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# **Submission to the SFC Consultation Paper on expanding the scope of short position reporting and on the corresponding amendments to the Securities and Futures (Short Position Reporting) Rules**

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For enquiries on this submission, please contact

**CompliancePlus Consulting Limited understands and  
agrees that our name and/or submission may be published by the SFC.**

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## Introduction

The Securities and Futures Commission (“SFC”) has issued a Consultation Paper on the proposed scope expansion of the short position reporting regime and the proposed amendments to the Securities and Futures (Short Position Reporting) Rules (Cap 571AJ), with the purpose of further improving the transparency and monitoring of short selling activities in Hong Kong.

This submission is prepared in response to the SFC’s Consultation Paper dated November 2015 and our comments are set out below. Terms defined or given a particular construction in the Consultation Paper have the same meaning in this Response unless a contrary indication appears.

## Consultation Questions

### **Question 1: Do you have any comments on expanding the scope of short position reporting to all Designated Securities?**

We agree that there is a justifiable need to expand the present scope of short position reporting from a subset of 127 stocks to all Designated Securities on the list of The Stock Exchange of Hong Kong Limited (“SEHK”). Since the Designated Securities that are not covered by the current Short Position Reporting (“SPR”) Rules account for a very significant portion of the total market capitalization, daily turnover and short selling activities in the Hong Kong market, it is indispensable that sufficient information and transparency of these securities should be readily available so that the SFC could efficiently perform its monitoring function. We also agree that with the additional information about short positions in the Hong Kong market after the proposed scope expansion, the SFC could identify possible buildup of substantial short positions that may have potentially disruptive impacts to the financial stability of Hong Kong.

We are also of the opinion that covering collective investment schemes (“CISs”), which include exchange traded funds (“ETFs”), real estate investment trusts (“REITs”) and other types of unit trusts and mutual funds, under the rule is reasonable. Given the gradual increase in trading activities of CISs since 2012 and their substantial turnover contribution, it is evident that these investment instruments could have more significant potential impacts on the orderly functioning of the market. As a result, we agree that expanding the scope of short position reporting is necessary to help the SFC better perform its regulatory functions.

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Furthermore, we also note that the proposed scope expansion of short position reporting are based on similar principles from various international regimes. We note that the SFC's rationale is in line with, for example, the approach outlined in the Regulation (EU) No. 236/2012 of the European Parliament and of the Council of 14 March 2012 on short selling and certain aspects of credit default swaps. Thus, we believe by expanding the current reporting scope, the SFC's short position reporting requirement would be more aligned to other regimes on an international front.

### **Question 2: Is it appropriate not to apply the existing threshold trigger of 0.02% for reporting short positions in CISs?**

We, in principle, agree that it is appropriate not to apply the existing threshold trigger of 0.02% for reporting short positions in CISs. We are of the same opinion as stated in the Consultation Paper that it is impractical to set the reporting threshold for CISs by referencing to the market capitalization. We agree that the computation process which involves obtaining the outstanding units or shares is complicated as the numbers may fluctuate a lot due to daily creation and redemption. We also hold the same view as the SFC that the reporting regime would be too complex if different reporting thresholds are to be applied on different classes of shares.

### **Questions 3: 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?**

With regard to the daily reporting requirement, we understand that occasions may arise where continuous reporting on the short positions in certain Designated Securities would play an important role in preventing potentially disruptive impacts to the financial stability of the Hong Kong market. We also agree with the SFC that it is impractical and operationally burdensome to require daily reporting of short positions in all Designated Securities. Thus, our view is consistent with the SFC's that said reporting requirement should only apply to the Daily Reporting Securities as determined by the SFC in contingency situations.

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We would, however, appreciate further comments from the SFC elaborating on the circumstances that could constitute such a contingency situation. According to Rule 7(1)(a) of Part 3 of the Securities and Futures (Short Position Reporting) Rules, the SFC may publish a daily reporting requirement notice in accordance with this rule if the SFC believes that - circumstances exist, in Hong Kong or elsewhere, which threaten or may threaten the financial stability of Hong Kong. The current rule does not provide market participants with a comprehensive understanding on what circumstances would be considered threatening to the market. The SFC may consider to offer a Frequently-Asked-Questions web page or to issue a note with examples that illustrate what may trigger such threatening circumstances.

Moreover, with regard to the notice period before the daily reporting takes effect, we suggest the SFC conduct a review to see if the current notice period offer market participants sufficient time to produce an accurate Short Position Report. As Section B (V) of the Consultation Paper stated, there has been a number of instances where reports submitted had failed to comply with the Notes to the Reportable Short Position Form (“Notes”). An unfamiliarity with the daily reporting process due to a short notice period could be a possible cause leading to some of the dissatisfactory report submissions.

### **Questions 4: 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?**

As the expanded scope of short position reporting would generate a large amount of additional information, we understand the SFC’s longer term plan to provide for another alternative electronic system for reporting. On one hand, we welcome the flexibility in terms of report submission offered by this arrangement. We also note that having more than one electronic system to report short positions could be a good measure to prevent system overload and service interruptions in case one of the systems go down.

On the other hand, we would like to express some concerns with regard to the use of multiple electronic systems to report short positions. Firstly, market participants who are required to submit reports might be confused by the potentially different operations of multiple reporting systems, thus possibly resulting in failure to comply with the submission instructions. In addition, with the foreseen increased volume of information the SFC will receive after the

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scope expansion, operating multiple reporting systems may result in a need to centralize and consolidate a vast amount of short positions data regularly. We believe it is important that the SFC will be well prepared for any additional infrastructure needed to collect and record such information. Moreover, we urge the SFC to have a comprehensive plan with regard to the implementation of multiple reporting systems and we also recommend the SFC to publish a clear timeline for market participants once said timeline is confirmed.

We would also like to note that the current Notes to the Reportable Short Position Form (“Notes”) offer detailed and useful instructions to market participants in terms of how to properly file a short position report. We recommend the SFC to offer the same level of guidance should multiple reporting systems are to be implemented in the future.

### Conclusion

In general, we agree that expanding the current scope of short position reporting to all Designated Securities would help the SFC to better perform its regulatory function and help deter abusive and inappropriate short selling behaviours. We also concur that it is appropriate not to apply the existing threshold trigger of 0.02% for reporting short positions in CSIs due to the impracticality and difficulty that may arise from the calculation process. In respect to the proposal that daily reporting on short positions would only apply to those Daily Reporting Securities as determined by the SFC in contingency situations, we fully understand the SFC’s rationale behind this proposal.

We recommend the SFC to offer further illustrations on some of the definitions involved and we suggest the SFC to review the length of the daily reporting notice period. Last but not least, we express our understanding on the SFC’s plan to utilize multiple reporting systems in the future. In light of this future plan, we recommend the SFC to be better prepared for the possible technical challenges and consult the industry or related industry organization on this further.

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