

LEGISLATIVE COUNCIL BRIEF

SECURITIES AND FUTURES ORDINANCE (CAP. 571)

SECURITIES AND FUTURES (CONTRACTS LIMITS AND REPORTABLE POSITIONS) (AMENDMENT) RULES 2007

INTRODUCTION

1. At its meeting on 15 January 2007, the Securities and Futures Commission (the “**Commission**”) made the Securities and Futures (Contracts Limits and Reportable Positions) (Amendment) Rules 2007 (the “**Amendment Rules**”) at the Annex.

BACKGROUND AND ARGUMENT

2. Section 35(1) of the Securities and Futures Ordinance (Cap. 571) (the “**SFO**”) provides that the Commission may prescribe limits and reportable positions on futures contracts and options contracts. These limits and positions are prescribed in the Securities and Futures (Contracts Limits and Reportable Positions) Rules (Cap. 571Y, sub leg) (the “**Rules**”).

*Adjustment to the Position Limits of Hang Seng China Enterprises Index (“**H-shares index**”) futures and options contracts*

3. To maintain Hong Kong’s position as the premier capital raising centre for the Mainland, we must be able to provide cost effective and highly liquid derivative products for market participants to manage the risks of H-shares and other Mainland related securities.
4. The Commission proposes to adjust the position limits of H-shares index futures and options contracts from 6,000 contracts per futures contract month or options contracts series to an aggregate delta limit of 12,000 applicable to all futures contract months and options series.

5. The Commission has been keeping watch of the market situation and in discussions with Hong Kong Exchanges and Clearing Limited (“**HKEx**”) in respect of the current position limits of H-shares index futures and options contracts. The market feedback is that the present position limits are not sufficient to cope with the strong growth in the H-shares market. Between December 2003 to December 2006, market capitalization and average daily turnover of Hshares have increased by 728% to HK\$3,379 billion and by 224% to HK\$17.8 billion respectively but the position limits of H-shares index futures and options contracts have remained unchanged.
6. If the position limits of H-shares index futures and options contracts are not sufficient to meet the trading needs of market participants, they would have to shift part of their positions from HKEx’s derivative market to the Over-The-Counter (“**OTC**”) market or offshore markets. This would have an impact on market transparency as HKEx and the Commission would not be able to obtain information on the actual size of their positions. By increasing the position limits of H-shares index futures and options contracts, market participants would be encouraged to establish their positions on HKEx’s derivative market. This would help the Commission to identify any large exposure to the Hong Kong market and assess any potential implications to market stability.
7. The proposed adjustment to the position limits of H-shares index futures and options contracts could further enhance the liquidity of our market. It would also help to maintain Hong Kong’s competitiveness and leading market position vis-à-vis other exchanges which are keen to develop derivative products on Mainland related equities.
8. The Focus Group on Financial Services formed under the Economic Summit on “China’s 11th Five Year Plan and the development of Hong Kong” has also recommended adjustment to the position limits of H-shares index futures and options contracts.

THE AMENDMENT RULES

9. The Amendment Rules amend the Rules by repealing items 5 and 6 of Schedule 1 and replacing them with a new item 5 which combines the prescribed limits of H-shares index futures contracts and options contracts into an aggregate delta limit of 12,000 applicable to all H-shares index futures contract months and options series.
10. At present, the position limits of H-shares index futures and options contracts are separately applied to individual futures contracts months and options series. The proposed aggregate delta limit of 12,000 would better meet the market needs and accommodate the related risk exposure. It is also in line with the delta position limit arrangements of Hang Seng Index futures and options contracts.

PUBLIC CONSULTATION

11. As the amendments are essentially of a technical nature and in response to market feedback, the Commission does not consider it necessary to conduct a public consultation.
12. The Risk Management Committee (formed under section 65 of the SFO) and the Derivative Market Consultative Panel of HKEx have been consulted on the proposed amendment, and have not indicated any objection.

FINANCIAL AND STAFFING IMPLICATIONS

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

COMMENCEMENT

14. The Amendment Rules will come into operation on 30 March 2007.

PUBLICITY

15. The Amendment Rules will be gazetted on 2 February 2007.

ENQUIRIES

16. For any enquiries on this brief, please contact Lisa Chen, Counsel of the Legal Services Division of the Commission (at 2283 6183), or Stanley Ng, Senior Manager of the Supervision of Markets Division of the Commission (at 2283 6133).

The Securities and Futures Commission

29 January 2007