

► Securities Law and Listing Rules



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THE SECURITIES AND FUTURES ORDINANCE

**PART XV
DISCLOSURE OF INTERESTS**

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Introduction

The SFO considerably broadens the previous regime governing the disclosure of interests in the shares and debentures of Hong Kong listed companies with a view to enhancing transparency in the Hong Kong market.

Substantial Shareholders

As previously, disclosure is required:

- ▶ when a person acquires or ceases to have a notifiable interest; and
- ▶ when there is a change in the percentage *level* (ie. the figure rounded down to the next whole number) of his interest.

The New Features

Reduction of Substantial Shareholding Threshold

- ▶ Reduction of threshold from 10% to 5% of a Hong Kong listed company's issued voting share capital
- ▶ Where there is more than one class of shares, the percentage of each class is taken separately

Shortening of Notification Period

- ▶ The notification period is shortened from 5 days to 3 business days (which includes Saturdays), subject to limited exceptions

Disclosure of Interests in Equity Derivatives

- ▶ Previously the disclosure requirements applied only to physically settled derivatives.
- ▶ A key change under the SFO is the extension of the disclosure requirements to:
 - interests in the unissued shares of listed companies which, if issued, would carry the right to vote (eg. under options, subscription warrants and convertible bonds); and
 - cash settled derivatives.

Disclosure of Short Positions

Another key change is the extension of the disclosure obligations to cover 'short positions'.

A person is taken to have a 'short position' if he:

- ▶ holds, writes or issues financial instruments under which:
 - a) he can require another 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
- ▶ borrows shares under a securities and borrowing lending agreement.

Disclosure of Short Positions (Cont'd)

Note however that:

- ▶ A short position is only discloseable if the person (other than a director) already holds a 5% interest;
- ▶ The short position must be at least 1%;
- ▶ Changes in short positions need only be disclosed when they cross a percentage level or the person ceases to have a short position;
- ▶ Long and short positions cannot be netted off: they must be calculated and notified separately.

Calculation of A Person's Interest

Nominal value of shares in which a person is interested*

_____ x 100

Nominal value of the issued shares of the listed company of the same class

- * This includes interests in issued shares and interests in shares underlying equity derivatives whether issued or unissued.

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Notification of Changes in the Nature of Interests

Disclosure obligations extended to cover changes in the nature of interests already disclosed.

No change:

- i) on taking delivery of shares where the acquisition of an equitable interest on contracting to purchase has previously been disclosed;
- ii) where a vendor enters into a contract for sale, if the sale is to be completed within 4 trading days;
- iii) on a change in the terms of equity derivatives due to 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' takes a security interest in shares; and
- vi) for a holding company, on a transfer of shares from one wholly owned subsidiary to another.

Deemed Interests

As previously, need to aggregate:

- ▶ interests of spouse and children under 18;
- ▶ interests of 'controlled companies' (ie. of which the person controls 1/3 of the voting power at general meetings or if the company or its directors are accustomed to acting in accordance with his directions);
- ▶ interests of a trust of which a person is a trustee (unless a bare trustee);
- ▶ beneficial interests under a trust (other than discretionary interests of substantial shareholders);

Deemed Interests (Cont'd)

New provisions in the SFO:

- ▶ interests of a discretionary trust are attributed to the 'founder' of such a trust;
- ▶ concert party agreements - provisions requiring parties to concert party agreements to aggregate the interests of all other parties are extended to cover arrangements where a 'controlling person' or director of a listed company lends money to another to purchase shares in the company.
 - A 'controlling person' is a person who alone or with associates : controls 30% of the voting power at general meetings
 - can nominate any of its directors
 - can modify or veto resolutions at general meetings

Exemption where the director or 'controlling person' is a 'qualified lender' acting in the ordinary course of his business.

Exemptions

1. Basket Derivatives
2. De minimis change exemptions on change in long or short positions
3. De minimis change exemption on change in nature of interests
4. Exempt Security Interests
5. Wholly owned group exemption
6. Bonus and Rights Issue Exemption
7. Investment Managers, Custodians and Trustees
8. Disaggregated Group Interests
9. Securities Borrowing and Lending Exemption
10. Collective Investment Schemes

Penalties for Failure to Disclose

Failure to disclose or the making of a statement which is false or misleading in any material particular is a criminal offence liable to a maximum fine of \$100,000 or maximum prison sentence of 2 years.

Directors and Chief Executives

As previously, disclosure requirements are broader than for substantial shareholders:

- must disclose interests in any shares (not just voting shares) or debentures of a listed company of which they are a director and any associated company;
- no disclosure threshold – all interests must be disclosed however small.
- definition of ‘Associated Company’

The SFO extends directors’ disclosure obligations to cover:

- ▶ interests under equity derivatives
- ▶ short positions
- ▶ changes in the nature of interests

Changes in Nature of Interest

Only 3 circumstances where there is taken to be no change:

- On delivery of shares to him, if acquisition of equitable interest previously notified;
- Change in the terms of equity derivatives due to a change in the number of underlying shares in issue;
- Where a 'qualified lender' comes to have a security interest in the shares.

Exemptions

Exemptions for directors limited to exemptions for:

- basket derivatives
- bare trustees
- collective investment schemes

Registration of the Interests and Short Positions of Substantial Shareholders and Directors and Chief Executives

Details to be included within 3 business days of receipt of information.

Details to be recorded on the grant to a director or chief executive of a right to subscribe for shares or debentures of a company (Section 352(3)).

Information to be recorded on the exercise of any such right (Section 352(4)).

Investigations of Shareholders by a Listed Company

A listed company has the power to investigate the identity of holders of:

- interests and short positions in its shares
- equity derivatives where the underlying shares are shares in the listed company.

A listed company may also be required to exercise such powers on the request of its members.

THE SECURITIES AND FUTURES ORDINANCE

**PARTS XIII AND XIV
MARKET MISCONDUCT**

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Introduction

Parts XIII and XIV broaden the previous law on market manipulation and disclosure of false or misleading information relating to securities and futures.

Key Features

- ▶ Market Misconduct comprises 6 offences:
 - insider dealing
 - false trading
 - price rigging
 - disclosure of information about prohibited transactions
 - disclosure of false or misleading information inducing transactions
 - stock market manipulation

Key Features (Cont'd)

- ▶ Part XIV also creates 3 new criminal offences:
 - use of fraudulent or deceptive devices in transactions in securities, futures contracts or leveraged foreign exchange dealing
 - disclosure of false or misleading information inducing others to enter leveraged foreign exchange contracts
 - falsely representing dealings in futures contracts on behalf of others

Key Features (Cont'd)

- ▶ The civil regime under Part XIII covers **all** types of market misconduct (not just insider dealing as previously)
- ▶ The criminal regime under Part XIV also covers all types of market misconduct (including insider dealing, previously subject only to civil proceedings)
- ▶ Wider range of civil sanctions available to the Market Misconduct Tribunal
- ▶ The SFO creates a right of civil action in favour of a person who has suffered financial loss to seek compensation from the perpetrator of market misconduct
- ▶ The SFO imposes a duty on all officers of a company to take reasonable measures to ensure that the company does not contravene the market misconduct provisions.

Insider Dealing

In broad terms insider dealing takes place where a person buys or sells shares in a listed company when he has insider information – that is, knowledge of certain facts about that company which the public does not have and which, if known to the public, would have an impact on the price of the company's shares.

Insider Dealing (Cont'd)

The definition of insider dealing is largely the same as under the previous legislation. There are basically 7 heads of 'insider dealing' :

- a) person with insider information deals in shares of a corporation with which he is connected;
- b) take-over offer – bidder deals in shares of target;
- c) person connected with a corporation leaks insider information about that corporation;
- d) bidder leaks take-over information;
- e) recipient of insider information from person connected with a corporation deals in the shares of that corporation;
- f) recipient of insider information about a take-over deals in shares of the target; and
- g) person with insider information seeks to facilitate a dealing on an overseas market.

The definition of 'Listed securities' under the SFO has been extended so that the insider dealing provisions now catch 'grey market' dealings prior to a secondary issue of securities.

False Trading

False trading prohibits:

- i) intentionally or recklessly creating (or doing anything likely to create) a false or misleading appearance of active trading in, or as to the market for, or price of, securities or futures; and
- ii) transactions (which need not be in securities or futures) entered into with the intention that, or being reckless as to whether, they create or maintain an artificial price for securities or futures.

In the case of on-market ‘wash sales’ (ie. trades involving no change in beneficial ownership) and ‘matched orders’ (ie. offers to sell or buy matched by offers to buy or sell substantially the same number of securities at substantially the same price), there is a rebuttable presumption that the person who entered into it intended, or was reckless as to whether, his conduct created the appearance at (i) above.

Price Rigging

Price rigging prohibits:

- i) engaging in wash sales which affect the price of securities (unless the defendant can show that his purposes did not include the purpose of creating a false or misleading appearance as to the price of securities); and
- ii) engaging in a fictitious or artificial transaction intending that, or being reckless as to whether, it will affect the price of securities or futures.

Stock Market Manipulation

These provisions prohibit engaging in transactions in securities of a corporation that affect the price of any securities, intending to induce investment decisions relating to the securities of the corporation or to those of a related corporation.

Disclosure of Information about Prohibited Transactions

This offence prohibits a person from disclosing information that the price of securities or futures traded on an exchange or through an automated trading system ('ATS') in Hong Kong will be affected by a transaction in contravention of the market misconduct provisions or Part XIV, if he or his associate entered into the transaction or will benefit from the disclosure. Defences are available to those who innocently report market misconduct and its effect on price (eg. journalists and research analysts).

Disclosure of False or Misleading Information Inducing Transactions

This offence prohibits the disclosure of information about securities or futures which is materially false or misleading that is likely to induce investment decisions or affect prices in Hong Kong, if the defendant knows that, or is reckless or, *for civil liability only*, negligent as to whether, the information is materially false or misleading. There are a number of narrowly drafted defences available to businesses who passively disseminate information provided by others.

Scope of Offences

The market manipulation offences (ie. false trading, price rigging and stock market manipulation) cover both conduct in Hong Kong or elsewhere which affects securities (or futures) traded on an exchange or through an ATS in Hong Kong and conduct in Hong Kong which has the same effect on securities (or futures) traded on an overseas market. Where the conduct affects an overseas market, the prosecution must prove that the conduct is also unlawful in the country in which the market is situated.

Effects of Market Misconduct

THE MARKET MISCONDUCT TRIBUNAL (“MMT”)

- the purpose of proceedings before the MMT is to determine:
 - a) whether any market misconduct has taken place;
 - b) the identity of each person involved; and
 - c) the amount of any profit gained or loss avoided as a result
- the MMT makes its findings on the civil standard of proof – ie. on the balance of probabilities
- the MMT can receive any evidence, whether or not it would be admissible in criminal or civil proceedings

Orders of The MMT

The MMT may impose any of the following sanctions:

- Disqualification order
- Cold shoulder order
- Cease and desist order
- Disgorgement order
- Government costs order
- SFC costs order
- Disciplinary referral order

Criminal Penalties

The maximum criminal sanctions are 10 years' imprisonment and fines of up to \$10 million

NO DOUBLE JEOPARDY

A person will not be subject to the 'double jeopardy' of both civil proceedings under Part XIII and criminal proceedings under Part XIV for the same conduct.

Civil Liability – Private Right of Action

A private right of action is created in favour of anyone who has suffered financial loss as a result of market misconduct or a Part XIV offence to seek compensation from the perpetrator.

A person is taken to have committed market misconduct if:

- he has perpetrated the market misconduct; or
- the market misconduct was perpetrated by a company of which he is an officer with his consent or connivance; or
- another person committed market misconduct and he assisted or connived in the perpetration thereof, knowing that such conduct constitutes or might constitute market misconduct.

Liability of Officers of A Corporation

Section 279 imposes a duty on officers of a company to take reasonable measures to ensure that proper safeguards exist to prevent the company contravening the market misconduct provisions.

The definition of 'officer' includes a director, a manager or secretary of, or any other person involved in the management of a company.

**STABILISATION UNDER
THE SECURITIES AND FUTURES
(PRICE STABILISING) RULES**

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Introduction

The SFO allows the SFC to make rules creating defences to the market misconduct provisions of Parts XIII and XIV of the SFO.

The Securities and Futures Price Stabilising Rules (the 'Rules') are made under that provision and prescribe the circumstances in which price stabilisation may be carried out without constituting market misconduct. The Rules came into effect on 1 April 2003.

Previous Position

Previously, a restricted form of stabilisation was permitted under policy statements of the SFC and the Hong Kong Stock Exchange whereby:

- ▶ there was an over-allotment of securities by the underwriters;
- ▶ the short position created by the over-allotment was covered by an over-allotment option granted by the issuer and/or stock borrowing arrangements;
- ▶ 'genuine purchases' to satisfy the over-allotment which also reduced excess supply were permitted.

Conditions to be Satisfied

To qualify for the safe harbour under the Rules, the offer must be of 'relevant securities' and

- ▶ the offer must be for cash;
- ▶ the securities must be listed on a recognised stock exchange or traded through an authorised automated trading system;
- ▶ the offer size (excluding over-allocated securities) must be at least \$100 million*;
- ▶ the offer must be to the public;
- ▶ the offer must be:

Conditions to be Satisfied (Cont'd)

- i. the subject of a prospectus or a document authorised under S105 of the SFO (to cover offers of debt securities by government agencies); or
 - ii. a placing or other offer of shares of a class which is already listed to Companies Ordinance 'professionals' only. It must not comprise a sell-down element and must be the subject of a public announcement containing the offer price and the disclosure and warnings relating to the proposed stabilisation required by the Rules.
- * The minimum offer size means that any stabilisation conducted in respect of an offer below \$100 million now potentially constitutes market misconduct.

Relevant securities are equity securities, debt securities or depositary receipts.

Primary Stabilising Actions

- ▶ The stabilising manager can buy relevant securities in the secondary market to support their price.
- ▶ These purchases may (but do not have to) be made to satisfy an over-allotment of the securities.
- ▶ All stabilising purchases must be for the account of the Stabilising Manager.

Ancillary Stabilising Actions

Permitted ancillary stabilising action allows the Stabilising Manager to:

- ▶ over-allocate or establish a short position in the relevant securities;
- ▶ exercise an over-allotment option to close out any such short position;
- ▶ liquidate net long positions acquired in the course of primary stabilising activity.

The SFC has also indicated that securities borrowing arrangements and the subsequent return of borrowed shares should be covered as ancillary stabilising activity.

Time Limits for Stabilising Actions

Primary Stabilising Actions

The period runs from the commencement of trading on a recognised stock exchange or through an authorised automated trading service after the issue of the offer document and announcement of the offer price.

It ends 30 days after the earlier of the closing date or the commencement of trading on a recognised stock exchange.

Ancillary Stabilising Actions

No time limits apply.

However the SFC has indicated that, as a matter of good practice, net long positions should be liquidated as soon as is practicable at a profit without disrupting the market.

Price Limits For Stabilising Actions

Upper price limits apply to primary stabilising actions for **equity securities** but not **debt securities**.

Item	Action	Maximum Price
1	Initial stabilising action	The offer price
2	After the initial stabilising action, when there has been no deal or transaction described in item 3.	The initial stabilising price
3	After the initial stabilising action, where there has been an independent* deal or transaction on a recognised stock market or through an ATS at a price above the initial stabilising price.	The lower of the offer price and the price at which the deal or transaction was effected

The 'initial stabilising action' is the first stabilising purchase made by the Stabilising Manager.

The 'initial stabilising price' is the price of the first stabilising purchase.

* With respect to item 3, the deal or transaction must be truly independent. Any deal or transaction effected by or on the instructions of the Stabilising Manager does not count.

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The Role of the Stabilising Manager

- ▶ The Stabilising Manager is ultimately responsible for the conduct of any agent appointed to carry out stabilisation;
- ▶ The Stabilising Manager should separate its stabilising activities from its other trading activities (including proprietary trading);
- ▶ Dealings between the Stabilising Manager and its agents as principals is prohibited – unless the identity of the counter-party is unknown.

Disclosure Requirements

Prior Disclosure

Adequate disclosure of the fact that stabilisation may be undertaken must be made in the first public announcement of the offer and in all subsequent communications until detailed warnings and disclosure are made in the prospectus or other offer document.

Disclosure Requirements (Cont'd)

Interim Disclosure

Exercise of Over-allotment option.

A public announcement is required as soon as possible after any exercise of an over-allotment option stating:

- the number of securities purchased or subscribed for; and
- the number of securities still available under the unexercised portion of the option.

Disclosure Requirements (Cont'd)

A public announcement must be made within 7 days of the end of the stabilising period stating:

- the ending date of the stabilisation period;
- whether or not stabilising action was undertaken;
- the price range between which purchases were made;
- the date and price of the last stabilising purchase;
- the extent to which any over-allotment option was exercised.

Record Keeping of Stabilising Actions

- Stabilising Manager to maintain a register of all stabilising actions taken;
- Register to be updated immediately or on a daily basis;
- Register to be kept for 7 years after the end of the stabilising period;
- The Issuer can inspect the register within 3 months of the end of the stabilising period;
- The SFC can inspect the register at any time.

CONSULTATION PAPER ON THE REGULATION OF IPO INTERMEDIARIES

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Introduction

A consultation paper was issued in May this year on tightening the regulation of sponsors and independent financial advisers ('IFA's) to new applicants and listed issuers on the Exchange's Main Board or the Growth Enterprise Market ('GEM').

Key Features

- ▶ A new regime administered by the Exchange to establish the acceptability of firms to act as sponsors and IFAs.
- ▶ Eligibility depends on corporate finance experience of a firm's 'eligible supervisors'.
- ▶ Sponsors to have 4 eligible supervisors.
- ▶ IFAs to have 2 eligible supervisors.

Key Features (Cont'd)

“Eligible Supervisors” must, as an on-going requirement:

- ▶ have at least 4 years’ relevant corporate finance experience;
- ▶ have played a ‘substantive role’ in at least 3 completed ‘significant transactions’ including at least one of each of:
 - a transaction involving a company listed on the Exchange;
 - a transaction completed in the previous 2 years; and
 - for sponsor firms only, an IPO.

Sponsors' Due Diligence

Proposed changes to the Listing Rules require sponsors to conduct reasonable investigations to satisfy themselves that:

- the new applicant is suitable for listing, its directors appreciate their responsibilities and the applicant and its directors can be expected to meet their obligations under the Listing Rules and Listing Agreement;
- the non-expert sections of the listing application and prospectus are true and do not omit to state a material fact;
- there are no reasonable grounds to believe that the 'expert' sections are not true or omit to state a material fact.

Sponsors' Due Diligence (Cont'd)

Proposed declaration by the sponsor and lead-underwriter in the prospectus as to the due diligence performed.

Non-expert sections – confirmation that after 'reasonable investigations' they believe and have reasonable grounds to believe that the information is not false or misleading.

Expert sections – confirmation that they have no grounds to believe and do not believe that the information is materially false or misleading.

IFAs' Due Diligence and Declaration

Proposed changes to the Listing Rules will require IFAs to:

- take all reasonable steps to satisfy themselves:
 - * that the terms and conditions of the transaction or arrangement are fair and reasonable and in the interest of the issuer and its shareholders as a whole; and
 - * that there are no grounds to believe that any information or opinion relied upon is not true or omits to state a material fact; and
- make a declaration in their report as to the due diligence performed in reaching their conclusion as to the fairness and reasonableness of the transaction or arrangement.

On-going Advice for Listed Issuers

- All newly listed issuers on both the Main Board and GEM to appoint a sponsor to advise for a period after listing.
- For main board issuers – the period ends on the publication of the financial results for the first full year after listing.
- For GEM issuers – the period is the remainder of the current financial year and the following 2 financial years.
- Sponsor's advice to be sought on the publication of any regulatory announcement, circular or financial report, where a notifiable transaction is contemplated and monitoring the use of proceeds and adherence to the business plan.

Independence Of Sponsors and IFAs

- New directions given as to when a sponsor or IFA is not independent of the applicant and cannot act in that capacity.
- Sponsors and IFAs are to be required to declare their independence.

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