

# Further consultation on Securities and Futures (Short Position Reporting) Rules ends on 4 November

## Introduction

On 18 October 2011, the Securities and Futures Commission (SFC) published its Consultation Conclusions and Further Consultation on the Securities and Futures (Short Position Reporting) Rules (Consultation Conclusions).

This followed earlier consultation and conclusion papers published in May 2011<sup>1</sup>, March 2010<sup>2</sup> and July 2009<sup>3</sup>.

Following the financial crisis and more recently, the SFC has not seen a need to impose any emergency short selling measures as Hong Kong had already adopted a more stringent approach than those of major overseas markets. The SFC has proposed a short position reporting regime as a means to enhance transparency of short positions.

Despite considerable comments received from the market on criminality, the SFC is going ahead with creating a criminal offence for a breach of the short position report requirement and this remains to be the biggest issue.

Many market participants continue to be concerned about the low combined threshold of 0.02% and HK\$30 million, but the SFC has made no further adjustments or references to the threshold in its Consultation Conclusions.

## Who to report

The SFC reiterated in its Consultation Conclusions that the person or entity who beneficially owns the short position has the obligation to report. However, the party who has the statutory obligation to report may authorize its agent to do so on its behalf. For example, a collective investment scheme may delegate the reporting to its fund manager. However, the beneficial owner will remain legally responsible for the reporting.

The SFC will publish FAQs and guidance in scenarios where more than one person beneficially owns a reportable short position.

## Key Issues

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### When and how to report

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If you would like to know more about the subjects covered in this publication or our services, please contact:

[Martin Rogers](#) +852 2826 2437

[Mark Shipman](#) +852 2825 8992

[Matt Feldmann](#) +852 2825 8859

[James Wadham](#) +852 2825 8837

To email one of the above, please use  
firstname.lastname@cliffordchance.com

Clifford Chance, 28th Floor, Jardine House,  
One Connaught Place, Hong Kong SAR

<sup>1</sup> Consultation on Securities and Futures (Short Position Reporting) Rules, SFC

<sup>2</sup> Consultation Conclusions in Increasing Short Position Transparency, SFC

<sup>3</sup> Consultation on Increasing Short Position Transparency, SFC

## When and how to report

One of the more significant developments in the Consultation Conclusions is that the SFC is now proposing that a person or legal entity will be required to report short positions on a net basis. The SFC considers this a more pragmatic approach, following responses received from market participants who voiced concerns that reporting on a gross basis would impose an undue burden on them. Whilst the SFC is happy to move forward with the short position reporting regime on a net basis approach, it will continue to assess whether the short positions data is sufficient to meet its regulatory purpose; the SFC will consider further adjusting the requirement if necessary.

A legal entity which organizes and conducts its trading activities on a trading units/books basis, each of which has its own trading objectives and strategies, should net the short positions at the trading units/books level. The legal entity should not net off positions against different trading units/books.

To determine whether the legal entity has triggered the reporting requirement, the legal entity should aggregate all net short positions from different trading units/books but exclude those trading units/books that have a net long position.

The SFC is seeking comments to Section 3(2) of the proposed Securities and Futures (Short Position Reporting) Rules (Rules) which is now modified to reflect a net basis approach.

In its consultation paper the SFC provided in the draft reporting template a "Position Composition" flag to let a firm distinguish its on and off exchange short positions when making a short position report to the SFC. The SFC has subsequently decided in its Consultation Conclusions to remove the flagging requirement based on the market feedback that most financial institutions would incur significant compliance cost in meeting this requirement.

## The penalties

Although there was a strong industry response against criminal sanctions for a breach of the disclosure obligations, the SFC has maintained that such breach should constitute a criminal offence. However, the SFC modified its proposals to state that only a contravention of Section 3(1), without "reasonable excuse" should constitute an offence, which will be subject to a fine or imprisonment of up to two years. The SFC's proposal to introduce a defense of "reasonable excuse" without clear guidance of what would be considered as such continues to leave considerably uncertainty with respect to this important issue.

## Operation

While the reporting obligation is usually on a weekly basis within two business days after the last trading day of the week, the SFC has the power to require daily reporting within one business day in contingency situations.

In the previous consultation, market participants expressed that they may face difficulties in meeting the one business day reporting requirement in contingency situations, and suggested that the reporting deadline be extended to two business days. The SFC stressed that it is particularly critical that it receives timely information during stressed market conditions hence reporting of short positions in a crisis is expected to be carried out by the next business day as envisaged previously.

The SFC has made it clear that it intends to move quickly to implementing the short position reporting regime and plans to publish conclusions to its further consultation as soon as possible. The Rules will be tabled for negative vetting by the Legislative Council upon publication of the consultation conclusions. Subject to the legislative process, the SFC targets to implement the short position reporting requirement by the end of Q1 2012.

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