



**CONSULTATION TO EXPAND THE SCOPE OF SHORT POSITION
REPORTING AND ON THE CORRESPONDING AMENDMENTS TO
THE SECURITIES AND FUTURES (SHORT POSITION
REPORTING) RULES**

The Law Society's Submissions

The Law Society appreciates the opportunity to be consulted and to respond to the above consultation. Overall, the Law Society considers the proposed changes to be worthwhile, subject to the points and observations made in response to the questions below.

Where relevant, the abbreviations and the terms used in the submission below shall follow those used in the captioned Consultation Paper.

Q1. Do you have any comments on expanding the scope of short position reporting to all Designated Securities?

As recognised in the consultation paper:

...the market value of the additional securities proposed to be included in the SPR Rules are generally smaller than that of the index constituent stocks... (para. 18 of the Consultation Paper)

Accordingly, there is less of a market instability argument for the wider scope.

Instead, the Law Society notes the broadening of the covered specified shares represents the SFC widening its focus from market stability considerations to include the potential usage of the additional information for supervision and enforcement purposes.

As a practical matter, the Law Society considers that the proposed change may indeed help to remove or reduce temptation on the part of short sellers intending to “game” the market from simply targeting stocks not covered by the SPR Rules: their activities would become subject to more transparency to SFC scrutiny.

It would be instructive and important to monitor on an ongoing basis the broadened range of Designated Securities treated as specified shares, to ensure that the resources and costs of compliance with the new requirements are warranted by the practical surveillance benefits in respect of and activity levels in respect of the larger universe of entities.

Overall, the proposal makes logical and practical sense in the current environment, assuming the balance can on an ongoing basis be shown to be justifiable as a means of containing the risk of a disorderly market (not just at the overall market level, but also at the individual stock level for investor protection purposes).

Note: As a minor drafting point, it would seem appropriate to refer to "specified interests" rather than "specified shares", given the inclusion of CIS interests which may or may not be shares in a company.

Q2. Is it appropriate not to apply the existing threshold trigger of 0.02% for reporting short positions in CIs?

This is a sensible modification of the requirements, given the practical realities.

Q3. Do you have any comments on the proposal that daily reporting on short positions would only apply to those Daily Reporting Securities as determined by the SFC in contingency situations?

This seems to be a sensible approach to avoid overload of information in an emergency situation where realistically only a sub-set of the Designated Securities may be relevant.

Guidance as to the process of selection of the particular Designated Securities would be useful for market participants to provide a degree of warning as to the likely starting point for the relevant securities. It is appreciated that this would be indicative only, and the Law Society presumes that the most likely criteria would be the levels of market capitalization and short selling activity in respect of the Designated Securities – given the basis of the imposition of daily reporting to be threats or possible threats to Hong Kong financial stability, it seems unlikely that there would be a blanket need for daily reporting in respect of all Designated Securities.

Q4. Do you have any comments on the proposal to provide in the SPR Rules the flexibility for the SFC to designate the use of more than one electronic system to report short positions?

This seems to us uncontroversial from a legal perspective.

However, the Law Society notes the more stringent approach to reporting, in the new section 4A(b) of the SPR Rules, namely that a report is to be regarded as “duly submitted” only if it is submitted through a designated electronic system in accordance with the directions and instructions relating to the system published by the SFC. Such submission will be required to be in the manner considered appropriate by the SFC. Since a contravention of the SPR Rules would (without a reasonable excuse) be a criminal offence, the Law Society considers that a degree of materiality should be built into the requirements, since honest mistake in relation to a relatively minor aspect of the report would not afford a “reasonable excuse”. The Law Society submits that it should be made clear on the face of the requirements that compliance in all material respects would suffice.

The Law Society of Hong Kong
22 December 2015

