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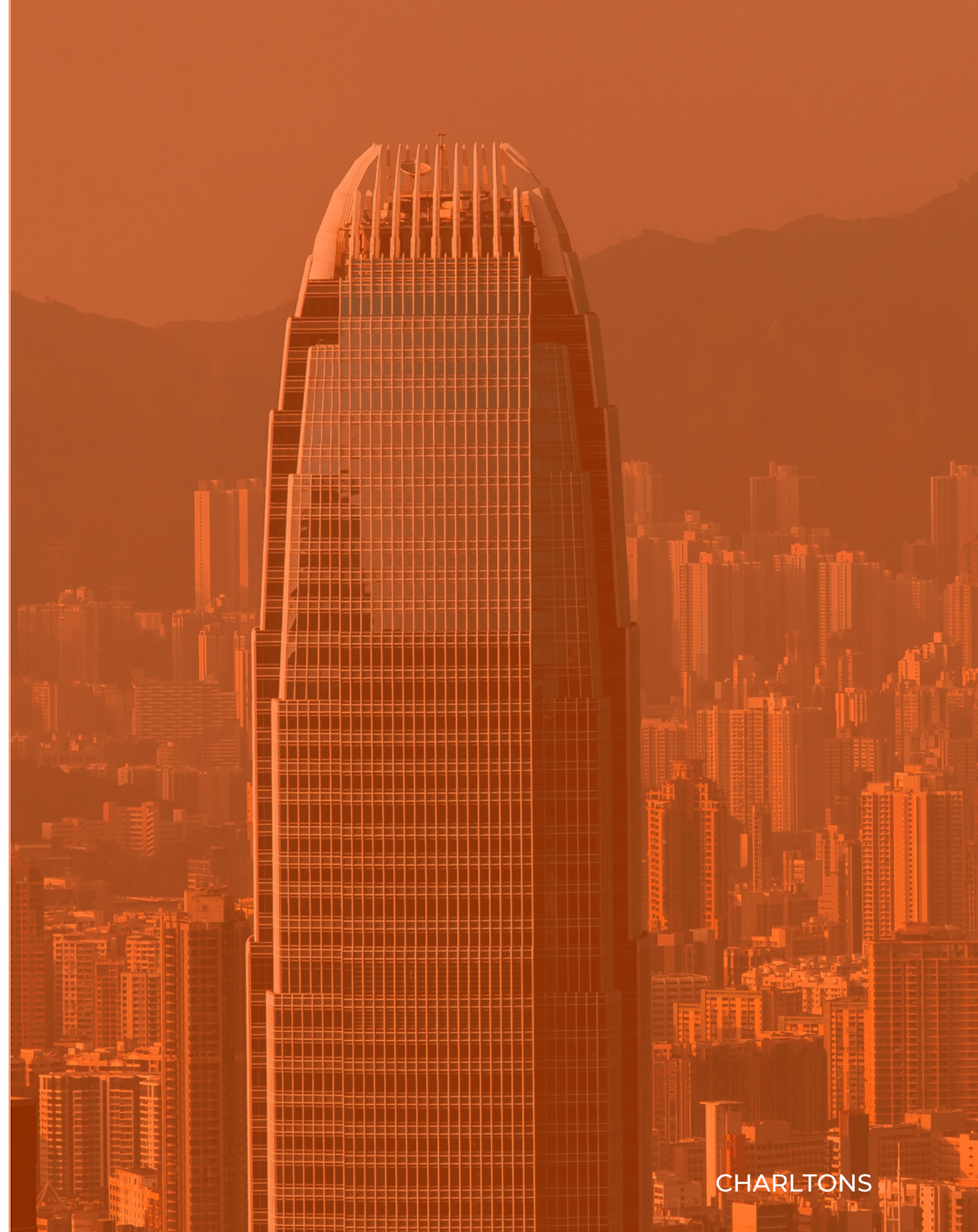
Disclosure of Interests
Webinar



Overview of Hong Kong's Disclosure of Interests Regime

Introduction

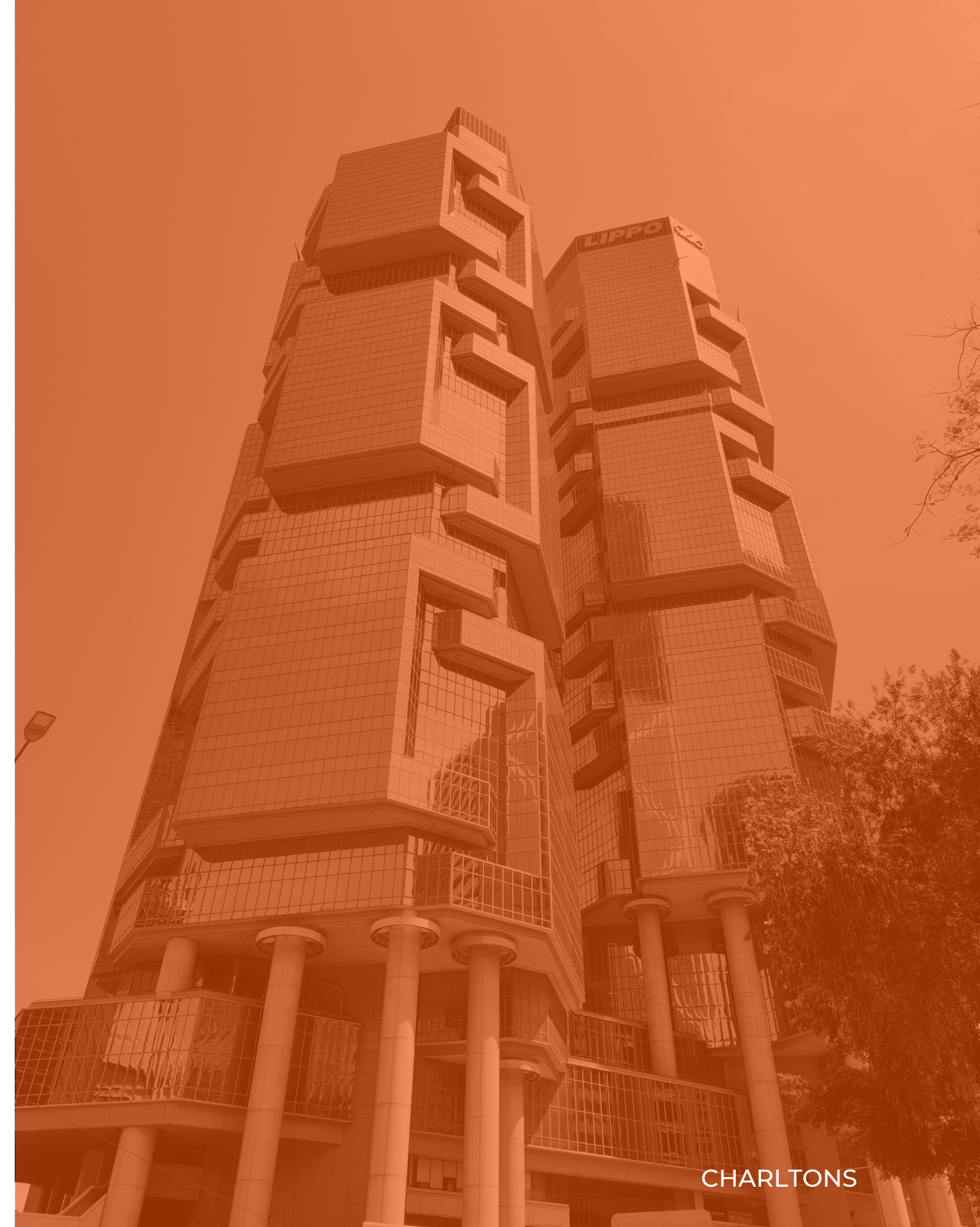
- Part XV of the Securities and Futures Ordinance (“SFO”): disclosure of interests (“DI”) regime
- Securities and Futures Commission (“SFC”) has published an “Outline of Part XV”



Overview of Hong Kong's Disclosure of Interests Regime (cont.)

Application of the DI regime

- Applies to corporations with securities listed on the HKEx
 - Have received unconditional approval to list securities



Overview of Hong Kong's Disclosure of Interests Regime (cont.)

Objective of the DI regime

- Regulators: monitor compliance with laws and regulations relating to the conduct of owners of, and those interested in, listed corporations
- Investors: informed investment decisions

Overview of Hong Kong's Disclosure of Interests Regime (cont.)

Criminal penalties

- Criminal offences:
 - Failure to make a Part XV disclosure
 - Knowingly or recklessly make a false or misleading statement when making a disclosure
- Maximum penalty for an offence: HK\$100,000 fine and two years' imprisonment
- Members and officers can be personally liable for the offences of a corporation
- Other routes of action for failure to comply with Part XV, e.g. the SFC's power to take disciplinary action against a regulated person which is guilty of misconduct or is not fit and proper to remain regulated

Concepts Underlying the Disclosure of Interests Regime

Two regimes in Part XV

- Substantial shareholders' regime
- Directors' and chief executives' regime

Concepts Underlying the Disclosure of Interests Regime (cont.)

Equity derivatives

- Holder/writer/issuer of “equity derivatives” has an “interest” in the “underlying shares” of the equity derivatives
- “Equity derivatives”:
 - (a) rights, options or interests in or in respect of “underlying shares” (or rights, options or interests in or in respect of any such rights, options or interests);
 - (b) any contract whose settlement amount is calculated wholly or partly by reference to the price or value, or a change in the price or value, of the underlying shares or rights, options or interests in the underlying shares; or
 - (c) financial instruments or other documents creating, acknowledging or evidencing any rights, options or interests or any contracts referred to in (a) or (b)
- E.g. options, warrants, convertible bonds and other equity linked instruments, depositary receipts or stock futures

Concepts Underlying the Disclosure of Interests Regime (cont.)

Underlying shares

- “Underlying shares” of an equity derivative are the shares that:
 - (a) may be required to be delivered to the holder/writer/issuer of the equity derivative;
 - (b) the holder/writer/issuer of the equity derivative may be required to deliver; or
 - (c) will be used to determine the price or value of the equity derivative
- Issued shares or unissued shares
- Interests in the underlying shares of equity derivatives must be aggregated with the person’s other interests
- The disclosure of interests under equity derivatives must be made in relation to the underlying shares (not the equity derivatives)

Concepts Underlying the Disclosure of Interests Regime (cont.)

Physically settled vs. cash settled

- Equity derivatives: “physically settled” or “cash settled”
- Physically settled contracts: require the delivery of the actual shares at the time of exercise
 - Purchase a physically settled call option over shares: receive the actual shares when the option is exercised
- Cash settled contracts: require that the holder pay, or entitle the holder to receive, an amount of money calculated by reference to the price/value of the shares at the time of exercise
 - Purchase a cash settled call option: receive an amount of cash which is the difference between the exercise price and the price of the shares at the time the option is exercised

Concepts Underlying the Disclosure of Interests Regime (cont.)

Long and short positions

- A person has a “long_position” if:
 - (a) is the registered owner of the shares;
 - (b) has agreed to purchase the shares; or
 - (c) is entitled to exercise any right conferred by the holding of the shares or controls the exercise of any such right



Concepts Underlying the Disclosure of Interests Regime (cont.)

Long and short positions (cont.)

A person also has a “long position” if:

A person has a “short position” if:

he/she has interests in underlying shares through equity derivatives under which the person:

- has a right to require another person to deliver the shares to it;
- is under an obligation to take delivery of the shares;
- has a right to receive money from another person if the price of the shares is above a certain level; or
- is under an obligation to pay money to another person if the price of the shares is below a certain level

- has a right to require another person to take delivery of the shares;
- is under an obligation to deliver the shares to another person;
- has a right to receive money from another person if the price of the shares is below a certain level; or
- is under an obligation to pay money to another person if the price of the shares is above a certain level

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

Concepts Underlying the Disclosure of Interests Regime (cont.)

Securities borrowing and lending (“SBL”) transactions

- Shares are transferred from the lender to the borrower (transfer of legal title). The borrower is under a contractual obligation to return the shares (or the same number of shares in the same company) to the lender on or before a certain date
- Borrower: both long and short positions
 - Long position: when borrow shares, actually own them
 - Short position: contractual obligation to return the shares
- SBL transactions to “short” shares – prohibition on “naked shorts” in Hong Kong

Introduction

- “Substantial shareholders”: individuals and corporations who are “interested” in 5% or more of any class of voting shares in a listed company
 - The term “substantial shareholder” is widely used when discussing the DI regime – but not used in Part XV of the SFO
 - Different to “substantial shareholder” in the Listing Rules or in schedule 1 to the SFO
- Must disclose “interests” and “short positions” in the “voting shares” of a listed company above certain thresholds

Substantial Shareholders' Regime

Substantial Shareholders' Regime (cont.)

Voting shares

- “Voting shares”: the listed company’s shares of a class which carry rights to vote in all circumstances at general meetings of the company
- Both issued shares and unissued shares
- Voting shares may be unidentifiable

Substantial Shareholders' Regime (cont.)

Interest

- “Interest”: any kind of interest in the voting shares
 - All beneficial, security and other interests recognised by law
- E.g. registered owner of shares; deemed interests; holding shares through a stockbroker/custodian/trustee/nominee; having a long position in equity derivatives; entering into a contract to acquire shares; or holding shares as security
- May have an “interest” even if the right in the shares is conditional or is subject to any restraint/restriction
- Short positions do not count as “interests”

Substantial Shareholders' Regime (cont.)

Deemed interests

- Disclosure is made in relation to shares in which a person is: (a) directly interested; and (b) “deemed” to be interested

Deemed interests include interests of/under:

- The person's spouse and children under the age of 18
- Corporations which the person controls (“controlled corporations”):
 - (i) a corporation in which the person controls, directly or indirectly, at least 1/3 of the voting power at general meetings; or
 - (ii) where the corporation or its directors are accustomed to act in accordance with the directions or instructions of that person
 - Limited liability partnership is a corporation for the purposes of the Part XV regime
- Discretionary trust of which the person is the “founder”
- Trust of which the person is a beneficiary (unless a discretionary beneficiary)
- Trust of which the person is a trustee (unless a bare trustee)
- Each other party to a “section 317 agreement”
- Substantial shareholders include “short positions” of the above as their own short positions

Substantial Shareholders' Regime (cont.)

Percentage levels and percentage figures

- “Notifiable interest”: the aggregate number of voting shares in which a person is (directly and deemed) interested, as a % of the number of issued voting shares of the company \geq the “notifiable percentage level”
- “Notifiable percentage level”: 5% of the issued voting shares of the company
- “Percentage level” of a person’s interest:

$$\frac{\text{Total number of shares (both issued and unissued) in which the person is interested}}{\text{Number of issued shares of the company of the same class}} \times 100$$

Percentage levels and percentage figures (cont.)

- Percentage level of A's interest:

$$\frac{100,000 + 250,000}{6,800,000} \times 100 = 5.15\% - 5\%$$

- Percentage level: percentages rounded down to the next whole number
- “Percentage figure” in the forms: rounded to two decimal places
- The number of voting shares in which a holder/writer/ issuer of equity derivatives is taken to be interested in, or have a short position in, is:
 - the number of the underlying shares to be delivered;
 - the number of the underlying shares by reference to which the amount payable under the derivatives is determined; or
 - in the case of a stock futures contract, the contract multiplier

Substantial Shareholders' Regime (cont.)

Substantial Shareholders' Regime (cont.)

Disclosure of short positions

- Disclosure of short positions of 1% or more in the voting shares in the listed company

- “Percentage level” of a person’s short position:

Total number of shares (both issued and unissued)
in which the person has a short position

$$\frac{\text{Total number of shares (both issued and unissued) in which the person has a short position}}{\text{Number of issued shares of the company of the same class}} \times 100$$

- “Specified percentage level”: 1% of the issued voting shares of the company
- Only disclose short positions if have a notifiable interest
- Cannot “net off” a short position against long positions

Substantial Shareholders' Regime (cont.)

Relevant events

- Requirement to file a disclosure notice when come under a “duty of disclosure”, which arises on the occurrence of a “relevant event”
- Percentage level is calculated at the time that the relevant event takes place

Relevant events include:

- | | |
|---|--|
| <ul style="list-style-type: none">● first acquiring a notifiable interest;● ceasing to have a notifiable interest;● while having a notifiable interest and a short position, there is a change in the percentage level of the short position; or● when the shares of a corporation in which a person has an interest of 5% or more become listed | <ul style="list-style-type: none">● while having a notifiable interest,<ul style="list-style-type: none">● there is a change in nature of the interest;● there is a change in the percentage level of the interest; or● first having or ceasing to have a short position of 1% or more |
|---|--|

Substantial Shareholders' Regime (cont.)

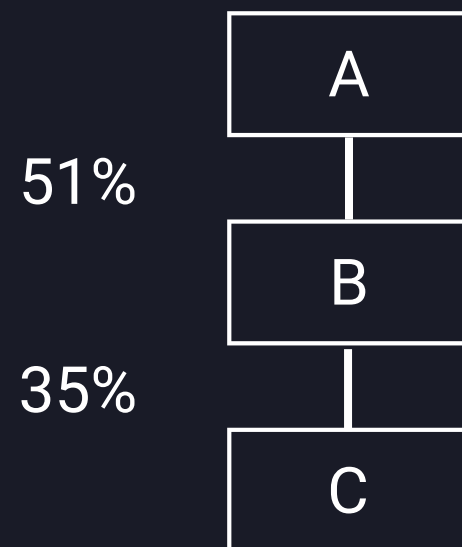
Change in the nature of interest

- Obligation to disclose a change in the nature of an interest (while having a continuing notifiable interest) will arise if there is any change in the nature of:
 - (i) the person's title to the shares;
 - (ii) any of the person's interest (legal or equitable) in the shares; or
 - (iii) any of the person's interest in the underlying shares of equity derivatives on the exercise (by or against the person) of rights under the derivatives
- E.g. exercising an option; lending shares under an SBL agreement; entering into a contract for sale of shares; or providing an interest in shares as security

Controlled corporations

- Substantial shareholders must disclose interests and short positions held by corporations “controlled” by them
- Test of control is applied at each point in the chain of companies
- Each member in the chain must disclose their own interests and the interests of its controlled corporations
- The interest is not increased because of the ownership chain

Example



Substantial Shareholders' Regime (cont.)

Exemptions

Change in the nature of interest

No disclosure obligation although there is a change in the nature of an interest:

- Exemption: percentage level of the interest that has not changed in nature immediately after the relevant event = percentage level of the interest at the last notification
- Exemption: (i) percentage level of the interest that has not changed in nature immediately after the relevant event \leq percentage level at the last notification; and (ii) difference between percentage figure of the interest disclosed in the last notification and percentage figure of the interest that has not changed in nature at all times since the last notification $< 0.5\%$
- “Last notification”: a notice given of a change in the percentage level of a person’s interest $> 5\%$ (excludes a notice given on first crossing the 5% threshold or notice of a change in the nature of an interest)

Exemptions (cont.)

Change in the nature of interest (cont.)

Exemption for sellers and purchasers of shares:

- Purchaser: if filing is made at the time the contract is entered into, does not need to file again when the contract is completed and becomes the legal owner of the shares
- Seller:
 - If the sale is required to be completed within four trading days: no requirement to file on entering into the contract of sale, but requirement to file on completion of the sale
 - If the sale is not required to be completed within four trading days: requirement to file both on entering into the contract of sale and on completion of the sale

Exemptions (cont.)

Generally applicable exemptions

- Derivatives that derive their value from a basket of listed corporations' shares
- Issuers of structured products
- Rights received and taken up under a rights issue (disclosure required if do not take up rights)
- Bare trustees, beneficiaries of discretionary trusts, and corporate custodians
- Authorised CIS, pension and provident fund schemes, and qualified overseas schemes
- Shares held by qualified lenders by way of security
- SBL transactions where shares are lent through lending agents approved by the SFC
- Interests of "Type 1" intermediaries acquired for a maximum of three business days
- Interests of "Type 1" or "Type 2" intermediaries arising under exchange traded stock futures contracts or stock options contracts

Exemptions (cont.)

Generally applicable exemptions (cont.)

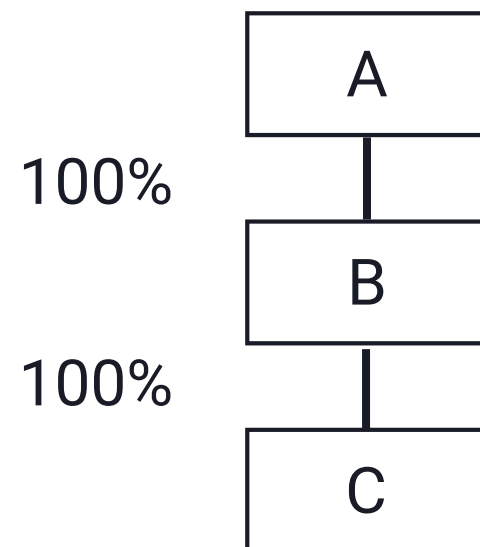
- A dual listed issuer may apply to the SFC for exemption (for itself and on behalf of others in respect of the issuer)
- De minimis exemption: (i) percentage level of the interest or short position immediately after the relevant event \leq percentage level at the last notification; and (ii) difference between percentage figure of the interest or short position disclosed in the last notification and percentage figure at all times since the last notification $< 0.5\%$

Exemptions (cont.)

“Wholly owned group” exemption

- No disclosure obligation on wholly owned subsidiaries in certain circumstances if the holding company has complied with its duty of disclosure
 - Does not apply where the duty arises in respect of an interest in the company at the time of listing
- Where a corporation ceases to be a wholly owned subsidiary, the corporation is taken to have acquired the interest
- Exemption only applies between corporations

Example



Introduction

- Directors include shadow directors and any person occupying the position of director by whatever name called

- Chief executive: a person engaged by a corporation who, alone or together with other person(s), is responsible under the immediate authority of the board for the conduct of the corporation's business

Directors' and Chief Executives' Regime

Directors' and Chief Executives' Regime (cont.)

Differences from substantial shareholders' regime – directors and CEs must disclose:

- *Any* interest and *any* short position in their listed company
 - No thresholds for long or short positions
 - Disclosure of short positions even if no notifiable long position
 - Disclosure applies to *any* shares
- *All* changes in interests and short positions in their listed company
 - No disclosure threshold based on changes in percentage level

Directors' and Chief Executives' Regime (cont.)

Differences from substantial shareholders' regime – directors and CEs must disclose (cont.):

- Interests and short positions in the shares of any “associated corporation” of the listed company
 - “Associated corporations” of a listed company: its holding company; its subsidiaries; subsidiaries of its holding company; or a corporation in which it has an interest of more than 20% of the issued shares of a class of its share capital
 - “Subsidiary” and “holding company” are defined by reference to a control test (i.e. control of the board's composition, control of over half of the voting power at general meetings, or holding over half of the issued share capital)

Differences from substantial shareholders' regime – directors and CEs must disclose (cont.):

- Interests in any debentures of the listed company and debentures of any of its associated corporations
- “Debenture” includes debenture stocks, bonds and other debt securities of a corporation, whether constituting a charge on the assets of the corporation or not

Directors' and Chief Executives' Regime (cont.)

Directors' and Chief Executives' Regime (cont.)

Differences from substantial shareholders' regime – modification of deemed interests:

- Exclusion of the interests of spouse and children under 18 where the spouse/child is a director or chief executive of the listed corporation
- Inclusion of the interests of a beneficiary of a discretionary trust

Differences from substantial shareholders' regime – available exemptions:

- Derivatives that derive their value from a basket of listed corporations' shares
- The interests of bare trustees
- The interests of holders of units or shares in authorised CIS, pension and provident fund schemes, and qualified overseas schemes

Directors' and Chief Executives' Regime (cont.)

Directors' and Chief Executives' Regime (cont.)

Relevant events

A duty of disclosure arises:

- on becoming or ceasing to be interested in the shares/debentures of the listed/associated corporation (whether or not having or retaining an interest in other shares/debentures of that corporation);
- on coming to have or ceasing to have a short position in the shares of the listed/associated corporation (whether or not having or retaining a short position in other shares of that corporation);
- while having an interest in the shares/debentures of the listed/associated corporation, on the occurrence a change in the nature of the interest;
- on entering into a contract to sell shares/debentures of the listed/associated corporation;
- on assigning any right granted by the listed corporation to subscribe for shares/debentures of the listed corporation;
- on the associated corporation granting a right to subscribe for shares/debentures of the associated corporation, or the exercise or assignment of that right; or
- while having an interest or short position in the shares or an interest in the debentures of the listed/associated corporation, on the occurrence of:
 - the listed corporation first becoming listed;
 - the person first becoming a director or chief executive of the listed corporation; or
 - the associated corporation first becoming an associated corporation of the listed corporation

Practicalities

Forms

- SFO: disclosure filings must be made to both the listed company and HKEx
 - But, HKEx provides forms to the listed company
- Electronic filings to HKEx through the Disclosure of Interests System (“DION System”) on HKEx website
- Representative may complete forms, but the filer is responsible for ensuring timely disclosure and the accuracy of information
- Disclosures are publicly available on HKEx website

Practicalities (cont.)

Filing

- Filings must generally be made within 3 business days after the day on which the relevant event occurs (or on which the filer becomes aware of the relevant event occurring)
 - “Initial” disclosures must generally be made within 10 business (e.g. when company is first listed or becomes an associated company, or a person becomes a director or chief executive)
- Not business days: Saturdays, public holidays (including Sundays) and days on which a gale or black rainstorm warning is in force
- The day on which the relevant event occurs is excluded in the calculation

Registers

- Requirement on listed companies to keep:
 - A register of interests and short positions of substantial shareholders
 - A register of interests and short positions of directors and chief executives

Practicalities (cont.)

Practicalities (cont.)

Power of listed company to investigate ownership (section 329 of the SFO)

- A listed company may conduct an investigation to confirm the identity of persons (i.e. not limited to substantial shareholders) who currently or in the past three years:
 - Interested in its voting shares (or equity derivatives where the underlying shares of the derivatives are its voting shares); or
 - Have a short position in its voting shares
- May require confirmation of the particulars of their interests or short positions
- Shareholders $\geq 10\%$ of voting shares may require a listed company to conduct an investigation
- Notification to HKEx and SFC (and in the case of AIs, HKMA) of any information received

Practicalities (cont.)

Relationship with the Takeovers Code

- Rule 22 of the Takeovers Code: parties to an offer and their respective “associates” must disclose dealings in “relevant securities” of the offeree company conducted for themselves or on behalf of discretionary clients during an offer period
- “Associate” under the Takeovers Code includes any person who owns or controls 5% or more of any class of relevant securities

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MCQs

Question 1

Which of the following are NOT deemed interests under the substantial shareholders' regime?

- (A) Interests of the person's spouse
- ✓ (B) Interests of all of the person's children
- (C) Interests under a trust where the person is a trustee of the trust (except where the person is a bare trustee)
- (D) Interests of the person's controlled corporations

Question 2

Which of the following is correct?

- (A) All persons must disclose short positions of 5% or more
- (B) All shareholders of a listed corporation must disclose short positions of 1% or more
- ✓ (C) Persons interested in 5% or more of any class of voting shares in a listed corporation must disclose short positions of 1% or more
- (D) Persons interested in 5% or more of any class of voting shares in a listed corporation must disclose all short positions

Question 3

Which of the following is the most correct?

- (A) Directors and chief executives of a listed corporation must disclose interests of 5% or more and short positions of 1% or more in any shares in the listed corporation
- (B) Directors and chief executives of a listed corporation must disclose all interests and short positions in the voting shares in the listed corporation
- (C) Directors and chief executives of a listed corporation must disclose all interests and short positions in the voting shares of any associated corporation of the listed corporation
- ✓ (D) Directors and chief executives of a listed corporation must disclose all interests in any debentures of the listed corporation and interests in any debentures of any of its associated corporations

Question 4

Under the substantial shareholders' regime, there are NO exemptions available in respect of which of the following?

- ✓ (A) On entering into a contract to sell shares if the sale is required to be completed within ten business days
- (B) Securities borrowing and lending transactions where the shares are lent through SFC lending agents
- (C) Rights received and taken up under a rights issue
- (D) Wholly owned subsidiaries where the holding company has complied with its duty of disclosure

Question 5

If a relevant event occurs on Tuesday and the person becomes aware of the relevant on the same day, when must filing generally be made by (assuming it is not an initial disclosure)?

- (A) Thursday of the same week
- ✓ (B) Friday of the same week
- (C) Tuesday of the following week
- (D) Tuesday a fortnight later

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Q&A

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