

26 September 2008

**Circular to All Licensed Corporations and Registered Institutions
("intermediaries")**

**Short Selling Requirements and Obligations under
the Securities and Futures Ordinance**

Many markets around the world have made significant changes to rules regarding short selling in recent weeks. In particular, many regulators have moved to ban "naked" short selling (a practice that has been prohibited in Hong Kong since short selling was first introduced) or to completely suspend short selling for certain stocks.

SFC is closely monitoring short selling activities. While we believe the existing regime (which has been enhanced in 1998) has served Hong Kong well, we have proposed to the Hong Kong Exchanges and Clearing Ltd (HKEx) that the default fee for settlement failure be doubled as soon as possible. Currently, the Hong Kong Securities Clearing Co, Ltd charges a penalty fee, known as default fee, under the Central Clearing and Settlement System Rules, of 0.25% of the market value of the failed transactions. HKEx will make a further announcement about this later today.

In addition, we have suspended the proposal to remove the tick rule.

We would also like to remind all intermediaries of the short selling requirements and obligations stipulated under the Securities and Futures Ordinance ("SFO"). A breach of any of these requirements or obligations may constitute a criminal offence under the SFO and is punishable by fines and/or imprisonment. The requirements and obligations are set out in summary below.

- Unless exempted, naked short selling is prohibited. The selling of securities at or through the Stock Exchange of Hong Kong Ltd (SEHK) is naked short selling unless at the time of the sale, the seller (or his client, if he is an agent) has a presently exercisable and unconditional right to vest the securities in the purchaser of them, or believes and has reasonable grounds to believe that he (or his client, as the case may be) has such a right.
- Covered short sales (i.e., "short selling orders") are permitted provided that the reporting obligations are complied with. In summary, (i) the seller (whether acting as principal or agent) must, at the time of placing a short selling order, identify it as a short selling order and provide documentary assurance that the sale is "covered" and (ii) an intermediary who receives a short selling order must ensure that he has obtained a documentary assurance that the sale is "covered".
- An exchange participant (or his representative), when inputting a short selling order into the SEHK trading system, must mark it as a short sale in accordance with the SEHK rules.

Supervision of Markets Division
Securities and Futures Commission

End