

年利達律師事務所的信頭

Letterhead of LINKLATERS & ALLIANCE LINKLATERS

e-mail pauline.ashall@linklaters.com

Our ref PAA

Your ref

The Honourable Ronald Arculli, JP
Chairman of the Bills Committee on the
Securities (Amendment) Bill
Legislative Council
Legislative Council Building
8 Jackson Road
Central
Hong Kong

Dear Mr Arculli

Securities (Amendment) Bill

I am writing on behalf of the Group of financial institutions named at the end of this letter. Representatives of the Group attended a meeting with the Financial Services Bureau and the Securities and Futures Commission yesterday. We also received a letter from the Financial Services Bureau last night, together with an amended draft of the Bill, which we understand has also been given to the Bills Committee and will be considered at a meeting of the Bills Committee at 2:30 pm today.

I attach a letter from the Group to the FSB setting out, in the very limited time available, the Group's comments on the redrafted Bill. Although a number of the issues we had raised are addressed by the redraft, we remain very concerned about the requirement for a seller to provide a "documentary assurance" to the broker, at the time of placing the order, containing the information required under Section 80B of the Bill and rules to be made by the SFC.

The Honourable Ronald Arculli, JP

21 March 2000

In practice, the Group believes that it will not be practicable for the seller to obtain the necessary information from the stock lender before placing the order. Nor does it believe that telephone taping technology provides an adequate means for seller and the broker to comply with their respective obligations under the Bill. The Bill as drafted would lead to considerable delays in sellers being able to place covered short selling orders. The concerns are particularly grave if the information which the seller needs to provide at that time includes a "hold number" to be issued by the stock lender from whom the securities are being borrowed.

Representatives of the Group would be happy to attend this afternoon's meeting of the Bills Committee if the Committee would find this helpful.

Yours sincerely,

Pauline Ashall

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The Chase Manhattan Bank
Credit Lyonnais Securities (Asia) Limited
Credit Suisse First Boston (Hong Kong) Limited
Deutsche Securities Asia Limited
Donaldson Lufkin & Jenrette Asia Limited
Goldman Sachs (Asia) L.L.C.
Jardine Fleming Securities Limited
JP Morgan Securities Asia Pte Ltd
Kleinwort Benson Securities (Asia) Limited
Merrill Lynch (Asia Pacific) Limited
Morgan Stanley Dean Witter Asia Limited
Nomura International (Hong Kong) Limited
Salomon Smith Barney Hong Kong Limited
Warburg Dillon Read
Pan Asian Securities Lending Association
and
The Hong Kong Securities Industry Group

cc: Bryan Chan - The Financial Services Bureau
Mark Dickens/Stella Leung - The Securities and Futures Commission

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Your ref

Bryan Chan
Financial Services Bureau
18th Floor, Admiralty Centre
Tower 1
18 Harcourt Road
Hong Kong

Dear Bryan

Securities (Amendment) Bill

We are writing on behalf of the Group of financial institutions named at the end of this letter, to follow up on our meeting yesterday, and your letter received last night.

Although we have only had a very limited time to consider the redrafted Bill, we are writing to summarise the Group's position on it. As discussed below, the remaining area of major concern is the "documentary assurance" needed from the seller at the time of placing the order.

Scope of "short selling order"

We welcome the changes, although one point remains. The definition will not include a sale of securities by a person who holds options, convertibles etc relating to those securities, and has given irrevocable instructions to obtain the underlying securities. The way in which instructions need to be given to obtain the underlying securities will depend on the terms of the options, convertibles etc, and instructions, once given, will not necessarily be "irrevocable". We would prefer to see this word deleted.

Defences

A “defence” has been introduced in Section 80B(7) for a person who did not know that the order was a short selling order, or who believed on reasonable grounds that the order was not a short selling order. In principle, rather than having a strict liability offence with a “defence” (the burden of proof of which would fall on the defendant), we consider that knowledge and/or recklessness should be required as an element of the offences in Sections 80B(1), (2) and (3).

This would be consistent with Section 80C(3), where the offence is only committed where the person concerned acted “knowingly or recklessly”. In the light of this amendment, we have no further comments on Section 80C.

Documentary assurance

No changes of substance have been made to the obligations in Section 80B, under which a seller needs to provide a documentary assurance to the broker at the time of placing the order. Where the seller is a borrower of securities, the assurance will need to confirm, not just that the seller has a presently exercisable and unconditional right to vest the securities in the purchaser, but also that the lender has the stocks available to deliver to the purchaser. Furthermore, the SFC can make rules under Section 146 of the Securities Ordinance requiring additional information to be provided, either at the time of the order or subsequently. In practice, we understand from our discussions with the Financial Services Bureau and the SFC that the documentary evidence that needs to be provided at the time of placing the order, will include a “hold number” issued by the lender in respect of the stock loan.

Furthermore, if the seller is an exchange participant selling as principal, he will need to obtain documentary assurance from the lender that the lender has the securities available to lend to him.

As previously pointed out these requirements would impose extremely onerous burdens on stock lenders, institutional investors, proprietary traders and brokers alike. Some lenders will be unwilling to continue lending Hong Kong securities, because the extra costs involved in providing the relevant information on a real time basis would exceed the returns to be made. Other lenders will increase the costs charged to borrowers. The effect would be to reduce the liquidity in the market and to increase the cost of dealing in Hong Kong securities.

The fact that the broker’s phone lines may be recorded (and the taped record constitutes a “document”) does not solve the practical difficulties. First, the obligation under the Bill is on the seller to give a documentary assurance to the broker. Even if the seller knows that it is the broker’s practice to tape the call, the seller can never be sure whether the call is in fact being recorded. Even if it is, it is difficult to regard the broker’s tapes as a documentary assurance given by the seller. Furthermore, the amount of information required to be provided is, in our view, impractical to obtain over the phone. Finally, from the broker’s point of view, it would be unsafe to rely on the tape as the “documentary assurance”, since that assurance needs to be retained for at least 12 months, and it would be very difficult to keep the tape recordings for this length of time and to be confident of being able to locate the relevant conversation if a request was made by the Hong Kong regulators during that period.

The Group does not believe that the HKFE Rule for taping of calls provides any kind of analogy with the current proposals. That Rule only applies to HKFE Members, and does not impose requirements on clients placing orders with HKFE Members. Nor is there any requirement for particular assurances or other information to be obtained from the clients during the telephone calls. Finally, the tapes need only be maintained for 3 months.

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The Group does not agree that all this documentary evidence needs to be available at the time of placing the order for the regulation of short selling to be effective. As we discussed at our meeting, we believe it should be possible for stocklenders to record the time at which the "hold" was given. Even if the seller only gives documentary evidence of the cover (e.g. a "hold number") after the sale order is placed, it would be possible for the SFC, using its powers under the rules to be made under Section 146, to check whether the hold had been put in place prior to the sale order.

SFC Rules

While it is not mentioned in your letter, we are also concerned that the SFC will have power to make rules imposing reporting requirements where purchases are effected to cover "shorts". Imposing reporting requirements in this area could create as many practical difficulties for the industry as the reporting obligations set out in the Bill itself. The Group does not think it is appropriate for the SFC to have powers to make rules in this area without further consideration of the matter by the Legislative Council, and consultation with the industry.

You said at the meeting that such requirements already applied in the U.S. and Australia. Our information is that, in each country, there is no need to record or report purchases effected to cover shorts. In Australia, there is a requirement under the Australian Stock Exchange Rules for a broker to report open short positions to the market once a week. In the U.S., brokers provide the Exchange (and NASD) with short position reports periodically, but do not have to identify whether purchases are for the purpose of covering shorts.

In summary, while the redraft of the Bill meets some of the industry's concerns, the major outstanding issue is the need for the documentary assurance to be provided at the time of placing an order. In the view of the Group, this would considerably impede legitimate transactions in Hong Kong securities, affecting market liquidity and volumes. It would also add significantly to the costs of carrying out stock lending, trading and hedging transactions in the Hong Kong market, and we do not believe that it is necessary in order to meet the regulatory objectives underlying the Bill.

We are copying this letter to the Chairman of the Bills Committee, and representatives of the Group would be very happy to attend today's meeting of the Bills Committee if this would be helpful.

Yours sincerely

Pauline Ashall

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Hon. Ronald Arculli/Constance Li - Legco