SECURITIES AND FUTURES COMMISSION
證券及期貨事務監察委員會

Consultation on Securities and Futures (Short Position Reporting) Rules

May 2011

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Foreword

In July 2009, the Securities and Futures Commission ("SFC") conducted a public consultation on increasing short position transparency ("Consultation")[1]. The SFC, in the Consultation Conclusions on increasing short position transparency[2] ("Consultation Conclusions") published last March, announced the introduction of a new reporting requirement of short positions and the reporting model for the Hong Kong equity market. As explained in the Consultation Conclusions, legislation is required to implement this new reporting requirement. This consultation paper is a follow-up to the Consultation Conclusions and it seeks comments on the draft subsidiary legislation which will give effect to the short position reporting regime.

How to and the deadline to submit comments

Interested parties are invited to submit written comments by any one of the following methods on or before **30 June 2011**:

On-line submission:	http://www.sfc.hk/sfc/html/EN/speeches/consult/consult.html
Email:	shortpositions@sfc.hk
Post :	Supervision of Markets Securities and Futures Commission 8th Floor, Chater House 8 Connaught Road Central Hong Kong
Fax:	(852) 2521 7917

A person commenting on the consultation paper should provide details of any organisation whose views he represents.

Please note that the names of the commentators and the contents of their submissions may be published on the SFC's website and in other documents to be published by the SFC. In this regard, please read the Personal Information Collection Statement attached to this consultation paper as Appendix D.

If you do not want your personal information, your submission or any part of it to be disclosed to the public, please state your request clearly in your submission. In this connection, the SFC will not regard a standard confidentiality statement in an email message as a request not to publish name and/or submission.

1 https://www.sfc.hk/sfcConsultation/EN/sfcConsultFileServlet?name=incshtpostrans&type=1&docno=1
2 http://www.sfc.hk/sfc/doc/EN/speeches/consult/consultationconclusion2march2010english.pdf

Executive Summary

1. This consultation paper invites the public to comment on the draft subsidiary legislation ("Rules") which will give effect to the short position reporting regime that was announced in the Consultation Conclusions.

2. There are two sections to this paper: sections A and B. Section A recapitulates some background information to remind the context in which the short position reporting requirement was introduced.

3. The other section – Section B - is the consultation that comprises four parts. For ease of reference, Part I of Section B reproduces the short position reporting model that was proposed in the Consultation Conclusions which is as follows:

   (a) A person who has a gross short position (i.e. the beneficial owner of the short position) in shares of the constituent companies of the Hang Seng Index, the Hang Seng China Enterprises Index and other financial companies specified by the SFC, that amounts to or exceeds 0.02 % of the issued share capital of that particular listed company or $30 million[3], whichever is lower, at the end of the last trading day of each week, has the obligation to report the short position to the SFC;

      (i) In the case of funds, the reporting requirement applies to each fund. The fund manager may report the position on behalf of each of the funds it manages but will not be required to aggregate the short positions of different funds or be permitted to net positions between different funds;
      (ii) In the case of a group structure that has multiple legal entities (e.g. global financial institutions), the reporting obligation will be on individual legal entities within the group structure. They are not required to aggregate the short positions within the group.

   (b) The reporting requirement applies only to short positions resulted from trading on the Stock Exchange of Hong Kong Ltd ("SEHK") and other trading venues specified by the SFC[4]. Short positions created via OTC trading and economic short positions created by use of derivatives will be excluded for reporting purpose;

   (c) The report must be submitted, electronically, by the second business day of the following week. The SFC will set up an electronic reporting facility and prescribe a template to be used for reporting;

   (d) The SFC will publish aggregated short positions for each stock, on an anonymous basis, one week after the receipt of the reports; and

   (e) The SFC will be empowered to tighten the reporting requirements to increase transparency (such as requiring more frequent reporting) in contingency situations.

4. The SFC addresses some further comments which it received after the publication of the Consultation Conclusions in Part II of Section B. Part III of Section B explains the draft Rules and seeks comment from the public. And Part IV discusses the consequences of a breach of the reporting requirement.

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[3] Unless otherwise specified, figures in this paper are denominated in Hong Kong dollars.
[4] Other trading venues such as an Automated Trading Services ("**ATS**") authorised by the SFC.

5. The draft Rules are attached to this paper as Appendix A and the template for reporting can be found in Appendix B. Part 2 of the Rules titled “*Reportable Short Positions”* sets out the provisions on who has the responsibility to report, when to report, how to report, and publication of particulars of the short positions by the SFC. Schedule 1 of the Rules specifies the shares of those companies that are subject to reporting. Part 3 of the Rules titled “*Daily Reporting Requirements”* fleshes out the details on SFC’s power to modify the reporting requirements in contingency situations.

6. We propose some slight modifications to the model as disclosed in the Consultation Conclusions and explain in detail in the body of this paper why these modifications are necessary.

7. The SFC is working towards implementing the short position reporting requirement as soon as possible. We will give the market an indicative implementation time table when we publish our conclusions to this consultation and in this regard, we will give the market reasonable lead time to get their reporting systems and procedures in place.

Section A

Introduction

Context of introducing short position reporting

8. In the face of a worsening of the global financial crisis in September 2008, regulators in some major markets took steps to address concerns regarding short sales in their markets. As market confidence was fragile, the concern was that short selling would exacerbate the downward spiral in the share price of stocks, including stocks of financial institutions, which could potentially pose serious threats to the stability of the financial system as a whole.

9. To address these concerns, regulators imposed temporary emergency measures which included banning or restricting short selling of shares of selected stocks; requiring reporting by certain investors of short sales or net short sale positions to regulators and to the public; and conducting heightened surveillance of trading to detect abusive short selling. Some of these temporary measures had either lapsed or were extended, depending on domestic market conditions. In some jurisdictions, the temporary measures were replaced with permanent rules.

10. As events in September 2008 had demonstrated, without sufficient data on short selling activities in the market, regulators were not able to assess the implications of short selling on the orderly functioning or stability of their respective markets. They were forced by circumstances to take actions in the crisis which could have been avoided if they were to have more information.

11. One of the lessons learnt from the crisis is the importance for regulators to have access to useful information. Regulators can make use of this information to assess the market dynamics, and if necessary, take appropriate regulatory action to address any potential risks that might be emerging.

12. The SFC has access to some data on short selling activities (e.g. short selling transactions conducted by Exchange Participants of SEHK), however as explained in the Consultation, this information has its limitations[5]. The SFC believes that a systematic collection of data on short positions will complement the information it currently has access to, and these taken together, will present a better picture of the overall short selling activities in the Hong Kong market. Also, as part of global regulatory reforms to improve the resilience of the international financial system, a number of major markets have implemented short position reporting or are studying proposals to enhance short position transparency. The SFC believes that, given the interconnections between global financial markets, Hong Kong, as an international financial centre, should also take steps to increase the transparency of short positions.

[5] Page 4 of the Consultation

Section B

I. Hong Kong's short position reporting requirements

13. The SFC, after having carefully reviewed all the comments received in response to the Consultation and taking into consideration the local market characteristics (such as the size of listed companies in terms of market capitalisation, the free float of listed companies, the daily turnover, and the investors' demographic), sets out in the Consultation Conclusions that Hong Kong's short position regime will be as follows:

(a) A person who has a gross short position (i.e. the beneficial owner of the short position) in shares of the constituent companies of the Hang Seng Index, the Hang Seng China Enterprises Index and other financial companies specified by the SFC, that amounts to or exceeds 0.02 % of the issued share capital of that particular listed company or $30 million, whichever is lower, at the end of the last trading day of each week, has the obligation to report the short position to the SFC;

(i) In the case of funds, the reporting requirement applies to each fund. The fund manager may report the position on behalf of each of the funds it manages but will not be required to aggregate the short positions of different funds or be permitted to net positions between different funds;
(ii) In the case of a group structure that has multiple legal entities (e.g. global financial institutions), the reporting obligation will be on individual legal entities within the group structure. They are not required to aggregate the short positions within the group.

(b) The reporting requirement applies only to short positions resulted from trading on the SEHK and other trading venues specified by the SFC[6]. Short positions created via OTC trading and economic short positions created by use of derivatives will be excluded for reporting purpose;

(c) The report must be submitted, electronically, by the second business day of the following week. The SFC will set up an electronic reporting facility and prescribe a template to be used for reporting;

(d) The SFC will publish aggregated short positions for each stock, on an anonymous basis, one week after the receipt of the reports; and

(e) The SFC will be empowered to tighten the reporting requirements to increase transparency (such as requiring more frequent reporting) in contingency situations.

II. Addressing further comments from the market

14. We received some further comments from the market after the publication of the Consultation Conclusions and we like to take this opportunity to address these comments.

[6] Other trading venues such as an Automated Trading Services ("**ATS**") authorised by the SFC.

OTC trades

15. Concerns were raised about the implications following from the SFC's decision to exclude short positions created via OTC trading for reporting purposes. The SFC was informed that reporting systems maintained by financial firms typically make no distinction between positions created on or off the exchange and to enable the systems to make such a distinction would entail significant costs and changes to the firms' booking systems and procedures.

16. To address this issue, the SFC has decided that market participants need not distinguish short positions established via trades on the exchange or off the exchange. A firm will be allowed to report its short position when it reaches the threshold even if the position does not result solely from trades executed on the exchange and other trading venues specified by the SFC. However, in reporting a short position, a firm will be asked to indicate in the reporting template whether a component of the position reported is created off the exchange.

Optional reporting

17. Some market participants have voiced a potential challenge in complying with the reporting obligation, given the high volume of transactions they would be required to monitor to determine whether the statutory threshold has been reached. As a remedial measure, the SFC was asked to consider permitting a market participant to submit reports in respect of all its short positions regardless of whether they hit the statutory threshold. In this regard, our view is that we would not reject such reports of short position if a market participant volunteers the information. The SFC will monitor this aspect of the reporting to assess whether any change is required in the future.

Reporting on legal entity basis

18. A comment was made that mandating reporting of short position on a legal entity basis may pose practical problems in the case of a global financial institution as business lines in some financial institutions may cut across different legal entities. We are inclined to maintain our position that reporting will rest on the individual legal entity in a group structure for the reasons given in the Consultation. In this regard, we note that the short position reporting regime in other markets (e.g. UK, Australia) has also adopted a similar approach to require reporting within a group structure at the legal entity level.

Threshold level

19. We received further feedback from the market that the thresholds of 0.02% of the issued share capital and $30 million are too low. SFC recognises that setting the appropriate threshold that would generate meaningful information is key to a reporting regime. To achieve that, the threshold level has to be tailored to the circumstances of a particular market; a "one-size-fits-all" approach would not work[7]. The regulatory objectives of reporting would also influence the threshold level. In some markets, regulators require the market participants to disclose a significant short position including their identity to the public in the hope that it would deter market participants from aggressively building

[7] In UK, the threshold for disclosure of net short position (which includes positions created via the use of derivatives) is set at 0.25% and Germany's threshold to disclose net short position to regulator is set at 0.2% and to the market, on an anonymous basis, at 0.5%. In Australia, a short position that falls below 0.01% and AUD$100,000 is exempted from reporting. Appendix C provides some further information on regulatory developments in Europe and Australia on the short position reporting front that have emerged since the publication of the Consultation Conclusions.

up short positions. In others, the regulators use short position reporting as a tool to monitor the build up of large short positions and in such circumstances, it is logical that the monitoring should start from a level which is considered appropriate in the context of the particular characteristics of the local markets. As said earlier in this paper and in the Consultation Conclusions, the SFC sets the thresholds at 0.02% and $30 million after having carefully reviewed all the comments received in response to the Consultation and taking into consideration the local market characteristics (such as the size of listed companies in terms of market capitalisation, the free float of listed companies, the daily turnover, and the investors' demographic).

Excluding derivatives

20. The question on why derivatives are excluded from reporting was raised again. The arguments for and against the case for including derivatives were canvassed in the Consultation Conclusions. Those who opposed cited significant compliance costs and complications of "double counting" as reasons in support of their case. Those who favoured inclusion believed that, with the burgeoning use of financial innovation by the financial industry, including derivatives as part of the reporting would seem a logical and necessary step towards having a more complete picture of short positions in the market. We noted the merits in both sides' arguments in the Consultation Conclusions.

21. The different local market structures, different starting points in terms of the pre-existing short selling regulatory framework and different regulatory objectives would inevitably lead to some differences in the short position reporting regimes across different markets. In some, such as the UK and some member states of the EU, the reporting regime includes derivatives; while in others, such as Japan and Australia, derivatives are excluded from their short position reporting regime.

22. Hong Kong's short selling regulatory regime is different from that of the UK - we have a transactional reporting requirement for short selling orders that has been in place since 2000 and UK does not[8]. Market participants in Hong Kong are also subject to the statutory obligation under the existing Securities and Futures (Contracts Limits and Reportable Positions) Rules (Chapter 571Y) ("Large Open Position Rules") to report an open position in futures contracts or stock options contracts that exceeds the respective levels prescribed by the Large Open Position Rules. These two measures provide us with some information on the level of short selling and derivatives activities in the market. The systematic collection of data on short positions via the short position regime will complement this information and these different sets of data taken together, will give the SFC a better picture of the overall short selling activities in the Hong Kong market.

23. In addition, we envisage the regulatory reforms announced in December 2010 by the Hong Kong Monetary Authority, the Hong Kong Exchanges and Clearing Limited ("HKEx") and the SFC, as part of the global financial reforms, to regulate and enhance the functioning, risk management and transparency of the OTC derivatives markets by setting up a central counterparty in Hong Kong to cover OTC derivatives, and a local trade repository for collecting data on OTC derivatives trades, would provide regulators with new information on derivatives.

[8] In fact, many of EU member states do not have a transactional reporting requirement for short selling orders. The European Commission is proposing such a measure. Please see Appendix C for details.

24. Given the abovesaid, and after balancing the pros and cons, we came to the view that as short position reporting is a new regulatory requirement, adopting a more pragmatic approach by excluding derivatives, would facilitate the market to adjust to this new obligation.

III. The subsidiary legislation

25. Appendix A to this Consultation Paper contains the draft Rules which the SFC believes would give effect to the model as described above, with some slight modifications as explained in detail below. These Rules will be made pursuant to section 397(1) of the Securities and Futures Ordinance (Cap. 571) ("SFO"), and section 397(2) of that ordinance after consultation with the Financial Secretary.

Part 2 of the Rules - who, when and how to report and publication

26. Part 2 of the Rules titled "*Reportable Short Positions"* sets out the provisions on who has the responsibility to report, when to report, how to report, and publication of particulars of the short positions by the SFC. Schedule 1 of the Rules specifies the shares of those companies to which the reporting requirement would apply.

Who to report

27. The data collected from the short position reports would only be meaningful if they are accurate. In this regard, as explained in the Consultation and the Consultation Conclusions, the SFC believes it is logical that the person/entity who would be responsible to report should be the one who is in the position to know the total outstanding short position. In most cases, this would be the person or entity that has ownership over the short position. Consequently, the SFC decided that, as the first line policy choice, the legal obligation to report would reside with the person who beneficially owns the short position. In cases where this may not be feasible (e.g. beneficiaries in a trust), the obligation to report would rest on the person who would be best placed to know the total outstanding position (e.g. a trustee in a trust).

28. In the case of funds, the Consultation Conclusions set out the possibility that the investment manager may report the position on behalf of each of the funds it manages separately, without the aggregation or netting of positions between funds. However, such an approach could be complicated and in some cases, fails to capture the short positions as intended. The latter would arise in cases where a fund has more than one investment manager (through delegation or sub-delegation of investment functions) and in such a situation, each manager may independently accumulate a position that would not, on its own, reach the threshold, but if aggregated with the positions of the other investment managers of the same fund, might reach the threshold. Requiring the aggregation of short positions of the different investment managers of a fund, which would entail the investment managers monitoring each other's short position in order to determine whether the fund's total short position has hit the statutory threshold, might solve the problem. However, the SFC is mindful of the potential complications associated with aggregation. Another potential complication is the risk of multiple reporting if the different investment managers file identical reports for the fund. Consequently, the SFC, after deliberation, has decided against this approach. Instead, the SFC believes that the trustee of a trust including a fund, who is best placed to know the total outstanding short position of the fund, should be responsible for the reporting of the fund's short position.

The trustee would have to regard the short position of each trust he administers separately; short positions of different trusts should not be aggregated.

29. In the case of a group structure that has multiple legal entities (e.g. global financial institutions), individual legal entities within the group will have to report their short positions on a separate basis; they are not required to aggregate their short positions. The SFC had explained the reasons for adopting this approach in the Consultation and the Consultation Conclusions.

30. In summary, the party who is responsible to report a short position will be:

(a) The person who beneficially owns the short position;

(b) In the case of a group structure, individual legal entities within the group. They are not required to aggregate the short positions within the group; and

(c) In the case of trusts including funds, the trustee. Short position of each trust is to be treated separately and not to be aggregated.

31. As stated in the Consultation Conclusions, for practical purposes, the party who has the statutory obligation to report may authorise his agent to do so on his behalf. However, it is to be clear that, in such circumstances, the principal would remain legally responsible for the reporting.

When to report

32. A person has an obligation to report if, at the close of trading on a Friday (or the last trading day of the week, if SEHK is closed for trading on Friday), he has a “reportable short position”. Described in section 3(2) of the Rules, a “reportable short position” is the aggregated short position in “specified shares” resulting from short sales, either naked (i.e. the person, at the time of sale, did not have a presently exercisable and unconditional right to vest the shares in the purchaser)[9] or covered (the sale was made pursuant to a short selling order[10]), that amounts to or exceeds the threshold of 0.02 % of the issued share capital or $30 million, whichever is lower. This person will have to report his “reportable short position” to the SFC within two business days, which will be the following Tuesday, if the position was determined as at Friday. The “specified shares” shown on Schedule 1 of the Rules are shares of the constituent companies of the Hang Seng Index, the Hang Seng China Enterprises Index and other financial companies specified by the SFC. An updated list of the “specified shares” will be provided on the SFC’s website.

[9] Securities and Futures (Short Selling and Securities Borrowing and Lending (Miscellaneous)) Rules specify classes of transactions to which naked short selling prohibition does not apply.

[10] Short selling order is defined in Schedule 1 to the SFO to mean essentially, for the purpose of this paper, an order to sell shares in respect of which the seller has a presently exercisable and unconditional right to vest the shares in the purchaser either because he has borrowed the shares or has the right to acquire the shares through the exercise of other financial instruments that he owns.

33. The reporting requirement applies only to short positions resulted from short selling transactions executed on the SEHK and on other trading venues specified by the SFC. In this context, other trading venues refer to ATSs authorised by the SFC. Section 3(2)(a) provides that "*a person has a reportable short position when the person has a position in specified shares as a result of selling specified shares at, on, through or by means of any one or more of the Stock Exchange or a specified ATS*". Although at this stage, there is no specified ATS on Schedule 2 of the Rules, the Rules have been drafted to cover the possibility that an ATS authorised by the SFC may become an important trading venue of securities in the Hong Kong market.

34. A person in determining whether he has the obligation to report may potentially run into difficulties in comparing the two thresholds, as they are based on different parameters, one pertains to quantity of shares (0.02% of the issued share capital), and the other, value of shares ($30 million). To avoid any potential problems, we have expressed both thresholds as values in section 3(2)(b).

How to report

35. It is the SFC's intention that the short positions report would be submitted on-line and in this regard, the SFC is creating an electronic reporting facility. Attached as Appendix B is the draft template that the SFC proposes to be used for reporting. We will publish guidance in due course on the use of the electronic facility, which will also cover contingency arrangements in situations when the facility encounters operational difficulties.

Publication of particulars by the SFC

36. As stated in the Consultation Conclusions, the SFC will publish aggregated short positions for each stock, on an anonymous basis, one week after the receipt of the reports. It is our intention to publish the aggregated data on the SFC's website.

37. It is to be noted that the Rules provides for a separate commencement date for section 4 that sets out the provisions regarding SFC's publication of the aggregated short positions. We explained in the Consultation Conclusions that the SFC does not intend to publish the aggregated data when the reporting regime is first implemented as there might be teething problems in reporting at the initial stage. The SFC will monitor and address any issues that may arise during the first few months of implementation and will commence publication when we are satisfied that the significant issues (if any) that might impact the integrity of data have been addressed and the market has adjusted to the new reporting requirement.

Seeking public comment

38. The SFC invites the public to comment on Part 2 of the Rules which sets out the obligation to report; timing within which the report must be made; the method of reporting and the publication of particulars of reported short positions by the SFC.

Part 3 of the Rules – reporting and publication in contingency situations

Daily reporting in contingency situations

39. We said in the Consultation Conclusions that the SFC would have the power to modify the reporting requirements (such as requiring more frequent reporting) in contingency situations. The modified reporting requirements imposed in a crisis would be temporary and would be lifted when the market condition normalises. This is a balanced solution addressing the regulator's need for timely information in a crisis without imposing unduly burdensome compliance obligation on the market during normal circumstances.

40. Section 5 of the Rules fleshes out the details on SFC's power to modify the reporting requirements in contingency situations. In substance, this section empowers the SFC, in circumstances (whether in Hong Kong or otherwise) that would pose a threat to the financial stability of Hong Kong, to require market participants to report their short position if, as at the end of each trading day, it reaches the threshold of 0.02% or $30 million; and the reporting must be done the following business day. This is a tightened requirement when compared to that under normal conditions. In normal times, market participants are only obliged to report if, as at the end of each week, they have a short position that hits the threshold and they have two business days to submit their reports. In other words, when there is a crisis, the frequency of reporting of short position may increase but the thresholds and the stocks that will be subject to the short position reporting requirement will remain unaffected.

41. We decided to focus, in the initial phase of this new regime, on enhancing the frequency of reporting in a crisis. We believe that the more frequent reporting of the short positions in a crisis would provide us with relevant market information in a more timely manner and this would assist us in our surveillance and assessment of the market. We will monitor and if our assessment is that tightening just this one aspect of the short position reporting in a crisis is not sufficient in providing us with the necessary information for us to discharge our regulatory function, we would take steps to further tighten the reporting requirements, as said in the Consultation Conclusions. In this regard, we would consult the public before making any changes to the Rules.

42. If the SFC exercises this power, it will have to make a public announcement giving market participants at least 24 hours prior notice before the effective date of the enhanced reporting. Similarly, when the SFC believes that the temporary enhanced reporting is no longer necessary, the SFC will have to publish a notice announcing the cessation date.

Weekly publication in contingency situations

43. In terms of publication of the aggregated data in contingency situations, this was not specifically addressed in the Consultation Conclusions. After deliberation, the SFC has decided that it will maintain the publication of the aggregated data on a once-a-week basis, as under normal market conditions; this will ensure that market participants will continue to have access to information on short positions in a crisis. We plan to publish only the aggregated data of short positions reported as of the last trading day of the week, as per the practice during normal times. This would continue to allow the market to have information on short positions and, at the same time, would permit the SFC to focus its

attention and resources, in a crisis, to analyse and assess the implications of market information and to take regulatory action, as appropriate.

Seeking public comment

44. The SFC invites the public to comment on the specific arrangements as described in Part 3 of the Rules relating to SFC's power to require daily reporting of short positions in contingency situations.

IV. Penalty for breach

45. The SFC would take the opportunity to discuss in this paper the question on the consequences of a breach of the reporting requirement. It is the SFC's intention to create a criminal offence for a breach of the short position reporting requirement.

46. In this regard, the Commission intends to recommend to the Chief Executive in Council that the Securities and Futures (Offences and Penalties) Regulation (Cap. 571AH) be amended, pursuant to section 398(6) of the SFO, to provide that a person who contravenes section 3(1) of the Rules, commits an offence and is liable on conviction to a penalty to be specified. The maximum penalties that may be specified by the Chief Executive in Council are:

(i) on conviction on indictment a fine of $500,000 and a term of imprisonment of 2 years;
(ii) on summary conviction a fine at level 6[11] and a term of imprisonment of 6 months.

Concluding Remarks

47. This paper consults on the Rules that will give effect to the short position reporting requirement that SFC announced in the Consultation Conclusions. In this consultation, we have proposed some slight modifications to the model as disclosed in the Consultation Conclusions; and these modifications are necessary either to address practical difficulties that have emerged or potential issues that could give rise to complications.

48. The SFC is working towards implementing the short position reporting requirement as soon as possible. We will provide the market with an indicative implementation time table when we publish the conclusions to this consultation and in this regard, we will give the market reasonable lead time to get their reporting systems and procedures in place.

[11] Schedule 8 of the Criminal Procedure Ordinance (Cap. 221) shows the amount of fines for different levels of fine and a fine at level 6 is a fine of $100,000.

Appendix A

SECURITIES AND FUTURES (SHORT POSITION REPORTING) RULES

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

PART 1

PRELIMINARY

1. Commencement

(1) Subject to subsection (2), these Rules come into operation on [date].

(2) Section 4 comes into operation on a day to be appointed by the Commission by notice in the Gazette.

2. Interpretation

In these Rules –

“business day” has the meaning given by section 1 of Part 1 of Schedule 1 to the Ordinance except that it does not include Saturday;

“reportable short position” has the meaning given by section 3(2);

“reporting day” means –
- (a) Friday, or if the Stock Exchange does not open for trading on that day, the last weekday before Friday on which the Stock Exchange is open for trading; or
- (b) when a notice under section 5(1) is in force, each day on which the Stock Exchange is open for trading;

“reporting deadline” means –
- (a) within two business days after the reporting day; or
- (b) when a notice under section 5(1) is in force, within one business day after the reporting day.

“specified ATS” means an authorized automated trading service specified in Schedule 2;

“specified shares” means shares in a corporation which are listed or admitted to trading on the Stock Exchange and specified in Schedule 1;

“Stock Exchange” means the recognized stock market operated by the Stock Exchange Company.

PART 2

REPORTABLE SHORT POSITIONS

3. Notice of reportable short positions to be given to the Commission

(1) Subject to subsection (3), a person who beneficially owns a reportable short position at the close of trading on the Stock Exchange on the reporting day must notify the Commission in accordance with this section by the reporting deadline.

(2) For the purposes of subsection (1), a person has a reportable short position when the person has a position in specified shares -

(a) as a result of selling specified shares at, on, through or by means of any one or more of the Stock Exchange or a specified ATS where –

(i) at the time of each sale comprised in the position, the person did not have a presently exercisable and unconditional right to vest the shares in the purchaser; or

(ii) each sale comprised in the position was the subject of a short selling order; and

(b) the number of specified shares in the position multiplied by the closing price of the specified shares on the reporting day as determined in accordance with the rules of the Stock Exchange (or, if on the reporting day the shares are suspended from trading on the Stock Exchange, the last closing price before the suspension) is equal to or more than the lower of –

(i) 0.02% of that closing price multiplied by total number of specified shares issued by the corporation; and

(ii) $30 million.

(3) Where a position in specified shares is held on trust –

(a) subsection (1) does not apply to a beneficiary of the trust and instead applies to the person who is the trustee of the trust; and

(b) in determining whether that person has a reportable position, the position in specified shares attributable to each such trust is to be treated separately and not aggregated.

(4) A notice required to be submitted to the Commission under subsection (1) must -

(a) be in the form specified by the Commission under section 402 of the Ordinance for the purposes of this section;

(b) contain the particulars specified in the form including particulars relating to the person and the reportable short position; and

(c) be submitted to the Commission electronically by means of an online communication system approved by the Commission under subsection (5) for the purposes of this section.

(5) The Commission may, for the purposes of this section, approve an online communication system.

(6) Where the Commission approves an online communication system under subsection (5), it must as soon as reasonably practicable publish directions and instructions for the use of that system in the manner that it considers appropriate.

4. Commission to publish particulars of reported short positions

(1) Subject to subsections (2) and (3), the Commission must, as soon as reasonably practicable after the reporting deadline, publish such particulars of the reportable short positions notified to it under section 3(1) as it considers appropriate.

(2) Subsection (1) does not require the Commission to publish particulars –

(a) earlier than five business days after the reporting day; or

(b) when a notice under section 5(1) is in force, more frequently than once a week.

(3) Any particulars published under subsection (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 section 3(1) and that person's reportable short position being ascertained from it.

(4) Particulars published under this section are not subsidiary legislation.

PART 3

DAILY REPORTING REQUIREMENTS

5. Commission may require daily reporting

(1) The Commission may publish a notice in accordance with this section declaring that paragraph (b) of the meanings given by section 2 to "reporting day" and "reporting deadline" will have effect from the date specified in the notice, 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 notice under subsection (1) must be –

(a) published on the Commission's website at least 24 hours before the date specified in the notice; and

(b) published or announced in the ways (if any) and at the times that the Commission considers appropriate to bring the notice to the attention of persons likely to be affected by the notice.

(3) If a notice published under subsection (1) 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 declaring that the notice under subsection (1) will cease to have effect from the date specified in the notice.

(4) A notice published under subsection (1) or (3) is not subsidiary legislation.

SCHEDULE 1

[section 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 are –

    (i) determined by the Stock Exchange to be a “designated security” in accordance with the rules of the Stock Exchange; and
    (ii) classified by the Hang Seng Indexes Company Limited as financial stocks in accordance with the Hang Seng Industry Classification System.

SCHEDULE 2

[section 2]

SPECIFIED ATS

Note: the Commission intends to recommend to the Chief Executive in Council that the Securities and Futures (Offences and Penalties) Regulation (Cap. 571AH) be amended pursuant to section 398(6) of the Securities and Futures Ordinance (Cap. 571) to provide that a person who contravenes section 3(1) commits an offence and is liable on conviction to a penalty to be specified. The maximum penalties that may be specified by the Chief Executive in Council are –

(a) on conviction on indictment a fine of $500,000 and a term of imprisonment of 2 years;

(b) on summary conviction a fine at level 6 and a term of imprisonment of 6 months.

Appendix B

Reporting Template

<u>Guide to report short positions</u>

The SFC Online Services Portal ("the Portal") provides access to a number of electronic services offered by the SFC to intermediaries and the investing public. Examples of the services include Electronic Submission of Financial Return, Subscription to SFC Update Alert, etc. The Portal can be accessed through the SFC website (www.sfc.hk) or
the link: https://portal.sfc.hk/sfcportal/sfc_online_portal/online_service.html

For reporting of short positions pursuant to the Securities and Futures (Short Position Reporting) Rules ("Short Position Rules"), a new reporting service, Disclosure of Short Positions Reporting Service ("DSP Reporting Service") will be introduced on the Portal. Short position reports are to be submitted electronically through this service.

Below is an overview of how to report short positions through the DSP Reporting Service:

1. Registration (one time requirement only)	⇨	2. Provide submitter contact information	⇨	3. Provide short position details	⇨	4. Submission and acknowledgement

1. <u>Registration</u>

In order to report short positions, the party who is legally obliged to report his short position under the Short Position Rules must obtain a unique identifier by registering through the DSP Reporting Service. A unique reference, the Disclosure of Short Positions Reference ("DSPREF"), will be assigned to each registrant upon successful registration. Registration is only required once. The DSPREF will be used for all subsequent reporting.

The registrant is required to provide the following information during registration:

- Registrant's information e.g. company name, identification document type, identification number, nature of business etc.
- Contact information e.g. contact person name, correspondence address, email address, telephone number, etc.

If an agent is reporting on his behalf, his agent will also be required to register and obtain a DSPREF. More guidance will be provided on the registration requirements and procedures in due course.

2. Provide submitter contact information

Once the registrant obtains a DSPREF, he or she may now submit the report of short position which would include the following information:

- Submitter's information e.g. DSPREF, contact person name, telephone number, email address (if the contact person is different from the person named in the initial registration), the agent's DSPREF (if the reporting is done by an agent).

SFC may use the information to contact the contact person named in the report regarding the submission.

3. Provide short position details

The DSP Reporting Service will provide a short position template as a standardized short position report for submission. The template will be in comma separated value ("CSV") format which is commonly used for exchanging data. It can be edited by common spreadsheet program like Microsoft Excel or common text editor. The template can be downloaded from the DSP Reporting Service. Below is the template that the SFC will be providing:

The first row of each template would include only column headers. All six columns must be filled.

Disclosure of Short Positions Reference ("DSPREF") is a unique 10-character alphanumeric code assigned by the SFC after registration. Please state the DSPREF of the party who is legally obliged to report the short position under the Short Position Rules.

Please state the name of the party who is legally obliged to report the short position under the Short Position Rules.

No leading zero is required for the stock code. The corresponding stock name can be found on HKEx's website*.

DSPREF	Name of the Reporting Party	Stock code	Stock name	No. of shares	Position composition
G3VA8F69MT	ABC Growth Fund	5	HSBC HOLDINGS	1000000	S
G3VA8F69MT	ABC Growth Fund	1	CHEUNG KONG	2000000	S
G3VA8F69MT	ABC Growth Fund	941	CHINA MOBILE	1000000	T

It refers to the total quantity of open short position of a particular stock as at the "reporting day" as defined in the Short Position Rules. There should be no sign or comma as this is in CSV format.

Please state "S" or "T" here **:
"S"—all short positions established on SEHK only
"T"—includes short positions established via trades executed off SEHK.

*http://www.hkex.com.hk/eng/market/sec_tradinfo/stkcdorder.htm

**Short positions resulted from trades executed off SEHK are not required to be reported under the Short Position Rules. However, market participants may choose to include such short position in the report if they are not able to distinguish short positions that are established via trades executed on exchange and off exchange.

Note:

DSP Reporting Service supports template up to 1000 rows. A reporting party who has more than 1000 positions to report would have to split them into multiple files for submission.

4. Reporting by multiple parties

The DSP Reporting Service supports reporting of short positions involving multiple parties. For example, a trustee may report the short positions of the different funds it administers in a single file. The following example illustrates a reporting of short positions on behalf of three funds, namely ABC Growth Fund, ABC Balanced Fund and ABC High Yield Fund. Each fund will have its own DSPREF.

DSPREF	Name of the Reporting Party	Stock code	Stock name	No. of shares	Position composition
G3VA8F69MT	ABC Growth Fund	5	HSBC HOLDINGS	1000000	S
G3VA8F69MT	ABC Growth Fund	1	CHEUNG KONG	2000000	S
G3VA8F69MT	ABC Growth Fund	941	CHINA MOBILE	1000000	S
K3MD9R36UT	ABC Balanced Fund	5	HSBC HOLDINGS	2300000	T
K3MD9R36UT	ABC Balanced Fund	1	CHEUNG KONG	3000000	S
K3MD9R36UT	ABC Balanced Fund	941	CHINA MOBILE	1500000	T
A4KE6T45HJ	ABC High Yield Fund	2628	CHINA LIFE	3500000	S
A4KE6T45HJ	ABC High Yield Fund	857	PETROCHINA	3500000	S

5. Submission and acknowledgement

Submission will be done by uploading a data file with the submission details onto the DSP webpage. Once the submission is done, an electronic acknowledgement will be generated with the submission details which the submitter may print or save it for record.

Appendix C

International regulatory developments

Since the publication of the Consultation Conclusions, there have been some regulatory developments on the short position reporting front:

Australia

- In June 2010, the Australian short position reporting regime came into effect. Under that regime if a seller makes a covered short sale, he may be required to report his short position to the Australian Securities and Investments Commission. A seller will be exempted from reporting if he has a short position that does not exceed <u>both</u> the "value limit" (i.e. AUD $100,000) <u>and</u> the "volume limit" (i.e. 0.01% of the total quantity of the products in the class).

Europe

- In September 2010, the European Commission made a proposal for a Regulation of the European Parliament and of the Council on short selling and certain aspects of Credit Default Swaps[12], which is still subject to the approval of the European Parliament and the Council. The proposal includes the following:

  (i) A requirement for the marking of short orders of shares executed on trading venues. There will be daily publication by the trading venue of the information on the volume of short sales executed on it.
  (ii) A two-tiered disclosure model for significant net short position in shares: investors will have to disclose short positions to regulators when their net short positions crosses a lower threshold of 0.2% of the issued share capital, and to the market, at the higher threshold of 0.5% of the issued share capital. Notification to regulators or disclosure to the market, setting out particulars including details of the identity of the investor, the size of the position and the name of the issuer company etc, would have to be made on the next trading day (i.e. T + 1). After the initial notification or disclosure, further notification or disclosure would have to be made if there is a change of a short position (either up or down) that crosses incremental bands of 0.1%.This model[13] is largely based on the Pan-European model that was put forward by the Committee of European Securities Regulators (CESR) in March 2010[14].
  (iii) The reporting requirements would apply to short positions created by trading on trading venues, OTC trading and economic short positions created by use of derivatives.
  (iv) In exceptional situations, national regulators would have powers to temporarily restrict or ban short selling in any financial instrument or require further reporting requirements.

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12 http://ec.europa.eu/internal_market/securities/docs/short_selling/20100915_proposal_en.pdf

13 CESR's disclosure model sets the lower threshold at 0.1% of the issued share capital.

14 A few EU member states including Germany and France have introduced short position reporting based on the CESR's model.

Appendix D

Personal Information Collection Statement

1. This Personal Information Collection Statement ("PICS") is made in accordance with the guidelines issued by the Privacy Commissioner for Personal Data. The PICS sets out the purposes for which your Personal Data[15] will be used following collection, what you are agreeing to with respect to the SFC's use of your Personal Data and your rights under the Personal Data (Privacy) Ordinance, Cap. 486 ("PDPO").

Purpose of collection

2. The Personal Data provided in your submission to the SFC in response to this consultation paper may be used by the SFC for one or more of the following purposes:

   (a) To administer the relevant provisions[16] and codes and guidelines published pursuant to the powers vested in the SFC;

   (b) In performing the SFC's statutory functions under the relevant provisions;

   (c) For research and statistical purposes;

   (d) For other purposes permitted by law.

Transfer of personal data

3. Personal Data may be disclosed by the SFC to members of the public in Hong Kong and elsewhere, as part of the public consultation on this consultation paper. The names of persons who submit comments on this consultation paper together with the whole or part of their submission may be disclosed to members of the public. This will be done by publishing this information on the SFC's website and in documents to be published by the SFC during the consultation period or at its conclusion.

Access to data

4. You have the right to request access to and correction of your Personal Data in accordance with the provisions of the PDPO. Your right of access includes the right to obtain a copy of your Personal Data provided in your submission on this consultation paper. The SFC has the right to charge a reasonable fee for processing any data access request.

Retention

5. Personal Data provided to the SFC in response to this consultation paper will be retained for such period as may be necessary for the proper discharge of the SFC's functions.

[15] Personal Data means personal data as defined in the Personal Data (Privacy) Ordinance.
[16] Defined in Schedule 1 of the SFO to mean provisions of the SFO and subsidiary legislation made under it; and provisions of Parts II and XII of the Companies Ordinance (Cap. 32), so far as those Parts relate, directly or indirectly, to the performance of functions relating to: prospectuses; the purchase by a corporation of its own shares; a corporation giving financial assistance for the acquisition of its own shares etc.

Enquiries

6. Any inquiries regarding the Personal Data provided in your submission on this consultation paper, or requests for access to Personal Data or correction of Personal Data, should be addressed in writing to:

The Data Privacy Officer
Securities and Futures Commission
8th Floor, Chater House
8 Connaught Road Central
Hong Kong

A copy of the Privacy Policy Statement adopted by the SFC is available upon request.