

LEGISLATIVE COUNCIL BRIEF

SECURITIES AND FUTURES ORDINANCE (CAP. 571)

SECURITIES AND FUTURES (CONTRACTS LIMITS AND REPORTABLE POSITIONS) (AMENDMENT) RULES 2017

INTRODUCTION

Pursuant to section 35 of the Securities and Futures Ordinance (“SFO”), the Securities and Futures Commission (“SFC”) made the Securities and Futures (Contracts Limits and Reportable Positions) (Amendment) Rules 2017 at the Annex on 20 February 2017 (“Amendment Rules”).

BACKGROUND AND ARGUMENT

The Position Limit Regime

2. The position limit regime for futures and options contracts in Hong Kong was introduced in 1999 in the wake of the Asian Financial Crisis with the purpose to prevent and discourage the build-up of large positions in the market which may pose a threat to the orderly functioning and stability of the Hong

Kong financial market. Under section 35(1) of the SFO, the SFC may make rules to prescribe position limits and reportable positions on futures contracts and options contracts. These are set out in the Securities and Futures (Contracts Limits and Reportable Positions) Rules (Cap. 571Y) (“CLRP Rules”). The position limit regime establishes different levels of position limits and large open position reporting requirements for different futures and options contracts traded on The Stock Exchange of Hong Kong (“SEHK”) or the Hong Kong Futures Exchange (“HKFE”). The CLRP Rules currently provide the following specific exceptions for market participants to hold or control excess positions under certain conditions –

- (a) the SEHK or the HKFE may authorize the following persons to hold futures and options positions in excess of the statutory position limits –
 - (i) market makers or liquidity providers of futures/options contracts traded on the HKFE and stock options contracts traded on the SEHK for the purpose of performing market making or liquidity providing activities in respect of the relevant futures/options or stock options contracts; and
 - (ii) issuers (or their related corporations) of structured products listed under Chapter 15A of the SEHK’s Listing Rules who hold or control futures/options contracts or stock options

contracts in the course of hedging the risks of the structured products acquired for the purpose of performing liquidity providing activities; and

- (b) the SFC may approve an exchange participant (“EP”) and its affiliate to hold or control an excess position limit for the Hang Seng Index (“HSI”) and the Hang Seng China Enterprises Index (“HHI”) futures and options contracts up to 50% of the statutory position limit for client facilitation purposes (“Client Facilitation Excess Position Limit”). In addition, the SFC may authorize a person to hold or control a futures contract or stock options contract in excess of the prescribed limit if the SFC is satisfied that there are special circumstances which warrant the person holding or controlling such excess position.

3. Over the years, the SFC has regularly reviewed the position limits and made amendments, as appropriate, to ensure that a proper balance is struck between maintaining financial stability and facilitating market development. In light of the continuous growth and developments in the Hong Kong securities and futures markets in recent years, the SFC proposes some enhancements to the position limit regime. The proposed enhancements comprise the following five areas –

- (a) raising the cap on the excess position limit that may be granted to an EP or its affiliate under the existing Client Facilitation Excess Position Limit;
- (b) introducing a new excess position limit for market makers of exchange traded funds (“ETFs”);
- (c) introducing a new excess position limit for index arbitrage activities;
- (d) introducing a new excess position limit for asset managers; and
- (e) increasing the statutory position limit for stock options contracts.

Details are set out in the following sections.

Client Facilitation Excess Position Limit

4. Currently, under section 4(7) of the CLRP Rules, the SFC may authorize an EP or its affiliate to hold or control a specified contract, i.e. any of the HSI and the HHI futures and options contracts, in excess of the prescribed limits by up to 50%. The SFC may authorize such excess position limit if the SFC is satisfied that the EP or its affiliate has a “relevant business need”¹. The

¹ The term “relevant business need” is defined in section 4(10) of the CLRP Rules to mean a business need that requires an exchange participant or its affiliate to engage in hedging activities to facilitate the provision of services to its clients. For example, the firm may have sold an over-the-counter (“OTC”) derivatives product to a client and then use a futures contract to hedge the risk of the OTC derivatives product.

criterion was designed to ensure that excess positions would be sought and authorized only for the purpose of helping EPs and their affiliates to better serve their clients.

5. Despite the growth of the Hong Kong market in recent years, the SFC notes that the Client Facilitation Excess Position Limit has not been widely used. Some market participants explained to the SFC that as the maximum cap on the excess limit of 50% is not large enough vis-à-vis the size of their business activities, there has been no strong incentive for them to apply for the excess position; instead they would rely on the OTC derivatives market for hedging purposes. They also expressed that they would prefer to use more exchange-traded contracts to meet their business needs as exchange markets offer better price transparency, operation efficiency and capital efficiency. Raising the cap on the excess position limit will encourage market participants to move their OTC derivative positions to the exchange market which will result in greater market transparency and enable the SFC to better assess the potential implications on the stability of the financial market. In view of the above, the SFC proposes to raise the cap on the Client Facilitation Excess Position Limit from its current level of 50% to 300%².

² As in the case of the maximum cap on the excess limit of 50%, the proposed cap of 300% is an upper limit. The SFC will determine the size of the excess position to be authorized on a case-by-case basis after taking into consideration various factors such as the needs of the applicant and prevailing market conditions.

6. Currently, to apply for the excess position limit, an EP or its affiliate is required to have “adequate financial capability”. As defined in section 4(10) of the CLRP Rules, this means that the EP or its affiliate or their holding company must have either a net asset value (“NAV”) of not less than \$2 billion as set out in the latest audited financial statements or a qualifying credit rating³. To ensure that an EP or its affiliate has sufficient financial capability to manage the risk exposure that could result from the higher position limit, the SFC proposes to tighten the financial requirements by raising the NAV requirement to the level of not less than \$5 billion.

Exchange Traded Funds Market Maker Excess Position Limit

7. At present, under sections 4(2) and 4(3) of the CLRP Rules, market makers and liquidity providers registered with the HKFE and the SEHK, and issuers of structured products listed under Chapter 15A of the SEHK’s Listing Rules and their related corporations, may be authorized by the HKFE or the SEHK to hold or control futures or stock options contracts in excess of the prescribed limits for the purposes of conducting market making or liquidity providing activities, or hedging the related risks. These provisions do not cover ETF market makers who may also have a need to hedge their ETF market

³ As defined in Schedule 1 to the SFO, a qualifying credit rating means (1) a rating of A3 or above for long term debt; or a Prime-3 or above for short term debt issued by Moody’s Investors Service; or (2) a rating of A or above for long term debt; or A-3 or above for short term debt issued by Standard & Poor’s Corporation.

making positions using futures and options contracts. If the futures and options contracts held by ETF market makers get close to the position limits, they may not be able to effectively hedge the risks of any additional ETF positions. This could hinder them from performing their market making function and adversely affect investors who want to trade the relevant ETFs⁴.

8. In view of the above, the SFC proposes to expand the classes of persons specified under section 4(3) of the CLRP Rules such that the SEHK or the HKFE may authorize ETF market makers to hold or control futures or options contracts in excess of the prescribed limits for hedging the risks that arise from their ETF market making activities. This will facilitate ETF market makers in discharging their market making function and managing the associated risks.

Index Arbitrage Activity Excess Position Limit

9. Index arbitrage is a trading strategy designed to capture the profit arising from price discrepancies between the value of some or all of the stocks comprising an index and the price of the derivatives products with that index as the underlying, e.g. stock index futures. Index arbitrage activities can provide

⁴ The ETF market in Hong Kong has been expanding significantly over the past decade. During the period from 2005 to 2015, the average daily turnover of ETFs tracking the HSI and the HHI grew at an annualized rate of 44% and 67% respectively.

liquidity to the derivatives market as well as the stock market. More importantly, if there is mispricing between stock index derivatives contracts and the underlying stocks of the index concerned, index arbitrage activities can help to bring the price of stock index derivatives to a fair level. This price adjustment process is important, as bringing the price of stock index derivatives more in line with the value of the underlying stocks of the index would make stock index derivatives more effective hedging instruments. On the other hand, if there is misalignment between the price of the stock index derivatives and the value of the constituent stocks of the underlying index, investors using stock index derivatives to hedge their exposure would face a higher cost.

10. The SFC has received feedback from market participants that index arbitrage activities should also be considered as eligible to apply for an excess position limit. In view of the benefits of index arbitrage activities to the market and the expected need for an excess position limit to facilitate such activities, the SFC proposes that EPs and their affiliates should be eligible to apply to the SFC for authorization to hold or control HSI and HHI futures and options contracts in excess of their prescribed limits. The cap on the excess position limits to be granted will be set at 300% of the prescribed limits.

11. Similar to the case of the Client Facilitation Excess Position Limit, such authorization will only be granted to an EP or its affiliate who meets the

following criteria –

- (a) the excess position limit must be used for genuine index arbitrage activities;
- (b) the EP or its affiliate should have strong financial capability to cover the potential risks arising from the excess position. In this regard, the SFC proposes to apply the new “adequate financial capability” requirement for the Client Facilitation Excess Position Limit as proposed in paragraph 6 above; and
- (c) the EP must have effective internal control procedures and risk management systems to manage the potential risks arising from the excess limit.

Asset Manager Excess Position Limit

12. For the purpose of compliance with the prescribed limits and reporting requirements, section 7 of the CLRP Rules allows a person to disaggregate his own position from the position he holds or controls for other persons. However, as provided in the CLRP Rules, a person who has the discretion to buy or sell any futures contracts or stock options contracts for another person is

regarded as holding or controlling the contracts for the second person. In such cases, the prescribed limits and reportable positions will apply to the total positions that the first person “holds or controls”, i.e., the futures contracts or stock options contracts he holds or controls for his own account and those of the second person.

13. An asset manager who has the mandate to buy and sell futures and options contracts for funds under his management is considered to “hold or control” the positions of the funds under his management under the CLRP Rules. Therefore, he is required to aggregate all the futures and options positions of each fund for the purpose of compliance with the prescribed limits. As a result, some asset managers have voiced concerns that the existing prescribed limits are too restrictive.

14. Based on market feedback, we understand that asset managers may have a genuine business need to use stock index futures and options contracts to facilitate portfolio management. Therefore, the SFC proposes to introduce a new excess position limit under which the SFC may authorize asset managers to hold or control HSI and HHI futures and options contracts in excess of the prescribed limits. The cap on the excess position limits to be granted will be set at 300% of the prescribed limits. This will provide asset managers with

greater flexibility in managing different funds under their control and in turn help to further promote Hong Kong as an asset management centre.

15. As the build-up of substantial positions could have a significant impact on the stability of the financial market, the SFC also proposes some safeguards to minimise any undesirable impact. To be eligible for the excess position limit, an asset manager must satisfy the criteria of –

- (a) being an intermediary licensed or registered for Type 9 regulated activity (i.e. asset management) under the SFO and the total value of assets under management (“AUM”) should be no less than \$80 billion;
- (b) demonstrating that he or she has a genuine business need to use HSI and HHI futures and options contracts to facilitate the asset management activity; and
- (c) having effective internal control procedures and risk management systems to manage the potential risks arising from the excess position.

Stock Options Contracts Position Limit

16. The Hong Kong Exchanges and Clearing Limited (“HKEX”) issued a consultation paper on its proposal to revise its stock option position limit model in April 2016. One key aspect of the HKEX’s proposal is to raise the position limit for stock options. The HKEX proposed to replace its existing two-tier position limit model (i.e. 30 000 and 50 000 contracts) with a three-tier model, comprising higher position limit levels of 50 000, 100 000 and 150 000 contracts. The HKEX will assign position limit tiers to individual stock options contracts using a methodology based on market capitalization and liquidity of the underlying securities of the stock options contracts. The assigned tiers will be reviewed both on a regular and ad-hoc basis. The consultation conclusions were published in June 2016. A majority of respondents were in favour of the proposal.

17. At present, the prescribed limit for all stock options contracts under the CLRP Rules is 50 000 contracts. This position limit has been in place since 2006. On the other hand, the stock options market has since experienced significant growth. The number of underlying stocks increased from 42 in 2006 to 84 in 2015, whilst the average daily turnover rose from 73 390 contracts to 374 346 contracts.

18. Based on the SFC's analysis and discussion with market participants, the SFC agrees that there is a need to increase the position limit for stock options across the board and that the proposed increase in the stock options position limit would not create any significant risks to the Hong Kong stock market.

19. To facilitate the HKEX's implementation of its proposal, the SFC proposes to amend the CLRP Rules to increase the prescribed limit of stock options contracts from 50 000 contracts to 150 000 contracts. The proposed limit of 150 000 contracts will apply to all stock options contracts.

20. Overall, the SFC considers that the proposed enhancements to the existing position limit regime mentioned in paragraphs 4 to 19 above will bring benefits to the Hong Kong market and encourage market participants to establish their positions on the exchange-traded market, resulting in greater market transparency. The proposals will also help to promote Hong Kong as a risk management centre and an asset management centre. Various measures are included in the proposals to minimise the associated risks to the Hong Kong market or any potential adverse impact on market stability.

Prescribed Limits and Reporting Levels for New Futures Contracts

21. The HKFE launched a number of new futures and options contracts, including –

- (a) three cash-settled London Metal Mini futures contracts on nickel, lead and tin launched on 14 December 2015;
- (b) a cash-settled currency futures contract on Renminbi against the US dollar launched on 30 May 2016;
- (c) a cash-settled Mini-Hang Seng China Enterprises Index options contract launched on 5 September 2016; and
- (d) a physically-settled options contract on the US dollar against Renminbi launched on 20 March 2017.

22. The SFC proposes to set prescribed limits and reportable positions for these new futures and options contracts in the CLRP Rules. To minimise the compliance burden of market participants, the SFC proposes to impose the same reportable positions of 500 contracts on all these new contracts. The proposed limits and reportable positions mirror those currently specified in the HKFE rules and market participants are already required to comply with these requirements. For the futures and options contracts that have the same underlying index or currency pair as the other existing contracts traded on the

HKFE, they will share an aggregate position limit with those existing contracts.

23. Details of the proposed limits and reportable positions of the new futures and options contracts are set out in section 6 of the Amendment Rules (items 5, 13, 18, 19 and 20 in Schedule 1 to the CLRP Rules). The Amendment Rules also include some minor amendments to the descriptions of the contracts referred to in items 4, 5 and 9 in Schedule 1 to the CLRP Rules.

THE AMENDMENT RULES

24. The main object of the Amendment Rules is to amend the CLRP Rules by expanding the categories of persons who may be authorized to hold or control a futures contract or stock options contract in excess of the prescribed limits set out in Schedule 1 or 2 to the CLRP Rules (“excess authorizations”), and by increasing the prescribed limits for stock options contracts set out in Schedule 2 to the CLRP Rules. The main provisions of the Amendment Rules are as follows –

- (a) section 3 amends section 2 of the CLRP Rules by adding definitions used in new sections 4C, 4D and 4E, which respectively relate to excess authorizations granted by the SFC

for Client Facilitation Excess Position Limit, Index Arbitrage Activity Excess Position Limit and Asset Manager Excess Position Limit, and amends the definition of “specified contract” for clarity;

(b) section 4 amends section 4 of the CLRP Rules (“existing section 4”) and section 5 adds new sections 4A to 4E to the CLRP Rules, which seek to expand the scope of excess authorizations that may be granted, together with consequential amendments to restructure the existing section 4 for better presentation. These include –

(i) the new section 4A sets out the categories of persons (existing section 4(3)) who may be granted excess authorizations under the rules of the relevant recognized exchange company under the existing section 4(2) and expands the scope to include Stock Exchange Company market makers in ETFs;

(ii) the new section 4B provides for the SFC’s power to grant excess authorizations to persons in special circumstances (existing section 4(5));

- (iii) the new section 4(3) expands the categories of persons who may be granted excess authorization by the SFC;
 - (iv) the new sections 4(4) and (5) set out the various matters (similar to the existing sections 4(4), (8) and (9)) relating to the grant and withdrawal of excess authorizations by the SFC;
 - (v) the new section 4C provides for the SFC's power to grant the Client Facilitation Excess Position Limit (similar to the existing sections 4(6) and (7), except in so far as the definitions of "adequate financial capability" and "specified percentage" are concerned);
 - (vi) the new section 4D empowers the SFC to grant excess authorizations for the purpose of index arbitrage activity;
and
 - (vii) the new section 4E empowers the SFC to grant excess authorizations for the purpose of asset management activity.
- (c) section 6 amends Schedule 1 to the CLRP Rules by –
- (i) making minor drafting amendments to the descriptions of the contracts referred to in items 4, 5 and 9;

- (ii) adding the Mini-Hang Seng China Enterprises Index options contract to item 5;
 - (iii) adding the US Dollar vs Renminbi (Hong Kong) options contract and the Renminbi (Hong Kong) vs US Dollar futures contract to item 13;
 - (iv) adding the London Metal Mini futures contracts respectively for nickel (item 18), lead (item 19) and tin (item 20); and
- (d) section 7 amends Schedule 2 to the CLRP Rules by increasing the prescribed limits for stock options contracts to 150 000 contracts.

COMMENCEMENT DATE

25. The Amendment Rules will come into operation on 1 June 2017.

FINANCIAL AND STAFFING IMPLICATIONS

26. There are no financial or staffing implications for the Government or the SFC.

PUBLIC CONSULTATION

27. On 20 September 2016, the SFC issued a public consultation paper on the proposed enhancements to the position limit regime, as well as the associated amendments to the CLRP Rules and the Guidance Note on Position Limits and Large Open Position Reporting Requirements. The public consultation ended on 21 November 2016. During the consultation period, the SFC received a total of ten written submissions from various market participants and professional bodies. In general, the respondents were supportive of the proposals to enhance the position limit regime. A number of them further suggested relaxing some of the proposed requirements and criteria for the proposed excess position limits. After considering all the comments received and suggestions put forward, the SFC considers that the proposed enhancements are appropriate. In response to the comments received, the SFC has revised the AUM requirement applicable to the Asset Manager Excess Position Limit from \$100 billion to \$80 billion. The other proposals remain unchanged. The SFC published the consultation conclusions and issued a press release on 21 March 2017.

28. On 14 December 2016, the SFC briefed the Legislative Council Panel on Financial Affairs on the proposed enhancements to the position limit regime.

Panel members were generally supportive of the SFC's proposals.

PUBLICITY

29. The Amendment Rules will be published in the Gazette on 24 March 2017.

ENQUIRIES

30. For any enquiries on this brief, please contact Mr Stanley Ng, Associate Director of the Supervision of Markets Division of the SFC at 2231 1133.

The Securities and Futures Commission

22 March 2017

Securities and Futures (Contracts Limits and Reportable Positions) (Amendment) Rules 2017

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Securities and Futures (Contracts Limits and Reportable Positions) (Amendment) Rules 2017

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

1. Commencement

These Rules come into operation on 1 June 2017.

2. Securities and Futures (Contracts Limits and Reportable Positions) Rules amended

The Securities and Futures (Contracts Limits and Reportable Positions) Rules (Cap. 571 sub. leg. Y) are amended as set out in sections 3 to 7.

3. Section 2 amended (interpretation)

- (1) Section 2(1), definition of *reportable position*, paragraph (b)—

Repeal the full stop

Substitute a semicolon.

- (2) Section 2(1)—

Add in alphabetical order

“*adequate financial capability* (充足財政能力), in relation to an exchange participant or an affiliate of an exchange participant, means any one of the exchange participant, the affiliate or their holding company, has—

- (a) a net asset value of not less than \$5 billion as set out in its latest audited financial statements; or

- (b) a qualifying credit rating;

affiliate (聯屬公司), in relation to an exchange participant, means any corporation belonging to the same group of companies as the exchange participant;

specified contract (指明合約) means any of the following futures contracts—

- (a) Hang Seng Index futures contracts and options contracts;

- (b) Hang Seng China Enterprises Index futures contracts and options contracts;

specified percentage (指明百分率) means 300%.”.

4. Section 4 amended (restrictions on number of contracts held or controlled)

- (1) Section 4(1)—

Repeal

“and (4)”

Substitute

“and (3)”.

- (2) Section 4(2)—

Repeal

“in subsection (3)”

Substitute

“in section 4A”.

- (3) Section 4—

Repeal subsections (3), (4) and (5)

Substitute

- “(3) A person may hold or control a futures contract or stock options contract in excess of the prescribed limit if the person is authorized by the Commission to do so under section 4B, 4C, 4D or 4E.
- (4) The Commission may, under section 4B, 4C, 4D or 4E, authorize a person to hold or control a futures contract or stock options contract in excess of the prescribed limit—
- (a) except in circumstances where 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);
 - (b) only if the Commission is satisfied that the excess 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; and
 - (c) by giving the person a notice of authorization in writing.
- (5) An authorization granted under section 4B, 4C, 4D or 4E—
- (a) subject to paragraph (b), is valid for the period (if any) that the Commission may specify in the notice of authorization given under subsection (4)(c);
 - (b) may be withdrawn by the Commission, at any time, by at least 5 business days’ notice in writing to the person authorized and, where the person authorized is an affiliate of an exchange participant, also to the exchange participant; and

- (c) is subject to any reasonable conditions that the Commission may specify in the notice of authorization given under subsection (4)(c) and the Commission may, at any time, by at least 5 business days’ notice in writing to the person authorized and, where the person authorized is an affiliate of an exchange participant, also to the exchange participant, amend or revoke any condition or impose new conditions as may be reasonable in the circumstances.”.

(4) Section 4—

Repeal subsections (6), (7), (8), (9) and (10).

5. Sections 4A to 4E added

After section 4—

Add

“4A. Authorization under rules of recognized exchange company to hold or control contracts in excess of prescribed limit

A person who may be authorized for the purposes of section 4(2) is—

- (a) a person registered with the Futures Exchange Company for the purpose of performing market making or liquidity providing activities in respect of futures contracts in accordance with its rules;
- (b) a person registered with the Stock Exchange Company for the purpose of performing market making or liquidity providing activities, in accordance with its rules—
 - (i) in respect of stock options contracts; or

- (ii) in respect of exchange traded funds, where the person holds or controls futures contracts or stock options contracts in the course of hedging the risks arising from performing market making or liquidity providing activities;
- (c) an issuer of securities listed under Chapter 15A of the Listing Rules who holds or controls futures contracts or stock options contracts in the course of hedging the risks of positions previously acquired in such listed securities for the purpose of performing liquidity providing activities in respect of such listed securities; or
- (d) a related corporation of an issuer of securities listed under Chapter 15A of the Listing Rules, where the related corporation holds or controls futures contracts or stock options contracts in the course of hedging the risks of positions previously acquired in such listed securities for the purpose of performing liquidity providing activities in respect of such listed securities.

4B. Authorization by Commission to hold or control contracts in excess of prescribed limit in special circumstances

Subject to section 4(4)(a) and (b), the Commission may authorize a person to hold or control a futures contract or stock options contract in excess of the prescribed limit if the Commission is satisfied that there are special circumstances which warrant the person holding or controlling the excess.

4C. Authorization by Commission to hold or control contracts in excess of prescribed limit for purposes of facilitating provision of services to clients

- (1) Subject to subsection (2) and section 4(4)(a) and (b), the Commission may authorize an exchange participant or an affiliate of an exchange participant to hold or control a specified contract in excess of the prescribed limit by up to the specified percentage.
- (2) The Commission must not authorize an exchange participant or an affiliate of an exchange participant to hold or control a specified contract in excess of the prescribed limit unless the exchange participant satisfies the Commission that—
 - (a) 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;
 - (b) either the exchange participant or the affiliate has adequate financial capability to cover the potential risks arising from the excess; and
 - (c) the exchange participant has effective internal control procedures and risk management systems to manage the potential risks arising from the excess.
- (3) In this section—

relevant business need (相關業務需要), in relation to an exchange participant or an affiliate of an exchange participant, means a business need that requires the exchange participant or the affiliate to engage in hedging activities to facilitate the provision of services to its clients.

4D. Authorization by Commission to hold or control contracts in excess of prescribed limit for purposes of index arbitrage activity

- (1) Subject to subsection (2) and section 4(4)(a) and (b), the Commission may authorize an exchange participant or an affiliate of an exchange participant to hold or control a specified contract in excess of the prescribed limit by up to the specified percentage.
- (2) The Commission must not authorize an exchange participant or an affiliate of an exchange participant to hold or control a specified contract in excess of the prescribed limit unless the exchange participant satisfies the Commission that—
 - (a) the exchange participant or the affiliate (as the case may be) engages in index arbitrage activities, and will, if authorization is granted, hold or control the excess for the purposes of those activities;
 - (b) either the exchange participant or the affiliate has adequate financial capability to cover the potential risks arising from the excess; and
 - (c) the exchange participant has effective internal control procedures and risk management systems to manage the potential risks arising from the excess.
- (3) In this section—

index arbitrage (指數套戥), in relation to an exchange participant or an affiliate of an exchange participant, means a trading strategy engaged in by the exchange participant or the affiliate—

- (a) involving—
 - (i) the purchase (or sale) of a stock index futures contract; or
 - (ii) the purchase (or sale) of a stock index call options contract together with the sale (or purchase) of a stock index put options contract, where both contracts have the same underlying index, expiry date and strike price;
- (b) in conjunction with the sale (or purchase) of some or all of the stocks comprised in the underlying basket of stocks used to compile the index underlying the stock index futures contract or the stock index options contracts; and
- (c) with a view to securing a profit from any difference in price between the stocks and the stock index futures contract or the stock index options contracts.

4E. Authorization by Commission for asset manager to hold or control contracts in excess of prescribed limit for purposes of asset management activity

- (1) Subject to subsection (2) and section 4(4)(a) and (b), the Commission may authorize a person referred to in subsection (3) to hold or control a specified contract in excess of the prescribed limit by up to the specified percentage.
- (2) The Commission must not authorize a person referred to in subsection (3) to hold or control a specified contract in excess of the prescribed limit unless the person satisfies the Commission that—

- (a) the person has a need for holding or controlling the excess for which authorization is sought, for the purposes of the asset management activity for which the person is licensed or registered; and
 - (b) the person has effective internal control procedures and risk management systems to manage the potential risks arising from the excess.
- (3) Subsection (1) applies to a person that—
- (a) is a licensed corporation that is licensed for, or a registered institution that is registered for, Type 9 regulated activity; and
 - (b) in the course of that regulated activity, manages assets having a total value of not less than \$80 billion.”.

6. Schedule 1 amended (prescribed limit and reporting level for futures contracts)

(1) Schedule 1—

Repeal item 4

Substitute

“4.	Hang Seng Index futures contract and options contract, and Mini-Hang Seng Index futures contract and options	10 000 long or short position delta limit for all contract months combined, provided that the position delta for the Mini-Hang Seng Index futures contracts	500 open Hang Seng Index futures contracts for any one contract month; 500 open Hang Seng Index options contracts for any one series;
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contract	or Mini-Hang Seng Index options contracts must not at any time exceed 2 000 long or short for all contract months combined	2 500 open Mini-Hang Seng Index futures contracts for any one contract month and 2 500 open Mini-Hang Seng Index options contracts for any one series”.
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(2) Schedule 1—

Repeal item 5

Substitute

“5.	Hang Seng China Enterprises Index futures contract and options contract, and Mini-Hang Seng China Enterprises Index futures contract and options contract	12 000 long or short position delta limit for all contract months combined, provided that the position delta for the Mini-Hang Seng China Enterprises Index futures contracts or Mini-Hang Seng China Enterprises Index options contracts must not at any time exceed	500 open Hang Seng China Enterprises Index futures contracts for any one contract month; 500 open Hang Seng China Enterprises Index options contracts for any one series; 2 500 open Mini-Hang Seng China Enterprises
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|-----|--|---|---|
| | | 2 400 long or short for all contract months combined | Index futures contracts for any one contract month and 2 500 open Mini-Hang Seng China Enterprises Index options contracts for any one series”. |
| (3) | Schedule 1—
Repeal item 9
Substitute | | |
| | “9. FTSE/Xinhua China 25 Index futures contract and options contract | 6 000 long or short position delta limit for all contract months combined | 500 open FTSE/Xinhua China 25 Index futures contracts for any one contract month and 500 open FTSE/Xinhua China 25 Index options contracts for any one series”. |
| (4) | Schedule 1—
Repeal item 13
Substitute | | |
| | “13. US Dollar vs | 8 000 long or | 500 open US |

- | | | | | |
|-----|--|--|---|--|
| | | Renminbi (Hong Kong) futures contract and options contract, and Renminbi (Hong Kong) vs US Dollar futures contract | short position delta limit for all contract months combined, provided that the position delta for the spot month US Dollar vs Renminbi (Hong Kong) futures contracts and the spot month US Dollar vs Renminbi (Hong Kong) options contracts combined during the last 5 trading days must not exceed 2 000 long or short | Dollar vs Renminbi (Hong Kong) futures contracts for any one contract month; 500 open US Dollar vs Renminbi (Hong Kong) options contracts for any one series and 500 open Renminbi (Hong Kong) vs US Dollar futures contracts for any one contract month”. |
| (5) | Schedule 1, after item 17—
Add | | | |
| | “18. London Nickel Mini futures contract | 50 000 net long or short contracts for all contract months combined | 500 open contracts for any one contract month | |
| | 19. London Lead Mini futures contract | 25 000 net long or short contracts for all contract months combined | 500 open contracts for any one contract month | |

20.	London Tin Mini futures contract	15 000 net long or short contracts for all contract months combined	500 open contracts for any one contract month”.
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7. **Schedule 2 amended (prescribed limit and reporting level for stock options contracts)**

Schedule 2, items 1 and 2—

Repeal

“50 000 open contracts”

Substitute

“150 000 open contracts”.



Ashley Alder

Chief Executive Officer,
Securities and Futures Commission

20 February 2017

Explanatory Note

The main object of these Rules is to amend the Securities and Futures (Contracts Limits and Reportable Positions) Rules (Cap. 571 sub. leg. Y) (*principal Rules*) by expanding the categories of persons who may be authorized to hold or control a futures contract or stock options contract in excess of the prescribed limit set out in Schedule 1 or 2 to the principal Rules (*excess authorizations*), and by increasing the prescribed limits for stock options contracts set out in Schedule 2 to the principal Rules.

2. Section 3 amends section 2 of the principal Rules by adding definitions used in new sections 4C, 4D and 4E, which respectively relate to excess authorizations granted by the Securities and Futures Commission (*Commission*) for the purposes of facilitating the provision of services to clients, index arbitrage activity and asset management activity, and amends the definition of *specified contract* for clarity.
3. Section 4 amends section 4 of the principal Rules (*existing section 4*) and section 5 adds new sections 4A to 4E to the principal Rules by expanding the scope of excess authorizations that may be granted, and by making consequential amendments that restructure the existing section 4 for better presentation, as follows—
 - (a) the categories of persons who may be granted excess authorizations under the rules of the relevant recognized exchange company under the existing section 4(2) are moved from the existing section 4(3) to the new section 4A, and expanded to include Stock Exchange Company market makers in exchange traded funds;

- (b) the Commission's power to grant excess authorizations to persons in special circumstances is moved from the existing section 4(5) to the new section 4B;
 - (c) the new section 4(3) expands the categories of persons who may be granted excess authorizations by the Commission;
 - (d) various matters set out in the existing section 4(4), (8) and (9) relating to granting and withdrawing excess authorizations by the Commission, are moved to the new section 4(4) and (5) without substantive changes;
 - (e) the Commission's power to grant excess authorizations where there is a relevant business need for facilitating the provision of services to clients is moved from the existing section 4(6) and (7) to the new section 4C, without substantive changes (except in so far as the definitions of *adequate financial capability* and *specified percentage* are amended);
 - (f) the new section 4D empowers the Commission to grant excess authorizations for the purposes of index arbitrage activity; and
 - (g) the new section 4E empowers the Commission to grant excess authorizations for the purposes of asset management activity.
4. Section 6 amends Schedule 1 to the principal Rules by—
- (a) making minor drafting amendments to the descriptions of the contracts referred to in items 4, 5 and 9;
 - (b) adding the Mini-Hang Seng China Enterprises Index options contract to item 5;

- (c) adding the US Dollar vs Renminbi (Hong Kong) options contract and the Renminbi (Hong Kong) vs US Dollar futures contract to item 13; and
 - (d) adding London Metal Mini futures contracts for nickel, lead and tin, by adding items 18, 19 and 20.
5. Section 7 amends Schedule 2 to the principal Rules by increasing the prescribed limits for stock options contracts.