



**SECURITIES AND
FUTURES COMMISSION**
證券及期貨事務監察委員會

**A Consultation Paper on the Securities
and Futures (Disclosure of Interests –
Securities Borrowing and Lending) Rules**

《證券及期貨(披露權益 – 證券借貸)規則》諮詢文件

Hong Kong
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Introduction

This consultation document invites public comments on the draft **Securities and Futures (Disclosure of Interests – Securities Borrowing and Lending) Rules** (“the SBL Rules”) which the Securities and Futures Commission proposes to make under Part XV of the Securities and Futures Bill (disclosure of interests in listed companies) when it becomes law.

Part XV of the Bill seeks to modernize the disclosure of interests in securities. The objective of the Bill is to provide investors with more complete information, of better quality, on a timely basis to enable them to make informed investment decisions.

Part XV requires shareholders who have an interest in **5% or more** of the shares of a listed corporation to give notice of interests in voting shares of listed corporations in certain specified circumstances. It also requires a director or a chief executive, who is interested in the shares or debentures of a listed corporation (of which he is a director or chief executive) or any of its associated corporations, to give notice in certain specified circumstances.

This paper is concerned with the disclosure obligations that may arise when a person lends or borrows shares in a listed corporation. We will first give a brief summary of the disclosure obligations under Part XV for 5% shareholders (and directors) and then we will explain the simplified disclosure regime that will be available under the SBL Rules for the persons who are most active in lending and borrowing shares.

In reading this summary it is important to remember that persons who are interested in less than 5% of the shares of a listed corporation, and who are not a director or chief executive of the listed corporation, will have no disclosure obligations.

Disclosure of stock borrowing and lending (“SBL”) under Part XV of the Bill

The position of the borrower and the lender under Part XV are slightly different.

The borrower

The borrower of stock acquires an interest in the shares of a listed company when he borrows them. The borrowing of shares also creates a “short position” for the stock borrower (because he has an obligation to return the shares). A person’s long and short position cannot be netted off when calculating the percentage level of a person’s interest. However, the borrower will only have to give a notice if, as a result of the borrowing or the return, the shares in which he has an interest, expressed as a percentage of the shares in issue -

- (1) rises above 5%;
- (2) drops below 5%;
- (3) passes through a whole percentage level above 5% e.g. passes through 6% or 7%; or

- (4) exceeds 5% and the short position created by borrowing shares passes through a whole percentage level e.g. 1% or 2% of the shares in issue.

In addition, an exemption (the *de minimis* exemption) will usually exempt small fluctuations in the percentage figure of a person's shareholding, that take a person's interest through a whole percentage level above 5% (e.g. the 6% percentage level), if the amount of shares borrowed or returned is less than 0.5%. The 0.5% fluctuation is calculated by comparing the percentage figure of his interest after borrowing the shares with the percentage figure of his interest in the last notification filed by him.

The lender

When a person lends shares he does not acquire an interest in shares or cease to have an interest in shares. Instead there is a change in the nature of his interest in the shares when they are lent and returned. However, the lender will only have to give a notice if -

- (1) the total shares in which he is interested exceed 5% of the shares in issue; and
- (2) after he lends shares, or shares are returned to him, the percentage level of his interest (not counting the shares that have been lent or returned) is different to the percentage level of his interest in the last notification filed by him.

The *de minimis* exemption will also usually exempt loans, and returns, of shares if the percentage figure of a person's interest in the shares that are not lent or returned fluctuates by less than 0.5%. The 0.5% fluctuation is calculated by comparing the percentage figure of his interest after lending the shares (not counting the shares that have been lent) with the percentage figure of his interest in the last notification filed by him.

Simplified disclosure regime under the SBL Rules

The SBL Rules will establish a simplified disclosure regime for disclosure of securities borrowing and lending by persons who are most active in the SBL industry :

- (1) "institutional investors" - the managers of local or overseas collective investment schemes or pension funds and local or overseas banks and insurance companies;
- (2) "approved lending agents" - custodians or lending agents that are approved by the SFC; and
- (3) "regulated persons" - local brokers and dealers and overseas brokers and dealers in approved jurisdictions.

Under the SBL Rules :

- (1) Institutional investors and their approved lending agents, who make a disclosure when shares are authorised to be lent, and cease to be authorised to be lent are relieved of the duty of disclosing any subsequent lending and return of those shares.

- (2) Interests and short positions in shares resulting from borrowing and lending by regulated persons 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.
- (3) Persons taking advantage of the simplified disclosure regime must keep records of the shares borrowed/lent and returned as prescribed in the SBL Rules.

Records

Institutional investors who lend directly to borrowers, lending agents and regulated persons who use the simplified disclosure regime under the SBL Rules are required to keep certain records. These records need not be maintained in a special ledger or form and there should be no duplication with records kept for other purposes such as the ledgers maintained for the purposes of the Stamp Duty relief for stock borrowing and lending.

Examples of how the SBL Rules will operate

Example 1 – Lending by an institutional investor using a lending agent

Assume :

HK Equity Fund (“Fund”) owns 6% of the shares of XYZ Ltd., a company listed on the Stock Exchange of Hong Kong. All of Fund’s shares are held by Secure Custodian Bank (“Custodian”) which has no authority to exercise discretion in dealing with shares that it holds in custody for its customers. Custodian is a corporation incorporated in Delaware with an office in Hong Kong. It has been approved by the SFC as an approved lending agent under section 6 of the SBL Rules. On 1-3-2002 Fund authorises Custodian to lend 50% of its shares in accordance with Custodian’s lending program. At that date Custodian had authority to lend 1% of the shares of XYZ Ltd. from other customers.

Simplified disclosure regime

If Fund makes a disclosure of the lending authorisation it will not be required to make further disclosures when the shares are subsequently lent and returned. Custodian will not be under a duty to disclose the lending authorisation, or the subsequent lending and return of the shares, as the shares that it was authorised to lend by all of its customers represented only 4% of the shares in XYZ Ltd. - less than the 5% disclosure threshold.

If Fund subsequently purchases 2% more shares in XYZ Ltd. then it must give notification of the purchase in the usual way as the percentage level of its interest increased to 8%. If the new shares are delivered to Custodian for safe custody, and 50% are covered by the lending authorisation then, if Fund makes a disclosure of the lending authorisation, it will not be required to make further disclosures when the shares are subsequently lent and returned.

Custodian is now authorised to lend a total of 5% of the shares of XYZ Ltd (4% for Fund and 1% for other customers). If Custodian makes a disclosure of the lending authorisation then it will not be required to make further disclosures when the shares are subsequently

lent and returned. The disclosure of the lending authorisation would be a disclosure due to a change in the nature of its interest in the shares, not an increase or a reduction in the size of a custodian's interest. An initial disclosure under the SBL Rules will therefore save Custodian from having to make multiple disclosures.

If Fund subsequently purchases 0.5% more shares in XYZ Ltd. then it does not need to give notification of the purchase as the percentage level of its interest has not changed. If the new shares are delivered to Custodian for safe custody, and 50% are covered by the lending authorisation then, Fund does not need to make a disclosure of the lending authorisation, and it will not be required to make further disclosures when the shares are subsequently lent and returned. Similarly, Custodian will also not need to disclose the lending authorisation as the percentage level of the shares which it is authorised to lend has not changed. Custodian will not be required to make further disclosures when the extra 0.25% of shares are subsequently lent and returned.

Example 2 – Borrowing and lending by a broker acting as a conduit

Assume :

NB Securities Ltd. (“NBS”) is an exchange participant and is registered for dealing in securities in Hong Kong. NBS owns 4.5% of the shares of XYZ Ltd. that it holds as a proprietary trading position. These shares are presently charged to a bank and are not available for lending. NBS has entered into a stock borrowing and lending agreement with Custodian some months previously.

A client of NBS (“Client”) tells NBS that he wishes to sell XYZ Ltd. short. He says that he may need to borrow up to 2% of the shares of XYZ Ltd. and has previously signed a stock borrowing and lending agreement with NBS.

Monday 1-4-2002	NBS asks Custodian to place a “hold” on 2% of the shares of XYL Ltd for it.
Tuesday 2-4-2002	Client instructs NBS to sell 1.5% short. NBS gives Custodian confirmation of the loan and provides collateral of 105% of the value of the shares to be borrowed. NBS then sells 1.5% of XYZ Ltd. for Client.
Wednesday 3-4-2002	Custodian delivers the shares to NBS (strictly, it issues a Settlement Instruction to CCASS to transfer the shares to the account of NBS).
Thursday 4-4-2002	NBS uses 1.5% of the shares borrowed to settle the short sale. Strictly, this is a loan of the shares to Client. NBS retains the proceeds of sale (and a further 5% deposited by Client) as collateral.
Tuesday 9-4-2002	Client informs NBS that he will not in fact be making any further short sales and would like to close his position. NBS returns the 0.5% of the shares borrowed to Custodian and buys 1.5% of XYZ Ltd. in the market.

Thursday 11-4-2002	The buy back is settled and NBS returns the 1.5% of XYZ Ltd. to Custodian.
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In this example the “hold”, “confirmation” and delivery are spread over 3 days to show more clearly the point from which time begins to run under the SBL Rules. In practice they could all take place on one day.

Simplified disclosure regime

NBS does not have to make any disclosures under Part XV. The shares borrowed were all used for a “prescribed purpose” within 5 business days i.e. they were :

- (1) on-lent under the terms of a stock borrowing and lending agreement with collateral, determined by reference to the market value of the shares lent, being provided; or
- (2) returned to a person from whom the shares were borrowed,

all within 5 business days of Tuesday 2-4-2002 (counting from the day after the day that NBS first acquired an interest in the shares).

Since the shares were used for a prescribed purpose NBS’s interest in the 2% of shares borrowed is disregarded and need not be aggregated with its 4.5% proprietary position.

If, however, NBS had retained the 0.5% of shares borrowed for a further day and had returned them to Custodian on Wednesday 10-4-2002 NBS would have had a disclosure obligation. This is because it would have acquired an interest in 0.5% of the shares of XYZ Ltd. on Tuesday 9-4-2002 (i.e. on the last day of the 5 business days for using the shares) and these shares would have raised its total interest to 5%. The notification would have to be filed within 3 business days thereafter i.e. on or before Friday 12-4-2002.

The SFC welcomes comments from industry practitioners and members of the investing public on the Draft Rules.

Comments should be submitted by 26th January 2002, by way of e-mail to SBLRulesconsult@hksfc.org.hk or faxed to (852) 2521-7917. Written comments are welcome and should be addressed to:

Securities and Futures Commission
12/F, Edinburgh Tower
The Landmark
15 Queen's Road Central
Hong Kong

Attn: Supervision of Markets Division

Hard copies, in Chinese and English, of the Draft Rules are available at the offices of the SFC. Copies may also be downloaded from the SFC website: <http://www.hksfc.org.hk>.

Please note that the names of the commentators and the contents of their submissions may be published on the SFC web site and in other documents to be published by the SFC. In this connection, please read the Personal Information Collection Statement attached to this consultation paper.

You may not wish your name and/or submission to be published by the SFC. If this is the case, please state that you wish your name and/or submission to be withheld from publication when you make your submission.

Personal Information Collection Statement

1. This Personal Information Collection Statement (“PICS”) is made in accordance with the guidelines issued by the Privacy Commissioner for Personal Data. The PICS sets out the purposes for which your Personal Data¹ will be used following collection, what you are agreeing to with respect to the SFC’s use of your Personal Data and your rights under the PDPO.

Purpose of Collection

2. The Personal Data provided in your submission to the SFC in response to the Consultation Paper on the Securities and Futures (Disclosure of Interests – Securities Borrowing and Lending) Rules (“the Consultation Paper”) may be used by the SFC for one or more of the following purposes:
 - to administer the relevant Ordinances, rules, regulations, codes and guidelines made or promulgated pursuant to the powers vested in the SFC
 - for the purposes of performing the SFC’s statutory functions under the relevant Ordinances
 - for research and statistical purposes
 - other purposes permitted by law

Transfer of Personal Data

3. Personal Data may be disclosed by the SFC to the members of the public in Hong Kong and elsewhere, as part of the public consultation on the Consultation Paper. The names of persons who submit comments on the Consultation Paper together with the whole or part of their submission may be disclosed to members of the public. This will be done by publishing this information on the SFC web site and in documents to be published by the SFC throughout and at the conclusion of the consultation period.

Access to Data

4. You have the right to request access to and correction of your Personal Data in accordance with the provisions of the PDPO. Your right of access includes the right to obtain a copy of your Personal Data provided in your submission on the Consultation Paper. The SFC has the right to charge a reasonable fee for processing any data access request.

Enquiries

5. Any enquiries regarding the Personal Data provided in your submission on the Consultation Paper, or requests for access to Personal Data or correction of Personal Data, should be addressed in writing to:

The Data Privacy Officer
The Securities and Futures Commission
12/F, Edinburgh Tower, The Landmark
15 Queen’s Road Central, Hong Kong

A copy of the Privacy Policy Statement adopted by the SFC is available upon request.

¹ Personal Data means personal data as defined in the Personal Data (Privacy) Ordinance, Cap 486 (“PDPO”)

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

(Cap. XXX, section [])

ARRANGEMENT OF SECTIONS

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

(Made by the Commission under section [] of the Securities and Futures Ordinance
([] of 2001)

PART I PRELIMINARY

1. Commencement

These rules shall come into operation on the day appointed for the commencement of Part XV of the Ordinance.

2. Interpretation

- (1) In these rules, unless the context otherwise requires –
- “approved lending agent” () means a corporation that is approved by the Commission in accordance with section 7;
- “equivalent shares” () means shares of an identical description, nominal value and amount to the particular shares lent;
- “collateral” () means money or securities provided to secure the return of shares lent and includes a letter of credit and a guarantee;
- “designated shares” () means shares in which an institutional investor is interested which –
- (a) have been set apart as being available for lending; or
 - (b) have been identified by a record as being available for lending;
- “duty of disclosure” () has the same meaning as in section [] of the Ordinance;
- “institutional investor” () means -
- (a) a collective investment scheme authorized under section 103 of the Ordinance;
 - (b) an approved pension scheme that is approved by the Commission under section [] of the Ordinance;
 - (c) an authorized financial institution;
 - (d) an insurer authorized under the Insurance Companies Ordinance (Cap. 41);
 - (e) a qualified overseas scheme;

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- (f) a corporation authorized under the law of any place outside Hong Kong, recognized for the purposes of these rules by the Commission by notice in the Gazette, to carry on business as –
 - (i) a bank;
 - (ii) an insurance company;
- (g) a manager of a person referred to in paragraphs (a) to (f) in relation to the interest in shares of the person referred to in paragraphs (a) to (f); and
- (h) any person of a class prescribed by the Commission for the purposes of these rules by notice in the Gazette;

“lend” () means to transfer shares to a person who is required to return those shares, or equivalent shares, if requested to do so, and “borrow” shall be construed accordingly;

“listed corporation” () has the same meaning as in section [] of the Ordinance;

“prescribed particulars” () in relation to an event mentioned in sections 7 to 9 means –

- (a) the date of the event;
- (b) the description and quantity of the shares the subject of the event; and
- (c) the value of any collateral given, taken, returned or given up (as the case may be);

"prescribed purpose" () means-

- (a) on-lending the interest in shares, under the terms of a relevant agreement, to another person;
- (b) returning the interest in shares in accordance with the terms of a relevant agreement, to a person from whom such an interest in shares was borrowed;

"qualified overseas scheme" () has the same meaning as in section [314(4)] of the Ordinance;

“qualifying shares” () means shares in which an institutional investor is interested and which an approved lending agent has authority to lend as agent for an institutional investor;

“regulated person”() means –

- (a) an intermediary licensed or registered for Type 1 regulated activity; or

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- (b) a corporation which is licensed or registered in a place outside Hong Kong, recognized for the purposes of these rules by the Commission, for an activity which in the opinion of the Commission is equivalent to Type 1 regulated activity;

“relevant agreement” () means a securities borrowing and lending agreement under which –

- (a) the borrower of shares is required to provide collateral, determined by reference to the market value of the shares lent, to secure the return of the shares; and
- (b) the lender of the shares can require the return of the shares at any time on giving notice to the borrower;

“relevant share capital” () has the same meaning as in section [] of the Ordinance;

“shares” () means shares comprised in the relevant share capital of a listed corporation and -

- (a) includes an interest in shares so comprised; and
- (b) where shares so comprised are returned under the terms of a relevant agreement, includes equivalent shares.

“short position” () has the same meaning as in section [] of the Ordinance;

PART II EXEMPTIONS AND INTERESTS DISREGARDED

3. Prescribed circumstances

- (1) In the following circumstances an institutional investor who –
 - (a) is interested in shares held by an approved lending agent; and
 - (b) complies with the conditions set out in subsection (4)

will not be under a duty of disclosure under section 304(1)(d) of the Ordinance -

- (i) where the approved lending agent lends qualifying shares under the terms of a relevant agreement; or
- (ii) where shares to which paragraph (i) applied are returned in accordance with the terms of the relevant agreement.

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- (2) In the following circumstances an approved lending agent who -
- (a) complies with the conditions set out in subsection (4); and
 - (b) complies with the requirements of section 7,

will not be under a duty of disclosure under section 304(1)(d) of the Ordinance -

- (i) where the approved lending agent lends qualifying shares under the terms of a relevant agreement; or
- (ii) where shares to which paragraph (i) applied are returned in accordance with the terms of the relevant agreement.

- (3) In the following circumstances an institutional investor who –

- (a) complies with the conditions set out in subsection (5); and
- (b) complies with the requirements of section 8; and

will not be under a duty of disclosure under section 304(1)(d) of the Ordinance -

- (i) where the institutional investor lends shares under the terms of a relevant agreement; or
- (ii) where shares to which paragraph (i) applied are returned in accordance with the terms of the relevant agreement.

(4) The conditions referred to in subsections (1) and (2) are that when shares in which an institutional investor or approved lending agent (as the case may be) is interested –

- (a) become qualifying shares; or
- (b) cease to be qualifying shares;

he treats each of the events mentioned in paragraph (a) and (b), for the purposes of the Ordinance, as if it were a change in the nature of his interest in those shares.

(5) The conditions referred to in subsection (3) are that when shares in which an institutional investor is interested –

- (a) become designated shares; or
- (b) cease to be designated shares,

he treats each of the events mentioned in paragraph (a) and (b), for the purposes of the Ordinance, as if it were a change in the nature of his interest in those shares;

(6) If an approved lending agent fails to comply with the requirements of section 7 he shall be taken, for the purposes for the purposes of Divisions 2 to 5 of the Ordinance, to

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have lent all shares then lent by him under the terms of a relevant agreement, at the time that he failed to comply with the requirements of section 7.

(7) If an institutional investor fails to comply with the requirements of section 8 he shall be taken, for the purposes for the purposes of Divisions 2 to 5 of the Ordinance, to have lent all shares then lent by him under the terms of a relevant agreement, at the time that he failed to comply with the requirements of section 8.

4. Prescribed interests in shares

(1) Subject to subsections (2) (3) and (4), the following interests are prescribed interests, and prescribed short positions, for the purposes of section 314(1)(j) of the Ordinance

- (a) the interest, or short position, in shares of a regulated person where -
 - (i) the interest in shares has been borrowed under the terms of a relevant agreement; and
 - (ii) the interest in shares is used, or intended to be used, within 5 business days after the day on which the interest was borrowed by the regulated person for a prescribed purpose; and
- (b) the interest in shares, or short position, of a regulated person where –
 - (i) the interest in shares to which paragraph (a) applies is returned to the regulated person in accordance with the terms of the relevant agreement under which the interest was lent, by the person who borrowed that interest; and
 - (ii) the interests in shares is used, or intended to be used, within 5 business days after the day on which the interest was returned to the regulated person for a prescribed purpose.

(2) Subject to subsections (3) and (4), where an interest in shares is not used for a prescribed purpose by the regulated person, or by a related corporation of the regulated person, within the period of 5 business days specified in subsection (1) the regulated person shall be taken to have acquired that interest, or come to have that short position, (as the case may be) for the purposes of Divisions 2 to 5 of the Ordinance on the last day of that period.

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(3) Subject to subsection (4), where an interest in shares is used for a purpose, other than a prescribed purpose, by the regulated person, or by a related corporation of the regulated person, within the period of 5 business days specified in subsection (1) the regulated person shall be taken to have acquired that interest, or come to have that short position, (as the case may be) for the purposes of Divisions 2 to 5 of the Ordinance on the day that it is used for that purpose.

(4) If a regulated person fails to comply with the requirements of section 9 all interests, and short positions, in shares of a regulated person that are prescribed interests and short positions under subsection (1) shall cease to be prescribed interests or short positions (as the case may be) and the regulated person shall be taken to have acquired an interest, or come to have a short position (as the case may be) in such shares for the purposes of Divisions 2 to 5 of the Ordinance, on the day that -

- (a) he failed to comply with the requirements of section 9; or
- (b) he acquired that interest, or came to have that short position, in shares, which ever is the later.

5. Notification by agents

Where -

- (a) an approved lending agent lends an interest in shares to which section 3(1)(i) or (2)(i) applies; or
- (b) an interest in shares to which paragraph (a) applies is returned in the circumstances set out in section 3(1)(ii) or (2)(ii),

an institutional investor shall not be required, under section 312 of the Ordinance, to secure that its agent notifies it of the lending or the return of the interest.

PART III APPROVALS AND RECORDS

6. Approved Lending agents

(1) A corporation is an approved lending agent if it is approved by the Commission, in writing, as an approved lending agent for the purposes of these rules.

- (2) An application for approval under subsection (1) shall be accompanied

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by -

- (a) such information and particulars as the Commission may reasonably require; and
- (b) an application fee prescribed by rules made under section 382 for the purposes of this section;

(3) The Commission may, by notice in writing served on a person approved under subsection (1) withdraw its approval where the Commission is satisfied that it is appropriate to do so.

7. Records to be kept by approved lending agents

(1) On the occurrence of any of the following events an approved lending agent shall record prescribed particulars of the event -

- (a) the approved lending agent lends shares to which section 3(2)(i) applies;
- (b) shares to which section 3(2)(ii) applies are returned to the approved lending agent.

(2) An approved lending agent shall -

- (a) subject to paragraph (b), retain each record referred to in subsection (1) for not less than three years from the date the relevant record was made; and
- (b) if requested by an employee of the Commission, within such period, provide any such record to the Commission within 5 business days.

8. Records to be kept by institutional investors

(1) On the occurrence of any of the following events a institutional investor shall record prescribed particulars of the event -

- (a) the institutional investor lends shares to which section 3(3)(i) applies;
- (b) shares to which section 3(3)(ii) applies are returned to the institutional investor.

(2) A institutional investor shall -

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- (a) subject to paragraph (b), retain each record referred to in subsection (1) for not less than three years from the date the relevant record was made; and
- (b) if requested by an employee of the Commission, within such period, provide any such record to the Commission within 5 business days.

9. Records to be kept by regulated persons

(1) On the occurrence of any the following events a regulated person shall record the prescribed particulars of that event –

- (a) the regulated person borrows or lends an interest in shares to which section 4(1)(a) applies;
- (b) an interest in shares to which section 4(1)(b) applies is returned to the regulated person;
- (c) the regulated person –
 - (i) borrows an interest in shares to which section 4(1)(a) applies; or
 - (ii) an interest in shares to which section 4(1)(b) applies, is returned to a regulated person,and the interest in shares is not used for a prescribed purpose within the period of 5 business days specified in section 4(1);

(2) A regulated person shall-

- (a) subject to paragraph (b), retain each record referred to in subsection (1) for not less than three years from the date the relevant record was made; and
- (b) if requested by an employee of the Commission, within such period, provide any such record to the Commission within 5 business days of such request.

Chairman,
Securities and Futures Commission

[] 2001

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EXPLANATORY NOTE

These Rules are made by the Securities and Futures Commission under section [] of the Securities and Futures Ordinance (of 2001). They prescribe the circumstances in which persons lending shares are exempt from the duty of disclosure under Divisions 2 to 4 of Part XV of the Ordinance and prescribe interests, and short positions, in shares held by regulated persons that are to be disregarded under section [314] of the Ordinance. The Rules provide for approval of custodians and others as approved lending agents and the keeping of records of dealings in interests in shares that are exempt from the duty of disclosure or disregarded under these Rules.