

LEGISLATIVE COUNCIL BRIEF

**SECURITIES AND FUTURES ORDINANCE
(Chapter 571)**

**SECURITIES AND FUTURES
(SHORT POSITION REPORTING) RULES**

**SECURITIES AND FUTURES (OFFENCES AND PENALTIES)
(AMENDMENT) REGULATION 2012**

INTRODUCTION

At its meeting on 18 January 2012, the Securities and Futures Commission (SFC), under section 397(1) and (2) of the Securities and Futures Ordinance (Cap. 571) (“SFO”), after consultation with the Financial Secretary, made the Securities and Futures (Short Position Reporting) Rules (“the Rules”), at Annex A.

A

2. At the meeting of the Executive Council on 13 March 2012, the Council ADVISED and the Chief Executive ORDERED that, under section 398(6) of the SFO, the Securities and Futures (Offences and Penalties) (Amendment) Regulation 2012 (“the Amendment Regulation”), at Annex B, should be made to provide for the offences and penalties under the Rules.

B

JUSTIFICATIONS

3. In the wake of the global financial crisis in September 2008, regulators in various jurisdictions took steps to strengthen their short selling regulations to address concerns regarding short sales in their markets. The International Organisation of Securities Commissions (“IOSCO”) also recommended four high level principles as the international standard for the effective regulation of short selling¹ in the report entitled “Regulation of

¹ The four principles in the IOSCO report are –

1. short selling activities should be subject to appropriate controls to reduce or minimise the potential risks that could affect the orderly and efficient functioning and stability of financial markets;
2. short selling should be subject to a reporting regime that provides timely information to the market or

Short Selling” published in June 2009. One of the recommended principles is that short selling should be subject to a reporting regime.

4. In light of the above, we support SFC’s proposal to introduce a short position reporting regime to enhance SFC’s ability to monitor short selling activities in the market to enable it to achieve its regulatory objectives more effectively.

5. Key features of the new regime include -

- (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, Hang Seng China Enterprises Index 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 the Stock Exchange of Hong Kong (“SEHK”) or other trading venues specified by SFC²;
- (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; and
- (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.

to market authorities;

- 3. short selling should be subject to an effective compliance and enforcement system; and
- 4. short selling regulation should allow appropriate exceptions for certain types of transactions for efficient market functioning and development.

² This refers to the authorized automated trading services specified in Schedule 2 to the Rules.

6. SFC will implement the new reporting regime through promulgation of the Rules, details of which are set out in paragraphs 9-13 below.

7. Section 2 of the Securities and Futures (Offences and Penalties) Regulation (Cap. 571AH) (“the Principal Regulation”) provides that a person who, without reasonable excuse, contravenes a provision specified in its Schedule commits an offence and is liable on conviction to the penalty specified in the Schedule. As mentioned in paragraph 5(g) above, a weekly reporting duty would be imposed in normal circumstances and a daily reporting requirement would be put in place in a contingency situation. To ensure effective enforcement by SFC, we believe that breaches of the reporting requirements stipulated in the Rules should be made an offence with proportionate penalties. Based on the recommendation of SFC, we propose that, under section 398(6) of SFO, the Schedule to the Principal Regulation be amended, so that pursuant to section 2 of the Principal Regulation as read together with the Schedule (as amended), a person who, without reasonable excuse, contravenes Rule 4(2) of the Rules, i.e., the duty to report weekly, or Rule 4(4) of the Rules, i.e., the duty to report daily, commits an offence and is liable on conviction on indictment to a fine at level 6³ and a term of imprisonment of 2 years, and on summary conviction to a fine at level 3⁴ and a term of imprisonment of 6 months. The level of penalty is consistent with those prescribed for other similar offences under SFO, e.g., non-compliance with the disclosure of interests requirements under Part XV of SFO and a breach of the reporting requirements on large open positions stipulated under the Securities and Futures (Contracts Limits and Reportable Positions) Rules (Cap. 571Y).

OTHER OPTIONS

8. While the new reporting requirements could be implemented administratively, it would not have sufficient deterrent effect. The proposed penalties for a breach of the reporting requirements strike a reasonable balance in having a sufficient deterrent effect against non-compliance and are proportional to the severity of the offence committed.

³ The current level is \$100,000.

⁴ The current level is \$10,000.

THE SECURITIES AND FUTURES (SHORT POSITION REPORTING) RULES

9. Rule 3 provides for the meaning of a reportable short position by reference to a threshold. Rule 4 sets out who has the duty to report, when the duty arises and how the report is to be made. The details are as follows –

- (a) the duty to report is imposed on a person who has a reportable short position in any specified shares at the close of trading on a reporting day;
- (b) unless a notice requiring daily reporting is in force, the reporting day is the last trading day of each week and a reportable short position must be reported within two business days after the reporting day;
- (c) if a notice requiring daily reporting is in force, every trading day is a reporting day and a reportable short position must be reported within one business day after the reporting day;
- (d) if the short position in specified shares is held on trust, then the trustee has the duty to report;
- (e) for corporations, the short position in any specified shares that is attributable to more than one collective investment scheme must be reported separately;
- (f) if the partners in a partnership have a reportable short position, then a notice submitted by a partner or another person authorised by all the partners in the partnership is regarded as having complied with the statutory duty to notify under Rule 4; and
- (g) a person who has short positions in any specified shares as a partner in more than one partnership must report the short position attributable to each partnership separately.

10. Rule 5 provides that SFC may designate an online communication system for the purposes of reporting under the Rules.

11. Rule 6 requires SFC to publish particulars of the reportable short positions reported to it.

12. Rule 7 empowers SFC, in a contingency situation, to require daily reporting of reportable short positions. Rule 7(1) defines the contingency situation.

13. Schedule 1 specifies the shares to be specified shares. Schedule 2 is for specification of the authorized automated trading services (ATSs) to be specified ATS. Schedule 2 is currently left blank and SFC may later amend the Schedule to specify the authorized ATSs.

THE SECURITIES AND FUTURES (OFFENCES AND PENALTIES) (AMENDMENT) REGULATION 2012

14. Section 3 of the Amendment Regulation adds two items to the Schedule to the Principal Regulation –

- (a) the new item 5, read together with section 2 of the Principal Regulation, provides that a person who, without reasonable excuse, contravenes Rule 4(2) of the Rules commits an offence and is liable on conviction on indictment to a fine at level 6 and imprisonment for 2 years, and on summary conviction to a fine at level 3 and imprisonment for 6 months; and
- (b) the new item 6, read together with section 2 of the Principal Regulation, provides that a person who, without reasonable excuse, contravenes Rule 4(4) of the Rules commits an offence and is liable on conviction to the same level of penalty as set out in paragraph (a) above.

15. The Amendment Regulation and the Rules (except its Rule 6)⁵ will come into operation on 18 June 2012.

LEGISLATIVE TIMETABLE

16. The legislative timetable will be as follows –

⁵ Rule 6 provides that SFC will publish particulars of the reportable short positions as soon as practicable and in the manner that it considers appropriate. SFC expects that at the initial stage of implementation, there may be operational and other factors which could impact the integrity of data. Hence it would require some leadtime to ensure proper collation and disclosure of such data. SFC has proposed that Rule 6 will come into effect in August 2012, subject to the necessary legislative process.

Publication in Gazette	23 March 2012
Tabling at the Legislative Council (LegCo)	28 March 2012

IMPLICATIONS OF THE PROPOSAL

Financial and Civil Service Implications

17. There are no financial and civil service implications to the Government arising from the proposal.

Economic Implications

18. The proposal would enhance information flow in the stock market and strengthen SFC's market capability in respect of short selling activities, and is thus conducive to the financial stability of Hong Kong.

Other Implications

19. The proposal is in conformity with the Basic Law, including the provisions concerning human rights. It does not affect the current binding effect of the existing provisions of SFO and its subsidiary legislation. It has no environmental or sustainability implications.

PUBLIC CONSULTATION

20. SFC conducted public consultation in July 2009 on the reporting regime, and in May and October 2011 on the draft Rules, and received broad market support in general. Comments from the market on the draft Rules have been incorporated where appropriate. The Panel on Financial Affairs of LegCo was consulted in July 2011 and January 2012 and supported the proposal in general.

PUBLICITY

21. A press release will be issued. A spokesman will be available to handle media enquiries.

BACKGROUND

22. Hong Kong has a robust regulatory framework for short selling. Under SFO, naked short selling is generally prohibited. In other words, short sellers are required to borrow shares before a short selling order can be submitted to SEHK for execution. Further, short selling orders must be “marked” so that short selling transactions are traceable by SFC. On top of these statutory requirements, SEHK has established eligibility criteria such that only the more liquid securities are allowed for short selling and has an uptick requirement to prevent short sales of securities at successively lower prices.

23. Recently, there have been increasing concerns on the impact of short selling activities on market stability and whether there is market manipulation involved. With the new reporting regime, the regulator could collect more information about short selling activities in Hong Kong. In particular, SFC would be informed of the net short positions of major stocks in the market. This would facilitate its market monitoring efforts. As SFC will publish the reported short positions on an aggregated basis, the public would be able to have more information about short selling activities as well.

24. The new reporting regime would facilitate SFC in achieving its regulatory objectives as stipulated in section 4 of SFO, namely to reduce systemic risks in the securities industry, and to assist the Financial Secretary in maintaining the financial stability of Hong Kong. This would also help to maintain and promote the transparency and orderliness of the securities industry and to minimize crime and misconduct in the securities industry.

25. Under section 398(6) of SFO, where rules are made by SFC under any provision of SFO and SFO has not provided that a contravention of the rules constitutes an offence, CE in Council may make regulations to provide that a person who contravenes any specified provision of the rules commits an offence and is liable to a specified penalty not exceeding the maximum levels specified in section 398(6), namely: –

- (a) on conviction on indictment a fine of \$500,000 and a term of imprisonment of 2 years; and
- (b) on summary conviction a fine at level 6 and a term of imprisonment of 6 months.

ENQUIRIES

26. Any enquiries on this brief may be addressed to Ms Sara Tse, Principal Assistant Secretary for Financial Services and the Treasury (Financial Services) (1) (acting), at telephone number 2810 2054, or Mr Rico Leung of SFC, at telephone number 2840 9357.

**Financial Service Branch
Financial Services and the Treasury Bureau
March 2012**

Securities and Futures (Short Position Reporting) Rules

Part 1
Rule 1

1

Securities and Futures (Short Position Reporting) Rules

(Made by the Securities and Futures Commission under section 397(1) and (2) of the Securities and Futures Ordinance (Cap. 571) after consultation with the Financial Secretary)

Part 1**Preliminary****1. Commencement**

- (1) Subject to subrule (2), these Rules come into operation on 18 June 2012.
- (2) Rule 6 comes into operation on a day to be appointed by the Securities and Futures Commission by notice published in the Gazette.

2. Interpretation

In these Rules—

business day (營業日) means a day other than—

- (a) a public holiday;
- (b) a Saturday; and
- (c) a gale warning day or a black rainstorm warning day as defined in section 71(2) of the Interpretation and General Clauses Ordinance (Cap. 1);

daily reporting requirement notice (每日申報規定公告) means a notice published under rule 7(1);

reportable short position (須申報淡倉) has the meaning given by rule 3;

reporting day (申報日) means—

Securities and Futures (Short Position Reporting) Rules

Part 1
Rule 3

2

- (a) unless paragraph (b) applies, the day specified in rule 4(1); or
- (b) if a daily reporting requirement notice is in force, the day specified in rule 4(3);

reporting deadline (申報期限) means—

- (a) unless paragraph (b) applies, the period specified in rule 4(2); or
- (b) if a daily reporting requirement notice is in force, the period specified in rule 4(4);

specified ATS (指明自動化交易服務) means an authorized automated trading services specified in Schedule 2;

specified shares (指明股份) means shares in a corporation which are listed or admitted to trading on the Stock Exchange and specified in Schedule 1;

Stock Exchange (證券交易所) means the recognized stock market operated by the Stock Exchange Company.

3. Reportable short position

- (1) In these Rules, a person has a reportable short position in any specified shares if the person has a net short position value in the specified shares that is equal to or more than the threshold specified in subrule (2)(b).
- (2) For the purposes of this rule—
 - (a) the net short position value that a person has in any specified shares is calculated in accordance with the following formula—

$$(A - B) \times C$$

Where—

- A is the number of the specified shares in the person's short position;

- B is the number of the specified shares in the person's long position;
- C is the specified closing price of the specified shares;
- (b) in subrule (1), the threshold in relation to a reporting day is the lower of—
- (i) \$30 million; and
 - (ii) 0.02% of the value of the total number of the specified shares issued by the corporation concerned, calculated in accordance with the following formula—

$$C \times D$$

Where—

- C is the specified closing price of the specified shares;
- D is the total number of the specified shares issued by the corporation, as at the close of trading on the Stock Exchange on the reporting day;
- (c) in paragraphs (a) and (b), specified closing price, in relation to any specified shares, is—
- (i) the closing price of the specified shares on the reporting day; or
 - (ii) if on the reporting day the specified shares are suspended from trading on the Stock Exchange, the last closing price of the specified shares before the suspension,
- as determined in accordance with the rules of the Stock Exchange Company.

(3) In this rule—

long position (好倉), in relation to any specified shares, means the number of the specified shares that a person beneficially owns;

short position (淡倉), in relation to any specified shares, means the position in the specified shares that a person has as a result of selling the specified shares at or through the Stock Exchange or by means of any one or more specified ATS, or any combination of these methods of selling, where—

- (a) at the time of each sale comprised in the position, the person did not have a presently exercisable and unconditional right to vest the specified shares in the purchaser; or
- (b) each sale comprised in the position was the subject of a short selling order.

Part 2

Reportable Short Positions

4. Reportable short positions to be notified to Commission
- (1) Unless a daily reporting requirement notice is in force, subrule (2) applies to a person who has a reportable short position in any specified shares at the close of trading on the Stock Exchange on—
 - (a) the Friday of any week; or
 - (b) if the Stock Exchange does not open for trading on the Friday of any week, the last weekday before Friday on which the Stock Exchange is open for trading.
 - (2) A person to whom this subrule applies must notify the Commission of the reportable short position within 2 business days after the day specified in subrule (1) in accordance with this rule.
 - (3) If a daily reporting requirement notice is in force, subrule (4) applies to a person who has a reportable short position in any specified shares at the close of trading on the Stock Exchange on each day on which the Stock Exchange is open for trading.
 - (4) A person to whom this subrule applies must notify the Commission of the reportable short position within 1 business day after the day specified in subrule (3) in accordance with this rule.
 - (5) If a reportable short position in any specified shares is held on trust, the duty to notify under subrule (2) or (4) does not apply to a beneficiary of the trust and instead applies to the person who is the trustee of the trust as if that person were the beneficiary.
 - (6) In determining whether a corporation has a reportable short position in any specified shares—

- (a) the short position and the long position (if any) in the specified shares attributable to a particular collective investment scheme; and
 - (b) those attributable to another collective investment scheme,
are to be treated separately and not to be aggregated.
- (7) In determining whether a person has a reportable short position in any specified shares—
- (a) the short position and the long position (if any) in the specified shares attributable to any partnership; and
 - (b) those attributable to another partnership,
are to be treated separately and not to be aggregated.
- (8) If the partners in a partnership have a reportable short position in any specified shares attributable to the partnership, those partners are regarded as having complied with the duty to notify under subrule (2) or (4) in respect of those specified shares if one of those partners or another person authorized by all those partners has submitted, on behalf of those partners, a notice that complies with subrule (9).
- (9) Notification to the Commission required under subrule (2) or (4) must—
- (a) be in the form specified by the Commission under section 402 of the Ordinance for the purposes of this rule;
 - (b) contain—
 - (i) particulars identifying the person who has a reportable short position in specified shares;
 - (ii) particulars of the net short position value and number of specified shares comprised in the reportable short position; and
 - (iii) the name and stock code of the specified shares comprised in the reportable short position; and

- (c) be submitted to the Commission electronically by means of an online communication system designated by the Commission under rule 5(1) for the purposes of these Rules.

5. Commission may designate online communication system

- (1) The Commission may, for the purposes of these Rules, designate an online communication system.
- (2) Where the Commission designates an online communication system under subrule (1), it must as soon as reasonably practicable publish directions and instructions relating to the use of that system in the manner that it considers appropriate.

6. Commission to publish particulars of reported short positions

- (1) Subject to subrules (2) and (3), the Commission must, as soon as reasonably practicable after the reporting deadline for a reporting day, publish in the manner that it considers appropriate the particulars of the reportable short positions notified to it in respect of the reporting day under rule 4(2) or (4) that it considers appropriate.
- (2) Subrule (1) does not require the Commission to publish particulars—
 - (a) earlier than 5 business days after the reporting day; or
 - (b) if a daily reporting requirement notice is in force, more frequently than once a week.
- (3) Any particulars published under subrule (1) must be, so far as reasonably practicable, presented in a way which prevents the identity of a person who has submitted a notice under rule 4(2) or (4) and that person's reportable short position from being ascertained from it.

Part 3

Daily Reporting Requirements

7. Daily reporting requirement notice

- (1) The Commission may publish a daily reporting requirement notice in accordance with this rule if the Commission believes that—
 - (a) circumstances exist, in Hong Kong or elsewhere, which threaten or may threaten the financial stability of Hong Kong; and
 - (b) as a result of those circumstances, the Commission needs to be notified of reportable short positions on a daily basis.
- (2) A daily reporting requirement notice—
 - (a) must declare that, from the date specified in the notice, a person who has a reportable short position on each day on which the Stock Exchange is open for trading must notify the Commission of the reportable short position within 1 business day;
 - (b) must be published in the Gazette at least 24 hours before the date specified in the notice; and
 - (c) may be published or announced on the Commission's website and in any other manner and at the times that the Commission considers appropriate.
- (3) If a daily reporting requirement notice is in force and the Commission believes that it no longer needs to be notified of reportable short positions on a daily basis, the Commission must publish on its website a notice (*cessation notice*) declaring that the daily reporting requirement notice is to cease to have effect from the date specified in the cessation notice.

- (4) Neither a daily reporting requirement notice nor a cessation notice is subsidiary legislation.
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Schedule 1

[r. 2]

Specified Shares

1. Shares which are a constituent of the Hang Seng Index.
 2. Shares which are a constituent of the Hang Seng China Enterprises Index.
 3. Shares which—
 - (a) are shares determined by the Stock Exchange Company to be a “designated security” in accordance with the rules of the Stock Exchange Company; and
 - (b) are shares classified by the Hang Seng Indexes Company Limited as financial stocks in accordance with the Hang Seng Industry Classification System.
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Schedule 2

[r. 2]

Specified ATS

[This schedule is deliberately left blank]

Chief Executive Officer,
Securities and Futures Commission

2012

Explanatory Note

The object of these Rules is to impose a duty on a person who has a net short position in certain shares that amounts to or exceeds certain threshold to report the short position to the Securities and Futures Commission (*Commission*) on or before a reporting deadline.

2. Rule 2 sets out the definitions to be used in the Rules.
3. Rule 3 provides for the meaning of reportable short position by reference to a threshold.
4. Rule 4 sets out who has the duty to report, when the duty arises and how the report is to be made. The details are as follows—
 - (a) The duty to report is imposed on a person who has a reportable short position in any specified shares at the close of trading on a reporting day.
 - (b) Unless a notice requiring daily reporting is in force, the reporting day is the last trading day of each week and a reportable short position must be reported within 2 business days after the reporting day.
 - (c) If a notice requiring daily reporting is in force, every trading day is a reporting day and a reportable short position must be reported within 1 business day after the reporting day.
 - (d) If the short position in specified shares is held on trust, then the trustee has the duty to report.
 - (e) For corporations, the short position in any specified shares that is attributable to more than one collective investment scheme must be reported separately.
 - (f) If the partners in a partnership have a reportable short position, then a notice submitted by a partner or another person authorized by all the partners in the partnership is regarded as having complied with the statutory duty to notify under rule 4.

Securities and Futures (Short Position Reporting) Rules

Explanatory Note

Paragraph 5

13

- (g) A person who has short positions in any specified shares as a partner in more than one partnership must report the short position attributable to each partnership separately.
5. Rule 5 provides that the Commission may designate an online communication system for the purposes of reporting under the Rules.
 6. Rule 6 requires the Commission to publish particulars of the reportable short positions notified to it.
 7. Rule 7 empowers the Commission, in a contingency situation, to require daily reporting of reportable short positions. Rule 7(1) defines the contingency situation.
 8. Schedule 1 specifies the shares to be specified shares.
 9. Schedule 2 is for specification of the authorized automated trading services to be specified ATS. Schedule 2 is currently left blank and the Commission may later amend the Schedule to specify the authorized automated trading services.

**Securities and Futures (Offences and Penalties)
(Amendment) Regulation 2012**

(Made by the Chief Executive in Council under section 398(6) of the Securities and Futures Ordinance (Cap. 571))

1. Commencement

This Regulation comes into operation on 18 June 2012.

2. Securities and Futures (Offences and Penalties) Regulation amended

The Securities and Futures (Offences and Penalties) Regulation (Cap. 571 sub. leg. AH) is amended as set out in section 3.

3. Schedule amended

The Schedule, after item 4—

Add

“5. Rule 4(2) of the Securities and Futures (Short Position Reporting) Rules (L.N. of 2012)

On conviction on indictment, a fine at level 6 and imprisonment for 2 years

On summary conviction, a fine at level 3 and imprisonment for 6 months

6. Rule 4(4) of the Securities and Futures (Short Position Reporting) Rules (L.N. of 2012)

On conviction on indictment, a fine at level 6 and imprisonment for 2

years

On summary conviction, a fine at level 3 and imprisonment for 6 months”.

Clerk to the Executive Council

COUNCIL CHAMBER

2012

Explanatory Note

Under rule 4(2) and (4) of the Securities and Futures (Short Position Reporting) Rules (L.N. of 2012) (*the Rules*), a person who has a reportable short position in specified shares on a reporting day is required to notify the Securities and Futures Commission (*Commission*) of the short position on or before the reporting deadline for the reporting day. Under rule 4(1) and (2) of the Rules, the reporting day is the last trading day of each week and a reportable short position must be reported within 2 business days after the reporting day. Under rule 4(3) and (4) of the Rules, if a notice requiring daily reporting is in force, every trading day is a reporting day and a reportable short position must be reported within 1 business day after the reporting day.

2. This Regulation amends the Schedule to the Securities and Futures (Offences and Penalties) Regulation (Cap. 571 sub. leg. AH) by providing that a person who, without reasonable excuse, fails to notify the Commission as required by the Rules commits an offence, and is liable on conviction, to a fine and imprisonment specified in the Schedule.