

**For discussion  
on 15 July 2002**

**Paper No. 21/02**

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

**Securities and Futures (Disclosure of Interests – Securities  
Borrowing and Lending) Rules**

This paper sets out the proposals of the Securities and Futures Commission (SFC) to exempt certain stock borrowing and lending (SBL) transactions from disclosure requirements under Part XV of the Securities and Futures Ordinance (SFO) (5 of 2002) so as to establish a simplified disclosure regime for SBL.

**Proposal**

2. The SFC proposes to make the Securities and Futures (Disclosure of Interests – Securities Borrowing and Lending) Rules, now in draft at **Annex 1**, under section 377 of the SFO.

**Power to make the Rules**

3. Part XV of the SFO deals with the regulatory framework for the disclosure of interest. It imposes a disclosure obligation on the change in nature of interest, including changes in nature of interest that occur in SBL transactions.

4. The objectives of the new disclosure regime are two-fold: to give investors more complete, better and more timely information which is price sensitive so that they can make better informed investment decisions; and to minimise compliance burden. As explained at the meetings of the Legislative Council Bills Committee on the Securities and Futures Bill and Banking (Amendment) Bill 2000 on 12 October 2001 and 11 December 2001 [Paper no. CE13/01 and CSA13/01], we believe that it is appropriate to establish a simplified disclosure regime that will limit the disclosure obligations of certain classes of participants in the SBL market without undermining the integrity of the disclosure regime. In SBL business, a large number of loans and returns of shares can be transacted from the same lending pool. This would give rise to a large number of disclosures for movements in the same lending pool, which may be of limited value to investors.

5. The SFC established a Working Group involving market participants in April 2001 to consider the details of the simplified disclosure regime for SBL activities. The Working Group came to the consensus that the SFC should be given limited power to make rules to provide certain exemptions relating to SBL – rather than incorporating these provisions in the primary legislation. The enabling provision for these rules is included in section 377 of the SFO.

6. Section 377 of the SFO states expressly that the SFC may make rules to prescribe interests and short positions in shares that are dealt with pursuant to the provisions of a SBL agreement, to be disregarded for the purposes of disclosure of interest. The SFC may also provide for exclusions from the requirement to give notification under any provision of Part XV of the SFO in respect of interests, or short positions, in shares that are dealt with pursuant to the provisions of a SBL agreement.

7. The SFC is of the view that the draft Rules would be intra vires if made as drafted.

### **Major features of the draft Rules**

8. The draft Rules at Annex 1 is to be made by the SFC under section 377 of the SFO. It will establish a simplified disclosure regime for approved lending agents (ALAs), substantial shareholders and regulated persons with respect to their SBL transactions–

- (a) substantial shareholders, who lend through an ALA that uses a specified form of agreement (i.e. a relevant agreement<sup>1</sup> as defined) when lending the shares, will be exempt from making disclosures of changes in the nature of their interests that result from the lending and return of shares (clause 3 of the draft Rules);
- (b) ALAs – persons approved by the SFC as ALAs (generally custodians) will be exempted from disclosure requirements when they lend shares from their lending pool or when shares are returned to their lending pool. ALAs will have to disclose changes in the percentage level of their lending

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<sup>1</sup> Briefly, a relevant agreement refers to a SBL agreement providing that the borrowers of shares is required to provide collateral of a value exceeding the value of shares lent, the value of collateral is marked to market to avoid any shortfall and the lender of shares can require the return of shares at any time.

pool but the amount of information required to be included in their notification has been simplified (combined effect of clauses 4, 5, and 6 of the draft Rules); and

- (c) “regulated persons” – interests in shares borrowed by local brokers and overseas brokers in approved jurisdictions that merely act as a conduit (i.e. regulated persons who borrow and on-lend the shares within 5 business days) are to be disregarded (clause 7 of the draft Rules).

9. The simplified disclosure regime for ALAs will also be extended to cover holding companies of ALAs that are taken to be interested in shares in which an ALA is interested under section 316(2) of the SFO. ALAs and regulated persons taking advantage of the simplified disclosure regime will have to keep records of the transactions in accordance to the requirements set out in sections 9 and 10 of the draft Rules.

## **Public consultation**

10. The SFC released a consultation document and an exposure draft of the Rules on 19<sup>th</sup> December 2001 for comment by the public. A total of five submissions were received. In the light of the comments received, the SFC has subsequently met with those who submitted comments, to discuss the proposals with them in more detail. The proposed draft Rules at Annex 1 have taken into account comments from the consultation and the results of further discussions with the industry. They aim to facilitate compliance by simplifying disclosure procedures and requirements without undermining the overall integrity of the regime.

11. 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. Members would appreciate that certain proposals in the exposure draft of the Rules may have become outdated as the proposals and draft Rules were refined in the light of the comments received during the consultation and further discussion with the industry. The draft Rules as revised are at Annex 1 for Members' consideration; and
- (b) Consultation Conclusions and Summary of Comments and the SFC's Responses, at **Annex 3**, which set out the

conclusions from the consultation and further discussions with the industry as well as the SFC's responses in the form of a table. A list of respondents is attached to the Consultation Conclusions.

## **Way forward**

12. Subject to Members' views, the SFC will proceed to make the Rules under the authority vested with it and publish the Rules so made 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.

Securities and Futures Commission  
Financial Services and the Treasury Bureau  
8 July 2002

**SECURITIES AND FUTURES (DISCLOSURE OF INTERESTS –  
SECURITIES BORROWING AND LENDING) RULES**

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## **DRAFT**

[Cf: Sections 310, 313, 316, 321, 323, 377 and 395 of the Securities and Futures Ordinance]

### **SECURITIES AND FUTURES (DISCLOSURE OF INTERESTS – SECURITIES BORROWING AND LENDING) RULES**

(Made by the Securities and Futures Commission under section 377 of the Securities and Futures Ordinance (5 of 2002) after consultation with the Financial Secretary)

#### **1. Commencement**

These Rules shall come into operation on the day on which Part XV of the Securities and Futures Ordinance (5 of 2002) comes into operation.

#### **2. Interpretation**

- (1) In these Rules, unless the context otherwise requires – "approved lending agent" ( ) means a corporation approved by the Commission in accordance with section 8 and the approval has not been withdrawn under that section;
- "collateral" ( ) means any money, securities, letter of credit or guarantee deposited with, or otherwise provided by or on behalf of a borrower to, a lender, of shares (or deposited or provided in accordance with the lender's instructions) under a relevant agreement, which are so deposited or provided as security for the return of shares lent;

"duty of disclosure" ( ) has the meaning assigned to

it by section 308 of the Ordinance;

"equivalent shares" ( ) means shares of an identical description, nominal value and amount to the particular shares lent by, or transferred or delivered to, an approved lending agent or a regulated person (as the case may be);

"listed corporation" ( ) has the meaning assigned to it by section 308 of the Ordinance;

"marked to market" ( ) means adjusting the valuation of shares or collateral the subject of a relevant agreement to reflect their current market value;

"prescribed purpose" ( ), in relation to shares lent or borrowed under a relevant agreement, means -

- (a) on-lending the shares, under the terms of a relevant agreement, to a third party; or
- (b) returning the shares, under the terms of a relevant agreement, to the same person from whom the shares were borrowed;

"qualified shares" ( ) means shares -

- (a) in which a person is interested; and
- (b) for which the person has authorized an approved lending agent to lend as agent only if the lending is made under a relevant agreement,

and shall include shares that have been lent by an approved lending agent under a relevant agreement only if under the relevant agreement the right of the approved lending agent to require the return of the shares has not been extinguished;

"regulated person" ( ) means -

- (a) an intermediary licensed or registered under Part V of the Ordinance for Type 1 regulated activity;  
or
- (b) a corporation which is licensed, registered or exempt in a place outside Hong Kong recognized for the purposes of these Rules by the Commission for an activity which in the opinion of the Commission is equivalent to Type 1 regulated activity;

"relevant agreement" ( ) means a securities borrowing and lending agreement containing provisions under which -

- (a) the borrower of shares is required to deliver to the lender of the shares (or in accordance with the lender's instructions), on delivery of the shares, collateral of a value exceeding the market value of the shares lent, as a security for the return of the shares lent;
- (b) the value of the collateral delivered to the lender (or in accordance with the lender's instructions), and the value of the shares lent, are marked to

market on a daily basis and the borrower of the shares is required to provide additional collateral if the value of the collateral is less than the market value of the shares lent; and

- (c) the lender of the shares can require the return of the shares , and the borrower is obliged to return the shares, at any time on giving notice to the borrower,

and such provisions are of the essence of the agreement;

"relevant event" ( ) for the purposes of these Rules, and for determining a duty of disclosure and a duty to give a notification under Part XV of the Ordinance pursuant to these Rules, means in a case under section 3(3), 5(4) or (5) or 7(2), (3) or (4), the event or change referred to in such section;

"relevant share capital" ( ) has the meaning assigned to it by section 308 of the Ordinance;

"relevant time" ( ) means the time of the occurrence of the relevant event;

"shares" ( ) means shares comprised in the relevant share capital of a listed corporation and include -

- (a) an interest in the shares so comprised; and
- (b) equivalent shares;

"short position" ( ) has the meaning assigned to it by section 308 of the Ordinance.

(2) For the purposes of these Rules, a reference to shares lent shall be construed as a reference to shares transferred or delivered by a person, under a relevant agreement, to another person who is required to return the shares to the first-mentioned person, if requested to do so, and a reference to shares borrowed shall be construed accordingly.

**3. Exclusion for a person lending through an approved lending agent**

(1) Subject to subsection (3), a person who would otherwise come under a duty of disclosure under section 310 of the Ordinance in the circumstances specified in section 313(1)(d) of the Ordinance is not under such a duty if the change in the nature of his interest in shares occurs in the circumstances specified in subsection (2).

(2) Subsection (1) applies where -

(a) the shares are transferred or delivered by the person to an approved lending agent on condition

that the shares -

(i) are held by the approved lending agent,

as agent for the person, for lending only

and for no other purpose; and

(ii) may only be lent under a relevant

agreement;

- (b) qualified shares are lent by an approved lending agent to a third party under the terms of a relevant agreement;
  - (c) qualified shares lent by an approved lending agent are returned to the person by the approved lending agent; or
  - (d) qualified shares lent by an approved lending agent are returned to the approved lending agent by a third party under the terms of a relevant agreement.
- (3) If the shares referred to in subsection (1) are used by the approved lending agent for any purpose other than a purpose referred to in subsection (2), there shall be taken, for the purposes of Divisions 2 to 5 of Part XV of the Ordinance, to have been a change in the nature of the person's interest in the shares that were so used.

**4. Notification by an approved lending agent**

Where a person transfers or delivers qualified shares to an approved lending agent and -

- (a) the approved lending agent lends qualified shares to a third party under the terms of a relevant agreement; or

(b) qualified shares are returned to the approved lending agent by the third party, the person shall not be required, under section 321 of the Ordinance, to secure that the relevant approved lending agent notifies it of the lending or return of the qualified shares.

**5. Exclusion for an approved lending agent and a person controlling an approved lending agent**

(1) Subject to subsections (4) and (5), an approved lending agent who would otherwise come under a duty of disclosure under section 310 of the Ordinance in the circumstances specified in section 313(1) of the Ordinance is not under such a duty in the circumstances specified in subsection (3) if the approved lending agent complies with the conditions in subsection (4).

(2) Subject to subsections (4) and (5), a person that is taken under section 316(2) of the Ordinance to be interested in shares in which an approved lending agent is interested who would otherwise come under a duty of disclosure under section 310 of the Ordinance in the circumstances specified in section 313(1) of the Ordinance, is not under such a duty in the circumstances specified in subsection (3).

(3) Subsections (1) and (2) apply where -

(a) qualified shares are transferred by a person to an approved lending agent;

- (b) shares held by, or on behalf of, an approved lending agent become qualified shares when the person authorizes the approved lending agent to lend the shares;
  - (c) qualified shares are lent by the approved lending agent to a third party under the terms of a relevant agreement;
  - (d) qualified shares are returned to the person by the approved lending agent;
  - (e) qualified shares held by, or on behalf of, the approved lending agent cease to be qualified shares;  
or
  - (f) qualified shares lent by the approved lending agent are returned to the approved lending agent by a third party under the terms of a relevant agreement.
- (4) In the circumstances specified in -
- (a) subsection (3)(a) or (b), the approved lending agent and the person referred to in subsection (2) (if any) shall be taken, for the purposes of Divisions 2 to 5 of Part XV of the Ordinance, to have acquired an interest in the shares at the relevant time;
  - (b) subsection (3)(d) or (e), the approved lending agent and the person referred to in subsection (2)

(if any) shall be taken, for the purposes of Divisions 2 to 5 of Part XV of the Ordinance, to have ceased to have an interest in the shares at the relevant time; and

- (c) in the event an approved lending agent ceases to have a subsisting right, under the relevant agreement under which qualified shares were lent, to require the return of the shares, the approved lending agent and the person referred to in subsection (2)(if any) shall be taken, for the purposes of Divisions 2 to 5 of Part XV of the Ordinance, to have ceased to have an interest in such shares at the relevant time,

and the approved lending agent and the person referred to in subsection (2)(if any) shall, where a duty of disclosure arises under section 310 of the Ordinance on the occurrence of such an event, come under a duty of disclosure.

(5) Where -

- (a) an approved lending agent or the person referred to in subsection (2)(if any) fail to comply with a duty of disclosure on the occurrence of an event set out in subsection (4); or
- (b) an approved lending agent fails to comply with a duty of disclosure on the occurrence of an event

set out in subsection (4), or the requirements of section 9,

the approved lending agent, and the person referred to in subsection (2) (if any) shall be taken, for the purposes of Divisions 2 to 5 of Part XV of the Ordinance, to have acquired all qualified shares in which the approved lending agent was interested under the terms of a relevant agreement at the time when it failed to comply with a duty of disclosure on the occurrence of an event set out in, or the requirements of section 9, whichever is the earlier.

**6. Exclusion of certain particulars  
to be specified in notifications**

Where a duty of disclosure arises under section 310 of the Ordinance on the occurrence of an event set out in section 5(4), an approved lending agent, and a person referred to in section 5(2) (if any) shall, in performing the duty of disclosure, only specify in the notification given pursuant to section 324 of the Ordinance its name and address, and (so far as it is aware) the particulars specified -

- (a) (in the case of an approved lending agent) in section 326(1)(a), (b), (d), (e) and (k) of the Ordinance; and

(b) (in the case of a person referred to in section 5(2))  
in section 326(1)(a), (b), (d), (e), (g), (i) and  
(k) of the Ordinance.

**7. Prescribed interests and short positions to be disregarded for the purpose of notification**

(1) Subject to subsections (2), (3) and (4), the following interests and classes of interests, and short positions and classes of short positions, are prescribed for the purposes of section 323 of the Ordinance -

- (a) an interest, or short position, in the shares of a regulated person where -
- (i) the shares have been borrowed by the regulated person under the terms of a relevant agreement; and
- (ii) the shares are used, or intended to be used, by the regulated person or by a related corporation of the regulated person, within 5 business days after the day on which the shares were acquired by the regulated person for a prescribed purpose; and

(b) an interest, or short position, in the shares of a regulated person where -

- (i) the shares lent by the regulated person are returned to the regulated person in accordance with the terms of the relevant agreement under which the shares were lent, by the third party; and
- (ii) the shares are used, or intended to be used, by the regulated person or by a related corporation of the regulated person, within 5 business days after the day on which the shares were returned to the regulated person for a prescribed purpose.

(2) Where the shares are not used for a prescribed purpose by the regulated person, or by a related corporation of the regulated person, within the period of 5 business days as specified in subsection (1) (a) (ii) or (b) (ii), the regulated person shall be taken to have acquired an interest, and come to have a short position, in the shares for the purposes of Divisions 2 to 5 of Part XV of the Ordinance on the last day of that period.

(3) Where the shares are used for a purpose, other than a prescribed purpose, by the regulated person, or by a related corporation of the regulated person, within the period of 5 business

days specified in subsection (1) (a) (ii) or (b) (ii), the regulated person shall be taken to have acquired an interest, and come to have a short position, in the shares for the purposes of Divisions 2 to 5 of Part XV of the Ordinance on the day that the shares are used for that purpose.

(4) If a regulated person fails to comply with any requirement imposed under section 10, all shares, and short positions in the shares, of the regulated person that are prescribed interests and short positions under subsection (1) shall cease to be prescribed interests and short positions and the regulated person shall be taken to have acquired an interest and come to have a short position in the shares for the purposes of Divisions 2 to 5 of Part XV of the Ordinance on the following days -

- (a) in the case of a failure to comply with section 10(1), on the last day of the period within which the regulated person is required to make the record;
- (b) in the case of a failure to comply with section 10(3)(a), on the first day that the regulated person failed to retain the record; or
- (c) in the case of a failure to comply with section 10(3)(b), on the last day of the period within which the regulated person is required to produce the record,

and subsection (1) shall not apply to any interest, or short position, in shares acquired after that date.

**8. Approved lending agents**

(1) The Commission may, upon application by a corporation and on payment of the prescribed fee, approve in writing, the corporation as an approved lending agent for the purposes of these Rules.

(2) An application under subsection (1) shall be made in a specified form and the form shall be accompanied by -

- (a) such information and particulars as the Commission may reasonably require; and
- (b) an application fee prescribed by rules made under section 395 of the Ordinance for the purposes of this section.

(3) The Commission may approve or refuse the application.

(4) An approval under subsection (1) shall be subject to compliance with section 9 and such reasonable conditions as the Commission may impose on the corporation from time to time.

(5) Where the Commission refuses an application, the Commission shall notify the applicant in writing of the decision and the reasons for refusal.

(6) Where the Commission is satisfied that it is appropriate to do so the Commission may, by notice in writing serve on the

corporation approved under subsection (1), withdraw its approval with effect from the date specified in the notice.

**9. Records to be kept by an approved lending agent**

(1) Where -

- (a) qualified shares to which section 5(3)(a) applies are transferred by a person to the approved lending agent;
- (b) shares become qualified shares to which section 5(3)(b) applies;
- (c) an approved lending agent lends qualified shares to which section 5(3)(c) applies;
- (d) qualified shares to which section 5(3)(d) applies are returned to the person;
- (e) qualified shares to which section 5(3)(e) applies held by, or on behalf of, the approved lending agent cease to be qualified shares; or
- (f) qualified shares to which section 5(3)(f) applies are returned to the approved lending agent,

the approved lending agent shall within 3 business days of the event make a record of the event.

(2) A record made under subsection (1) shall contain the following particulars -

- (a) the date of the event;
  - (b) the description and quantity of the shares or qualified shares the subject of the event; and
  - (c) (in the case of the events referred to in subsection (1) (b) and (d)) the value of any collateral given, taken, returned or given up (as the case may be) in the event.
- (3) An approved lending agent shall -
- (a) retain the record made under subsection (1) for not less than 3 years after the last day of the period within which the record is required to be made; and
  - (b) if requested by the Commission, within the period of 3 years after the last day of the period within which the relevant record is required to be made, provide any such record to the Commission within 5 business days after the date of the request.

**10. Records to be kept by a regulated person**

- (1) Where -
- (a) shares to which section 7(1) (a) (i) applies are borrowed by a regulated person;
  - (b) shares to which section 7(1) (b) (i) applies are returned to the regulated person;

- (c) shares to which section 7(1)(a)(ii) or (b)(ii) applies are used for a prescribed purpose by the regulated person, or by a related corporation of the regulated person, within 5 business days after the date of the borrowing or return (as the case may be);
- (d) the regulated person borrows shares to which section 7(1)(a) applies, or shares to which section 7(1)(b) applies are returned to the regulated person, and the shares are not used for a prescribed purpose by the regulated person, or by a related corporation of the regulated person, within the period of 5 business days from the date of the borrowing or return (as the case may be),

the regulated person shall within 3 business days of the event make a record of the event.

- (2) A record made under subsection (1) shall contain the following particulars -
  - (a) the date of the event;
  - (b) the description and quantity of the shares the subject of the event; and
  - (c) the value of any collateral given, taken, returned or given up (as the case may be) in the event.
- (3) A regulated person shall -

- (a) retain the record made under subsection (1) for not less than 3 years after the last day of the period within which the record is required to be made; and
- (b) if requested by the Commission, within a period of 3 years after the last day of the period within which the relevant record is required to be made, provide any such record to the Commission within 5 business days after the date of the request.

Chairman,  
Securities and Futures Commission

2002

**Explanatory Note**

These Rules are made by the Securities and Futures Commission under section 377 of the Securities and Futures Ordinance (5 of 2002) ("the Ordinance"). They prescribe the circumstances in which persons lending shares are exempt from the duty of disclosure under Divisions 2 to 5 of Part XV of the Ordinance and prescribe shares, and short positions in shares, held by regulated persons that are to be disregarded under section 326 of the Ordinance. These Rules

also provide for approval of corporations (including custodians) as approved lending agents, and the keeping of records, by approved lending agents and regulated persons, of dealings in shares that are exempt from the duty of disclosure or disregarded for the purposes of Part XV of the Ordinance.



**SFC**  
證監會

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

## **A Consultation Paper on the Securities and Futures (Disclosure of Interests – Securities Borrowing and Lending) Rules**

《證券及期貨(披露權益 – 證券借貸)規則》諮詢文件

Hong Kong  
December 2001

香港  
2001年12月

## **Introduction**

This consultation document invites public comments on the draft **Securities and Futures (Disclosure of Interests – Securities Borrowing and Lending) Rules** (“the SBL Rules”) which the Securities and Futures Commission proposes to make under Part XV of the Securities and Futures Bill (disclosure of interests in listed companies) when it becomes law.

Part XV of the Bill seeks to modernize the disclosure of interests in securities. The objective of the Bill is to provide investors with more complete information, of better quality, on a timely basis to enable them to make informed investment decisions.

Part XV requires shareholders who have an interest in **5% or more** of the shares of a listed corporation to give notice of interests in voting shares of listed corporations in certain specified circumstances. It also requires a director or a chief executive, who is interested in the shares or debentures of a listed corporation (of which he is a director or chief executive) or any of its associated corporations, to give notice in certain specified circumstances.

This paper is concerned with the disclosure obligations that may arise when a person lends or borrows shares in a listed corporation. We will first give a brief summary of the disclosure obligations under Part XV for 5% shareholders (and directors) and then we will explain the simplified disclosure regime that will be available under the SBL Rules for the persons who are most active in lending and borrowing shares.

In reading this summary it is important to remember that persons who are interested in less than 5% of the shares of a listed corporation, and who are not a director or chief executive of the listed corporation, will have no disclosure obligations.

### **Disclosure of stock borrowing and lending (“SBL”) under Part XV of the Bill**

The position of the borrower and the lender under Part XV are slightly different.

#### *The borrower*

The borrower of stock acquires an interest in the shares of a listed company when he borrows them. The borrowing of shares also creates a “short position” for the stock borrower (because he has an obligation to return the shares). A person’s long and short position cannot be netted off when calculating the percentage level of a person’s interest. However, the borrower will **only** have to give a notice if, as a result of the borrowing or the return, the shares in which he has an interest, expressed as a percentage of the shares in issue -

- (1) rises above 5%;
- (2) drops below 5%;
- (3) passes through a whole percentage level above 5% e.g. passes through 6% or 7%; or

- (4) exceeds 5% and the short position created by borrowing shares passes through a whole percentage level e.g. 1% or 2% of the shares in issue.

In addition, an exemption (the *de minimis* exemption) will usually exempt small fluctuations in the percentage figure of a person's shareholding, that take a person's interest through a whole percentage level above 5% (e.g. the 6% percentage level), if the amount of shares borrowed or returned is less than 0.5%. The 0.5% fluctuation is calculated by comparing the percentage figure of his interest after borrowing the shares with the percentage figure of his interest in the last notification filed by him.

#### *The lender*

When a person lends shares he does not acquire an interest in shares or cease to have an interest in shares. Instead there is a change in the nature of his interest in the shares when they are lent and returned. However, the lender will only have to give a notice if -

- (1) the total shares in which he is interested exceed 5% of the shares in issue; and
- (2) after he lends shares, or shares are returned to him, the percentage level of his interest (not counting the shares that have been lent or returned) is different to the percentage level of his interest in the last notification filed by him.

The *de minimis* exemption will also usually exempt loans, and returns, of shares if the percentage figure of a person's interest in the shares that are not lent or returned fluctuates by less than 0.5%. The 0.5% fluctuation is calculated by comparing the percentage figure of his interest after lending the shares (not counting the shares that have been lent) with the percentage figure of his interest in the last notification filed by him.

#### **Simplified disclosure regime under the SBL Rules**

The SBL Rules will establish a simplified disclosure regime for disclosure of securities borrowing and lending by persons who are most active in the SBL industry :

- (1) “institutional investors” - the managers of local or overseas collective investment schemes or pension funds and local or overseas banks and insurance companies;
- (2) “approved lending agents” - custodians or lending agents that are approved by the SFC; and
- (3) “regulated persons” - local brokers and dealers and overseas brokers and dealers in approved jurisdictions.

Under the SBL Rules :

- (1) Institutional investors and their approved lending agents, who make a disclosure when shares are authorised to be lent, and cease to be authorised to be lent are relieved of the duty of disclosing any subsequent lending and return of those shares.

- (2) Interests and short positions in shares resulting from borrowing and lending by regulated persons that merely act as a conduit (i.e. regulated persons who borrow and on-lend the shares within 5 business days) are to be disregarded.
- (3) Persons taking advantage of the simplified disclosure regime must keep records of the shares borrowed/lent and returned as prescribed in the SBL Rules.

*Records*

Institutional investors who lend directly to borrowers, lending agents and regulated persons who use the simplified disclosure regime under the SBL Rules are required to keep certain records. These records need not be maintained in a special ledger or form and there should be no duplication with records kept for other purposes such as the ledgers maintained for the purposes of the Stamp Duty relief for stock borrowing and lending.

**Examples of how the SBL Rules will operate**

**Example 1 – Lending by an institutional investor using a lending agent**

*Assume :*

HK Equity Fund (“Fund”) owns 6% of the shares of XYL Ltd., a company listed on the Stock Exchange of Hong Kong. All of Fund’s shares are held by Secure Custodian Bank (“Custodian”) which has no authority to exercise discretion in dealing with shares that it holds in custody for its customers. Custodian is a corporation incorporated in Delaware with an office in Hong Kong. It has been approved by the SFC as an approved lending agent under section 6 of the SBL Rules. On 1-3-2002 Fund authorises Custodian to lend 50% of its shares in accordance with Custodian’s lending program. At that date Custodian had authority to lend 1% of the shares of XYZ Ltd. from other customers.

*Simplified disclosure regime*

If Fund makes a disclosure of the lending authorisation it will not be required to make further disclosures when the shares are subsequently lent and returned. Custodian will not be under a duty to disclose the lending authorisation, or the subsequent lending and return of the shares, as the shares that it was authorised to lend by all of its customers represented only 4% of the shares in XYZ Ltd. - less than the 5% disclosure threshold.

If Fund subsequently purchases 2% more shares in XYZ Ltd. then it must give notification of the purchase in the usual way as the percentage level of its interest increased to 8%. If the new shares are delivered to Custodian for safe custody, and 50% are covered by the lending authorisation then, if Fund makes a disclosure of the lending authorisation, it will not be required to make further disclosures when the shares are subsequently lent and returned.

Custodian is now authorised to lend a total of 5% of the shares of XYZ Ltd (4% for Fund and 1% for other customers). If Custodian makes a disclosure of the lending authorisation then it will not be required to make further disclosures when the shares are subsequently

lent and returned. The disclosure of the lending authorisation would be a disclosure due to a change in the nature of its interest in the shares, not an increase or a reduction in the size of a custodian's interest. An initial disclosure under the SBL Rules will therefore save Custodian from having to make multiple disclosures.

If Fund subsequently purchases 0.5% more shares in XYZ Ltd. then it does not need to give notification of the purchase as the percentage level of its interest has not changed. If the new shares are delivered to Custodian for safe custody, and 50% are covered by the lending authorisation then, Fund does not need to make a disclosure of the lending authorisation, and it will not be required to make further disclosures when the shares are subsequently lent and returned. Similarly, Custodian will also not need to disclose the lending authorisation as the percentage level of the shares which it is authorised to lend has not changed. Custodian will not be required to make further disclosures when the extra 0.25% of shares are subsequently lent and returned.

### **Example 2 – Borrowing and lending by a broker acting as a conduit**

*Assume :*

NB Securities Ltd. (“NBS”) is an exchange participant and is registered for dealing in securities in Hong Kong. NBS owns 4.5% of the shares of XYZ Ltd. that it holds as a proprietary trading position. These shares are presently charged to a bank and are not available for lending. NBS has entered into a stock borrowing and lending agreement with Custodian some months previously.

A client of NBS (“Client”) tells NBS that he wishes to sell XYZ Ltd. short. He says that he may need to borrow up to 2% of the shares of XYZ Ltd. and has previously signed a stock borrowing and lending agreement with NBS.

Monday 1-4-2002	NBS asks Custodian to place a “hold” on 2% of the shares of XYL Ltd for it.
Tuesday 2-4-2002	Client instructs NBS to sell 1.5% short. NBS gives Custodian confirmation of the loan and provides collateral of 105% of the value of the shares to be borrowed. NBS then sells 1.5% of XYZ Ltd. for Client.
Wednesday 3-4-2002	Custodian delivers the shares to NBS (strictly, it issues a Settlement Instruction to CCASS to transfer the shares to the account of NBS).
Thursday 4-4-2002	NBS uses 1.5% of the shares borrowed to settle the short sale. Strictly, this is a loan of the shares to Client. NBS retains the proceeds of sale (and a further 5% deposited by Client) as collateral.
Tuesday 9-4-2002	Client informs NBS that he will not in fact be making any further short sales and would like to close his position. NBS returns the 0.5% of the shares borrowed to Custodian and buys 1.5% of XYZ Ltd. in the market.

Thursday 11-4-2002	The buy back is settled and NBS returns the 1.5% of XYZ Ltd. to Custodian.
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In this example the “hold”, “confirmation” and delivery are spread over 3 days to show more clearly the point from which time begins to run under the SBL Rules. In practice they could all take place on one day.

*Simplified disclosure regime*

NBS does not have to make any disclosures under Part XV. The shares borrowed were all used for a “prescribed purpose” within 5 business days i.e. they were :

- (1) on-lent under the terms of a stock borrowing and lending agreement with collateral, determined by reference to the market value of the shares lent, being provided; or
- (2) returned to a person from whom the shares were borrowed,

all within 5 business days of Tuesday 2-4-2002 (counting from the day after the day that NBS first acquired an interest in the shares).

Since the shares were used for a prescribed purpose NBS’s interest in the 2% of shares borrowed is disregarded and need not be aggregated with its 4.5% proprietary position.

If, however, NBS had retained the 0.5% of shares borrowed for a further day and had returned them to Custodian on Wednesday 10-4-2002 NBS would have had a disclosure obligation. This is because it would have acquired an interest in 0.5% of the shares of XYZ Ltd. on Tuesday 9-4-2002 ( i.e. on the last day of the 5 business days for using the shares) and these shares would have raised its total interest to 5%. The notification would have to be filed within 3 business days thereafter i.e. on or before Friday 12-4-2002.

The SFC welcomes comments from industry practitioners and members of the investing public on the Draft Rules.

Comments should be submitted by 26th January 2002, by way of e-mail to [SBLRulesconsult@hksfc.org.hk](mailto:SBLRulesconsult@hksfc.org.hk) or faxed to (852) 2521-7917. Written comments are welcome and should be addressed to:

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

Attn: Supervision of Markets Division

Hard copies, in Chinese and English, of the Draft Rules are available at the offices of the SFC. Copies may also be downloaded from the SFC website: <http://www.hksfc.org.hk>.

**Please note that the names of the commentators and the contents of their submissions may be published on the SFC web site 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.**

## **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 Data<sup>1</sup> 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 Securities and Futures (Disclosure of Interests – Securities Borrowing and Lending) 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 purposes 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 web site 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:

The Data Privacy Officer  
The 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.

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

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**SECURITIES AND FUTURES (DISCLOSURE OF INTERESTS – SECURITIES  
BORROWING AND LENDING) RULES**

( Cap. XXX, section [ ] )

**ARRANGEMENT OF SECTIONS**

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PRELIMINARY**

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## **DRAFT**

# **SECURITIES AND FUTURES (DISCLOSURE OF INTERESTS – SECURITIES BORROWING AND LENDING) RULES**

( Made by the Commission under section [] of the Securities and Futures Ordinance  
([ ] of 2001)

## **PART I PRELIMINARY**

### **1. Commencement**

These rules shall come into operation on the day appointed for the commencement of Part XV of the Ordinance.

### **2. Interpretation**

- (1) In these rules, unless the context otherwise requires –
- “approved lending agent” ( ) means a corporation that is approved by the Commission in accordance with section 7;
- “equivalent shares” ( ) means shares of an identical description, nominal value and amount to the particular shares lent;
- “collateral” ( ) means money or securities provided to secure the return of shares lent and includes a letter of credit and a guarantee;
- “designated shares” ( ) means shares in which an institutional investor is interested which –
- (a) have been set apart as being available for lending; or
  - (b) have been identified by a record as being available for lending;
- “duty of disclosure” ( ) has the same meaning as in section [ ] of the Ordinance;
- “institutional investor” ( ) means –
- (a) a collective investment scheme authorized under section 103 of the Ordinance;
  - (b) an approved pension scheme that is approved by the Commission under section [ ] of the Ordinance;
  - (c) an authorized financial institution;
  - (d) an insurer authorized under the Insurance Companies Ordinance (Cap. 41);
  - (e) a qualified overseas scheme;

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- (f) a corporation authorized under the law of any place outside Hong Kong, recognized for the purposes of these rules by the Commission by notice in the Gazette, to carry on business as –
  - (i) a bank;
  - (ii) an insurance company;
- (g) a manager of a person referred to in paragraphs (a) to (f) in relation to the interest in shares of the person referred to in paragraphs (a) to (f); and
- (h) any person of a class prescribed by the Commission for the purposes of these rules by notice in the Gazette;

“lend” ( ) means to transfer shares to a person who is required to return those shares, or equivalent shares, if requested to do so, and “borrow” shall be construed accordingly;

“listed corporation” ( ) has the same meaning as in section [ ] of the Ordinance;

“prescribed particulars” ( ) in relation to an event mentioned in sections 7 to 9 means –

- (a) the date of the event;
- (b) the description and quantity of the shares the subject of the event; and
- (c) the value of any collateral given, taken, returned or given up (as the case may be);

“prescribed purpose” ( ) means-

- (a) on-lending the interest in shares, under the terms of a relevant agreement, to another person;
- (b) returning the interest in shares in accordance with the terms of a relevant agreement, to a person from whom such an interest in shares was borrowed;

“qualified overseas scheme” ( ) has the same meaning as in section [ 314(4)] of the Ordinance;

“qualifying shares” ( ) means shares in which an institutional investor is interested and which an approved lending agent has authority to lend as agent for an institutional investor;

“regulated person”( ) means –

- (a) an intermediary licensed or registered for Type 1 regulated activity; or

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- (b) a corporation which is licensed or registered in a place outside Hong Kong, recognized for the purposes of these rules by the Commission, for an activity which in the opinion of the Commission is equivalent to Type 1 regulated activity;

“relevant agreement” ( ) means a securities borrowing and lending agreement under which –

- (a) the borrower of shares is required to provide collateral, determined by reference to the market value of the shares lent, to secure the return of the shares; and
- (b) the lender of the shares can require the return of the shares at any time on giving notice to the borrower;

“relevant share capital” ( ) has the same meaning as in section [ ] of the Ordinance;

“shares” ( ) means shares comprised in the relevant share capital of a listed corporation and -

- (a) includes an interest in shares so comprised; and
- (b) where shares so comprised are returned under the terms of a relevant agreement, includes equivalent shares.

“short position” ( ) has the same meaning as in section [ ] of the Ordinance;

## **PART II** **EXEMPTIONS AND INTERESTS DISREGARDED**

### **3. Prescribed circumstances**

- (1) In the following circumstances an institutional investor who –
- (a) is interested in shares held by an approved lending agent; and
  - (b) complies with the conditions set out in subsection (4)

will not be under a duty of disclosure under section 304(1)(d) of the Ordinance -

- (i) where the approved lending agent lends qualifying shares under the terms of a relevant agreement; or
- (ii) where shares to which paragraph (i) applied are returned in accordance with the terms of the relevant agreement.

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- (2) In the following circumstances an approved lending agent who -
- (a) complies with the conditions set out in subsection (4); and
  - (b) complies with the requirements of section 7,

will not be under a duty of disclosure under section 304(1)(d) of the Ordinance -

- (i) where the approved lending agent lends qualifying shares under the terms of a relevant agreement; or
- (ii) where shares to which paragraph (i) applied are returned in accordance with the terms of the relevant agreement.

- (3) In the following circumstances an institutional investor who –

- (a) complies with the conditions set out in subsection (5); and
- (b) complies with the requirements of section 8; and

will not be under a duty of disclosure under section 304(1)(d) of the Ordinance -

- (i) where the institutional investor lends shares under the terms of a relevant agreement; or
- (ii) where shares to which paragraph (ii) applied are returned in accordance with the terms of the relevant agreement.

(4) The conditions referred to in subsections (1) and (2) are that when shares in which an institutional investor or approved lending agent (as the case may be) is interested –

- (a) become qualifying shares; or
- (b) cease to be qualifying shares;

he treats each of the events mentioned in paragraph (a) and (b), for the purposes of the Ordinance, as if it were a change in the nature of his interest in those shares.

(5) The conditions referred to in subsection (3) are that when shares in which an institutional investor is interested –

- (a) become designated shares; or
- (b) cease to be designated shares,

he treats each of the events mentioned in paragraph (a) and (b), for the purposes of the Ordinance, as if it were a change in the nature of his interest in those shares;

(6) If an approved lending agent fails to comply with the requirements of section 7 he shall be taken, for the purposes for the purposes of Divisions 2 to 5 of the Ordinance, to

## **DRAFT**

have lent all shares then lent by him under the terms of a relevant agreement, at the time that he failed to comply with the requirements of section 7.

(7) If an institutional investor fails to comply with the requirements of section 8 he shall be taken, for the purposes for the purposes of Divisions 2 to 5 of the Ordinance, to have lent all shares then lent by him under the terms of a relevant agreement, at the time that he failed to comply with the requirements of section 8.

### **4. Prescribed interests in shares**

(1) Subject to subsections (2) (3) and (4), the following interests are prescribed interests, and prescribed short positions, for the purposes of section 314(1)(j) of the Ordinance -

- (a) the interest, or short position, in shares of a regulated person where -
  - (i) the interest in shares has been borrowed under the terms of a relevant agreement; and
  - (ii) the interest in shares is used, or intended to be used, within 5 business days after the day on which the interest was borrowed by the regulated person for a prescribed purpose; and
- (b) the interest in shares, or short position, of a regulated person where -
  - (i) the interest in shares to which paragraph (a) applies is returned to the regulated person in accordance with the terms of the relevant agreement under which the interest was lent, by the person who borrowed that interest; and
  - (ii) the interest in shares is used, or intended to be used, within 5 business days after the day on which the interest was returned to the regulated person for a prescribed purpose.

(2) Subject to subsections (3) and (4), where an interest in shares is not used for a prescribed purpose by the regulated person, or by a related corporation of the regulated person, within the period of 5 business days specified in subsection (1) the regulated person shall be taken to have acquired that interest, or come to have that short position, (as the case may be) for the purposes of Divisions 2 to 5 of the Ordinance on the last day of that period.

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(3) Subject to subsection (4), where an interest in shares is used for a purpose, other than a prescribed purpose, by the regulated person, or by a related corporation of the regulated person, within the period of 5 business days specified in subsection (1) the regulated person shall be taken to have acquired that interest, or come to have that short position, (as the case may be) for the purposes of Divisions 2 to 5 of the Ordinance on the day that it is used for that purpose.

(4) If a regulated person fails to comply with the requirements of section 9 all interests, and short positions, in shares of a regulated person that are prescribed interests and short positions under subsection (1) shall cease to be prescribed interests or short positions (as the case may be) and the regulated person shall be taken to have acquired an interest, or come to have a short position (as the case may be) in such shares for the purposes of Divisions 2 to 5 of the Ordinance, on the day that -

- (a) he failed to comply with the requirements of section 9; or
- (b) he acquired that interest, or came to have that short position, in shares, which ever is the later.

### **5. Notification by agents**

Where -

- (a) an approved lending agent lends an interest in shares to which section 3(1)(i) or (2)(i) applies; or
- (b) an interest in shares to which paragraph (a) applies is returned in the circumstances set out in section 3(1)(ii) or (2)(ii),

an institutional investor shall not be required, under section 312 of the Ordinance, to secure that its agent notifies it of the lending or the return of the interest.

## **PART III** **APPROVALS AND RECORDS**

### **6. Approved Lending agents**

- (1) A corporation is an approved lending agent if it is approved by the Commission, in writing, as an approved lending agent for the purposes of these rules.
- (2) An application for approval under subsection (1) shall be accompanied

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by -

- (a) such information and particulars as the Commission may reasonably require; and
  - (b) an application fee prescribed by rules made under section 382 for the purposes of this section;
- (3) The Commission may, by notice in writing served on a person approved under subsection (1) withdraw its approval where the Commission is satisfied that it is appropriate to do so.

### **7. Records to be kept by approved lending agents**

- (1) On the occurrence of any of the following events an approved lending agent shall record prescribed particulars of the event -
  - (a) the approved lending agent lends shares to which section 3(2)(i) applies;
  - (b) shares to which section 3(2)(ii) applies are returned to the approved lending agent.
- (2) An approved lending agent shall -
  - (a) subject to paragraph (b), retain each record referred to in subsection (1) for not less than three years from the date the relevant record was made; and
  - (b) if requested by an employee of the Commission, within such period, provide any such record to the Commission within 5 business days.

### **8. Records to be kept by institutional investors**

- (1) On the occurrence of any of the following events a institutional investor shall record prescribed particulars of the event -
  - (a) the institutional investor lends shares to which section 3(3)(i) applies;
  - (b) shares to which section 3(3)(ii) applies are returned to the institutional investor.
- (2) A institutional investor shall -

## **DRAFT**

- (a) subject to paragraph (b), retain each record referred to in subsection (1) for not less than three years from the date the relevant record was made; and
- (b) if requested by an employee of the Commission, within such period, provide any such record to the Commission within 5 business days.

### **9. Records to be kept by regulated persons**

(1) On the occurrence of any the following events a regulated person shall record the prescribed particulars of that event –

- (a) the regulated person borrows or lends an interest in shares to which section 4(1)(a) applies;
- (b) an interest in shares to which section 4(1)(b) applies is returned to the regulated person;
- (c) the regulated person –
  - (i) borrows an interest in shares to which section 4(1)(a) applies; or
  - (ii) an interest in shares to which section 4(1)(b) applies, is returned to a regulated person,

and the interest in shares is not used for a prescribed purpose within the period of 5 business days specified in section 4(1);

(2) A regulated person shall-

- (a) subject to paragraph (b), retain each record referred to in subsection (1) for not less than three years from the date the relevant record was made; and
- (b) if requested by an employee of the Commission, within such period, provide any such record to the Commission within 5 business days of such request.

Chairman,  
Securities and Futures Commission

[ ] 2001

## **DRAFT**

### **EXPLANATORY NOTE**

These Rules are made by the Securities and Futures Commission under section [ ] of the Securities and Futures Ordinance ( [ ] of 2001). They prescribe the circumstances in which persons lending shares are exempt from the duty of disclosure under Divisions 2 to 4 of Part XV of the Ordinance and prescribe interests, and short positions, in shares held by regulated persons that are to be disregarded under section [314] of the Ordinance. The Rules provide for approval of custodians and others as approved lending agents and the keeping of records of dealings in interests in shares that are exempt from the duty of disclosure or disregarded under these Rules.



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

**Consultation Conclusions on the draft  
Securities and Futures (Disclosure of Interests –  
Securities Borrowing and Lending) Rules**

《證券及期貨(披露權益 - 證券借貸)規則》草擬本諮詢總結

Hong Kong  
June 2002

香港  
2002年6月

## **INTRODUCTION**

1. On 19<sup>th</sup> December 2001, the Securities and Futures Commission ("SFC") issued a consultation paper ("the Consultation Paper") to solicit comments on the draft Securities and Futures (Disclosure of Interests – Securities Borrowing and Lending) Rules (the "draft Rules").
2. The draft Rules are concerned with establishing a simplified disclosure regime for disclosure of securities borrowing and lending by persons who are most active in the SBL industry in place of the disclosure obligations that may arise when a person lends or borrows shares in a listed corporation under Part XV of the Securities and Futures Ordinance (5 of 2002) ("SFO").
3. The consultation exercise ended on 16 April 2002 but the SFC has subsequently conducted further consultation with the persons who submitted comments on the draft Rules and industry representative. SFC has made further changes to the draft Rules in the light of the comments received.
4. The purpose of this document is to provide interested persons with an analysis of the comments raised during the consultation exercise and the rationale for the SFC's conclusions. It is advisable to read this document in conjunction with the consultation paper itself.

## **PUBLIC CONSULTATION**

### **Consultation process**

5. In addition to the public announcement inviting comments, the Consultation Paper was distributed to various interested parties and professional bodies. The consultation paper and the draft Rules were posted on the website of the SFC and distributed to all registrants through FinNet.
6. A total of five submissions were received from -
  - (a) Linklaters & Alliance for a group of seven financial institutions
  - (b) The Northern Trust Company
  - (c) State Street Bank and Trust Company
  - (d) The Hong Kong Association of Banks
  - (e) HSBC
7. Most comments were supportive of the proposed subsidiary legislation but they called for a widening of the exemptions provided in the draft Rules in a number of respects. A summary of the comments received is set out in the Appendix.
8. In the light of the comments received the SFC has subsequently conducted extensive further consultation with the persons who submitted comments on the draft rules and also with The Pan Asian Securities Lending Association Limited ("PASLA").

## **Consultation Conclusions**

9. Having regard to these submissions the SFC proposes to enlarge further the simplified disclosure regime for approved lending agents, the exemption for substantial shareholders and the exclusion for regulated persons in certain circumstances –
  - “approved lending agents” – persons approved by the Commission (generally custodians) who will merely have to disclose changes in the percentage level of their “lending pool”. The revised proposals encompass all stages of the stock borrowing and lending process in which approved lending agents are involved. The simplified disclosure regime has also been extended to cover holding companies of approved lending agents that are taken to be interested in shares in which an approved lending agent is interested under section 316(2) of the SFO.
  - substantial shareholders, who lend through an approved lending agent that uses a specified form of agreement (i.e. a relevant agreement as defined) when lending the shares, will be exempt from making disclosures of changes in the nature of their interests that result from the lending and return of shares. This represents significant enlargement of the exemption set out in the draft rules exposed for consultation, which was confined to “institutional investors” who lent shares.
  - “regulated persons” – interests in shares borrowed by local brokers and overseas brokers in approved jurisdictions that merely act as a conduit (i.e. regulated persons who borrow and on-lend the shares within 5 business days) are to be disregarded. The draft Rules have been amended to provide for interests to be disregarded if the shares are passed to a corporation in the same group as the regulated person – provided they are on-lent or returned to a person outside the group within the period of 5 business days.
10. Approved lending agents and regulated persons taking advantage of the simplified disclosure regime will have to keep records of the shares borrowed/lent and returned.
11. These changes to the draft Rules extend and simplify the exemptions with a view to facilitating market development and enhancing liquidity, whilst maintaining adequate transparency in the disclosure regime to protect the interests of investors. The draft Rules have also been further refined to better reflect the policy intention and to improve drafting.

## **SUMMARY OF COMMENTS AND SFC’S RESPONSES**

12. A summary of the comments received are set out in the Appendix.

**Draft Securities and Futures (Disclosure of Interests – Stock Borrowing and Lending) Rules**  
**Summary of Comments Received and SFC's Response**

	Section reference	Details of Exposure Draft of the Rules	Respondent's comments	SFC's response
1.	2	“qualifying shares” means shares in which an institutional investor is interested and which an approved lending agent (“ALA”) has authority to lend as agent for an institutional investor;	<p>[ Linklaters &amp; Alliance ]</p> <p>The definition of “qualifying shares” refers to shares which are “given to” an ALA (and Rule 7(1)(b) refers to shares being “returned” to the ALA). It is unclear whether the Rules as drafted are intended to cover the situation where an ALA has responsibility for lending out client securities but the shares are held by a third party custodian (and the borrower would therefore return equivalent shares to the custodian).</p>	The definition of “qualifying shares” has been amended so that it covers the situation where an ALA has authority, as agent for the ultimate lender, to lend shares held by a third party.
2.	2	Definition of “qualifying shares”.	<p>[Hong Kong Association of Banks]</p> <p>“Qualifying shares” refer to those shares which an ALA has authority to lend as agent. It is increasingly common that ALAs are asked to contract as principal with both lender and borrower. The SBL rules should clarify as to whether an ALA would be liable to disclose in these circumstances.</p>	If an ALA acquires shares from the ultimate lender as principal the transaction is one of borrowing shares – not lending them as agent for the ultimate lender. Under the existing S(DI)O there is no exemption for borrowing shares. Under the draft SBL Rules the exemption for borrowing is limited to the 5 business day “conduit exemption” for regulated persons. (The “conduit exemption” is now in clause 7 of the revised draft Rules)
3.	3	“In the following circumstances an institutional investor who – (a) is interested in shares held by an ALA; and	<p>[ Northern Trust ]</p> <p>We are concerned that the implementation of the proposed disclosure requirements for</p>	The class of persons entitled to qualify for the exemption has been expanded from “institutional investors” to include all substantial shareholders.

	<b>Section reference</b>	<b>Details of Exposure Draft of the Rules</b>	<b>Respondent's comments</b>	<b>SFC's response</b>
		(b) complies with the conditions set out in subsection (4) will not be under a duty of disclosure under section 304(1)(d) of the SFO- (i) where the ALA lends qualifying shares under the terms of a relevant agreement; or (ii) where shares to which paragraph (i) applied are returned in accordance with the terms of the relevant agreement”	substantial shareholders may result in a further reduction of liquidity in the Hong Kong securities lending market. Clients who are the beneficial owner and ultimate lender may find the additional monitoring and reporting requirements to be too onerous, and the risk of non-compliance, which carries criminal liability, is too great relative to the returns.	(Clause 3 (1)of the draft Rules exposed for consultation is now clause 3(1) and (2) of the revised draft Rules)
4.	3	As above	[State Street]  We request that you consider broadening the definition of “institutional investors”.  Additional disclosure requirements for lenders are likely to result in lenders ceasing lending activities or limitations and restrictions being placed on lending mandates in order to remain under the 5% threshold which will have an adverse effect on liquidity of securities.	The class of persons entitled to qualify for the exemption has been expanded from “institutional investors” to include all substantial shareholders.
5.	3	As above	[ Linklaters & Alliance ]  In our view, the definition of “institutional investor” is unduly narrow and excludes various categories of investors which regularly make securities available from their	The class of persons entitled to qualify for the exemption has been expanded to include all substantial shareholders.

	<b>Section reference</b>	<b>Details of Exposure Draft of the Rules</b>	<b>Respondent's comments</b>	<b>SFC's response</b>
			<p>investment portfolio for lending, simply to enhance their investment returns.</p> <p>Consideration should be given to treating any “professional investor” as eligible for the stock lending exemptions in the SBL Rules. At least the definition of “institutional investor” should be expanded to include:</p> <ul style="list-style-type: none"> <li>• all banks and insurance companies</li> <li>• all offshore funds and pension schemes falling within the definition of “professional investor”</li> <li>• governments, central banks and multilateral agencies.</li> </ul>	
6.	3	As above	<p>[Hong Kong Association of Banks]</p> <p>The disclosure of interests in shares will impose an onerous administrative burden on custodians. Given that the lender is already under a duty of disclosure at 5%, it is suggested that when holding shares purely in the capacity of custodian or bare trustee the ALAs should be totally exempted.</p>	<p>Custodians having no discretion in dealing with shares are exempted in these circumstances – see s.323(1)(b) and (3).</p> <p>However, ALAs have a discretion in the manner in which they deal in shares and therefore have a discloseable interest. The circumstances in which ALAs have to make disclosures, and the details that must be disclosed have been minimized under the draft Rules.</p> <p>As lenders who lend through ALAs have been relieved of their duty of disclosure the underlying assumption of the comments is no longer relevant.</p>
7.	3(4)	Requirement for disclosure	[ Linklaters & Alliance ]	Clause 3(4) of the draft Rules exposed for

	Section reference	Details of Exposure Draft of the Rules	Respondent's comments	SFC's response
		<p>when shares become qualified shares or cease to become qualifying shares (i.e. when there is change in the size of the lending pool).</p>	<p>A difficulty with treating a fluctuation in the size of the lending pool as a change in nature of an interest is that the events resulting in a change in the size of the lending pool will normally also involve an increase or decrease in the size of the interest of the end-lender or ALA (e.g. because shares which were subject to lending authority have been sold). It seems that separate disclosures may therefore need to be made to comply with:</p> <ul style="list-style-type: none"> <li>• the provisions of the SFO relating to interests in shares and</li> <li>• the Securities and Futures (Disclosure of Interest – Stock Borrowing and Lending) Rules.</li> </ul> <p>From the point of view of the ALA, it would be more satisfactory if shares becoming or ceasing to be qualifying or designated shares was not treated as a change in the nature of the interest, but the Rules simply required that, whenever a disclosure is made in respect of fluctuations in the amount of an interest that includes an interest held by an ALA that disclosure should also indicate the amount currently available for lending.</p> <p>An alternative approach would be to require the ALA to make a disclosure of a change in nature of interest when the amount of shares available for lending crosses, up or down, the 5% threshold (irrespective of whether this would also trigger a disclosure in respect of</p>	<p>consultation is now clause 5 of the revised draft Rules.</p> <p>The disclosure regime for ALAs has been simplified so that the provisions of the SFO relating to interests in qualifying shares received, held, or lent by an ALA will not apply. The only disclosure obligations that an ALA will have in respect of qualifying shares arise under the draft Rules where the ALA is required to disclose merely fluctuations in the size of the shares that it has authority to lend (i.e. the size of the lending pool) when the pool reaches 5% and passes through a whole percentage level thereafter e.g. 6%, 7% etc. We believe such disclosures are important to maintain the integrity of the disclosure system and market transparency.</p>

	<b>Section reference</b>	<b>Details of Exposure Draft of the Rules</b>	<b>Respondent's comments</b>	<b>SFC's response</b>
			the amount of its interest) but not to require other fluctuations to be disclosed. In the case of an ALA, which would only lend out stock in response to market demand, there can be little or no justification for needing to disclose relatively small fluctuations in the size of its lending pool.	
8.	4(3)	"Where an interest in shares is used for a purpose, other than a prescribed purpose, by the regulated person, or by a related corporation of the regulated person, within the period of 5 business days specified in subsection (1) the regulated person shall be taken to have acquired that interest, or come to have that short position, (as the case may be) for the purposes of Divisions 2 to 5 of the SFO on the day that it is used for that purpose."	[ Linklaters & Alliance ]  We assume that Section 4(3) would not be interpreted as having the effect of disapplying the exemption because the securities are used for short selling (i.e. a purpose other than a "prescribed purpose") by the related corporation during the 5 day period.	If the shares are used for a purpose other than a prescribed purpose disclosure must be made. The object of the SBL exemption is to establish a simplified disclosure regime for borrowing and lending – not an exemption for all transactions using borrowed stock.  (Clause 4(3) of the draft Rules exposed for consultation is now clause 7(3) of the revised draft Rules)
9.	5	Where - (a) an ALA lends an interest in shares to which section 3(1)(i) or (2)(i) applies; or (b) an interest in shares to which paragraph (a) applies is returned in the circumstances set out in section 3(1)(ii) or	[ Linklaters & Alliance ]  While we have no objection to Section 5 as drafted, in our view it should not be interpreted as meaning that Clause 312 of the Bill (now s.321 of the SFO) applies whenever an agent lends out stock in circumstances where the SBL Rules do not exempt such lending from disclosure. We would be grateful for the SFC's confirmation on this	Strictly, a loan of stock under an SBL agreement represents the disposal of an interest in shares lent and the immediate acquisition of another interest (the right of recall) such that the percentage level of his interest in shares of the listed corporation does not change. Given that there is a disposal and an acquisition, section 321 of the SFO does apply to SBL transactions not effected through an ALA.

	<b>Section reference</b>	<b>Details of Exposure Draft of the Rules</b>	<b>Respondent's comments</b>	<b>SFC's response</b>
		(2)(ii), an institutional investor shall not be required, under section 312 of the SFO, to secure that its agent notifies it of the lending or the return of the interest.	point.	(Clause 5 of the draft Rules exposed for consultation is now clause 4 of the revised draft Rules)
10.	6	<b>6. Approved Lending agents</b>  (1) A corporation is an ALA if it is approved by the Commission, in writing, as an ALA for the purposes of these rules.  (2) An application for approval under subsection (1) shall be accompanied by - (a) such information and particulars as the Commission may reasonably require; and (b) an application fee prescribed by rules made under section 382 for the purposes of this section;  (3) The Commission may, by notice in writing served on a person approved under subsection (1) withdraw its approval where the Commission is satisfied that it is appropriate to do so.	[ Linklaters & Alliance ]  Section 6 of the Rules gives the Commission power to approve applications to become an ALA and to withdraw any approval granted where the Commission "is satisfied that it is appropriate to do so". The Commission is not required to give reasons for any refusal or withdrawal of approval.  Clarification is sought on the criteria the Commission will take into account in considering applications for approval, or withdrawing its approval once given. We consider that reasons should be given for any refusal or withdrawal, and that such decisions by the Commission should be "specified decisions" for the purposes of Schedule 7 to the Bill, enabling an appeal to be made against any such decision to the Securities and Futures Appeal Tribunal.	A requirement to give reasons has been added. Furthermore, refusal of application or withdrawal of approval granted will be included as specified decisions.  We are proposing to develop guidelines setting out the criteria the Commission will take into account in considering applications for approval, or withdrawing its approval once given. We envisage that there will be 2 types of corporations who satisfy the criteria (1) custodians and (2) third party lending agents in their capacities as ALAs.  (Clause 6 of the draft Rules exposed for consultation is now clause 8 of the revised draft Rules)
11.	General	-	[HSBC]	Persons who were "exempt persons" are

	<b>Section reference</b>	<b>Details of Exposure Draft of the Rules</b>	<b>Respondent's comments</b>	<b>SFC's response</b>
			Can persons offering equity finance business, therefore assuming a principal (rather than agency) role in conduit activities, take advantage of the simplified disclosure regime for regulated persons.	now referred to in the Bill as "registered institutions" and, the term "regulated person" in the draft Rules covers "an intermediary licensed or registered for Type 1 regulated activity". Accordingly authorised financial institutions will normally qualify as regulated persons.
12.	General	-	<p>[HSBC]</p> <p>A conduit lender (can be a bank or broker) signs up with an institutional investor and agrees an exclusive arrangement to borrow from the latter for onward lending purposes from time to time. Under the draft rule, the institutional lender can make a one-off disclosure (if any of the lines represented holding of 5% or more). Would the conduit lender need to make a similar disclosure, or can he rely on the conduit lender provision that such interests would be disregarded and no disclosure would be required?</p>	An arrangement with an investor giving a borrower "exclusive" rights to borrow shares held from time to time by an investor does not of itself give a borrower an interest in the shares. It would be the equivalent of a "hold" in a normal SBL transaction. The "borrowing" would occur at the time that the Borrower confirmed that it would borrow a specific number of the shares or asked for certain shares to be transferred to its account. However, much would depend upon the terms of the agreement and if the terms of the agreement were such as to give the borrower an option in respect of specific shares this would create an interest in the shares - quite independently of the borrowing. Any restriction on the investor selling the shares or requirement that he hold a certain number of shares available for borrowing would be relevant in this context.
13.			<p>[ Linklaters &amp; Alliance ]</p> <p>We propose that the Commission should, in</p>	Disaggregation of SBL activities carried on by ALAs goes far beyond the original concept of establishing a simplified

	Section reference	Details of Exposure Draft of the Rules	Respondent's comments	SFC's response
			<p>the Rules, provide an exemption from aggregation in respect of the “interest” of an ALA.</p>	<p>disclosure regime for SBL. The draft Rules were developed to ensure that liquidity in the SBL market was not adversely affected by the burden of disclosure obligations placed on lenders of shares. The draft Rules were not established to provide a mechanism for groups of companies to place shares with an ALA in order that they could keep below the disclosure threshold.</p> <p>Ultimate lenders of shares do not cease to be interested in shares that their subsidiaries place with an ALA for lending. They must still aggregate those shares.</p> <p>Nevertheless, we recognize that parent companies of ALAs should be entitled to take advantage of the simplified disclosure regime in respect of stock borrowing and lending and we have provided for a similar exemption in Section 5(2) of the draft Rules.</p>