

LINKLATERS ON BEHALF OF A GROUP OF FINANCIAL INSTITUTIONS

SUMMARY OF COMMENTS ON PART XV OF THE SECURITIES AND FUTURES BILL

INTRODUCTION

The Group of financial institutions listed below submitted detailed written comments to the Bills Committee in January, and made a brief presentation at the Bills Committee meeting on 3 February 2001.

To the extent that Part XV (Disclosure of Interests) will bring the Hong Kong disclosure regime into line with that of other international markets - by reducing the disclosure threshold to 5% and requiring disclosure within 3 business days - we welcome these changes. However, the proposed disclosure regime goes considerably further than the equivalent legislation in other international markets, by requiring disclosure of:

- interests in unissued shares
- interests arising under cash-settled derivatives
- short positions
- changes in the nature of a person's interest.

Treating the above situations as potentially disclosable makes it extremely complex and costly to monitor whether disclosure obligations have been triggered, and may result in very large numbers of disclosures having to be made. We question whether the information that is disclosed will be of value to listed corporations and investors, and we believe that the proposed disclosure regime will have an adverse effect on liquidity and volume in the Hong Kong markets.

We note that there are already detailed statutory requirements for disclosure and record-keeping in respect of short selling transactions in the Hong Kong market. The SFC also has extensive powers to investigate matters such as stock price movements, and directors of listed corporations are subject to disclosure requirements under the Stock Exchange's Listing Rules. If there are particular types of transactions that the SFC or the Exchange would expect to be announced, or where they would want to have further information, we suggest that particular rules and regulations could be introduced to achieve this purpose. However, to impose blanket disclosure requirements on all significant market participants appears out of proportion to the benefits of such disclosure to the market, and unlikely to assist the regulators, listed corporations and investors in detecting particular transactions that may be of legitimate interest to them.

We welcome the fact that, in its letter dated 7 May 2001 to the Bills Committee, the International Swaps and Derivatives Association, Inc. has endorsed the Group's comments, and expressed its concern on the proposed extension of the disclosure regime to cash-settled derivatives contracts.

Proposed exemptions from the disclosure regime

As indicated above, our preference would be to see the disclosure regime amended so that it reflected more closely the existing laws in Hong Kong (and the laws of other financial markets internationally), so that transactions such as cash-settled derivatives did not trigger disclosure obligations under the new disclosure regime. This would reduce the need for "exemptions" to be introduced into the legislation.

However, if the scope of the disclosure regime continues to be as widely defined as in the Bill, exemptions to reduce the practical consequences of the new disclosure regime will be of great importance. We note that, in the Bill, the Administration has introduced a few additional exemptions, for intra-group activities, for “conduit” stock borrowing and lending, and for derivatives over a basket of shares. However, as we have discussed in meetings and correspondence with the FSB and the SFC, we believe that there are a number of serious technical deficiencies with the drafting and that exemption for stock borrowing and lending does not go far enough.

From our discussions, we understand that the FSB and SFC are to consider making drafting amendments, and introducing a wider exemption in respect of some stock lending and borrowing activities. This is to be welcomed, but it will be of the utmost importance to ensure that the revised drafting addresses the concerns we have raised. In our view, the problem is simply that the disclosure regime is drafted too widely in the first place: trying to solve the resulting difficulties through creating piecemeal exemptions will almost inevitably create difficulties of drafting, interpretation and complexity.

In relation to stock borrowing and lending activities, the SFC has established a Working Group to consider further the scope of the exemptions for these activities, and we are pleased that some members of the Group are represented on that Working Group. We hope that Part XV can be improved by drafting amendments and the creation of additional exemptions. Nevertheless, the Group continues to believe that a more radical reconsideration of the policy underlying Part XV is needed, to achieve legislation that would be consistent with international market practice, and would provide sufficient market transparency without unduly discouraging legitimate investment and trading activities in Hong Kong shares.

List of submitting group members

Credit Suisse First Boston (Hong Kong) Limited

Deutsche Bank AG

Dresdner Kleinwort Wasserstein

Goldman Sachs (Asia) L.L.C.

Merrill Lynch (Asia Pacific) Limited

JP Morgan

Morgan Stanley Dean Witter Asia Limited

Salomon Smith Barney Hong Kong Limited

UBS Warburg

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LINKLATERS & ALLIANCE

18 May 2001

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Our ref
Your ref

Secretary to the Bills Committee
on the Securities and Futures Bill
Legislative Council
8 Jackson Road
Central
Hong Kong

Dear Sirs

Securities and Futures Bill - Part XV

The Group of financial institutions for which Linklaters is acting has already provided written submissions on the Bill to the Bills Committee. We note that the Bills Committee is currently considering Part XV of the Bill, relating to Disclosure of Interests in Shares. These provisions of the Bill are of great importance to the operation of the financial markets in Hong Kong, and a further submission to the Bills Committee in respect of these provisions is attached. This highlights some of the more important points made in our previous submission, and provides some information for the Bills Committee on discussions that have taken place between the Group and the FSB and SFC.

18 May 2001

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Please arrange to circulate this submission to members of the Bills Committee. We can also arrange to let you have a Chinese translation if this would be helpful.

Yours faithfully

Linklaters

cc: Au King Chi - Financial Services Bureau
Mark Dickens - Securities & Futures Commission