

## LEGISLATIVE COUNCIL BRIEF

### SECURITIES AND FUTURES ORDINANCE (CAP. 571)

#### SECURITIES AND FUTURES (CONTRACTS LIMITS AND REPORTABLE POSITIONS) (AMENDMENT) RULES 2009

#### INTRODUCTION

1. At its meeting on 16 June 2008, the Securities and Futures Commission (the “**Commission**”) made the Securities and Futures (Contracts Limits and Reportable Positions) (Amendment) Rules 2008 now re-titled the Securities and Futures (Contracts Limits and Reportable Positions) (Amendment) Rules 2009 (the “**Amendment Rules**”) at the Annex.

#### BACKGROUND AND ARGUMENT

2. Section 35(1) of the Securities and Futures Ordinance (Cap. 571) provides that the Commission may make rules to prescribe limits on the number of futures contracts that may be held or controlled by a person and to require a person holding or controlling a specified reportable position to notify the recognised exchange company or the Commission. These limits and reportable positions are prescribed in the Securities and Futures (Contracts Limits and Reportable Positions) Rules (Cap. 571, sub. leg. Y) (the “**Rules**”).

#### *Position limit and reportable position of gold futures contract*

3. On 20 October 2008, Hong Kong Futures Exchange Limited (“**HKFE**”), a subsidiary of Hong Kong Exchanges and Clearing Limited (“**HKEx**”), launched a new futures contract on gold. HKEx launched the gold futures contract in response to the recommendation of the Government’s Economic Summit Report to develop commodity futures. The contract size of the gold futures contract is 100 troy ounces and it is denominated, traded and settled in US Dollars. The contract is cash-settled.

4. The Commission proposes to amend the Rules to set a reportable position and a position limit for the gold futures contract.
5. Under the rules of HKFE, the large open position reporting level for the gold futures contract is 500 open contracts in any one contract month. This requirement is identical to the large open position reporting level for major stock index futures and options contracts traded on HKEx. The Commission proposes to amend the Rules to set the reportable position for the gold futures contract at 500 open contracts in any one contract month.
6. The HKFE rules do not impose a position limit on the gold futures contract for the following reasons:-
  - (a) The gold market is a global market with ample liquidity and it is therefore relatively difficult for speculators to manipulate the price of gold.
  - (b) As the gold futures contract is settled in cash and does not require physical delivery of gold for settlement, the risk of short squeeze<sup>1</sup> is low.
  - (c) Other global products of HKEx are not subject to any position limit.
  - (d) The Loco London gold market, an Over-The-Counter gold market which is in competition with HKEx's gold futures contract, does not impose any position limit.

The Commission proposes to amend the Rules to set the position limit for gold futures contract at “nil”.

7. Although most gold futures contracts traded in overseas markets are subject to position limits, those contracts are settled via physical delivery of gold instead of cash and their position limits are therefore mainly intended to address the risks arising from physical delivery, eg a lack of sufficient physical gold available for delivery on settlement. If large positions are built up in the gold futures market which pose a threat to the market, HKEx can exercise its power

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<sup>1</sup> A “short squeeze” occurs when a lack of supply forces prices upwards rapidly. If the price of a commodity futures contract increases rapidly, many traders with short positions in respect of that commodity futures contract are forced to buy commodities in order to cover their positions and prevent or limit losses. This sudden surge of buying leads to even higher prices which further aggravates the losses of short sellers who have not covered their positions.

under the rules of HKFE to reduce the positions by setting a position limit. In such circumstances, the Rules can be further amended by the Commission.

8. For the reasons set out above, the Commission considers that the large open position reporting level and position limit under the rules of HKFE are reasonable and should be incorporated in the Rules.

#### **THE AMENDMENT RULES**

9. The Amendment Rules amend the Rules by adding a new item 5B to Schedule 1 to specify the position limit and reportable position for the gold futures contract.
10. The amendments mirror the position limit and the large open position reporting level specified in rules of HKFE.

#### **PUBLIC CONSULTATION**

11. The gold futures contract was launched on 20 October 2008. Since the market participants are required to comply with the large open position reporting requirement specified in the HKFE rules, the Commission does not consider it necessary to conduct any public consultation on the Amendment Rules which sets the same reportable position for the gold futures contract as specified in HKFE rules.

#### **FINANCIAL AND STAFFING IMPLICATIONS**

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

## **COMMENCEMENT**

13. The Amendment Rules will come into operation on 20 November 2009.

## **PUBLICITY**

14. The Amendment Rules will be gazetted on 3 July 2009.

## **ENQUIRIES**

15. For any enquiries on this brief, please contact Stanley Ng, Senior Manager of the Supervision of Markets Division of the Commission (at 2283 6133) or Vania Cheng, Senior Counsel of the Legal Services Division of the Commission (at 2283 6166).

**The Securities and Futures Commission**

**29 June 2009**

## Annex

### **SECURITIES AND FUTURES (CONTRACTS LIMITS AND REPORTABLE POSITIONS) (AMENDMENT) RULES 2009**

(Made by the Securities and Futures Commission under section 35(1) of the Securities and Futures Ordinance (Cap. 571))

#### **1. Commencement**

These Rules come into operation on 20 November 2009.

#### **2. Prescribed limit and reporting level for futures contracts**

Schedule 1 to the Securities and Futures (Contracts Limits and Reportable Positions) Rules (Cap. 571 sub. leg. Y) is amended by adding –

|      |                       |     |   |
|------|-----------------------|-----|---|
| “5B. | Gold futures contract | Nil | 500 open contracts for any one contract month”. |
|------|-----------------------|-----|---|

Martin WHEATLEY  
Chief Executive Officer,  
Securities and Futures Commission

29 June 2009

#### **Explanatory Note**

Under section 35(1) of the Securities and Futures Ordinance (Cap. 571), the Securities and Futures Commission may prescribe limits on the number of futures contracts that may be held or controlled by any person. It may also prescribe the reportable positions in respect of such contracts.

2. Such limits and reportable positions are established and fixed for the futures contracts specified in Schedule 1 to the Securities and Futures (Contracts Limits and Reportable Positions) Rules (Cap. 571 sub. leg. Y). The purpose of these Rules is to set out the prescribed limit and reportable position for a gold futures contract.