

**立法會**  
**Legislative Council**

LC Paper No. CB(1)253/07-08

Ref : CB1/SS/3/07

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

**Background brief**

**Purpose**

This paper provides background information on the Securities and Futures (Contracts Limits and Reportable Positions) (Amendment) (No.2) Rules 2007 (the Amendment Rules) and highlights the key issues which may warrant further scrutiny from the policy and legal/drafting perspectives.

**Background**

2. At present, section 4 of the Securities and Futures (Contracts Limits and Reportable Positions) Rules (the Rules) prohibits a person (except an authorized person) from holding or controlling a futures contract or a stock options contract in excess of the prescribed limit set out in Schedules 1 and 2 to the Rules. Section 4(4)(a) of the Rules empowers the Securities and Futures Commission (SFC) to authorize a person to hold or control the relevant contract exceeding the prescribed limit if such person is able to satisfy SFC that there are special circumstances which warrant the excess position.

3. On 18 May 2007, SFC issued a consultation paper to invite comments on proposed amendments to the Rules and the Guidance Note on Position Limits and Large Open Position Reporting Requirements<sup>1</sup>. The consultation period ended on 18 June 2007 and a total of seven responses were received. According to SFC, most respondents to the consultation were generally supportive of the proposed amendments to the Rules. SFC has also revised some of its original proposals in the light of the comments received.

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<sup>1</sup> The Guidance Note is issued by SFC to help market participants better understand how the Rules are intended to operate in practice and explain compliance requirements of the Rules. It is intended to clarify SFC's policy intent and position on issues raised by the industry and does not have the force of law. The Guidance Note was first published in March 2003 and revised in April 2004.

## **The Amendment Rules**

4. The Amendment Rules seek to amend section 4 of the Rules to empower SFC to authorize an exchange participant or his affiliate<sup>2</sup> to hold or control a specified contract in excess of the prescribed limit up to the specified percentage (proposed to be set at 50%) if SFC is satisfied that there is a relevant business need for the excess. In other words, a new category of authorization that may be granted by SFC is to be introduced. The terms "relevant business need", "specified contract" and "specified percentage" are defined in the new section 4(10) as added by the Amendment Rules. "Relevant business need" means a business need that requires an exchange participant or his affiliate to engage in hedging activities to facilitate the provision of services to his clients. "Specified contract" and "specified percentage" are defined to mean respectively a futures contract or stock options contract and the percentage specified by SFC by notice published in the Gazette. The new section 4(11) provides that such notice is not subsidiary legislation.

## **Issues for further consideration**

5. Pursuant to the decision of the House Committee on 9 November 2007, a subcommittee has been set up to examine the Amendment Rules. In this connection, members may wish to give further consideration to the following issues :

### Nature of the notice referred to in the definitions of "specified contract" and "specified percentage" under the Amendment Rules

6. SFC's original proposal that went to consultation was to specify the upper limit of 50% in the Rules themselves. According to paragraph 17 of the LegCo Brief issued by SFC in October 2007, many respondents suggested removing or increasing the 50% limit as that would provide greater flexibility. SFC has subsequently revised its proposal so that the upper limit of 50% will not be specified in the Rules per se, but by notice published in the Gazette. Such notice is not subsidiary legislation. SFC considers that the new arrangement will enable SFC to change the upper limit within a shorter period of time if necessary, thereby allowing for a degree of flexibility whilst still providing greater certainty for the market.

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<sup>2</sup> Pursuant to Part 1 of Schedule 1 to the Securities and Futures Ordinance (Cap. 571), "Exchange Participant" means a person (a) who, in accordance with the rules of a recognized exchange company, may trade through that exchange company or on a recognized stock market or a recognized futures market operated by that exchange company; and (b) whose name is entered in a list, roll or register kept by that recognized exchange company as a person who may trade through that exchange company or on a recognized stock market or a recognized futures market operated by that exchange company. Under the Amendment Rules, "affiliate" means, in relation to an exchange participant, any corporation belonging to the same group of companies as the exchange participant.

7. It should be noted that under the new arrangement, the notice published in the Gazette is not subsidiary legislation and will not therefore be subject to the vetting or amendment by the Legislative Council in accordance with section 34 or section 35 of the Interpretation and General Clauses Ordinance (Cap.1). SFC is of the view that the new arrangement is consistent with the policy adopted in the Securities and Futures Ordinance (Cap. 571) (SFO) and its subsidiary legislation, which contain provisions similar to the new section 4(11) of the Amendment Rules. Examples cited by SFC include sections 20(3), 24(7), 41(7), 175(8A), 324 and 402 of SFO; as well as section 25(5) and (6) of the Securities and Futures (Investor Compensation – Levy) Rules (Cap. 571 sub. leg. AB). A summary of the relevant provisions is in the **Appendix I**.

8. Members may wish to examine whether it is justifiable and desirable for SFC to adopt this approach in specifying the upper limit on excess position, instead of including the percentage in the Rules as previously proposed.

#### Legal basis for the making of the Amendment Rules

9. It is noted that section 35(1) of SFO under which the Amendment Rules are made specifies that the rules are to be made by SFC. Under section 10(2)(b) and Part 2 of Schedule 2 to SFO, no delegation of SFC's functions shall be made in respect of the function to make subsidiary legislation under or pursuant to any Ordinance. The Amendment Rules, as published in L.N.198, are signed by the Chief Executive Officer of SFC. It is also noted that rules made by SFC under SFO before the commencement of the Securities and Futures (Amendment) Ordinance (15 of 2006) on 23 June 2006 were signed by the Chairman of SFC.

10. In its written reply, SFC confirmed that the Amendment Rules were made by the Commission at its meeting on 29 August 2007. In line with the Commission's usual practice, the Amendment Rules were subsequently signed on behalf of the Commission by the Chief Executive Officer. SFC has also advised that following the enactment of the Securities and Futures (Amendment) Ordinance (15 of 2006), the Chairman of SFC is no longer an executive post and the Chief Executive Officer has performed the executive functions previously performed by the SFC Chairman.

#### Bilingual texts

11. It has been found that the bilingual texts of the new section 4(7)(a) and (8), as added by the Amendment Rules, do not match in that the Chinese text contains more details which are not found in the English text; and that the drafting of the section is inconsistent with that of section 4(4)(a) and (4)(b). According to SFC, the matter has been considered by the Law Drafting Division of the Department of Justice which is of the view that there is no discrepancy in the legal meaning of the bilingual texts of the new section 4(7)(a) and (8). A table setting out the relevant texts is at **Appendix II**.

12. Members may wish to consider whether the provisions, as currently drafted, are desirable.

Council Business Division 1  
Legislative Council Secretariat  
15 November 2007

### **Summary of sections 20(3), 24(7), 41(7), 175(8A), 324 and 402 of SFO and section 25(5) and (6) of the Securities and Futures (Investor Compensation – Levy) Rules (Cap. 571 sub. leg. AB)**

(i) Section 20(3) of SFO

Section 20(1) of SFO provides that no transaction may be conducted on a recognized stock market other than dealings in securities, and other financial products which are approved by SFC by notice published in the Gazette either generally or in a particular case. A similar provision that applies to transactions on a recognized futures market is provided in section 20(2). Section 20(3) provides that a notice under section 20(1) and (2) is not subsidiary legislation.

(ii) Sections 24(7) and 41(7) of SFO

Sections 24(1) and 41(1) of SFO respectively require the rules of a recognized exchange company and of a recognized clearing house to be approved by SFC before the rules can take effect. Under sections 24(7) and 41(7), SFC may by notice published in the Gazette declare a class of rules which are not required to be so approved. Such notice is not subsidiary legislation as provided in sections 24(8) and 41(8).

(iii) Section 175(8A) of SFO

Under section 175(1) of SFO, an intermediary or representative for certain regulated activities shall not communicate an offer to acquire or dispose of any securities of, or issued by, a body unless the offer complies with the requirements specified in the section. Section 175(5)(aa)(ii) provides that section 175 does not apply to an offer specified by SFC, by notice published in the Gazette, as an offer to which section 175 does not apply. Section 175(8A) provides that a notice published under section 175(5)(aa)(ii) is not subsidiary legislation.

(iv) Sections 324 and 402 of SFO

Section 324 of SFO empowers SFC to specify by notice published in the Gazette the form of a notification required to be given under that section. Section 402 provides that SFC may, by notice published in the Gazette, specify any form in respect of any other document required to be lodged, filed or submitted with or to SFC for the purposes of SFO. Sections 324(8) and 402(7) provide that such notice is not subsidiary legislation.

(v) Section 25(5) and (6) of the Securities and Futures (Investor Compensation – Levy) Rules (Cap. 571 sub. leg. AB) ("the Levy Rules")

Under section 25 of the Levy Rules, SFC is required to publish an exemption notice in the Gazette under specified circumstances exempting a person from paying any levy under the Levy Rules in respect of a sale or purchase of securities or futures contract that takes place on or after the date specified in the exemption notice. Section 25(6) of the Levy Rules provides that an exemption notice is not subsidiary legislation.

## Appendix II

### Bilingual texts of section 4(4)(a),(4)(b),(7)(a) and (8) of the Securities and Futures (Contracts Limits and Reportable Positions) Rules as amended by L.N. 198 of 2007

(Prepared by the Legal Service Division of the Legislative Council Secretariat)

Section	English text	Chinese text
4(7)(a)	"the exchange participant or the affiliate (as the case may be) has a relevant need for <u>the excess for which authorization is sought</u> ".	"該交易所參與者或聯繫人(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"。
4(8)	"The Commission shall not grant an authorization under subsection (6) if <u>the excess for which authorization is sought</u> may be authorized under the rules of the recognized exchange company concerned as referred to in subsection (2).".	"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。"。
4(4)(a)	"the person- (i) is <u>authorized</u> under subsection (5) <u>to hold or control such excess</u> ' or (ii) is <u>authorized</u> under subsection (6) <u>to hold or control such excess</u> ".	"該人— (i) 根據第(5)款獲授權持有或控制該等超逾訂明上限的合約；或 (ii) 根據第(6)款獲授權持有或控制該等超逾訂明上限的合約"。
4(4)(b)	"the Commission is satisfied that <u>the excess</u> would not be prejudicial to the interest of the investing public having regard to the prescribed limit and the liquidity of the futures contract or stock options contract in question".	"證監會在顧及有關期貨合約或股票期權合約的訂明上限及流通量後，信納超逾上限不會損害投資大眾的利益"。