

# New Position Limits for Stock Options

Under the Securities and Futures Ordinance (SFO), the Securities and Futures Commission (SFC) sets position limits for stock options and other products at HKEx. The existing position limits for stock options have been in place since the stock options market was launched in 1995. Since then, the stock options market has grown steadily as reflected in the increase in number of options classes by year-end, average daily volume and year-end open interest.

	1995 <sup>(1)</sup>	2005 <sup>(2)</sup>	Increase of
<b>Number of option classes by year-end</b>	9	43	3.8 times
<b>Average daily volume (contracts)</b>	4,769	35,385	6.4 times
<b>Year-end open interest</b>	44,578	1,021,913	21.9 times

HKEx believes the existing position limits need to be adjusted for the following reasons:

1. They have failed to keep pace with market growth and development, in particular in meeting the trading and hedging needs of Exchange Participants and their clients.
2. Position limits in Hong Kong are much lower than those in competing overseas options markets that impose position limits, in particular overseas options on stocks of Mainland companies listed in the US.
3. The stock options market is restrained by the small position limits and has a comparative disadvantage to the over-the-counter markets where the level of transparency is much lower.

The SFC has made rule changes under the SFO to increase the position limits for stock options. Changes to the subsidiary legislation are expected to take effect on 10 February 2006.

Upon the anticipated introduction of the new stock options position limits under the SFO, the maximum number of open contracts which a single party can hold for an option class in any one market direction for all expiry months combined will be 50,000 contracts. Also under the SFO, any single party holding in excess of 1,000 open contracts per option class per expiry month will need to report the position to HKEx.

Coupled with the said introduction of the new stock options position limits under the SFO, the position limits and reporting levels under HKEx rules will also be adjusted and will become effective on the day when changes to the subsidiary legislation come into operation. The changes to the position limits and reporting levels prescribed by HKEx are summarised below:

<sup>1</sup> Period covered: 8 September 1995 (launch) to 31 December 1995

<sup>2</sup> Period covered: 1 January 2005 to 31 December 2005

- a. Existing Gross Position Limits of 5,000 contracts per expiry month for Tier 1 option classes and 25,000 contracts per expiry month for Tier 2 option classes will no longer be applicable;
- b. A single position limit per option class of 50,000 open contracts in one market direction for all expiry months combined will replace the existing Net Position Limits in one market direction of 10,000 for Tier 1 and 30,000 contracts for Tier 2. However, a lower limit of 30,000 open contracts in one market direction for all expiry months combined will be applied to some option classes;
- c. Market makers and other Options Exchange Participants qualifying as persons to hold positions in excess of the statutory limit under the SFO will continue to be authorised to hold positions in excess of the statutory limit if they have been approved by the Exchange to have a higher limit. This statutory arrangement remains unchanged and will not be affected by the proposed change in position limit; and
- d. A single reporting level per option class of 1,000 open contracts per expiry month will replace the existing Tier 1 level of 1,000 and Tier 2 level of 5,000 contracts gross per expiry month.

The examples below illustrate when the position limit and reporting level are exceeded.

(I) Examples on the adjusted position limit

	<b>Example I</b>	<b>Example II</b>
<b>Position limit for an option class</b>	30,000	50,000
<b>Positions held by a single party in the option class</b>	Long 28,000 calls Short 3,000 puts	Long 35,000 calls Long 15,000 puts Short 32,000 calls Short 10,000 puts
<b>Position in one market direction</b>	31,000 (long calls and short puts)	45,000 (long calls and short puts) 47,000 (short calls and long puts)
<b>Position limit</b>	Exceeded	Not exceeded

(II) Example on the adjusted reporting level

The reporting level for Cheung Kong Holdings (CKH) is 1,000 open contracts. A client buys 1,100 September CKH calls on Day 1. This position will have to be reported no later than 12:00 noon of Day 2. However, the client does not need to report on or before Day 2 if he sells 150 September CKH calls on Day 1 to close out some of the contracts, thereby reducing his position to below the reporting level.

So long as the client holds more than 1,000 September CKH calls on Day 2 or succeeding days, he will need to report his position daily even though his position may remain unchanged.

HKEx will make an announcement once it becomes clear when the new stock options position limits will become effective.