

**Subcommittee on Draft Subsidiary Legislation to be made under
the Securities and Futures Ordinance**

Securities and Futures (Price Stabilizing) Rules

This paper sets out the proposals of the Securities and Futures Commission (SFC) to make rules under sections 282(2) and 306(2) of the Securities and Futures Ordinance (SFO) (No. 5 of 2002) prescribing a safe harbour in respect of the market misconduct provisions in Part XIII and the criminal offence provisions under Part XIV of the SFO.

Proposal

2. The SFC proposes to make the Securities and Futures (Price Stabilizing) Rules to permit and regulate price stabilizing action connected with public offerings of securities, now in draft at **Annex 1**, under sections 282(2) and 306(2) of the SFO.

Power to make the Rules

3. Parts XIII and XIV of the SFO provide for parallel civil and criminal regimes to deal with market misconduct, respectively. Sections 282 of Part XIII and 306 of Part XIV of the SFO provide that a person who may otherwise have engaged in market misconduct (under Part XIII) or committed an offence (under Part XIV) shall not be regarded as having so engaged or shall have a defence if he establishes that the conduct in question is in accordance with rules made under such sections. Under sections 282(2) and 306(2), the SFC is empowered, after consulting the Financial Secretary, where it considers it is in the public interest, to make rules to prescribe the circumstances in which any conduct that would otherwise constitute market misconduct under Part XIII or a criminal offence under XIV shall not be so regarded.

4. The SFC is of the view that the draft Rules would be in the public interest and *intra vires* if made as drafted.

Major features of the draft Rules

5. The draft Rules at Annex 1 are to be made by the SFC under sections 282(2) and 306(2) of the SFO. They prescribe the circumstances in which the prices of certain securities offered to the public may be stabilized, the period in which they can be stabilized, the type of stabilizing action which may be undertaken and related requirements for carrying out stabilizing actions such as disclosure and record keeping.

Price stabilization

6. Price stabilization generally refers to transactions undertaken to stabilize the price of securities either to prevent them from declining or rising. Stabilization is potentially manipulative because it seeks to maintain or support the price of a security at a certain level and therefore distorts the price which would otherwise obtain as a result of a natural supply and demand of the security in the market. Under the SFO, these actions might be considered market misconduct under Part XIII or criminal offences under Part XIV, in particular in relation to insider dealing (sections 270 and 291), false trading (sections 274 and 295) and stock market manipulation (sections 278 and 299).

7. The SFC considers that it is in the public interest to make rules prescribing the circumstances in which price stabilizing actions may be taken in connection with public offerings of shares and debentures, and regulating such actions. The primary purpose of stabilization is to facilitate capital raising by corporations by addressing short-term fluctuations resulting from the sudden increase in supply in the secondary market (which would generally result in a decrease in the price of the newly offered securities).

8. Stabilization has been practised in the Hong Kong market in a restricted sense in connection with initial public offerings. The SFC currently permits certain stabilizing actions to be carried out in circumstances as prescribed in its policy statements issued in 1994 and further elaborated in 1998. The draft Rules will provide a clear regulatory framework for stabilizing actions so that they may be conducted in an open, transparent and accountable manner without compromising investor protection.

Commensurate with international practices

9. In formulating the draft Rules consideration has been given to recent regulatory developments in other major financial centres, particularly the UK and the US. The draft Rules are to a large extent commensurate with the international standards so as to facilitate global offerings of securities conducted

in Hong Kong and in other markets. Having regard to the similarity in the regulatory framework for securities transactions and mechanisms for securities offerings, the SFC has modelled the draft Rules closely on the UK Price Stabilizing Rules issued by the Financial Services Authority in December 2001 pursuant to the Financial Services and Markets Act 2000.

Threshold for size of public offer

10. The draft Rules will apply only to public offers in Hong Kong of publicly traded shares or debentures and certain secondary offers which are public in character where the total cost of the securities subject to the offer is at least HK\$100 million (clause 3).

Stabilizing period

11. It is proposed that under the draft Rules, the stabilizing manager appointed by the offeror may purchase securities in the secondary market to support the price of the relevant newly offered securities (clause 6) within the stabilising period. The stabilizing period is defined in clause 2 of the draft Rules to be 30 days from the earlier of the closing date of the offer or the commencement of trading of the relevant securities.

Disclosure and record-keeping requirements

12. Stabilizing actions may not be taken if adequate disclosure of the action has not been given (clause 8), proper records are not kept in accordance with clause 13 or the price of the relevant securities has already become artificial as a result of market misconduct (clause 10(1)). The particulars of the disclosure requirements are set out in Schedule 1 to the draft Rules. The stabilizing manager is also required to disclose the information specified in Schedule 3 to the draft Rules after the expiry of the stabilizing period (clause 9).

13. Stabilizing actions may not be taken with respect to convertible debt securities if their conversion terms have not been publicly announced (clause 10(2)). The stabilizing manager may not take any action in any case where it or its associates, in respect of the offer, holds any options over the securities which are to be stabilized, and the terms of which have not been disclosed to the public in accordance with the draft Rules (clause 10(3)). This prohibition addresses conflicts of interest on the part of the stabilizing manager.

Stabilizing price

14. Stabilizing bids, if effected in relation to equity securities, will be subject to a pricing limit mechanism and the maximum stabilizing bid should not exceed the public offer price (clause 11). The pricing limits are prescribed in Schedule 2 to the draft Rules. No downward stabilization¹ would be allowed. This will prevent capping the market price of the relevant securities.

15. Stabilizing actions related to over-allocation of relevant securities and the subsequent exercise of an option to purchase or subscribe for relevant securities in order to close out the position established by the over-allocation are permitted under clause 7. Sale of relevant securities acquired by the stabilizing manager in the course of stabilizing actions is also permitted.

Stabilizing manager

16. The draft Rules require that the stabilizing action be carried out only by the stabilizing manager or its agent (clause 12(4)).

17. Clauses 13 and 14 require the stabilizing manager to keep and maintain a register of stabilizing actions, available for inspection by the SFC and the offeror upon notice. The register should contain all the transaction details about stabilizing actions for each offer of securities.

Stabilization actions conducted overseas

18. In order to facilitate global offerings, clause 15 provides that certain stabilizing actions will not for the purpose of the SFO be regarded as market misconduct. These are stabilizing actions conducted overseas with a view to stabilizing the price of securities on the overseas market and effected in accordance with the stabilization rules in recognized jurisdictions specified in Schedule 4 to the draft Rules, which provide similar regulatory safeguards against market manipulation.

¹ Downward stabilization refers to actions to prevent the excessive increase of the price of newly offered securities.

Consistency with SFC regulatory objectives

19. The SFC considers that permitting stabilizing action in respect of public offers of listed securities in accordance with the draft Rules would be consistent with the SFC's objective in section 4(a) of the SFO "to maintain and promote the fairness, efficiency, competitiveness, transparency and orderliness of the securities and futures industry". As stabilization of the price of securities conducted in relation to public offers addresses short-term fluctuations resulting from the sudden increase in supply in the secondary market, such activities are expected to assist in maintaining the orderliness and efficiency of the markets. The disclosure and recording requirements set out in the draft rules will be consistent with the SFC's objective of maintaining and promoting the transparency of the securities and futures industry.

Public consultation

20. The SFC released a consultation document and an exposure draft of the Rules on 8 February 2002 for comment by the public. A total of 7 submissions were received. The SFC has considered all the comments received and has made some amendments to the draft Rules, which incorporate the following major changes –

- (a) the threshold for the size of public offer of equity securities and debenture was reduced from HK\$200 million to HK\$ 100 million;
- (b) stabilizing action may now be conducted in respect of offers to the public which are not the subject of a prospectus; and
- (c) stabilizing action may be conducted with respect to certificates giving the holder a right to the relevant securities (depository receipts).

21. We attach the following documents for Members' reference –

- (a) Consultation Document on the draft Rules, at **Annex 2**, which sets out the underlying policy together with the exposure draft of the Rules. The revised draft Rules are now at Annex 1 for Members' consideration;
- (b) Consultation Conclusions, at **Annex 3**, which set out the conclusions from the consultation and the SFC's responses to the comments received; and

- (c) Summary of Comments and SFC's responses, at **Annex 4**, which set out comments received and SFC's response thereto in the form of a table. A list of respondents is attached to the summary table.

Way forward

22. Subject to Members' views, the SFC will proceed to consult the Financial Secretary and make the Rules under the authority vested in it. The Rules so made will be published in the Gazette for tabling before the Legislative Council in the normal manner. The intention is that the Rules shall come into operation on the commencement of the SFO.

23. Members may wish to note that it is the intention of the SFC to keep the safe harbour provisions under regular view in light of latest market developments and international trends, in order to ensure that our price stabilization regime is modern and effective in enabling the market to develop further.

Securities and Futures Commission
Financial Services Bureau
29 June 2002

[c.f. : sections 237, 273, 277, 292, 294 and 297 of the Securities and Futures Ordinance]

SECURITIES AND FUTURES (PRICE STABILIZING) RULES

(Made by the Securities and Futures Commission under sections 282(2) and 306(2) of the Securities and Futures Ordinance (5 of 2002) after consultation with the Financial Secretary)

PART I

PRELIMINARY

1. Commencement

These Rules shall come into operation on the day on which Parts XIII and XIV of the Securities and Futures Ordinance (5 of 2002) come into operation.

2. Interpretation

In these Rules, unless the context otherwise requires -
"ancillary stabilizing action" (), in relation to any relevant securities, means any action that may be taken under section 7 in connection with any primary stabilizing action in respect of the relevant securities;

"associate" () -

- (a) for the purposes of or in connection with determining the application of section 4, has the meaning assigned to it by section 245(1) of the Ordinance; or

(b) for the purposes of or in connection with determining the application of section 5, has the meaning assigned to it by section 285(1) of the Ordinance;

"closing date" (), in relation to any relevant securities, means -

- (a) the date specified in an offer document relating to the relevant securities as the last date for acceptance of the offer; or
- (b) if no such date is specified in the offer document relating to the relevant securities, the date on which the offeror receives any of the proceeds of the offer;

"commission" () means any form of commission, including a benefit of any kind, offered or given in connection with any regulated activity;

"debt securities" () means debentures issued by, or which it is reasonably foreseeable will be issued by, a corporation, a government or municipal government authority or a multilateral agency;

"depository receipt" () means a certificate or any other instrument which -

- (a) confers contractual or property rights (other than rights consisting of options) on its holder in respect of equity securities or debt securities held by a depository, custodian or other person ("the custodian") not being the person on whom the rights are conferred by the certificate or

instrument;

(b) may be transferred by its holder without requiring the consent of the custodian;

(c) is traded or has been admitted to trading on an overseas stock market; and

(d) is uniform in all material respects with the equity securities or the debt securities it represents and is changeable by its holder into the equity securities or the debt securities at any time, and, for the purposes of these Rules, a depositary receipt is regarded as the same as the equity securities or the debt securities it represents in the corresponding quantity;

"equity securities" (), means shares issued by, or which it is reasonably foreseeable will be issued by, a corporation, but does not include any interest in any collective investment scheme;

"first public announcement date" (), in relation to any relevant securities, means the date of the first public announcement relating to the relevant securities which indicates, or might reasonably be understood as indicating, that an offer relating to the relevant securities is intended to take place in some form and at some time;

"initial stabilizing action" (), in relation to any relevant securities, means the first action taken by the stabilizing manager in the course of primary stabilizing action in respect of the relevant securities;

"initial stabilizing price" (), in relation to any relevant

securities, means the price at which the stabilizing manager takes any initial stabilizing action in respect of the relevant securities;

"issuer" () -

(a) in relation to a depositary receipt, means the person who issued or is to issue the securities which the depositary receipt represents; or

(b) in relation to any other relevant securities, means the person by whom the relevant securities are or are to be issued;

"offer" () means an offer or an invitation to make an offer, or (except in sections 6(b) and 7(1)(d)) an issue;

"offer document" () -

(a) in relation to an offer described in section 3(d)(i), means a prospectus, or an advertisement, invitation or document the issue of which has been authorized by the Commission under section 105 of the Ordinance; or

(b) in relation to an offer described in section 3(d)(ii), means the public announcement referred to therein;

"offer price" (), in relation to any relevant securities, means the specified price at which the relevant securities are offered to the public without accounting for any concessions, commission, brokerage, transaction fees or levies;

"offeror" (), in relation to an offer of any relevant securities, means the issuer, or a holder of the relevant

securities making the offer;

"overseas stock market" () means a stock market outside Hong Kong;

"primary stabilizing action" (), in relation to any relevant securities, means any action that may be taken under section 6;

"prospectus" () -

(a) in relation to an offer of any relevant securities in a company, means a prospectus authorized for registration under section 38D of the Companies Ordinance (Cap. 32); or

(b) in relation to an offer of any relevant securities in an overseas company, means a prospectus authorized for registration under section 342C of the Companies Ordinance (Cap. 32);

"public announcement" (), in relation to any relevant securities, means any communication made by or on behalf of an offeror or the stabilizing manager, being a communication made in circumstances in which it is likely that members of the public will become aware of the communication;

"relevant authorized automated trading services" () means authorized automated trading services where -

(a) the terms of their authorization include a term permitting stabilizing action to be taken in compliance with these Rules in respect of relevant securities traded by means of such authorized automated trading services; and

(b) such term is contained in the register maintained

under section 99(1) of the Ordinance;

"relevant communications" () means any of the communications specified in Schedule 1;

"relevant offer" () means an offer of relevant securities in respect of which any stabilizing action is taken;

"relevant securities" () means -

- (a) equity securities;
- (b) debt securities; or
- (c) depositary receipts of equity securities or debt securities;

"stabilizing action" () means primary stabilizing action or ancillary stabilizing action;

"stabilizing manager" () means the single intermediary appointed by or on behalf of the offeror to take any stabilizing action under these Rules;

"stabilizing period" (), in relation to any relevant securities, means the period -

- (a) beginning with the commencement of trading of the relevant securities offered on a recognized stock market or by means of relevant authorized automated trading services after the offer document relating to the relevant securities is issued and the offer price for the relevant securities is announced, whether in the offer document or otherwise; and
- (b) ending on the earlier of the thirtieth day after -
 - (i) the closing date; or
 - (ii) the commencement of trading of the relevant securities offered on a

recognized stock market;

"stabilizing price" (), in relation to any relevant securities, means the price at which any stabilizing action in respect of the relevant securities is taken.

3. Application

Notwithstanding anything in these Rules, stabilizing action may only be taken in respect of relevant securities the subject of an offer for cash where -

- (a) the offer for cash is to be, or has been, made at a specified price payable in Hong Kong dollars or in any foreign currency;
- (b) the relevant securities are traded or have been admitted to trading on a recognized stock market or by means of relevant authorized automated trading services, or are the subject of an application for admission for trading on a recognized stock market or by means of relevant authorized automated trading services;
- (c) the total value of the relevant securities offered (excluding any allocation of the relevant securities referred to in section 7(1)(a)(i)) at the offer price is not less than \$100 million (or its equivalent in any foreign currency); and
- (d) the offer is to the public, and such offer -
 - (i) is to be, is, or has been subject of a prospectus, or an advertisement, invitation or document the issue of which

has been authorized by the Commission under section 105 of the Ordinance; or

(ii) (A) is an offer -

(I) within the meaning of section 343(2) of the Companies Ordinance (Cap. 32); or

(II) in respect of which an exemption from compliance with the requirements of sections 38(1) and (3) and 44A(2) of the Companies Ordinance (Cap. 32) is made by virtue of section 3 of the Companies Ordinance (Exemption of Companies and Prospectuses from Compliance with Provisions) Notice (Cap. 32 sub. leg.);

(B) is for relevant securities that are or will be uniform in all respects with securities previously issued and for the time being traded or admitted to trading on a recognized stock market or by means of relevant authorized automated trading services; and

(C) is to be, is, or has been subject of a public announcement containing the offer price of the relevant securities and the information relating to the relevant securities required in item 4 of Schedule 1, provided that if the offer comprises equity securities to be sold by an existing shareholder, the shareholder has agreed to subscribe for the same number of such equity securities at the same price after taking account of expenses incurred.

PART II

EXEMPTION FOR STABILIZING ACTION

4. Conduct not to constitute market misconduct

For the purposes of section 282(1) of the Ordinance, any stabilizing action in respect of any relevant securities conducted in compliance with these Rules shall not be regarded as constituting market misconduct.

5. Conduct not to constitute offences under Part XIV of the Ordinance

For the purposes of section 306(1) of the Ordinance, any stabilizing action in respect of any relevant securities conducted in compliance with these Rules shall not be regarded as

constituting an offence under Part XIV (other than section 300 or 302) of the Ordinance.

PART III

STABILIZING ACTION

6. Primary stabilizing action

The stabilizing manager may take all or any of the following actions in respect of any relevant securities during the stabilizing period -

- (a) purchase, or agree to purchase, any of the relevant securities;
- (b) offer or attempt to do anything as described in paragraph (a),

for the sole purpose of preventing or minimizing any reduction in the market price of the relevant securities.

7. Ancillary stabilizing action

(1) The stabilizing manager may, in connection with any primary stabilizing action taken in respect of any relevant securities under section 6, take all or any of the following actions -

- (a) for the purpose of preventing or minimizing any reduction in the market price of the relevant securities -

- (i) allocate a greater number of the relevant securities than the number that is initially offered; or

- (ii) sell or agree to sell the relevant securities so as to establish a short position in them;
- (b) pursuant to an option or other right to purchase or subscribe for the relevant securities as referred to in section 10(3), purchase or subscribe for or agree to purchase or subscribe for the relevant securities in order to close out any position established under paragraph (a);
- (c) sell or agree to sell any relevant securities acquired by the stabilizing manager in the course of the primary stabilizing action in order to liquidate any position that has been established by such action;
- (d) offer or attempt to do anything as described in paragraph (a)(ii), (b) or (c).

(2) Ancillary stabilizing action under subsection (1)(b) may be taken without regard to the limits on pricing in section 11 and Schedule 2.

8. Disclosure of stabilizing action

(1) The stabilizing manager may not take any stabilizing action in respect of any relevant securities unless -

- (a) from the first public announcement date, adequate disclosure is made, in relevant communications issued by or on behalf of the offeror or the stabilizing manager, of the fact that stabilizing action may take place in relation to the offer;

- (b) where the recognized exchange company operating the recognized stock market or the operator of the overseas stock market on which the relevant securities are or will be traded, or the person authorized to provide the relevant authorized automated trading services by means of which the relevant securities are or will be traded, requires to be informed of any stabilizing action that may take place in respect of the relevant securities during the stabilizing period, the requirement has been complied with; and
- (c) a register has been established and kept in compliance with section 13(1).

(2) For the purposes of subsection (1)(a), adequate disclosure is regarded as having been made in relevant communications issued by or on behalf of an offeror or the stabilizing manager if, in the relevant communications specified in Schedule 1, disclosure is made as prescribed in the Notes to Schedule 1.

(3) The requirement to make adequate disclosure in subsection (1)(a) in relevant communications does not apply to any communication which is not specified in Schedule 1.

9. Interim and post-stabilization disclosure

(1) As soon as reasonably practicable after purchasing or subscribing for or agreeing to purchase or subscribe for any relevant securities pursuant to the exercise or partial exercise of an option under section 7(1)(b), the stabilizing manager shall

ensure that a public announcement stating the number of relevant securities purchased or subscribed for, or which have been agreed to be purchased or subscribed for, pursuant to such exercise or partial exercise of such option and the number of relevant securities available thereafter under any unexercised portion of the option is issued, whether by or on behalf of the offeror or the stabilizing manager.

(2) Within 7 days after the end of the stabilizing period, the stabilizing manager shall ensure that a public announcement containing the information required in Schedule 3 is issued, whether by or on behalf of the offeror or by the stabilizing manager.

10. Restrictions on stabilizing action

(1) The stabilizing manager shall not take stabilizing action in respect of any relevant securities in any case where -

- (a) at the time when the offer price of the relevant securities was determined, the market price of the relevant securities or of rights to them was or could reasonably be anticipated to be an artificial price; and
- (b) the stabilizing manager knew or ought reasonably to have known that the artificiality in the market price was attributable in whole or in part to any conduct of any person which constitutes market misconduct or an offence under Part XIV of the Ordinance.

(2) The stabilizing manager shall not take stabilizing

action in respect of any relevant securities in any case where -

- (a) the relevant securities are debt securities;
- (b) there are equity securities into which those debt securities can be converted or to the purchase of which those debt securities give rights; and
- (c) the terms of conversion, purchase or subscription have not yet been the subject of a public announcement.

(3) The stabilizing manager shall not take stabilizing action in respect of any relevant securities in any case where -

- (a) he or an associate of his has, in connection with the offer relating to the relevant securities, an option or other right to purchase or subscribe for relevant securities from the offeror; and
- (b) that option or right may be exercised or relied on after the first public announcement date and during or after the stabilizing period,

unless the existence and principal terms of the option or right have been disclosed in the relevant offer document.

11. Limit on pricing in stabilizing action

(1) Subject to subsection (2), the stabilizing manager shall not, in the course of any primary stabilizing action taken in respect of any relevant securities, make any bid or effect any transaction in relation to the relevant securities at a price exceeding, where the bid or transaction is made or effected at a time or in the circumstances specified in column 2 of Schedule 2, the price specified in column 3 of that Schedule opposite the time

or circumstances so specified.

(2) The prohibition in subsection (1) does not apply to any stabilizing action taken in respect of debt securities.

12. Management of stabilization

(1) The stabilizing manager shall ensure that, in relation to any stabilizing action taken or to be taken by it -

- (a) the disclosure requirements specified in sections 8 and 9 are complied with;
- (b) where the recognized exchange company operating the recognized stock market or the operator of the overseas stock market on which the relevant securities are or will be traded, or the person authorized to provide relevant authorized automated trading services by means of which the relevant securities are or will be traded, requires to be informed of any stabilizing action that may take place in respect of the relevant securities, the requirement has been complied with; and
- (c) any person appointed by the stabilizing manager to act as his agent for the purpose of making any bid or effecting any transaction in the course of the stabilizing action complies with the applicable requirements of these Rules.

(2) No bid may be made or transaction effected in the course of any stabilizing action unless the stabilizing manager -

- (a) has established the register required in section 13;
- and

(b) is in compliance with the registration requirements in section 13 in respect of all earlier transactions effected in the course of stabilizing action in connection with the relevant offer.

(3) Subject to subsection (4), no bid may be made or transaction effected in the course of any stabilizing action in respect of any relevant offer except by the stabilizing manager appointed in respect of the relevant offer.

(4) The stabilizing manager may appoint a person to act as its agent for the purpose of making any bid or effecting any transaction in the course of any stabilizing action on terms which -

- (a) make the agent responsible to the stabilizing manager; and
- (b) make the stabilizing manager responsible to others for the conduct of the agent as if the conduct were committed by the stabilizing manager.

(5) Subject to subsection (6), during the stabilizing period for any relevant offer, the stabilizing manager shall not as principal enter into any dealing in any relevant securities to which the stabilizing action relates with any agent it has appointed under subsection (4) to act on his behalf in respect of such stabilizing action.

(6) Subsection (5) does not apply if, at the time of the transaction, neither the stabilizing manager nor the agent concerned knew or ought reasonably to have known the identity of the counterparty.

PART IV

REGISTER OF STABILIZING ACTIONS

13. Record keeping for stabilizing actions taken

(1) The stabilizing manager shall establish and keep a register in respect of each offer of relevant securities to which these Rules apply under section 3.

(2) The stabilizing manager shall ensure that the register referred to in subsection (1) contains, and is updated immediately or on a daily basis (from business day to business day) -

- (a) the names of all agents appointed under section 12 and details of the terms of the appointment of each;
- (b) the general parameters (including the initial stabilizing price) laid down by the stabilizing manager for each of the agents and the date and time of their communication, variation or revocation;
- (c) details of each transaction effected in the course of the stabilizing action in question including -
 - (i) the type of the relevant securities;
 - (ii) the unit price of the relevant securities;
 - (iii) the quantity or total value of the relevant securities in the transaction;
 - (iv) the date and time of the transaction; and
 - (v) details of the counterparty to the transaction;
- (d) details of the allocation of relevant securities (name of offeree and amount allotted); and

(e) details (so far as known to the stabilizing manager) of transactions other than those which are effected by or in accordance with the instructions of the stabilizing manager at a price above the then current stabilizing price for the purposes of determining the maximum price in respect of item 2 of Schedule 2.

(3) The register shall be -

(a) kept in Hong Kong; or

(b) be capable of being brought to, or reconstituted in, Hong Kong within 48 hours of receipt by the stabilizing manager of notification in writing for access from anyone entitled to inspect it under section 14.

(4) If the register is not kept in either English or Chinese, it shall be capable of being converted into either language within the 48-hour period referred to in subsection (3).

(5) The register shall be maintained for a period of at least 7 years after the end of the stabilizing period.

14. Inspection of register

(1) Subject to subsection (2), where any stabilizing action has been taken in respect of any relevant securities, any offeror of the relevant securities may, within 3 months after the end of stabilizing period, by giving notification in writing to the stabilizing manager concerned, inspect the register kept and maintained under section 13.

(2) Subsection (1) does not entitle an offeror to inspect

any part of the register other than the details described in section 13(2)(c)(i), (ii), (iii) or (iv).

(3) Without prejudice to section 13(3), the stabilizing manager shall make the part of the register to which an offeror is entitled to inspect under subsection (2) available for inspection within a reasonable time of being notified by the offeror under subsection (1) that he wishes to make the inspection.

(4) The Commission may inspect the register and take copies of it at any time and, without prejudice to section 13(3), the stabilizing manager shall make the register available to the Commission or a person authorized in writing by the Commission for the purpose.

PART V

MISCELLANEOUS

15. Overseas stabilization

(1) A person who, in a place outside Hong Kong, commits any conduct in respect of any relevant securities -

- (a) for the purpose of preventing or minimizing any reduction in the market price of the relevant securities on an overseas stock market;
- (b) in compliance with provisions specified in Schedule 4 and made by a body or authority also specified in that Schedule; and
- (c) in relation to an offer of relevant securities which is governed by and made in accordance with the laws of the country (or the state or territory

in a country) of the body or authority specified in Schedule 4,

shall be regarded for the purposes of sections 282(1) and 306(1) of the Ordinance as committing the conduct for the purpose referred to in paragraph (a) and in compliance with the other applicable provisions of these Rules.

(2) The provisions specified in Schedule 4 are specified as they have effect from time to time.

SCHEDULE 1

[ss. 2, 3 & 8]

RELEVANT COMMUNICATIONS

Item	Communication	Relevant Notes (see below)
1.	Any electronic screen based statement	(a), (b), (d) and (e)
2.	Press announcement (or other public announcement)	(c), (d) and (e)
3.	Invitation telex (or similar communication)	(b) and (e)
4.	Offer document	(f)

Notes:

- (a) Item 1 extends to any statement in respect of the offer made by or on behalf of the offeror or the stabilizing manager on screen facilities (whether provided by the stabilizing manager or not) conveying information on prices for a sale or purchase of securities.
- (b) For items 1 and 3, adequate disclosure is given if the communication contains some indication of the fact that the securities the subject of the offer may be stabilized in accordance with these Rules. For this purpose, a reference to "details of intended stabilization/SFO in [name the relevant offer document]" will be sufficient.
- (c) For item 2, adequate disclosure is given if the announcement includes a statement of the fact that securities the subject of the offer may be stabilized in accordance with these Rules. For this purpose, a reference to "the details of the intended

stabilization and how it will be regulated under the Securities and Futures Ordinance will be contained in [name the relevant offer document]" or words to similar effect, will be sufficient.

- (d) Items 1 and 2 only apply to communications made after the later of the following 2 dates -
 - (i) the first public announcement date; or
 - (ii) the 45th day before the first day of the stabilizing period.
- (e) Items 1, 2 and 3 only apply to communications made prior to the issue of the offer document.
- (f) For item 4, adequate disclosure is given if the communication contains -
 - (i) wording substantially similar to the following -

"In connection with this [issue/offer], [name the stabilizing manager] [or any person acting for it] may over-allot or effect transactions with a view to supporting the market price of [give description of the relevant securities] at a level higher than that which might otherwise prevail for a limited period after the issue date. However, there is no obligation on [name the stabilizing manager] [or any person acting for it] to do this. Such stabilizing action, if taken, may be discontinued at any time, and is required to be brought to an end after a limited period.";
 - (ii) a summary of the possible stabilizing action to be taken under section 6 or 7 of these Rules;
 - (iii) warnings to the effect -
 - (A) that the stabilizing manager may, in connection with the stabilizing action, maintain a long position in the relevant securities;
 - (B) that there is no certainty regarding the extent to which and the time period for which the stabilizing manager will maintain such a position;
 - (C) that investors should be warned of possible impact in the case of liquidation of the long position by the stabilizing manager;
 - (D) that stabilizing action cannot be taken to

support the price of any relevant securities for longer than the stabilizing period which begins with the date of the commencement of trading of the relevant securities after the offer document is issued and the offer price for the relevant securities is announced, whether in the offer document or otherwise, and ends on the earlier of the thirtieth day after (I) the closing day or (II) the commencement of trading of the relevant securities, that the stabilizing period is expected to expire on [insert date], and that after this date, when no further stabilizing action may be taken, demand for the security, and therefore its price, could fall;

- (E) that investors should be aware that the price of the security cannot be assured to stay at or above its offer price by the taking of any stabilizing action;
- (F) that stabilizing bids may be made or transactions effected in the course of the stabilizing action at any price at or below the offer price, which means that stabilizing bids may be made or transactions effected at a price below the price the investor has paid for the security.

SCHEDULE 2

[ss. 7, 11 & 13]

PRICING LIMITS

Time or circumstances of action	Maximum Price
1. Initial stabilizing action	The offer price
2. After the initial stabilizing action, where there has been a deal done or transaction effected at a price above the stabilizing price on the relevant market	The offer price, or the price at which that deal was done or at which that transaction was effected, whichever is the lower
3. After the initial stabilizing action, where there has been no deal or transaction described in item 2	The offer price, or the initial stabilizing price, whichever is the lower

Notes:

- (a) For the purposes of item 2, a deal done or transaction

effected does not include a deal done or transaction effected by or on the instructions of the stabilizing manager.

- (b) For the purposes of this Schedule, "relevant market" () means the relevant recognized stock market, relevant authorized automated trading services, or relevant overseas market which the stabilizing manager believes to be the principal market on which those securities are dealt in at the time of the deal or transaction.
- (c) Where the price of any relevant securities on the relevant market is in a currency other than the currency of the price of the securities to be stabilized, stabilizing bids may be made or transactions effected at a price that reflects any change in the relevant rate of exchange; but this does not permit stabilizing action at a price above the equivalent, in the other currency, of the offer price in the currency of the relevant exchange.

SCHEDULE 3

[s. 9]

POST-STABILIZATION DISCLOSURE

The public announcement referred to in section 9(2) of these Rules shall contain the following information -

- (a) the ending date of stabilizing period;
- (b) whether or not any stabilizing action was taken;
- (c) where there were more than one purchase in the course of any stabilizing action, the price range between which purchases were made;
- (d) where applicable, the date of the last purchase in the course of any stabilizing action and the price at which it was made; and
- (e) where applicable, the extent to which any over-allotment option was exercised.

SCHEDULE 4

[s. 15]

OVERSEAS STABILIZATION

Chairman,
Securities and Futures Commission

2002

Explanatory Note

These Rules are made by the Securities and Futures Commission under sections 282(2) and 306(2) of the Securities and Futures Ordinance (5 of 2002) for the purpose of excluding price stabilization conducted in accordance with these Rules from the application of the market misconduct provisions in Part XIII and the offence provisions in Part XIV of the Ordinance. They prescribe the circumstances in which the prices of certain securities offered to the public may be stabilized for a limited period and the type of stabilizing action which may be taken and the requirements for disclosure of such action.

**A CONSULTATION PAPER ON
THE DRAFT SECURITIES AND FUTURES
(PRICE STABILIZING) RULES**

February 2002

[Note : Please refer to the derivation table at the end of this document for cross references to the section numbers under the Securities and Futures Ordinance as gazetted on 28 March 2002.]

**A CONSULTATION PAPER ON
THE DRAFT SECURITIES AND FUTURES (PRICE STABILIZING) RULES**

The Securities and Futures Commission invites market participants and interested parties to submit written comments on the proposals discussed in this consultation paper or to comment on related matters that might have a significant impact upon the proposals **no later than 8 March 2002**. Any person wishing to comment on the proposals should provide details of any organization whose views they represent.

Please note that the names of the commentators and the contents of their submissions may be published on the SFC website and in other documents to be published by the SFC. In this connection, please read the Personal Information Collection Statement attached to this consultation paper.

You may not wish your name and/or submission to be published by the SFC. If this is the case, please state that you wish your name and/or submission to be withheld from publication when you make your submission.

Written comments may be sent

By mail to: SFC Price Stabilizing Rules
Securities and Futures Commission
12/F Edinburgh Tower
The Landmark
15 Queen's Road Central
Hong Kong

By fax to: (852) 2810 5385

By on-line submission: <http://www.hksfc.org.hk>

By e-mail to: cfconsult@hksfc.org.hk

For further information, please contact the Corporate Finance Division at (852) 2840 9216 or 2840 9235.

Additional copies of the consultation paper may be obtained from the above address of the SFC. A copy of this paper can also be found on the SFC website at <http://www.hksfc.org.hk>.

Corporate Finance Division
Securities and Futures Commission
Hong Kong

February 2002

Personal Information Collection Statement

1. This Personal Information Collection Statement (“PICS”) is made in accordance with the guidelines issued by the Privacy Commissioner for Personal Data. The PICS sets out the purposes for which your Personal Data¹ will be used following collection, what you are agreeing to with respect to the SFC’s use of your Personal Data and your rights under the PDPO.

Purpose of Collection

2. The Personal Data provided in your submission to the SFC in response to the Consultation Paper on the Draft Securities and Futures (Price Stabilizing) Rules (“the Consultation Paper”) may be used by the SFC for one or more of the following purposes:
 - to administer the relevant Ordinances, rules, regulations, codes and guidelines made or promulgated pursuant to the powers vested in the SFC
 - for the purpose of performing the SFC’s statutory functions under the relevant Ordinances
 - for research and statistical purposes
 - other purposes permitted by law.

Transfer of Personal Data

3. Personal Data may be disclosed by the SFC to the members of the public in Hong Kong and elsewhere, as part of the public consultation on the Consultation Paper. The names of persons who submit comments on the Consultation Paper together with the whole or part of their submission may be disclosed to members of the public. This will be done by publishing this information on the SFC website and in documents to be published by the SFC throughout and at the conclusion of the consultation period.

Access to Data

4. You have the right to request access to and correction of your Personal Data in accordance with the provisions of the PDPO. Your right of access includes the right to obtain a copy of your Personal Data provided in your submission on the Consultation Paper. The SFC has the right to charge a reasonable fee for processing any data access request.

Enquiries

5. Any enquiries regarding the Personal Data provided in your submission on the Consultation Paper, or requests for access to Personal Data or correction of Personal Data, should be addressed in writing to:

¹ Personal Data means personal data as defined in the Personal Data (Privacy) Ordinance, Cap 486 (“PDPO”)

The Data Privacy Officer
Securities and Futures Commission
12/F, Edinburgh Tower
The Landmark
15 Queen's Road Central
Hong Kong

A copy of the Privacy Policy Statement adopted by the SFC is available upon request.

Introduction

1. The Securities and Futures Bill (the “Bill”) defines certain behaviour in relation to securities as market misconduct in Parts XIII and XIV. Price stabilizing, rigging or pegging, the maintaining of the price of a security, the creation of a false market and insider dealing fall within the meaning of market misconduct under the Bill. Under Part XIII, a Market Misconduct Tribunal will be established which will be empowered to impose penalties on persons engaged in market misconduct. Separately under Part XIV of the Bill, market misconduct is also liable to criminal consequences with proof of criminal intent.
2. The Bill gives rule-making powers to the SFC under sections 273(1) and 297(1) to prescribe safe harbour rules in respect of the market misconduct provisions in Part XIII and the criminal offences provisions under Part XIV of the Bill after consultation with the Financial Secretary.
3. The SFC considers that it is in the public interest to prescribe the Price Stabilizing Rules (the “PS Rules”) to permit and regulate price stabilizing action connected with public offerings. The purpose of this consultation paper is to seek the views of the public on the proposed regulatory approach and the practical implications of implementing the PS Rules under the Bill. The draft PS Rules will be prepared on the basis of the proposal in this consultation paper, subject to any amendments consequential to the public response, and will be tabled before the Legislative Council for approval as subsidiary legislation.
4. The purpose of the PS Rules is to facilitate public offers of securities so that issuers or underwriters of newly issued securities may conduct stabilizing action to prevent or retard the decline of the price of the newly offered securities, and rely on the PS Rules as a defence in respect of market misconduct under Parts XIII and XIV of the Bill. The PS Rules are not intended to allow downward stabilization, that is, capping the market price of a security.
5. The PS Rules will apply to public offers of shares and debentures for cash in Hong Kong which meet a certain threshold amount, currently proposed at HK\$200 million. A stabilizing manager must be appointed in Hong Kong to oversee compliance with the PS Rules for stabilizing activities that would otherwise be regarded as market misconduct under the Bill. The stabilizing manager has to ensure that proper disclosure is made and records of stabilizing actions are properly kept and made available for inspection by the issuer and the SFC.
6. It is proposed that under the PS Rules, the stabilizing manager may purchase securities in the secondary market to stabilize. Stabilising bids, if effected in relation to equity securities, will be subject to a pricing limit mechanism and the maximum stabilizing bid should not exceed the public offer price. It may do so without having to create a prior short position with the securities. This

means a stabilizing manager is able to hold a “net long” position pursuant to the PS Rules.

Background

7. Transactions may be undertaken to stabilize the price of securities either to prevent them from declining or rising. Stabilization is potentially manipulative because it seeks to maintain or support the price of a security at a certain level and therefore distorts the price which would otherwise obtain as a result of a natural supply and demand of the security in the market.
8. Unlike the UK or the US, Hong Kong does not have price stabilizing rules which permit certain types of stabilizing actions to be undertaken in prescribed circumstances. The SFC, however, issued policy statements on stabilizing actions by way of the Joint Announcement with the SEHK on 4 November 1994 and further elaborated its views in the Conclusion Paper for the Consultation on Offering Mechanisms in 1998. A copy of the 1994 announcement and the excerpts from the 1998 Conclusion Paper are attached in **Annex I**. In short, the SFC took the view that genuine purchases in the market effected solely to cover over-allotment would not of themselves infringe the relevant provisions of the Securities Ordinance which prohibit market manipulation by pegging or stabilizing the price of the securities.
9. Stabilization has been practised in the Hong Kong market in a restricted sense in connection with initial public offerings (“IPOs”). These actions usually appear in the form of over-allotment by the underwriters, related securities borrowing transactions backed by over-allotment options granted by the issuer (“greenshoe”) and the satisfaction of over-allotments by purchases of securities in the secondary market.
10. Under the market misconduct regime under the Bill, actions to support or maintain the price of a security will be prohibited. In view of the enactment of the Bill later this year, this is an opportune time to review the way stabilizing action related to public offerings is regulated in Hong Kong. It is also intended that the PS Rules, to be proposed as subsidiary legislation under the Bill, can provide a regulatory framework for stabilizing and ancillary actions so that they may be conducted in an open, transparent and accountable manner without compromising investor protection.
11. In formulating the PS Rules, we have considered recent regulatory developments in other major financial centres, particularly the UK and the US. We take the view that the PS Rules should to a large extent commensurate with the international standard so as to facilitate global offerings of securities conducted in Hong Kong and in other markets. Having regard to the similarity in the regulatory framework for securities transactions and mechanisms for securities offerings, we propose to model the PS Rules closely on the UK Price Stabilizing Rules issued pursuant to the Financial Services and Markets Act 2000.

Regulatory approach

What is the policy thinking behind the PS Rules?

12. In the past few years, the Hong Kong market has seen a significant number of large scale IPOs and an increase in global offerings, including multiple listings on the SEHK and overseas markets like NYSE and Nasdaq.
13. Stabilizing activities as described in paragraph 9 above are said to facilitate these corporate fund raising exercises. In particular, upward stabilization conducted in relation to public offers addresses short-term fluctuations resulting from the sudden increase in supply in the secondary market.
14. The PS Rules enable stabilizing activities effected for the purpose of upward stabilization to be carried out in an open, transparent and accountable manner. Following this rationale, we believe that the PS Rules should also apply to secondary offers in so far as these offers are of a public character and are made for corporate fund raising. In addition, it will be in line with current market practice and consistent with good corporate governance principles that issuers should not be involved in stabilizing the price of their own securities. Accordingly, only lead managers and underwriters for public offerings may conduct stabilization and be the persons acting as or appointing stabilizing manager.

What types of securities are covered by the PS Rules?

15. As discussed above, the primary purpose of stabilization is to facilitate capital raising by corporations. The most common types of securities publicly offered for this purpose in Hong Kong are broadly shares and debentures. Whilst it is possible that in future other types of securities may become increasingly used, we would propose confining the application of the PS Rules to shares and debentures only. The PS Rules are new to the market and in the initial stage, a prudent regulatory approach should be adopted to afford greater investor protection.
16. Under the PS Rules, a stabilizing manager can only stabilize the price of a security by effecting transactions prescribed in the PS Rules in the same type of security. In practice, this means that a stabilizing manager may not stabilize the price of a share of an issuer by purchasing securities such as derivatives or convertible debt securities relating to the share.
17. The SFC may in the future review whether it is in the public interest to amend the PS Rules to extend the range of securities in respect of which stabilizing action may take place.

Q 1: *What is your view on stabilizing action being permitted only in respect of the same type of security as the one being publicly offered but not in respect of its “associated” securities?*

What sort of stabilizing actions are permitted under the PS Rules?

18. As mentioned above, the SFC believes that under the PS Rules, only upward stabilization should be permitted. Accordingly, stabilizing actions that depress or attempt to depress the price of a security in the market cannot claim safe harbour under the PS Rules.
19. In upward stabilization for public offerings, stabilization takes place where the stabilizing managers purchase the security in the secondary market to support its price. We consider that purchases of the relevant securities in the secondary market by the stabilizing manager are core stabilizing actions. These purchases should be permitted, whether or not conducted for the purpose of covering over-allotments. This means that “net long” positions may be held by underwriters for stabilization purposes under the PS Rules. This relaxes the SFC’s position in respect of the Securities Ordinance that purchases in the secondary market may only satisfy the short position created by underwriters due to over-allotment backed by a greenshoe.
20. Due to legal constraints under the Securities Ordinance (and the Bill), underwriters cannot hold “naked short” positions. In order to cover the short position, underwriters would have the benefit of a greenshoe and usually a securities borrowing arrangement with a controlling shareholder, and in some cases both. The creation of a prior short position by the underwriters is therefore covered, and can be satisfied by subsequent stabilizing action, i.e. purchases in the secondary market. The SFC considers that these activities are ancillary stabilizing actions and should be allowed under the PS Rules.
21. If under the PS Rules, “net long” positions are held by the stabilizing managers, the SFC is of the view that purchases must be made for the account of the stabilizing managers and not the issuer. No stabilizing actions should be undertaken by an issuer through a repurchase of its issued securities.
22. Stabilizing managers holding “net long” positions may wish to unwind their holdings. The SFC proposes that stabilizing managers may liquidate their “long positions” achieved through core stabilizing actions conducted in compliance with the PS Rules. Liquidation will be regarded as permitted ancillary stabilizing action under the PS Rules.

Q 2: Should stabilizing managers be allowed to hold “net long” positions and to liquidate such positions?

What kinds of securities offerings will fall within the PS Rules?

23. In order to rely on the PS Rules as a safe harbour, the issuer must be able to meet the following conditions in respect of its offer of securities:
 - The offer must be public in character;
 - The offer must be the subject of a prospectus issued in connection with the offer;

- The securities must be either listed on a relevant stock exchange or traded on an authorised automated trading system (“ATS”);
 - The size of the offer in Hong Kong shall not be less than HK\$200 million; and
 - The offer of securities must be made for cash. This would exclude securities exchange offers normally encountered in takeover transactions.
24. The requirement that securities be listed on the Stock Exchange of Hong Kong or admitted for trading on an authorised ATS ensures transparency.
 25. The threshold amount of HK\$200 million is proposed based on experience of overseas markets and the SFC may, subject to results of the public consultation, review the threshold.
 26. If a threshold amount is adopted under the PS Rules, some smaller issuers making offers to the public may not be able to take advantage of the stabilization safe harbour.
 27. Over-allotment and the exercise of a greenshoe to satisfy this over-allotment, but without transactions in the secondary market, are not in isolation price stabilization. However, underwriters should ensure that prior disclosure to the investing public is made in respect of the over-allotment size and the greenshoe. The SFC has been and still is of the view that any over-allotment should be limited in size by the greenshoe.
 28. On the other hand, in the absence of a stabilization safe harbour under the PS Rules, underwriters who want to purchase securities in the market to cover a short position created by over-allotment, or to satisfy outstanding obligations pursuant to securities borrowings, may contravene the market misconduct provisions of the Bill.

Q 3: What is your view about the proposal to impose a threshold amount of HK\$200 million for public offers under the PS Rules?

What is the period within which stabilizing actions may be conducted under the PS Rules?

29. Stabilizing actions under the PS Rules will broadly be divided into core stabilizing actions (as mentioned in paragraph 19) and permitted ancillary stabilizing actions (as mentioned in paragraph 20). It is proposed that core stabilizing actions are allowed only during the stabilizing period, that is, a 30-day period from the date of the prospectus. It is proposed that no time limit will be imposed on permitted ancillary stabilizing actions.
30. Ancillary stabilizing action such as granting the greenshoe and its exercise, and the liquidation of “net long” positions, may take place in different time-frames. They may occur before the date of the prospectus or after 30 days from the date of the prospectus. To impose time limits for ancillary stabilizing

actions may seem unreasonable and in some cases unrealistic. Stabilizing managers may wish to liquidate their “net long” positions by selling at a favourable price. Decisions to dispose of securities depend on the market conditions. So long as these ancillary stabilizing actions are carried out in connection with core stabilizing actions under the PS Rules, they need not be carried out within the stabilizing period but are expected to be carried out as soon as practicable thereafter.

Q 4: What is your view on the adoption of a 30-day time limit for core stabilizing actions but not for ancillary stabilizing actions?

What are the restrictions for conducting stabilizing actions under the PS Rules?

31. The SFC proposes certain restrictions for stabilizing actions to be undertaken under the PS Rules. No stabilizing actions may be undertaken in the following circumstances:
- When the price of the security is, to the knowledge of the stabilizing manager, already artificially affected.
 - With respect to convertible debt securities if their conversion terms have not been publicly announced.
 - When the stabilizing manager or its associates, in respect of the offer, hold any options over the security which is to be stabilized, the terms of which have not been disclosed to the public in accordance with the PS Rules. This prohibition addresses conflicts of interest on the part of the stabilizing manager.

Will there be pricing limits on the core stabilizing actions?

32. Pricing limits are proposed for core stabilizing actions for offers of equity securities. We propose that the upper price limit for core stabilizing actions should be the public offer price (“A”). A stabilizing manager is allowed to make any stabilizing bid (“B”) which is at or below the public offer price, A. Stabilizing managers may subsequently stabilize at or below the initial stabilizing price B. If an independent deal is done on the principal market for that security (which does not necessarily have to be in Hong Kong) at a price (“C”) higher than B but below A, the stabilizing manager then have a new maximum price C, so that it may stabilize at or below C.
33. The pricing limit described in paragraph 32 does not apply to stabilizing actions for offers of debentures. Pricing limits for stabilizing debentures are unlikely to be applicable due to different pricing mechanisms for shares and debentures. The focus of pricing a bond or other debentures is usually the spread over a benchmark bond at which the new bond is expected to trade. Underwriters are more concerned about maintaining or reducing the spread

between the bond and the benchmark bond, whereas in equity securities, the focus is more normally on the price of the stock.

Q 5: What is your view on the pricing limits for stabilizing equity securities?

Q 6: Do you agree that stabilizing actions for offerings of debentures need not be subject to pricing limits?

What is the management requirement for stabilization under the PS Rules?

34. To oversee the compliance with the PS Rules including prior disclosure of stabilizing actions in communications with the public, and proper record keeping of all such actions, the PS Rules will require the appointment of a stabilizing manager. A stabilizing manager shall either be a licensed corporation such as a licensed securities dealer or a registered institution, e.g. a licensed bank in the context of the Bill.
35. In undertaking stabilizing action, the stabilizing manager may appoint agents, local and overseas, but it would remain ultimately responsible to the issuer and be accountable for compliance with the PS Rules. In the case of a global offering where an issuer's securities are offered in overseas jurisdictions as well as in Hong Kong, stabilizing managers appointed under the PS Rules are required to ensure that local and overseas stabilizing records are properly kept so that overseas records can be re-constituted in Hong Kong within a period of 48 hours after they are requested for inspection.

Q 7: What is your view about the role of a stabilizing manager under the PS Rules? Do you foresee any practical difficulties for the stabilizing manager to discharge its role as described?

What are the disclosure requirements for stabilizing actions?

36. The SFC proposes that prior disclosure of stabilizing actions be made when the offer of securities is publicly announced, and be continued to be made throughout the period up to the commencement of the stabilizing period. This period will be the "introductory period" in the PS Rules. To forewarn investors of forthcoming stabilizing actions, in particular in the case of secondary offerings, we believe that appropriate disclosure of the potential stabilizing actions should be made in all communications issued during the introductory period. These may include screen-based statements, press announcements and teletext. The SFC, however, proposes that detailed disclosure and prior warnings need only be made in the prospectus. Wording suggested for detailed disclosure and prior warnings to be made by an issuer in its prospectus is contained in **Annex II**.
37. Apart from warning statements, it would be useful for the investing public to be informed of the extent of the forthcoming stabilizing actions. We propose

that a summary of possible stabilizing actions to be undertaken by the stabilizing manager such as size of over-allotment option, and the possibility of holding “net long” positions should be included in the prospectus to which the public offering relates.

38. We have considered whether a stabilizing manager should identify and disclose its stabilizing bid to the market in the course of its stabilizing actions. A requirement to inform the market of a stabilizing bid on a real time basis by the stabilizing manager (“flagging”) is found in the US Rules. Whilst simultaneous disclosure may increase transparency, we note that some market practitioners hold a different view. Accordingly, we would like to invite public comments on the suitability of imposing a simultaneous disclosure requirement for stabilizing bids.

Q 8: What is your view about simultaneous “flagging” to the market of the stabilizing bid placed by the stabilizing manager?

What are the record keeping requirements for stabilizing actions?

39. The stabilizing manager is required to keep a register of stabilizing actions, available for inspection by the SFC and the issuer upon notice.
40. The register should contain all the transaction details about stabilizing actions for each offer of securities including the type of security, price, time, volume, and the details of the counterparty. It should also contain details about allotment of the security and the names of agents engaged for stabilizing actions.
41. The register should be kept for a period of 7 years from the end of the stabilizing period for SFC inspection. This proposed time-frame is consistent with the record keeping period for intermediaries under the Bill. The issuer is allowed to inspect the register within a 3-month period from the end of the stabilizing period.

Recognition of overseas price stabilizing rules

42. In global offerings, securities offered may be traded on an overseas market as well as in the Hong Kong market. Underwriters for the overseas portion of the offering may wish to conduct stabilization in the overseas market, which may affect the price of the securities traded on the Hong Kong market. In view of this and in order to facilitate global offerings, we believe it would be useful if the PS Rules recognise that stabilization actions effected in accordance with the stabilization rules in certain recognised jurisdictions, which provide similar regulatory safeguards against market manipulation, would not for the purpose of the Bill be regarded as market misconduct.

Transitional arrangements

43. As the market misconduct provisions are not intended to have retroactive effect, the SFC takes the view that in the case where a public announcement of the offer with the offer price stated has been made before the commencement date of the PS Rules, an issuer and the underwriter for the public offer of the issuer's security may continue stabilizing actions described in paragraph 9 above provided that these actions are consistent with SFC's policy statements about stabilization in the Joint Announcement on Offering Mechanisms in 1994 and its views expressed in the Consultation Conclusion Paper for Offering Mechanisms in 1998.

Way Forward

44. The public is invited to furnish us with their comments on regulatory approach as specified in this paper, in particular, your replies to the questions set out in **Annex III**. The Draft PS Rules are set out in **Annex IV**. This public consultation is open from now to 8 March 2002. Upon conclusion of this consultation, the SFC will publish a conclusion paper together with the draft PS Rules which will be tabled before the Legislative Council for approval.
45. Following the effective date of the PS rules, the SFC may contact issuers and stabilizing managers who have conducted stabilizing activities under the PS Rules to solicit their feedback on the practical implications of the PS Rules and any difficulties encountered in complying with the Rules. Information so obtained would form part of the database on which we can rely to conduct future reviews of the PS Rules.

Annex I (1)

(1) 1994 Joint Announcement of the SFC and the SEHK

THE STOCK EXCHANGE OF HONG KONG LIMITED

SECURITIES AND FUTURES COMMISSION

Joint Policy Statement on Offering Mechanisms

The Stock Exchange of Hong Kong Limited (the "Exchange") and the Securities and Futures Commission ("SFC") have recognized that global equity offerings, which involve the tapping of funds from both the domestic and international markets, have become more common for large scale new issues in Hong Kong. Accordingly, a joint Working Party was set up by the two authorities earlier this year to study the subject of offering mechanisms. Set forth below is a synopsis of the views and conclusions of the Working Party which have been endorsed by the Exchange and the SFC.

The Working Party was established to review whether the Hong Kong fixed price public offer method disadvantages Hong Kong in the context of participating in multi-jurisdictional equity offerings and whether Hong Kong should adopt alternative forms of offering mechanisms. In pursuing this goal, both the Exchange and the SFC had in mind to introduce greater flexibility for the public distribution of securities in equity offerings while ensuring that the interests of local investors are not disadvantaged by this approach.

In the case of a simultaneous dual listing in Hong Kong and another overseas market where the placing or book-building system is used and where the commencement of trading is to occur on the same day, issuers have encountered difficulties in reconciling the timing for the commencement of trading of the Hong Kong fixed price subscription tranche and the U.S. placing tranche.

The Working Party consulted a number of merchant banks who have participated in recent global equity offerings and in particular, studied the U.S. system of book-building, stabilization and distribution system as a whole. The Exchange is of the view that there are feasible solutions, although still subject to refinement, for reconciling the offering timetables of an offer for subscription and a book-built placing which do not require amendments to the existing Listing Rules. For example, if trading in Hong Kong can commence within 5 days after a range price public offer is closed, then, coupled with a price fixing on a weekend in the U.S., it would appear that the timing problem can be resolved.

The task of finding an optimal schedule which reconciles the needs of international investors with those of local subscribers is ultimately a commercial one and there is little need for regulatory intervention. For the purposes of enhancing market transparency and minimizing grey market activities however, it would be preferable in the case of dual listings for trading in Hong Kong to commence as soon as possible after allocation and at least simultaneously with or before the commencement of trading on overseas exchanges.

In order to achieve simultaneous dual listings, the Hong Kong initial public offering timetable has to be shortened to accommodate the practice of dealing immediately after allocation under the U.S. book-building system, or at the very least, to minimize the period of time between allocation and commencement of trading. The Exchange and the SFC have identified a number of feasible options to achieve this. It is up to an issuer and its underwriter to decide whether to adopt one of these acceptable ways or to come up with some other methods. One way to achieve this is to publish in some form the identities of the successful applicants in newspapers so that they become aware of their respective allotments and would be able to trade immediately provided arrangements are made to meet settlement obligations. Another option is to require all applicants to subscribe shares through brokers by using yellow application forms only. Since the allotted shares are deposited directly into CCASS, successful allottees can commence trading once allocation is complete and can withdraw the physical scrips at a later date if they so desire. A third option is to allow only successful yellow form applicants to trade on the day immediately after price fixing with the white form applicants (i.e. those who want their shares to be registered under their own names) to commence trading upon receipt of the scrips. None of these suggested options require amendments to the Listing Rules.

In a global offering involving a simultaneous Hong Kong subscription and an international placing, it is up to the issuer and the underwriter to determine the size of the Hong Kong subscription tranche and the international placing tranche(s). The Exchange does not intend at this time to stipulate a minimum dollar value or percentage of a new issue that must be allocated for public subscription in Hong Kong. This is a matter for the issuer and its underwriter to decide. However, the Exchange expects underwriters and issuers to have due regard to the interests of local retail investors in any new listing in developing offering mechanisms that are suitable for their issues at the time.

Inter-tranche flow of allocations between the local and the international tranche should be permitted so that securities may be allocated to markets where real demand lies. The objective is to facilitate optimal equilibrium between the primary market supply and demand and to minimize market imbalance. In the case where the inter-tranche flow may be effected, whether through a claw-back formula or otherwise determined by the issuer and the underwriter, such disclosure should be clearly made in the offering documents.

The Exchange and the SFC recognize the need to accept alternative offering mechanisms. Underwriters and issuers who wish to offer shares through other methods in addition to the traditional public subscription are encouraged to seek early consultation with the Exchange.

Where shares of the Hong Kong public offer tranche are sold by way of an offering method other than the traditional subscription method, issuers are expected to ensure that the alternative method does not disadvantage retail participation and that the allocation of shares is made independent of the applicant's identity, the time of application and any business relationship between the applicant and the issuer or any of its advisers, but should only be a function of the number of shares applied for and, if any, bid price(s).

As part of the study, the SFC has examined the need for rules permitting stabilization during the initial public offering period in Hong Kong in the context of the Securities Ordinance and Hong Kong's participation in global offerings. The SFC's position is that where underwriters have over-allotted in an offering (with or without the benefit of an over-allotment option), genuine purchases in the secondary market effected solely for the purpose of covering such over-allotment (short covering) would not of themselves infringe the relevant provisions of

the Securities Ordinance which prohibit market manipulation in the form of pegging or stabilizing the price of securities. This means that an underwriter of a global offering, who is short shares in a new issue due solely to over-allotment, can cover its short position in the Hong Kong secondary market, even though the distribution might not be completed in other markets, so long as the underwriter's trading does not constitute manipulation as contemplated in the Securities Ordinance.

If the underwriters wish to reserve the right to over-allot it is important that this fact be disclosed in the prospectus, together with details of any over-allotment option granted by the company to the underwriters. The prospectus should also include a statement that the underwriters may cover the over-allotment either by purchasing the shares in the secondary market or by exercising the over-allotment option or a combination of both.

From discussions between the SFC and underwriters of global offerings, it appears that the ability for underwriters to short cover in Hong Kong obviates any need to bring in rules permitting stabilization during the initial public offering period.

For and on behalf of
The Stock Exchange of Hong Kong Limited
Herbert Hui
Executive Director
and Head of Listing

For and on behalf of
Securities and Futures Commission
Laura M. Cha
Member of the Commission
and Executive Director

4th November, 1994

Annex I (2)

(2) Excerpts from 1998 Conclusion Paper for the Consultation Paper on Offering Mechanisms

VI. Extent of over-allocation of shares

34. In the consultation paper the SFC clarified that the extent of over-allocation of shares should be limited to that provided under the over-allotment option.
35. Many commentators argued that market stabilisation activities benefit investors and issuers. Major markets such as New York and London allow stabilisation activities provided these are carried out within clearly defined limits. Commentators argued that over-allocation gives underwriters a legitimate and effective tool to assist in an orderly after market, particularly one that is experiencing selling pressure. Genuine purchases in the after market not only serve to cover underwriter's over-allocations but also reduce the excess supply created by investors selling into the after market. Investors, whether retail or institutional, benefit from and are protected by an orderly and efficient after market and benefit from stabilisation activities by underwriters.
36. The SFC has reconsidered whether the powers of the SFC to make rules under Section 137 of the Securities Ordinance are sufficient to enable the enactment of rules governing stabilisation activities, and concluded that there is scope under current legislation to enact rules governing stabilisation activities. The SFC will review such activities and determine whether as a matter of policy it would be appropriate to enact rules under Section 137 relating to stabilisation activities.
37. In the absence of any such rules being enacted, the SFC's position is that the creation of short positions without the benefit of an over-allotment option, or creating short position, in excess of the limit under which shares could be allocated pursuant to such option is, prima facie, subject to the scrutiny of the SFC. The SFC would take necessary action should there be evidence of the creation of a false market. Hence, underwriters should restrict the extent of over-allocation of shares to the limit permitted under the over-allotment option.

Annex II

Suggested wording for disclosure of stabilization

1. *“In connection with this [issue] [offer], [name of the stabilizing manager] [or any person acting for him] may over-allot or effect transactions with a view to supporting the market price of [description of the relevant securities] at a level higher than that which might otherwise prevail for a limited period after the issue date. However, there may be no obligation on [name of stabilizing manager] [or any of his agent] to do this. Such stabilizing, if commenced, may be discontinued at any time, and must be brought to an end after a limited period.”*
2. *“The stabilizing manager may, in connection with the stabilizing action, maintain a long position in the relevant securities, and there is no certainty as to the extent and time period for which the stabilizing manager will maintain a long position. Investors should be warned of the possible impact of any liquidation of the long position by the stabilizing manager.”*
3. *“Stabilization cannot be used to support the price of a security for longer than the stabilization period. After this period, when any stabilization must end, demand for the security – and therefore its price could fall.”*
4. *“Investors should be aware that the price cannot be assured to stay at or above its offer price by way of stabilization.”*
5. *“Stabilization can be done at any price below the offer price. This means that it could be at a price below the offer price or the price the investor has paid in acquiring the security.”*

Annex III

Summary of questions for public consultation on Price Stabilizing Rules

- Q 1: What is your view on stabilizing action being permitted only in respect of the same type of security as the one being publicly offered but not in respect of its “associated” securities?*
- Q 2: Should stabilizing managers be allowed to hold “net long” positions and to liquidate such positions?*
- Q 3: What is your view about the proposal to impose a threshold amount of HK\$200 million for public offers under the PS Rules?*
- Q 4: What is your view on the adoption of a 30-day time limit for core stabilizing actions but not for ancillary stabilizing actions?*
- Q 5: What is your view on the pricing limits for stabilizing equity securities?*
- Q 6: Do you agree that stabilizing actions for offerings of debentures need not be subject to pricing limits?*
- Q 7: What is your view about the role of a stabilizing manager under the PS Rules? Do you foresee any practical difficulties for the stabilizing manager to discharge its role as described?*
- Q 8: What is your view about simultaneous “flagging” to the market of the stabilizing bid placed by the stabilizing manager?*

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Annex IV

SECURITIES AND FUTURES (PRICE STABILIZING) RULES

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PRICE STABILIZING RULES

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SECURITIES AND FUTURES COMMISSION

(PRICE STABILIZING RULES)

Made by the Securities and Futures Commission under sections 273(1) and 297(1) of the Securities and Futures Ordinance (xx of 2002) in the public interest, after consultation with the Financial Secretary.

PART I

PRELIMINARY

1. Commencement

These Rules come into operation on the day appointed for the commencement of Part XIII and Part XIV of the Securities and Futures Ordinance (of 2002).

2. Interpretation

In these Rules, unless the context otherwise requires-

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"ancillary stabilizing action" () means action ancillary to stabilizing action, permitted under section 9;

"associate" () means "associate" as defined in section 237(1) and section 277(1) of the Ordinance;

"commission" () means any form of commission, including a benefit of any kind, offered or given in connection with regulated activities;

"debt securities" () means debentures issued by, or which it is reasonably foreseeable will be issued by a corporation;

"equity securities" () means shares issued by, or which it is reasonably foreseeable will be issued by a corporation, but does not include any interest in any collective investment scheme;

"initial stabilizing price" () means the price determined by the stabilizing manager at which the initial stabilizing action in relation to relevant securities may be taken subject to the limits in Schedule 2;

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"introductory period" () means the period starting at the time of the first public announcement from which it could reasonably be deduced that the offer was intended to take place in some form and at some time, and ending with the beginning of the stabilizing period;

"offer" () means an offer or an invitation to make an offer and (except in section 6(1)(b) and section 9(1)(d)), an issue;

"offer for cash" () means an offer which satisfies the conditions set out in section 5;

"offer price" () means the specified price at which the relevant security is offered to the public without deducting any selling concessions or commission;

the "Ordinance" () means the Securities and Futures Ordinance (of 2002);

"prospectus" (), in relation to an offer, means the prospectus authorised for registration pursuant to the Companies Ordinance, where the offer is in respect of relevant securities in -

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- (a) a company, pursuant to section 38D of the Companies Ordinance; and
- (b) a company incorporated outside Hong Kong, pursuant to section 342C of the Companies Ordinance.

"public announcement" () means any communication made by or on behalf of the issuer or the stabilizing manager being a communication made in circumstances in which it is likely that members of the public will become aware of the communication;

"public offer" () means an offer to the public;

"relevant securities" () means equity securities and debt securities;

"stabilizing action" () means any action contemplated by section 6 or section 9;

"stabilizing manager" () means the single person responsible for stabilizing action under these Rules;

"stabilizing period" (), in relation to an offer of a relevant security, means the period:

- (a) beginning with the date of the prospectus issued in respect of the offer; and

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(b) ending on the thirtieth day after date of the prospectus issued in respect of the offer;

"stabilizing price" () means the initial price (at or below the offer price) up to which the stabilizing manager has determined that he may wish to take stabilizing action; and if the effect of Schedule 2 to these Rules is to raise that price above the initial stabilizing price, then "stabilizing price" thereafter means that new, higher, price.

3. Conduct not to constitute "market misconduct" under Part XIII of the Ordinance

For the purpose of section 273(1), any conduct effected in conformity with these Rules in respect of the relevant securities will not be regarded as constituting market misconduct under Part XIII of the Ordinance.

4. Conduct not to constitute certain offences under Part XIV of the Ordinance

For the purpose of section 297(1), any conduct effected in conformity with these Rules in respect of the relevant securities will not be regarded as constituting

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an offence under Part XIV (other than sections 292 or 294) of the Ordinance.

5. Application

These Rules apply to an offer for cash, that is, an offer of relevant *securities*:

- (a) where the offer for cash is to be, or has been, made at a specified price payable in Hong Kong dollars or another currency;
- (b) where those securities are traded or have been admitted to trading, or are the subject of an application for admission for trading, on a recognised stock market or by means of authorised automated trading services;
- (c) where the total cost of the securities subject to the offer at the offer price is at least [HK\$200 million] (or its equivalent in another currency); and
- (d) where the offer is a public offer and is to be, is, or has been subject of a prospectus.

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PART II

PRICE STABILIZATION

6. Stabilizing action

(1) During the stabilizing period, the stabilizing manager may do any or all of the following:

(a) purchase, or agree to purchase, any of the relevant securities for the sole purpose of preventing or minimising any reduction in the market price of the relevant securities; and

(b) offer or attempt to do anything in subsection (1)(a) for the sole purpose of preventing or minimizing any reduction in the market price of the relevant securities.

(2) Notwithstanding subsection (1), these Rules may not be relied on for the purpose of section 3 or 4 if, at the time of the relevant act or omission under subsection (1), the stabilizing manager knew or should reasonably have known that:

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- (a) disclosure had not been made in accordance with section 7(1)(a) and the operator of the relevant recognized stock market or overseas stock market or the authorized provider, as the case may be, had not been informed in accordance with section 7(1)(b); or
- (b) records are obliged to be but have not been or are not being kept in accordance with section 7(1)(c); or
- (c) the price of any relevant securities was already artificial or maintained at a level that is artificial (whether or not it was previously artificial).

7. Disclosure of stabilizing action

(1) The stabilizing manager may not take any stabilizing action in any relevant securities under these Rules unless:

- (a) from the commencement of the introductory period, adequate disclosure is made of the fact that stabilizing action may take place in relation to the offer;

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(b) any requirement of the operator of the recognised stock market or overseas stock market on, or the person authorised to provide automated trading services by means of, which the relevant securities are or will be traded to inform it that stabilizing action in those securities may take place during the stabilizing period has been complied with; and

(c) the stabilizing manager has established the register required by section 12(1) for recording each stabilizing action effected by him in the relevant securities and the matters required to be recorded by section 12(2) in relation to it.

(2) For the purpose of subsection (1)(a), adequate disclosure is regarded as having been made for communications specified in Schedule 1 to these Rules, by or on behalf of the issuer or the stabilizing manager, if disclosure is made in the manner specified in that Schedule.

8. Restrictions on stabilizing action

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(1) The stabilizing manager may not take stabilizing action in any case where:

(a) at the time when the offer price of the relevant securities was determined, the market price of the relevant securities or of rights to them, was or could reasonably be anticipated to be an artificial price; and

(b) the stabilizing manager knew or should reasonably have known that the artificiality in the market price was or would be attributable in whole or in part to any act or course of conduct on the part of any person which constitutes market misconduct under Part XIII or an offence under Part XIV of the Ordinance.

(2) The stabilizing manager may not take stabilizing action in any case where:

(a) the relevant securities are debt securities;

(b) there are equity securities into which those debt securities can be converted or

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to the purchase of which those debt securities give rights; and

- (c) the terms of conversion, purchase or subscription have not yet been publicly announced.

(3) The stabilizing manager may not take stabilizing action in any case where:

- (a) he or an associate of his has, in connection with the offer, an option or other right to subscribe for relevant securities from the issuer; and
- (b) that option or right may be exercised or relied on after the start of the introductory period and during or after the remainder of the stabilizing period;

unless the existence and principal terms of the option or right have been disclosed in the relevant prospectus, and, in any public announcement in respect of the offer prior to the date of the prospectus.

9. Permitted ancillary stabilizing action

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(1) Subject to subsection (2), the stabilizing manager may:

(a) for the sole purpose of preventing or minimizing any reduction in the market price of the relevant securities by action under section 6:

i) make allotments of a greater number of the relevant securities than the number that will be offered in the public offer; or

ii) sell or agree to sell relevant securities so as to establish a short position in them;

(b) purchase or subscribe for or agree to purchase or subscribe for relevant securities in order to close out any position established under subsection (1) (a); or

(c) sell or agree to sell relevant securities acquired by the stabilizing manager in the course of stabilizing action in order to

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liquidate any position that has been established by such action; or

(d) offer or attempt to do anything permitted by subsection (1)(a)(ii), (b) or (c).

(2) Ancillary stabilizing action under subsection (1)(b) may be taken without regard to the limits on pricing in section 10 and Schedule 2 to these Rules.

10. Limit on pricing in stabilizing action

(1) No bid may be made or transaction effected in the case of action described in section 6 at a price higher than any relevant price indicated in accordance with Schedule 2 to these Rules (including any relevant notes thereto).

(2) The prohibition in subsection (1) does not apply to stabilizing action related to debt securities.

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11. Management of stabilization

(1) The stabilizing manager must be a licensed corporation or a registered institution.

(2) It will be the duty of the stabilizing manager to ensure -

(a) that the disclosure requirements specified in Schedule 1 to these Rules are complied with;

(b) any requirements of the operator of the recognised stock market or overseas stock market on, or the person authorised to provide automated trading services by means of, which the relevant securities are or will be traded to inform it that stabilizing action in those securities may take place have been complied with; and

(c) any person appointed by the stabilizing manager to act as its agent for the purpose of effecting any bid or transaction in the course of stabilizing action complies with these Rules.

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(3) No bid may be made or transaction effected in the course of stabilizing action unless the stabilizing manager:

- (a) has established the relevant register in compliance with section 12;
- (b) is in compliance with the registration requirements in section 12 in respect of all earlier transactions effected in the course of stabilizing action in connection with the offer in question.

(4) No bid may be made or transaction effected in the course of stabilizing action except by:

- (a) the stabilizing manager itself; or
- (b) a person appointed by the stabilizing manager to act as its agent on terms which:
 - (i) make the agent responsible to the stabilizing manager; and
 - (ii) make the stabilizing manager responsible to others for the acts or omissions of the agent as if they had

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been done or omitted by the stabilizing manager.

(5) The stabilizing manager may not during the stabilizing period enter into any dealing as principal in relevant securities with any agent of its appointed under subsection (4)(b).

(6) Subsection (5) does not apply if, at the time of the transaction, neither the stabilizing manager nor the agent knew or should reasonably have known the identity of its counterparty.

PART III

REGISTER OF STABILIZING ACTION

12. Record keeping for action taken

(1) The stabilizing manager must establish and keep a register in respect of each offer of securities covered by these Rules.

(2) The stabilizing manager must ensure that the register referred to in subsection (1) contains, either

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in real time or updated on a daily basis (from business day to business day):

- (a) the names of all agents appointed under section 11 and details of the terms of the appointment of each;
- (b) the general parameters (including the initial stabilizing price) laid down by the stabilizing manager for his agents and the date and time of their communication, variation or revocation;
- (c) each transaction effected in the course of the stabilizing action including:
 - i) the type of security;
 - ii) the unit price;
 - iii) the size;
 - iv) the date and time; and
 - v) details of the counterparty;
- (d) details of the allotment of relevant securities (allottee and amount allotted);
and

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(e) details (so far as known to the stabilizing manager) of transactions which are effected at a price above the then current stabilizing price for the purposes of Schedule 2 to these Rules (pricing after independent deals).

(3) The register must be kept in Hong Kong, or else be capable of being brought to, or reconstituted in, Hong Kong within 48 hours of a request for access from anyone entitled to inspect it pursuant to section 13.

(4) If the register is not kept in either English or Chinese, it must be capable of being converted into either language within the 48-hour period mentioned in subsection (3).

13. Maintenance and Inspection of register

(1) During the 3 months from the end of the stabilizing period, the issuer is entitled to inspect that part of the register which is kept under section 12(2)(c)(i) to (c)(iv) and without prejudice to section 12(3), the stabilizing manager must make that part of the register available for inspection within a reasonable

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time of being notified by the issuer that it wishes to make the inspection.

(2) The register must be maintained for a period of at least 7 years from the date of the end of the stabilizing period.

(3) The Commission is entitled to inspect the register and to take copies thereof at any time and without prejudice to section 12(3), the stabilizing manager must make the register available to the Commission or a person authorized in writing by the Commission.

PART IV

MISCELLANEOUS

14.Overseas Stabilization

(1) A person who, in a place outside Hong Kong, carries out any conduct in respect of relevant securities

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(a) for the sole purpose of preventing or minimising any reduction in the market price of the relevant securities;

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(b) in conformity with such provisions made by an authority or regulatory organisation outside Hong Kong as are set out in Schedule 3; and

(c) and in relation to an offer which is governed by the laws of the country (or the state or territory in a country) in which the authority or regulatory organization is situated;

is to be treated for the purposes of sections 273(1) and 297(1) of the Ordinance as acting or engaging in such conduct for that purpose and in conformity with these Rules.

(2) For the purposes of subsection (1), "market price" is the market price of the relevant securities on an overseas market in the relevant country (or the state or territory).

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Schedule 1

Relevant Communications

Item	Communication	Relevant Notes (see below)
1	Any screen based statement	a,b,d
2	Press announcement (or other public announcement)	c,d
3	Invitation telex (or similar)	b
4	Prospectus	e

Notes:

- (a) Item 1 extends to any statement made by the stabilizing manager or issuer on screen facilities (whether provided by the stabilizing manager or not) conveying prices for a purchase or sale of the relevant securities.
- (b) For items 1 and 3, adequate disclosure is given if the communication contains some indication of the fact that the offer may be stabilized in accordance with these Rules. For this purpose - (i) the term "stabilization/SFO"; or (ii) during the introductory period, a reference to "details of intended stabilization/SFO in prospectus"; is sufficient.
- (c) For item 2, adequate disclosure is given if the announcement includes a statement of the fact that the offer may be stabilized in accordance with these rules. For this purpose- (i) a statement in the following terms: "This offer may be stabilized in accordance with the Price Stabilizing Rules made under the Securities and Futures Ordinance"; or (ii) during the introductory period, a reference to " the details of the intended stabilization and how it will be regulated under the Securities and Futures Ordinance will be contained in the prospectus"; is sufficient.
- (d) Items 1 and 2 apply from the beginning of the shorter of the following two periods, that is:
 - (i) the introductory period; or

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- (ii) the period beginning 45 days before the day proposed for the issue of the relevant securities and ending with the start of the stabilizing period.
- (e) For item 4, adequate disclosure is given if the communication contains:
- (i) wording substantially similar to the following:

"In connection with this [issue] [offer], [name of the stabilizing manager] [or any person acting for him] may over-allot or effect transactions with a view to supporting the market price of [description of the relevant securities] at a level higher than that which might otherwise prevail for a limited period after the issue date. However, there may be no obligation on [name of stabilizing manager] [or any of his agent] to do this. Such stabilizing, if commenced, may be discontinued at any time, and must be brought to an end after a limited period."
 - (ii) a summary of the possible stabilizing action to be undertaken under section 6 or section 9;
 - (iii) warnings to the effect that:
 - (1) the stabilizing manager may, in connection with the stabilizing action, maintain a long position in the relevant securities;
 - (2) there is no certainty regarding the extent and time period for which the stabilizing manager will maintain such a position;
 - (3) investors should be warned of possible impact in the case of liquidation of the long position by the stabilizing manager;
 - (4) stabilization cannot be used to support the price of a security for longer than the stabilization period which is 30 days from the date of the prospectus. After this period, when any stabilization must end, demand for

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the security, and therefore its price could fall;

- (5) investors should be aware that the price of the security cannot be assured to stay at or above its offer price by way of stabilization;
- (6) stabilizing bids may be made or transactions effected in the course of stabilization at any price below the offer price. This means that stabilizing bids may be made or transactions effected at a price below the price the investor has paid for the security.

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Schedule 2

Pricing Limits

Time of action	Maximum Price
1. Initial stabilizing action	The offer price
2. After the initial stabilizing action, there has been a deal done (transaction effected) at a price above the stabilizing price on the relevant market	The offer price, or the price at which that deal was done, whichever is lower
3. Alternatively, if after the initial stabilizing action, there has been no deal mentioned in paragraph 2 above	The offer price, or the initial stabilizing price, whichever is the lower

Notes:

- (a) For the purpose of paragraph 2 above, a deal done does not include a deal done by or on the instructions of the stabilizing manager.
- (b) For the purpose of this Schedule, "relevant market" means the relevant recognised market, authorised automated trading services, or relevant overseas market which the stabilizing manager believes to be the principal market on which those securities are dealt in at the time of the transaction.
- (c) Where the price of any relevant securities on the relevant market is in a currency other than the currency of the price of the securities to be stabilized, stabilizing bids may be made or transactions effected at a price that reflects any change in the relevant rate of exchange; but this does not permit stabilizing action at a price above the equivalent, in the other currency, of the offer price in the currency of the relevant exchange.

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Schedule 3

Overseas Stabilization

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Chairman
Securities and Futures
Commission

Date 2002

Explanatory Note

These Rules are made by the Securities and Futures Commission under sections 273(1) and 297(1) of the Securities and Futures Ordinance (of 2002) for the purpose of excluding price stabilization conducted in accordance with these Rules from the application of the market misconduct provisions in Parts XIII and XIV of the Ordinance. They prescribe the circumstances in which the prices of certain securities offered to the public may be stabilized for a limited period and the type of stabilizing action which may be undertaken and the requirements for disclosure of such action.

Derivation Table

Clause in the Securities and Futures Bill	Section in the Securities and Futures Ordinance
237(1)	245(1)
273(1)	282(2)
277(1)	285(1)
292	300
294	302
297(1)	306(2)



**SECURITIES AND
FUTURES COMMISSION**
證券及期貨事務監察委員會

Annex 3

**Consultation Conclusions on
The draft Securities and Futures
(Price Stabilizing) Rules**

Hong Kong
June 2002

香港
2002年6月

Introduction

1. On 8 February 2002 the SFC issued a consultation paper on the draft Securities and Futures (Price Stabilizing) Rules (“PS Rules”) to seek the views of the public on the proposed regulatory approach and practical implications of implementing the PS Rules under the Securities and Futures Ordinance (“Ordinance”).
2. The consultation period ended on 8 March 2002 but late submissions were accepted and considered. A total of 7 written submissions were received. These included one submission made on behalf of 7 financial institutions and submissions from professional bodies and other market practitioners. A profile of the respondents is set out in the Annex.
3. This document analyses the major comments received and explains the conclusions drawn by the SFC. This paper should be read in conjunction with the consultation paper.
4. After the PS rules have been brought into operation, the SFC may contact issuers and stabilizing managers who have conducted stabilizing activities under the PS Rules to solicit their feedback on the practical implications of the PS Rules and any difficulties encountered in complying with the Rules. Information so obtained would form part of the database on which we can rely to conduct future reviews of the PS Rules.

Summary of Comments and Conclusions

Types of securities covered by the PS rules

5. The consultation paper proposed to apply the PS Rules to shares and debentures only, which are broadly the most common types of securities publicly offered for corporate fund raising in Hong Kong. A stabilizing manager can only stabilize the price of a share or debenture by effecting transactions prescribed in the PS Rules in the same type of security, but not in respect of “associated securities”.
6. Some commentators suggested to include in the PS Rules securities associated with the shares or debentures being offered, for example, derivatives and depositary receipts. They argued that the use of associated securities for stabilization purposes is of particular importance in issues of convertible or exchangeable securities.
7. The SFC is of the view that the PS Rules are new to the market and in this initial step a prudent regulatory approach should be adopted. The use of derivatives or other associated securities in general in stabilization is not considered appropriate at this stage.
8. On the other hand, the SFC agrees that depositary receipts, which are in all material respects identical to the underlying securities, should be deemed to be

the same security as the one being offered and should be covered by the PS Rules. The PS Rules have been amended to clarify the position of depositary receipts.

9. The SFC may in the future review whether it is in the public interest to amend the PS Rules to extend the range of securities in respect of which stabilizing actions may take place.

“Net long” positions held by stabilizing managers

10. The consultation paper proposed that only upward stabilization should be permitted. In upward stabilization, stabilization takes place where the stabilizing manager purchases the security in the secondary market to support its price, whether or not for the purpose of covering an over-allocation. This means that the stabilizing manager may hold “net long” positions for stabilization purposes under the PS Rules.
11. Commentators generally agreed with the proposal. One commentator suggested imposing a limit on the “net long” positions a stabilizing manager may hold with reference to the size of the offering.
12. The SFC does not consider it necessary to impose a pre-determined limit as in practice the size of the “net long” positions will be a matter subject to market forces and other regulatory requirements such as those relating to public float (in case the size of the “net long” positions were such that would render the stabilizing manager a connected person of the issuer within the meaning of the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited) and disclosure of interests (under Part XV of the Ordinance). Such a limit is also not in line with international practice.

Applicable offers

13. The consultation paper proposed that an offer of securities must meet the following conditions in order to be able to rely on the PS Rules as a safe harbour:
 - The offer must be public in character;
 - The offer must be the subject of a prospectus issued in connection with the offer;
 - The size of the offer shall not be less than HK\$200 million;
 - The securities must be either listed on a relevant stock exchange or traded on an authorised automated trading system; and
 - The offer of securities must be made for cash.
14. Although the consultation paper only invited comments in respect of the threshold amount of HK\$200 million for offers under the PS Rules, a number of comments on the requirement of a prospectus for applicable offers were also received.

Document requirement

15. While the consultation paper envisaged that secondary offerings which are public in character and are made for corporate fund raising will also be eligible for the safe harbour under the PS Rules, commentators generally regarded the prospectus requirement as unduly restrictive and suggested the scope of the PS Rules be widened to accommodate offers not involving a prospectus, such as placing and top-up and offers to institutional investors, in which case a public announcement rather than a prospectus may be adequate for the offer to be conducted under existing rules and regulations.
16. The SFC is aware that placing and top-up transactions are often conducted to facilitate secondary offerings in fulfilling corporate fund-raising. The SFC agrees that secondary offers of a public character but which do not involve the issue of a prospectus should also be eligible for the safe harbour under the PS Rules, provided that the terms of the offer and relevant disclosure on stabilization activities are made in a public announcement prior to the commencement of the stabilization actions. This will cover large secondary new issues and placing and top-up transactions.
17. Offers for sale of shares by existing shareholders will be covered by the PS Rules if a prospectus is issued. Offers in which a placing and top-up is combined with a sell-down by the existing shareholder(s), or placing and top-up in which the new shares subscribed by the selling shareholder(s) are less than the total number of shares placed, are not intended to be covered by the PS Rules, as these offers are not regarded as wholly for corporate fund-raising. Block trades, whereby a holder of a relevant security unloads a part or the whole of his holding to one or more buyers, are not intended to be covered by the PS Rules since they are not considered to be offers which are public in character as such trades normally involve only a handful of buyers, nor are they regarded as capital raising exercises.
18. To accommodate the increasing number of retail offerings of debt securities by government agencies in Hong Kong, the PS Rules will also apply to public offers of securities that are not subject of a prospectus but instead are subject of an authorization from the SFC under section 105 of the Ordinance. For the purpose of the PS Rules, securities in collective investment schemes, in the offerings of which price stabilization is not a normal feature, are excluded.
19. Relevant changes have been made in the PS Rules to accommodate offerings without a prospectus as referred to above. References to issuers have also been amended where appropriate to include existing holders of securities.

Threshold amount

20. Most of the commentators had no objection to the HK\$200 million threshold proposed in the consultation paper, while two commentators believed that a threshold would be inappropriate since regulated stabilization should apply in principle to offers regardless of their size. There was an observation that a

large number of offers in Hong Kong were smaller than HK\$200 million and that small offerings tended to be more volatile in their trading.

21. The SFC believes that a threshold is appropriate taking into account the extent of distribution and potential market impact of offers of different sizes and is in line with international practice. In view of the size of most of the fund raising exercises in Hong Kong and the after-market price performance of offers, the SFC considers it reasonable to begin with a lower threshold of HK\$100 million. The SFC will closely monitor stabilization activities and performance of offers of different sizes and may in future review the threshold.

Core stabilizing actions and ancillary stabilizing actions

22. The consultation paper categorized purchases of the relevant securities in the secondary market by the stabilizing manager as core stabilizing actions.
23. In order to cover any short position, underwriters would have to have an over-allotment option and usually a securities borrowing arrangement with a controlling shareholder. These activities, including the exercise of any over-allotment options and the returning of securities under the relevant securities borrowing arrangement, are regarded as ancillary stabilizing actions under the PS Rules and are not subject to the time limit and price limits as for core stabilizing actions. Liquidation of “net long” positions created through stabilizing purchases will also be regarded as permitted ancillary stabilizing action under the PS Rules.
24. Some commentators felt that whether subsequent purchases in the market to cover a prior short position should be subject to the price limits was unclear and requested that be clarified.
25. The SFC would like to confirm that purchases in the secondary market to close out a prior short position should fall under core stabilizing actions and be subject to the relevant limits on price and timing. The SFC believes that, to qualify for the safe harbour, the prior short position should be created with a view to facilitating core stabilizing actions, i.e. stabilization at or below the pricing limits. If it subsequently transpires that the stabilizing manager cannot cover the short position in accordance within such limits, i.e. purchasing at or below the offer price, the stabilizing manager will have recourse to the over-allotment option granted by the offeror of the securities, and would not need to purchase at above the price limit to close out the position. The PS Rules have been amended to clarify the position.

Time limit for stabilizing actions

26. The consultation paper proposed that core stabilizing actions be allowed only during the stabilizing period with a 30-day time limit commencing on the date of the prospectus. It was also proposed that no time limit will be imposed on permitted ancillary stabilizing actions as such may occur before the date of the offer document, such as the grant of the over-allotment option, or after the end of the stabilizing period, such as the liquidation of the stabilizing manager’s

“net long” positions. So long as these ancillary stabilizing actions are carried out in connection with core stabilizing actions under the PS Rules, they need not be carried out within the stabilizing period but are expected to be carried out as soon as practicable.

27. The commentators generally do not have any comment on the proposals on the 30-day time limit but various commentators have comments on the beginning date and end of the stabilizing period.

Duration of the stabilizing period and grey market trading

28. Some respondents queried whether stabilizing activities may take place in “the grey market”, that is, the informal market that exists between the date of the offer document and the official commencement of trading of a security on an exchange or other trading platforms, if the stabilizing period starts on the date of the prospectus. One respondent pointed out that there may not be sufficient transparency if stabilization may take place in the grey market and that it is easier to monitor stabilizing actions in a regulated market.
29. The SFC believes that stabilization may only take place in a market with adequate transparency and would like to clarify that core stabilizing activities may only take place after the commencement of trading on a recognized stock market or authorized automatic trading services in order to provide transparency in the pricing and execution of stabilizing activities. Accordingly, the stabilizing period under the PS Rules has been amended to begin only after trading of the relevant securities has commenced following the issue of the relevant offer document. The authorised automatic trading services through which stabilization may be undertaken has also been qualified to include only those that have been specifically authorized by the SFC for purposes of the PS Rules.
30. One respondent suggested that the stabilizing period should start on the date of the first public announcement stating the offer price and end on the earlier of the thirtieth day after the closing date or the sixtieth day after the date of allotment, following the UK practice, to allow more time and hence flexibility in carrying out the stabilizing actions.
31. The SFC agrees that the UK practice allows more time and flexibility for stabilizing actions. Taking into account the restriction on the timing of allotment under the Companies Ordinance and local market practice, the duration of the stabilizing period has been amended to end on the earlier of the thirtieth day after the closing day or the thirtieth day after the commencement of trading of the relevant securities under the offer on a recognized stock market.

Time limit for liquidation of “net long” position

32. One commentator was concerned about the suggestion in the consultation paper that liquidation of any “net long” positions arising from stabilizing transactions are expected to be carried out as soon as practicable. It was felt

that a stabilizing manager should not be under any kind of obligation to unwind a “net long” position if this would result in a loss or is likely to destabilize the price.

33. The SFC does not expect the “net long” position should be held for an unduly long period of time as this would affect the liquidity of the security but agrees that the stabilizing manager should be given the discretion to decide when to unwind the “net long” position so long as the liquidation is executed in a way which minimize market impact.

Pricing limits

34. In the consultation paper, pricing limits were proposed for core stabilizing actions for offers of equity securities but not debentures, due to different pricing mechanisms for shares and debentures. A stabilizing manager is allowed to make any stabilizing bid (“B”) which is at or below the upper price limit, that is, the offer price of the security (“A”). The stabilizing manager may subsequently stabilize at or below such initial stabilizing price B. If an independent deal is done on the principal market for that security (which does not necessarily have to be in Hong Kong) at a price (“C”) higher than B but below A, the stabilizing manager then have a new maximum price C, so that it may stabilize at or below C.
35. Commentators generally had no objection to the proposal that the stabilizing actions for offerings of debentures need not be subject to price limits. While most commentators had no objection to the price limits on stabilizing actions of equity securities, one commentator did not consider such limits appropriate and another commentator suggested a floor for compulsory stabilizing actions when the market price falls below a certain percentage from the offer price.
36. The SFC considers the price limits an important element for the proper functioning of the PS rules and for entitling transactions under the rules the safe harbour from market misconduct offences. However, a floor limit would not be appropriate since it is believed that safe harbour rules exist to facilitate market operations and not to impose compulsory market actions. Investors must be aware that there is no guarantee that stabilization will be undertaken. Imposing a floor limit for stabilizing activities is also not in line with international practice.
37. One commentator believed that, after the initial stabilizing action, a new price ceiling should be allowed to be set as a result of a deal done by or on the instructions of the stabilizing manager as it is possible that the stabilizing manager may have been engaged in proprietary trading or acting on the instructions of a genuine client.
38. The SFC is of the view that only completely independent transactions should be taken into account in setting the price ceilings. To facilitate monitoring, deals done by or on the instruction of a stabilizing manager should be excluded such that independence can be readily established. It may not

always be apparent whether a transaction is truly independent if deals done by the stabilizing manager were also counted.

Role of the stabilizing manager

The stabilizing manager's responsibilities for its agent's actions

39. The stabilizing manager appointed to conduct the stabilizing action is responsible for overseeing compliance with the PS Rules including prior disclosure of stabilizing actions in communications with the public, and proper record keeping of all such actions. In undertaking stabilizing action, the stabilizing manager may appoint agents, local and overseas, but it will remain ultimately responsible to the issuer and be accountable for compliance with the PS Rules.
40. Some commentators expressed concerns about the responsibilities of the stabilizing manager over the actions of its agents and argued that the stabilizing manager should only be responsible for those acts or omissions of the agents it has authorized or knowingly permitted. One commentator also queried whether in the case of a global offering, the overseas stabilizing manager need to be appointed as an agent of any stabilizing manager which is acting in connection with the Hong Kong offer.
41. The SFC considers that, for regulatory purposes, it is important to establish a clear accountability obligation under the PS Rules. The stabilizing manager, being the person to oversee the compliance with the PS Rules, should take overall responsibility for the stabilizing actions taken and ensure that its agents comply with the PS Rules. This applies to local and global offerings alike. In global offerings, the underwriter responsible for overseas stabilization actions, if he is not also the Hong Kong stabilizing manager, should be an agent appointed by the stabilizing manager under the PS Rules.
42. If the stabilizing manager believes it has difficulties in ensuring its agents comply with the PS Rules, he should seriously consider whether it should delegate any of its functions under the PS Rules to any agent. In practice, in case an agent was in breach of any of the PS Rules, factors such as the circumstances of the breach and the steps taken by the stabilizing manager in seeking to ensure that the agent did comply with the rules will be considered before any enforcement action is taken.

Separation of stabilizing activities and other trading activities

43. One commentator believed that there might be practical difficulties in distinguishing between stabilizing actions and genuine principal investment activities of the stabilizing manager.
44. The SFC expects the stabilizing manager to properly separate its activities as stabilizing manager and its other trading activities, including proprietary trading, to avoid committing market misconducts not covered by the safe harbour under the PS Rules. All stabilizing actions, in order to be eligible for

the safe harbour, should be recorded in the register required to be kept under the PS Rules in real time or updated on a daily basis.

Principal transactions between the stabilizing manager and its agent

45. The PS Rules do not allow principal transactions between the stabilizing manager and its agents, unless at the time of the transaction, neither the stabilizing manager nor the agent knew or should reasonably have known the identity of the counterparty.
46. Some commentators felt that principal transactions should be allowed between the stabilizing manager and its agents, where the agent is an affiliate of the stabilizing manager or where there are appropriate Chinese walls between the stabilizing actions and other trading activities of the stabilizing manager, otherwise market activities would be restricted.
47. In order to set out a clear framework within which transactions of the securities being stabilized will be deemed eligible for the safe harbour, and in line with international practice, the SFC considers it necessary to prohibit principal transactions between the stabilizing manager and its agent(s). We do not expect the prohibition would affect more than a limited number of transactions. The PS Rules will not hinder proprietary trading activities of the stabilizing manager and its agent as long as their transactions are executed through the normal order matching mechanism in the open market and the identity of the counterparties are not known to each of the parties. The PS Rules also will not prohibit client transactions for which the stabilizing manager is merely an agent of its clients.
48. The SFC is aware that there have been discussions in overseas markets on allowing certain principal transactions between the stabilizing manager and its agents to be effected in the course of stabilizing actions in respect of debt securities. The SFC is monitoring international development and proposes to make comparable amendments to the PS Rules where necessary.

Inadvertent breach of the PS Rules by the stabilizing manager

49. The PS Rules prescribe that if the stabilizing manager knows or should reasonably have known that the relevant disclosure had not been made, the necessary records had not been kept, or the price of the securities was artificial, the safe harbour under the rules would not apply.
50. Some commentators were concerned that trivial breach by a stabilizing manager, or a breach arising from a force majeure type event, in respect of the disclosure or record-keeping requirement would mean that the safe harbour was lost. It was suggested that the safe harbour should still be available so long as the stabilizing manager has taken all reasonable steps to satisfy himself that the disclosure requirements are met, or so long as the SFC had not removed the benefit of the safe harbour.

51. The SFC believes that the intent of the safe harbour is to provide a clear set of parameters for transactions to take place without being taken as market misconducts and avoid any uncertainty in its application. In case of a loss of the safe harbour due to minor breach in respect of the disclosure or record keeping requirement, factors such as the circumstances of the breach and the steps taken by the stabilizing manager in complying with the relevant requirements will be considered before any enforcement action is taken.

Disclosure requirements

Prior disclosure

52. The PS Rules propose that prior disclosure of stabilizing actions be made when the offer of securities is first publicly announced, and be continued to be made until detailed disclosure of the extent of the forthcoming stabilizing actions and prior warnings have been made in the relevant offer document.
53. A commentator was concerned that the disclosure requirements under the PS Rules might catch oral communication and hence might result in inadvertent breach. It was also felt that the PS Rules should allow adaptation or omission of the disclosure wordings set out in Schedule 1 of the PS Rules if the communication is directed wholly or partly at persons outside Hong Kong in certain circumstances.
54. The SFC wishes to clarify that oral communication which is made in conjunction with a press announcement, or which forms part of a public announcement, is not required to separately comply with the disclosure requirements under the PS Rules so long as appropriate disclosure has been made in the relevant public or press announcement as specified in Schedule 1 of the PS Rules.
55. The PS Rules also already allows modifications of the disclosure wordings in Schedule 1. Wordings substantially similar to those suggested or warnings to the same effect are also acceptable.

Simultaneous and post stabilization disclosure

56. The SFC specifically invited public comments on whether a stabilizing manager should identify and disclose its stabilizing bid to the market in the course of its stabilizing actions (so-called “flagging” in the US where there is a requirement to inform the market of a stabilizing bid on a real-time basis).
57. Most commentators objected to the idea of flagging and believed that flagging would convey a negative message to the market as to the performance of the offer and defeat the purposes that the stabilizing bids seek to achieve. On the other hand, one commentator supported flagging as it would increase transparency of the stabilizing bids to the market and suggested that the stabilization register be open for public inspection and the data be released at the end of each trading day to increase transparency.

58. Commentators opposing flagging also pointed to the UK and European Union rules which do not impose such a requirement.
59. The SFC acknowledges the existence of differing views on the disclosure of stabilizing actions. To strike a balance between market transparency and the potentially damaging effects of flagging on the stabilizing efforts, the SFC is of the view that limited post-stabilization disclosure will be appropriate. The PS Rules will require disclosure of exercise of the over-allotment option immediately after any such exercise and disclosure of the following information within 7 days from the end of the stabilizing period:
- Date of end of the stabilizing period;
 - Whether or not stabilization was undertaken;
 - The price range between which stabilizing purchases were undertaken;
 - Date and price of the last stabilizing purchase; and
 - Whether or not and the extent to which the over-allotment option was exercised.
60. The SFC notes that international discussion is currently under way on whether to include the volume of stabilizing purchases undertaken in the post stabilization disclosure. While we currently does not see any immediate need to include this item in our disclosure requirement, we will review this at a later date in the light of developments in other jurisdictions and amend the requirement where necessary in order to bring the PS Rules on a par with international standards.

Overseas stabilization

61. The consultation paper recognized the need for offerings of securities traded in Hong Kong and overseas to have stabilizing activities conducted overseas and it was proposed that the safe harbour under the PS Rules will be available to such activities if they are effected in accordance with the price stabilizing rules in certain recognised jurisdictions which provide similar regulatory safeguards against market manipulation, and if the offer is governed by the laws of the relevant jurisdiction.

Stabilizing activities conducted in Hong Kong

62. Some commentators suggested that the scope of the safe harbour should also cover stabilizing activities conducted in Hong Kong or that may impact on the Hong Kong market, whether or not the securities themselves are offered or listed in Hong Kong, so long as the stabilizing actions are in accordance with the rules of a recognized jurisdiction. For example, in respect of a London offer of a bond convertible into Hong Kong listed securities, stabilization in relation to the underlying Hong Kong securities should be allowed in Hong Kong in accordance with the UK stabilization rules.
63. The SFC disagreed with the suggestion. The safe harbour under the PS Rules should only be available when the stabilizing activities conducted in Hong Kong are in accordance with the PS Rules. In addition, it is the SFC's view

that the PS Rules should adopt a prudent approach in the initial stage of its introduction and should only allow stabilizing transactions effected in the same security as the one which is being offered. For example, in a convertible bond offer in London, only stabilizing activities using the relevant bond in accordance with the PS Rules will be allowed in Hong Kong, provided that it is traded in a recognized market in Hong Kong.

Stabilizing actions pursuant to rules and regulations in recognized jurisdictions

64. One commentator suggested that, in addition to stabilizing actions conducted pursuant to the official stabilizing rules or regulations in a recognized jurisdiction, it would be helpful if overseas stabilization would be expanded to refer more broadly to price-support conduct in a recognized jurisdiction carried on without infringing applicable laws and regulations in that jurisdiction. For example, in the US, support by underwriters for an issue in the secondary market is often carried out simply by way of short covering for the syndicate account rather than in accordance with Regulation M, the official stabilization rule.
65. The SFC intends to recognize only stabilizing actions conducted under the rules in the recognized jurisdiction as it would not be appropriate to recognize actions which are not officially entitled to the safe harbour in the relevant jurisdiction, i.e. actions which are potentially in “grey areas”, for the purpose of the PS Rules.

Offers governed by the laws of an overseas jurisdiction

66. One commentator felt that the meaning of “an offer which is governed by the laws” of the relevant jurisdiction in section 14(1)(c) was unclear as to whether the governing law in question is that of the public offer rules being adhered to (if any), the underwriting agreement or the terms of the securities.
67. The SFC would like to clarify that governing law refers to the law in accordance to which the offer is conducted in any jurisdiction. The PS Rules is intended to apply only to offers duly conducted in accordance with the laws of the relevant jurisdictions which are expected to afford some degree of investor protection.

Stabilizing activities and market misconduct

Market misconduct involving fraudulent and deceptive devices

68. The PS Rules provide a safe harbour from certain market misconduct defined under Parts XIII and XIV of the Ordinance pursuant to the rule-making power of the SFC under sections 282 and 306 of the Ordinance. The safe harbour, however, does not cover transactions involving fraudulent and deceptive devices under section 300 or falsely representing dealings in futures contracts on behalf of others under section 302 of the Ordinance.

69. A commentator argued that the safe harbour should also extend to “deceptive” activities as it might be argued that stabilizing activities are “deceptive” within the meaning of section 300 of the Ordinance.
70. It is legally not possible for the safe harbour to extend to “deceptive” activities under section 300 of the Ordinance. That section is outside the SFC’s rule-making power under sections 282 and 306 of the Ordinance.

Interpretation of “artificiality”

71. The PS Rules proposed to prohibit the stabilizing manager from conducting any stabilizing actions where the market price of the relevant securities was already artificial or maintained at a level that is artificial.
72. Some commentators felt that the meaning of the term “artificial” was unclear. One commentator believed that it would be particularly difficult to determine whether the price of the relevant security was already “artificial” if the market was volatile and suggested to tie the concept to breach of the market misconduct provisions in the Ordinance.
73. The SFC is of the view that prices in a volatile market, that is, one with large swings in price or trading volume, are not necessarily artificial. Artificiality would depend on whether the volatility was caused by manipulation. This is consistent with other parts of the Ordinance where the same term is used. The SFC also notes that the term “artificial” has been widely used in international regulatory context.
74. Furthermore, the SFC wishes to stress that a stabilizing manager is prohibited from conducting stabilizing activities where the market price of the relevant securities was already artificial or maintained at a level that is artificial only if the stabilizing manager knew or should reasonably have known that the artificiality was attributable to market misconduct activities. This has been clarified in the PS Rules.

Transitional arrangements

75. As the market misconduct provisions are not intended to have retroactive effect, the SFC takes the view that in the case where a public announcement of the offer with the offer price stated has been made before the commencement date of the PS Rules, underwriters may continue stabilization in the form of over-allocation by the underwriters, related securities borrowing transactions backed by over-allotment options granted by the issuers, and the satisfaction of over-allocations by purchases of securities in the secondary market, provided that these actions are consistent with the SFC’s policy statements about stabilization in the Joint Announcement on Offering Mechanisms in 1994 and its views expressed in the Consultation Conclusion Paper for Offering Mechanisms in 1998.

Annex

Profile of respondents

<u>Nature of business</u>	<u>Number</u>
Legal advisers	2 (<i>Note</i>)
Financial institutions	2
Other organizations	3
	<hr/>
	7

Note: One legal adviser made the submission on behalf of 7 financial institutions

Exposure Draft of the Securities and Futures (Price Stabilizing) Rules
Summary of comments received and SFC's response

Item No.	Section reference ¹	Details of the Rules	Respondent's comments	SFC's response
<p>What is your view on stabilization action being permitted only in respect of the same type of security as the one being publicly offered but not in respect of its “associated securities”?</p>				
<p><i>(a) Publicly offered securities</i></p>				
1.	5(d)	<p>One of the requirements stipulated under section 5 is that the PS Rules can only be applicable to an offer which is an offer to the public and is subject of a prospectus.</p>	<p><i>Linklaters, HKSPA, Respondent A, Respondent C and Respondent D:</i> The requirement of a prospectus is too restrictive. Price stabilisation should be available to offers to institutional investors, sale of existing shares and secondary offerings, which normally are not subject of a prospectus, so long as the offers are to be, or has been the subject a public announcement, or an offer document which is not necessarily a prospectus.</p>	<p>Agreed. Secondary offers which are public in character but for which the requirement of a prospectus is either exempted or not required by the Companies Ordinance or otherwise waived by the SFC pursuant to any class exemption should also be entitled to the safe harbour under the PS Rules provided that the terms of the offer and relevant disclosure on stabilization activities are made in a public announcement prior to the commencement of the stabilizing action. Placing and top up, to the extent that the selling shareholder(s) subscribe for the same number of new shares as that placed, will be covered. To accommodate retail offering of debentures by government agencies, the PS Rules will also apply to public offer of securities (excluding collective investment schemes) that are subject of an authorization from the SFC under section 105 of the Ordinance instead of a prospectus.</p>

¹ Please refer to the derivation table at the end of this document for cross references to the clause number in the revised draft Rules at Annex 1.

Item No.	Section reference	Details of the Rules	Respondent's comments	SFC's response
(b) Associated securities				
2.	6	The stabilizing manager may only conduct stabilizing activities in respect of the same type of security as the one being publicly offered.	Linklaters and HKSPA: The safe harbour should extend to dealing in associated securities such as derivatives.	The SFC has considered the suggestion but concluded that, since the PS Rules are new to the market, a prudent regulatory approach should be adopted in the initial stage to afford greater investor protection. Accordingly, the safe harbour at this present stage will only be limited to stabilization of the same security as the one being offered.
3.	As above	As above	Linklaters and Respondent C: It is unclear whether the term "relevant securities" are intended to include securities as traded in the form of ADRs or other certificates giving the holder a right to the underlying securities listed on the Exchange.	Agreed. The term "relevant securities" will be extended to include depositary receipts of relevant securities which are in all material respects identical to the underlying securities.
(c) Definition of "debt securities"				
4.	2 Definition of "debt securities"	Definition of debt securities only include those issued by a corporation.	Linklaters: Definition of debt securities should be extended to include securities issued by governments and multilateral organizations, not just debentures issued by corporations.	Agreed.

Item No.	Section reference	Details of the Rules	Respondent's comments	SFC's response
Should stabilizing managers be allowed to hold “net long” positions and to liquidate such positions?				
5.	--	--	<p>HKSA and HKSPA: Agreed, as it helps to provide support to the securities.</p> <p>Respondent C: Agreed, so long as prior disclosure is made to the public.</p> <p>Linklaters, Respondent A, Respondent B and Respondent D: No comment.</p>	Noted. Schedule 1 requires the stabilizing manager to warn investors of the possibility of the holding of net long positions prior to the commencement of the stabilizing actions.
6.	Paragraph (e)(iii) of Schedule 1	Warnings that the stabilizing manager may maintain a “net long” position in the relevant securities have to be disclosed in the offer document.	<p>Respondent B: The PS Rules should impose a limit for the “net long” position a stabilizing manager may hold with reference to the size of public offering.</p>	The SFC considers such limit not necessary as in practice the size of the “net long” positions will be a matter subject to market forces and other regulatory requirements such as those relating to public float and disclosure of interests. Such practice is also not in line with international practice.
What is your view about the proposal to impose a threshold amount of HK\$200 million for public offers under the PS Rules?				
7.	5 (c)	Stabilizing activities are only allowed where the total cost of the securities subject to the offer at the offer price is at least HK\$200 million.	<p>Linklaters: No objection to HK\$200 million threshold.</p> <p>HKSA:</p>	The SFC believes that a threshold is appropriate taking into account the extent of distribution and potential market impact of offers of different sizes and is in line with international practice. In

Item No.	Section reference	Details of the Rules	Respondent's comments	SFC's response
			<p>No objection but see no reason why smaller issues should not benefit from the PS Rules.</p> <p>Respondent A and Respondent D: No comment</p> <p>Respondent B: The rationale for proposing the HK\$200 million threshold should be spelt out.</p> <p>Respondent C: There was a concern that a threshold would be inappropriate since regulated stabilization should apply in principle to offers regardless of their size. If a threshold is to be adopted, perhaps the rationale behind it could be made public.</p> <p>HKSPA: A threshold amount was inappropriate as all public offers should be able to benefit from the PS Rules. An overwhelming number of public offers in Hong Kong are smaller than HK\$200 million.</p>	<p>view of the size of the majority of fund raising exercises in Hong Kong and the after-market price performance of offers of different sizes, the SFC considers it reasonable to begin with a lower threshold of HK\$100 million.</p>

Item No.	Section reference	Details of the Rules	Respondent's comments	SFC's response
What is your view on the adoption of a 30-day limit for the core stabilizing actions but not for ancillary stabilizing actions?				
8.	2 Definition of "stabilizing period"	The term "stabilizing period" is to begin with the date of the prospectus and ending on thirtieth day after the date of prospectus.	<p>Linklaters, Respondent B and Respondent C: Stabilization activities may take place in the grey market if the stabilizing period starts with the prospectus date but before formal trading commences.</p> <p>Respondent B: There may not be sufficient transparency if stabilization may take place in the grey market. It is easier to monitor stabilizing actions in a regulated market.</p>	The SFC believes that stabilization may only take place in a market with adequate transparency and would like to clarify that core stabilizing activities may only take place after the official commencement of trading on a recognized stock market or authorized automated trading services in order to provide transparency in the pricing and execution of stabilizing activities. The term "stabilizing period" has been amended to begin only after trading of the relevant securities has commenced following the the relevant offer document has been issued and the offer price has been announced. The authorized automated trading services through which stabilization may be undertaken has also been qualified to include only those which have been specifically authorized by the SFC for the purposes of the PS Rules.
9.	As above	As above	<p>Respondent D: The stabilizing period should start on the date of the first public announcement stating the offer price and end on the earlier of the thirtieth day after the closing date or the sixtieth day after the date of allotment, following the UK practice, to allow more time and hence flexibility in carrying out the stabilizing actions.</p>	The SFC agrees that the UK practice allows more time and flexibility for stabilizing actions. Taking into account the restriction on the timing of allotment under the Companies Ordinance and local market practice, the duration of the stabilizing period has been amended to end on the earlier of the thirtieth day after (i) the closing day; and (ii) the commencement of trading of

Item No.	Section reference	Details of the Rules	Respondent's comments	SFC's response
				the relevant securities under the offer on a recognized stock market.
What is your view on the pricing limits for stabilizing equity securities?				
10.	10 and Schedule 2	There is a limit on pricing in stabilizing actions. No stabilizing bid can be made higher than certain relevant price limits indicated in Schedule 2. In determining a new price limit, transactions done by or on the instructions of the stabilizing manager are excluded.	Respondent C: A new "price ceiling" should be allowed to be set as a result of a deal done by or on the instructions of the stabilizing manager as it is possible that stabilizing manager may have been engaged in proprietary trading or acting on the instructions of a genuine client for the purpose of genuine trading.	Disagreed. The SFC is of the view that only completely independent transactions should be taken into account in setting the price ceilings. To facilitate monitoring, deals done by or on the instruction of a stabilizing manager should be excluded such that independence can be readily established. It may not always be apparent whether a transaction is truly independent if deals done by the stabilizing manager were also counted.
11.	As above	As above	HKSA: A floor should be set for compulsory stabilizing actions i.e. compulsory stabilizing action when the price falls below a certain percentage.	Disagreed. Safe harbour rules exist to facilitate market operations and not to impose compulsory market actions. Investors must be aware that there is no guarantee that stabilization will be undertaken.
12.	As above	As above	HKSPA: It would be inappropriate to impose any price limit on core stabilizing actions.	Disagreed. The SFC considers the price limits an important element for the proper functioning of the PS rules and for entitling transactions under the rules the safe harbour from market misconduct offences

Item No.	Section reference	Details of the Rules	Respondent's comments	SFC's response
Do you agree that stabilizing actions for offerings of debentures need not be subject to pricing limits?				
13.	10 (2)	No pricing limit for stabilizing action in relation to debt securities.	<p>Linklaters and HKSPA: Agreed that stabilizing actions for offerings of debentures need not be subject to price limits.</p> <p>HKSA, Respondent A, Respondent B, Respondent C and Respondent D: No comment</p>	Noted
What is your view about the role of a stabilizing manager under the PS Rules? Do you foresee any practical difficulties for the stabilizing manager to discharge its role as described?				
14.	11(4)	A stabilizing manager is responsible for the acts or omissions of the agent appointed by him.	<p>Linklaters : The stabilizing manager should only be responsible for those acts or omissions of agents it has authorized or knowingly permitted. An overseas stabilizing manager need not be appointed as an agent of any stabilizing manager which is acting in connection with the Hong Kong public offer.</p> <p>Respondent C: If the agent were in breach of the PS Rules, whether the stabilizing manager itself has committed an offence should be construed separately by having regards to the actions of the manager, including whether it has taken sufficient steps to</p>	Disagreed. The SFC considers that, for regulatory purposes, it is important to establish a clear accountability obligation under the PS Rules. The stabilizing manager, being the person to oversee compliance with the PS Rules, should take overall responsibility for the stabilizing actions taken and ensure that its agents comply with the PS Rules. This applies to local and global offerings alike. In global offerings, the underwriter responsible for overseas stabilization actions, if he is not the stabilizing manager himself, should be an agent appointed by the stabilizing manager under the PS Rules.

Item No.	Section reference	Details of the Rules	Respondent's comments	SFC's response
			ensure that the agent complies with the PS Rules.	
15.	11(5)	A stabilizing manager may not during the stabilizing period enter into any dealing as principal in relevant securities with any agent appointed by such stabilizing manager.	<p><i>Linklaters and Respondent C:</i> Principal transactions between the stabilizing manager and its agents should be allowed where the agent is an affiliate of the stabilizing manager, or where there are appropriate Chinese walls, otherwise market activities would be restricted.</p>	In order to set out a clear framework within which transactions of the securities which are being stabilized will be deemed eligible for the safe harbour and in line with international practice, the SFC considers it necessary to prohibit principal transactions between the stabilizing manager and its agent(s). We do not expect the prohibition would affect more than a limited number of transactions. The PS Rules will not hinder proprietary trading activities of the stabilizing manager and its agent so long as their transactions are executed through the normal order matching mechanism in the open market and the identity of the counterparties are not known to each parties. The PS Rules will not prohibit client transactions for which the stabilizing manager is merely an agent of its clients.
16.	--	--	<p><i>HKSPA:</i> There might be practical difficulties in distinguishing between stabilizing actions and genuine principal investment activities of the stabilizing manager.</p>	The SFC expects the stabilizing manager to properly separate its activities as stabilizing manager and its other trading activities, including proprietary trading, to avoid committing market misconduct not covered by the safe harbour under the PS Rules. All stabilizing actions, in order to be eligible for the safe harbour, should be recorded in the register required to be kept

Item No.	Section reference	Details of the Rules	Respondent's comments	SFC's response
				under the PS Rules in real time or updated on a daily basis.
What is your view about simultaneous “flagging” to the market of the stabilizing bid placed by the stabilizing manager?				
17.	--	--	<p>Linklaters, HKSPA and Respondent D: Objected to the idea of flagging and believed that flagging would convey a negative message to the market and to the performance of the offer and defeat the purposes that the stabilizing bids seek to achieve.</p> <p>HKSA: Supported flagging, as it would increase transparency of the stabilizing bids to the market, and suggested that the stabilization register be open for public inspection and the data be released at the end of each trading day to increase transparency.</p>	<p>The SFC acknowledges the existence of differing views on the disclosure of stabilizing actions. To strike a balance between market transparency and the potentially damaging effects of flagging on the stabilizing effort, the SFC is of the view that limited post-stabilization disclosure will be appropriate.</p> <p>Proposed post stabilization disclosure would include the following:</p> <ol style="list-style-type: none"> 1) Date of end of stabilization period 2) Whether or not stabilization was undertaken 3) Price range between which stabilizing purchases were undertaken 4) Date and price of the last stabilizing purchase 5) The extent to which the over-allotment option was exercised

Item No.	Section reference	Details of the Rules	Respondent's comments	SFC's response
Other comments				
<i>Definition of "public announcement"</i>				
18.2	Definition of "public announcement"	"Public announcement" is defined to mean any communication made by or on behalf of the offeror or the stabilizing manager, being a communication made in circumstances in which it is likely that members of the public will become aware of the circumstances.	<i>Respondent C:</i> The existing definition might catch oral communications, and might result in oral communications having to comply with section 7(2) and Schedule 1, which might be difficult.	The SFC wish to clarify that oral communication which is made in conjunction with a press announcement, or which forms part of a public announcement, is not required to separately comply with the disclosure requirements under the PS Rules so long as appropriate disclosure has been made in the relevant public or press announcement as specified in Schedule 1 of the PS Rules.
<i>Conduct not to constitute offences under Part XIV of the Ordinance</i>				
19.4		The safe harbour under the PS Rules relate to offences under Part XIV of the Ordinance save for offence under sections 300 and 302 of the Ordinance.	<i>Linklaters:</i> The safe harbour should also cover transactions involving fraudulent and deceptive devices under section 300 of the Ordinance as it might be argued that stabilizing transactions are "deceptive" within the meaning of section 300.	It is legally not possible for the safe harbour to extend to "deceptive" activities under section 300 of the Ordinance. That section is outside the SFC's rule-making power under sections 282 and 306 of the Ordinance.
<i>Stabilizing actions</i>				
20.	6(2)(a) and (b)	The stabilizing manager will lose the safe harbour if disclosure of stabilization had not been made or records of stabilizing actions	<i>Linklaters:</i> Trivial breach by a stabilizing manager, or a breach arising from a force majeure type event, in respect of the disclosure or record-keeping requirement would mean	Disagreed. The SFC believes that the intent of the safe harbour is to provide a clear set of parameters for transactions to take place without being taken as market misconducts and avoid any

Item No.	Section reference	Details of the Rules	Respondent's comments	SFC's response
		have not been kept as required under the Rules.	that the safe harbour was lost. It was suggested that the safe harbour should still be available so long as the stabilizing manager has taken all reasonable steps to satisfy himself that the disclosure requirements are met, or so long as the SFC had not removed the benefit of the safe harbour.	uncertainty in its application. In case of a loss of the safe harbour due to minor breach in respect of disclosure or record keeping requirement, factors such as the circumstances of the breach and the steps taken by the stabilizing manager in complying with the relevant requirements will be considered before any enforcement action is taken.
Meaning of "artificial"				
21.	6(2)(c)	The stabilizing manager is prohibited from conducting any stabilizing actions where the market price of the relevant securities was already artificial or maintained at a level that is artificial.	Linklaters and Respondent C: The meaning of "artificial" was not entirely clear. The concept could perhaps be more closely tied to a breach of the market misconduct provisions in the Ordinance.	Artificiality would depend on whether the volatility was caused by manipulation. This is consistent with other parts of the Ordinance where the same term is used. The SFC also notes that the term "artificial" has been widely used in international regulatory context. Furthermore, the SFC wishes to stress that a stabilizing manager is prohibited from conducting stabilizing activities where the market price of the relevant securities was already artificial or maintained at a level that is artificial only if the stabilizing manager knew or should reasonably have known that the artificiality was attributable to market misconduct activities. This has been clarified in the PS Rules.

Item No.	Section reference	Details of the Rules	Respondent's comments	SFC's response
<i>Purchases on secondary market to close out prior short positions</i>				
22.	9 (1)(b)	Ancillary stabilizing actions include purchase or subscription of relevant securities in order to close out any prior short position.	Respondent C: The SFC should clarify whether subsequent purchases in the market to cover a prior short position should be subject to the price limits.	The SFC would like to confirm that purchases in the secondary market to close out a prior short position should fall under core stabilizing actions and be subject to the relevant limits on price and timing. The SFC believes that, to qualify for the safe harbour, the prior short position should be created with a view to facilitating core stabilizing actions, i.e. stabilization at or below the pricing limits. If it subsequently transpires that it is not possible to cover the short position within limits, the stabilizing manager will have recourse to the over-allotment option granted by the offeror of the securities and would not need to purchase at above the price limit to close out the position. Section 7(1)(b) has been amended to refer only to purchase or subscription of relevant securities pursuant to the exercise of an over-allotment option granted to the stabilizing manager.
<i>Relevant communications</i>				
23.	Schedule 1	Relevant communications should contain specified disclosures.	Respondent C: The PS Rules should allow adaptation or omission of the disclosure wording if the communication is directed wholly or partly at persons outside of Hong Kong in certain circumstances.	The SFC is of the view the PS Rules already allows modifications of the disclosure wordings in Schedule 1 since wordings substantially similar to those suggested or warnings to the same effect are also acceptable.

List of Respondents

Date received	Respondent
8 March 2002	Linklaters & Alliance (“Linklaters”), submitting on behalf of Credit Suisse First Boston (Hong Kong) Limited, Deutsche Securities (Asia) Limited, Goldman Sachs (Asia) L.L.C., J.P. Morgan, Merrill Lynch (Asia Pacific) Limited, Morgan Stanley Dean Witter Asia Limited and Salomon Smith Barney Hong Kong Limited
11 March 2002	A financial institution who wished to remain anonymous (“Respondent A”)
11 March 2002	Hong Kong Stockbrokers Association Ltd (“HKSA”)
12 March 2002	An organization who wished to remain anonymous (“Respondent B”)
13 March 2002	A law firm who wished to remain anonymous (“Respondent C”)
19 March 2002	Hong Kong Securities Professionals Association Ltd (“HKSPA”)
20 March 2002	A financial institution who wished to remain anonymous (“Respondent D”)

Derivation table

Clause in the exposure draft of the PS Rules	Clause in the revised draft PS Rules
4	5
5(c)	3(c)
5(d)	3(d)
6(2)(a)&(b)	8(1)
6(2)(c)	10(1)(a) and (b)
9(1)(b)	7(1)(b)
10(2)	11(2)
11(4)	12(4)
11(5)	12(5)
Paragraph (e)(iii) of Schedule 1	Paragraph (f)(iii) of Schedule 1