

**Press Release**

**LCQ2: Regulation of short selling activities**

Wednesday, June 28, 2017

Following is a question by the Hon Christopher Cheung and a reply by the Secretary for Financial Services and the Treasury, Professor K C Chan, in the Legislative Council today (June 28):

Question:

It has been reported that in recent months, a number of institutions engaged in short selling activities (short selling institutions) published a number of research reports or commentaries targeted at certain local listed companies, querying that such companies had problems in areas such as governance, finances and business prospects, and setting extremely low target share prices for such companies. The share prices of the named companies plunged immediately and trading of their shares even had to be suspended. As a knock-on effect, the share prices of listed companies in related industries also fluctuated significantly, causing serious disturbance to market order and sending jitters through the market, thus resulting in quite a number of investors having sustained huge losses. However, the publication of such reports or commentaries by short selling institutions is not a regulated activity under the Securities and Futures Ordinance. As such, these institutions are not required to apply to the Securities and Futures Commission (SFC) for any licence. In this connection, will the Government inform this Council:

(1) whether it knows the number of complaints received by SFC in each of the past five years that the reports published by short selling institutions on listed companies contained false or misleading representations, and the details of such complaints;

(2) whether it knows if SFC investigated in the past five years the situation of short selling institutions joining hands with speculators to short sell the shares of a particular listed company before publishing a negative report on that company; if SFC did, whether any market misconduct has been uncovered, and whether punishment has been imposed in respect of substantiated market misconduct; and

(3) whether the authorities will make reference to the practices of major overseas financial markets and stringently monitor the activities of short selling institutions, so as to strengthen the protection for local investors?

Reply:

President,

Our response to the three parts of the question is as follows:

(1) From June 1, 2012 to June 15, 2017, the Securities and Futures Commission (SFC) received 12 complaints about research reports by short sellers, including complaints that these reports contained false or misleading representations. The SFC would not comment on details of individual complaints.

(2) The SFC has conducted investigations into short sellers who issued short seller reports. There is usually a statement in this kind of report declaring that the authors of the report may have a short interest in the relevant stock and stand to realise significant gains if the price of the stock declines. The SFC investigations, therefore, usually focus on whether there has been any manipulative trading or naked short selling which is illegal under the Securities and Futures Ordinance (Cap. 571) (SFO) and whether the short seller report contained any materially false or misleading statements. If the short seller report seems plausible, the SFC also investigates open mindedly whether the listed company concerned has issued false or misleading information. To date, one completed investigation has resulted in enforcement against the issuer of a short selling report (the issuer). In that case, the SFC brought Market Misconduct Tribunal (MMT) proceedings against the issuer. The MMT found that the issuer had breached section 277 of the SFO for negligently issuing false or misleading information about a listed company, alleging that the listed company was insolvent and had engaged in accounting fraud. The MMT imposed a number of penalties on the issuer as a result.

(3) Hong Kong has a stringent short-selling regime. Only covered short selling for certain designated securities, as prescribed by the Stock Exchange of Hong Kong (SEHK), is permitted. Our short selling regulation requires a full audit trail to be kept for covered short sales, meaning that when clients place short selling orders, they must provide documentary confirmation to their brokers or

agents that the sale is shorted and it is covered. In June 2012, the SFC introduced a short position reporting regime under which reportable short positions must be reported to the SFC on a weekly basis and the aggregated short positions reported is published by the SFC. The short position reporting regime was expanded in March 2017 to cover all securities eligible for short selling to further enhance the SFC's monitoring of short selling activities and improve market transparency. Breaches of these statutory requirements may result in criminal prosecution. Apart from the statutory requirements, the SEHK requires that short selling may be executed only on its trading system at or above the best current ask price (the so-called "tick rule"). In addition, Hong Kong Securities Clearing Company Limited (HKSCC) has implemented measures to safeguard brokers from late delivery. If a broker fails to deliver securities to settle its short transactions on the settlement day (i.e. T+2), the HKSCC will execute compulsory buy-in. The SFC will continue to review and if necessary, enhance the short-selling regime based on changing market activities and global regulatory developments.

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