

LEGISLATIVE COUNCIL BRIEF

Securities and Futures Ordinance (Cap. 571)

SECURITIES AND FUTURES (DISCLOSURE OF INTERESTS – SECURITIES BORROWING AND LENDING) RULES

INTRODUCTION

Pursuant to section 377 of the Securities and Futures Ordinance (Cap. 571) (SFO), the Securities and Futures Commission (SFC) has made the Securities and Futures (Disclosure of Interests - Securities Borrowing and Lending) 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 provides 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 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. The Rules supplement the regulatory regime for disclosure of securities interests in Part XV of the SFO. Part XV replaces the existing Securities (Disclosure of Interests) Ordinance (Cap. 396) and requires substantial shareholders, directors and chief executives to disclose interests in shares of listed companies. The objectives of the new disclosure regime are two-fold: to give investors more complete, better and more timely information which is price sensitive so that they can make better informed investment decisions; and to minimize the compliance burden.

5. In securities borrowing and lending (SBL) business, a large number of loans and returns of shares can be transacted from the same lending pool. This would give rise to a large number of disclosures for movements in the same lending pool, which may be of limited value to investors. The SFC is of the view that it is appropriate to establish a simplified disclosure regime that will limit the disclosure obligations of certain classes of participants in the SBL market without undermining the integrity of the disclosure regime or compromising investor protection. Accordingly, the SFC has made the Rules to simplify the disclosure requirements in respect of specified SBL transactions.

THE RULES

6. The Rules will establish a simplified disclosure regime for the following types of persons with respect to their SBL transactions—

- (a) substantial shareholders, who lend through an approved lending agent (ALA) (see paragraph (b) below) that uses a specified form of agreement (i.e. a relevant agreement¹ as defined) when lending the shares, will be exempt from making disclosures of changes in the nature of their interests that result from the lending and return of shares (section 3 of the Rules);

¹ Briefly, a relevant agreement refers to a SBL agreement providing that the borrower of shares is required to provide collateral of a value exceeding the value of shares lent, the value of collateral is marked to market to avoid any shortfall and the lender of shares can require the return of shares at any time.

- (b) ALAs – persons approved by the Commission as ALAs (generally custodians) will be exempt from the disclosure requirements when they lend shares from their lending pool or when shares are returned to their lending pool. ALAs will have to disclose changes in the percentage level of their lending pool but the amount of information required to be included in their notification has been simplified (sections 4, 5, 6 and 8 of the Rules); and
- (c) “regulated persons” – interests in shares borrowed by local brokers and overseas brokers in approved jurisdictions that merely act as a conduit (i.e. regulated persons who borrow and on-lend the shares within 5 business days) are to be disregarded (section 7 of the Rules).

7. The simplified disclosure regime for ALAs will also be extended to cover holding companies of ALAs that are taken to be interested in shares in which an ALA is interested under section 316(2) of the SFO. ALAs and regulated persons taking advantage of the simplified disclosure regime will have to keep records of the transactions in accordance with the requirements set out in sections 9 and 10 respectively of the Rules.

PUBLIC CONSULTATION

8. The SFC released a consultation document and an exposure draft of the Rules on 19 December 2001 for comment by the public. A total of five submissions were received. In the light of the comments received, the SFC subsequently met with the respondents, to discuss the proposals with them in more detail. The Rules have taken into account comments from the consultation and the results of further discussions with the industry.

9. A draft of the Rules was considered by the Subcommittee at its meeting held on 15 July 2002. No major concerns were expressed by members of the Subcommittee at the meeting.

FINANCIAL AND STAFFING IMPLICATIONS

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

COMMENCEMENT DATE

11. 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

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

ENQUIRIES

13. For any enquiries on this brief, please contact Mr. Anthony Wood of the Legal Services Division of the Commission at 2840 9276 or Mr. Brian Ho of the Corporate Finance Division of the Commission at 2840 9321.

The Securities and Futures Commission
13 December 2002