

LEGISLATIVE COUNCIL BRIEF

Securities and Futures Ordinance (Cap. 571)

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

INTRODUCTION

Pursuant to section 377 of the Securities and Futures Ordinance (Cap. 571) (SFO), the Securities and Futures Commission (SFC) has made the Securities and Futures (Disclosure of Interests - Securities Borrowing and Lending) Rules (the Rules) at the **Annex**.

BACKGROUND

The SFO

2. The SFO was enacted in March 2002. It consolidates and modernizes ten existing ordinances governing the securities and futures markets into a composite piece of legislation to keep the regulatory regime on a par with international standards and practices. For effective regulation, the SFO provides flexibility in addressing changing market practices and global conditions by empowering the Chief Executive in Council, the Financial Secretary, the Chief Justice and the SFC to prescribe detailed and technical requirements as necessary by way of subsidiary legislation, to supplement the regulatory framework laid down under the primary legislation.

3. On 22 February 2002, the House Committee of the Legislative Council established the Subcommittee on Draft Subsidiary Legislation to be made under the SFO (the Subcommittee) to study the subsidiary legislation necessary for commencing the SFO. From March 2002 to October 2002, the Subcommittee held 12 meetings and considered a total of 37 sets of draft subsidiary legislation, including the *vires* to make them.

THE PROPOSALS

Major policy considerations

4. The Rules supplement the regulatory regime for disclosure of securities interests in Part XV of the SFO. Part XV replaces the existing Securities (Disclosure of Interests) Ordinance (Cap. 396) and requires substantial shareholders, directors and chief executives to disclose interests in shares of listed companies. 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 minimize the compliance burden.

5. In securities borrowing and lending (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. The SFC is of the view 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 or compromising investor protection. Accordingly, the SFC has made the Rules to simplify the disclosure requirements in respect of specified SBL transactions.

THE RULES

6. The Rules will establish a simplified disclosure regime for the following types of persons with respect to their SBL transactions—

- (a) substantial shareholders, who lend through an approved lending agent (ALA) (see paragraph (b) below) that uses a specified form of agreement (i.e. a relevant agreement¹ 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 (section 3 of the Rules);

¹ Briefly, a relevant agreement refers to a SBL agreement providing that the borrower 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.

- (b) ALAs – persons approved by the Commission as ALAs (generally custodians) will be exempt from the 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 pool but the amount of information required to be included in their notification has been simplified (sections 4, 5, 6 and 8 of the 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 (section 7 of the Rules).

7. 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 with the requirements set out in sections 9 and 10 respectively of the Rules.

PUBLIC CONSULTATION

8. The SFC released a consultation document and an exposure draft of the Rules on 19 December 2001 for comment by the public. A total of five submissions were received. In the light of the comments received, the SFC subsequently met with the respondents, to discuss the proposals with them in more detail. The Rules have taken into account comments from the consultation and the results of further discussions with the industry.

9. A draft of the Rules was considered by the Subcommittee at its meeting held on 15 July 2002. No major concerns were expressed by members of the Subcommittee at the meeting.

FINANCIAL AND STAFFING IMPLICATIONS

10. There are no financial or staffing implications for the Government.

COMMENCEMENT DATE

11. The Rules will come into operation on the day appointed for the commencement of the SFO, together with other subsidiary legislation necessary for the commencement. We expect this to take place shortly, after completion of the negative vetting procedure through the Legislative Council and allowing the industry a reasonable period of time for making necessary adjustments with reference to the subsidiary legislation. We aim to announce the target commencement date by the end of 2002.

PUBLICITY

12. The Rules will be published in the Gazette on 13 December 2002. The SFC will issue a press release on the same day.

ENQUIRIES

13. For any enquiries on this brief, please contact Mr. Anthony Wood of the Legal Services Division of the Commission at 2840 9276 or Mr. Brian Ho of the Corporate Finance Division of the Commission at 2840 9321.

The Securities and Futures Commission
13 December 2002

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

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**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 (Cap. 571)
after consultation with the Financial Secretary)

1. Commencement

These Rules shall come into operation on the day appointed for the commencement of the Securities and Futures Ordinance (Cap. 571).

2. Interpretation

(1) In these Rules, unless the context otherwise requires -
"approved lending agent" (核准借出代理人) means a corporation approved by the Commission in accordance with section 8, in so far as the approval has not been withdrawn under that section;

"collateral" (抵押品) means any money, securities, letter of credit or guarantee deposited with, or otherwise provided by or on behalf of a borrower of shares, to a lender of the shares (or deposited or provided in accordance with the lender's instructions) under a relevant agreement, which is so

deposited or provided as security for the return of shares lent under the relevant agreement;

"duty of disclosure" (披露責任) has the meaning assigned to it by section 308 of the Ordinance;

"equivalent shares" (相等股份) 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" (上市法團) has the meaning assigned to it by section 308 of the Ordinance;

"mark to market" (按照市值計算差額) means to adjust the valuation of shares lent or collateral, being the subject of a relevant agreement, to reflect their current market values;

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

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

"qualified shares" (合資格股份) means shares -

- (a) in which a person is interested;

(b) which the person has authorized an approved lending agent to lend as his agent; and

(c) which the approved lending agent is authorized to lend only under a relevant agreement,

and, in the case where any of those shares have been lent by the approved lending agent under a relevant agreement, shall include the shares so lent, only if the right of the approved lending agent under the relevant agreement to require the return of the shares has not been extinguished;

"regulated person" (受規管人士) 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" (有關協議) means a securities borrowing and lending agreement containing provisions under which -

(a) on delivery of the shares borrowed, the borrower of shares is required to deliver to the lender of the shares (or in accordance with the lender's instructions), collateral of a value exceeding the

market value of the shares lent, as security for the return of the shares lent;

(b) the value of the collateral and the shares lent are marked to market on a daily basis, and the borrower 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 can require the return of the shares lent, 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" (有關事件) 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 circumstances referred to in such section;

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

"relevant time" (有關時間) means the time of the occurrence of the relevant event;

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

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

(b) equivalent shares;

"short position" (淡倉) 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 has to return the shares to the first-mentioned person, when required 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 borrower under 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 borrower under a relevant agreement.

(3) If the shares referred to in subsection (1) are used by the approved lending agent in circumstances other than those specified 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 at the relevant time.

4. Notification by an approved lending agent

Where a person authorizes an approved lending agent to lend shares, only under a relevant agreement, as agent and -

- (a) the approved lending agent lends qualified shares to a borrower under the terms of a relevant agreement; or
- (b) qualified shares are returned to the approved lending agent by the borrower,

the person shall not be required to secure under section 321 of the Ordinance that the approved lending agent notifies him 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 subsection(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).

(2) Subject to subsection(5), a person 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) The circumstances referred to in subsections (1) and (2), in which the approved lending agent or person (as the case may be) is not under a duty of disclosure, are those where -

- (a) qualified shares are transferred or delivered by the person to the approved lending agent;
- (b) shares held by, or on behalf of, the approved lending agent become qualified shares when the person referred to in paragraph (a) authorizes the approved lending agent to lend the shares;
- (c) qualified shares are lent by the approved lending agent to a borrower under a relevant agreement;
- (d) qualified shares lent by the approved lending agent are returned to the approved lending agent by a borrower under a relevant agreement;
- (e) qualified shares held by, or on behalf of, the approved lending agent cease to be qualified shares;
- or
- (f) qualified shares are returned to the person referred to in paragraph (a) by the approved lending agent.

(4) (a) In the circumstances specified in -

- (i) subsection (3) (a) or (b), the approved lending agent and the person referred to in subsection (2) (if any) are 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; or

(ii) subsection (3)(e) or (f), the approved lending agent and the person referred to in subsection (2) (if any) are 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

(b) in the circumstances where the 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) are 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,

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 in such circumstances, come under a duty of disclosure.

(5) If an approved lending agent fails to comply with any requirement imposed under section 9, the approved lending agent and the person referred to in subsection (2) (if any) are taken, for the purposes of Divisions 2 to 5 of Part XV of the Ordinance, to have acquired an interest in all qualified shares in which the approved lending agent was interested under the terms of a relevant agreement -

- (a) in the case of a failure to comply with section 9(1), on the last day of the period within which the approved lending agent is required to make the record;
- (b) in the case of a failure to comply with section 9(3) (a), on the first day that the approved lending agent fails to retain the record; or
- (c) in the case of a failure to comply with section 9(3) (b), on the last day of the period within which the approved lending agent is required to provide the record,

and subsections (1) and (2) shall not apply to any interest of the approved lending agent in qualified shares after that day.

6. Exclusion of certain particulars to be specified in notification

Where a duty of disclosure arises under section 310 of the Ordinance in the circumstances specified in section 5(4), an approved lending agent or a person referred to in section 5(2) (if any) shall, in performing the duty of disclosure, only specify in the notification given under section 324 of the Ordinance its or his name and address, and (so far as it or he 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 in shares of a regulated person to be disregarded for the purpose of notification

(1) Subject to subsections (2), (3) and (4), the following interests or classes of interests, and short positions or 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 the shares -

- (i) have been borrowed by the regulated person under a relevant agreement; and
 - (ii) are used, or are intended to be used, by the regulated person or by a related corporation of the regulated person within 5 business days after the date 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 the shares -
 - (i) in the case where shares have been lent by the regulated person under a relevant agreement to a borrower, are returned to the regulated person under the relevant agreement by the borrower; and
 - (ii) are used, or are intended to be used, by the regulated person or by a related corporation of the regulated person within 5 business days after the date 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 is taken to have acquired an interest or come to have a short position (as the case may be) 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 as specified in subsection (1) (a) (ii) or (b) (ii), the regulated person is taken to have acquired an interest or come to have a short position (as the case may be) 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 interests and short positions of the regulated person in shares that are interests and short positions prescribed under subsection (1) shall cease to be such prescribed interests and short positions and the regulated person is taken, for the purposes of Divisions 2 to 5 of Part XV of the Ordinance, to have acquired an interest and come to have a short position in the shares -

- (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 fails 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 provide the record,

and subsection (1) shall not apply to any interest or short position in shares of the regulated person after that day.

8. Approved lending agents

(1) The Commission may, upon application by a corporation, 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 form specified by the Commission and 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 refuse to approve an applicant corporation as an approved lending agent.

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

(5) Where the Commission refuses an application of an applicant corporation under subsection (3), the Commission shall notify the applicant corporation 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 are transferred or delivered by a person to an approved lending agent, as referred to in section 5(3)(a);
- (b) shares become qualified shares, as referred to in section 5(3)(b);

- (c) an approved lending agent lends qualified shares, as referred to in section 5(3)(c);
- (d) qualified shares are returned to the approved lending agent, as referred to in section 5(3)(d);
- (e) qualified shares held by, or on behalf of, an approved lending agent cease to be qualified shares, as referred to in section 5(3)(e);
- (f) qualified shares are returned to a person, as referred to in section 5(3)(f); or
- (g) an approved lending agent ceases to have a subsisting right to require the return of qualified shares, as referred to in section 5(4)(b),

the approved lending agent shall, within 3 business days after the occurrence 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 occurrence of the event;
- (b) the description and quantity of the shares or qualified shares which are the subject of the event; and
- (c) (in the case of an event referred to in subsection (1)(c), (d), and (g)) 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 at any time within 3 years after the last day of the period within which the relevant record is required to be made, provide 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 are borrowed by a regulated person, as referred to in section 7(1)(a)(i);
 - (b) shares are returned to a regulated person, as referred to in section 7(1)(b)(i);
 - (c) shares are used for a prescribed purpose by a regulated person, or by a related corporation of the regulated person, within 5 business days after the date on which the shares are acquired or returned (as the case may be), as referred to in section 7(1)(a)(ii) or (b)(ii); or
 - (d) shares -

(i) borrowed by a regulated person, as referred to in section 7(1)(a)(i); or
(ii) returned to a regulated person, as referred to in section 7(1)(b)(i),
are not 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 on which the shares are acquired or returned (as the case may be),

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

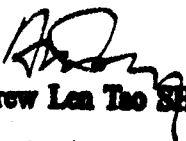
(2) A record made under subsection (1) shall contain the following particulars -

- (a) the date of the occurrence of the event;
- (b) the description and quantity of the shares which are 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 at any time within 3 years after the last day of the period within which

the relevant record is required to be made, provide such record to the Commission within 5 business days after the date of the request.


Andrew Leo Tao SHENG

Chairman,
Securities and Futures Commission

9th December, 2002

Explanatory Note

These Rules 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 Securities and Futures Ordinance (Cap. 571) ("the Ordinance"), subject to the conditions that the shares are lent through approved lending agents (which are corporations approved by the Securities and Futures Commission) and records are duly kept.

2. These Rules also prescribe interests and short positions in shares held by regulated persons (which are licensed or registered intermediaries or overseas corporations dealing in securities) that are to be disregarded under section 323 of the Ordinance for

the purpose of notification, subject to the condition that records are duly kept.