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[online version](http://www.charltonslaw.com/sfc-publishes-consultation-conclusions-on-amendments-to-the-disclosure-of-interests-regime/)

# SFC Publishes Consultation Conclusions On Amendments To The Disclosure Of Interests Regime

## Introduction

The Securities and Futures Commission (the **SFC**) has published the Consultation Conclusions on its proposed amendments to the disclosure of interests regime published in its January consultation paper. The Consultation Conclusions on the Review of the Disclosure of Interests Regime under Part XV of the Securities and Futures Ordinance (the **Consultation Conclusions**) is available on the [SFC website](http://www.sfc.hk).

The SFC proposes to make the necessary amendments to the Securities and Futures Ordinance (the **SFO**) within the 2004-2005 legislative session. It will also revise its Outline of Part XV of the Securities and Futures Ordinance (the **Outline**) which is available on the SFC website to clarify a number of matters of interpretation. The Consultation Conclusions also include a note outlining the SFC's policy regarding investigation of suspected breaches.

The purpose of this note is to highlight the Consultation Conclusions' final proposals. The text in blue can be clicked through to view further information on a selected subject.

## 1. Forms And Codes

More codes will be added to identify the events giving rise to the disclosure and the capacity in which interests and short positions are held. These will include codes for pledges and charges of shares, the spouse of a substantial shareholder or director becoming or ceasing to be a director, lending or recalling shares under a securities and borrowing lending agreement and a code for correcting erroneous notifications.

An optional narrative box will also be added.

The original proposal to use the letter "D" in front of standard codes to denote transactions involving derivatives will not be adopted. Instead, it is proposed that the letter "C" should denote complex transactions. The narrative box can be used to explain the complex transaction in question. Dialogue will be continued with market participants to find-tune this proposal.

In response to specific queries raised:

1. the Consultation Conclusions clarify that a notice filed to correct an error should include information required so as to provide an accurate and complete representation of the position at the time of the previous notice;
2. in relation to Table 2 (capacity in Forms 1, 2, 3A and 3B), respondents suggested that this code should state whether an underwriter's interest in a listed corporation is held directly or indirectly (eg. through subsidiaries). The SFC will consider the suggestion further but notes that such a requirement would have to apply to all interests and not only those of underwriters; and
3. in Table 2 (Forms 3C and 3D), the words "deriving from the debentures" will be added after the words "including derivatives".

## 2. Security Interests Given By Substantial Shareholders

The Consultation Paper sought views on:

1. whether the existing exemption for security interests should be removed or narrowed; and
2. a proposal to accelerate the time frame for disclosures once steps are taken to enforce security interests. This would mean that the market would be informed of impending forced sales immediately, instead of 3 business days later as is currently the case.

In view of the lack of consensus on resolving this issue and the time frame for amending the SFO, the SFC will set up a working group with market participants, investors and the lending industry to further consider the proposals.

The SFC's summary of the pros and cons of 4 possible ways of resolving this issue is attached at Annex A.

## 3. De Minimis Exception

The de minimis exemption will be simplified in accordance with the Consultation Paper's Alternative 1 by:

1. removing the need to keep track of preceding interests; and
2. removing the prohibition on an increase of the last notified percentage figure qualifying for a de minimis exception.

Accordingly, where an interest changes across a percentage level, the substantial shareholder would simply compare the percentage figure with the last notified percentage figure to see whether it is within 0.5% to determine whether the exception applies.

### De Minimis Exception and Last Notification

The SFO will be amended so that notifications made on acquiring an interest of 5% or more (ie. initial notifications) and notifications of a change in nature of an interest will also qualify as a "last notification" for the purposes of claiming the de minimis exception. Currently, only notifications made on a change in the percentage level of a person's interest qualify as "last notifications".

Similar amendments are proposed for a change in nature of an interest and change in short positions.

## 4. Aggregation Exemption

The "aggregation exemption" (Section 316(5) SFO) removes the obligation on a holding company to aggregate the interests of controlled companies who are investment managers. For the exemption to apply, the investment management company must act independently "without any reference to" any other entity within the group. The exemption is available only to "qualified investment managers" (ie. intermediaries licensed or registered under the SFO for regulated activity type 9 or overseas corporations regulated in a recognised jurisdiction with equivalent regulation eg. the UK or Australia).

### Communication among Investment Managers

The SFO will be amended so that where investment managers communicate with each other in relation to investment strategy (which currently acts as a bar to the exemption being claimed):

1. the investment managers' interests should be aggregated and disclosed at the relevant thresholds, but need not be aggregated with the interests of the holding company; and
2. the holding company will continue to be responsible for reporting the aggregated interests of the qualified investment managers (separately from its own interests and other interests attributed to it).

### Disaggregation of Interests within a Single Company

The aggregation exemption currently applies only where the controlled corporation is a single legal entity carrying on investment management business. It is not available where a controlled corporation has several divisions carrying out different business functions including investment management, even where segregation of business functions is strictly enforced. The exemption will be extended to such controlled corporations subject to the condition that the burden would fall on the person claiming the exceptions to prove that:

i.there are adequate internal controls to segregate the investment management business; and

1. the controls have been in fact observed.

## 5. Stock Borrowing And Lending

Approved Lending Agents (**ALA**s) operate within a simplified disclosure regime for stock borrowing and lending. Lending to affiliates from the lending pool is however prohibited by the conditions of approval of an ALA. In addition, shares that an ALA lends on behalf of its affiliates and the ALA's own shares cannot be treated as "qualified shares" for the purpose of the ALA exemption.

The SFO will be amended to allow the following:

1. lending shares in which an affiliate is interested via the lending pool operated by an ALA within the same group;
2. lending shares from the lending pool of an ALA within the same group to an affiliate; and
3. lending shares in which an ALA is interested via the lending pool.

If any exemptions are to apply, it will be necessary to ensure that the businesses are carried out at arms length and between independent business units and the ALA Guidelines will need to prohibit the affiliate or holding company from controlling the flow of the stock borrowing and lending. In addition the wholly-owned group exemption will not apply and borrowings from ALAs and changes in the lending pool will be discloseable.

## 6. Credit Derivatives

The SFO will be amended to exempt from disclosure credit derivatives with convertible or exchangeable bonds as the reference security. This will be subject to the condition that that the value of the credit derivative is determined by reference to the creditworthiness in relation to the issuer of the reference security without any regard to the equity conversion or exchange value of the reference security.

## 7. Index-Linked Equity Instruments

There will be an increase in the percentage limitation in respect of each stock as a percentage of the value of the entire basket of Hang Seng Index stocks, so that equity derivatives linked to the Hang Seng Index will be able to claim the exemption from disclosure for equity derivatives deriving their value from a basket of shares in at least 5 listed companies where (currently) no one share accounts for over 30% of the value of the entire basket. As HSBC represents more than 30% in value of the Hang Seng Index, the exemption is not currently available to equity derivatives linked to the Hang Seng Index.

## 8. Changes In Nature Of Interests

The SFO will be amended to define exhaustively when there is a "change in the nature" of a person's interest in shares.

The situations will be as follows:

1. When a person exercises rights under an agreement including equity derivatives;
2. When a person has rights under an agreement including equity derivatives exercised against him;
3. Where a person exercises rights under equity derivatives to require another person to take delivery of shares;
4. Where rights under equity derivatives are exercised against a person to require him to deliver shares to another person;
5. In relation to stock borrowing and lending, when a lender delivers shares to a borrower and when a lender receives the shares back;
6. When a person enters into an agreement for the sale of shares that he holds;
7. When a person takes delivery of shares from another person; and
8. Where a person takes an interest in the shares as security;
9. Where steps are taken against a person to enforce a security interest;
10. Where steps are taken by a person to enforce his security interest in the shares;
11. Any other situations prescribed by rules under the SFO.

In relation to attributed interests, it will be clarified that the specified changes are disclosable by the person holding the interest directly, as well as by the other persons to whom that interest is attributable.

In relation to item (vi) above, the Consultation Conclusions clarify that the entry into an agreement for the sale of shares will not give rise to a discloseable short position unless the agreement is an equity derivative.

## 9. Reference Dates For Filing Notices Of Sales And Purchases To Be Synchronised

Currently, the reference date for reporting a purchase of an interest is the date on which the contract is entered into (ie. the trade date). The reference date for reporting a sale of an interest, however, is the date of delivery of the interest (ie. the settlement date).

The SFO will be amended so that if shares are required by the contract to be delivered within 4 trading days:

1. the seller will not be required to notify a change in nature of the interest that takes place at the time of entry into the agreement to sell the shares; and
2. the seller will be required instead to disclose the cessation (or reduction) of his interest within 3 days of the date of entering into the contract (rather than within 3 days of the date of delivery as currently).

Accordingly both purchaser and seller will make a notification by reference to the date of entering into the contract, provided that delivery takes place within the following 4 trading days. If it does not, the vendor will be required within 3 days of the 4th trading day to file the following additional notifications:

1. a notification of an "acquisition" of the interest (if he has previously reported a reduction of his interest); and
2. a notification of a change in nature of that interest where he remains under an obligation to deliver the interest (since this was not previously reported). There will be a code in the form for a "change in nature following a fail".

The Consultation Conclusions further confirm that disclosures may be made on the basis of the end-of-the day position. The Outline will be revised to clarify that the position at the day-end can be the net position after offsetting increases and decreases in shareholding within the same day.

Where there are multiple transactions, these should be filed with "C" to denote a "complex transaction" and the optional narrative box can be used to explain the nature of the transaction.

## 10. Filing Of Notices For Options On Grant, Exercise And Completion

The proposal to synchronise the reference dates for buyers and sellers completing a transaction within 4 days (see paragraph 9 above) will be extended to physically settled options. On the exercise of an option, the grantor of the option will only have to disclose the cessation of his interest and short position (or change in percentage level, as the case may be). Provided the interests are delivered within 4 trading days of exercise of the option, he would not need to make any disclosure by reference to events occurring on the settlement date. If delivery does not take place within 4 trading days, the grantor of the option will have to make disclosures similar to those described in paragraph 9 above.

## 11. Notification Periods To Exclude Saturdays

Notifications will be required within a relevant number of "trading days", being days on which the Hong Kong Stock Exchange is open for business, rather than "business days". "Trading days" will exclude Saturdays.

## 12. Exempt Custodian Interest

The exempt custodian interest (Section 323(3) SFO) is currently available only if the custodian has no authority to exercise discretion in dealing in the shares or in exercising rights attaching to the shares held in custody.

The SFO will be amended so that the exemption will still be available:

1. where the custodian has a right to resort to the property to satisfy any outstanding charge or lien or for the payment of any duty, tax, cost or other outgoings;
2. where a customer fails to give instructions in respect of its interest and the custodian is under an obligation to exercise any rights or powers it holds on behalf of its customer in respect of the interests to protect the customer's investments or to collect the client's entitlements on its behalf; and
3. where the custodian has discretion only over a small number of shares which are impossible to allocate to customers, the existence of the newly issued shares (eg. on the issue of a scrip dividend) will not affect the exemption in respect of the original holding.

## 13. Exempt Security Interest

Currently, "qualified lenders" (ie. authorised institutions and licensed brokers) need not disclose an "exempt security interest", being an interest held "by way of security **only** for the purposes of a transaction entered into in the ordinary course of business" of the qualified lender (emphasis added). It is proposed to amend the definition to remove the word "only" to make clear that the exemption is available in the following situations:

1. where a broker re-pledges collateral pledged to secure margin facilities to another financial institution. Currently there is an argument that the exemption would no longer be available since the broker would not be holding the interests "by way of security **only**";
2. where securities are pooled and transferred into the name of a mortgagee bank or its nominee or held in electronic form in the clearing system in the name of HKSCC Nominee Ltd.; and
3. where collateral is taken by way of "absolute" transfers of title.

### Security Agents

The exempt security interest exemption will be extended to security agents holding securities as collateral for a syndicated loan where (i) all members in the syndicate are qualified lenders and (ii) the security agent is regulated in a recognized jurisdiction. The definition of "security agent" will include a corporation whose business includes holding securities in safekeeping for qualified lenders.

However, a corporation will not be regarded as a security agent for particular interests in shares that it holds for a qualified lender if it has authority:

1. to exercise discretion in dealing in the interests; or
2. to exercise rights attached to the interests,

except where such authority is limited to:

1. taking, maintaining or releasing the security over the interest in shares;
2. collecting dividends payable, taking up rights or other entitlements in respect of the interests in shares or preserving the value of the security in the interests of the qualified lenders; or
3. dealing in the interests in shares, or exercising rights attaching to the interests in circumstances where there has been an event of default by the person providing the interest as collateral.

It is proposed that the security agent must be (i) an authorized financial institution or (ii) a corporation authorized under the law of any place outside Hong Kong recognized for the purposes of sections 313(13), 317(6), 317(7) or 341(5) by the SFC to carry on business as a bank, and holding security for a syndicated loan as agent on behalf of participants in the syndicated loan.

## 14. Wholly Owned Group Exemption

The wholly-owned group exemption (Section 313(10) SFO) which exempts a wholly-owned subsidiary from disclosing its interest in a listed corporation if its holding company discloses such interest does not apply on the initial listing of a company in which the subsidiary holds an interest. The SFO will be amended so that a wholly-owned subsidiary will not need to disclose its interest on the initial listing of a corporation, provided that the interest is disclosed by its holding company.

## 15. Short Positions Held In Same Capacity As Interests Disregarded

The SFO will be amended so that short positions will be disregarded if held in the same capacity as interests in shares that are disregarded under Section 323 SFO, notwithstanding that there are other notifiable interests held in a different capacity.

## 16. Concert Party Provisions And Underwriting Agreements For Equity Derivatives

The existing exclusion from the concert party provisions for agreements to underwrite an offer of shares in a company, provided that the purposes of the agreement are confined to the underwriting and matters incidental to it, will be extended to cover underwriting agreements for offers of equity derivatives such as warrants or convertible bonds.

## 17. Director/Substantial Shareholder And Spouse's Interests

A substantial shareholder is taken to be interested in shares held by his/her spouse. A director is also taken to hold his spouse's interests except where the spouse is also a director of the same listed corporation. The question arises whether a substantial shareholder who is also a director must include the spouse's interest if the spouse is also a director.

The SFO will be amended to clarify that provided a director fulfils his/her obligations to make a disclosure, the spouse will not be deemed to hold the interests of that director. Codes will also be added to indicate the event that a spouse becomes a director or ceases to be a director, so that it is clear why a person is reporting a reduction or increase in the total interests held (whether as a substantial shareholder or director).

## 18. Director/Chief Executive Of Listed Associated Companies

Currently, a person is required to disclose shareholdings of listed corporations of which he is a director or chief executive and shareholdings of the associated corporations of the listed corporation. If the associated corporation is also listed and the person is a director or chief executive of that corporation, the converse applies. It is proposed to amend the SFO to remove the need for duplicated disclosures in this situation.

## 19. Matters For Futher Clarification In The Outline

The Consultation Paper also sets a number of matters of interpretation which will be incorporated into the Outline. These include:

### i. Change in Nature of Interest and Equitable Interests

Where the equitable interests of a person are notifiable or have previously been notified, the delivery of the shares is not considered a "change in nature" of an interest. The Outline will clarify that the term "equitable interests" includes interests in unidentified shares, on-market transactions (relating to shares which are fungible within the clearing system) and interests on subscription in unidentified shares.

### ii. Complex and Other Derivatives

The Outline will be revised to clarify that:

1. for market transparency, the intention has always been that secondary derivatives must be disclosed; and
2. the disclosure treatment for complex derivatives should be determined by the underlying commercial reality of the transaction and not does not depend on the documentation used. The intention of paragraph 2.6.3.2 of the Outline is to deal with a structured derivative involving a combination of option positions. For such derivatives, a person can either report the long and short positions by adding individual option positions together or report the effective long and short positions of the structured derivative. Long and short positions cannot be netted off against each other.

Further discussion will also be held with the market and consideration given to providing further guidance on the disclosure of complex derivatives.

### iii. Persons in Accordance with whose Directions a Company Acts

The SFC considers that the description of "persons in accordance with whose directions a company acts" in the Outline and disclosure forms is too wide. The issue is one of fact and dependent on all the circumstances. The Outline will be revised to include indicia that could be taken into account in determining such control.

### iv. Short Positions at IPOs

The Outline will clarify that where a person comes under a duty to disclose any notifiable interests when a corporation is listed, he is also required to include in the form details of any short position he holds.

### v. Liability of Brokers as Agents

With respect to Section 321 SFO, the Outline will clarify that the liability for filing the form lies with the principal and not the agent.

### vi. Private Unit Trusts

The Outline will clarify that, unless specifically exempted, Part XV requires unit holders in a private unit trust to disclose interests in shares held by the trust.

### vii. Debentures

With respect to the description of "debentures" in the Outline, the Outline will clarify that a purposive approach should be adopted in interpreting the Ordinance and that interests in shares under equity derivatives are not required to be disclosed again as "debentures". The Outline will also clarify the position for instruments such as loans and mortgages over property.

### viii. Exclusions Regulation

The Outline will clarify that under the definition of "conditional offer" in the Securities and Futures (Disclosure of Interests-Exclusions) Regulation, the offer cannot also be subject to conditions other than the acceptance conditions.

## 20. Responses To Other Comments

The Consultation Conclusions also set out the SFC's responses to other comments received, which include the following.

### i. Underwriting at Initial Public Offering

Disclosures required at initial public offerings extend to interests and short positions of underwriters. Comments have been received that these requirements on underwriters do not add to market transparency, impact permitted stabilization activities and are overly burdensome.

The SFC will not change the requirement for underwriters to file disclosures. It will however allow an "end-of-day" approach so that positions may be disclosed on a net basis at the end of the day in respect of primary and secondary offerings, top-up placings and block trades. This will be clarified in the Outline.

### ii. Exempt Security Interests

For security interests to be exempted under the exempt security interests provision, the security interest must be taken for the purposes of a "transaction". To address concerns that security interests taken by brokers over clients' accounts to cover the debts that the clients owe from time to time on the accounts cannot benefit from this exemption, the SFC has confirmed that it takes a purposive approach of the law and that the exempt security interest provision will apply in such circumstances.

### iii. Reconciliation of Boxes 17, 18 and 19 of Form 2

The SFC confirms in the Consultation Conclusions that it will allow the use of end-of-day information for filing disclosure forms. It further confirms that the information in Boxes 18 and 19 should reflect the end-of-day positions on the day prior to the relevant event and the day of the relevant event. Firms should then disclose in Box 17 the most significant transaction for the relevant day. It will not be necessary to reconcile boxes 17, 18 and 19. This will be clarified in the Outline.

## 21. The SFC's Note On Policy Regarding Investigation Of Suspected Breaches Of Part XV

The Consultation Conclusions include a note outlining the SFC's policy regarding investigation of suspected breaches in 4 main categories.

An apparent breach of Part XV is dealt with by the SFC's Enforcement Division in one of 3 main ways: no action is taken; a warning letter is issued; or the matter is referred for investigation with a view to prosecution.

### i. Late Disclosures

These are normally dealt with as follows:

1. No action is usually appropriate if the disclosure did not conceal price sensitive information, the time delay is not significant and the aggregated value of the interests involved is less than HK$100,000.
2. Warnings are usually appropriate if the late disclosure did not conceal price sensitive information and:

- the person involved has submitted late returns before but has not been warned; or

- the time delay is not significant and the aggregated value of the interests involved is less than HK$1 million.
3. Referral for investigation with a view to prosecution is usually appropriate if:

- the case only justifies a warning, but a warning has been given on a previous occasion;

- the time delay is significant and the aggregated value of the interests is more than HK$1 million; or

- the late disclosure (whatever the delay in disclosure) concealed materially price sensitive information.

### ii. Failing to Complete the Form in accordance with the Form's Directions and Instructions

The Hong Kong Stock Exchange will normally return the form asking the person to resubmit it, failing which the Stock Exchange will refer the case to the SFC. Upon receipt of a referral from the Stock Exchange, the SFC will issue a warning requiring the person to resubmit the form immediately in accordance with the form's instructions and directions. If the person fails to do so within 5 days, the case will be referred for investigation.

### iii. Including False or Misleading Information in the Form

The normal course of action is to refer the matter for investigation with a view to prosecution. However a warning will be appropriate if the aggregated value of the interests involved is less than HK$100,000 and the person has not been warned before.

### iv. Failing to Disclose a Notifiable Event

The matter will normally be referred for investigation with a view to prosecution. However, a warning will be appropriate if the aggregated value of the interests involved is less than HK$100,000 and the person has not been warned before.

## Annex A

Summary of pros and cons of ways to address issue of disclosing security interests

### 1. Requiring a disclosure on giving of security interests by substantial shareholders

**Pros**

**Cons**

* May serve as a signal of potential for forced sales, or speculation about controlling shareholders defaulting on margin calls.
* Provides investors with a signal about which companies might have certain risks associated with share pledges. Investors can choose to act to protect their investment or decide whether to invest in a company or not.
* Disclosure of security interests of themselves does not tell investors about the risk of default, unless a lot more information on the personal financial position of the substantial shareholder is provided in addition. A requirement to disclose such additional information is viewed as an unacceptable erosion of the substantial shareholder's privacy rights.
* Likelihood that there will be many disclosures, as shareholders frequently give security interests even when not in financial difficulty. Disclosure of security interests alone is not likely to help investors distinguish between companies.
* Share pledges by substantial shareholders do not relate to the listed company's daily operations.
* Speculation about the possibility of a substantial shareholder's share being sold (e.g. where he initiates the sale himself or a sale by the lender) and what a substantial shareholder may or may not do with his shares (on the buy side or the sell side) is an inherent and fundamental part of any free security market. Such speculation is not a problem peculiar to security interests.
* The current regime adequately addresses the needs of various market users. The proposal tips the scale towards speculators possible at the expense of investors.
* Poor liquidity already implies potential volatility for sudden sales.

Reports on sudden price drop arising from enforcement of security interest cause damage to the reputation of Hong Kong as a major financial centre.

* Cases in respect of which there was speculation about margin calls in the past year have been isolated to 3 cases. There is no need to disrupt the operation of the entire market to cater for a small number of potential incidents.

The spirit of disclosure is to let market participants have the information to act on and it is common that different investors interpret differently.

* Disclosure may cause a negative impact on the share price especially when the market is falling generally or when the shares are falling in price for reasons not relate to the listed company's financial condition.
* It is likely that disclosure will in itself cause market fluctuations.
* Disclosure may be a misleading indication if it is taken as an automatic sign of financial weakness.
* There will be possible panic selling by investors if unwarranted conclusions are made from the fact of disclosure. Panic selling may lead to sudden sharp fall in share prices. This will trigger margin calls and may result in default in some cases, the precise situation that we are seeking to avoid.
* Speculators are likely to capitalize on the opportunity and sell to create more market volatility.
* Some new risks may be opened up by disclosure and it is inappropriate for a regulatory regime to create such speculative risks and the following consequences:
	+ A potential false market by raising possible unfounded speculation.
	+ Acts of speculators (e.g. sales and short sales) may have the effect of pushing the share price lower.
	+ Increased chance of a margin call.

Substantial shareholders should bear the responsibility for disclosure of security interests on the basis of transparency and good governance.

* Disclosure of share pledges infringes on privacy right of substantial shareholders.
* Disclosure imposes heavy compliance burden to the market without a corresponding balancing benefit to the market.
* Disclosure would prejudice many shareholders who provide adequate security and regularly service their debts.

Taiwan and Shanghai Stock Exchange ask for disclosure of share pledges by substantial shareholders.

No major jurisdiction requires disclosure of share pledges with qualified lenders.

Part XV is not the correct mechanism for disclosing to the market the financial condition of borrowing shareholders and inability to repay loans. If this information is of importance to the listed company's future, business etc., then the company should disclose it under the Listing Rules.

Likely to be transitional issues to address if imposed as there are likely to be security interests with qualified lenders today that would suddenly need to be disclosed.

The proposal is out of step with other developed markets. In a world where several financial markets are increasingly competing for new listings, imposing additional burdens on substantial shareholders and lenders alike will not enhance Hong Kong's attractiveness as a place in which to seek a listing.

### 2. Keeping the exempt security interest provision

Pros

Cons

Supported by those who oppose disclosure of share pledges.

Opposed by the media and those who support disclosure of share pledges.

See Cons of Option 1 above.

See Pros of Option 1 above.

Perceived "problem" has been limited to 3 cases that may or may not have involved enforcement of share pledges given by substantial shareholders. This does not warrant a revamp of the existing disclosure regime.

Media complaints that regulators are not doing enough to protect the interests of general investors.

Disclosure would prejudice creditors who may need to aggregate all interests held (whether as collateral or not) and this would undermine rationale for the disclosures. Separate reporting may impose administrative burdens and could provide an information overload.

### 3. Accelerated disclosures on taking steps to enforce

Pros

Cons

Supported as reported in the press by a few commentators.

Opposed by 23 respondents.

Provides a more focussed solution in that it affects only companies where a substantial shareholder has defaulted.

* Immediate disclosure may cause market panic and accelerate a fall in market price.
* The disclosure will lead to sell down by other lenders that would affect the share price.
* May prejudice the creditors' ability to recover the loan from selling the shares and prejudice the substantial shareholders with a worse price to pay off the loan.
* Regulators should balance interests of investors and business parties.
* Lenders may also price the risk of panic selling into their lending criteria and be less flexible about enforcing security interests.
* The proposal will add an administrative burden to make disclosure when the bank is busy in negotiating settlement with borrower.
* Announcing a default as it occurs would immobilise the market and prevent a restructuring of the company involved.
* Disclosure will definitely force lender to liquidate the position immediately and thus cause unnecessary disruption to the market.
* Disclosure may send a wrong signal to the market and may cause unnecessary chaos or panic selling.

Allows the market to know what's happening and corrects false rumours at an earlier time than today.

* Investors may not be in any better position, since the price of shares (especially those which are thinly traded) will in any event fall on disclosure.
* Hong Kong is an efficient market and people would be aware that something had happened when the shares were disposed of.
* It is likely that all would happen very quickly and before the issuer had made an announcement.
* Alternatively, if the price falls low enough, lenders may elect to refrain from selling till the price has improved, effectively creating an overhang depressing the price for some time to the detriment of all the shareholders.

Investors have the right to know what is happening.

* Trading may be suspended pending announcement and this will unfairly prevent the forced sale.
* Disclosure will prevent lenders from selling the position outside the listed market privately at the best obtainable price.
* The actions of qualified lenders are enforcement actions that are merely consequences of taking security interest. Sales of securities by qualified lenders should not be seen as insider dealing and do not need to be so strictly controlled.
* No reasons why qualified lenders should be treated differently from investment managers or other substantial shareholders who are selling shares.
* Potential for avoiding requirement if substantial shareholder negotiates with the lender for a structured "voluntary" sale of the relevant interest (by him or at his instructions) that would not trigger such accelerated disclosure.
* Places interests of other shareholders (other than substantial shareholders) ahead of the (a) substantial shareholder (b) the security holder, and (c) potentially, other creditors of the substantial shareholders. There is no rationale for giving precedence to one group of stakeholders in a listed company over other interests.
* Some technical issues to be resolved. There is a need to clarify the meaning of "forthwith" or state a specified period of time, and what is considered to be "evidencing an intention to exercise voting rights".

### 4. Disclosure of security interests only where the interest held is for example, 30% or more

Pros

Cons

More targeted than disclosure for interests over 5%.

Probably still affects many companies. It is unlikely that substantial shareholders will let their shares sit idle.

Companies are even more singled out by the disclosures, resulting in worse speculations and there is potential for panic selling.

 *This note is intended as a summary only of the proposals set out in the Consultation Conclusions, the full text of which is available on the* [*SFC website*](http://www.sfc.hk)*. Specific legal advice should be sought in relation to any particular situation.*

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