



GUIDANCE NOTE ON POSITION LIMITS AND LARGE OPEN POSITION REPORTING REQUIREMENTS

1. Introduction

- 
- 2.3. The prescribed limits on certain futures contracts such as stock index futures and stock index options contracts, currency futures contracts and commodity futures contracts are calculated on a net basis for all contract months combined. Moreover, for stock index futures and stock index options contracts with the same underlying index, as well as currency futures and currency options contracts with the same underlying currency pair, the futures-equivalent positions in options contracts are added to the positions in futures contracts for purposes of determining compliance with the prescribed limits. The futures-equivalent position in an options contract is the delta value⁵ of the options contract determined by the Hong Kong Futures Exchange (“HKFE”) at the close of market on each trading day multiplied by the number of contracts held or controlled.

Example :

A person holds the following positions:

- Long 8,000 September HSI futures contracts*
- Short 1,000 October HSI futures contracts*
- Long 2,500 November Mini-HSI futures contracts*
- Long 5,000 September HSI calls with a delta value of 0.5*

Since the contract value of the Mini-HSI futures contract is one-fifth of that of the HSI futures contract, 2,500 Mini-HSI futures contracts are equivalent to 500 HSI futures contracts. The futures-equivalent positions in September HSI calls are 2,500 contracts which are obtained by multiplying the delta value (0.5) by the number of contracts held (5,000 contracts). In deciding whether the person has reached the prescribed limit of 10,000 contracts, positions in all contracts are netted, i.e. 8,000 contracts (long September HSI futures contract) minus 1,000 contracts (short October HSI futures contract) plus 500 contracts (long November Mini-HSI futures contract) plus 2,500 contracts (long September HSI calls). That means the person holds a net position of 10,000 contracts and has reached the prescribed limit.

- 2.4. Schedule 2 of the Rules specifies the maximum number of stock options contracts in any one market direction⁶ for all expiry months combined that may be held or controlled by a person. *For example, the prescribed limit on any stock options contract is 150,000 contracts in any one market direction. If a person holds 30,000 long calls in month A, 100,000 short calls in month B and 50,000 long puts in month C, he will reach the prescribed limit on this contract for the short market direction, but will still be able to hold 120,000 more contracts for the long market direction. (The position in the long market direction is 30,000 contracts (i.e. 30,000 long calls) and the position in the short market direction is 150,000 contracts (i.e. 100,000 short calls plus 50,000 long puts).)*

⁵ Delta is the amount by which the price of an option will change for a corresponding change in price of the underlying market. Delta can be used to equate the directional risk of an option position with a position of similar size in the underlying market. For example, if a person holds 1,000 HSI options contracts (delta value of the contract is +0.6), he is long 600 deltas or in equivalent terms, 600 HSI futures contracts.

⁶ Long calls and short puts are in the same market direction; and short calls and long puts are in the same market direction.



- 2.5. In general, the prescribed limits in Schedule 1 and Schedule 2 are also reflected in rules of the HKFE and the Stock Exchange of Hong Kong (“SEHK”). Market participants should note that in addition to the prescribed limits, the HKFE and SEHK may impose other position limits on a particular contract, Exchange Participant or client where situations warrant such action.

Aggregation



- 3.13. The SFC may grant authorizations under Sections 4C and 4D to an Exchange Participant or persons who belong to a group of companies that includes an Exchange Participant. This is because Exchange Participants and their affiliates generally have a greater need for holding excess positions to provide client facilitation services. In addition, Exchange Participants are licensed corporations under the SFO and therefore the SFC can better assess whether they would have the capabilities to hold excess positions and manage the resultant risks.
- 3.14 The SFC will determine the size of excess positions to be authorized for an applicant on a case by case basis after taking into consideration various factors including the prevailing market situation. It should be noted that although the upper limit set by the specified percentage is a per applicant upper limit, the SFC will take into account any excess positions already authorized to other members within the same group as the applicant. Under Section 4(4)(b), the SFC may authorise the excess sought only if it is satisfied that the excess would not be prejudicial to the interest of the investing public having regard to the prescribed c



- (1) Positions can be carried through any affiliate, but must be carried



3.24. In the case of an application for authorization under Section 4C, the SFC will require the applicant to provide the following information:

- (a) a description of the nature of positions held or controlled (including transactions in other related markets which are an integral part of the entire portfolio);
- (b) a full and complete explanation of the needs for holding or controlling excess positions and how the excess positions will be used to support the business of the relevant Exchange Participant and (if applicable) the affiliate and such explanation to include:

the nature and size of the positions established, or to be established, in connection with the excess positions



the contingency measures that will be applied to minimize the impact of a default by the counterparties, including the procedures for





authorization is inconsistent with the SFC's regulatory objectives in Section 4 of the SFO, in particular:

- (1) to maintain and promote the fairness, efficiency, competitiveness, transparency and orderliness of the securities and futures industry;
- (2) to reduce systemic risks in the securities and futures industry; or
- (3) to assist the Financial Secretary in maintaining the financial stability of Hong Kong by taking appropriate steps in relation to the securities and futures industry.

3.30. The SFC may decide to approve or deny the application or impose conditions on the authorization. Conditions imposed on an authorization may be varied or



expect Exchange Participants/their affiliates to evidence the use of their excess positions. To this end, the SFC will expect authorized Exchange Participants/affiliates to submit regular reports confirming:

- (1) the amount of excess used;
- (2) a general description of the size of the stock index derivatives positions used for index arbitrage activities;
- (3) details of the stock portfolio established; and
- (4) the daily risk position of the entire index 26 630.7 Tm(risk)-29(po6.1 87.91 311.69 630.7 Tm



- (2) when the relevant contracts are due to expire; and
- (3) whether the withdrawal may be delayed until the time of such expiry taking into account the reasons for the withdrawal.

3.40. As a guiding principle, the SFC will not normally consider withdrawing an authorization unless it believes:

- (1) one or more of the relevant preconditions set out in the Rules in respect of the authorization in question cease to exist;
- (2) the authorization ceases to be consistent with the SFC's regulatory objectives in Section 4 of the SFO; or
- (3) one or more of the conditions attached to the authorization have failed to be met and adequate steps have not been taken, or cannot be taken, to



- 4.2. Reportable positions for futures contracts and stock options contracts are specified in Schedule 1 and Schedule 2 of the Rules respectively. Similar to the prescribed limits, the reportable positions for futures contracts are calculated based on the number of contracts held or controlled for a contract month or series while the reportable positions for stock options contracts are calculated based on the number of contracts held or controlled in an expiry month.
- 4.3. The aggregation requirements as mentioned in paragraphs 2.6 and 2.7 above equally apply to the reportable positions for futures contracts and stock options contracts.

Responsibilities of reporting

- 4.4. The notice of a reportable position specified in Section 6(1) may be submitted by:

(1)



- (1) the day on which the person first holds or controls the reportable positions; and
- (2) each succeeding day on which the person continues to hold or control the reportable positions.

For the avoidance of doubt, once a person has held or controlled a reportable position, it will be required to file the notice of the reportable position to the HKFE or SEHK (as the case may be) on each reporting day even though his position remains unchanged.

4.9. Section 6(2) of the Rules further requires that the notice of a reportable position shall be accompanied by the following information:

- (1) the number of futures contracts or stock options contracts held or controlled by the person in respect of the reportable position in each relevant contract month; and
- (2) where the reportable position is held or controlled for another person (e.g. a client), the identity of that person and the number of futures contracts or stock options contracts held or controlled for such person in respect of the reportable position in each relevant contract month.

In respect of the information about the identity of a client, the requirements are set out in the Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission and the Client Identity Rule Policy.

4.10. In the stock options market, positions held by a market maker are recorded by the SEHK Options Clearing House in a segregated clearing account. Under SEHK rules, positions held by market makers in segregated clearing accounts are treated as having been reported to the SEHK. The SFC accepts that if the segregated clearing account is used exclusively to keep positions of a single market maker, the market maker will be deemed to have fulfilled the reporting requirements as stated in Sections 6(1) and 6(2) of the Rules.

4.11. Appendix 2 provides examples to illustrate the application of the prescribed limits and reportable positions.

Other reporting requirements specified by the HKFE/SEHK

4.12. The HKFE and SEHK have developed more detailed reporting requirements to facilitate their monitoring of reportable positions as required under Section 6 of the Rules. These requirements include the use of a prescribed form for reporting and the specific deadline for submission of the notice of reportable positions¹⁰.

4.13. The HKFE and SEHK also request Exchange Participants to provide additional information other than those specified in Section 6(2) such as (i) the account number, account name and identity of the transaction originator of a reportable

¹⁰ HKFE requires Exchange Participants to submit the notice of reportable positions by 12:00 noon on the reporting day (T+1).



position; (ii) the nature of a reportable position (i.e. for hedging, arbitrage or trading purposes); and (iii) the account type (i.e. house account, client account or market maker account). Exchange Participants should refer to the relevant position reporting procedures prescribed by the HKFE or SEHK for details.

- 4.14. In order to assess the systemic impact of large reportable positions on the market and monitor concentration risk more effectively, the HKFE and SEHK may make enquiries into transactions/positions in other markets (e.g. OTC market) underlying the reportable positions held by Exchange Participants. For this



and in such case, he will not be regarded as holding or controlling the position for the other person for the purpose of applying the disaggregation provision to this position.

Examples of such person include a fund manager controlling positions for his



6. Application of the Rules to Different Entities

Persons holding or controlling positions at multiple firms

- 6.1. If a person holds or controls positions in accounts at more than one firm, the person should have the obligation to aggregate positions for purposes of applying the prescribed limits and reportable position requirements.
- 6.2. If a person holding or controlling positions at multiple firms chooses to submit the notice of reportable positions to the Exchange through one of the firms (e.g. an Exchange Participant) where the firm agrees to submit the notice on the person's behalf, it should provide to the firm its total positions held at other firms.
- 6.3. For the avoidance of doubt, if a person holds a reportable position but only part of the position (which has not exceeded the reportable level) is held by a firm, the firm will not need to report that position to the Exchange unless it knows that the total position held by the person in other firms has exceeded the reportable level.

Transaction originators

- 6.4. A transaction originator is a person who is ultimately responsible for originating instructions for transactions on behalf of the other person. The most common type of transaction originator is a fund manager who manages assets of a fund at his own discretion according to the investment policy of the fund. As explained in paragraph 5.2 above, since the transaction originator has discretion in relation to positions he holds or controls for his principals, he is not allowed to disaggregate the positions held or controlled for each of the principals for the purpose of applying the Rules.
- 6.5. If the total positions controlled by a transaction originator (including positions belonging to different principals, e.g., different funds, but under his control) have exceeded the reportable level, the transaction originator will be required to notify the HKFE or SEHK (as the case may be) of such positions. As required in Section 6(2) of the Rules, the transaction originator should also provide the information about identities of each of his principals whose positions have exceeded the reportable level. *For example, a fund manager is in charge of the investment of three funds, namely, Fund A, Fund B and F*



Omnibus accounts

- 6.8. In the case of an omnibus account, the Rules apply separately to the positions held by each of the underlying clients of the omnibus account except where the omnibus account operator has discretion over the positions. For this reason, positions held by different underlying clients should not be netted off for purposes of calculating and reporting reportable positions or determining compliance with the prescribed limits.
- 6.9. If an underlying client of the omnibus account holds or controls a reportable position, the omnibus account operator should inform the HKFE or SEHK (as the case may be) of such reportable position. An omnibus account operator can notify the Exchange of the reportable positions by itself or ask its agent (e.g. an Exchange Participant) carrying the account to submit the notice of reportable positions. The notice of reportable positions should be accompanied by the information about identities of the underlying clients whose positions have exceeded the reportable level.
- 6.10. There are situations where an underlying client of the omnibus account is also an omnibus account, i.e., there are more than one layer of omnibus account. If the omnibus account operator in one layer has notified the Exchange of the reportable positions held by the ultimate clients including identities of each of them (either by itself or through its agent), the SFC accepts that the other omnibus account operators below this layer will not be required to notify the Exchange of any reportable positions held in their accounts.

Example:

Suppose that Exchange Participant A has an omnibus account B holding 1,000 long futures contracts. One of the underlying clients of omnibus account B is also an omnibus account (account C) which holds 900 long futures contracts. Positions in omnibus account C are owned by Company D (800 long futures contracts) and other small investors (a total of 100 long futures contracts).

Assume that the reportable level is 500 contracts. Exchange Participant A should inform the Exchange of the position held by the omnibus account B (i.e. 1,000 contracts). If the operator of omnibus account B has obtained the information about the ultimate client from the operator of omnibus account C and notified the Exchange of the reportable position held by Company D including its identity (the reportable position can be reported to the Exchange by the operator B itself or through the Exchange Participant A), the operator of omnibus account C will not be required to submit any notice of reportable positions to the Exchange.

- 6.11. Where the omnibus account operator has discretion over positions held with it, it should aggregate such positions with its own position in the application of the prescribed limits.



Appendix 1

Examples illustrating the use of excess positions

Example 1:

Assume a firm's proprietary trading desk has a position of HSI futures contracts equivalent to 9,000 position delta, and that its sales desk wants to facilitate clients' trades resulting in the use of about 30,000 HSI futures contracts for hedging purpose. Assume also that the specified percentage is 300%. Can the firm apply for excess?



Appendix 2

For example: Reportable Position is 450 contracts

has an account with the Exchange Participant which contains 500 contracts.

The Exchange Participant has a client account under the name of which it uses for booking transactions for his and for the trading of . Client



- (b) Client B should notify the Exchange of 500 contracts each held by the EP's proprietary account, Client X and Y.
- (c) Client A, Client X, Client Y, Client D, Client E, should each notify the Exchange of their own positions of 500 contracts.
- (d) Client C should notify the Exchange of 500 contracts each held by Client D and Client E.
- (e) Fund Manager B should notify the Exchange of the 800 contracts he controls and that 500 contracts are for Fund G.
- (f) Fund G should notify the Exchange of its 800 contracts, 500 of which are held by Fund Manager B and 300 held by Fund Manager H.

Notwithstanding the above filing requirements, the notice of a reportable position may be