

**立法會**  
**Legislative Council**

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**Panel on Financial Affairs**

**Meeting on 1 February 2016**

**Background brief on the short position reporting regime of Hong Kong**

**Purpose**

1. This paper provides background information on Hong Kong's short position reporting regime, which was established by the Securities and Futures Commission ("SFC") in 2012. The paper also summarizes the major views and concerns expressed by members on the subject at meetings of the Financial Affairs Panel ("FA Panel") in 2011 and 2012.

**Background**

Regulatory framework for short selling

2. Under the Securities and Futures Ordinance ("SFO") (Cap. 571), naked short selling is generally prohibited. Only covered short sales are allowed, in that, shares should be borrowed before placing a short selling order on the Stock Exchange of Hong Kong ("SEHK") for execution. In addition, short selling orders must be "marked" so that the short selling transaction is traceable by the regulator (i.e. transactional reporting requirement)<sup>1</sup>. Apart from the statutory requirements, SEHK has established selection criteria such that only the more liquid securities are allowed for short selling<sup>2</sup>.

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<sup>1</sup> Sections 170 - 172 of SFO

<sup>2</sup> A list of "Designated Securities" which can be short sold is published on the website of Hong Kong Exchanges and Clearing Limited.

### Establishment of the short position reporting regime

3. In the wake of the global financial crisis in September 2008, there have been increasing concerns on the impact of short selling activities on market stability and whether there is market manipulation involved. In line with the global efforts to enhance the effectiveness of regulation of short selling, SFC launched a public consultation on increasing short position transparency in July 2009. SFC indicated in the consultation conclusions published in March 2010 that the market was in general supportive of the proposal of introducing a new short position reporting regime. The regime will enable SFC to collect more information about short selling activities in Hong Kong and facilitate its market monitoring efforts, as well as enable the public to have more information on the matter. SFC further consulted the public on a set of draft rules to be made under sections 397(1) and 397(2) of SFO to implement the short position reporting regime in May 2011 and October 2011 respectively. According to SFC, there was broad market support for the draft rules, and comments from the market on the draft rules had also been incorporated where appropriate.

4. Key features of the short position reporting regime are as follows:

- (a) net short positions are to be reported;
- (b) the threshold of reporting is 0.02% of the issued share capital of a particular listed company or \$30 million, whichever is lower, at the end of the last trading day of each week;
- (c) the scope is limited to shares of the constituent companies of the Hang Seng Index ("HSI"), Hang Seng China Enterprises Index ("HSCEI") and other financial companies specified by SFC ("specified shares");
- (d) the reporting requirement applies to short positions in any specified shares established via trades executed on SEHK or other trading venues specified by SFC;
- (e) SFC will set up an electronic reporting facility and specify a form for reporting;
- (f) SFC will publish the aggregated short position for each stock, on an anonymous basis, within three business days after the receipt of the reports;
- (g) in normal circumstances, the report is to be made once a week, and SFC will be empowered to tighten the reporting requirements

in a contingency situation by publishing a notice in the Gazette, in which case, the report is to be made for each trading day; and

- (h) breaches of the reporting requirements in (g) above will be an offence with penalty.

5. To implement the short position reporting regime, the Government tabled the Securities and Futures (Short Position Reporting) Rules ("SPR Rules") and the Securities and Futures (Offences and Penalties) (Amendment) Regulation 2012 at the Council meeting of 28 March 2012. Most of the provisions of the two items of subsidiary legislation came into operation on 18 June 2012<sup>3</sup>. On the rule (paragraph 4(f) above) for SFC to publish particulars of the reportable short positions notified to it, in order to allow SFC some leadtime to ensure proper collation and disclosure of the data, the Securities and Futures (Short Position Reporting) Rules (Commencement) Notice<sup>4</sup> was tabled at the Council meeting of 6 June 2012 to effect commencement of the rule on 7 September 2012.

### **Views and concerns expressed by members of the Panel on Financial Affairs**

6. The Administration and SFC briefed FA Panel on SFC's proposal for introducing a short position reporting regime at the meetings on 4 July 2011 and 6 January 2012. The major views and concerns expressed by members at the above meetings are summarized in the ensuing paragraphs.

#### Reporting threshold under the short position reporting regime

7. Members enquired about the rationale for devising a short position reporting regime in Hong Kong, and whether the proposed regime was in line with the relevant international standards and practices. SFC advised that after the global financial crisis in September 2008, the International Organization of Securities Commissions published a report entitled "Regulation of Short Selling" which recommended, among other things, that short selling should be subject to a reporting regime providing timely information to the market or to market authorities. Australia and the United Kingdom ("UK") had introduced a short position reporting regime while the European Union was in the process of formulating a standard short position reporting mechanism for compliance by all member countries. The proposed short position reporting regime in Hong Kong was in line with the practice of other major stock markets in the world.

<sup>3</sup> No subcommittees were formed to scrutinize the two pieces of subsidiary legislation.

<sup>4</sup> No subcommittee was formed to scrutinize the Notice.

8. Some members considered that the reporting threshold 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 about the low threshold imposing an undue compliance burden on investors conducting short selling.

9. SFC advised that a balance had to be struck between minimizing compliance burden on short sellers and enhancing market transparency for regulators. There was no international standard on the reporting threshold, and each stock market had to take into account its market characteristics in devising its own regime. While the 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. The proposed reporting threshold was set 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 HSI and HSCEI, and having regard to the feedback to the public consultation exercises. SFC would review the threshold after the regime had been implemented for a period of time.

10. There were concerns about circumvention of the reporting requirements by short sellers if sellers were only required to report their short positions at the end of the last trading day of each week. A 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 the reporting obligation. A short seller might also short sell the same stock through multiple intermediaries.

11. SFC advised 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 above the reporting threshold, 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.

#### Protection for small investors

12. Some members raised concern that the short selling system in Hong Kong would only facilitate large overseas investment institutions/investors to manipulate the stock market in Hong Kong. They considered that given the existing restrictions on short selling, small investors were unable to participate in short selling activities and this had created an unlevel playing field in the

stock market. They also enquired about measures the Administration and SFC would take to protect small investors given that short selling activities had a significant impact on share prices.

13. SFC advised 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. Upon request of members, the Administration had provided supplementary information on short selling activities in Hong Kong, including short selling transactions handled by participant brokers, and benefits of the proposed reporting regime for stock market and investors<sup>5</sup>.

14. On the issue of providing a level playing field in the market, the Administration and SFC advised 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. Hong Kong had a robust regulatory framework for short selling. Under SFO, naked short selling was generally prohibited. The proposed regime would further empower SFC to tighten the reporting requirements, e.g. changing the weekly reporting requirement to a daily reporting requirement in contingency situations. As regards protection for small investors, the Administration and regulatory bodies would strike a balance between market development and investor protection in implementing measures to regulate the stock market.

### **Council questions**

15. Hon Emily LAU and Hon Frederick FUNG raised written questions on "Short selling activities" and "Regulation of credit rating agencies in Hong Kong" at the Council meetings of 12 November 2008 and 7 December 2011 respectively. Ms LAU enquired, inter alia, whether the Administration would follow the practices of certain overseas financial markets to ban short selling activities so as to maintain the stability of Hong Kong's financial system, and Mr FUNG enquired about the regulation of naked short selling activities in Hong Kong. The questions and the Administration's written responses are hyperlinked in the **Appendix**.

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<sup>5</sup> The supplementary information provided by SFC was circulated to members vide LC Paper No. CB(1)969/11-12 on 11 February 2012.

## Latest developments

16. From 27 November to 31 December 2015, SFC launched a consultation on expanding the scope of short position reporting and the corresponding amendments to the SPR Rules. The major proposed changes to the existing short position reporting regime are as follows:

- (a) short position reporting will be extended to all securities that can be short sold under the SPR Rules; and
- (b) the reporting threshold trigger for stocks will remain unchanged<sup>6</sup>, but for those that are collective investment schemes, the reporting threshold trigger will be set at \$30 million.

17. The Administration and SFC will consult FA Panel on 1 February 2016 on the proposed extension of the scope of the short position reporting regime in Hong Kong.

## Relevant papers

18. A list of relevant papers is in the **Appendix**.

Council Business Division 1  
Legislative Council Secretariat  
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<sup>6</sup> The current reporting threshold was 0.02% of the issued share capital of a particular listed company or \$30 million, whichever was lower, at the end of the last trading day of each week.

## Appendix

### List of relevant papers

Date	Event	Paper/Minutes of meeting
12 November 2008	Hon Emily LAU raised a written question on short selling activities	<a href="#">Hansard</a> (pages 1563-1565)
July 2009 – September 2009	Consultation on increasing short position transparency conducted by the Securities and Futures Commission ("SFC")	<a href="#">Consultation paper</a> <a href="#">Consultation conclusions</a>
May 2011 – November 2011	Consultations on the Securities and Futures (Short Position Reporting) Rules conducted by SFC	<a href="#">Consultation paper</a> <a href="#">Consultation conclusions and further consultation</a> <a href="#">Conclusions on further consultation</a>
4 July 2011	The Panel on Financial Affairs ("FA Panel") was briefed on the proposal on short position reporting regime	<a href="#">Administration's paper</a> (LC Paper No. CB(1)2601/10-11(02)) <a href="#">Minutes</a> (LC Paper No. CB(1)324/11-12)
7 December 2011	Hon Frederick FUNG raised a written question on regulation of credit rating agencies in Hong Kong	<a href="#">Hansard</a> (pages 3124-3127)
6 January 2012	FA Panel was further briefed on the proposal on short position reporting regime	<a href="#">Administration's paper</a> (LC Paper No. CB(1)732/11-12(03)) <a href="#">Minutes</a> (LC Paper No. CB(1)1145/11-12) Follow-up papers <u>1</u> and <u>2</u> (LC Paper Nos. CB(1)969/11-12(01) and (02))

<b>Date</b>	<b>Event</b>	<b>Paper/Minutes of meeting</b>
28 March 2012	The Securities and Futures (Short Position Reporting) Rules and the Securities and Futures (Offences and Penalties) (Amendment) Regulation 2012 were tabled in the Legislative Council	<a href="#">Legislative Council Brief</a> (File Ref.: SUB14/1/4(2010))  <a href="#">Legal Service Division Report</a> (LC Paper No. LS51/11-12)
6 June 2012	The Securities and Futures (Short Position Reporting) Rules (Commencement) Notice was tabled in the Legislative Council	<a href="#">Legislative Council Brief</a>  <a href="#">Legal Service Division Report</a> (LC Paper No. LS77/11-12)
27 November 2015	SFC launched a consultation on expanding the scope of short position reporting	<a href="#">Press release</a>  <a href="#">Consultation paper</a>