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# Stabilisation Under The Securities And Futures (Price Stabilising) Rules

## Introduction

The Securities and Futures (Price Stabilising) Rules (the **Rules**) made under the Securities and Futures Ordinance (the **SFO**) prescribe the circumstances in which price stabilisation may be carried out without constituting market misconduct under the provisions of the SFO. Without the safe harbour established by the Rules, price stabilisation, being potentially manipulative, could contravene the provisions of the new market misconduct regime under Parts XIII and XIV SFO. The Rules are modelled largely on the UK Price Stabilising Rules and, like the SFO, came into effect on 1 April 2003.

Prior to the introduction of the Rules, a restricted form of stabilisation was permitted under policy statements issued by the SFC and the Stock Exchange of Hong Kong. This involved over-allotments of securities by the underwriters and covering the short position by an over-allotment option granted by the issuer (i.e. a 'greenshoe') and/or share borrowing arrangements. 'Genuine purchases' to satisfy the over-allotment which also reduced excess supply created by investors selling into the after-market were permitted and could rely on the policy statements that such action did not breach the relevant market misconduct legislation.

This memorandum is intended as a summary of the principal provisions of the Rules. In essence, the Rules provide a safe harbour for stabilisation conducted only in relation to **public offerings of at least $100 million** (excluding any over-allocated securities) where the detailed provisions of the Rules are complied with. Other key features of the Rules are that:

* a Stabilising Manager must be appointed to carry out or oversee all stabilising activity and keep records of such activity;
* stabilising bids for shares are subject to upper price limits;
* time limits apply to primary stabilising actions for both debt and equity securities;
* prior disclosure is required of proposed stabilising activity; and
* after the end of the stabilising period, disclosure is required of specified information relating to stabilising actions undertaken.

## Scope Of The Rules

In order to qualify for the safe harbour under the Rules, the offer must be of relevant securities and meet the following conditions:

1. the offer must be for cash;
2. the securities must be listed on a recognised stock exchange or traded through an authorised automated trading system;
3. the size of the offer (excluding any over-allocated securities) must be not less than $100 million;
4. the offer must be to the public;
5. the offer must be:
   1. the subject of a prospectus or a document authorised by the SFC under Section 105 SFO (this ensures that offers of debt securities by government agencies are covered by the Rules); **or**
      1. is an offer to Companies Ordinance (**CO**) professionals only;
      2. is for relevant securities that are uniform in all respects with existing securities traded or admitted to trading on a recognised stock market or through an ATS; and
      3. is the subject of a public announcement containing the offer price and the disclosure and warnings relating to stabilisation of the securities required by the Rules, provided that if the offer comprises shares being sold by an existing shareholder, the shareholder must have agreed to subscribe for the same number of shares at the same price after taking account of expenses.

In this memorandum, the term '**offer document**', means a prospectus or a document authorised under S105 SFO as referred to in paragraph (d)(i) above, or in the case of an offer to CO professionals only, a public announcement referred to in paragraph (d)(ii)(C) above.

Taking the requirements in turn.

### What securities can be stabilised?

Only 'relevant securities' can be stabilised. These are defined as equity securities, debt securities or depositary receipts of equity or debt securities.

Price stabilisation is permitted only in the same type of securities as are the subject of the offer. Dealing in associated securities to support the price of relevant securities is not allowed. Dealing in the underlying securities of a convertible or exchangeable issue or in derivatives to achieve an equivalent effect to stabilisation are not therefore covered by the Rules.

#### Document requirement

The Rules cover both primary offers and placings and other offers of shares of a class which is already listed provided that the relevant document requirement is met. Offers must be to the public and either;

1. the subject of a prospectus or a document approved under S105 SFO; **or**
2. a placing or other offer of shares of a class already listed to Companies Ordinance professionals only which does not comprise a sell-down element. In this case a public announcement containing the offer price and the disclosure and warning statements required by the Rules is considered to be adequate disclosure.

#### Placings and other Offers of Shares of a Class which is already Listed

Offers of shares of a class which is already listed and placing and top-up transactions meeting the offer size requirement which are not the subject of a prospectus will therefore need to be to CO 'professionals' only if they are to rely on the Rules. CO 'professionals' are currently defined as persons 'whose ordinary business is to buy or sell shares or debentures, whether as principal or agent'. In practice, this currently means that investors (including large corporate investors) who are not buying or selling shares or debentures in the ordinary course of their business may not, strictly speaking, be within the 'professionals' definition. The Companies (Amendment) Bill 2003 however proposes to replace the narrow CO definition with the new definition of 'professional investors' contained in the SFO which specifies the types of persons who may be regarded as 'professional investors'.

In addition, a public announcement is required containing the offer price and the disclosure relating to the proposed stabilising activity required by the Rules.

#### Existing Shares

One of the anomalies of the Rules is that where a new issue is combined with an offer for sale of shares by existing shareholders, the safe harbour is available if a prospectus is issued. However, if a prospectus is not issued, a placing which has a sell-down element is not covered by the Rules: the argument being that the sell-down precludes the offer from being regarded as for fund-raising purposes, notwithstanding that this should be equally so where, in the same circumstances, a prospectus is issued and reliance on the Rules is permitted.

## Primary Stabilising Actions

Section 6 of the Rules allows the Stabilising Manager to buy relevant securities in the secondary market in order to prevent or minimise a reduction in their price. Such purchases may (but do not have to) be conducted to satisfy an over-allotment of the securities. Hence the Stabilising Manager can now hold net long positions for the purposes of stabilisation, whereas previously such purchases were permitted only to cover an over-allotment.

All stabilising purchases must be for the account of the Stabilising Manager, rather than the issuer. No stabilising actions may be taken by the issuer through a repurchase of its issued securities. Purchases in the secondary market to satisfy an over-allotment are therefore categorised as primary stabilising action and accordingly are subject to the time and (in the case of equity securities) price limits described below.

## Ancillary Stabilising Actions

Permitted ancillary stabilising activity under the Rules allows the Stabilising Manger to:

1. over-allocate or establish a short position in the relevant securities;
2. exercise an over-allotment option to close out any short position created under paragraph (a); and
3. liquidate net long positions in relevant securities acquired in the course of primary stabilising activity.

The SFC has indicated that securities borrowing arrangements and the subsequent return of borrowed securities should also be covered under permitted ancillary stabilising actions, although they are not specifically mentioned in the Rules.

Ancillary stabilising actions are not subject to the time and price limits as for primary stabilising actions. To qualify for the safe harbour, they should however be carried out with a view to facilitating primary stabilising activities. In addition, the SFC remains of the view that any over-allotment should be limited in size by the greenshoe.

## Time Limits For Stabilising Actions

### Primary Stabilising Actions

The 'stabilising period' during which primary stabilising actions are permitted runs from the commencement of trading on a recognised exchange or through an ATS, after the issue of the offer document (which includes the public announcement issued on an offer to CO professionals only ) and the offer price is announced. It ends 30 days after the earlier of the closing date or the commencement of trading on a recognised stock market.

The original proposal was for the stabilising period to commence on the date of the prospectus. The amendment to allow stabilisation to begin only after the commencement of trading makes clear that no stabilising activity is permitted in the grey-market.

### Ancillary Stabilising Actions

There are no time limits for conducting ancillary stabilising actions since they are likely to occur before the commencement of trading, such as the grant of the over-allotment option or after the end of the stabilising period, notably the liquidation of the Stabilising Manager's net long positions. However, with respect to the liquidation of net long positions, the SFC has indicated that, as a matter of good practice, these should be liquidated as soon as it is practicable to do so at a profit without disrupting the market.

## Price Limits For Stabilising Actions

### Primary Stabilising Actions

Under Section 11 of the Rules upper pricing limits apply to primary stabilising actions for offers of **equity securities**, including the purchase of securities in the secondary market to close out the short position created by the over-allotment. These are set out below.

Item

Action

Maximum Price

1

Initial stabilising action

The offer price

2

After the initial stabilising action, when there has been no deal or transaction described in item 3.

The initial stabilising price

3

After the initial stabilising action, where there has been an independent deal or transaction on a recognised stock market or through an ATS at a price above the initial stabilising price.

The lower of the offer price and the price at which the deal or transaction was effected

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

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

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

In summary therefore, stabilising can never be carried out above the offer price. The upper price limit for the first stabilising purchase by the Stabilising Manager is the offer price (A). After the initial purchase, the Stabilising Manager can stabilise at or below the new price limit which is now the initial stabilising price (B). If an independent deal or transaction is effected on a recognised stock market or through an ATS at a price (C) which is higher than the initial stabilising price (B) but below the offer price (A), the new maximum price is C. The Stabilising Manager may then stabilise at or below the price at which the independent deal was effected (i.e. C).

If the Stabilising Manager is unable to close out the short position created by the over-allotment by purchases within the prescribed price limits, the SFC expects that it will exercise the over-allotment option to close out the position.

**The price limits described above do not apply to stabilising actions for debt securities.**

### Ancillary Stabilising Actions

Price limits do not apply to ancillary stabilising actions. There are therefore no limits on the price at which the Stabilising Manager liquidates any net long position.

## Restrictions On Stabilisation

The Stabilising Manager is prohibited from taking any stabilising action if:

1. at the time the offer price was fixed, the market price of the relevant securities or of rights to them was, or could reasonably be anticipated to be, artificial; **and**
2. the Stabilising Manager knew, or ought reasonably to have known, that the artificiality was attributable wholly or partly to market misconduct activities (Section 10(1)).

Stabilising activity is also prohibited in relation to:

1. debt securities which are convertible into, or give rights to purchase, equity securities where the terms of conversion, purchase or subscription have not yet been publicly announced (Section 10(2)); and
2. any relevant securities where the Stabilising Manager or any of its associates holds an option granted by the issuer over the securities which are to be stabilised, the terms of which have not been disclosed to the public as required by the Rules (Section 10(3)).

## What Is The Role Of The Stabilising Manager?

The Rules require the appointment of a Stabilising Manager who must be either a licensed corporation, such as a registered securities dealer, or a registered institution, eg. a licensed bank under the SFO. The Stabilising Manager is responsible for overseeing compliance with the Rules including ensuring that the disclosure and record keeping requirements of the Rules (see below) are met.

### Responsibility for Agents' actions

The Rules permit the Stabilising Manager to appoint agents, local and overseas, to make bids and effect transactions in the course of stabilisation. The Stabilising Manager is however ultimately responsible for the conduct of the agent and for ensuring that it complies with the Rules. In global offerings where the issuer's securities are also offered overseas, the underwriter responsible for stabilising the securities overseas, if different from the Hong Kong Stabilising Manager, should be appointed as an agent of the Stabilising Manager under the Rules.

### Separation of stabilising and other trading activities

The SFC expects the Stabilising Manager to properly separate its activities as Stabilising Manager from its other trading activities, including proprietary trading. All stabilising actions must be recorded in the register required to be maintained under the Rules in order to qualify for the safe harbour.

### Transactions between the Stabilising Manager and its agents as principals

The Rules prohibit dealings in the securities to be stabilised between the Stabilising Manager and its agents as principals, unless at the time of the transaction, neither party knew or ought reasonably to have known the identity of the counterparty (Sub-sections 12(5) and (6)).

These provisions will not however affect proprietary trading activities of the Stabilising Manager and its agents where transactions are effected through the order matching mechanism in the open market where the identity of counterparties is unknown. Likewise, client transactions where the Stabilising Manager acts as agent for its clients are not prohibited.

### Notification of Stock Exchange

The Stabilising Manager is also responsible for ensuring compliance with the requirements of any recognised stock exchange or operator of any relevant ATS on which the relevant securities are to be traded to be notified of any stabilizing action that may be taken in respect of the securities.

## Disclosure Requirements

### Prior Disclosure

The Rules require that adequate disclosure of the fact that stabilising action may be undertaken in relation to the offer should be made in the first public announcement of the offer (ie. the first public announcement indicating that an offer of the relevant securities is intended) and in all subsequent communications issued on behalf of the issuer or Stabilising Manager until detailed disclosure and warnings are made in the prospectus or other offer document (which includes the public announcement required on an offer to CO professionals only). Schedule 1 to the Rules sets out what will be regarded as adequate disclosure of proposed stabilising activity for different types of communication. Suggested wording for detailed disclosure and prior warnings to be given in the prospectus or other offer document is also provided in Schedule 1. To view the Rules please [click here](http://www.legislation.gov.hk/blis_pdf.nsf/6799165D2FEE3FA94825755E0033E532/20144753FD35754D482575EF001DC9DC/$FILE/CAP_571W_e_b5.pdf) ([see archive](CAP_571W_e_b5.pdf)).

### Interim and Post-Stabilisation Disclosure

The Stabilising Manager is responsible for ensuring that the following public announcements are made by or on behalf of either the Stabilising Manager or the issuer:

#### Exercise of Over-allotment Option (Section 9(1))

A public announcement must be made as soon as reasonably practicable after any exercise (wholly or partly) of an over-allotment option. The announcement must include the following information:

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

#### Post Stabilisation Disclosure (Section 9(2))

A public announcement must be made within 7 days of the end of the stabilising period containing the following information:

* the ending date of the stabilising period;
* whether or not any stabilising action was taken;
* where there were more than one purchase in the course of any stabilising action, the price range between which purchases were made;
* where applicable, the date of the last purchase in the course of any stabilising action and the price at which it was made; and
* where applicable, the extent to which any over-allotment option was exercised.

## Record Keeping Of Stabilising Actions Taken

Section 13 of the Rules requires the Stabilising Manager to establish a register of all stabilising actions taken which must be updated immediately or on a daily basis (from business day to business day). The details required to be included in the register are specified in Section 13. Stabilising activity is prohibited if the Stabilising Manger does not comply with its record keeping obligations. The Stabilising Manager is also responsible for ensuring that its agents comply with the requirement to keep their own registers up-to-date.

The register is required to be kept for at least 7 years after the end of the stabilising period. If it is not kept in Hong Kong in either English or Chinese, it must be capable of being reconstituted in Hong Kong and translated into either of those languages within 48 hours of the Stabilising Manager being notified that a person entitled to inspect the register requires access to it.

### Persons entitled to inspect the register

The issuer is entitled to inspect the register within 3 months of the end of the stabilising period by giving written notice to the Stabilising Manager. The issuer is only entitled to inspect specified sections of the register which must me made available by the Stabilising Manager within a reasonable time of receipt of notice. The SFC may inspect and take copies of the register at any time.

## Overseas Stabilisation

The Rules accept that where securities are traded both in Hong Kong and overseas, stabilising activity may need to be undertaken overseas. The market misconduct provisions of the SFO are far-reaching, catching both actions in Hong Kong and overseas which may impact on the price of securities traded on an exchange or through an ATS in Hong Kong. Stabilisation conducted in an overseas market which might affect the price of the securities traded on the Hong Kong market could therefore amount to market misconduct under the SFO. The Rules therefore provide that stabilising activities conducted overseas will not constitute market misconduct if they are conducted in compliance with the price stabilising rules of certain recognised jurisdictions to be specified by the SFC in Schedule 4 to the Rules and the offer is governed by the laws of the relevant jurisdiction (Section 15). The SFC published a consultation paper in July 2003 inviting comments on its proposal to include the UK as a recognised jurisdiction in Schedule 4.

It should be noted, however, that the overseas price stabilising rules are recognised only in relation to stabilisation conducted in the relevant overseas jurisdiction. Stabilising activities in Hong Kong must be conducted in accordance with the Rules.

This memorandum is intended as a summary only of the detailed provisions of the Securities and Futures (Price Stabilising) Rules. Specific legal advice should be sought in relation to any particular situation.

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