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[online version](http://www.charltonslaw.com/new-position-limits-for-h-shares-index-futures-and-options/)

# Hong Kong Law Issue 44

## 1. New Position Limits For H-Shares Index Futures And Options Effective March 30, 2007

Subject to negative vetting by the Legislative Council, amendments to the rules on the position limits for Hang Seng China Enterprises Index (**H-shares index**) futures and options contracts will come into effect on 30 March 2007. The amendments to the Securities and Futures (Contracts Limits and Reportable Positions) Rules will adjust the prescribed limits for H-shares index futures and options contracts from 6,000 contracts per futures contract month or options contract series, to an aggregate delta limit of 12,000 applicable to all futures contract months and options series.

The new limits are designed to promote the growth of Hong Kong's futures and options markets and to help Hong Kong fend off competition from other exchanges which are keen to develop derivative products on Mainland related equities. The amendments are in line with the measures proposed by the Focus Group on Financial Services in their report on "China's 11th Five-Year Plan and the Development of Hong Kong".

The SFC is also considering adjusting the position limit for Hang Seng Index futures and options contracts and will consult the market in the next few months.

Prescribed limits are tools for the surveillance and regulation of the derivatives markets, intended to prevent the build up of excessive and over-concentrated positions which may threaten the orderly functioning and financial stability of the markets. The existing limits are designed to avoid the effects of massive hedge fund sell-offs, such as occurred in 1998, when the government intervened to prevent a collapse of the territory's market caused by sell-offs on the part of global hedge-fund managers.

## 2. Proposals To Relax Short Selling Rules

The SFC plans to relax restrictions on short selling for the first time since they were introduced as part of a packet of measures to combat speculation during the Asian financial crisis.

To enhance Hong Kong's status as an international finance centre on a par with the world's leading bourses, the SFC proposes to remove the uptick rule, which bans short selling below the market price, after a review over the next few months. The uptick rule is thought to inhibit timely execution of transactions and affect the price formation process in the stock market.

Short selling is the process in which investors borrow shares and then sell them in the hope that their price will drop before they need to be returned to the lender. In uncovered shorts, investors sell the shares before they own them, in the hope that they can be bought at a lower price in the three-day window before they need to be delivered to the buyer.

Currently only 370 stocks are eligible for short selling. With effect from 30 March 2007, 30 stocks have been added, and 24 existing designated stocks have been removed from, the list of securities that are eligible for short selling. The full list of designated securities is available on the Stock Exchange website at [www.hkex.com.hk](http://www.hkex.com.hk/).

The SFC hopes that the relaxation will improve market efficiency. Short selling currently accounts for only about 5% of total market turnover in Hong Kong, compared with 25% to 30% in New York and London.

## 3. Exchange To Shorten Suspension Period On Abolition Of Paid Newspaper Announcements

Recent media reports have indicated that the Exchange plans to substantially shorten the period during which trading in a company's shares is suspended when it issues an announcement.

Under the current rules, once trading in a company's shares is suspended, it may not be resumed until the announcement for which the suspension was granted is published in an English and Chinese-language newspaper on the following day. It has been suggested that that rule has led to recent instances in which mainland companies have not asked for trading in their shares to be suspended despite having price-sensitive information on hand.

It has been reported that the shortened suspension period will be introduced later this year when the rule requiring newspaper announcements is abolished. A consultation paper on the exact timing of the suspension will be published in due course.

## 4. Exchange Rejects Plan To Narrow Spreads For Stocks Trading Below $2

The Exchange has decided not to proceed with the reduction of minimum trading spreads (the difference between bid and offer price) for the almost 700 stocks that trade between HK$0.25 and HK$2.

This followed opposition from small brokers who argued that where spreads of more expensive shares had been narrowed, retail investors, who make up the bulk of their clients, had pulled out of the market. Larger brokers that are active derivatives traders favoured narrower spreads as a means of lowering transaction prices and giving more freedom in hedging.

Large and small brokers have battled over spreads since 1994, when the Exchange ordered the narrowing of spreads for stocks trading below HK$10, but was forced to back down in the face of opposition from retail brokers and investors two months later. In July 2005, the Exchange cut the spreads of 36 stocks trading above HK$30. In February 2006, it decided to cut spreads of all stocks trading at less than HK$20, leaving the spreads of stocks trading at between HK$20 and HK$30 unchanged. However, in the face of strong opposition, the Exchange partially backed down in June 2006 and exempted shares trading at less than HK$2 from the narrower spreads pending a review at the board meeting on February 14. Following a review of the trading and market data for the first 6 months of this year and taking into account the comments received, the Exchange's board dropped the initiative to cut spreads for stocks trading at less than HK$2.

## 5. CSRC To Encourage More Domestic Listings

The CSRC plans to make it easier for overseas listed local companies to return to the home market by streamlining procedures and encouraging a domestic venture capital market. The return of such companies would give domestic investors access to more quality mainland companies.

In 2006, mainland companies raised US$44 billion from eight overseas markets including Hong Kong, almost three times the amount raised in the domestic market. A recent research report by the CSRC said this trend would curb the asset growth and competitiveness of the local capital market.

There have been reports that, in an attempt to encourage local listings, the CSRC has been slowing approvals for mainland companies selling shares overseas.

The CSRC plans to improve procedures for dual listing in the mainland and Hong Kong markets. It will also gradually relax the requirement that all listing candidates must submit documents and seek approval from the regulator. It hopes eventually to leave most of the procedures to the exchanges, so that companies will only need to register with the CSRC for a listing.

The CSRC has also said that the lack of local venture capital funds leads to local companies listing overseas. It plans to improve the regulation of foreign capital investments in mainland equities. Currently, several regulatory bodies supervise investment by venture capital funds.

This note contains a summary only of recent regulatory developments. It does not constitute legal advice and specific advice should be sought in any particular situation.

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