



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

**Consultation Conclusions on the draft Securities and  
Futures (Disclosure of Interests - Exclusions)  
Regulation**

**《證券及期貨(披露權益 - 免除)規例》草擬本諮詢總結**

Hong Kong  
June 2002

香港  
2002年6月

## **INTRODUCTION**

1. On 16<sup>th</sup> May 2002, the Securities and Futures Commission ("SFC") issued a consultation paper ("the Consultation Paper") to solicit comments on the draft **Securities and Futures (Disclosure of Interests - Exclusions) Regulation** ("the draft Regulation").
2. The draft Regulation creates certain exclusions from the disclosure obligations that may arise when a person acquires, or ceases to have, or there is a change in the nature of a person's interest in shares of a listed corporation under Part XV of the Securities and Futures Ordinance ( 5 of 2002) ("SFO").
3. The consultation exercise ended on 8<sup>th</sup> June 2002 but the SFC has subsequently conducted further consultation with the persons who submitted comments on the draft Regulation and proposes an enlargement of the draft Regulation in response to these submissions.
4. The purpose of this document is to provide interested persons with an analysis of the comments raised during the consultation exercise and the rationale for the SFC's conclusions. It is advisable to read this document in conjunction with the Consultation Paper itself.

## **PUBLIC CONSULTATION**

### **Consultation process**

5. In addition to the public announcement inviting comments, the Consultation Paper was distributed to various interested parties and professional bodies. The Consultation Paper and the draft Regulation were posted on the website of the SFC and distributed to all registrants through FinNet.
6. A single submission was received from Linklaters & Alliance for a group of eight financial institutions -
  - (a) Credit Suisse First Boston (Hong Kong) Ltd
  - (b) Goldman Sachs (Asia) L.L.C.
  - (c) Morgan Stanley Dean Whitter Asia Ltd
  - (d) Salomon Smith Barney Hong Kong Ltd
  - (e) Deutsche Securities Asia Ltd
  - (f) J.P.Morgan
  - (g) Merrill Lynch (Asia Pacific) Ltd.
  - (h) UBS Warburg.
7. No comments were made on the text of the exemptions contained in the draft Regulation. However, Linklaters & Alliance called for a widening of the exemptions provided in the draft Regulation.

## **Consultation Conclusion**

8. Having regard to the comments received the SFC proposes to create an additional exemption for intermediaries who enter into transactions in Exchange traded stock futures contracts and stock options contracts for their clients. The SFC considers that the exemption can be compared with the existing exemption, in section 323(1)(i) of the SFO, for an intermediary who acquires an interest in shares of a listed corporation as an agent for a client. The exemption can be justified on a similar basis – that the intermediary does not acquire an economic interest in the underlying shares if the intermediary, to all intents and purposes, entered into the futures or options contract for a client.
9. The changes to the draft Regulation extend the exemptions with a view to minimizing unnecessary disclosures, whilst maintaining adequate transparency in the disclosure regime to protect the interests of investors. The draft Regulation has also been further refined to better reflect the policy intention and to improve drafting.

## **SUMMARY OF COMMENTS AND SFC'S RESPONSES**

10. A summary of the comments received together with the SFC's responses is set out in the Appendix.

**Summary of Comments Received on Securities and Futures (Disclosure of Interests –Exclusions) Regulation**

	<b>Section No.</b>	<b>Respondent’s comments</b>	<b>SFC’s response</b>
1.	Request for new exemption (Intermediary interest in stock option and futures.)	<p>[ Linklaters &amp; Alliance ]</p> <p>Where a dealer buys or sells shares for its client, it is arguable that the dealer acquires an “interest” in the shares pending settlement. For the avoidance of doubt, an exemption has been introduced in Section 323(1)(i) of the FSO to exempt the dealer from any duty of disclosure in such circumstances.</p> <p>However, this exemption will not apply where a dealer which is an Exchange participant is entering into transactions in Exchange-traded stock options or stock futures relating to underlying shares in a Hong Kong listed corporation. In summary, when an Exchange participant opens a position for a client, this involves two contracts, one buy and a matching sell, being entered into:</p> <ul style="list-style-type: none"> <li>• between the Exchange participant and (by novation) the clearing house, and</li> <li>• between the Exchange participant and the client.</li> </ul> <p>Under the Exchange Rules, all transactions effected by an Exchange participant in options and futures will be clearly designated as either being for the account of a client or for the Exchange participant’s own account. Where transactions are effected for clients, the Exchange participant has no “economic” interest in the positions created. The role of the dealer is analogous to that of an agency broker in the cash market, even though (because of the way in which the clearing system operates) the transactions are effected as back to back principal positions.</p> <p>We therefore propose an exemption to enable an Exchange participant to disregard for disclosure purposes interests and</p>	<p>Viewed strictly, the position of an intermediary who enters into a stock futures contract or a stock options contract is different from the position of an intermediary who buys shares as agent for his client. An intermediary who enters into a stock futures contract, or a stock options contract, is (1) acting as principal rather than as agent; and (2) will hold the position until the end of the contract – up to three months, as opposed to 3 days in the case of the exemption under section 323(1)(i) of the SFO.</p> <p>Nevertheless, where in reality the exchange participant is entering in the transaction solely for a client, and has no real economic interest in the underlying shares, we agree that the interest, or short position, of the exchange participant should be disregarded. In the same way that the exemption under section 323(1)(i) of the SFO is not available for contracts entered into for clients that are related corporations, we propose that the new exclusion should be similarly limited. The new provisions appear in clause 3(1)(d) of the draft Regulation.</p>

	Section No.	Respondent's comments	SFC's response
		short positions arising from transactions effected, for the account of clients, in stock options and stock futures traded on a recognized exchange company in Hong Kong.	
2.	Request for new exemption (Client facilitation activities)	<p>[ Linklaters &amp; Alliance ]</p> <p>When a dealer receives an order from a client to buy or sell Hong Kong shares, or a basket of shares, the dealer may commit to achieve a particular standard of execution (for example, no worse than the value-weighted average price for transactions in the market on the trading day). While the dealer will effect the purchases or sales as the client's agent, if this does not achieve the agreed execution price, part of the trade will be rebooked as a principal trade, to achieve that price. Similarly, a dealer may buy a block of shares from a client at an agreed price for immediate on-sale into the market, or may "go short" in order to fill an order from a client or from the market (for example, when acting as a liquidity provider in respect of structured products).</p> <p>To the extent that the dealer is not acting as agent, the "agency brokerage" exemption in Section 323(1)(i) will not apply. However, we consider that an equivalent exemption from Part XV should be available in respect of interests/short positions temporarily arising in the course of effecting a transaction resulting from the instructions of a client, where the transaction is effected in the ordinary course of the dealer's business, and the interest or short position is held for no more than 3 business days and ceases on settlement of the transaction with the client.</p>	<p>In the circumstances outlined by Linklaters &amp; Alliance, the dealer is not really acting as agent for a client but is acquiring an economic interest in the shares itself. We are concerned that this will unduly enlarge the "agency exemption" in s. 323(1)(i). In practice, it would not be possible to distinguish between a situation where the dealer is intending to buy/sell for a client and the situation where the dealer is buying on his own behalf.</p>
3.	Request for new exemption (IPOs-related transactions)	<p>[ Linklaters &amp; Alliance ]</p> <p>In relation to Initial Public Offerings ("IPOs") and follow-on offerings Linklaters &amp; Alliance ask for exemptions for, effectively, all transactions in which managers might be engaged. Specifically they sought an exemption from Part XV for interests/short positions of the managers of an issue of securities potentially arising as a result of activities carried out for or on behalf of the syndicate of managers, during the period of 30 days after the date of the offering. The exemption would cover :</p>	<ol style="list-style-type: none"> <li>1. We believe that the difficulties of compliance are overstated. Managers who undertake underwriting commitments, borrowing stock and carrying out stabilising activities must know their positions. The requirement for completing a disclosure form at the end of each trading day will not be unduly onerous and we do not think that this is a sound reason for creating an exemption.</li> <li>2. In all disclosure regimes there are certain elements of double counting but despite this it is</li> </ol>

	<b>Section No.</b>	<b>Respondent's comments</b>	<b>SFC's response</b>
		<ul style="list-style-type: none"> <li>• Underwriting commitments</li> <li>• Greenshoe options (15% over-allotment option);</li> <li>• Agreements among managers;</li> <li>• Stock borrowing to cover over-allocations;</li> <li>• Stabilising activities, (i.e. purchases within certain price levels fixed by the Securities and Futures (Price Stabilising ) Rules)</li> <li>• Ancillary stabilising activities (under the draft Stabilising Rules this would include over-allotments, short selling and exercise of options to purchase shares)</li> </ul> <p>In support of their request Linklaters submitted that –</p> <ol style="list-style-type: none"> <li>1. To report the interests/short positions of the syndicate members prior to the offering taking place, and during the stabilisation period, could be very onerous.</li> <li>2. There could be “double counting” among the various syndicate members, and the resulting information could be misleading.</li> <li>3. Disclosures under Part XV could make it more difficult to carry out legitimate stabilising activities and undermine the maintenance of an orderly market.</li> </ol>	<p>not difficult for analysts to grasp the full picture. In contrast, if substantial information were not disclosed, it would be impossible to form an opinion on the full picture. The non-disclosure of transactions surrounding an IPO could therefore undermine market transparency.</p> <p>3. We do not think that secrecy is a precondition for the success of stabilising action. The stabilising effect comes from the purchases and sales themselves – and the immediate market response. It is worthwhile to note that the disclosures are only made 3 business days after the day of the transaction and the Exchange publishes the following day. Hence a trade on Monday will not be made public until Friday. We do not think that disclosure of stabilising activities will undermine the maintenance of an orderly market.</p> <p>The new disclosure regime under Part XV of the SFO will be reviewed at an appropriate time in the light of its actual implementation. These issues could be revisited in the light of the experience gained.</p>