

REIT

SFC Consults on Changes to Hong Kong REIT & Listed CIS Statutory Regimes

The [Securities and Futures Commission's \(the SFC\) March Consultation Paper](#) proposes to introduce a statutory scheme of arrangement and compulsory acquisition mechanism for real estate investment trusts (**REITs**) similar to those applicable to Hong Kong-incorporated companies. It also proposes extending the market misconduct, disclosure of inside information and disclosure of interests regimes applicable to Hong Kong-listed companies to listed collective investment schemes (**CISs**). The aim is to boost Hong Kong's attractiveness as an investment destination and its status as an international financial hub. The cut-off date for responding to the Consultation Paper is 27 May 2024.

Proposed improvements to Hong Kong REIT and Listed CIS Statutory Regimes

The proposed statutory scheme of arrangement and compulsory acquisition scheme for REITs under the Securities and Futures Ordinance (Cap. 571 of the laws of Hong Kong) (the **SFO**) would allow REITs to conduct privatisation and corporate restructuring in a similar way to listed companies. REIT unitholders would be given various safeguards and protections. As regards listed collective investment schemes, including REITs, the SFC is proposing to extend to them the following regimes under the SFO: the market misconduct regime under Parts XIII and XIV; the disclosure of inside information regime under Part XIVA; and the disclosure of interests regime under Part XV.

Prior to publishing the Consultation Paper, the SFC consulted market participants and stakeholders and apparently received positive feedback on the proposals.

Proposed Statutory Scheme of Arrangement and Compulsory Acquisition Mechanism for Hong Kong REITs

The first proposal is to introduce a statutory framework to enable a court-supervised scheme of arrangement and compulsory acquisitions for SFC –authorised REITs in Hong Kong.

Hong Kong provides a statutory mechanism for companies formed and registered under Part 13 of the Companies Ordinance (Cap. 622 of the laws of Hong Kong) (the **Companies Ordinance**) to carry out a corporate restructuring by way of a scheme of arrangement. However, REITs are constituted as trusts, not companies, and thus cannot rely on the Companies Ordinance's scheme of arrangement and compulsory acquisitions mechanism.

REITs can only achieve privatisation indirectly by first disposing of all or a substantial part of their assets and then delisting from the Hong Kong Stock Exchange and de-authorisation under the SFC's Codes on Takeovers and Mergers and Shares Buy-backs (the **Takeovers Code**) and the SFC Code on Real Estate Investment Trusts (the **Hong Kong REIT Code**).

Codes and the SFC Code on REITs.

Part 13 of the Companies Ordinance contains detailed procedures for companies incorporated or registered in Hong Kong to undertake schemes of arrangement as part of corporate restructuring and to compulsorily acquire shares after a takeover offer or a general offer for a share buy-back.

Under section 670 of the Companies Ordinance, on application by the relevant parties, the court can direct a meeting of members or creditors to consider a proposed scheme. If a meeting is called, the relevant parties must convene the meeting in accordance with section 671 of the Companies Ordinance and its notice and content requirements. Meetings must be held in compliance with these requirements which ensure that meeting notices are comprehensive and issued in a timely manner to ensure that parties receive accurate and adequate information to make informed decisions. Once the arrangement or compromise is approved, the court can sanction it, and a copy of the court order must be registered with the Registrar of Companies.

These statutory restructuring mechanisms are not available to REITs because they are established as trusts. If a REIT manager wishes to privatise the REIT or undertake a corporate restructuring, it generally has to do so by way of asset disposal followed by delisting and deauthorisation of the REIT under paragraph 11.13 of the Hong Kong REIT Code and Note 7 to Rule 2 of the Takeovers Code, subject to obtaining sufficient votes under Rule 2.10 of the Takeovers Code. After the asset disposal, the REIT will no longer meet the investment requirements of paragraph 3.2 of the Hong Kong REIT Code and its listing can no longer be maintained, rendering it ineligible for authorisation under the SFO.

Calls for Change for Hong Kong REITs

The industry had been calling for a direct exit option similar to the statutory scheme of arrangement and compulsory acquisition regime for listed companies. Although REITs and listed companies operate as different legal forms, units and shares are similar in terms of their rights and the interests attached to them. Merger and acquisition activities involving REITs and listed companies also have similar commercial characteristics. Despite the SFC extending the Takeovers Code to REITs, it does not provide for a "squeeze out" provision on a REIT takeover or for the privatisation of REITs.

Without a "squeeze out" mechanism, a general offer to take over a REIT entirely would not be achievable. Obtaining acceptance from all unitholders is impossible, and accepting less than 100% acceptance risks leaving the offeror with minority unitholders. Unlike listed companies, the Hong Kong REIT Code lacks a mechanism for the offeror to remove resistant minority unitholders, regardless of their size. Australia and Singapore adopted a compulsory acquisition mechanism in 2000 and 2009, respectively.

It is common for Hong Kong companies to privatise by way of a scheme of arrangement. A scheme of arrangement is binding on all shareholders after the scheme is approved in a meeting by shareholders and/or creditors and sanctioned by the court. There is, however, no equivalent mechanism for REITs to privatise. Australia and Singapore have a scheme of arrangement that allows REITs to be privatised.

The Financial Service Development Council (**FSDC**) issued a paper in 2013 suggesting a statutory scheme of arrangement and compulsory acquisition regime for REITs to promote liquidity and revitalise Hong Kong's REIT market. Although Hong Kong was one of the earlier markets to allow the trading of REITs under the Hong Kong REIT Code, its regime lags that of other financial products. The FSDC paper revisited the two main issues: the absence of: (i) squeeze-out provisions to facilitate REIT takeovers; and (ii) a scheme of arrangement provision to allow REITs to privatise.

Proposed Changes to the Hong Kong SFO

The SFC proposes introducing a new Part to the SFO which would allow REITs to conduct an arrangement or compromise similar to that available to companies under the Companies Ordinance.

The proposed statutory framework would include the following features which are similar to those available under the Companies Ordinance, with adjustments tailored to the characteristics of REITs:

1. For a scheme entered into with creditors (or a class of creditors), the scheme's terms would need to be approved by a majority in number representing at least 75% in value of the creditors (or a class of creditors) present and voting at the relevant meeting.
2. For a scheme entered into with unitholders (or a class of unitholders), the scheme's terms would be subject to the approval of:
 - unitholders representing at least 75% in value of the voting rights present and voting; and
 - unless otherwise ordered by the court, a majority in number of unitholders' rights present and voting.
3. If a general offer or takeover offer is involved in a scheme entered into with unitholders (or a class of unitholders), it:
 - must be approved by unitholders representing at least 75% in value of the voting rights present and voting; and
 - must not be voted against by 10% or more of the voting rights of disinterested unitholders or disinterested unitholders of that class.
4. The REIT's management company, trustee, unitholders or creditors may apply to the court to order a meeting and sanction the scheme.
5. The REIT's management company, trustee and all its directors must disclose all material interests in the arrangement or compromise in an explanatory statement sent prior to the court-ordered meeting.
6. An arrangement or compromise of a REIT sanctioned by the court is binding on the relevant parties including the REIT's trustee and management company, its unitholders and creditors.
7. The court order sanctioning the arrangement or compromise has no effect until a copy of the court order is delivered to the SFC for filing.

Current Position on Compulsory Acquisition of Hong Kong REITs

For companies registered under the Companies Ordinance, the provisions relating to the compulsory acquisition of shares following a takeover offer or general offer are found in sections 687 to 704 of the Companies Ordinance. Section 689(1) defines a takeover as an offer to acquire all the shares in the company except those held by the offeror at the date of the offer. The terms of the offer must be the same for all the shares to which the offer relates (or all the shares of the class to which the offer relates).

Section 689(3) provides that "shares that are held by an offeror" include shares that the offeror has contracted, unconditionally or conditionally to acquire, but exclude shares that are subject to a contract is that is intended to secure that the shareholder will accept the offer when it is made and entered into for no consideration and by deed, for consideration of negligible value, or for consideration consisting of a promise by the offeror to make the offer.

Sections 689 and 691 state that a takeover offer may relate to:

- shares that are allotted after the date of the offer but before a date specified in the offer as set out in Section 689(6);
- shares that the offeror acquires or contracted to acquire other than by virtue of acceptances of the offer during the offer period, unless the acquisition consideration exceeds the consideration specified in the terms of the offer as set out in section 691(2); and
- shares which a nominee or an associate of the offeror has contracted to acquire after a takeover offer is made but before the end of the offer period, unless the acquisition consideration exceeds the consideration specified in the offer as set out in section 691(4).

The Companies Ordinance includes mechanisms that allow for the mandatory acquisition or "squeeze-out" of

minority shareholdings if the acquiring company or offeror obtains acceptances exceeding 90% of the total shares or a specific class of shares in a takeover or general offer. When the majority shareholding reaches that threshold, the offeror can require the minority shareholders to sell their shares. The minority shareholders can obtain a court order to prevent the acquisition if the compulsory acquisition would result in their unfair treatment. Minority shareholders also have a “sell-out” right, which means that they can require the acquiring company or offeror to purchase their remaining shares if it achieves a 90% acceptance rate and control of the company in a takeover or general offer.

Proposed Compulsory Acquisition Mechanism to the Hong Kong SFO

The SFC is proposing that the Companies Ordinance’s compulsory acquisition provisions are mirrored in the SFO. The key elements of the proposal are that:

1. “Squeeze-out” and “sell-out” provisions would apply after a takeover offer or general offer for a unit buy-back. These would be based on the provisions under Divisions 4 and 5 of Part 13 of the Companies Ordinance;
2. The provisions for the procedures and timelines for giving an acquisition notice will be similar to those under the Companies Ordinance, with certain modifications:
 - the offeror or repurchaser in a “squeeze out” would have to provide notice to minority holders within the earlier of: (i) three months from the day after the offer period of the takeover offer or general offer ends; or (ii) six months from the date of the takeover offer or general offer. A disinterested unitholder could apply to the court to determine whether the “squeeze out” can be carried out or not; and
 - notice to minority unitholders regarding their rights to a “sell-out” would have to be given within one month after the first day on which the unitholders become entitled to a sell-out. Those rights would be exercisable by minority unitholders within three months after the later of: (i) the end of the offer period; or (ii) the date notice is given by the offeror or repurchaser. Notices issued before the expiry of an offer period would be required to state that the offer is still open for acceptance;
3. If the offeror or the repurchaser has acquired acceptances of at least 90% of the number of units in the offer, the management company or the trustee of the offeror or the repurchaser could apply to the court to authorise the issue of an acquisition notice to buy out the remaining units upon satisfying the court that: (i) the consideration is fair and reasonable; and (ii) the buy-out is fair;
4. The time and manner for the issue of an acquisition notice will be similar to that under the Companies Ordinance;
5. Where a unitholder’s address is not available from the register of holders, the management company or the trustee of the offeror or the repurchaser could apply to the SFC for directions on delivery of the acquisition notice;
6. The SFC would be able to issue directions as to the form of an acquisition notice;
7. Similar to sections 698, 699, 716, and 717 of the Companies Ordinance, the trustee of the REIT would be required to hold the consideration monies on trust for the entitled unitholders pending completion of the acquisition; and
8. On a takeover offer and compulsory acquisition, the REIT’s trustee would be responsible for updating the unitholders’ register to show the offeror as the holder of the acquired units. Conversely, in a general offer for a unit buy-back, the REIT’s trustee would be required to cancel the relevant units.

Proposed Modifications to Cater for Hong Kong REIT Capital Characteristics

Given the specific features of REITs, new definitions will be added into the interpretation section of the new part of the SFO which will largely follow the definitions used in the Companies Ordinance sections 666 and 667, namely the definitions of “Child”, “Cohabitation Relationship”, “Offer Period”, “Repurchase Company” and “Associate”. It would also include new terms such as “Management Company” and “REITs”.

One of the main differences between a REIT and a company is that a REIT lacks legal personality. The proposals would therefore introduce new provisions to deem the acts and powers of a REIT’s trustees, management company

and directors as being exercised on behalf of the REIT. Obligations and powers imposed or conferred on the REIT would be deemed to be imposed or conferred on the REIT's trustee or management company.

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Similarly, (i) voting rights owned, controlled, or held by a trustee or a management company and/or any of the management company's directors; and (ii) property, undertaking or liabilities or rights attached, held or exercised by a REIT's trustees and/or its management company or directors, would be considered to be owned or held etc. on behalf of the REIT.

Creditors to whom the trustee and/or the management company incur liability on behalf of the REIT will be deemed to be creditors of the REIT.

Finally, the definition of "responsible person" of a company under section 3 of the Companies Ordinance will be extended to include officers of the management company, and the officers of the management company will be deemed to have committed an offence if it fails to comply with the new provisions.

Other Notable Amendments for Hong Kong REITs

Section 675 of the Companies Ordinance caters for a court-free regime for amalgamations. However, this regime is limited to amalgamations of wholly-owned intra-group companies limited by shares and is not used in other jurisdictions such as Australia, Singapore or the United Kingdom. Therefore, the SFC will not extend these provisions to REITs.

Housekeeping amendments include amendments to section 400 of the SFO so that service of notices will include references to REITs. Although the new proposals will be inserted into the SFO, certain provisions and interpretations are set out in the Schedule IX (REIT Guidance Note) of the Takeovers and Buy-back Codes.

Extension of SFO Market Misconduct Statutory Regime to Hong Kong Listed CISOs

The SFC's second proposal would amend the SFO to explicitly apply the market conduct regimes to listed CISOs. Parts XIII to XV of the SFO set out the statutory frameworks governing market misconduct, offences relating to dealings in securities and futures contracts, the disclosure of inside information and disclosure of interests listed securities and listed corporations.

Some of the SFO's market misconduct provisions, such as section 270 on insider dealing, apply only to listed corporations. To ensure that all listed CISOs are subject to appropriate market conduct and transparency standards, the SFC will refine its previous proposals.

Previous SFC proposals

To ensure certainty with respect to listed CISOs and to align with the approach in countries like Australia, Singapore and the United Kingdom, the SFC has proposed amending the SFO to expand the market conduct regimes to REITs and non-corporate listed entities.

Two consultations were held previously. The first was a January [2010](#) consultation paper on proposals to:

- extend the application of the Codes on Takeovers and Mergers and Share Repurchases to SFC-authorized REITs and related amendments; and
- extend Parts XIII to XV of the SFO to listed collective investment schemes.

A subsequent consultation paper in November 2012 proposed enhancing the regulatory regime for non-corporate listed entities. Both received positive feedback. After publishing consultation conclusions to these two consultation papers on 25 June 2010 and 27 March 2013, respectively, the SFC and the Hong Kong Government started preparing legislative amendments based on the two consultation papers. However, the process was stalled by technical difficulties. It was considered that more discussions would be required. Meanwhile, the SFC has imposed other measures to supervise REITs and other listed CISs, including:

- close surveillance of any untoward price or volume movements;
- imposing disclosure obligations on REITs to include requirements in their trust deeds similar to those in Part XV of the SFO, and
- close supervision of SFC licensed managers and their management of listed CIS.

The 2024 proposals will fine tune the technical difficulties and implement the two consultation conclusions. Based on the two previous consultation conclusions, the proposed legislative amendments would include the following:

- As regards the Part XIII provisions on the Market Misconduct Tribunal, the objective of the market misconduct regime is to promote fairness in the market and minimise crime and misconduct. Currently, some defined terms such as “associate” and “controller” cater only for corporations. In view of the CIS market in Hong Kong, amendments will be made to explicitly confer powers on the SFC to initiate civil proceedings in the Market Misconduct Tribunal in relation to listed CISs. The Courts and the Secretary for Justice will have the power to handle proceedings and make orders in relation to a listed CIS. This will eliminate any doubt in the legislation and provide investors with the same protections against market misconduct as investors in listed corporations;
- Part XIV of the SFO is the criminal market misconduct regime. Similar amendments to those made to Part XIII will be made. Any contravention of Part XIV by a listed CIS will lead to criminal liability;
- Part XIVA relates to public disclosure of inside information. Currently, Part XIVA requires listed corporations to disclose price sensitive or inside information on a timely basis. However, this statutory disclosure obligation does not apply to listed CISs. From investors’ point of view, investments in listed CISs and listed companies are very similar economically and in terms of the fundamental rights and interests attaching to units in CISs and shares in a listed company. It would therefore be expected that the statutory disclosure obligations are similar. Accordingly, amendments will be made to oblige listed CISs and their officers, including management companies and their officers, to promptly disclose inside information. Otherwise, the SFC will be able to bring Market Misconduct Tribunal proceedings. The Courts and Secretary for Justice will be able to bring proceedings and make orders if there is a breach of the disclosure obligation by the officers of a listed CIS. The general principles and guidance set out in the Guidelines on Disclosure of Inside Information will also be modified accordingly. The safe harbours under the price sensitive information regime for listed corporations would also apply to listed CISs; and
- Part XV on Disclosure of Interests explicitly refers to shares and debentures of a listed corporation. Part XV currently provides investors in listed corporations with more complete and quality information to allow investors to make informed investment decisions. This regime also allows investors to identify the persons who control, or are in a position to control, interests in shares in listed corporations and those who may benefit from transactions involving associated corporations of listed corporations. However, currently it does not apply to CIS which are constituted in the form of trusts or other non-corporate form.

Accordingly, the disclosure of interests regime will be modified to extend to substantial unitholders and relevant personnel of listed close-ended CISs (that is CISs other than a listed open-ended CIS consisting mostly of exchange-traded funds).

The consultation paper published in 2012 also proposed complementary amendments to the SFC’s investigation and intervention powers under Parts VIII and X of the SFO. Currently, Part VIII of the SFO gives the SFC with supervisory and investigative powers. The SFC intends to clarify that the powers of the SFC under this part will allow it to investigate and intervene in misconduct on the part of listed CISs. Part X allows the SFC to apply to court for injunctions and other orders to remedy or regulate misconduct or oppression in the way a listed company’s affairs are conducted. The proposed amendments would empower the SFC to apply for court orders to remedy market misconduct on the part of listed CISs.

The proposed amendments would provide greater consistency in the regulation of Hong Kong listed entities and align Hong Kong's regulatory regime for listed entities more closely with standards used in other overseas jurisdictions.

Proposed refinements

Given the technical challenges previously encountered in the drafting process and to support effective enforcement, the Consultation Paper proposes further refinements to the previous proposed legislative amendments to the SFO discussed in the 2010 and 2012 consultation papers. The amendments will ensure that the provisions operate appropriately in the context of listed CISs. The SFC is proposing to fine-tune its proposals based on the 2024 consultation:

1. *Limiting the scope of the extension to Hong Kong listed CISs only*

Currently, the only type of non-corporate entities listed on the Hong Kong Stock Exchange are listed CIS, including REITS. Hence the legislative amendments will specifically target listed CISs and their management companies. The amendments will not apply to all forms of non-corporate entities. If any new form of non-corporate listed entity appears in the market, the consultation paper provides that the SFC will consider then whether the market conduct regimes would be applicable to those entities.

2. *Streamlining the proposed legislative amendments*

The legislative amendments will impose relevant obligations under the market conduct regime on the management company of a listed CIS and the CIS directors in the case of a corporate CIS. Trustees and custodians are responsible for overseeing the operations of listed CISs. However, management companies and CIS directors carry out the executive and managerial functions of a listed CIS. Their functions are comparable to that of directors of listed companies. Consequentially, trustees and custodians will not be referred to in some definitions such as "associate", "controller", "persons connected with a corporation", "inside information", "subsidiary" and "related corporation" under Parts XIII to XV of the SFO. However, the trustee or custodian of a listed CIS will be retained under Parts VIII and X of the SFO. Parts VIII and X of the SFO relate to the SFC's supervisory and investigative powers over trustees or custodians of a listed CIS since they can act on behalf of the CIS. For instance, trustees and custodians will be required to provide all information relevant to an investigation under section 179 of the SFO. The court can also order trustees and custodians to bring proceedings in the name of the listed CIS against such persons as the court may see fit under section 214 of the SFO.

Additionally, as the duty to provide information pursuant to the listed CIS's constitutive documents, the duty to keep a register of unitholders and other investigative powers have already been provided for under existing similar regulations, the consultation proposal will not extend to listed CIS the equivalent provisions under Divisions 5, 6, 10, 11 and 12 of Part XV of the SFO.

Other consequential amendments include clarifications as to the scope of application of the market conduct regimes to listed CISs. All listed CISs, including those structured in corporate form, open-ended fund companies or other corporate funds established overseas, will be subject to the market conduct regime. This however excludes overlapping provisions applicable to listed corporations. Further, various definitions will be added to Part 1 of Schedule 1 of the SFO including:

- the definition of "officer" will be expanded to include the management company of a CIS and its manager, director or secretary; and
- definitions for "fund subsidiary", "fund-holding entity" and "fund-related entity" will be included. They will bear similar meanings to "subsidiary", "holding company" and "related corporation". However, modifications to these definitions will be made as a holding entity and subsidiary of a listed CIS may or may not be a listed CIS, and voting rights of a listed CIS may be exercised by its trustee or management company (or its directors) on behalf of a listed CIS.

Subject to the legislative process, consequential amendments may be made to existing subsidiary legislation under the SFO. An enabling power will be included in the proposed legislation to enable amendments to be made correspondingly. The amendments will also include changes to the provisions on insider dealing as set out in the [consultation conclusions on proposed amendments to enforcement related provisions of the SFO published in August 2023](#).

The proposals regarding listed CISs aims to apply aspects of the SFO's market conduct regime to listed CIS.

Implementation Timeline

The proposal is subject to a two-month public consultation which will end on 27 May 2024. The SFC aims to complete the legislative process before December 2025. The SFC does not consider a transition period to be necessary.

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