



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

**A Consultation Paper on the Securities  
and Futures (Short Selling Exemption and Stock  
Lending) Rules**

**《證券及期貨(賣空豁免及證券借出)規則》  
諮詢文件**

Hong Kong  
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## A Introduction

1. This consultation document invites public comments on the draft **Securities and Futures (Short Selling Exemption and Stock Lending) Rules** (“the draft Rules”), which are to be made under section 397 and 398 of the Securities and Futures Ordinance (No. 5 of 2002).
2. The draft Rules will be based on the Securities (Miscellaneous) Rules (“the existing Rules”), which have been made under the Securities Ordinance (Cap.333). In addition, the SFC proposes to extend the existing exemptions in rule 17 of the existing Rules (which was made under section 80(4)(d) of the Securities Ordinance) and create exemptions from the requirements in section 171 of the Securities and Futures Ordinance (i.e., sections 80B and C of the Securities Ordinance).
3. The public may obtain copies of the consultation document free of charge at the SFC’s office and on the SFC’s Internet website at <http://www.hksfc.org.hk>.
4. There are controls built into the legislative system, whereby any rules made by the SFC must be subject to negative vetting by the Legislative Council. In addition, a mandatory consultation requirement is stipulated in section 398 of the Securities and Futures Ordinance.
5. The SFC invites interested parties to submit written comments on the proposed exemptions or to comment on related matters that might have a significant impact upon the draft Rules no later than 21 June 2002. Any persons wishing to comment should provide details of any organization whose views they represent. In addition, persons suggesting alternative approaches are encouraged to submit proposed text to be incorporated into the draft Rules.

## B. The existing law and exemptions

### *Section 80 of the Securities Ordinance (SO)*

6. Section 80(1) of the SO prohibits naked short selling, that is, selling of securities at or through the Exchange where the seller does not have a reasonable and honest belief that he has a presently exercisable and unconditional right to vest the securities in the purchaser of them. Section 80 is repeated in section 170 of the Securities and Futures Ordinance.
7. Currently, there are some situations in which section 80(1) does not apply. These are set out in Rules 17 of the Securities (Miscellaneous) Rules and include –
  - (a) sales of specific instruments by Hong Kong Monetary Authority appointed market makers;

- (b) sales of exchange traded funds shares by their market makers in performance of market making obligations;
  - (c) sales of underlying securities of stock futures and stock options contracts by their market makers for hedging purposes.
8. Exemptions for section 170 are to be provided for in the draft Rules.

*Sections 80A to C*

9. Sections 80A to C of the SO apply to sell orders for securities where the seller has a presently exercisable and unconditional right to vest the securities in the purchaser by virtue of the following ways –
- (a) the seller is a party to a securities borrowing and lending agreement under which he has borrowed the securities or obtained a confirmation from the lender that he has the securities available to lend to him;
  - (b) the seller holds options, a subscription right or warrant or convertible or exchangeable security which, in any case, confers the right to acquire the securities to which the order relates.
10. In general, these sections oblige sellers (whether principals or agents) to, at the time the order is placed or received, confirm that it is a short selling order and that the sale is covered. A broker who receives such an order is required to obtain a confirmation from the seller prior to transmitting the order. Documentary records obtained under these provisions are required to be retained for 12 months and provided to the Commission upon request.
11. Section 80A of the SO is repeated in the Part 1 of Schedule 1 of the Securities and Futures Ordinance and sections 80B and C are repeated in Sections 171 and 172 of the Securities and Futures Ordinance respectively. There are currently no exemptions for sections 80A to C of the SO although the Commission has power to create exemptions in rules.

**C. The proposed exemptions**

12. The application of the proposed exemptions are described in the following sections.

*Section 170 exemptions (section 80 of the Securities Ordinance)*

13. The current exemption for Hong Kong Monetary Authority appointed market makers will be reproduced in the draft Rules.
14. The current exemption which allows exchange traded funds (ETFs) market makers to short sell ETF shares under the existing rules will be extended to all SEHK registered market makers and liquidity providers.

15. The current exemptions which allow stock options market makers and stock futures market makers to short sell underlying securities for hedging purposes will be extended to all SEHK and HKFE participants who are registered with the respective exchanges to perform market making or liquidity providing functions for derivative products listed or traded on SEHK (like ETFs, derivative warrants and stock options) and futures contracts which are traded on the HKFE. In addition, hedging transactions of issuers of structured products under the proposed new chapter of the SEHK's Listing Rules<sup>1</sup> will also be exempt from section 170(1).

*Section 171 exemptions*

16. The SFC intends to create exemptions to the reporting requirements under section 171 (sections 171(1), (3) and (5)). There are currently no exemptions to these reporting requirements. We propose three exemptions.
17. The first exemption - sellers who provide or receive (as the case may be) an oral assurance (instead of a documentary assurance) when they place or accept (as the case may be) a short selling order will be exempt from the section 171 reporting requirements if certain particulars are recorded on a record which is time-stamped. These particulars are specified in the draft Rules and include the securities or group of securities, their quantity etc.. The record should be completed and time-stamped prior to the execution of the order and kept for 12 months. Sellers will be permitted to rely on the records kept by their agents, principals or counterparties provided prior arrangements are in place.
18. The second exemption - sellers who obtain tape-recordings of an assurance, made orally at the time the short selling order is placed, of the matters set out in sections 171(1), (3) and (5) will be exempt from the reporting requirements in those sections. The tape recordings will be required to be kept for 12 months. Sellers may either make a tape recording of the assurance themselves or rely on the tape recordings of their agents, principals or counterparties provided prior arrangements are in place.
19. The third exemption - sellers who obtain or convey (as the case may be) an assurance orally, at the time of the short selling order, of the matters set out in sections 171(1), (3) and (5) and, who by the end of the trading day, provide or receive (as the case may be) a documentary confirmation of the matters in these sections will be exempt from the reporting requirements in section 171. The documentary confirmation is to be kept for 12 months.
20. These proposed exemptions will apply to sellers, as principals and agents, of short selling orders which are made pursuant to a stock

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<sup>1</sup> These issuers are required to appoint an Exchange Participant to make markets or provide liquidity in the structured products.

borrowing and lending agreement as defined in the Securities and Futures Ordinance.

21. Notwithstanding these exemptions, the records made or kept under the draft Rules are required to be produced to the Commission upon request.

**D. New Policy Initiatives**

22. The proposed exemptions are based on discussions, which the SFC has had with industry participants. They have been proposed for the purpose of facilitating market making transactions and, in the case of the section 171 exemptions, reducing compliance burdens of industry participants and facilitating timely execution of transactions.

*Section 170 exemptions*

23. No new policy changes will be incorporated into the draft Rules, which will on the whole amalgamate the existing Rules and address the inconsistencies in the current exemptions to enable market makers to short sell securities in performing their market making obligations as well as to short sell underlying securities of products for which they act as market makers for hedging purposes.

*Section 171 exemptions*

24. There are currently no exemptions from the reporting requirements in the Securities Ordinance. The SFC appreciates that the reporting requirements may, in some cases, delay timely execution of transactions and increase compliance costs and burdens of industry participants. The exemptions are for the purposes of enabling timely execution of transactions and alleviating compliance burdens whilst preserving a proper audit trail for short selling transactions. Sellers who do not or fail to adopt the methods in these exemptions are required to comply with the requirements in section 171.

*The Securities (Stock Lending) Rules*

25. The current Securities (Stock Lending) Rules made under the SO have also been incorporated into the draft Rules. There have been no policy changes to these Rules.

**E. Other matters**

26. Please note that the names of the commentators and the contents of their submissions may be published on the SFC web site and in other documents to be published by the SFC. In this connection, please read the Personal Information Collection Statement attached to this consultation paper.
27. You may not wish your name to be published by the SFC. If this is the case, please state that you wish your name to be withheld from publication when you make your submission.

28. Written comments may be sent

By mail to: SFC (short selling exemptions)  
12/F, Edinburgh Tower  
The Landmark  
15 Queen's Road Central  
Hong Kong

Attn: Supervision of Markets Division

By fax to: (852) 25217917

By on-line submission at: <http://www/hksfc.org.hk>

By e-mail to: [short\\_selling\\_exemptions@hksfc.org.hk](mailto:short_selling_exemptions@hksfc.org.hk)

## **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<sup>2</sup> 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 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:
  - to administer the relevant Ordinances, rules, regulations, codes and guidelines
  - made or promulgated pursuant to the powers vested in the SFC
  - for the purposes of performing the SFC’s statutory functions under the relevant Ordinances
  - for research and statistical purposes
  - other purposes permitted by law

### **Transfer of Personal Data**

3. Personal Data may be disclosed by the SFC to the members of the public in Hong Kong and elsewhere, as part of the public consultation on the Consultation Paper. The names of persons who submit comments on the 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 web site and in documents to be published by the SFC throughout and at the conclusion of the consultation period.

### **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 the Consultation Paper. The SFC has the right to charge a reasonable fee for processing any data access request.

### **Enquiries**

5. Any enquiries regarding the Personal Data provided in your submission on the Consultation Paper, or requests for access to Personal Data or correction of Personal Data, should be addressed in writing to:

The Data Privacy Officer  
The Securities and Futures Commission  
12/F, Edinburgh Tower, The Landmark  
15 Queen’s Road Central, Hong Kong

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

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<sup>2</sup> Personal Data means personal data as defined in the Personal Data (Privacy) Ordinance, Cap 486 (“PDPO”)

## **SECURITIES AND FUTURES (SHORT SELLING EXEMPTION AND STOCK LENDING) RULES**

(Made by the Securities and Futures Commission under section 397(1)  
of the Securities and Futures Ordinance (5 of 2002))

### **1. Commencement**

These Rules shall come into operation on the day on which Part VII of the Securities and Futures Ordinance (5 of 2002) comes into operation.

### **2. Interpretation**

In these Rules, unless the context otherwise requires –

“blanket assurance” ( ) means a confirmation from a lender to a borrower that the lender has a sufficient overall supply of a defined group of securities such that for a specific period of time as agreed on by the parties the securities concerned are available to lend to the borrower;

“borrow” ( ) means a borrowing of securities pursuant to a securities borrowing and lending agreement, irrespective of whether the borrowed securities have been delivered by the lender to the borrower;

“Exchange Fund” ( ) means the fund established under section 3 of the Exchange Fund Ordinance (Cap. 66);

“Exchange Fund Bill” ( ) means any instrument described as such which is issued by the Government for the account of the Exchange Fund under the Exchange Fund Ordinance (Cap. 66);

“Exchange Fund Note” ( ) means any instrument described as such which is issued by the Government for the account of the Exchange Fund under the Exchange Fund Ordinance (Cap. 66);

“Futures Market Maker” ( ) means an exchange participant who is registered with the Futures Exchange Company for the purpose of performing market making or liquidity providing activities in respect of futures contracts admitted to trading on the recognized futures exchange it operates in accordance with its rules;

“hold” ( ) means a confirmation from a lender to a borrower that for a specific period of time as agreed on by the parties, specific securities in a specific quantity are available to lend to the borrower;

“lender” ( ) means a lender of securities under a securities borrowing and lending agreement, provided that where securities are being lent under the agreement as agent for clients, the agent and not also its clients shall be regarded as the lender for the purposes of these Rules;

“Monetary Authority-appointed market maker” ( ) means any person appointed as a market maker by the Monetary Authority under a letter of appointment currently in force for the purpose of conducting market making activities in respect of Exchange Fund Bills, Exchange Fund Notes and specified instruments;

“Securities Market Maker” ( ) means an exchange participant which is registered with the Stock Exchange Company for the purpose of performing market making or liquidity providing activities in respect of securities listed or admitted to trading on the recognized stock market it operates in accordance with its rules and an issuer of structured products which are listed on the recognized stock market operated by the Stock Exchange Company under Chapter 15A of its Listing Rules;

“specified instrument” ( ) means any note issued by the MTR Corporation Limited, the Airport Authority, the Hong Kong Mortgage Corporation Limited and the Kowloon-Canton Railway Corporation under their respective note issuance programmes arranged by the Monetary Authority;

### **3. Classes of transactions prescribed for the purposes of section 170(3)(e) of the Ordinance**

(1) The following classes of transactions are prescribed for the purposes of section 170(3)(e) of the Ordinance –

- (a) a sale by a Monetary Authority-appointed market maker of

- (i) Exchange Fund Bills;
    - (ii) Exchange Fund Notes; or
    - (iii) specified instruments;
  - (b) a sale of a security in conducting jobbing business.
- (2) For the purpose of this section, the following transactions or dealings constitute jobbing business –
- (a) the sale of a security listed or admitted to trading by the Stock Exchange Company by a Securities Market Maker where the sale is for the purpose of hedging the risks of a position previously acquired in another security and the security that is sold is a component of that other security or vice versa;
  - (b) the sale of a security listed or admitted to trading by the Stock Exchange Company by a Futures Market Maker where the sale is for the purpose of hedging the risks of a position previously acquired in a futures contract in respect of the security or an index of securities which includes the same security;
  - (c) the sale of a security listed or admitted to trading by the Stock Exchange Company by a Securities Market Maker in the performance of market making or liquidity providing activities in the security if the Securities Market Maker acquires the right to vest the security in the purchaser of them before the end of the trading day following the day of the sale.

**4. Circumstances in which certain requirements of section 171 not to have effect**

- (1) Subject to subsections (2) to (8), section 171 of the Ordinance does not apply to a short selling order which is such order by virtue of paragraph

(a)(i) of the definition of “short selling order” in section 1 of Part 1 of Schedule 1 to the Ordinance.

(2) A person, where selling as a principal, at the time of conveying a short selling order referred to in subsection (1), shall provide his agent with an oral assurance that the counterparty to the securities borrowing and lending agreement has the securities to which the order relates available to lend or deliver to him and such person shall –

- (a) record such oral assurance in the form of a tape-recording;
- (b) have entered into an arrangement with his agent whereby the agent has agreed to –
  - (i) record such oral assurance in a tape recording; or
  - (ii) at the time of receiving a short selling order, record the particulars as described in subsection (5) to which the order relates on a time-stamped record; or
- (c) confirms the giving of the oral assurance in the form of a document to the agent by the end of the day on which it was given.

(3) An exchange participant, where selling as a principal, prior to conveying a short selling order referred to in subsection (1), shall –

- (a) have received from the counterparty to the securities borrowing and lending agreement an oral assurance that the counterparty has the securities to which the order relates available to lend or deliver to him and
- (b) have –
  - (i) recorded the oral assurance in a tape-recording;
  - (ii) recorded the particulars as described in subsection (5) to which the order relates on a time-stamped record; or

- (iii) entered into an arrangement with the counterparty whereby the counterparty has agreed to –
  - (A) record the particulars as described in subsection (5) to which the order relates in the form of a document;
  - (B) provide such document to the exchange participant to by the end of the day of which the assurance was given.

(4) A person, where selling as an agent, prior to conveying a short selling order referred to in subsection (1), shall –

- (a) have received from his principal, or the other person for whose benefit or on whose behalf such order is made (as the case may be) an oral assurance that the counterparty to the securities borrowing and lending agreement has the securities to which the order relates available to lend or deliver to him, and
- (b) have –
  - (i) recorded the oral assurance in a tape recording;
  - (ii) recorded the particulars as described in subsection (5) to which the order relates on a time-stamped record; or
  - (iii) entered into an arrangement with his principal, or the other person for whose benefit or on whose behalf the order is made (as the case may be), whereby his principal, or such other person (as the case may be) has agreed to provide a confirmation of the oral assurance in the form of a document to him by the end of the day on which the assurance was given.

(5) Particulars required under subsection (2)(b)(ii), (3)(b)(ii) and (iii)(A) and (4)(b)(ii) include –

- (a) the securities or group of securities borrowed, available for borrowing and the quantity; and
- (b) whether a blanket assurance or a hold has been given or a borrow has been entered into, and the time it was given or entered into, as the case may be.

(6) Any person who records an oral assurance, particulars as described in subsection (5) or a confirmation of an oral assurance in the form of a document (including a tape recording or time-stamped record) under this section must retain such document for not less than one year from the date of recording, collecting or receiving such assurance or particulars as the case may be.

(7) Upon request made at any time within the one year period referred to in subsection (6) by the Commission, the person must give the Commission access to and produce the document (including a tape recording or the time-stamped record (as the case may be)) containing the oral assurance or particulars (as the case may be), within the time and at the place specified by the Commission.

## **5. Record keeping by stock lender**

(1) When a lender gives a blanket assurance or a hold to a borrower, or enters into a borrow, the lender must record in the form of a document the following particulars –

- (a) the name of the borrower;
- (b) the securities or group of securities borrowed, or available for borrowing and the quantity thereof;
- (c) whether a blanket assurance or a hold has been given or a borrow has been entered into, and the time it was given or entered into, as the case may be.

(2) The lender must –

- (a) subject to paragraph (b), retain the document referred to in subsection (1) for not less than one year from the date the relevant record was made; and
  - (b) upon request made at any time within that year by the Commission, provide any such record to the Commission.
- (3) In this rule, “securities” means securities which are listed by the Stock Exchange Company.

Chairman,  
Securities and Futures Commission

2002

### **Explanatory Note**

These Rules are made by the Securities and Futures Commission under section 397(1) of the Securities and Futures Ordinance (5 of 2002). They prescribe for the purposes of section 170(3)(e) of the Ordinance the classes of transactions that are exempt from section 170(1) of the Ordinance and provide the circumstances in which certain requirements of section 171 do not have effect.