通告 CIRCULAR

Subject:	**Compliance Bulletin – Large Open Position ("LOP") Reporting, Client Margin Requirements and Block Trade**
Enquiry:	LOP Reporting / Client Margin Requirements: lophkfe@hkex.com.hk Block Trade: surveillance@hkex.com.hk

As part of our continuous efforts to promote transparency and compliance culture of our marketplace, the Exchange has prepared a Compliance Bulletin to offer the industry a better understanding of our enforcement work and regulatory expectation. It includes some common deficiencies and related issues identified and good practices observed, covering (I) LOP Reporting, (II) Client Margin Requirements and (III) Block Trade.

(I) LOP Reporting

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
  - 633(c) Responsibility of Informing Clients of the LOP reporting requirements

ii. **Operational Trading Procedures ("OTP") for Options Trading Exchange Participants of the Stock Exchange**

- Chapter 5： Client Services Support
  - 5.9 Position Limit and Reporting Level
  - 5.10 Responsibility of Reporting Excess in Reporting Level and Informing Clients of the LOP reporting requirements
  - 5.11 Reporting Excess in Reporting Level

iii. **Securities and Futures (Contracts Limits and Reportable Positions) Rules and Guidance Notes issued by the Securities and Futures Commission**

Deficiencies and instances of non-compliance
A. Inadequate supervisory review and documentation on LOP reporting procedures
Omission in submitting the LOP report due to staff oversight, which were commonly caused by: (i) Lack of handover or knowledge transfer with staff departure or operational restructuring. (ii) Inadequate documentation of daily LOP reporting procedures.
Good practices observed
Adequate internal controls on daily operational processes are in place for a full compliance of LOP reporting requirements under HKFE Rule 628 and OTP 5.11, including but not limited to: (i) Maker-checker mechanism to timely detect potential misreporting; (ii) Escalation and robust rectification process; (iii) Proper documentation; and (iv) Training and refresher to keep new and existing staff abreast of updated requirements.
B. ***Insufficient control on change management***
Omission in updating the LOP related parameters in the internal monitoring systems for certain new HKFE products, resulted in systems incapable of capturing the reportable positions of the relevant products.
Good practices observed
Appropriate change controls to ensure all system parameters are updated prior to commencement of trading of a new product, including but not limited to: (i) Change procedures established and documented; and (ii) Maker-checker mechanism with adequate supervisory oversight to ensure an effective monitoring is in place to timely detect misreporting.
C. ***Failure to inform Clients or inadequate communication with Clients on LOP reporting requirements and responsibilities of reporting***
Failure to adequately communicate with clients regarding LOP reporting responsibilities and requirements, including occasions of: (i) Only verbal communication and absence of any written records; and

(ii) Only inform when clients' positions reached the reportable level and/or prescribed limits. HKFE Rules 633(c) and OTP 5.10(3) stipulate that, EPs shall advise their clients of the 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.
Good practices observed
Adequate procedures to inform clients about the relevant rules and requirements, including but not limited to: (i) Readily accessible channels to ensure clients are properly communicated and able to access the relevant information on LOP reporting requirements and responsibilities; and (ii) Documentary evidence to demonstrate such communication has been performed.

(II) Client Margin Requirements

Relevant Requirements
i. Rules, Regulations and Procedures of the Futures Exchange ("HKFE Rules") ○ Chapter VI - Exchange Participants and Their Clients ▪ 617 Minimum Margins **ii. Circulars** ○ System Readiness in relation to the Revised Client Margining Methodology for Derivatives Products (Ref. No. DCRM/HKEX/198/2016) ○ Omnibus Accounts – Margin Requirements (Ref. No. MEM/CIR/9312050/017)
Deficiencies and instances of non-compliance
A. Incorrect calculation methodology and basis adopted in determining the amount of minimum client margin
Miscalculation of clients' minimum margin due to misinterpretation of the client margining methodology or incorrect system setup:

(i) Applied inaccurate client's minimum margin rate, resulted in the collected client margin below the amount as prescribed by the Exchange.

(ii) The positions in the Client Omnibus Account incorrectly margined on a net basis, resulted in an understatement of client's minimum margin amount.

The minimum client margin is set at 1.33 times of the clearing house margin as stipulated in the Circular dated 28 September 2016 (Ref. No. DCRM/HKEX/198/2016). It is also prescribed in the Circular dated 7 December 1993 (Ref. No. MEM/CIR/9312050/017) that positions in the omnibus accounts must be maintained and margined on a gross basis.

B. Failure to issue initial margin call to established Client on T-day

Failure to issue initial margin calls to established Clients for the amount of minimum margin within T-day for new positions established in T Session, due to:

(i) System configuration omitted to take into account the relevant time-zone adjustments (i.e. US Daylight Saving Time changes).

(ii) Delay in day-end batch processing for margin calculation due to various software and hardware issues.

Under HKFE Rule 617(b), in respect of a new position established on behalf of the established Client on T-day, EPs must issue a margin call for the amount of minimum margin within T-day, and advise that the minimum margin is due as soon as practicable after the call but in no event later than the next Business Day.

C. Inappropriate handling of non-established Clients' minimum margin requirement

Failure to properly handle non-established Clients by:

(i) Inappropriately allowed them to open new positions before receiving sufficient margin.

(ii) Inappropriately considered the client's assets held in his/her non-HKFE accounts maintained with group affiliates as collateral received from the client without conducting a fund transfer at day-end to meet the minimum margin requirement.

Pursuant to HKFE Rule 617(a), except for those who qualify as an established Client or for the purpose of closing out a client's open positions, EPs shall not transact F.O. Business for any client

until and unless the EP has received from that client collateral adequate to cover that client's minimum margin requirement.
Good practices observed in (II)(a)-(c)
Adequate policies to ensure a full compliance with the relevant rules and requirements in respect of Client Margin Requirements, including but not limited to: (i) Regular review on its system parameters and set-up for client margin calculations. (ii) Follow-up with their third party system vendor to validate the system setup and position maintaining methodology; and (iii) Sufficient staff training both initially and on an ongoing basis to ensure sufficient knowledge and understanding on Client Margin Requirements.

(III) Block Trade

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 ("OTR")** ○ Third Schedule – Regulations for Block Trades **iii. Circular** ○ "Guidance on Block Trade Order Aggregation" (Ref. No.: MO/DT/116/20) Block Trade orders must be executed in such manner and must satisfy the criteria laid down in HKFE Rule 815A and such other criteria as may be prescribed from time to time, 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, lowest traded price, bid and ask price of contract; or

[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.

- 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) [2];
- ***Aggregation Rule***: if a Block trade involves aggregation of separate orders, the Aggregation Rule under HKFE Rule 815A(2A) must be followed, which provide that an EP cannot aggregate separate orders or combine separate orders to generate a spread or strategy combination Block Trade unless a number of criteria are met. Subject to HKFE Rule 815A(2A), an Exchange Participant (EP) shall not execute any order as a 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

A. Insufficient understanding of the relevant Block Trade Order Aggregation requirements:
For an Aggregated Block Trade, some EPs misunderstood that at least one of the separate order regardless of futures legs or option legs needs to satisfy the MVT. However, as stated in the Rules:
- HKFE Rule 815A(2A)(b) – For Aggregated Futures Contracts, each separate order comprising the Block Trade has to satisfy the applicable MVT; and
- HKFE Rule 815A(2A)(c) & OTR Third Schedule Paragraph 2.2A.2 – For Aggregated Futures Contracts and / or Option Contracts, at least one of the separate orders comprising an option leg has to satisfy the applicable MVT.

B. Failure to group multiple legs comprising a Block Trade as one strategy pursuant to the HKATS User's Guide by:
- entering different "Info Fields" for each leg of a strategy of the Block Trade; or
- delay inputting of certain legs of the strategy into the Block Trade Facility for execution, resulted in certain legs being executed as different strategies.

C. Failure to obtain authorization from clients whose orders are being aggregated or combined.

D. Failure to observe the MVT requirement for the products executed via Block Trade Facility.

[2] The MVT each product eligible for block trading is set out in the Block Trade Facility web corner of the HKEX Website.

E. Inappropriately aggregated a Block Trade that comprised of separate orders which are below the applicable MVT to attempt to correct an execution error (e.g. price or volume calculation error) of another block trade that was executed earlier.
Good practices observed
(i) Regular training to staff responsible for Block Trade execution to ensure that they are familiar with the relevant rules and requirements in relation to Block Trades executed via the Block Trade Facility, in particular when there are personnel changes; (ii) Proper Internal controls and procedures in relation to Block Trade execution via the Block Trade Facility are in place. E.g. Independent checking by the Compliance officer/ Operations of the BT orders executed; and (iii) Regular review of the policies, procedures and internal controls in relation to Block Trade execution via the Block Trade Facility.

The Exchange would like to point out that the above examples are by no means exhaustive and EPs should always take into consideration their own circumstances to adopt appropriate internal controls and measures to ensure the compliance of 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-compliances should be reported to the Exchange about the incident as soon as practicable.

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

Felix Wang
Head
Market Surveillance and Monitoring
Operations Division

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.