



Hong Kong

March 2015

SHORT SELLING OF A SHARES VIA SHANGHAI-HONG KONG STOCK CONNECT STARTS MONDAY, 2 MARCH

The Hong Kong Stock Exchange (the **Exchange**) has **announced** that short selling of certain Shanghai-listed A shares through the Shanghai-Hong Kong Stock Connect programme (**Stock Connect**) is allowed from Monday, 2 March 2015.

Shanghai-Hong Kong Stock Connect

Stock Connect was launched on 17 November 2014 to allow Hong Kong and mainland Chinese investors to trade designated shares listed on the other market. Investment flows under the programme have however fallen short of initial expectations. While the northbound quota was expected to be quickly exhausted, slightly more than one third of the northbound quota of RMB 300 billion remains unused after three months.¹ Similarly, Chinese investors' trading of Hong Kong listed shares under the southbound link has used only 10% of the RMB 250 million total quota.

Li Xiaojia, Chief Executive of the Exchange, has proposed a number of measures to boost trading under the programme, including increasing the total quota, reducing market holidays, adding further eligible stocks, and the short selling arrangement. In an interview last week, Li commented that, despite the limited scope of the arrangement at this early stage, it is important that the initiative is available.

The rule change to allow short selling is the first reform to Stock Connect since its launch. Another major change which has been proposed is a new system under which institutional investors who hold A shares through custodians will no longer need to transfer their A shares to brokers the day before they want to sell to comply with China's pre-trade checking requirement. Many overseas fund managers are currently prevented from trading A shares through the northbound link as their rules prevent compliance with this requirement which is also contrary to standard international practice which allows settlement within two days after sale, a practice commonly followed in Hong Kong and other leading markets.

A Shares Eligible for Short Selling

According to the Exchange's circular "**Short Selling of China Connect Securities Through Shanghai-Hong Kong Stock Connect**" of 18 February 2015, short selling will be allowed of eligible China Connect Securities, the list of which is available on the Exchange's website at http://www.hkex.com.hk/eng/market/sec_tradinfra/chinaconnect/Eligiblestock.htm.

The following information will be published on the Exchange's website on each Stock Connect trading day for each Shanghai Stock Exchange-listed security eligible for short selling under the programme (**SSE Security**):

¹ The closing balance for northbound trades was 192,719 million as at 27 February 2015 (<http://www.hkex.com.hk/eng/csm/chinaConnect.asp?LangCode=en>).

Information Display	Update time/frequency
Maximum number of shares available for short selling for the CSC trading day	Before market open
Remaining balance available for short selling	Every 15 minutes
Short selling turnover (in shares and in value) for each SSE Security	After the close of morning session and after market close
Respective daily and 10-day cumulative short selling percentage	After market close

Short Selling Rules

Naked short selling is prohibited for northbound trading under Stock Connect. This means that investors need to borrow stocks from brokers at a margin before they can short them, which is a standard practice in Hong Kong.

Input of short selling orders will be subject to the following rules:

- **Time of input**

Short selling orders may only be submitted during the opening call auction and continuous auction sessions on each trading day.

- **Flagging**

China Connect Exchange Participants (**EPs**) must flag short selling orders when inputting them.

- **Orders**

Short selling orders must be submitted in multiples of 100 shares.

- **Price Restriction (the Tick Rule)**

The input price of a short selling order cannot be less than the most recent execution price of the SSE Security, or its previous closing price if no trades have been executed on a given day. If the SSE Security shares borrowed for short selling remain outstanding and have not been returned to the lender, the tick rule requirement remains applicable in

respect of any instructions for the sale of that SSE Security, except for those instructions that exceed the number of the outstanding and unreturned shares.

The Exchange may also impose an additional price restriction to block the input of short selling orders at an artificially high price which has the effect of using up the short selling limit. Investors should also be aware that the Shanghai Stock Exchange (**SSE**) will suspend further short selling of an eligible SSE Security if its total open short positions reach 25% of its listed and tradable shares. Resumption of short selling will be triggered if the total open short position drops below 20%. A list of SSE Securities which have reached this threshold will be published on the SSE website at <http://www.sse.com.cn/disclosure/disclosure/margin/>. The Exchange will also publish information regarding suspensions and resumptions of short selling of SSE securities on its website when notified by the SSE.

- **Quantity restrictions**

Quantity restrictions (i.e. short selling ratio limits) will apply to each SSE Security. The short selling ratio (i.e. the number of shares which may be sold short as a percentage of the total number of the same shares held by Hong Kong investors (calculated in real time throughout the relevant trading day) will be capped at 1%, and no more than 5% cumulatively over 10 consecutive trading days (calculated at the end of each trading day).

- **Pre-trade checking**

The SSE's pre-trade checking requirements apply to short selling orders. Accordingly, stocks borrowed for short selling should be held in the selling China Connect EP's Central Clearing and Settlement System (**CCASS**) account before the commencement of trading on the relevant trading day.

Execution of orders that fail to meet the above requirements will be rejected.

Reporting Requirements

EPs that need to conduct stock borrowing and lending for the purpose of short selling must submit to the Exchange the Undertaking by China Connect Exchange Participant Lending China Connect Securities to Clients (**Undertaking**) and/or the Confirmation by China Connect Exchange Participant Borrowing China Connect Securities (**Confirmation**).

Mandatory reporting requirements apply to stock borrowing and lending and short selling of A shares through the northbound link.

a) Stock Borrowing and Lending Monthly Report for China Connect Securities

China Connect EPs must submit this report to the Exchange on or before the 7th day of the following month if they have submitted an Undertaking or Confirmation.

b) Short Selling Weekly Report for China Connect Securities

China Connect EPs are required to submit a weekly report on their short selling activities in each SSE Security if:

- they have conducted any short selling activities, whether for their own account or for clients;
- any borrowed shares have been returned to the stock lender; or
- if there are outstanding short positions as at the end of the week.

The weekly report should be submitted via the Electronic Communication Platform (ECP) on or before the 1st working day of the following week.

c) Large Open Short Position Report for China Connect Securities

Both China Connect EPs and Trade-through EPs must submit this report if there is any open short position of an SSE Security after the market close on the last trading day of the week which exceeds RMB 25 million or 0.02% of the total issued shares of the relevant SSE Security.

Client Confirmation of Short Selling Orders

In order for China Connect EPs to flag short selling orders as required, they should confirm with their clients whether sell orders are short selling orders before inputting orders into the system. Alternatively, procedures should be put in place that require clients to inform the EP if an order is a short selling order at the time of placing the order. The EP must then maintain proper records which it will be able to produce to the Exchange upon request.

If a client borrows shares from a stock lender who is not the China Connect EP executing the short sale, the executing EP must require the client to inform it of the return of the stocks borrowed so that it can comply with its reporting requirements on open short positions.

Investors must also be aware of the requirement to inform the broker of a short sale. If an investor has borrowed shares for short selling, and has not yet returned the shares to the lender, a long sale of the same shares may be subject to the tick rule.

Further Information

Further information regarding Stock Connect and the requirements for short selling A shares can be found in the Exchange's [Shanghai-Hong Kong Stock Connect FAQ for Investors](#)² and its circular "Short Selling of China Connect Securities Through Shanghai-Hong Kong Stock Connect" of 18 February 2015.³

² The Exchange's "Shanghai-Hong Kong Stock Connect FAQ for Investors" at http://www.hkex.com.hk/eng/market/sec_tradinfra/chinaconnect/Documents/Investor_FAQ_En.pdf.

³ Exchange Circular CT/013/15 "Short Selling of China Connect Securities Through Shanghai-Hong Kong Stock Connect" at <http://www.hkex.com.hk/eng/market/partcir/sehk/2015/Documents/CT01315E.pdf>

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