

立法會
Legislative Council

LC Paper No. CB(1)1145/11-12
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by the Administration)

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Panel on Financial Affairs

Minutes of meeting
held on Friday, 6 January 2012 at 10:45 am
in Conference Room 1 of the Legislative Council Complex

Members present : Hon CHAN Kam-lam, SBS, JP (Chairman)
Hon CHAN Kin-por, JP (Deputy Chairman)
Hon Albert HO Chun-yan
Ir Dr Hon Raymond HO Chung-tai, SBS, S.B.St.J., JP
Dr Hon David LI Kwok-po, GBM, GBS, JP
Hon Emily LAU Wai-hing, JP
Hon LEE Wing-tat
Hon Jeffrey LAM Kin-fung, GBS, JP
Hon Andrew LEUNG Kwan-yuen, GBS, JP
Hon Ronny TONG Ka-wah, SC
Hon CHIM Pui-chung
Hon KAM Nai-wai, MH
Hon Paul CHAN Mo-po, MH, JP
Hon Mrs Regina IP LAU Suk-ye, GBS, JP

Members absent : Hon James TO Kun-sun
Dr Hon Philip WONG Yu-hong, GBS
Hon Abraham SHEK Lai-him, SBS, JP
Hon WONG Ting-kwong, BBS, JP
Hon Starry LEE Wai-king, JP

- Public officers attending** : Agenda Item II
- Miss Salina YAN, JP
Deputy Secretary for Financial Services and the Treasury (Financial Services) 1
- Miss Belinda KWAN
Principal Assistant Secretary for Financial Services and the Treasury (Financial Services) 1
- Miss Sara TSE
Assistant Secretary for Financial Services and the Treasury (Financial Services) 1
- Attendance by invitation** : Mr Keith LUI
Executive Director, Supervision of Markets Securities and Futures Commission
- Mr Rico LEUNG
Senior Director, Supervision of Markets Securities and Futures Commission
- Clerk in attendance:** Ms Anita SIT
Chief Council Secretary (1)5
- Staff in attendance :** Mr Noel SUNG
Senior Council Secretary (1)5
- Ms Haley CHEUNG
Legislative Assistant (1)5

Action

I Date of next meeting and items for discussion

- (LC Paper No. CB(1)732/11-12(01) — List of outstanding items for discussion
- LC Paper No. CB(1)732/11-12(02) — List of follow-up actions)

Meeting in February 2012

Members agreed to discuss the following items proposed by the Administration at the next regular meeting scheduled for 6 February 2012:

- (a) Budget of Securities and Futures Commission for the financial year of 2012 – 2013;
- (b) Proposed establishment of a Policyholders' Protection Fund - Consultation conclusions; and
- (c) Proposed creation of a supernumerary post of Assistant Commissioner of Insurance.

II Proposal of the Securities and Futures Commission for a short position reporting regime

(LC Paper No. CB(1)732/11-12(03) — Paper provided by the
(issued on 30 December 2011) Administration

LC Paper No. CB(1)731/11-12 — Background brief prepared by
(issued on 3 January 2012) the Legislative Council Secretariat)

2. At the invitation of the Chairman, the Deputy Secretary for Financial Services and the Treasury (DS(FS)) and the Executive Director (Supervision of Markets), Securities and Futures Commission (ED(SM)/SFC) briefed members on the latest development of SFC's proposal for a short position reporting regime, by highlighting the salient points in the paper.

Discussion

3. While supporting measures to enhance the transparency of short selling activities, Mr Ronny TONG was concerned that short sellers might find means to circumvent the reporting requirements. Mr TONG sought clarification on the basis for determining the net short position of a short seller. Mr TONG was also concerned that if a short seller was only required to report the short position at the end of the last trading day of each week, the short seller might short sell a large volume of shares during the week and reduced the size of the short position to below the reporting threshold in order to evade reporting the short position. A short seller might also short sell the same stock through multiple intermediaries.

4. ED(SM)/SFC responded that based on the proposal, a short seller was required to report any reportable short position at the end of the last trading day of each week, and to report on a net basis. If a person had a net short position which amount to or exceeding 0.02% of the issued share capital of the relevant listed company or \$30 million, whichever was lower, the person was required to report his net short position, irrespective of whether he had traded the relevant stock through multiple intermediaries. Since short selling usually formed part of the overall investment strategy, a short seller would not deliberately change the short position at the end of the week in order to circumvent the short position reporting requirements. Short sellers were mainly concerned that their respective short positions would be disclosed to other market participants, but were willing to report the short positions to the securities regulator. The proposed short position reporting regime was also in line with the practice of other major stock markets in the world.

5. While supporting the enhancement of the transparency of short position reporting system, the Deputy Chairman remarked that over-stringent requirements for reporting short positions should be avoided in order not to affect legitimate short selling activities. The Deputy Chairman enquired why the threshold of reporting was set at a relatively low level (i.e. 0.02% of the issued share capital of a particular listed company or \$30 million, whichever was lower), and expressed concern that an excessively low reporting threshold would impose an undue compliance burden on investors conducting short selling activities.

6. ED(SM)/SFC responded that there was not an international standard for setting the threshold for short position reporting, as each stock market had to take into account the characteristics of its own market in devising its short position reporting regime. While the United Kingdom (UK) stock market set the threshold for short position reporting at 0.25% of the issued share capital of the relevant listed company, the Australian stock market set the threshold at 0.01% of the issued share capital of the relevant listed company or A\$100,000. Given the similarities of the Hong Kong and Australian stock markets, and the significant variance of the issued share capitals of the constituent companies of the Hang Seng Index and Hang Seng China Enterprises Index, and having regard to the feedback in the public consultation exercises, SFC proposed that the threshold for short position reporting be set at 0.02% of the issued share capital of the relevant listed company or \$30 million, whichever was lower. ED(SM)/SFC remarked that a balance had to be struck between minimizing compliance burden on short sellers and enhancing market transparency to regulators. In the case of the UK stock market, the threshold of 0.25% was set in 2008 and had resulted in only about 20 short position reports in a month, despite the large trading volume of the UK stock market.

7. The Senior Director (Supervision of Markets), SFC supplemented that based on the analysis conducted by the SFC, the total outstanding short position of shares involved in short selling at any one time usually amounted to about only 1% of the issued share capital of a stock, and the threshold of 0.02% for short position reporting was considered appropriate. SFC would review the threshold after the short position report regime had been implemented for a period of time.

8. Mr CHIM Pui-chung opined that the short selling system in Hong Kong only facilitated large overseas investment institutions/investors to manipulate the stock market in Hong Kong, and this was unfair to small investors. Under the system, the Government and SFC only worked to serve the large overseas investment institutions/investors, ignoring the interests of local securities intermediaries. The quoting of the short selling arrangements in overseas stock markets was inappropriate and was only intended to mislead Members of the Legislative Council and the public. In the pretence of upholding Hong Kong as an international financial centre, the short selling arrangements allowed international financial predators to take advantage of local small investors. Mr CHIM requested that in relation to the short selling activities in Hong Kong, the Administration should provide the following information:

- (a) based on the monetary value of short selling transactions, the respective percentages of the short selling transactions handled by the three broad categories of stock exchange participant brokers;
- (b) the benefits of short selling for the Hong Kong stock market and investors; and
- (c) the channels through which share might be borrowed before placing a short selling order on the Stock Exchange of Hong Kong for execution.

(Post-meeting note: The information provided by SFC was circulated to Members vide LC Paper No. CB(1)969/11-12 on 11 February 2012)

9. ED(SM)/SFC remarked that while short selling was a highly sophisticated investment activity which was undertaken mostly by large investment institutions and investors, it was a legitimate means for investment institutions and investors to manage risks and conduct arbitrage. In line with international practices, the proposed short position reporting regime would enable SFC to monitor the build up of short positions in the Hong Kong market, and take appropriate actions to deal with the situation as and when necessary. The development of the short selling regime would contribute to the development of the stock market.

10. Mr CHIM Pui-chung expressed grave concern that given the present restrictions on short selling, small investors were unable to participate in short selling activities and this had created an unequal playing field in the stock market. Mr CHIM was also concerned that if the Hong Kong stock market was controlled by large overseas financial institutions, the Government would not be able to regulate the market and protect the interests of small investors, including participants under the Mandatory Provident Fund (MPF) schemes.

11. DS(FS) remarked that when a new financial product emerged in the market, the Government and the regulatory bodies would assess the merits and/or impact of the product and liaise with the relevant sectors to devise measures to regulate the relevant product/market activities, with a view to ensuring a level playing field in the market. In line with the objective of developing and promoting the diversification of the stock market, and the practice of major overseas stock markets, short selling was accepted as a legitimate tool used by investors for risk management. Hong Kong had a robust regulatory framework for short selling. Under the Securities and Futures Ordinance (SFO) (Cap. 571), naked short selling was generally prohibited. In 2000, amendments also had been made to the SFO to impose heavier penalties on naked short selling offences. After consultation with the stakeholders, the Government and SFC concluded that the threshold of 0.02% or \$30 million, whichever the lower, for reporting short selling positions was appropriate. Under the present proposal, SFC would also be empowered to tighten the reporting requirements, e.g. changing the weekly reporting requirement to a daily reporting requirement in contingency situations. DS(FS) pointed out that despite that lending of stocks under MPF scheme was allowed subject to the requirements laid down in the relevant regulation and guidelines (e.g., the trustee of an MPF fund should lend out no more than 10% of the assets of the relevant fund), it was understood that none of these funds were involved in stock lending. DS(FS) stressed that the Government and the regulators would keep a close watch on short selling activities in the Hong Kong stock market, and the proposed reporting regime was one of the measures to ensure the orderly operation of the market.

12. Mr CHIM Pui-chung enquired, given that short selling activities had a significant impact on share prices, and the majority of small investors lacked the knowledge and channels to participate in short selling activities, what measures would be taken to protect the interests of small investors, in particular in view of the proposal of the Hong Kong Exchanges and Clearing Limited (HKEx) to extend the trading hours of the futures market.

13. DS(FS) responded that she understood that HKEx had conducted public consultations on the proposal to extend the trading hours of the futures market, and had taken into account the feedback from relevant stakeholders in implementing the proposals in phases. The majority of the respondents

supported the extension of the trading hours of the futures market. In implementing measures to regulate the stock market, the Government and the regulatory bodies aimed to strike a balance between market development and investor protection. HKEx would stand ready to meet the representatives of the relevant industries again shortly regarding the proposal to further extend the trading hours of the futures market. ED(SM)/SFC added that in implementing the proposal to extend the trading hours of the futures market, HKEx had consulted the stakeholders and responded to the feedback from the local securities brokers. Given the keen competition of the stock markets in the region, measures had to be taken to further enhance the competitiveness of Hong Kong's stock market while maintaining a level playing field for all parties concerned. HKEx would continue to discuss with the relevant parties regarding the extension of the trading hours of the futures market.

III Any other business

Date of next meeting

14. The Chairman reminded members that the next meeting would be held on Monday 6 February 2012 at 10:45 am.
15. There being no other business, the meeting ended at 11:41 am.

Council Business Division 1
Legislative Council Secretariat
27 February 2012