

Subcommittee on Securities and Futures (Contracts Limits and Reportable Positions) (Amendment) (No.2) Rules 2007

Follow-up to the First Meeting on 16 November 2007

This paper sets out the SFC's response to the issues raised at the first meeting of the Subcommittee on 16 November 2007.

Sanctions and Penalties for Breach of Limits

2. At the last meeting, Members asked if there would be sanctions or penalties if a person breaches the excess limit specified in the Gazette. In response, the SFC would like to point out that the limit to be specified in the Gazette is merely an indication of the maximum extent to which an excess could be authorized by the SFC. Whether a person is in breach of the prescribed limits depends on whether he has breached the actual authorization granted by SFC (on a case-by-case basis), not the limit specified in the Gazette. If a person authorized to exceed the prescribed limits breaches the actual authorization granted, he is guilty of an offence. Pursuant to section 8 of the Securities and Futures (Contracts Limits and Reportable Positions) Rules, the person will be liable on conviction on indictment to a fine at level 6 and to imprisonment for 2 years; or on summary conviction to a fine at level 3 and to imprisonment for 6 months.

Proposed Amendments to the Amendment Rules

3. In response to Members' question on whether specifying the "specified percentage" by Gazette notice may be ultra vires, Members may wish to note that section 35(1)(a) and (b) of the Securities and Futures Ordinance ("SFO") empowers the SFC to prescribe limits on, or conditions relating to, the number of futures contracts and options contracts which may be held or controlled by any person. Pursuant to section 398(8) of the SFO, rules made by the SFC may provide for the exercise of discretion in specified cases. The SFC considers that by providing for the SFC to authorize excesses up to the "specified percentage" (to be specified by Gazette notice), the Amendment Rules effectively provide for the exercise of discretion by the SFC as to the granting of authorization and the maximum extent of excess that may be authorized.

4. Having considered Members' concerns, the SFC now proposes to set out the "specified percentage", as well as the "specified contracts" in the Rules. This will mean any future changes to the "specified percentage" and the "specified contracts" will be subject to negative vetting by the Legislative Council ("**LegCo**") upon future amendments. The relevant changes to the Amendment Rules are set out in the resolution at **Annex**.

Alternative Approach as proposed by Members of the Subcommittee

5. Regarding Members' suggestion of an alternative approach to increase the statutorily prescribed limits and empower the SFC to impose a lower limit under specified circumstances, the SFC is of the view that the approach would have an impact on financial stability as well as operational difficulties.

6. On the financial stability front, Members may wish to note that the prescribed limits were put in place following the Asian financial crisis in 1998 to prevent the build-up of very large positions that may threaten market stability. The SFC considers it prudent to take a more cautious approach in relaxing the position limits regime as it is important to maintain a proper balance between market development and market stability. In fact, market feedback and an analysis of the positions held in the market indicate that it is mainly exchange participants and their affiliates that need higher limits. For the vast majority of market participants, the existing prescribed limits should suffice. The SFC considers that the need for further relaxations can be reassessed in light of experience gained after the implementation of the current proposals, and will return to LegCo for further approval in this regard if further adjustments are considered necessary.

7. On the operational front, the SFC is of the view that there may be enforcement difficulties if the prescribed limits are raised and then lower limits are imposed on certain persons under certain circumstances. In particular, it may not be possible to gather the necessary evidence, or to gather it promptly enough, to impose the necessary limitation in time.

Matching of Bilingual Texts

8. At the last meeting of the Subcommittee, the Assistant Legal Adviser to LegCo commented that the Chinese text of sections 4(7)(a) and 4(8) of the Amendment Rules include words to the effect of “holding and controlling” whereas the English text does not.

9. Having considered Members’ comments about the desirability of consistency, the SFC proposes to amend the English text by adding the words “holding and controlling” in the relevant sections as reflected in the resolution at Annex and highlighted as follows -

Section 4(7)(a)

Proposed Amendment to English Text (as underlined) –

“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...”

Chinese Text –

“該交易所參與者或該聯繫人(視屬何情況而定) 對尋求獲授權持有或控制的該等超逾訂明上限的合約有相關業務需要”

Section 4(8)

Proposed Amendment to English Text (as underlined) –

“The Commission shall not grant an authorization under subsection (6) if 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).”

Chinese Text –

“就尋求獲授權持有或控制數目超逾訂明上限的指明合約一事而言，如該事宜可根據第(2)款提述的有關認可交易所的規章獲授權，則證監會不得根據第(6)款作出有關授權。”

Next Step

10. Subject to Members' views, it is proposed that a motion be moved at a LegCo meeting on or before 19 December 2007 to pass the resolution at Annex to amend the Amendment Rules.

Securities and Futures Commission
22 November 2007

INTERPRETATION AND GENERAL CLAUSES ORDINANCE

RESOLUTION

(Under section 34(2) of the Interpretation and General Clauses Ordinance
(Cap. 1))

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

RESOLVED that the Securities and Futures (Contracts Limits and Reportable Positions) (Amendment) (No. 2) Rules 2007, published in the Gazette as Legal Notice No. 198 of 2007 and laid on the table of the Legislative Council on 31 October 2007, be amended, in section 2 –

- (a) in the new section 4(7)(a) and (8), in the English text, by adding “holding or controlling” before “the excess”;
- (b) in the new section 4(10) –
 - (i) by repealing the definition of “specified contract” and substituting –
““specified contract” (指明合約) means any of the following futures contracts or stock options contracts -
 - (a) Hang Seng Index futures and options contracts;
 - (b) Hang Seng China Enterprises Index futures contracts and options contracts;”;
 - (ii) by repealing the definition of “specified percentage” and substituting –
““specified percentage” (指明百分率) means 50%.”;
- (c) by repealing the new section 4(11).