchange company or the SFC to allow a person to hold futures or stock options contracts in excess of the prescribed limits in specified circumstances.

5. Whilst no new policy changes have been incorporated into the existing Rules, a number of amendments have been made in order to enhance transparency, address market comments and improve drafting. Specifically, the Rules set out clearly the criteria which are currently adopted by the exchange companies in allowing certain persons to hold futures or stock options contracts in excess of the prescribed limits pursuant to the rules of the exchanges. The power to allow the holding of excesses on a case-by-case basis will now be vested in the SFC instead of the exchanges.

6. The notification requirements for a reportable position are now clearly set out in the Rules, which are adopted from the existing requirements under the rules of the exchanges. In accordance with section 35(2) of the SFO, the SFC has consulted the Financial Secretary before making the Rules.

7. The prescribed limits and reportable positions set out in the Schedules to the Rules have been updated to take into account the latest products launched on the exchanges. In addition, in response to market comments and having discussed with the exchanges, the SFC has decided to increase the reportable positions prescribed for the HSI and mini-HSI futures and options contracts (see item 27 of Schedule 1 to the Rules), from 250 to 500 and from 1250 to 2500 respectively. The SFC considers that increasing the thresholds for reportable positions will reduce the

administrative burdens of market participants without unduly increasing the systemic risks in the market. This will be welcomed by the market.

## **THE RULES**

8. Section 2 of the Rules contains interpretation provisions applicable throughout the Rules.

9. Section 3 of the Rules prescribes that the Rules shall apply to futures and stock options contracts that are traded on a recognized exchange company in accordance with its rules.

10. Section 4 of the Rules provides that no person may hold or control futures or stock options contracts in excess of the prescribed limits unless authorized by (a) the relevant exchange company under section 4(2); or (b) the SFC on a case-by-case basis under section 4(4). The types of persons who may be authorized by the exchange company under section 4(2) are market makers registered with either the Stock Exchange Company or the Futures Exchange Company, or issuers of structured products like derivative warrants and equity linked instruments listed under the Stock Exchange Listing Rules and their related corporations. Under section 4(4), the SFC may authorize certain persons to hold or control contracts in excess of the limits provided that such person is able to satisfy the SFC that special circumstances exist which warrant such excess and that such excess is not prejudicial to the interests of the investing public.

11. Section 5 provides that the limits on the number of contracts that may be held or controlled are specified, in respect of futures contracts in Schedule 1 and, in respect of stock options contracts, in Schedule 2.

12. Section 6(1) of the Rules provides that a person who holds or controls a reportable position must notify the exchange company concerned of that reportable position within one reporting day, providing the information specified in section 6(2).

13. Section 7 of the Rules permits the disaggregation of futures contracts or stock options contracts held on behalf of clients by exchange participants for the purposes of determining compliance with the limits and reporting requirements.

14. Section 8 of the Rules provides for the imposition of criminal penalties in respect of contraventions of section 4 or 6 of the Rules, and a defence of “reasonable excuse”. The maximum penalties are a fine at level 6 (currently at \$100,000) and 2 years’ imprisonment for conviction on indictment.

## **PUBLIC CONSULTATION**

15. The SFC released a consultation document and an exposure draft of the Rules on 28 March 2002 for comment by the public. Two submissions were received by the end of the consultation period.

16. A draft of the Rules was considered by the Subcommittee at its meeting on 16 September 2002. No major concerns were expressed by members of the Subcommittee at the meeting.

17. Subsequently, the SFC received further comments from the respondents as part of the ongoing dialogue regarding the Rules. The SFC has considered all the comments received and made amendments to the Rules as appropriate. The Subcommittee has been informed of these subsequent amendments.

## **FINANCIAL AND STAFFING IMPLICATIONS**

18. There are no financial or staffing implications for the Government.

## **COMMENCEMENT DATE**

19. The Rules will come into operation on the day appointed for the commencement of the SFO, together with other subsidiary legislation necessary for the commencement. We expect this to take place shortly, after completion of the negative vetting procedure through the Legislative Council and allowing the industry a reasonable period of time for making necessary adjustments with reference to the subsidiary legislation. We aim to announce the target commencement date by the end of 2002.

## **PUBLICITY**

20. The Rules will be published in the Gazette on 13 December 2002. The SFC will issue a press release on the same day.

## **ENQUIRIES**

21. For any enquiries on this brief, please contact Ms. Alexandra Yeong of the Supervision of Markets Division of the SFC at 2840 9247 or Ms. Mary Ahern of the Legal Services Division of the SFC at 2283 6809.

The Securities and Futures Commission  
13 December 2002