21 June 2022

To: The Securities and Futures Commission
54/F One Island East
18 Westlands Road
Quarry Bay, Hong Kong
Email: position-limit@sfc.hk

Dear Sirs/Madams

Consultation on Changes to the Position Limit Regime

FIA[1] appreciates the opportunity to respond to the proposals set out in the "Consultation on proposed changes to the Securities and Futures (Contracts Limits and Reportable Positions) Rules and the Guidance Note on Position Limits and Large Open Position Reporting Requirements" consultation paper (the **Consultation**) issued by the Securities and Futures Commission (**SFC**) in April 2022.

In general, greater transparency can benefit the entire industry. However, data reporting requirements should always be meaningful. There should also be an appreciation of the practicalities of imposing such requirements, and the benefits should be commensurate with the resources needed to meet these requirements.

We also note that the category of entities that can apply for increased position limits are quite narrow and suggest that it be expanded. For example, proprietary traders that use futures as a hedging tool will potentially need to trade more futures when the index value falls. However, they will be constrained by existing position limits and will not be eligible to apply for any increases.

We also wish to highlight some specific comments for consideration by the SFC. These follow the SFC's questionnaire format for gathering feedback. Unless otherwise defined, capitalised terms used in this letter will bear the same meanings ascribed to them in the Consultation.

[1] FIA is the leading global trade organization for the futures, options and centrally cleared derivatives markets, with offices in London, Singapore and Washington, D.C. FIA's membership includes clearing firms, exchanges, clearinghouses, trading firms and commodities specialists from more than 48 countries as well as technology vendors, lawyers and other professionals serving the industry. FIA's mission is to support open, transparent and competitive markets, protect and enhance the integrity of the financial system, and promote high standards of professional conduct. As the principal members of derivatives clearinghouses worldwide, FIA's member firms play a critical role in the reduction of systemic risk in global financial markets. Further information is available at www.fia.org.

PART I

Question 1

(i.) Do you have any comments on the proposed addition of the New Contracts to the list of "specified contract"?

We are supportive of the proposed addition as the New Contracts relate to existing contracts that are already on the list of "specified contract". In addition, there is already a high level of open interest in the New Contracts and such interest is expected to increase. By way of example, client demand relating to the Hang Seng TECH Index contracts is currently much higher than what is allowed per entity under the existing limit. Based on the trading data, the underlying stocks of the Hang Seng TECH index are very liquid. This supports the application of excess position limits by EPs, provided always that the proper internal controls and risk management measures are put in place.

We would also like to highlight a long-standing issue whereby EPs and their clients are temporarily required to observe two different limits for the same product whenever any new product is introduced by HKEX. While HKEX will prescribe position limits and reporting levels for any new product with immediate effect, the statutory position limit prescribed under the SFO takes more time to change. This creates a gap between what being prescribed under the Exchange Rules and SFO. While the EPs and their clients would always endeavor to abide by all imposed limits, such a discrepancy is unduly burdensome and poses additional operational and regulatory risks to them.

To resolve this issue, we respectfully suggest that the SFC considers removing Schedule 1 (Prescribed Limit and Reporting Level for Futures Contracts) and Schedule 2 (Prescribed Limit and Reporting Level for Stock Options Contracts) of the Securities and Futures (Contracts Limits and Reportable Positions) Rules (Cap. 571, section 35(1)) and instead provide that the statutory position limits for new products be the same as those prescribed by HKEX. This will not circumvent the SFC's authority to set appropriate position limits as any new products will still need to undergo the SFC's established vetting process and will serve to reduce the risks of inadvertent breaches by EPs and their clients.

(ii.) Are there any other futures and options contracts traded on HKFE which should also be included on the list?

In light of the recent issues with commodity contracts, this asset class should also be subject to prescribed position limits and be included on the list. While we recognize that existing open interest is not significant, concentration risk should still be monitored.

Question 2

Do you have any comments on the proposed reportable position reporting requirements for Holiday Contracts?

As highlighted above, data reporting requirements should be meaningful, and the benefits should be commensurate with the resources needed to meet these requirements.

In view of this, we suggest that there should be an analysis of the volume of Holiday Contracts traded during Holiday Trading Days before the proposed reporting requirements are imposed. Should the volume be insignificant compared to that of a normal trading day, we request that the SFC reconsiders the necessity of imposing such reporting requirements. This is especially if it is over a one day period.

Question 3

Do you have any comments on the proposal to set out in the Rules that a CP in exercising its right to dispose of its client's position when the client has defaulted on a payment shall not be regarded as having "discretion" as described in section 7(3)?

We agree that a CP does not have "discretion" over the client's positions in such a situation.

There are also other instances where a CP would also need to close out an ETD agreement upon other material breaches that are not related to a client's payment default. By way of example, a client may be in breach of its contractual agreement with the CP by making a material misrepresentation. In such cases, a CP might have no option but to terminate that agreement and close-out the client's position. Such a close-out should be not considered as a CP having "discretion" as described in section 7(3).

In light of this, we suggest the following amendments (in red) to section 7(4):

(4) A clearing participant of HKFECC or SEOCH is not to be regarded as having discretion in relation to futures contracts or stock options contracts he holds or controls for another person if the clearing participant's power to acquire or dispose of the other person's futures contracts or stock options

contracts (as the case may be) may only be exercised in the event of a default in meeting any ~~payment~~ contractual obligation (payment or otherwise) by the other person.

Question 4

Do you have any comments on the proposed authorisation mechanism for CPs which provide clearing services for persons authorised to hold or control contracts in excess of the prescribed limits?

Under proposed section 3.16(3) of the GN, if excess positions are carried through a CP appointed by a group EP, then that CP is required to seek the SFC's authorization under Section 4F. Proposed section 3.21 states that an application for authorization under Section 4F may be submitted by either the CP or its clearing client.

We would suggest that the application should only be submitted by the clearing client and not the CP. This is in line with Section 3.28 of the GN which recognizes that the submission of an application by a clearing client on behalf of its CP would make the application process more efficient and streamlined. This will also avoid any ambiguity in the application process and parties' responsibilities. In addition, this addresses instances where a clearing client uses more than one CP. The same process should also apply to the excess positions authorized by the HKFE/SEHK.

Question 5

(i.) Do you have any comments on the proposed changes to require a person, unless the person has discretion over the positions, to apply the prescribed limits and reportable positions separately to: (i) his or her own positions and the positions of a unit trust which he or she holds or controls and (ii) the positions in each unit trust where there is more than one unit trust?

In the interests of transparency, we are supportive of reporting at the individual unit trust level regardless of whether there is any discretion over the positions.

(ii.) Do you have any comments on the requirement that the name of the unit trust is to be provided in a notice of a reportable position of the unit trust?

While this requirement will provide transparency as to the underlying holders of the positions, we note that there may be sensitivities around disclosing this information

Question 6

(i.) Do you have any comments on the proposal to require the prescribed limits and reportable positions to be separately applied to each of the sub-funds under an umbrella fund as if each of sub-fund were a stand-alone fund?

Some members are not supportive of the proposal to require the prescribed limits and reportable positions to be separately applied to each of sub-funds under umbrella funds. While the proposal suggests each sub-funds to enjoy standalone limits, if the sub-funds of an umbrella fund being managed by same fund manager and where the investment discretion is being exercised, the sub-funds' positions would need to be aggregated on the fund manager level. In substance, the proposal would place no additional benefit to the umbrella funds if they were under same fund manager, as is normally the case. It also creates complexity where umbrella funds need to monitor delta positions on a sub-fund level and on fund manager level, instead of one delta position for the umbrella fund.

In practice, many market participants report large open positions for their fund clients. However, a requirement to report reportable positions down to each sub-fund level may require major changes with brokers. Such changes may not be limited only to changes in reporting systems, but even impact how accounts are set-up. We would suggest that SFC to retains the flexibility for umbrella funds to choose whether to report down to sub-fund level.

(ii.) Apart from umbrella funds constituted as unit trusts and corporate funds, are there any other legal forms or structures which should be addressed?

No others.

(iii.) Do you have any comments on the requirement that the name of the sub-fund be provided in a notice of a reportable position of a sub-fund?

While this requirement will provide transparency as to the underlying holders of the positions, there may be sensitivities around revealing this information

Other Requests for Clarification

i. It appears from the consultation paper that there will not be any additional financial requirements placed on a Clearing Participant if they were to apply for higher positions limits. Can the SFC please confirm this understanding?

ii. Assuming a CP has been authorized for higher positions limits, will they be restricted from taking on excess positions if their overall portfolio breaches the applicable capital based positions limits (CBPL)?

iii. Will the existing concentration framework at the CCPs be applicable on the excess positions for which the CP has the authorization?

iv. Does the scenario set out in paragraph 17 of the Consultation apply in a situation where a client has only a single clearing broker or does it also apply in cases where it has multiple clearing brokers? If the latter applies, please can the SFC clarify the following:

a. Do all the clearing brokers need to apply for excess position limits?

b. In the event a client does not notify one of its clearing brokers that it has been granted excess position limits, will that clearing broker be in breach of the Rules if that client holds excess positions with it?

c. Is it the client's obligation to notify all the clearing brokers that it is applying for and/or has been authorized to hold excess position limits?

d. As a clearing broker would not have visibility of its client's positions with other clearing brokers, it should ultimately the client's obligation to ensure its positions are within the approved limits. Please confirm this is the case.

v. Paragraph 17 of the Consultation states that "*the CP providing clearing services to this person will hold / control the excess positions for that person… If the CP in question has not been authorised to hold excess position, it is in breach of the Rules*". If a CP, who is aware or made aware of a breach of position limit by its client, immediately: (a) notifies the Exchange, and (b) requests the client to liquidate the excess position, will that CP still be in breach of the Rules?

vi. Under Paragraph 16 of the Consultation, the SFC proposes to clarify that a CP exercising its right to acquire/dispose of its clearing client's positions upon that client's default is not regarded as having "discretion". As such, that client's positions do not need to be aggregated to the CP's position limit. However, paragraph 17 of the Consultation seems to suggest that if CP providing clearing services to a client, then that client's position needs to be aggregated to the CP's position limit. Can the SFC please clarify the position?

Should a clearing broker disaggregate its client's positions where it does not have discretion over such positions, please consider updating Section 5.1 (*Compliance by Agents)* of SFC Guidance Note on Position Limits and Large Open Position Reporting Requirements to clarify as such.

We welcome the opportunity to work with the SFC to address these comments.

Please feel free to contact me at bherder@fia.org, or TzeMin Yeo, Head of Legal & Policy, Asia Pacific at tmyeo@fia.org should you wish to further discuss.

Yours faithfully

Bill Herder
Head of Asia-Pacific