

# LEGISLATIVE COUNCIL BRIEF

## Securities and Futures Ordinance (Cap. 571)

### SECURITIES AND FUTURES (PRICE STABILIZING) RULES

#### INTRODUCTION

Pursuant to sections 282 and 306 of the Securities and Futures Ordinance (Cap. 571) (SFO), the Securities and Futures Commission (SFC) has made the Securities and Futures (Price Stabilizing) Rules (the Rules) at the **Annex**.

#### BACKGROUND

##### The SFO

2. The SFO was enacted in March 2002. It consolidates and modernizes ten existing ordinances governing the securities and futures markets into a composite piece of legislation to keep the regulatory regime on a par with international standards and practices. For effective regulation, the SFO has already provided flexibility in addressing changing market practices and global conditions by empowering the Chief Executive in Council, the Financial Secretary, the Chief Justice and the SFC to prescribe detailed and technical requirements as necessary by way of subsidiary legislation, to supplement the regulatory framework laid down under the primary legislation.

3. On 22 February 2002, the House Committee of the Legislative Council has established the Subcommittee on Draft Subsidiary Legislation to be made under the SFO (the Subcommittee) to study the subsidiary legislation necessary for commencing the SFO. From March 2002 to October 2002, the Subcommittee held 12 meetings and considered a total of 37 sets of draft subsidiary legislation, including the *vires* to make them.

## **THE PROPOSALS**

### **Major policy considerations**

4. Price stabilization generally refers to transactions undertaken to stabilize the price of securities either to prevent them from declining or rising. Stabilization is potentially manipulative because it seeks to maintain or support the price of a security at a certain level and therefore distorts the price which would otherwise obtain as a result of a natural supply and demand of the security in the market.

5. Under the SFO, these actions might be considered market misconduct under Part XIII or XIV, which provide for parallel civil and criminal regimes to deal with market misconduct, respectively. In particular, such actions might be relevant to insider dealing (sections 270 and 291), false trading (sections 274 and 295) and stock market manipulation (sections 278 and 299). Sections 282 of Part XIII and 306 of Part XIV of the SFO provide that a person who may otherwise have engaged in market misconduct (under Part XIII) or committed an offence (under Part XIV) shall not be regarded as having so engaged or shall have a defence, if he establishes that the conduct in question is in accordance with rules made under such sections. Such rules prescribe a “safe harbour” for market misconduct provisions under Parts XIII and XIV of the SFO.

6. In accordance with sections 282(2) and 306(2) of the SFO, the SFC has consulted the Financial Secretary and considers that it is in the public interest to make the Rules to prescribe the circumstances in which price stabilizing action may be taken in connection with public offerings and regulating such action, so that it would not be considered market misconduct under Parts XIII and XIV of the SFO. The Rules prescribe the circumstances in which the prices of certain securities offered to the public may be stabilized, the period in which they can be stabilized in accordance with the Rules, the type of stabilizing action which may be undertaken and related requirements for carrying out stabilizing actions such as disclosure and record keeping.

7. The primary purpose of stabilization is to facilitate capital raising by corporations by addressing short-term fluctuations resulting from the sudden increase in supply in the secondary market (which would generally result in a decrease in the price of the securities being offered).

8. Stabilization has been practised in the Hong Kong market in a restricted sense in connection with initial public offerings. The SFC permits certain stabilizing actions to be carried out in prescribed circumstances. It is intended that the Rules will provide a clear regulatory framework for stabilizing actions so that they may be conducted in an open, transparent and accountable manner without compromising investor protection.

***Commensurate with international practices***

9. In formulating the Rules, consideration has been given to recent regulatory developments in other major financial centres, particularly the UK and the US. The Rules are to a large extent commensurate with the international standards so as to facilitate global offerings of securities conducted in Hong Kong and in other markets. Having regard to the similarity in the regulatory framework for securities transactions and mechanisms for securities offerings, the Rules have been modelled closely on the UK Price Stabilizing Rules issued pursuant to the Financial Services and Markets Act 2000.

10. In order to facilitate global offerings, flexibility has been built into the Rules. Accordingly, stabilizing action conducted overseas with a view to stabilizing the price of securities on the overseas market and effected in accordance with the stabilization rules of regulatory authorities in certain recognized jurisdictions specified in Schedule 4 to the Rules, which provide similar regulatory safeguards against market manipulation, will not for the purpose of the SFO be regarded as market misconduct. It is the SFC's intention to recognize certain overseas jurisdictions, in particular the UK as soon as possible once the Rules are made. The SFC has held ongoing discussions with the UK Financial Services Authority regarding recognition by it of the Rules.

11. The SFC will keep the Rules under regular review in light of actual operational experience, latest market developments and international trends, in order to ensure that our price stabilization regime is modern and effective in enabling market development.

## **THE RULES**

### ***Application***

12. Section 3 of the Rules specifies the application of the Rules. In particular, they will apply only to public offers in Hong Kong of publicly traded shares or debentures and certain secondary offers which are public in character where the total value of the securities subject to the offer is not less than HK\$100 million.

13. Sections 4 and 5 of the Rules specify that any stabilizing action taken in compliance with the Rules shall not be regarded as constituting market misconduct under Parts XIII and XIV of the SFO respectively.

### ***Stabilizing actions and stabilizing period***

14. The Rules permit the stabilizing manager<sup>1</sup> to purchase securities in the secondary market to support the price of the relevant securities (section 6) within the stabilizing period. The stabilizing period is defined in section 2 of the Rules to start from commencement of trading of the relevant securities and end on the earlier of the 30th day after, the closing date of the offer or the commencement of trading of the relevant securities.

15. Stabilizing action by way of over-allocation of relevant securities and the subsequent exercise of an option to purchase or subscribe for relevant securities in order to close out the position established by the over-allocation is permitted under section 7. The sale of relevant securities acquired by the stabilizing manager in the course of stabilizing action is also permitted.

### ***Disclosure of stabilizing action***

16. Stabilizing action may not be taken if adequate disclosure of the action has not been given (section 8). The particulars of the disclosure

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<sup>1</sup> “Stabilizing manager” is the single intermediary appointed by or on behalf of the offeror of any relevant securities to take any stabilizing action under the Rules.

requirements are set out in Schedule 1 to the Rules. The stabilizing manager is also required to disclose the information specified in Schedule 3 to the Rules after the expiry of the stabilizing period (section 9). The disclosure requirements for communications to the public in a variety of media are clearly set out in Schedule 1 in order to facilitate compliance by the stabilizing manager or its agents. Schedule 3 specifies the information which must be included in the required post-stabilization disclosure.

### ***Restrictions on stabilizing action***

17. Stabilizing action may not be taken if the price of the relevant securities has already become artificial as a result of market misconduct (section 10(1)). Convertible debt securities may not be stabilized if their conversion terms have not been publicly announced (section 10(2)). The stabilizing manager may not take any action in any case where it or its associates, in respect of the offer, holds any options over the securities which are to be stabilized, the terms of which have not been disclosed to the public in accordance with the Rules (section 10(3)). This prohibition addresses conflicts of interest on the part of the stabilizing manager.

### ***Limits on pricing***

18. Stabilizing bids, if effected in relation to equity securities, will be subject to a pricing limit mechanism and the maximum stabilizing bid should not exceed the public offer price (section 11). The pricing limits are prescribed in Schedule 2 to the Rules. Due to the difference in the pricing mechanisms, the pricing limits do not apply to stabilizing actions for offers of debentures.

### ***Stabilizing manager***

19. The Rules require that the stabilizing action be carried out only by the stabilizing manager or his agent (section 12(4)). Principal transactions between the stabilizing manager and his agent are prohibited (section 12(5)).

### ***Record keeping of stabilizing action taken***

20. Sections 13 and 14 require the stabilizing manager to keep and maintain a register of stabilizing actions, available for inspection by the SFC and the offeror upon notice. The register should contain all the transaction details about stabilizing actions for each offer of securities.

### ***Overseas stabilization***

21. Section 15 provides that stabilizing action conducted overseas with a view to stabilizing the price of securities on the overseas market and effected in accordance with the stabilization rules in certain recognized jurisdictions to be specified in Schedule 4 to the Rules will not for the purpose of the SFO be regarded as market misconduct.

## **PUBLIC CONSULTATION**

22. The SFC released a consultation document and an exposure draft of the Rules on 8 February 2002 for comment by the public. A total of 7 submissions were received. The SFC has considered all the comments received and in light of further comments from the market and the Legal Advisor to the Subcommittee, made amendments to the Rules, as appropriate.

23. A draft of the Rules was considered by the Subcommittee at its meeting held on 9 July 2002. No major concerns were expressed by members of the Subcommittee at the meeting.

## **FINANCIAL AND STAFFING IMPLICATIONS**

24. There are no financial or staffing implications for the Government.

## **COMMENCEMENT DATE**

25. The Rules will come into operation on the day appointed for the commencement of the SFO, together with other subsidiary legislation necessary for the commencement. We expect this to take place shortly, after completion of the negative vetting procedure through the Legislative

Council and allowing the industry a reasonable period of time for making necessary adjustments with reference to the subsidiary legislation. We aim to announce the target commencement date by the end of 2002.

## **PUBLICITY**

26. The Rules will be published in the Gazette on 13 December 2002. The SFC will issue a press release on the same day.

## **ENQUIRIES**

27. For any enquiries on this brief, please contact Ms. Daisy Lai of the Corporate Finance Division of the SFC at 2283 6816 or Mrs Mary Ahern of the Legal Services Division of the SFC at 2283 6809.

The Securities and Futures Commission  
13 December 2002