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**Disclosure of Interests under  
the Securities and Futures Ordinance**

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*Please note that this memorandum is for general information purposes only. Specific legal advice should be sought in relation to any particular situation.*

## INTRODUCTION

Hong Kong's disclosure of interests regime is set out in Part XV of the Securities and Futures Ordinance (Cap. 571) (**SFO**) and requires directors, chief executives and substantial shareholders of companies listed in Hong Kong to disclose their interests in the shares and debentures of such companies. Failure to make a disclosure required under Part XV is a criminal offence. Part XV also entitles listed companies to investigate ownership of their shares.

The regime is extremely complex. However, the conclusions reached following a 2005 SFC consultation<sup>1</sup> on revisions to the regime were never implemented. Most recently, the Financial Services Development Council has recommended simplifying the regime in a paper published in December 2014.<sup>2</sup>

The following is a summary of the current regime as it affects substantial shareholders, and directors and chief executives of companies listed in Hong Kong. The SFC's outline of Part XV (the **SFC Outline**), gives detailed examples of its application and is available on the SFC's website.<sup>3</sup>

### **A. DISCLOSURE BY SUBSTANTIAL SHAREHOLDERS**

The SFO requires disclosure when a person acquires or ceases to have a notifiable interest and when there is a change in the percentage *level* (i.e. the figure rounded down to the next whole number) of his interest.

#### **1. SUBSTANTIAL SHAREHOLDING THRESHOLD**

The SFO threshold for disclosure is 5% of a Hong Kong listed company's issued voting share capital. Where there are more than one class of listed shares, the percentage of each class is taken separately.

#### **2. WHEN IS NOTIFICATION REQUIRED?**

##### **2.1 *Notifications – Shortening of Notification Period***

Section 310(1) requires notification to be made on the occurrence of the relevant events set out in Section 313 which can be summarised as follows:

- (i) when a person first becomes interested in 5% or more of the shares of a listed company (ie. when he first acquires a notifiable interest) (Section 313(1)(a));
- (ii) when a person's interest drops below 5% (i.e. he ceases to have a notifiable interest) (Section 313(1)(b));

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<sup>1</sup> The SFC's May 2005 "[Consultation Conclusions on the Review of the Disclosure of Interests Regime under Part XV of the Securities and Futures Ordinance](#)" January 2005 "Consultation Paper on the Review of the Disclosure of Interests Regime under Part XV of the Securities and Futures Ordinance".

<sup>2</sup> FSDC Paper No. 12 "[Disclosure of Interests Regime in Hong Kong](#)". December 2014.

<sup>3</sup> At [http://en-rules.sfc.hk/net\\_file\\_store/new\\_rulebooks/h/k/HKSFC3527\\_4511\\_VER20.pdf](http://en-rules.sfc.hk/net_file_store/new_rulebooks/h/k/HKSFC3527_4511_VER20.pdf).

- (iii) when there is an increase or decrease in the percentage *level* (i.e. the figure rounded down to the next whole number) of a person's holding above 5% (e.g. his interest increases from 6.8% to 7.1% – so the percentage *level* increases from 6% to 7%) (Section 313(1)(c));
- (iv) when a person has a notifiable interest (i.e. 5%) and the nature of his interest in the shares changes (e.g. on exercise of an option) (Section 313(1)(d));
- (v) when a person has a notifiable interest and he comes to have, or ceases to have, a short position of more than 1% (e.g. he is already interested in 6.5% of the shares of a listed company and takes a short position of 1.7%) (Sections 313(4)(a) and (b)); and
- (vi) when a person has a notifiable interest and there is an increase or decrease in the percentage *level* of his short position (e.g. he is already interested in 6.8% of the shares of a listed company and increases his short position from 1.7% to 2.2%) (Section 313(4)(c)).

The notification period for such events is 3 business days after the date of the relevant event. If a person is not aware of the relevant event when it occurs, the 3 day limit runs from the date on which he is aware of its occurrence (i.e. the date on which he is aware of the facts which constitute the relevant event (e.g. a buy-back of shares) and not the date he realises he has a notifiable interest). A “**business day**” is a day other than a Saturday or Sunday, a public holiday or a day on which a gale or black rain storm warning is in force.

## 2.2 *Initial Notifications*

An “Initial Notification” does not refer to a notice given on initially crossing the 5% threshold. Instead it refers to a notice required to be given in the following circumstances:

- (i) where a person has 5% or more of the shares of a company which is being listed (Section 310(2)(a));
- (ii) where a person has 5% or more of shares of a class which is being listed or given full voting rights (Section 310(2)(b)); and
- (iii) if a person has a notifiable interest on either the 5% threshold or 1% threshold for short positions being reduced (Section 310(3)).

Under Section 325(2) the time limit for Initial Notifications only is 10 business days after the relevant event or, if later, the date on which the person concerned is aware of the relevant event (i.e. is aware of the facts which constitute the event).

## 3. **DISCLOSURE OF INTERESTS IN EQUITY DERIVATIVES**

Disclosure obligations of substantial shareholders cover interests in the **unissued** shares of listed companies which, if issued, would carry the right to vote and also to **cash settled** derivatives. Hence, interests in the “underlying shares” of all equity

derivatives (whether issued or unissued) are discloseable, including interests in options, subscription warrants, convertible bonds, ADRs and stock futures.

A holder, writer or issuer of equity derivatives will be taken to have a long position in the underlying shares and must add these to his other interests in determining his disclosure obligations if:

- (i) he has a right to take the underlying shares;
- (ii) he has an obligation to take the underlying shares; or
- (iii) he has a right to receive money or to avoid or reduce a loss, if the price of the underlying shares increases,

before or on a certain date or within a certain period (whether the right or obligation is conditional or absolute) (Section 322(8)).

#### **4. DISCLOSURE OF SHORT POSITIONS**

The SFO disclosure obligations of substantial shareholders also cover “short positions”. Under Section 308 a person is regarded as having a short position in shares if he:

- (i) holds, writes or issues financial instruments under which:
  - (a) he can require another person to take the underlying shares;
  - (b) he is obliged to deliver the underlying shares; or
  - (c) he has a right to receive money or to avoid or reduce a loss if the price of the underlying shares declines,

before or on a certain date or within a certain period (whether the right or obligation is conditional or absolute); or

- (ii) he borrows shares under a securities borrowing and lending agreement.

Hence the writing of a call option, holding of a put option and stock borrowings will be discloseable. However a person (not being a director) with a short position will only be required to disclose it if he already has a 5% interest in a class of a listed company's voting share capital ie. he must be a substantial shareholder before he has a duty to disclose a short position (Section 313(4)). Further the short position must be at least 1%. Thereafter, as with long positions, a change in the short position will only require disclosure if it results in the short position crossing a percentage level or in the person ceasing to have a short position of at least 1% (Sections 313(4)(b) and (c)).

Short positions cannot be netted off against long positions and the percentage figures for short and long positions must be calculated and notified separately.

#### 4.1 *Options*

The SFC Outline confirms that the SFC takes the view that when a listed company allots shares or issues an instrument under which it agrees to allot shares, or grants an option over its **own** shares, it is not taking a position in its own shares, short or long, but is simply issuing or agreeing to issue the shares. Hence there is no disclosure obligation for the company. Likewise, since the listed company is not taken to have a short position, a controller of the company will not be deemed to have a short position under the deeming provisions of the SFO and no disclosure is required. This view would appear to be at odds with a strict interpretation of the legislation and its wide definition of the term “short position”. It therefore seems likely that this view has been adopted more on the basis of the spirit of the legislation whose focus is primarily on the disclosure of positions held in other listed companies.

The holder of an option or other right to receive shares will however acquire a long position in the shares which must be disclosed.

Where a company grants an option over the shares of another listed company, then it is taking a short position which must be disclosed if the former company already holds a 5% interest and the short position amounts to 1% or more.

Note also that where a listed company grants an option over its own shares or debentures to a chief executive or director of that company, it is required to record details of the grant in its register of the interests of directors and chief executives (as described under Section C below).

#### 5. **HOW MANY SHARES IS A PERSON TAKEN TO BE INTERESTED IN IN THE CASE OF EQUITY DERIVATIVES?**

Holders, writers and issuers of equity derivatives are taken to be interested in, or have a short position in, the number of shares to be delivered, or by reference to which the amount payable is derived or (in the case of stock futures only) the relevant contract multiplier (Section 322(12)).

#### 6. **CALCULATION OF A PERSON'S INTEREST**

##### ***Long Positions***

The percentage *figure* of an interest in shares should be determined using the following formula:

$$\frac{\text{nominal value of shares in which a person is interested}^*}{\text{nominal value of the issued shares of the listed company of the same class}} \times 100$$

### ***Short Positions***

To calculate whether a short position constitutes 1% or more, a similar formula can be used:

$$\frac{\text{nominal value of shares in which a person has a short position}^*}{\text{nominal value of the issued shares of the listed company of the same class}} \times 100$$

\* Note that this will include all issued shares and shares underlying equity derivatives whether issued or unissued.

The forms require the percentage *figure* to be rounded to 2 decimal places. To find the *percentage level* of the interest the percentage *figure* is rounded down to the next whole number.

The date for calculating the relevant percentage is the date of occurrence of the relevant event and the number of shares in which a person is interested and the total number of issued shares should be determined on that day.

## **7. NOTIFICATION OF CHANGES IN THE NATURE OF INTERESTS**

Any change in the nature of an interest already notified is required to be disclosed under Section 313(d). The situations in which there is considered to be such a change are extensive and include a change in the nature of a person's title to shares, any of the person's interest whether legal or equitable or any of the person's interest in the underlying shares of equity derivatives on the exercise of rights thereunder (whether by or against him).

Common situations requiring notification of a change in interest will include:

- (i) the exercise of rights (by or against a person) under options and other derivatives;
- (ii) the lending of shares under a securities borrowing and lending agreement (unless the Securities Borrowing and Lending Exemption applies – see paragraph 12.9 below); and
- (iii) the giving of shares as security to another person.

There is not considered to be a change in the nature of an interest under Section 313(13) and Section 5 of the Securities and Futures (Disclosure of Interests – Exclusions) Regulation:

- (i) where a purchaser takes delivery of shares, if he has previously disclosed his equitable interest arising on contracting to buy the shares;
- (ii) where a vendor of shares enters into a contract for sale, if the sale is required to be completed within 4 days on which the Stock Exchange is open for business;

- (iii) where there is a change in the terms on which rights under equity derivatives may be exercised which results from a change in the number of underlying shares in issue;
- (iv) on the exercise of rights to subscribe for or on delivery of shares under a rights issue;
- (v) where a “qualified lender” comes to have a security interest in a person's shares (see paragraph 12.4 below); and
- (vi) where the person is a holding company and the transfer is of shares from one wholly owned subsidiary to another (see paragraph 12.5 below).

## **8. WHAT CONSTITUTES AN INTEREST IN SHARES?**

The definition of an “interest in shares” is extremely broad and includes the situations set out in Schedule 1 hereto.

### **8.1 *Buying and Selling Shares***

A buyer of shares acquires an interest in shares at the time when he contracts to buy and therefore is required to give notification within 3 business days of the contract. No further notice is required when the buyer takes delivery of the shares.

A seller of shares will normally only cease to have an interest when he actually transfers the shares to the buyer and is therefore required to notify the cessation of his interest within 3 business days after the settlement date (i.e. the date of the actual transfer). If the contract for sale of the shares provides for settlement within 4 days on which the Stock Exchange is open for business, notification by the seller is not required on the entering into of the contract.

If in fact a seller ceases to be interested in the shares on the date of the contract for sale (e.g. due to the operation of the clearing system), then notice should be filed within 3 business days of the contract for sale.

If a contract for sale specifies a settlement date which is 5 or more days on which the Stock Exchange is open for business after the date of the contract, then 2 notices are required: first, a notice of change in nature of the interest which must be filed within 3 business days of the contract and second, a notice of cessation of interest to be filed within 3 business days of delivery of the shares.

## **9. DEEMED INTERESTS**

There are a number of circumstances where the interests and derivative interests (including short positions) of others in a listed company's shares must be added to a person's own interest in calculating the number of shares in which they are interested.

### **9.1 *Family and Controlled Company Interests (Section 316)***



Interests of a person's spouse and children under 18 are attributable to him.

Also, a person will be deemed to be interested in the interests of any company which he “controls” (i.e. a company of which he controls, either directly or indirectly, one third or more of the voting power at general meetings or if the company or its directors are accustomed to act in accordance with that person's directions).

## **9.2 *Limited Liability Partnerships***

The SFC Outline confirms that the SFC regards a limited liability partnership as a company for the purposes of Part XV. Hence interests in shares held by a limited liability partnership should be disclosed by the general partner as interests in shares of a controlled corporation (rather than as joint interests of each partner).

## **9.3 *Trusts***

The interests of a trust of which a person is a trustee must also be aggregated with his own interests (with the exception of a trust of which he is a bare trustee (i.e. his only powers or duties are to transfer the underlying shares according to the directions of the beneficial owner – see paragraph 12.7 below).

A beneficiary of a trust must include the interests of the trust in calculating his own interest (Section 322(4)(a)). The interest of a beneficiary under a discretionary trust is however disregarded (Section 323(1)(a)(iii) provided that he is not also a director of the relevant listed company or a “founder” of the trust (see paragraph 9.4 below).

## **9.4 *“Founders” of Discretionary Trusts***

The interests of a “discretionary trust” are attributed to the “founder” of such trust (Section 322(4)(b)). The term “founder” is very widely defined and essentially will catch anyone who has procured the creation of the trust and (i) whose consent is a condition of a trustee's exercise of his discretion or (ii) in accordance with whose wishes a trustee is accustomed or expected to act (whether, in either case, legally enforceable or not).

## **9.5 *Concert Party Agreements (Section 317)***

In essence, the provisions apply where two or more persons agree to acquire shares in a target company and the agreement dictates the manner in which any one or more of the parties may exercise the rights attached to those shares or dispose of them. Each party to the agreement must include the interests of all other parties to the agreement in determining whether they together hold 5% or more of the listed company. If so, each party will be considered to be a substantial shareholder whose interests must be disclosed.

The provisions also cover any arrangement whereby a “controlling person” or director of a listed company makes a loan to a person on the understanding that the money will be used to acquire interests in shares in that company and shares are in fact acquired. A “controlling person” for these purposes is any person who, either alone or with associates, controls at least 30% of the voting power at general

meetings, can nominate any of its directors or veto or modify any resolution of a general meeting.

The effect of this is to create an irrebutable presumption that the loan or funding will be provided pursuant to an agreement dictating how the borrower may deal with his shares.

There is an exemption where a “controlling person” or director makes the loan in the ordinary course of his business as a “qualified lender” (as defined under paragraph 12.4 below).

Where 2 or more persons are interested in the same shares they must each make separate disclosure of their interests. Hence if X controls Y Ltd. which holds 6% of a listed company and Y Limited acquires a further 1%, then X, his spouse and Y Limited must each file a separate notice.

## **10. DISCLOSURE OBLIGATIONS RESULTING FROM SHARE REPURCHASES AND PLACEMENTS**

Disclosure obligations may also arise from actions taken by others. For example, if a listed company buys back shares thereby reducing the number of shares in issue, an increase in the percentage level of the interests of the remaining shareholders will be discloseable.

Conversely, in the case of a placement and top-up, where new shares are issued to a major shareholder to replace the shares he has placed with a third party, the number of shares in issue increases. The consequent reduction in the percentage level of the interests of the other shareholders will then be discloseable.

In both cases, the 3 business day time limit for disclosure runs only from the date the person concerned became aware of the facts that led to the change in the level of his interest i.e. the date on which he became aware that the number of issued shares had reduced/increased.

## **11. CESSATION OF INTERESTS (SECTION 322(10))**

A person is regarded as having ceased to be interested in shares if:

- (i) he delivers them to another person (or to his order) pursuant to a contract for sale, in fulfilment of his obligations under a call option, or on exercising his rights under a put option;
- (ii) his right to subscribe for or call for the delivery of shares lapses or he assigns such right to another;
- (iii) his obligation to take shares lapses or he assigns that obligation to another;
- (iv) he receives an amount from another person, or avoids or reduces a loss, on the assignment or settlement of any cash settled equity derivatives.

## 12. EXEMPTIONS

There are a number of exemptions and interests which may be disregarded. These are very detailed, hence the following is limited to a brief outline only of the principal exemptions and disregards.

### 12.1 *Basket Derivatives*

Basket derivatives over the shares of at least 5 companies listed on a “specified” stock exchange are disregarded provided that no one share accounts for over 30% of the value of the total basket. The percentage figure is calculated at the time of issue of the derivatives.

### 12.2 *De Minimis Change Exemption on Change in Long or Short Positions (Sections 313(7) and (9))*

The exemption applies so that an increase or decrease in a person’s holding or short position which results in his interest crossing over a percentage level above 5% (in the case of a holding) or 1% (in the case of a short position) will not be discloseable if:

- (i) the percentage *level* of his interest is the same as, or less than, the percentage *level* of his interest stated in the “Last Notification” given by him; and
- (ii) the difference between the percentage *figure* of his interest disclosed in his “Last Notification” and the percentage *figure* of his interest at all times after such notification, is less than 0.5%.

“Percentage *level*” in (i) above means the percentage figure rounded down (if not a whole number) to the next whole number. “Percentage *figure*” in (ii) above, however, means the actual (unrounded) percentage figure.

The “Last Notification” must, in the case of a holding, be a notice given under Section 313(1)(c) that is notice of a change in the percentage level of a person's interest above 5%. Hence a notification given on commencement of the SFO, on first crossing the 5% threshold or of a change in the nature of an interest will not qualify as a “Last Notification”. In the case of a short position, the “Last Notification” must be a notice given under Section 313(4)(c), that is notice of a change in the percentage level of a person's short position above 1%.

This exemption will not therefore apply if the percentage level of a person's interest has increased since his Last Notification or if at any time after such notification his percentage interest differed by 0.5% or more from the percentage figure of his interest stated in that notification.

### 12.3 *De Minimis Change Exemption on Change in the Nature of Interests (Section 313(8))*

There is no duty of disclosure where:

- (i) the “percentage level” (i.e. the rounded down figure as explained above) of a person's unchanged interest (i.e. disregarding the part in which his interest has changed) is the same as the percentage level of his interest in the last notice (this notice is not restricted to notices of change in the percentage level of an interest) given by him; or
- (ii) the percentage level of a person's unchanged interest has crossed over a percentage level if:
  - (a) the percentage level of his unchanged interest is the same as or less than the percentage level of his interest given in the “Last Notification” by him (i.e. a notice under Section 313(c) of a change in the level of a person's interest above 5%); and
  - (b) the difference between the percentage figure (i.e. the actual unrounded figure as noted above) of his unchanged interest and the percentage figure disclosed in the Last Notification has been less than 0.5% at all times since the giving of that notification.

The SFC's Outline of Part XV contains detailed examples illustrating the workings of the de minimis exemptions.

#### **12.4 Exempt Security Interests (Section 323(6))**

An interest in shares is not required to be disclosed if it qualifies as an “exempt security interest” i.e. if it is held by a “qualified lender by way of security only” for a transaction entered into in the ordinary course of his business (Section 323(6)). Further, the creation of the security interest in favour of a “qualified lender” will not result in a change in the nature of the holder's interest in those shares (Section 313(13)).

A “qualified lender” is defined under Section 308 to include an authorised financial institution, an authorised insurance company, an exchange participant of a recognised exchange company and an intermediary licensed to deal in securities or margin financing. The term also now includes overseas institutions authorised to carry on business as a bank, insurance company or activities which, in the opinion of the SFC, are equivalent to the regulated activities of intermediaries in countries recognised by the SFC.

As to when a qualified lender is taken to hold an interest in shares “by way of security only”, a distinction is drawn between the creation of a security interest in, and a transfer of title to, shares. If a person has a right to return equivalent shares and may deal with the shares transferred to him as if they are his own in the meantime, this is a transfer of title and not the creation of a security interest.

Under Section 323(7) an interest will no longer qualify as an “exempt security interest” if the qualified lender becomes entitled to exercise voting rights of the relevant shares due to default by the person who gave the security, and shows an intention or takes any step to exercise or control the exercise of those voting rights. Similarly, an interest will cease to be an “exempt security interest” if the power of

sale becomes exercisable and the qualified lender or its agent offers for sale all or any of the shares. In either case, the qualified lender is regarded as having acquired an interest in the shares and is obliged to disclose his interest.

### **12.5 Wholly Owned Group Exemption (Section 313(10))**

A wholly owned subsidiary is not required to notify an interest *in certain circumstances* if its ultimate holding company has given notice of its interest in the relevant shares. The certain circumstances in which wholly owned subsidiaries are exempted are those where the disclosure obligation arises under Sections 313(1) or (4) (as set out in paragraph 2.1 above). Significantly, the wholly owned group exemption is not available on the making of an “Initial Notification” under Sections 310(2) and (3) (i.e. notice given when the SFO came into force, when an interest is held in shares in a company which is being listed or when a notifiable interest is acquired on a reduction of the 5% threshold or 1% threshold for short positions is reduced (see paragraph 2.2 above). Hence, if a wholly owned subsidiary holds an interest of 5% or more in the shares of another company at the time that other company becomes listed, it cannot rely on the wholly owned group exemption: instead both the wholly owned subsidiary and its holding company will be obliged to separately disclose the interest in the shares held by the subsidiary.

Further, transactions between wholly owned subsidiaries of the same group do not give rise to a duty of disclosure since the number of shares in which the ultimate parent is interested or has a short position and the nature of its interest remains the same. Hence transfers of shares of a listed company, the grant and taking of options over such shares and the issue of warrants between wholly owned subsidiaries of the same group do not give rise to a duty of disclosure.

A duty of disclosure will arise if any relevant subsidiary ceases to be wholly owned, even if only 1% of its shares are sold to a third party.

### **12.6 Bonus and Rights Issue Exemption**

When there is a rights issue shareholders become interested in the unissued shares covered by the issue. In calculating their percentage interest the following formula should be used (Section 314(2)):

$$\frac{\text{nominal value of shares (including unissued shares)} \\ \text{in which the shareholder is interested}}{\text{nominal value of shares of the listed company of the same class in issue} \\ + \text{nominal value of shares to be issued on completion of the bonus/rights issue}^*} \times 100$$

\* This is the only situation where the denominator is increased to take account of unissued shares.

Shareholders of listed companies who take up rights under qualifying bonus and rights issues (and whose percentage interest therefore remains unchanged) are not required to make any disclosure whereas shareholders who do not take up their rights (and whose percentage interest therefore changes) will have to make disclosure.

If a shareholder sells his rights, both he and the buyer must make disclosure if their interests cross a percentage level.

A rights issue is defined to include the offer by a listed company of its shares to holders of its issued shares at a certain date (other than to shareholders whose address is in a place where such an offer is not allowed under local law) in proportion to the number of shares held by them at that date. A rights issue does not however cover an offer or issue of shares in lieu of a cash dividend.

The underwriter of the rights issue will acquire an interest in all rights shares that he agrees to take up if they are not taken up by shareholders. The underwriter will then need to file notice of cessation of his interest in the number of rights shares taken up by shareholders on completion of the rights issue.

### **12.7 *Investment Managers, Custodians and Trustees***

The exemption previously available to local SFC registered investment managers and trust companies is removed. The following exemptions may however be relied on:

#### *Bare Trustee Exemption*

A narrow exemption is retained for bare trustees i.e. a trustee who is only entitled to deal with the interest in accordance with the instructions of the beneficiary.

#### *Exempt Custodian Interest (Section 323(3))*

The interests of corporate custodians carrying on a business of holding securities in custody for others need not be disclosed provided that the custodian has no authority to exercise discretion in dealing in the shares or exercising the rights attached to those shares.

### **12.8 *Disaggregated Group Interests (Section 316(5))***

More importantly, the SFO removes the obligation of a holding company to aggregate the interests of controlled companies (see paragraph 9.1 above) who are investment managers, custodians or trustees whose interest in the shares arises solely from their obligation or entitlement to invest in, manage, deal in or hold interests in those shares on behalf of customers in their ordinary course of business as such. For the exemption to apply the controlled company must exercise any rights to vote in respect of the shares and any power to invest in, manage, deal in or hold the shares, independently of its controlling company and any “related corporations” (i.e. companies within the same group or under the same majority control (Section 3 of Schedule 1)).

This exemption is available for the fund management industry only. It does not entitle family members whose interests in the shares of “family controlled” listed companies are held by trustees to disaggregate such interests. A trustee of a trust does not have “customers” and will probably not be “carrying on a business” as an

investment manager, custodian or trustee. The terms “investment manager” and “trustee” are specifically defined in Section 316(7).

## **12.9 *Securities Borrowing and Lending Exemption***

The Securities and Futures (Disclosure of Interests – Securities Borrowing and Lending) Rules (“SBL Rules”) simplify the regime for disclosure of securities borrowing and lending for substantial shareholders (other than substantial shareholders who are also directors), “approved lending agents” and “regulated persons”.

### *Substantial Shareholders*

Substantial Shareholders are exempted from disclosing changes in the nature of their interest arising on the lending and return of shares provided that they lend shares through an “approved lending agent” (see below) who holds the shares as their agent for the sole purpose of lending shares and the shares are lent using a specified form of agreement. In essence, this is an agreement providing for the borrower to provide collateral exceeding the value of the shares lent. The value of the collateral is marked to market and the lender can require return of the shares at any time.

### *Approved Lending Agents*

Companies approved by the SFC as “Approved Lending Agents” (“ALAs”) holding 5% or more of the shares of a listed company will only be required to disclose changes in the percentage level of its “lending pool” of shares in that listed company. Hence if shares are added to or removed from the lending pool, a disclosure obligation will arise. ALA's are exempted from any disclosure requirements arising when shares are lent from or returned to their lending pool.

### *Regulated Persons*

Interests in shares borrowed by “regulated persons” (i.e. companies licensed to deal in securities and overseas brokers in recognised jurisdictions), that merely act as a conduit (i.e. they borrow and on-lend the shares within 5 business days) are disregarded. On the return of shares to the regulated person, it may either return them to the ultimate lender or lend them to another borrower. Provided this is done within 5 business days, the regulated person's interest is disregarded. Regulated persons can still rely on this exemption if it transfers shares to a related company provided that the related company on-lends the shares within 5 business days after they were acquired by the regulated person.

Both ALAs and regulated persons are required to keep records of their transactions in the shares.

## **12.10 *Collective Investment Schemes (Section 323(1)(c))***

The interests of holders, trustees and custodians of collective investment schemes authorised by the SFC, certain pension and provident funds schemes and qualified overseas schemes are not required to be disclosed.

A “qualified overseas scheme” means a collective investment scheme, pension scheme or provident fund scheme established in a country recognised by the SFC. It will not include a scheme which is not run as a business, has less than 100 holders or where less than 50 persons hold 75% or more of the interests in it (Section 323(5)).

#### **12.11 *Intermediary Exemption (Section 323(1)(i))***

The SFO provides an exemption for an intermediary (e.g. a dealer or broker) licensed or registered for dealing in securities who acquires interests in shares as agent for his client. The exemption only applies if (i) the interest is acquired for (and from) someone who is not a related company of the intermediary and (ii) the interest is held by the intermediary for not more than 3 business days.

A similar exemption applies to intermediaries whose interests arise under exchange traded stock futures or stock options contracts.

#### **12.12 *Further Exemptions***

- (i) Dual listings: a company may apply to the SFC for exemption from the provisions of Part XV if it is listed on an overseas exchange and certain other criteria are met.
- (ii) Structured products: the issuer of structured products may apply to the SFC for an exemption from Part XV. The main conditions to be satisfied are that the company's shares are not listed in Hong Kong, it does not intend to raise publicly traded equity capital in Hong Kong and only the structured products will be listed in Hong Kong. It is the substantial shareholders and directors of the issuer of the structured products who are able to claim the exemption. The issuer and holders of the equity derivatives must still include interests in the underlying shares of those derivatives in determining their disclosure obligations.

### **13. INFORMATION TO BE DISCLOSED (SECTION 326)**

The SFO requires the filing of structured notification forms to facilitate disclosure. Among the details to be disclosed by a substantial shareholder are the following:

1. In the case of corporate substantial shareholders, the name and address of any person in accordance with whose directions it, or its directors are accustomed or obliged to act, except where it is listed in Hong Kong or on a specified stock exchange or is the wholly owned subsidiary of any such listed company.
2. In the case of subsequent disclosures of long positions in shares disclosure is required of the highest price and average price per share paid or received in an on-exchange transaction. In off-exchange transactions the highest and average consideration per share and nature of the consideration must be disclosed. If no price or consideration has been paid or received, this should



be stated. Transactions in equity derivatives do not require details of price or consideration.

3. In the case of equity derivatives, details as to whether they are listed or unlisted, cash or physically settled, and details of the underlying shares.

#### **14. TIMING OF NOTICE**

Notices should be filed with the Stock Exchange and the relevant listed company at the same time or one immediately following the other (Section 324(2)).

#### **15. FORMS TO BE USED**

There are 6 separate forms to be used for notification of interests under the SFO. These are:

- Form 1 – Individual Substantial Shareholder Notice
- Form 2 – Corporate Substantial Shareholder Notice
- Form 3A – Director's/Chief Executive's Notice of Interests in Shares of a Listed Company
- Form 3B – Director's/Chief Executive's Notice of Interests in Shares of Associated Corporation
- Form 3C – Director's/Chief Executive's Notice of Interests in Debentures of Listed Company
- Form 3D – Director's/Chief Executive's Notice of Interests in Debentures of Associated Company

The forms and notes thereto can be downloaded in Chinese and English from the Hong Kong Exchange and Clearing Limited web-site or the SFC website.

The forms can be printed out and completed manually. Alternatively they are available in Microsoft Excel format and can be completed offline using the Excel programme.

**Directors who are also Substantial Shareholders must use Form 3A (annexed hereto) instead of Form 1 to disclose interests in shares of a listed company of which they are directors.**

If an event gives rise to separate disclosure obligations in each capacity (as director and substantial shareholder), both obligations can be fulfilled by filing Form 3A. For example, if a person has a 5.9% interest in the shares of a listed company and acquires a further 0.2%, he must file a notice as a director (who must disclose all transactions) and as a substantial shareholder because his interest has crossed a percentage level.

#### **16. PENALTIES FOR FAILURE TO DISCLOSE (SECTION 328)**

Failure to make disclosure within the time limits required by the SFO or the making of a statement which is false or misleading in any material particular constitutes a criminal offence carrying a maximum fine of \$100,000 or maximum prison sentence of 2 years for each offence. Members and officers of a company can also be personally liable for the offences of a company. The Financial Secretary may further impose restrictions on the transfer of the shares of any person convicted of an offence.

## **B. DIRECTORS AND CHIEF EXECUTIVES**

### **1. DISCLOSEABLE INTERESTS**

The disclosure requirements for directors and chief executives (“directors”) of a listed company are broader than for substantial shareholders requiring disclosure of interests in any shares (not just voting shares) or debentures of the listed company of which they are a director and any associated company. There is no disclosure threshold so that all interests must be disclosed however small.

The principal changes introduced by the SFO were to extend directors’ disclosure obligations in respect of interests in equity derivatives, short positions and changes in the nature of interests in shares and debentures.

#### **1.1 *Definition of Associated Company***

An associated company is defined to include holding companies and subsidiaries of the listed company, fellow subsidiaries of the listed company’s holding companies and any company in which the listed company has an interest of more than 20% of the nominal value of the issued shares of any class (Section 308).

A company will be a subsidiary of another if the other company controls the composition of its board of directors, controls half the voting power at general meetings, holds more than half of its issued share capital (excluding any part carrying no right to participate beyond a specified amount on a distribution of profits or capital) or is a subsidiary of a company which is the other company’s subsidiary. This definition thus makes each company in a chain of companies a subsidiary of the ultimate holding company (Section 2 of Schedule 1).

### **2. WHEN IS NOTIFICATION REQUIRED?**

#### **2.1 *Notifications – Shortening of Notification Period***

Section 341 requires that a director of a listed company must disclose any of the following “relevant events”:

- (i) when he becomes interested in the shares or debentures of a listed company or any associated company;
- (ii) when he ceases to be interested in such shares or debentures;
- (iii) when he enters into a contract to sell any such shares or debentures;

- (iv) when he assigns any right granted to him by the listed company to subscribe for shares or debentures of the listed company;
- (v) when an associated company grants him rights to subscribe for shares or debentures of that associated company, or if he exercises or assigns such rights;
- (vi) when the nature of his interest in the shares or debentures of the listed company or any associated company changes; and
- (vii) when he comes to have or ceases to have a short position in the shares of a listed company or any associated company.

As for substantial shareholders, the notification period is 3 business days.

## **2.2 Initial Notifications**

An “Initial Notification” is required in the following circumstances:

- (i) where a director has an interest in shares and debentures at the time the company becomes listed (Section 341(2)(a));
- (ii) where a director has an interest in shares and debentures at the time he becomes a director of a listed company (Section 341(2)(c)); and
- (iii) where a director of a listed company has an interest in shares and debentures in the shares of another company at the time that company becomes an associated company of the listed company (Section 341(2)(d)).

The period for notification in the case of an Initial Notification is 10 business days.

## **3. INTERESTS IN SHARES UNDER EQUITY DERIVATIVES**

As for substantial shareholders, the disclosure obligations of directors under the SFO extend to interests in equity derivatives which are not physically settled (i.e. interests in unissued shares such as options and interests under cash settled derivatives). For directors this includes interests in the shares of the listed company and its associated companies.

The circumstances in which a person will be taken to have a long position in the underlying shares of equity derivatives and the method of calculating the number of shares in which he is interested are the same as for substantial shareholders.

## **4. SHORT POSITIONS**

Directors must disclose all short positions under equity derivatives. A person will be taken to have a short position in the same situations as for substantial shareholders (see paragraph 4 under Substantial Shareholders) and the method of calculating the number of shares in which he is interested is the same. Similarly, the

SFO does not permit the netting off of long and short positions and requires each to be disclosed separately.

## **5. CALCULATION OF PERCENTAGE FIGURE OF DIRECTORS' INTERESTS**

Although the obligation of directors to disclose interests in shares is not determined by crossing a percentage level, directors are still required to state the percentage figure of their interests.

## **6. CHANGES IN THE NATURE OF INTERESTS**

Directors are further required to disclose any change in the nature of an interest which has previously been disclosed. The situations in which there will be such a change are wide and include a change in a person's title to shares or debentures, any of his legal or equitable interest in shares or debentures and any interest in the underlying shares of equity derivatives on the exercise (by or against him) under such derivatives.

The exercise of rights under options and other derivatives and the giving of shares as security (other than to a qualified lender – see paragraph 12.4 for the definition of qualified lender) will, among other things, require notification of a change in nature of a director's interest.

There are only 3 circumstances under Section 341(5) in which there is taken to be no change in the nature of a director's interest:

- (i) on the delivery of shares or debentures to him, if he has previously notified his acquisition of an equitable interest;
- (ii) where there is a change in the terms on which underlying shares are held due to a change in the number of underlying shares; and
- (iii) where a qualified lender (see above) comes to have a security interest in the shares or debentures.

Hence, in contrast to the position for substantial shareholders, there will be a notifiable change in the nature of a director's interest in shares on his exercise of rights to subscribe for and on delivery of shares under a rights issue.

## **7. DEEMED INTERESTS (SECTION 344)**

A director is taken to be interested in the interests of his spouse and minor children (not being themselves directors of the listed company), any company which he controls (i.e. a company of which he controls the exercise of one third or more of the voting power at general meetings or whose directors are accustomed or obliged to act in accordance with his directions or instructions) and trusts. A director must also disclose his interest under a discretionary trust.

Although directors are not required to include the interests of a spouse or minor children who are themselves directors and chief executives of the listed company when disclosing their interests as a director or chief executive, if they are also a “substantial shareholder” they must also disclose their interests held as such which *must include* interests held by a spouse or minor children irrespective of whether they are also directors of the company.

The provisions relating to cessation of interests are the same as for substantial shareholders.

## **8. EXEMPTIONS**

The exemptions available to directors are limited to those in respect of basket derivatives, bare trustees and collective investment schemes, all as outlined under Section A above.

In particular, the exemptions available to substantial shareholders in respect of de minimis changes, lending shares under the SBL Rules and bonus and rights issues are not available to directors.

## **9. INFORMATION TO BE DISCLOSED (SECTION 349)**

Where a director makes an “Initial Notification” he is required, in the case of an on-exchange transaction, to disclose the highest price and the average price paid for the interest in the 4 months preceding the date of the relevant event prompting notification. In an off-exchange transaction he must disclose the nature of the consideration and the highest and average amounts of considerations paid for the interest within the same 4 month period (Section 349(4)).

Subsequent notifications of acquisitions or disposals of interests must state, in on-exchange transactions, the highest and average price paid or received (or if no price is paid, that fact) and in off-exchange transactions the nature of the consideration and the highest and average price paid or received (or if no price is paid, that fact).

The amount and nature of consideration need not be stated in the case of “equity derivatives”. This does not apply to the grant to a director of equity derivatives by a listed company or any associated company or to the assignment of such rights in which case the price or consideration paid or received must be disclosed.

## **10. PENALTIES FOR FAILURE TO DISCLOSE**

Failure to make disclosure within the required time frame or the making of false or misleading statements constitute a criminal offence liable to the same fines and periods of imprisonment as for substantial shareholders (Section 351).

## **C. REGISTRATION OF THE INTERESTS AND SHORT POSITIONS OF SUBSTANTIAL SHAREHOLDERS, CHIEF EXECUTIVES AND DIRECTORS**

Listed companies are required to maintain registers of interests and short positions disclosed to them (Sections 336 and 352). Details must be entered on the register within 3 business days following the day of receipt of information by the listed company and the index must be updated within 10 business days of a name being entered on the register. In addition, the register must disclose details of any party holding shares pursuant to a concert party agreement (see paragraph 9.5 above).

If the register is not kept at the company's registered office, a listed company must inform the Registrar of Companies of its whereabouts using the prescribed form of notice now available on the SFC website. Directors and chief executives who are also substantial shareholders will give notice of their interests using Form 3A. The information given in these notices must be registered on both the register of interests and short positions of directors and chief executives and also the register of interests of substantial shareholders.

In addition, under Section 352(3) a listed company is required to record certain information when it grants to a director or chief executive a right to subscribe for shares or debentures of the company. The information required to be recorded against the person's name is as follows: the date on which the right is granted; the period during which, or the time at which, it is exercisable; the consideration for the grant (or if none, that fact); and a description of the shares or debentures involved, the number of shares or the amount of debentures and the price to be paid (or consideration to be given, if not in money). When any such right is exercised by a director or chief executive, the listed company is required to record specified information about that exercise in the register (Section 352(4)). The time limit for recording information relating to the grant and exercise of such rights is 3 business days from the date the obligation to record arises.

Further, under Section 352(4) when any such right is exercised by a director or chief executive, the listed company must record the following information against his name in the register:

- (a) the fact of the exercise (identifying the right);
- (b) the number of shares or amount of debentures in respect of which it has been exercised; and
- (c) if –
  - (i) they were registered in his name, that fact; or
  - (ii) they were not registered in his name, the name or names in which they were registered and the number of shares or amount of debentures registered in each name, if applicable.

The time limits for the listed company to record the above information in the register are 3 business days after the date of the grant of the right to subscribe for shares or debentures and 3 business days after the exercise of any such right.

#### **D. INVESTIGATIONS OF SHAREHOLDERS BY A LISTED COMPANY**

Under Section 329 a listed company has the power to investigate the identity of holders of interests and short positions in its shares and also the ownership of equity derivatives where the underlying shares of such derivatives are shares in that listed company. As under the previous legislation, a listed company may be required to exercise its powers of investigation on the request of members.

The listed company is then under a duty to inform the Stock Exchange, the SFC and, in the case of authorised financial institutions only, the Hong Kong Monetary Authority of any information received. This notification must be given before the end of the business day after the day on which the duty arises. The listed company must prepare a report of the information received pursuant to any such investigation and make that report available at its registered office within 10 business days of the end of the investigation and must deliver a copy of the report to the SFC and the Stock Exchange. Information received following an investigation must also be recorded in its register of interests and short positions.

#### ***Offences (Section 334)***

It is an offence for anyone to fail, without reasonable excuse, to comply with an investigation made by a listed company or to make a false or misleading statement in response to such investigation.

Further, a listed company and every officer who is in default commit an offence if they fail to prepare a report and deliver it to the SFC and the Stock Exchange within the specified periods.

#### **JANUARY 2015**

*This note is provided for information purposes only and does not constitute legal advice. Specific advice should be sought in relation to any particular situation. This note has been prepared based on the laws and regulations in force at the date of this note which may be subsequently amended, modified, re-enacted, restated or replaced.*

## SCHEDULE 1

### **EXAMPLES OF WHAT CONSTITUTES AN “INTEREST” IN SHARES**

- (i) If a person's name is listed in the register of members maintained by a listed company.
- (ii) If the shares are held for a person by another person such as his stockbroker, a custodian, a trustee or a nominee (e.g. in the Central Clearing and Settlement System (“CCASS”) or with HKSCC Nominees Limited, the CCASS depository).
- (iii) If a person is deemed by Part XV to be interested in the shares.
- (iv) If a person enters into a contract (for example if he holds, writes or issues financial instruments including equity derivatives) that give him a right to shares, or to a payment in the event of a change in the price of shares.
- (v) If a person holds shares as security.
- (vi) If a person is entitled to exercise rights attaching to the shares or control their exercise e.g. voting rights.