

G.N. 3690

**Securities and Futures Ordinance (Chapter 571)**

Pursuant to section 399(1) of the Securities and Futures Ordinance (Cap. 571), the Securities and Futures Commission publishes the Guidance Note on Short Position Reporting (Guidance Note) for reference.

The Guidance Note shall come into effect on 18 June 2012.

1 June 2012

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**GUIDANCE NOTE ON SHORT POSITION REPORTING**

**1. Introduction**

1.1 The Securities and Futures (Short Position Reporting) Rules (L.N. 48 of 2012) (the Rules) made by the Securities and Futures Commission (the SFC) under section 397(1) and (2) of the Securities and Futures Ordinance (Cap. 571) (the SFO) set out the regulatory requirements in relation to short position reporting.

1.2 The SFC published this Guidance Note pursuant to Section 399(1) of the SFO to explain SFC's policy intent in relation to certain aspects of the Rules and inform market participants how the Rules are intended to operate in practice so that they can structure their compliance process accordingly. It is, however, to be noted that the Guidance Note does not have the force of law.

1.3 Unless otherwise specified or the context otherwise requires, words and phrases in this Guidance Note shall be interpreted by reference to any definition of such word or phrase in the Rules.

**2. The duty to report**

*Control does not necessarily give rise to a duty to report*

2.1 The object of the Rules is to impose a duty to report on a person who has a reportable short position. A person who may exercise control over a short position does not necessarily have the duty to report under the Rules. An example of such a "person" would be a fund manager of a corporate fund, who pursuant to the

investment mandate given to him, may exercise discretion on taking long or short positions on behalf of the fund in the specified shares. In this case, the corporate fund has the statutory duty to report if it has a reportable short position as a result of the fund manager's dealings in the specified shares. The fund may authorize the fund manager to act as its agent to notify the SFC of its reportable short position. Likewise, a fund manager of a unit trust does not have a duty to report under the Rules. In such an instance, the Rules impose the duty to report on the trustee of the unit trust<sup>1</sup>.

#### Reporting of short positions held in a unit trust

- 2.2 Rule 4(5) provides that the trustee has the duty to report reportable short positions that are held on trust. In this connection, we like to clarify how we envisage this Rule would operate in the context of a unit trust.
- 2.3 A strict interpretation of Rule 4(5) requires the trustee of a unit trust to report for each beneficiary (i.e. individual holders of the trust) who has a reportable short position. Given that the underlying holders of a unit trust may change frequently, we take the view that it would be operationally challenging for a trustee to monitor the positions of the individual holders for short position reporting purposes. For pragmatic reasons, it is our policy intent that a trustee of a unit trust needs only to report the trust's overall short position if it triggers the reporting threshold. By doing so, the trustee will be deemed to have complied with Rule 4(5). Asking the trustee to report the unit trust's overall short position would simplify the compliance process. However, notwithstanding the aforesaid, the SFC will accept a trustee reporting the positions of individual unit holders.

#### Aggregation of net short positions of trading books/units

- 2.4 Rule 4(1) and 4(3) of the Rules impose a duty to report on "a person" who has a reportable short position. Rule 3 provides for the meaning of reportable short position by reference to the person's net short position value measured against a threshold.
- 2.5 A "person", defined in the Interpretation and General Clauses Ordinance (Cap. 1), includes any public body and any body of persons, corporate or unincorporated. In other words, a corporation, in determining whether it has a reportable short position, shall look at its overall position by aggregating the long and short positions of the entire legal entity in the relevant specified shares.

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<sup>1</sup> Please see Rule 4(5).

- 2.6 For the purpose of sections 170 (short selling restricted) and 171 of the SFO (requirements to confirm short selling order ), the SFC laid out in The Guidance Note on Short Selling Reporting and Stock Lending Record Keeping Requirements<sup>2</sup> three acceptable approaches for the purposes of determining whether a seller has a presently exercisable and unconditional right to vest the securities in the purchaser of them:
- the position of the seller’s own trading book (trading book basis);
  - the aggregated positions of a number of trading books which the seller controls or has knowledge of (trading unit basis); or
  - the aggregated position of the entire legal entity (legal entity basis).
- 2.7 Regardless of which one of the above three approaches a firm adopts for marking of short selling orders, the SFC considers that it is appropriate and makes good logical sense that the firm should apply the same approach in reporting short positions to maintain overall consistency in the data provided by the firm in relation to its short sales and short positions.
- 2.8 The objectives<sup>3</sup> of the SFC in introducing short position reporting to increase transparency on short positions include (i) to enable the SFC to have an effective means to monitor the market including detection of significant build-up of short positions, (ii) to deter and detect abusive short selling behaviour, (iii) to provide ready access to information on short selling to improve insight into market dynamics and (iv) to expedite post event investigation. To achieve these objectives, consistency in the information on short selling transactions and short positions, which are closely related sets of data, is an important consideration. The SFC takes the view that any incongruity between the two sets of data would undermine the informational value of the data towards serving the SFC’s regulatory and market monitoring objectives
- 2.9 The SFC expects that, if a firm tracks its short sales on a trading book basis, for purposes of short position reporting, the firm will add up the net short positions of the different trading books and to report the aggregated net short position to the SFC if it triggers the reporting threshold. Similarly for firms that mark its short selling orders on trading unit basis, they are expected to sum up the net short positions of the different trading units and to notify the SFC if the total net short position crosses the reporting threshold. And in cases where firms adopt the legal entity approach, they too ought to

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<sup>2</sup> Paragraphs 8.1 and 8.2 of the Guidance Note on Short Selling Reporting and Stock Lending Record Keeping Requirements.

<sup>3</sup> Please see paragraph 6 of the Consultation on increasing short position transparency dated 31 July 2009.

take a consistent approach in their short position reporting. The SFC will regard reporting of the resultant net short position derived, as explained, under each of the three different approaches as having complied with the Rules.

2.10 To be clear, two examples are provided below to illustrate short position reporting in “trading book” and “trading unit” scenarios:

Example I:

Entity D has trading books A, B and C.

	Trading book A		Trading book B		Trading book C	
1	<b>Bought shares</b>	1,000,000	<b>Bought shares</b>	50,000	<b>Bought shares</b>	1,200,000
2	<b>Sold shares</b>	-800,000	<b>Sold shares</b>	-80,000	<b>Sold shares</b>	-1,500,000
	<b>Day-end net position as at reporting day</b>	200,000 (net long)	<b>Day-end net position as at reporting day</b>	-30,000 (net short)	<b>Day-end net position as at reporting day</b>	-300,000 (net short)

For the purpose of reporting short position, Entity D will have to determine whether its total net short position of 330,000 shares ((-30,000 of trading book B) + (-300,000 of trading book C)) amounts to or exceeds the reporting threshold.

Example II:

Entity H has trading units<sup>4</sup> X, Y and Z.

	Trading unit X		Trading unit Y		Trading unit Z	
1	<b>Bought shares</b>	500,000	<b>Bought shares</b>	50,000	<b>Bought shares</b>	1,200,000
2	<b>Sold shares</b>	-800,000	<b>Sold shares</b>	-80,000	<b>Sold shares</b>	-2,500,000
3	<b>Bought shares</b>	100,000	<b>Sold shares</b>	-100,000	<b>Bought shares</b>	1,000,000
	<b>Day-end net position<sup>5</sup> as at reporting day</b>	- 200,000 (net short)	<b>Day-end net position as at reporting day</b>	-130,000 (net short)	<b>Day-end net position as at reporting day</b>	-300,000 (net short)

<sup>4</sup> A trading unit may run multiple trading books.

<sup>5</sup> This refers to the net position of all the trading books run by the trading unit.

Entity H will consider whether its total net short position of 630,000 shares ((-200,000 of trading unit X) + (- 130,000 of trading unit Y) + (-300,000 of trading unit Z)) amounts to or exceeds the reporting threshold.

- 2.11 After the Rules come into effect, the SFC will monitor the reporting by firms that are affected by paragraphs 2.7 to 2.10 and assess whether the SFC's regulatory objectives can be effectively achieved. In this regard, if our assessment is that amendments to the Rules are necessary, the SFC will take steps to make the necessary changes.