

September 2023

SFC's consultation conclusions on proposed risk management guidelines for futures brokers



Introduction

On 25 November 2022, the Securities and Futures Commission (the "SFC") issued a [Consultation Paper](#) to invite stakeholders to give feedback on the SFC's proposed risk management guidelines for licensed persons dealing in futures contracts. The consultation period began on 25 November 2022 and ended on 31 January 2023.

To address the industry's comments, the SFC published the [Consultation Conclusions on Proposed Risk Management Guidelines for Licensed Persons Dealing in Futures Contracts](#) on 25 August 2023 (the "**Consultation Conclusions**"). Appended to the Consultation Conclusions is the final form of the Risk Management Guidelines for Licensed Persons Dealing in Futures Contracts (the "**New Guidelines**") which will become effective on 25 February 2024 subject to the transitional arrangements set out therein.

The New Guidelines set out the minimum measures for control and management of key risks arising from futures dealing activities that are expected of futures brokers.

This client alert summarises the key requirements in the New Guidelines.

Key requirements

The New Guidelines have introduced 11 key areas with specific guidance for each of these areas, they are:

- 1. Risk management framework:** An effective risk governance framework to prudently manage both proprietary trading and clients' trading in futures contracts should be established. The risk management policies and procedures should cover the identification and assessment of risks and determination of risk appetites and risk limits; ongoing monitoring, controlling and reporting; escalation and resolution procedures for breaches; and stress testing and contingency planning.
- 2. Market risk management:** For futures brokers engaging in proprietary trading in futures contracts, all market risks arising from such proprietary trading should be properly quantified, monitored and controlled. A futures broker should also establish a market risk management system to estimate the probable impact on its proprietary positions of adverse changes in market conditions, regularly compare the estimated market risk exposures with the actual and hypothetical returns of its proprietary positions and establish prudent market risk limits that are commensurate with its financial and management capabilities.
- 3. Commodity futures trading:** A futures broker should maintain a list of commodity futures in which they can deal and monitor the risks of the commodity futures on such list. Futures brokers handling the physical settlement of commodity futures should also have sufficient knowledge about the underlying commodity markets, including the roles of the parties involved in the physical settlement and the relevant storage and delivery arrangement.
- 4. Client credit risk management:** A futures broker should put in place prudent risk limits, including position limits, for each client (or each group of connected clients where applicable) to mitigate client credit risk (meaning the risk of a futures broker suffering loss due to a client defaulting) and to ensure compliance with statutory and regulatory position limits. The SFC also provides detailed guidance and procedures in terms of margin financing for futures contracts, for example, futures brokers should set prudent thresholds for issuing margin calls, for stopping clients from opening further positions and for force-liquidating clients' positions, and will be required to follow their in-house policies and ensure that senior management properly exercises its approval power and provides justification if there is any deviation or waiver of its policies, or any margin call or forced liquidation waiver.
- 5. Concessionary margining:** A futures broker should only apply concessionary margining (which refers to margining arrangements whereby the client is not required to comply with an upfront collateral requirement) to a client in respect of trading in futures markets if the client has a record of consistently meeting margin requirements, the broker follows concessionary margining requirements set by the relevant exchange or clearing house and the broker has sufficient liquidity and financial capability to settle its counterparty margin requirements of all clients to which it extends concessionary margining.
- 6. Risk management over executing or clearing agents:** When engaging an executing or clearing agent, a futures broker should have written policies to ensure proper management of exposure to the agent and regularly conduct due diligence reviews of the agent if the agent is not a licensed corporation, registered institution, exchange participant, etc. and implement appropriate arrangements to manage the impact of the unavailability of that agent.
- 7. Funding liquidity risk management:** Client money or collateral should be sufficiently liquid to settle its counterparties' margin requirements for the trading of futures contracts on behalf of clients.

- 8. Safeguarding client assets:** A futures broker should make sure that proprietary trading and client positions in futures contracts and their related margins are booked separately in their accounts with counterparties, and client assets are held in a segregated trust account.
- 9. Trading in futures markets outside Hong Kong:** Where applicable, futures brokers should make written disclosures to their clients on the key risks of conducting transactions in overseas futures markets, and monitor material changes in the regulation of its overseas counterparties and those overseas markets.
- 10. Stress testing:** All futures brokers are required to perform stress testing at least weekly and during a volatile market, regardless of whether concessionary margining is applied. However, clients who have a record of consistently meeting margin requirements or maintaining sound financial positions relative to the size of their portfolios and trades could be exempted from such assessments.
- 11. Notification requirements:** Various matters need to be reported to the SFC, including any failure or potential failure to meet margin calls from any counterparty.

What else

The control measures specified in the New Guidelines are not meant to be exhaustive. Futures brokers should start considering the requirements in the New Guidelines, update their internal risk management policies and procedures to cover the requirements set out in the New Guidelines, and ensure their internal operation and systems can meet the requirements of the SFC.

However, the New Guidelines do not apply to any dealing activity in futures contracts carried out by a person licensed for both type 2 and type 9 regulated activities solely for the purposes of carrying on its type 9 regulated activity.

Next steps

The New Guidelines become effective on 25 February 2024, except that futures brokers will be given an additional 12 months to implement system development for (i) incorporating client risk limits into their risk management systems, order management systems or trading platforms; and (ii) carrying out stress tests using an assumed stress scenario designed in accordance with the New Guidelines with reference to past futures market stress events and assessments of emerging risk of futures products.

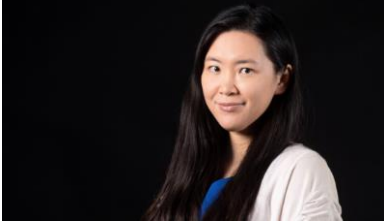
During this 12 month period, futures brokers that have not completed system development for implementing these requirements should put in place interim compensating measures, such as monitoring compliance with risk limits manually, to meet the risk management objective of the requirements.

How we can help

The New Guidelines provided more principles-based guidance in place of some prescriptive rules and quantitative thresholds, which reflects the SFC's expectation of futures broker to prudently manage risks for their proprietary and agency dealing businesses and maintain a robust risk management framework.

Many of our clients are licensed corporations that provide futures brokerage services. We regularly advise our clients on the issues identified in the New Guidelines and we have extensive experience advising our clients in the financial sector on issues regarding their policies and procedures. Please get in touch if you are interested in discussing any of the above.

Contact us



Katherine Liu

Partner, Head of finance and financial services regulation
T: +852 2533 2717
E: katherine.liu@shlegal.com



James Wong

Associate
T: +852 3166 6933
E: james.wong@shlegal.com



Alan Wong

Associate
T: +852 2533 2719
E: alan.wong@shlegal.com



Monica Jia

Associate
T: +852 2533 2795
E: monica.jia@shlegal.com

Stephenson Harwood is a law firm of over 1300 people worldwide, including 190 partners. Our people are committed to achieving the goals of our clients – listed and private companies, institutions and individuals.

We assemble teams of bright thinkers to match our clients' needs and give the right advice from the right person at the right time. Dedicating the highest calibre of legal talent to overcome the most complex issues, we deliver pragmatic, expert advice that is set squarely in the real world.

Our headquarters are in London, with eight offices across Asia, Europe and the Middle East. In addition, we have forged close ties with other high quality law firms. This diverse mix of expertise and culture results in a combination of deep local insight and the capability to provide a seamless international service.