

LEGISLATIVE COUNCIL BRIEF

SECURITIES ORDINANCE

SECURITIES (MISCELLANEOUS) (AMENDMENT) RULES 1999

INTRODUCTION

By a written resolution dated 10 August 1999 of all the members present in Hong Kong, the Securities and Futures Commission made the aforesaid Rules, the text of which is attached at the Annex (the “Rules”).

BACKGROUND AND ARGUMENT

2. Under the present arrangements with the Hong Kong Monetary Authority (“MA”), Market Makers designated for Exchange Fund Bills (“EFB”), Exchange Fund Notes (“EFN”) and other specified debt instruments¹ (“Specified Instruments”) are allowed to incur short positions during the day, provided that the Market Maker holds, as sole beneficial owner, long positions in other EFB, EFN or other Eligible Securities specified by the MA which are sufficient to cover the short positions. In addition, such long positions must be free from any security or other interest. A Market Maker which holds a short position in an issue at 4:00 p.m. on a business day is required to close out the short position by entering into a “repo”² with the MA at the end of the day.
3. Under this system, Market Makers frequently incur short positions on individual issues to take advantage of trading opportunities. The ability to short sell is one of the main incentives for a recognized dealer of the securities to become a Market Maker and an important element for Market Makers to quote two-way prices. The presence of Market Makers is expected to boost liquidity of the securities traded.
4. The Stock Exchange of Hong Kong Limited (“SEHK”) will start the trading of EFN³ on 16 August 1999. The Market Makers designated by the MA have

¹ As of today, the notes to be issued by the Mass Transit Railway Corporation, the Airport Authority and The Hong Kong Mortgage Corporation Limited under their respective note issuance programmes arranged by the MA have been designated as Specified Instruments.

² If a Market Maker holds a short position in any issue at 4 p.m. on any trading day, it must purchase from the MA the same issue to close its short position under the terms of a Master Sale and Repurchase Agreement (“Repo”). Under the Repo, the Market Maker will sell to the MA its long position in those debt instruments which have been designated by the MA as eligible for Repo and the MA will credit the account of the Market Maker with the instruments necessary to cover the short position. The Repo will be reversed on the next trading day.

³ SEHK has plans to launch EFB and Specified Instruments on the SEHK in the future. But as at present, SEHK has no concrete timetable as to when to do this.

expressed their interest to the SEHK to quote firm bid/ask price on the Exchange-listed market for their own proprietary trading and arbitrage in the professional market. If short-selling of these securities is not allowed, an inconsistent treatment of MA-designated Market Makers who participate in both markets will arise and they will be less willing to “make a market” in the Exchange-listed market.

5. It is proposed to maintain MA’s current system that makes short-selling of EFB, EFN and Specified Instruments available to its designated Market Makers only. These Market Makers are designated by the MA pursuant to a Letter of Appointment setting out the terms and conditions of the appointment and are regulated by the MA.
6. The purpose of allowing designated Market Makers of EFN to short sell is to facilitate their performance of market making functions and it is not intended to extend the facility to the general public.

PUBLIC CONSULTATION

7. Both the MA and the SEHK support this proposal. Given the technical nature of the proposal, it is considered not necessary to conduct consultation with the public.

FINANCIAL AND STAFFING IMPLICATIONS

8. There are no financial and staffing implications for Government.

COMMENCEMENT DATE

9. The commencement date for the Rules will be 13 August 1999.

PUBLICITY

10. The Rules will be published in the Gazette on 13 August 1999. The SEHK will make an announcement in due course.

ENQUIRIES

11. For any enquiries on this brief, please contact Mr. George Tam, Senior Manager, at 2840 9223 in the Supervision of Markets Division or Ms. Alexandra Lo, Senior Counsel, at 2840 9252 in the Legal Services Division of the Securities and Futures Commission.

The Securities & Futures Commission
11 August 1999