

**Appendix 1**

**Compliance Reminder on Position Limits and Large Open Position Reporting**

*(Applicable to HKFE Participants and SEHK Options Exchange Participants only)*

HKFE Participants and SEHK Options Exchange Participants (“EPs”) are required to comply with the relevant rules and requirements in relation to Position Limits and Large Open Position Reporting as stipulated in Chapter VI of Rules, Regulations and Procedures of the Futures Exchange (“HKFE Rules”), Chapter 4 of Options Trading Rules (“OTR”) and Chapter 5 of Operational Trading Procedures for Options Trading Exchange Participants of the Stock Exchange (“OTP”). EPs are advised to establish and maintain proper policies and procedures, as well as robust systems and controls, to ensure ongoing compliance to these rules and other applicable regulatory requirements.

In the 2019 Annual Attestation and Inspection Programme, some EPs were found deficient in the following areas:-

**1. Responsibility of Informing Clients**

- ***Failure to inform clients or inadequate communication with clients on prescribed position limits, Large Open Position (“LOP”) reporting requirements and responsibilities of reporting.***

Some EPs did not inform their clients on the relevant rules and requirements in relation to position limits and LOP reporting, while some assumed that they only need to inform when clients’ position reach the reportable level and/or prescribed limits

For those EPs who have informed their clients, we observed that EPs adopted different communication channels, including but not limited:

- Client Agreement
- New Client Onboarding Notice
- Client Statement
- Company Website
- Face-to-face Communication with Clients by Account Executives

It was noted that:

- Some EPs included inadequate provisions and clauses in those documents used for communicating such reporting responsibilities with regard to the product coverage, comprehensiveness of the rules and requirements, as well as the relevant references provided to clients.
- Some EPs merely make disclosures through company website but failed to properly communicate with clients to make reference to them.
- Some EPs failed to maintain proper documentary evidence to demonstrate such communication with clients.

- Some EPs incorporated the relevant reporting responsibilities in the internal procedures, but failed to provide sufficient guidelines in governing the details that should be covered during the communication with clients.
- ***EPs who are Non-Clearing Participants (“NCPs”) (1) failed to inform Clients and (2) assumed LOP reporting responsibility on General Clearing Participants (“GCPs”) without proper delegation arrangement***
  - Since the clients’ positions are cleared / kept by GCPs, some NCPs assumed that they have no responsibility to inform their clients in this regard.
  - Some NCPs assumed that the LOP reporting responsibilities would be taken up by the GCPs, or they have delegated such duties to the GCPs but without any documentary evidence on detailed arrangements.
  - Some NCPs claimed to have communicated the relevant rules and requirements in the tripartite agreement entered among the EP, Client and GCP, but the provision and clauses in the agreement were found to be inadequate to fulfil the requirement to inform clients of the relevant rules and requirements.

We wish to draw EPs’ attention to HKFE Rules 632A(a) & 633(c) and OTP 5.10(3) which stipulate that, EPs shall advise their clients of the prescribed position limits, reporting requirements and the responsibilities of reporting set out in the HKFE Rules, Regulations and Procedures, OTP 5.9, and in the Securities and Futures (Contracts Limits and Reportable Positions) Rules and related guidance notes issued by the Securities and Futures Commission. EPs are reminded to have adequate procedures and guidelines to ensure their clients are properly informed about the relevant rules and requirements.

EPs engaging in F.O Business and/or Exchange Traded Options Business are primarily obliged to comply with the Rules, Regulations and Procedures of the Futures Exchange, Options Trading Rules of the Stock Exchange, and Operational Trading Procedures for Options Trading Exchange Participants of the Stock Exchange. When delegating the reporting duties, EPs should clearly communicate with the designated party on the delegation, and maintain proper documentation on such arrangement.

## 2. Position Limit Monitoring

- ***Failure to observe position limits at all times.***

Some EPs conduct position limit monitoring on the opening positions at end-of-day only.

- ***Failure to apply appropriate and effective limits for position limit monitoring.***

Most EPs apply exposure limits in terms of margin and/or number of contracts in the trading system to prevent any trading account from exceeding the prescribed limits. However, some EPs did not apply appropriate limits on aggregate level for positions commonly held or controlled by the same person across different trading accounts. In some cases, the mere application of these exposure limits might not be sufficient given the different prescribed limits for different futures and options contracts within the portfolio. EPs should assess whether the controls in place can effectively ensure the positions from exceeding the relevant position limits.

Some EPs were found to have inadequate controls to ensure compliance with the prescribed limits for Spot Month USD/CNH Futures Contract and Options Contract, which is at position delta of 2,000 long or short currently.

- ***Inappropriate aggregation methodology for the purpose of position limit monitoring.***

Some EPs failed to compute the aggregated position delta of all products under the same underlying index for the comparison with the prescribed limits. For example, instead of adding up the position delta of all contracts with HSI as the underlying, some EPs used the delta of HSI futures, without aggregating those of HSI option, mini-HSI futures, mini-HSI options and other contracts with HSI as underlying, to compare with the prescribed limit at 10,000.

- ***Inadequate position limit monitoring mechanism.***

In some cases, the aggregation of positions commonly held or controlled by the same person for the purpose of position limit monitoring involves manual process which is prone to error, especially when considering the level of trading activities the EPs are involved in, as well as the number of positions requiring aggregation.

Position limits should be observed at all times, and are applicable to open positions on exchange traded products, accumulated and/or established, on both an inter-day and intra-day basis. EPs are reminded to implement appropriate and effective controls to ensure ongoing compliance with all applicable rules and requirements with regard to position limits.

### 3. Large Open Position Reporting

- ***Inappropriate aggregation methodology for identifying reportable positions, including:***
  - ***Failure to aggregate long and short positions of open contracts on a gross basis.***
  - ***Failure to aggregate positions controlled by the same transaction originator held in different accounts.***
  - ***Failure to aggregate positions arising from market making activities and proprietary trades.***
  - ***Failure to aggregate positions according to the reporting rule stipulated in the HKFE's Circular "[Strengthening Large Open Position Monitoring for Stock Index Futures and Options](#)" dated 26 November 2014.*** Some EPs failed to compute the aggregated position delta of all products under the same underlying index for the comparison with the 60% of position limit threshold.

Pursuant to HKFE Rule 628 and OTP 5.11(3) and, an EP holding positions in excess of the reporting level for its own account or for any clients should file an LOP report with the respective exchange in accordance with the prescribed form and timeframe. EP should implement appropriate and effective controls to ensure ongoing compliance with the LOP reporting requirements in this regard.

### 4. Policies and Procedures

- ***Inadequate details and lack of regular review on written policies and procedures.*** It was noted that the written policies and procedures contained inadequate details relating to controls over position limit monitoring and LOP reporting, including but not limited to:
  - obligation to inform clients of reporting responsibilities and requirements
  - identification, maintenance and review of accounts requiring aggregation
  - aggregation methodology for the purpose of position limit monitoring and identification of reportable positions
  - position limit monitoring, both intra-day and inter-day
  - follow-up procedures when the positions are approaching or exceeded the limits
  - controls in ensuring the completeness, accuracy and timeliness of LOP reporting
  - maker-checker mechanism over manual processes

In some cases, the procedural manual only summarizes rules and regulations that are applicable to the trading activities of the firm, but fails to establish and/or document the control arrangements to ensure compliance with those rules and requirements. Some procedures cover the controls in some but not all available systems and/or order placing channels.

It was also noted that some EPs did not conduct regular review even though such policies and procedures were in place.

Non-comprehensive policies and procedures may pose the risk of non-compliance with position limits, failure to identify reportable positions and to file the LOP report in accordance with the requirements and prescribed time frame. We wish to remind EPs that adequate policies and procedures should be established to ensure ongoing compliance with the relevant rules and requirements. Regular review and revision should also be conducted to ensure they are consistent, effective and up-to-date.

## 5. Staff Training

- ***Inadequate staff training.*** Some EPs did not provide adequate and product-specific training for all responsible staff involved in position limit monitoring and LOP reporting on a regular basis, while some merely relied on on-the-job training through sharing and coaching by senior staff members.

To foster a culture of compliance, we wish to remind EPs that they should provide adequate and appropriate training to all its responsible staff, both initially and on an ongoing basis.