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[online version](http://www.charltonslaw.com/disclosure-of-interests-under-the-securities-and-futures-ordinance/)

# Disclosure of Interests under the Securities and Futures Ordinance Overview

## Introduction

Part XV of the Securities and Futures Ordinance (**SFO**) which came into force on 1 April 2003 extends the regime for disclosure of interests in Hong Kong listed securities. The attached note sets out a summary of the new provisions as they relate to substantial shareholders, directors and chief executives of Hong Kong listed companies. The following is intended as a brief overview of the principal provisions. For details of these provisions and the defined terms used, please see the [attached note](1.html).

## Substantial Shareholders

As under the previous regime, notification 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.

### Notifiable Interest – Reduction of Substantial Shareholding Threshold

The SFO reduces the threshold at which the notification requirement kicks in from 10% to 5% of a Hong Kong listed company's issued voting share capital. Different classes of shares are taken separately.

### Notification Period

**Any interest not previously disclosed which became discloseable on the coming into force of the SFO must be notified on or before 14 April 2003.**

Schedule 1 to the attached note sets out a list of interests which became discloseable on the coming into force of the SFO and which should be notified before the 14 April deadline.

Otherwise, the time period for notification is shortened from 5 days to 3 business days (which includes Saturdays) after the relevant event, subject to certain limited exceptions.

Notices should be filed with the Stock Exchange and the relevant listed company at the same time or one immediately following the other. The previous requirement for notice to be given to the Stock Exchange first has been removed.

### Interests in Equity Derivatives

The previous regime only required disclosure of physically settled derivatives. A significant difference in the new disclosure provisions is that the SFO extends the disclosure obligations to all interests in the 'underlying shares' of equity derivatives including interests in **unissued** shares of listed companies which, if issued, would carry the right to vote and also to **cash settled** derivatives. Hence interests in options, subscription warrants and convertible bonds (among others) are now discloseable.

An exemption is available in respect of basket derivatives over the shares of at least 5 companies listed on a 'specified exchange' provided that no one share accounts for over 30% of the value of the total basket.

To calculate a person's percentage interest, he must add his interest in the underlying shares of any equity derivatives (including unissued shares) to his interest in the issued shares of that company. He must then calculate this as a percentage of the issued shares only of the company.

### Disclosure of Short Positions

The SFO extends the disclosure obligations to cover 'short positions' in Hong Kong listed securities. Consequently the writing of a call option, holding of a put option and stock borrowings will be discloseable.

It should be noted however that:

* a person (not being a director) must be a substantial shareholder (ie. must already have a 5% notifiable interest) before he is obliged to disclose a short position;
* the short position itself must be at least 1%;
* as with long positions, changes in short positions need only be disclosed when they cross a percentage level or the person ceases to have a short position; and
* long and short positions cannot be netted off and must be calculated and notified separately.

### Notification of Changes in the Nature of Interests

The SFO contains new requirements for the disclosure of changes in the nature of interests already disclosed. Common situations requiring notification of such change will include the exercise of rights (by or against a person) under options and other derivatives, the lending of shares under a securities borrowing and lending agreement and the giving of shares as security to anyone other than a 'qualified lender'. Certain limited exceptions are contained in the SFO and are detailed in the attached note.

### Deemed Interests

#### Discretionary Trusts

The provisions have been amended to improve transparency with respect to certain discretionary trusts. The interests of a discretionary trust will be attributed to a 'founder' of the trust. The definition of a 'founder' is wide and essentially will catch anyone who has procured its creation and who retains the ability (whether legally enforceable or not) to influence the discretion of its trustees.

#### Concert Party Agreements

The previous provisions are extended by the SFO to any arrangement whereby a 'controlling person' or director of a listed company makes a loan to a person on the understanding that the money will be used to acquire interests in shares in that company. There is then an irrebutable presumption that the funding is provided pursuant to an agreement dictating how the borrower may deal with the shares. There is an exemption where the director or 'controlling person' makes the loan in the ordinary course of his business as a 'qualified lender'.

#### Family and Controlled Company Interests

As previously, the interests of a person's spouse, children under 18 and a company which he 'controls' are attributable to him.

### Exemptions

There are a number of exemptions which are detailed in the attached note. The following is a brief outline of some of the exemptions which will commonly be relied upon.

#### Small Change Exemptions

Substantial shareholders are exempted from disclosing very small changes in their interests in shares. The exemption applies so that no notice will be required if:

1. the percentage level (i.e. the figure rounded down to the next whole number) of his interest is the same as or less than, the percentage level of his interest stated in the 'Last Notification' given by him; and
2. the difference between the percentage figure (i.e. the actual unrounded percentage) of his interest disclosed in his 'Last Notification' and the percentage figure of his interest at all times after such notification, is less than 0.5%.

A 'Last Notification' means a notice given of a change in the percentage level of a person's interest above 5%. Any notice given due to the commencement of the SFO, on first crossing the 5% threshold or of a change in nature of an interest will not count.

Further small change exemptions are available with respect to short positions and also to changes in the nature of a person's interest. Please see the attached note.

#### Exempt Security Interests

An interest in shares is not required to be disclosed if it qualifies as an 'exempt security interest' ie. it is held by a 'qualified lender' by way of security for a transaction entered into in the ordinary course of its business. The exemption has been widened to include margin financing and interests held by qualified lenders that are regulated overseas in jurisdictions approved by the SFC.

The SFO clarifies that an interest will cease to be an 'exempt security interest' once the lender starts to treat the shares as his own.

#### Wholly Owned Group Exemption

Members of a wholly owned group are not required to notify their interests (or changes in their nature) if their ultimate holding company gives notice of such interests.

#### Investment Managers, Custodians and Trustees

The exemption previously available to local SFC registered investment managers and trust companies is removed. Exemptions are available to bare trustees (ie. trustees entitled only to deal with the interests of the trust in accordance with the wishes of the beneficiary) and also to corporate custodians who have no authority to exercise discretion in dealing in the shares. More importantly, the SFO removes the obligation on a person to aggregate the interests of controlled companies that are investment managers, custodians or trustees whose interests in shares arise solely from their entitlement to invest in, manage, deal in or hold such interests on behalf of clients in the ordinary course of business as such. The exemption will only apply if the controlled company's power to vote and deal is exercised independently of other group members.

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

#### Bonus and Rights Issue Exemption

Shareholders who take up rights under qualifying bonus and rights issues (and whose percentage interest therefore remains unchanged) are not required to make any disclosure whereas shareholders who do not take up their rights (and whose percentage interest therefore changes) must disclose the change. A sale of such rights will require disclosure by both the buyer and seller if their interests cross a percentage level.

#### Securities Borrowing and Lending Exemption

The Securities and Futures (Disclosure of Interests – Securities Borrowing and Lending) Rules (**SBL Rules**) simplify the regime for disclosure of securities borrowing and lending for:

* substantial shareholders lending shares through an 'approved lending agent' using a specified form of agreement;
* companies approved by the SFC as 'approved lending agents'; and
* 'regulated persons' (i.e. companies licensed to deal in securities) who act merely as a conduit.

### Information to be disclosed

The SFO removes the requirement to disclose details of registered shareholders and changes in those details. It introduces instead more structured notification forms.

Directors who are also substantial shareholders must use Form 3A (Director's/Chief Executive's Notice of Interests in Shares of a Listed Company) which is annexed to the attached note.

### Penalties for failure to disclose

Failure to make disclosure within the time limits required by the SFO or the making of a statement which is false or misleading in any material particular constitutes a criminal offence carrying a maximum fine of $100,000 or maximum prison sentence of 2 years.

## Directors And Chief Executives

As previously, the disclosure requirements for directors and chief executives (**Directors**) are wider than for substantial shareholders requiring disclosure of interests in any shares (not just voting shares) or debentures of the listed company of which they are a Director and any associated company. Further there is no disclosure threshold requiring notification of all interests however small.

### Timing of Notification

Interests not discloseable under the previous regime which became discloseable on the coming into force of the SFO must be notified before **14 April 2003**. The principal interests falling into this category are:

1. short positions in shares;
2. interests in unissued shares such as options granted by a listed company; and
3. interests in shares resulting from the holding or writing of cash settled derivatives.

A Director who is also a substantial shareholder holding between 5% and 10% of the shares of a listed company must disclose this interest prior to 14 April even if he has already disclosed that interest in his capacity as a Director under the previous regime.

Otherwise, the period for filing notices is shortened to 3 business days as for substantial shareholders subject to certain limited exceptions.

### Interests under Equity Derivatives

As for substantial shareholders the SFO extends Directors' disclosure obligations to cover interests in all equity derivatives including over unissued shares and cash-settled equity derivatives. For Directors this includes interests in the shares of the listed company and its associated companies.

### Short Positions

Directors are required to disclose all short positions under equity derivatives including put options held and call options written. As for substantial shareholders, the SFO does not permit the netting off of long and short positions and requires each to be notified separately.

### Changes in the Nature of Interests

Any change in the nature of an interest already disclosed must be notified. The situations in which there will be such a change are extensive and include the exercise of rights (by or against a person) under equity derivatives. The exercise of rights under options and other derivatives and the giving of shares as security (other than to a qualified lender) will require notice of change in the nature of a Director's interest. The situations in which there is considered to be no change in the nature of a Director's interest are limited and are detailed in the attached note.

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

### Deemed Interests

The interests of a Director's spouse and minor children (not being themselves Directors of the listed company) and of any company which he 'controls' are attributed to him under the SFO.

As previously, a Director must also disclose any interest as a beneficiary under a discretionary trust.

### Exemptions

Very few exemptions are available to Directors. In particular, the exemptions available to substantial shareholders in respect of small changes in their interests and lending shares under the SBL Rules are nolt available to Directors.

### Non-compliance

Non-compliance and the provision of false or misleading information carry the same penalties as for substantial shareholders.

This note is intended as a brief overview of the provisions of Part XV. Specific legal advice should be sought in relation to any particular situation.

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