HKEX
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通告 CIRCULAR

Subject: **Compliance Bulletin (Issue No. 4) – Block Trade Execution and Large Open Position ("LOP") Reporting Procedures for Derivatives Holiday Trading**

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As part of our continuous efforts to promote transparency and a culture of compliance in our marketplace, the Exchange has prepared this Compliance Bulletin to offer the industry a better understanding of our enforcement work and regulatory expectations. It includes some common deficiencies and related issues identified and good practices observed, covering (1) issues on block trade execution, as well as (2) LOP reporting procedures for derivatives holiday trading.

1. Block Trade Execution

Relevant requirements

i. Rules, Regulations and Procedures of the Futures Exchange ("HKFE Rules")

- Chapter VIII (815 – 815D) – Execution of Block Trades

ii. Options Trading Rules of the Stock Exchange ("SEHK OTR")

- Third Schedule – Regulations for Block Trades

iii. Circular

- Guidance on Block Trade Order Aggregation (Ref. No.: MO/DT/116/20)

iv. Others

- Block Trade Facility Education Seminar Materials (18 May 2021) (Presentation)
- Frequently Asked Questions (Updated on 19 Oct 2021) (PDF)

Block Trade orders must be executed in accordance with requirements laid down in HKFE Rule 815A / Paragraph 2 of the Third Schedule to the SEHK OTR, including the following:

- ***Execution Price***: the price must be fair and reasonable, i.e. within the Permissible Price Range[1], which is determined in the following manners:
  - When the executed price is at or within the range of highest traded price[2], lowest traded price, bid and ask price of contract; or
  - When the executed price is within the price range to both sides of a reference price obtained through prevailing market prices, or if necessary, determined as the theoretical values based on the prevailing underlying values.
- ***Volume***: the Block Trade must satisfy the Minimum Volume Threshold (**"MVT"**)[3];
- ***Order Aggregation Rule***: Where a Block trade involves aggregation of separate orders, the aggregation rules under HKFE Rule 815A(2A) / Paragraph 2 of the Third Schedule to the SEHK OTR must be followed. The aggregation rules provide that an Exchange Participant (**"EP"**) cannot aggregate separate orders or combine separate orders to generate a spread or strategy combination Block Trade unless that order meets the applicable MVT and the EP has received instructions or has been specifically authorized to execute the order as a Block Trade.

Deficiencies and instances of non-compliance

Non-compliance with HKFE Rule 815A(2A)(b): For Futures Contracts only order aggregation, each separate order comprising the Block Trade has to satisfy the applicable MVT;

(i) Some EPs aggregated orders from clients to execute the Block Trade. However, the orders failed to meet the MVT requirement for Order Aggregation (Please refer to Scenario 1 of Appendix 1).

(ii) For a single order Block Trade involving only one buyer and one seller, some EPs inappropriately aggregated the clients' orders with their house orders in order to fulfil the MVT requirement of the Block Trade (Please refer to Scenario 2 of Appendix 1).

(iii) In situations where the Block Trade quantities of two clients' bid and ask orders are different, some EPs filled the difference by using house orders, albeit failed to meet the MVT requirement. This is in breach of the aggregation requirement. As an illustration, a Block Trade executed on a Stock Index Futures contract has a MVT of 100. Client A's bid order is 100 contracts, and client B's ask order is 103 contracts. The EP aggregated

[1] The Permissible Price Range of each product eligible for block trading is set out in the Block Trade Facility web corner of the HKEX Website.
[2] The highest traded price means the day-high at the time when the block trade is reported.
[3] The MVT each product eligible for block trading is set out in the Block Trade Facility web corner of the HKEX Website.

its house bid order of 3 contracts with that of client A to fill the difference. (Please refer to Scenario 3 of Appendix 1).

(iv) Some EPs misunderstood that each post-trade allocation (i.e. give-up and take-up) needs to fulfil the MVT requirements for Order Aggregation. As long as the original order meet the MVT requirement, the related post trade allocation would not have caused the Block Trade to have breached the MVT requirement. As an illustration, a Block Trade executed on a Stock Index Futures contract has a MVT of 50. Client A's bid order is 218 contracts, Client B's and Client C's ask orders are 109 contracts. For reporting the prices of the Clients' orders, the EP splits the bid and ask orders into two legs in its execution. After trade give-up, the second leg of Client B and Client C is 49 contracts. Instead of considering client's orders of 109 contracts fulfill the MVT requirements, EP misunderstood that the second leg 49 contracts fails to fulfill MVT requirement and add one contract to the leg as 50 contracts in order to fulfill MVT requirement. They accomplished this by aggregating 2 below MVT house orders with clients' orders and execute 220 contracts, subsequently giving up 50 contracts (leg 2) to Client B and Client C. The below MVT house orders fail to comply with the aggregation requirement. (Please refer to Scenario 4 of Appendix 1).

Common misunderstandings on Block Trade execution requirements

Below are two common misunderstandings:

(i) For a Block Trade that involves multiple legs arising from one buyer and one seller only, some EPs misunderstood that such Block Trade constitutes an aggregation of order, which in fact is a single order Block Trade (Frequently Asked Questions Q5);

(ii) For a Block Trade with Order Aggregation, some EPs misunderstood that only one of the separate order needs to satisfy the MVT, regardless of futures legs or option legs. This is an incorrect understanding. (HKFE Rule 815A(2A)(c) & OTR Third Schedule Paragraph 2.2A.2 – For Futures Contracts and / or Option Contracts with Order Aggregation, at least one of the separate orders comprising an option leg has to satisfy the applicable MVT)

Consequence of non-compliance

For any non-compliance with the Order Aggregation Rule, HKFE/SEHK will consider the nature and specific circumstance of the case that resulted in non-compliance. In cases where non-compliance was resulted from genuine mistakes or errors (for example, EP erroneously executes a client's order such that the resulting trade differs in quantity, contract month or position from that specified by the client), HKFE/SEHK may take enforcement actions against the EP, including issuance of compliance reminder to EP at the first time of non-compliance and reserve the right to take further disciplinary actions such as prohibition of Block Trade execution or imposition of restrictions/additional criteria should there be any repeated non-compliance on the part of the EP.

Pursuant to HKFE Rule 815C and Regulation 5 of the Third Schedule of the SEHK OTR, if the Chief Executive of HKFE/SEHK is of the opinion that any of the prescribed criteria are not properly followed by an Exchange Participant, the Chief Executive may prohibit the Exchange Participant from using the Block Trade Facility or impose such restrictions or additional criteria as he may consider appropriate on its use. Any Block Trade which is executed in breach of such notice will not be considered as a valid trade by the Exchange and will not be registered or cleared by the Clearing House.

2. LOP Reporting Procedures for Derivatives Holiday Trading

Relevant requirements
i. Rules, Regulations and Procedures of the Futures Exchange ("HKFE Rules") ○ Chapter VI - Exchange Participants and Their Clients • 628 Monitoring Large Open Positions • 630(a) Possible Enforcement Actions against Non-compliance of LOP reporting requirements • 633(c) Responsibility of Informing Clients of the LOP reporting requirements **ii. Circular** ○ Introduction of New LOP Reporting Procedures for Derivatives Holiday Trading (Ref. No.: MSM/003/2022) **iii. Securities and Futures (Contracts Limits and Reportable Positions) Rules and Guidance Notes issued by the Securities and Futures Commission**
Key points to note
A. LOP report submission timing and reporting form for Holiday Trading EPs on Hong Kong public holidays with trading and clearing services ("H-Days")
(i) There is no change to the submission deadline for LOP reporting during H-Days. LOP report for Holiday Trading Exchange Contracts (**"H-Contracts"**) shall be filed with HKFE by no later than 12:00 noon of the next Trading Day, regardless of whether it is a Hong Kong public holiday or not, after the positions are opened or accumulated. (ii) Same reporting form and the required contents are adopted for LOP reporting on H-Days.
B. LOP reporting procedures of Holiday Trading EPs on H-Days if:- ***(i) have LOPs in non H-Contracts only*** ***(ii) have LOPs in both H-Contracts and non H-Contracts***

(i) Have LOPs in non H-Contracts only

LOP reporting procedures for non H-Contracts remain unchanged. Holiday Trading EPs are only required to file the LOP reports for reportable positions in non H-Contracts by the next Business Day (i.e. Monday to Friday except public holiday) after the positions are opened or accumulated.

(ii) Have LOPs in both H-Contracts and non H-Contracts

Holiday Trading EPs are required to file the LOP reports for reportable positions in H-Contracts by the next Trading Day, regardless of whether it is a Hong Kong public holiday or not, after the positions are open or accumulated.

For the purpose of facilitating Holiday Trading EPs' system setup and reporting logistics, Holiday Trading EPs could opt-in to include the LOP in non H-Contracts together with LOP in H-Contracts in the LOP reports for submission during H-Days.

Should the Holiday Trading EPs decide to include both H-Contracts and non H-Contracts in the LOP reports for H-days, they shall apply the same reporting approach consistently in future submissions.

C. Form of communication for clients of Holiday Trading EPs to facilitate LOP reporting requirements of H-Contracts

Holiday Trading EPs are required to put in place adequate procedures to ensure their clients are properly informed of the LOP reporting requirements on H-Contracts and maintain sufficient documentary evidence to demonstrate such communication has been performed. However, there is no prescribed form of communication.

HKFE Rules 633(c) stipulates that, EPs shall advise their clients of the reporting requirements and the responsibilities of reporting set out in the HKFE Rules, Regulations and Procedures, and in the Securities and Futures (Contracts Limits and Reportable Positions) Rules and related guidance notes issued by the Securities and Futures Commission.

The Exchange would like to point out that the requirements and examples set out in this compliance bulletin are by no means exhaustive. EPs should always take into consideration their own circumstances and adopt appropriate internal controls and measures to ensure full compliance with the relevant rules and requirements.

EPs are strongly advised to review their current set up and implement appropriate measures to strengthen their controls. Any identified non-compliance incidents should be reported to the Exchange as soon as practicable.

EPs are also encouraged to contact the Market Surveillance and Monitoring Department (email: surveillance@hkex.com.hk) should they have any questions on the above.

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This circular has been issued in English together with Chinese translation of the same. If there is any discrepancy between the Chinese translation and the English version, the English version shall prevail.

Appendix 1

Scenario 1

Clients' Order Instructions (Price of $8,600):
Client A: Long x100 contracts of HHIU1.
Client B: Short x50 contracts of HHIU1.
Client C: Short x50 contracts of HHIU1.

MVT = 100. The clients' orders do NOT fulfil MVT

Client B & Client C's orders were below the MVT requirement of HHI Futures for Order Aggregation, which is in breach of Order Aggregation Rule.

Leg	Trade	Contract	Volume	Price	Bid/Ask	Client / House Order
1	Trade Entered	HHIU1	100	$8,600		
	Take Up	HHIU1	100		Bid	Client A
	Take Up	HHIU1	50		Ask	Client B
	Take Up	HHIU1	50		Ask	Client C

Scenario 2

Clients' Order Instructions (Price of $9,400):
Client A: Long x20 contracts of HHIU1.
Client B: Short x20 contracts of HHIU1.

MVT = 100. The clients' order does NOT fulfil MVT

The EP aggregates its house order with its clients' orders for the purpose of fulfilling the MVT requirement of 100 contracts, which is in breach of Order Aggregation Rule

Leg	Trade	Contract	Volume	Price	Bid/Ask	Clients/ House Order
1	Trade Entered	HHIU1	100	$9,400		
	No Take Up	HHIU1	80		Bid	House Order
	No Take Up	HHIU1	80		Ask	House Order
	Take Up	HHIU1	20		Bid	Client A
	Take Up	HHIU1	20		Ask	Client B

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Scenario 3

Clients' Order Instructions (Price of $8,775)
Client A: Long x100 contracts of HHIX1
Client B: Short x103 contracts of HHIX1

MVT = 100. The clients' order fulfil MVT

Client A and Client B's orders have already fulfilled the MVT requirements but the quantities of Client A's bid order and Client B's ask order of the Block Trade did not match.

The EP aggregates its house orders with clients' orders of which the house orders fail to meet the MVT requirement for Order Aggregation, which is in breach of Order Aggregation Rule

Leg	Trade	Contract	Volume	Price	Bid/Ask	Client / House Order
1	Trade Entered	HHIX1	103	$8,775		
	No Take Up	HHIX1	3		Bid	House Order
	Take Up	HHIX1	100		Bid	Client A
	Take Up	HHIX1	103		Ask	Client B

Scenario 4

Clients' Order Instructions (Price of $600.55)**:**
Client A: Long x218 contracts of MTWX1
Client B: Short x109 contracts of MTWX1
Client C: Short x109 contracts of MTWX1

MVT = 50. The clients' orders fulfil MVT

The EP executed orders from Client A, Client B and Client C into an Aggregated Block Trade and split them each into two trades (Leg 1 and Leg 2) in order to match with order price (i.e. $600.55).

However, the EP misunderstood that the two legs of Ask order of x49 contracts of Client B and Client C were below the MVT requirements for Order Aggregation.

The EP entered 220 contracts and adjusted the 2 legs of Ask Order x49 contracts of Client B and Client C to x50 contracts by aggregating house orders of x2 contracts with clients' orders in order to meet the MVT requirements. The house order of x2 contracts failed to meet the MVT requirement of 50, hence a breach of the Order Aggregation Rule (see table below for details):

Leg	Trade	Contract	Volume	Price	Bid/Ask	Client / House Order
1	Trade Entered	MTWX1	120	$600.5		
	Take Up	MTWX1	120		Bid	Client A
	No Take Up	MTWX1	2		Ask	House Order
	Take Up	MTWX1	59		Ask	Client B
	Take Up	MTWX1	59		Ask	Client C
2	Trade Entered	MTWX1	100	$600.6		
	Take Up	MTWX1	98		Bid	Client A
	No Take Up	MTWX1	2		Bid	House Order
	Take Up	MTWX1	50		Ask	Client B
	Take Up	MTWX1	50		Ask	Client C

The aggregated Block Trade would have met the Block Trade Order Aggregation Rule if treated as below:

Leg	Trade	Contract	Volume	Price	Bid/Ask	Client / House Order
1	Trade Entered	MTWX1	120	$600.5		
	Take Up	MTWX1	120		Bid	Client A
	Take Up	MTWX1	60		Ask	Client B
	Take Up	MTWX1	60		Ask	Client C
2	Trade Entered	MTWX1	98	$600.6		
	Take Up	MTWX1	98		Bid	Client A
	Take Up	MTWX1	49		Ask	Client B
	Take Up	MTWX1	49		Ask	Client C