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Client briefing
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SFC launches consultation on Securities and Futures (Short Position Reporting) Rules implementing new reporting regime

The Securities and Futures Commission (SFC) has issued a consultation paper (Consultation Paper) on the proposed Securities and Futures (Short Position Reporting) Rules, implementing a new reporting regime for short positions (Rules).

The proposed Rules largely follow the results of a first consultation launched by the SFC in 2009 on the introduction of such a reporting regime, which were published by the SFC in March 2010 (First Consultation Conclusions).

The short position disclosure regime under the Rules will complement the existing disclosure regime under Part XV of the Securities and Futures Ordinance (SFO), where certain short positions will also need to be disclosed. The Rules are issued in the form of subsidiary legislation, so amendments can be made more easily.

This briefing summarizes the key features of the proposed Rules and highlights the modifications introduced by the SFC compared to the First Consultation Conclusions.

The reporting requirements

Reporting threshold and time frame

As was already proposed in the First Consultation Conclusions, the new short position regime will require a person to report a short position in "specified shares" that amounts to or exceeds 0.02% of the issued share capital or HK$30 million, whichever is lower.

"Specified shares" comprise the constituent companies of the Hang Seng Index, the Hang Seng China Enterprises Index and other financial companies specified by the SFC.

A person is obliged to report when it has a "reportable short position" at the close of trading on Friday or the last trading day of the week, if The Stock Exchange of Hong Kong Limited (SEHK) is closed on Friday. The person will be required to file a report within two business days, i.e. normally by Tuesday of the next week.

Reportable short positions may result from both covered and naked short sales. As naked short selling is generally prohibited in Hong Kong, this means that the short position reporting obligation will also apply to trades which are normally excluded from that prohibition, such as SEHK participants buying or selling odd-lots or transactions specified under the Securities and Futures (Short Selling and Securities Borrowing and Lending (Miscellaneous)) Rules.

Moreover, none of the exceptions from the reporting requirements for long positions under Part XV of the SFO are applicable in relation to the disclosure regime under the new Rules.

Key Issues

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Reportable trades

The reporting requirement will apply to short positions resulting from trading either on the SEHK itself or on certain specified Automated Trading Services (ATS) authorized by the SFC. Short positions created via over the counter (OTC) trading are not reportable. Moreover, only short positions created through short selling shares are reportable – economic shorts through the trading of derivatives will be excluded from the reporting regime.

Interestingly, the SFC has provided for the flexibility to specify certain ATS as additional trading venues in respect of which the reporting requirement applies. This indicates that the SFC views ATS as gaining in importance as a means to trade Hong Kong securities. However, no ATS has been specified in the Rules at this stage. As ATS authorized in Hong Kong are not necessarily Hong Kong based, overseas users of ATS trading Hong Kong securities may be caught unaware by this inclusion.

The SFC notes in the Consultation Paper that it has received comments from the market that the thresholds specified in its First Consultation Conclusions are too low. However, the SFC emphasizes that it considers the threshold levels as appropriate in the context of the particular characteristics of the Hong Kong market and does not intend to make adjustments at this stage.

Some firms also raised concerns to the SFC that their systems cannot easily distinguish between on-exchange short positions (which are reportable) and off-exchange short positions (which are not). To address this issue, the SFC has decided to allow a firm to report its short positions when it reaches the reporting threshold even if its short positions comprise OTC trades. A firm will be required to indicate via the "position composition" flag in the reporting template whether its short positions include those established via trades executed off-exchange.

To accommodate those market participants who expressed concern that they may experience practical difficulties in determining whether a threshold has been triggered, the SFC is prepared to accept short position submissions regardless of whether the specified reporting threshold has been reached. However, the SFC has indicated that it will assess whether any change to such voluntary reporting is required in future.

Who must report

The party who is responsible to report a short position will be:

- The person who beneficially owns the short position

- In the case of a group structure, individual legal entities within the group

  For groups that have multiple legal entities, the reporting obligation will be on individual legal entities within the group structure i.e. individual legal entities within the group will have to report their short positions on a separate basis. There will be no requirements to aggregate the short positions within the group.

- In the case of trusts including funds, the trustee

  In its First Consultation Conclusions the SFC explored the possibility of having the investment manager report the short position on behalf of each of the funds it manages separately. The SFC notes that this approach could be complicated in cases where a fund has more than one investment manager through delegation or sub-delegation of investment functions; each manager may independently accumulate a position without triggering the reporting threshold, but might otherwise if aggregated with the positions of the other investment managers of the same fund.

  The SFC believes that the trustee of a trust is best placed to know the total outstanding short position of the fund . The trustee therefore 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.

  For funds, this rule clearly only applies where the fund is structured as a unit trust. The Rules do not address who should do the reporting for funds which are not trusts, for example limited partnerships, where the general partner would normally be expected to do the filings, even though all partners hold an interest in the partnership property.

Publication by the SFC

The SFC plans to publish on its website aggregated short positions for each stock, on an anonymous basis, one week after the receipt of the short position reports. Consistent with its approach stated in its First Consultation Conclusions, the SFC will start publishing the information a few months after the commencement of the short position reporting regime.

The later commencement date is intended to allow the SFC to monitor and address any issues that may arise during the initial stage of implementation.

Reporting and publication in contingency situations

Daily reporting in contingency situations

Under section 5 of the Rules the SFC will be empowered, if circumstances exist that would pose threats to the financial stability of Hong Kong, to require market participants to report their short positions at the end of each trading day (rather than the last trading day of the week); and the reporting must be done on the next business day. To exercise this power, the SFC must make a public announcement giving the market participants at least 24 hours lead time before the effective date of the enhanced reporting. Likewise, the SFC will have to publish a notice announcing the cessation date when enhanced reporting is no longer required.

The SFC indicated in its First Consultation Conclusions that it would seek authority to change the reporting requirements in contingency situations also by (i) lowering the trigger thresholds; and (ii) extending the reporting requirements to short positions of other shares. However, the Rules only empower the SFC to increase the frequency of the reporting to daily reporting.

Weekly publication in contingency situations

Notwithstanding the daily reporting requirement during a crisis, the aggregated short positions will continue to be published by the SFC on a weekly basis, with the aggregated data of short positions reported as of the last trading day of the week, consistent with the publication practice during normal times.

Penalty for Breach

The SFC intends to recommend amending the Securities and Futures (Offences and Penalties) Regulation to provide that a person who contravenes the reporting obligations under the Rules commits an offence and is liable on conviction to a penalty to be specified. The proposed maximum penalties are:

(i) on summary conviction a fine of HK$100,000 and a term of imprisonment of 6 months;

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

Comparable sanctions already exist for breaches of the disclosure obligations in relation to long positions under Part XV of the SFO.

Timetable

The SFC has invited the public to comment in particular on Part 2 and Part 3 of the Rules relating to the obligation to report; the timing within which the report must be made; the method of reporting; the publication of particulars of reported short positions by the SFC and SFC's power to require daily reporting of short positions in contingency situations. Responses are requested by **30 June 2011**.

The SFC intends to implement the short position reporting requirement as soon as possible. According to the SFC, the indicative implementation time table will be available when it publishes its conclusions to the Consultation Paper and the market participants will be given a reasonable lead time to prepare their reporting systems and procedures for the new short reporting regime.