

24 August 2009

Securities and Futures Commission  
8th Floor, Chater House, 8 Connaught Road Central  
Hong Kong

**RE: Consultation on increasing short position transparency**

Please find below our comments on the questions in the consultation paper.

**Q1. Is the use of close out indicators an appropriate method to enhance transparency of short selling in the cash market to the SFC? Please provide reasons.**

We are not in favor of introducing closeout indicators when buying back short positions as they will add additional complexity to the trading process above the current requirement for SLHKs & SSHKs for each short sell order, which increases the risk of errors and slippage.

Also we agree with the SFC that such indicators will not identify short position holders immediately if required and nor will it capture derivative or off-exchange transactions as these apply to cash market trades only.

**Q2. If you believe the use of close out indicators can be adopted, how can we address the limitations that are set out in paragraphs 13 and 14?**

We would not support the use of close out indicators given the reasons detailed in Q1 above.

**Q3. Should derivatives (both exchange traded and off-exchange transactions) be included in the short position reporting requirements? Please provide reasons.**

We would support derivative disclosure in principle. Disclosure should be comprehensive without placing a significant burden upon market participants in order to be effective.

Including single stock swaps would not add material complexity to the reporting process and will provide a far more complete picture of outstanding shorts positions in the market. Importantly, it also closes any obvious loopholes.

**Q4. If derivatives are included, which (if any) of the alternatives in paragraph 21 above is the most appropriate? Are there any other practical alternatives? Please provide reasons.**

As stated in Q3 our view is that disclosure needs to be comprehensive without placing a significant burden upon market participants. Disaggregating larger baskets and index instruments would be overly complex and burdensome, in our view. We would support the proposal outlined in Para 21 (a) for Single Stock Derivative disclosure.

However, if as a result of single stock derivative disclosure the Regulator became concerned at a significant increase in the number of smaller swap baskets which were created to provide a direct and substantial exposure to individual stocks and to circumvent disclosure reporting, then disclosure for

these could be considered by the Regulator to close a potential loophole. The rules around disclosure for these smaller baskets will need to be well defined.

**Q5** If any one of the approaches in paragraph 21 is adopted, should those derivatives be limited to ones that create direct exposures to the stock of the listed company? If so, what are the products that should be excluded (e.g., do you have any views on whether convertibles and other exchangeables should be included?) How should the definition of such derivative be crafted? Please provide reasons.

We believe the focus of disclosure should be on direct stock exposure, so all derivative products would be excluded apart from single stock equity swaps.

The definition of such a derivative is an Over the Counter (OTC) transaction that creates a single stock exposure to an underlying security.

We would also suggest considering whether Options can be incorporated within this regime, as they can be misused to create large exposures while avoiding disclosure. e.g. VW case in Europe recently.

**Q6** If derivatives are included, should they be included on a delta adjusted basis? Please provide reasons.

We would agree that to present a complete picture of the short exposure derivatives should be included on a delta adjusted basis in net exposure calculations rather than notional amounts.

**Q7** Should the reporting requirements cover short positions in Designated Securities only rather than in all listed corporations' securities? Please provide reasons.

Only designated securities should be reported, given that non-Designated securities can't be shorted in HK. Including non-Designated Securities would seem to impose additional administrative complexity in respect of a part of the market where these should be of little or no concern by market participants or the SFC.

**Q8** Which of the approaches above (i.e., threshold approach (with initial and subsequent reporting), or periodic reporting (with or without a threshold level) or either the threshold approach or periodic approach with flexibility to tighten the requirements during a contingency situation) would be the most appropriate for short position reporting? Do you have any other suggestions? Please provide reasons.

Marshall Wace can implement either Threshold or Periodic reporting. The process to provide such reporting would be straightforward to implement.

Of the two our preference would be for Periodic Reporting as described in Para21 Alternative (c) as this approach makes reporting reasonably timely and flexible.

The frequency of submissions and threshold level can be tightened in extreme market conditions while providing the SFC adequate levels of data during more regular trading activity.

Submissions made on a weekly basis for all positions above a reasonable threshold, such as 0.25bps, to provide a reasonable level of disclosure. If the threshold can be aligned with the UK, i.e. 0.25bps, this would ensure implementation of a consistent global approach. Although the SFC makes a strong case for a lower threshold (at para 26(b)(iv)) on the considerably lower short selling volume of HK vs London (6% vs 25% respectively), we believe it can be justified on the basis that the

0.25bps threshold would be more likely to be triggered if short selling volume were to rise – that, in itself, being a useful indicator.

**Q9** If a threshold approach is adopted, what is an appropriate threshold (and subsequent thresholds) for the Hong Kong market?

If periodic reporting is adopted, should thresholds (either a percentage of a listed corporation's issued share capital and/or a dollar value amount) apply? If so, what are appropriate thresholds for periodic reporting?

Please provide reasons. *If you are a broker or custodian*, it would be helpful if you could estimate how many of your clients would be required to file reports if the suggested threshold is adopted.

For Periodic reporting, disclosure on a percentage basis is more straightforward than tracking dollar value. Given the smaller short selling positions in HK versus other markets, a limit of 0.25bps of shares outstanding is a reasonable level with incremental 0.10bp triggers upwards.

**Q10** If you agree that short position reporting can be more relaxed during normal market situations and more frequent reporting with tighter threshold(s) may be required in the event of a contingency, what are the circumstances that may amount to a contingency situation (as this may need to be included in the legislation)? Please provide reasons.

Contingency levels are really a question for the regulator to define, but we would suggest the key determinant is the level of short interest vs available free float combined with spikes in short interest reporting.

**Q11** Are there any reasons why systems for complying with reporting requirements cannot be adjusted in the manner described in paragraph 26(d) above? What are other operational issues that we should consider? Please provide reasons.

Marshall Wace's systems are flexible and our reporting tools can be refactored to meet additional reporting requirements within a short period of time. We would prefer, as a minimum, a weekend (or preferably 5 days) to allow for adequate testing and deployment.

Potential Operational issues would arise if the reporting submission tool and / or website used to upload data also needed to be changed for new reporting requirements. If this is a simple file transfer process then this should not be an issue.

**Q12** What are your views on the timing of reporting for the different approaches? Please provide reasons.

We would be able to meet T+1 reporting as suggested in the consultation paper.

**Q13** Should the obligation to report short positions be placed on holders of short positions? Please provide reasons.

Yes, and disclosure should apply to all dealings in HK as a market conduct issue rather than only be applied to SFC-regulated firms. Disclosure by the investor in any jurisdiction is most appropriate, rather than disclosure by a broker or 3<sup>rd</sup> party.

**Q14 Should agents be permitted to report information on behalf of holders of short positions with the holders of the positions being held accountable? Please provide reasons.**

Some smaller market participants may need to use reporting applications managed by designated 3<sup>rd</sup> parties, such as prime brokers.

**Q15 In the case of funds, should the reporting requirements apply to individual funds rather than to the fund manager? Please provide reasons.**

We believe disclosure data should be aggregated at the manager and fund level, as with the UK regime. Disclosure should apply to dealings in HK as a market conduct issue rather than only to SFC-regulated firms.

**Q16 Do you agree that aggregation requirements should not be imposed on different entities within the same group? Please provide reasons.**

Yes, agree with the SFC paper that this would make disclosure overly complex and burdensome.

**Q17 What are your views on providing in the report to the SFC the net short position and the net position established on the SEHK? Please provide reasons.**

*Apologies – it's not entirely clear what the question is referring to.*

**Q18 What are your views on the creation of a template to facilitate electronic reporting through the SFC's website? Please provide reasons.**

A standard template would be straightforward for facilitating data upload to a website providing the process is simple yet secure so uploading can be done timely and meet appropriate standards in regard to information security.

**Q19 Should the information reported to the SFC be disclosed publicly on an aggregated and delayed basis? Please provide reasons.**

Disclosure should be made to the regulator only, with the regulator providing aggregated data to the market. There should be no delay on the publication of aggregated data to the market, as the degree of short interest in an issuer is information that is of use to all market participants.

Any disclosure of investor-level information to the market should only occur if this would have a demonstrable benefit, which would clearly need to be established by the Regulator.

**Q20 If the information is published on a delayed basis, what would be the appropriate 'delay' (e.g., on a weekly basis for positions as at the end of the preceding week)?**

We are fine with a weekly basis for publishing positions as at the end of the preceding week.

**Q21 Should the SFC consider any exemptions from the reporting requirements? Please provide reasons.**

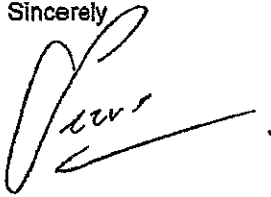
None

**Q22 Do you agree that the short position reporting requirements should not be homed in Part XV of the SFO or mirror the Part XV requirements? Please provide reasons.**

The existing SFO provisions on short selling reporting are aimed to provision for large position disclosure (5% threshold etc) and are not suitable for general position disclosure in the ways outlined in the SFC paper.

Given this we would agree new legislation is required to introduce the new reporting requirements.

Sincerely



Christopher Pearce

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Marshall Wace Asia Limited