

Press release

LCQ18: Short selling activities

Wednesday, November 12, 2008

Following is a question by the Hon Emily Lau Wai-hing and a written reply by the Secretary for Financial Services and the Treasury, Professor K C Chan, in the Legislative Council today (November 12):

Question:

In a study report published on 24th last month, Morgan Stanley, an international investment bank, pointed out that since the outbreak of the financial tsunami, HSBC Holdings PLC (HSBC Holdings) was the only financial institution in the world whose share price had not experienced a sharp fall. Moreover, it estimated that HSBC Holdings would reduce its dividend payments. As such, it had adjusted downward HSBC Holdings' target share price to \$75. On the same day, the share price of HSBC Holdings dropped from \$95 to \$88 and further to \$75 on 27th last month. Some members of the public doubted if the above situation involved short selling activities. In this connection, will the Executive Authorities inform this Council whether:

- (a) it will investigate if someone had deliberately disseminated news unfavourable to HSBC Holdings and gained profits from the fall of the company's share price through short selling activities; if it will, of the details; if not, the reasons for that; and
- (b) it will follow the practice of various financial markets in Europe and the United States to ban short selling activities so as to maintain the stability of our financial system and strengthen investors' confidence; if it will not, of the reasons for that?

Reply:

President,

(a) As the regulator of the securities and futures markets, the Securities and Futures Commission (SFC) ensures that the market operates in an efficient, fair, orderly and transparent manner. The SFC will investigate and follow up those cases where any persons or institutions are suspected to have provided false or misleading information to the market, or where such persons or institutions are suspected to have deployed the false or misleading information in market misconduct activities.

If the information provided by the persons or institutions to the market is true, or if the information consists of an opinion or a recommendation which has been formed in good faith or is otherwise reasonable and justifiable in all circumstances, providing such information will not amount to market misconduct.

The SFC does not comment on individual cases.

(b) The Administration is aware that a number of overseas jurisdictions have introduced temporary measures to restrict or prohibit short selling activities in response to market volatility and the situations of their financial markets.

We also note that some of the measures recently introduced by overseas jurisdictions against short selling have indeed been included in our existing short selling regime. For example, many European markets, including Germany, France and Italy, have recently banned naked short selling (Note 1). In fact, in accordance with the Securities and Futures Ordinance, naked short selling is prohibited in Hong Kong (Note 2).

Besides, the Administration has tightened its regulation of short selling regime after the Asian financial crisis in 1998. Currently, only covered short selling for certain designated securities, as prescribed by the Stock Exchange of Hong Kong Limited (SEHK), is permitted. Meanwhile, brokers/agents may execute short selling only on the SEHK's trading system at or above the best current asking price. Moreover, the relevant rules also require a full audit trail to be kept for covered short selling. Clients must provide documentary confirmation (including written confirmation, tapes or electronic documents) to their brokers or agents when the short selling is effected.

Generally speaking, the current short selling regime in Hong Kong is robust. Short selling activities are not the major cause for the recent decline of the stock market. Despite recent volatility in the global financial markets, short selling activities in Hong Kong remain at levels consistent with those prior to the current global financial turmoil.

Although the SFC has not found any abusive short selling activities at this stage, the SFC has, as a preventive measure, issued earlier a circular reminding intermediaries to strictly comply with the short selling rules. The Hong Kong Securities Clearing Company Limited has also doubled the default fee for failed settlement of short selling transactions.

The SFC will continue to closely monitor short selling activities in the stock market and will introduce market-wide control measures (including restriction of short selling activities) where necessary.

Notes:

1. Covered short sale requires the seller to have borrowed the stock or to have obtained a confirmation that the lender has the stock available to lend out at the time of sale. In contrast, naked short selling involves selling of securities without borrowing the stock or without having obtained the abovementioned confirmation.
2. Naked short selling has been prohibited in Hong Kong since short selling was first introduced in 1994.

Ends