



SFC's First Criminal Prosecution for Securities Fraud Involving Illegal Short Selling Transferred to District Court

On 20 March 2026, the Eastern Magistrates' Courts granted an application by the Department of Justice to transfer a securities fraud case brought by the Securities and Futures Commission (SFC) to the District Court for criminal proceedings. The case concerns Mr. Chan Hoi Shing and Mr. Li Po Ching, who are alleged to have operated a fraudulent scheme involving illegal short selling in the shares of 28 Hong Kong-listed companies, generating profits of approximately HK\$11 million. The first hearing in the District Court is fixed for 9 April 2026.

The transfer is a landmark. This is the first occasion on which a criminal prosecution for securities fraud involving illegal short selling under section 300 of the Securities and Futures Ordinance (the **SFO**) will be heard in the District Court, reflecting both the seriousness of the alleged conduct and the enhanced sentencing powers available to that court. For anyone inclined to regard Hong Kong's prohibition on naked short selling as a largely theoretical constraint, this case should dispel that notion.

Illegal Short Selling on HKEX

The SFC commenced proceedings at the Eastern Magistrates' Courts on 6 November 2025 against Mr. Chan Hoi Shing and Mr. Li Po Ching, alleging that between 27 May 2020 and 29 December 2020, the pair operated a fraudulent scheme involving illegal short selling in the shares of 28 Hong Kong-listed companies, in contravention of section 300 of the SFO.

The SFC alleges that Chan falsely represented to Black Marble Securities Limited that he held sufficient shares of the 28 companies to support sell orders placed through his securities account, when in fact he did not. The consequence, the regulator says, was that Chan and Li were able to carry out illegal short selling and generated profits of approximately HK\$11 million.

No plea was entered at the initial hearing in November, and the case was adjourned to February 2026, at which point the prosecution indicated its intention to seek transfer to the District Court. That application has now been granted.

At the hearing on 20 March 2026, bail was extended to both defendants on the same stringent conditions imposed at the outset: a prohibition on leaving Hong Kong, surrender of all travel documents, regular police reporting, cash bail of HK\$280,000 each, and a requirement to reside at their reported addresses with any change notified to the

police.

Why the District Court Transfer Matters

The transfer is significant for several reasons. The District Court has considerably greater sentencing powers than the Magistrates' Courts, with the capacity to impose custodial sentences of up to seven years for certain offences. The SFC's decision to pursue this matter at the District Court level sends an unmistakable signal about the gravity with which it views fraudulent short selling schemes, and about its willingness to seek the full weight of the criminal law in response.

That this represents the first such prosecution to reach the District Court under section 300 of the SFO in the context of illegal short selling is itself remarkable, given that the short selling regulatory framework has been in place for over two decades. It suggests either that such schemes have historically been addressed through other means, or that this particular case is regarded as sufficiently egregious to warrant a more robust prosecutorial approach.

A Timely Reminder: The Prohibition on Naked Short Selling

This prosecution serves as a timely reminder that "naked" or "uncovered" short selling is prohibited under section 170 of the SFO. The prohibition is not a technicality; it is a cornerstone of Hong Kong's market integrity framework, and the penalties for contravention are severe.

For practitioners and compliance professionals, it is worth revisiting the key provisions as set out in the SFC's [Guidance Note on Short Selling Reporting and Stock Lending Record Keeping Requirements](#) (the **Short Selling Guidance Note**).

Section 170(1) of the SFO makes it a criminal offence for a person to sell securities at or through a recognised stock market unless, at the time of the sale, the seller (or, where the seller is acting as agent, the seller's client) has a presently exercisable and unconditional right to vest the securities in the purchaser, or believes and has reasonable grounds to believe that such a right exists. The maximum penalties are a fine of HK\$100,000 and imprisonment for two years.

The provision is targeted squarely at the kind of conduct alleged in the Chan and Li case: selling securities one does not own and has made no arrangement to borrow or otherwise obtain. As the Short Selling Guidance Note illustrates by way of example, it would be a criminal offence if a person deliberately sold short and then went into the market to "cover" the short by buying the securities or arranging to borrow them to settle the sale only after the event.

Importantly, section 170 applies only to short sales conducted at or through a recognised stock market, presently the Stock Exchange of Hong Kong Limited. It does not extend to off-exchange short sales.

What is a "Covered" Position

The Short Selling Guidance Note identifies several circumstances in which the SFC accepts that a seller possesses the requisite right to vest, even where the seller does not physically hold the securities at the time of placing the order. These include situations where the seller has already purchased the securities (even if delivery has not yet occurred), where the seller has obtained a "hold notice" or "blanket assurance" from a stock lender confirming the availability of securities for borrowing, where the seller owns convertible instruments conferring a presently exercisable right to obtain the underlying securities, and where the seller has lent the relevant securities but retains a contractual right of recall.

The Short Selling Guidance Note also makes clear that the SFC does not intend to penalise genuine mistakes or errors. Where a seller believed, on reasonable grounds, that the necessary right existed, a defence is available under section 170(3)(a). However, a deliberate and systematic scheme of the kind now alleged against Chan and Li would plainly fall outside this safe harbour.

Reporting Obligations for Covered Short Sales

Even where a short sale is lawfully "covered", it attracts its own reporting regime under sections 171 and 172 of the SFO. At the time of placing a short selling order, the seller must identify it as such and provide a "documentary assurance" confirming that the sale is covered. The intermediary receiving the order must obtain and retain this assurance for at least 12 months. Hong Kong Stock Exchange participants inputting the order into the SEHK trading system must mark it as "short" in accordance with SEHK rules, and the "tick rule" applies, meaning a covered

short sale cannot be executed below the current best ask price. Breaches of these reporting requirements carry penalties of up to HK\$50,000 and 12 months' imprisonment.

Stock lenders, for their part, are required under section 5 of the Securities and Futures (Short Selling and Securities Borrowing and Lending (Miscellaneous)) Rules to maintain documentary records of all lending transactions, including hold notices, blanket assurances and borrows, and to retain those records for at least one year.

Short Selling Prosecuted as Securities Fraud under section 300 of the SFO

What makes this case particularly instructive is not simply the alleged breach of the short selling prohibition, but the manner in which it was allegedly carried out. The SFC's characterisation of the scheme as fraudulent, involving false representations to a brokerage firm about shareholdings, suggests a level of deliberate deception that goes well beyond carelessness or inadvertence. The invocation of section 300, rather than section 170 alone, underlines this point.

For intermediaries, the case is a reminder of the importance of robust pre-trade checks. The Short Selling Guidance Note emphasises that it is an intermediary's duty to verify whether clients have adequate securities available to support their sale orders. Firms that rely solely on client representations, without independent verification or appropriate safeguards, may find themselves uncomfortably exposed when those representations prove false. One might reasonably ask what checks Black Marble Securities Limited conducted, and whether more diligent verification might have detected the alleged misrepresentations sooner.

For the market more broadly, the landmark transfer to the District Court demonstrates that the SFC and the Department of Justice are prepared not only to prosecute but to pursue the most serious available forum where they identify systematic abuse of the short selling rules. In a market environment where short selling volumes continue to attract regulatory scrutiny globally, Hong Kong's enforcement posture sends an unambiguous signal: those who treat the prohibition on naked short selling as a rule to be circumvented rather than respected do so at very considerable personal risk.

This newsletter is for information purposes only

Its contents do not constitute legal advice and it should not be regarded as a substitute for detailed advice in individual cases. Transmission of this information is not intended to create and receipt does not constitute a lawyer-client relationship between Charltons and the user or browser. Charltons is not responsible for any third party content which can be accessed through the website.

If you do not wish to receive this newsletter please let us know by emailing us at unsubscribe@charltonslaw.com

CHARLTONS
易周律師行

Hong Kong Office

Dominion Centre 12th Floor
43-59 Queen's Road East Hong Kong

enquiries@charltonslaw.com

www.charltonslaw.com
Tel: + (852) 2905 7888
Fax: + (852) 2854 9596