CONSULTATION PAPER
ON
AMENDMENTS TO
THE SECURITIES (DISCLOSURE OF INTERESTS) ORDINANCE

Securities & Futures Commission

30 June 1998

CONTENTS

EXECUTIVE SUMMARY

Introduction

The Securities and Futures Commission (the *"**SFC**")* is consulting the public on certain proposed amendments to the Securities (Disclosure of Interests) Ordinance (the *"**Ordinance**")*. This Consultation Paper sets out the principal areas of change and the policy reasons for the amendments.

This Executive Summary provides an overview of the principal amendments being proposed and the main reasons for the proposals.

For the sake of simplicity, references to the PRC in this Paper mean the Mainland of the People's Republic of China and references to Hong Kong mean the Hong Kong Special Administrative Region of the People's Republic of China.

Reasons for amending the Ordinance

The Ordinance was enacted on 14 July 1988. It was declared effective on 1 September 1991. Since 26 June 1991, the Ordinance has not been materially revised.

The principal reasons for the SFC's proposal to amend the Ordinance are :

- To bring the Hong Kong securities disclosure regime in line with international and regional disclosure standards.
- To bring the Ordinance up-to-date with recent developments in the Hong Kong securities market.
- To improve transparency in the Hong Kong market by improving the extent of information available on price, securities dealings and persons having interests in shares.
- To remove unnecessary and unduly burdensome requirements currently laid down by the Ordinance and to introduce new statutory disclosure forms to facilitate systematic reporting of interests in shares.

Principal Amendments

The principal proposed amendments to the Ordinance are summarised as follows :

(1) ***Disclosure threshold*** : Reduce the initial substantial shareholding disclosure threshold from 10% to 5% (pages 11 and 12).

(2) ***Notification Period*** : Shorten the disclosure notification period from 5 calendar days to 2 business days (pages 12 to 14).

(3) ***Timing of Notification to the Stock Exchange and listed companies*** : Remove the requirement that notification of an interest in shares must be made to the Stock Exchange of Hong Kong Limited (*"**SEHK**"*) prior to notifying the listed company concerned (page 14).

(4) ***De minimis change exemption*** : Exempt substantial shareholders from the obligation of disclosure when their interests in shares fluctuate by a de minimis amount across a particular percentage level (pages 15 to 17).

(5) ***Remove unnecessary requirements and streamline disclosure of information***: Remove the requirement to disclose details of registered shareholders and their shareholdings (pages 17 and 18) and reduce multiple filings of notifications by allowing disclosures to be made on a group basis (Pages 48 and 49). A draft notification form is attached for comment by the public and examples of how to complete the draft form are set in Appendix 2.

(6) ***Consideration and terms of agreements*** : Substantial shareholders (i.e. persons holding interest in shares equal to or more than 5% of the issued share capital of a listed company carrying rights to vote at general meeting) will be required to disclose the highest and the average price payable or receivable by them in acquiring or disposing of interests in shares. In addition, both substantial shareholders and directors will be required to provide a copy of any written agreement relating to any off-exchange transaction that gives rise to a disclosure obligation. If there is no written agreement, it is proposed that material terms of the off-exchange transaction should be disclosed in a memorandum to be attached to the notification form (pages 19 to 21).

(7) ***Disclosure of shareholding structure of corporate substantial shareholders*** : When performing a duty of disclosure, an unlisted corporate substantial shareholder will be required to disclose, inter alia, details of any person holding 10% or more of its issued share capital and details of any person in accordance with whose directions it or its directors are accustomed to act (pages 21 to 24).

(8) ***Discretionary trusts*** : When performing a duty of disclosure, a trustee of a discretionary trust will be required to disclose the identity of any *"settlor*" of the trust. A *"settlor"* of a discretionary trust will be deemed to be interested in the shares held by the trust and may, as a result, be under a separate duty of disclosure. A proposed definition of *"settlor"* is included for comment (pages 25 to 32).

(9) ***"Concert party" agreements*** : Extend the scope of a *"concert party agreement"* under section 9 of the Ordinance to include any arrangement under which a controlling shareholder of a listed company provides any loan or security to another person on the understanding, or with the knowledge, that the loan or security will be used or applied to facilitate the acquisition of an interest in shares of the same listed company by that other person (pages 32 to 34).

(10) ***Investment managers and trust companies*** : Remove the exemption currently made available to Hong Kong registered investment managers and trust companies under the Securities (Disclosure of Interests)(Exclusions) Regulations (pages 34 to 37).

(11) ***Derivatives*** : In light of recent development of financial products in the market, the SFC considers it necessary to review the disclosure requirements with regard to derivative products. The circumstances under which a person may be required to disclose derivatives and the details to be disclosed are discussed in detail in this Paper (pages 38 to 48).

Apart from the above proposed amendments, the SFC is also consulting the market on two additional areas:

(a) ***Disclosure of pledges of shares*** : whether banks should be required to disclose pledges of listed shares made by substantial shareholders or should substantial shareholders be required to disclose pledges of shares when the pledge is created (pages 50 to 51); and

(b) ***Stock borrowing and lending*** : whether the revised Ordinance would create obstacles for bona fide stock borrowing and lending activities. If so, what would be the principal obstacles created (page 51).

If the revised Ordinance could be finalised before the enactment of the composite Securities and Futures Bill, the revised version of the Ordinance will form part of the composite Bill. If the revised Ordinance could not be finalised before the enactment of the composite Bill, the revised version of the Ordinance will be enacted as a separate Securities (Disclosure of Interests) Amendment Ordinance.

Consultation Period

The Securities and Futures Commission invites comments on the proposed amendments to the Ordinance as outlined in this Paper **by 31 August 1998**. Comments should be sent to :

The Securities and Futures Commission
12th Floor, Edinburgh Tower, The Landmark
15 Queen's Road Central, Hong Kong.
For the attention of the Secretary to the Securities and Futures Commission.

Interested persons may provide comments by E-mail to enquiry@hksfc.org.hk. This Paper is also available on the SFC website at http://www.hksfc.org.hk.

Note:

Whilst this Paper briefly summarises certain provisions of the Ordinance, these summaries are not an exhaustive examination of the Ordinance and they cannot be relied upon as an authoritative legal opinion on the Ordinance's contents. Accordingly, this Paper should not be relied upon as a substitute for seeking detailed legal advice on any specific case.

BACKGROUND

The Ordinance was first published in the form of a Securities (Disclosure of Interests) Bill in June 1987. It was modelled on the disclosure of interests provisions contained in Part VI of the U.K. Companies Act 1985.

In October 1987, the Hong Kong securities market suffered serious losses as a result of the global market crash. The incident revealed major weaknesses in the regulation of the Hong Kong market and caused the Governor to appoint a Securities Review Committee (chaired by Mr. Ian Hay Davison) to review the then regulatory system.

In a report issued by the Securities Review Committee in May 1988 (commonly known as the *"**Hay Davison Report**"),* the Committee identified the following four areas as the main objectives of the Ordinance :

"(a) to force disclosure of shareholdings of 10% or more within five days of the duty arising. The Bill looks through corporate interests to get at the reality of the controlling shareholder;

(b) to give companies the right to require a shareholder to provide information about his holding;

(c) to force the directors and chief executive of a listed company to disclose their interests in the company and of any dealings in the company's shares; and

(d) to enable the Financial Secretary to appoint inspectors to investigate the ownership of a listed company."[(1)]

The Securities Review Committee believed that the above objectives and the 1987 Bill were *"laudable",* but the legislation should not stop there. It recommended that the substantial shareholding disclosure threshold be reduced from 10% to 5% in order to meet international practice and to discourage insider trading.[(2)] However, this recommendation and some of the comments made by the public in 1987 were not incorporated into the Securities (Disclosure of Interests) Bill prior to its enactment.[(3)] At the time, the Government believed that the 1987 Bill, as it was then drafted, would be an appropriate starting point for the Hong Kong market. The intention was to review the Ordinance in two to three years time, and introduce changes to it in the light of practical experience obtained after the Ordinance was put into operation, and having regard to practices in other jurisdictions.[(4)]

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(1) *Paragraph 12.12 of the Hay Davison Report at pp.315-316*

(2) *Paragraph 12.13 of the Hay Davison Report at p.316.*

(3) *Comments received from the public during the consultation period with respect to the 1987 Bill included, for example, the call for specific provisions to require disclosure of interests associated with discretionary trusts, and provisions to cover interests in shares held in the form of subscription warrants. These proposals were not implemented in the Ordinance. For more details, please refer to paragraphs 8 (on discretionary trusts) and 11 (on derivatives) in the section headed "The Proposed Amendments".*

(4) *Hong Kong Legislative Council Papers, 8 June 1988.*

The Ordinance was subsequently enacted in July 1988 in substantially the same form as the 1987 Bill. It was next revised in June 1991 to apply to overseas incorporated companies with securities listed on the SEHK. The Ordinance was declared effective as of 1 September 1991.

DIRECTION FOR CHANGE

Since the Ordinance came into force in September 1991, the SFC has been primarily responsible for its administration, with the cooperation and assistance of the SEHK.

The SFC believes that amendment to the Ordinance should be made with the following objectives in mind:

- to remove unnecessary and unduly burdensome requirements currently laid down by the Ordinance and to streamline the reporting of interests in shares;
- to bring the Hong Kong securities disclosure regime in line with international and regional disclosure standards;
- to bring the Ordinance up-to-date with recent developments of the Hong Kong securities market; and
- to improve transparency in the Hong Kong market.

The reasons which lead the SFC to recommend changes towards such direction are set out below.

1. Removal of unnecessary and burdensome requirements

Over the past few years, the SFC has gained more practical experience in the operation of the Ordinance. It has received comments from the public and market practitioners regarding the interpretation and operation of the Ordinance.[(5)] As a result, the SFC believes that certain existing requirements of the Ordinance should be removed in order to reduce the compliance burden for all concerned. The disclosure process should also be streamlined. To this end, the SFC proposes, for example, that substantial shareholders should no longer be required to disclose details of registered shareholders and disclosure of interest on a group basis is encouraged.

2. Meeting international and regional standards

The SFC believes that for the purpose of maintaining Hong Kong as an international financial centre, it is important that our regulations should keep pace with current international and regional disclosure standards. Accordingly, the SFC considers it necessary that the initial substantial shareholding

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(5) *Particularly worth mentioning is the "Report for the Securities and Futures Commission concerning the Operation of the Securities (Disclosure of Interests) Ordinance" issued by the Hong Kong Institute of Company Secretaries in April 1994. The Report commented on certain provisions of the Ordinance and made a number of recommendations for change. These comments and recommendations were summarised and published in an article entitled "The Securities Ordinance : A Suitable Time for Review" in Volume 4, No. 5 of "Company Secretary".*

disclosure threshold be reduced to 5% and the notification period be shortened to 2 business days. These changes will bring Hong Kong's disclosure regime more in line with that of other international and regional financial centres.

3. Significant development of the Hong Kong securities market

The Hong Kong securities market has, since 1987, become more sophisticated, particularly in terms of the variety of securities instruments that could provide a person with an interest in shares. This is a direct result of the proliferation in the use and trading of derivative instruments such as derivative warrants, subscription warrants, convertible bonds, and over-the-counter and exchange traded stock options:

- Since the listing of the first derivative warrants in 1989, the listed derivative warrants market has experienced substantial growth both in the number of listings sought and the diversity of product types. The number of listed derivative warrants increased from 69 in 1993 to 346 by the end of 1997. In 1993, the total market capitalisation of derivative warrants was HK$37,805 million. This was increased to HK$64,344 million in July 1997 but had reduced since the economic downturn in October 1997 to about HK$9,129 million by the end of 1997. The annual trading of derivative warrants in 1997 amounted to HK$215,666 million, representing about 5.69% of the SEHK's total market turnover.[(6)] It is a particular feature of the Hong Kong market that retail investors are actively involved in the secondary trading of derivative warrants.[(7)]

- In 1987, there was a total of 77 subscription warrants listed on the SEHK. By December 1997, the number of listed subscription warrants increased to 187. The market value of these warrants as at December 1997 was HK$7,263 million, and their annual trading amounted to HK$60,243 million in 1997, representing about 1.59% of the SEHK's total market capitalisation.[(8)]

- The issue of convertible bonds by Hong Kong listed issuers became very active in 1993. From 1993 to 1997, 51 issues were launched.[(9)] Most of the convertible bonds were listed on the Luxembourg Stock Exchange with 7 issues simultaneously listed on the SEHK.

- The traded stock options market was launched in September 1995. By December 1997, there were 15 classes of stock options traded on the SEHK. The total contract volume for 1997 was 1,648,748 contracts

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(6) *All data from Stock Exchange Fact Book 1997 issued by the SEHK.*
(7) *Consultation Paper in relation to Derivative Warrants issued by the SEHK in November 1995.*
(8) *ibid, note (6) above.*
(9) *ibid, note (6) above.*

(compared to 1,269,912 contracts in 1996) with an average daily total contract volume of 6,730 (compared to 5,100 in 1996).[10]

The Ordinance, however, has not kept pace with these developments.

At present, the Ordinance only requires the disclosure of interests in shares held through derivative instruments in a piecemeal manner. For example, holders of subscription warrants and convertibles are not required to disclose their potential interests in shares because such interests do not relate to the issued share capital of a listed company. A call option is an *"interest in shares"*[11], and must be disclosed by the option holder should such interest (either on its own or in aggregate with other interests in shares held by the option holder) reaches the initial disclosure threshold of 10%. However, a put option is not an *"interest in shares"* and does not have to be disclosed by the holder.

Although equity derivatives do not give the holder direct control over, or ownership of, the underlying shares, they do provide him with an economic or indirect interest in the shares of a listed company. These instruments allow investors to acquire or dispose of economic exposure to equity price movements without buying or selling listed shares directly.

The question has, therefore, been raised in Hong Kong and in other jurisdictions[12] as to whether traditional disclosure regimes should require the notification of such economic interests in a more comprehensive manner.

In view of the significant growth in the use and trading of derivative instruments during recent years, the SFC believes that the issue, acquisition, disposal or exercise of derivative instruments on listed shares by a substantial shareholder or director is of informational value to the market. For example, the market would likely perceive the price of a company's securities differently if a shareholder or director holding 60% of the company's issued shares also holds a put option over the same shares exercisable by him at a particular price or price range. Similarly, the market would be interested to know if a person holds convertible securities or subscription warrants which give him the right to subscribe for a significant amount of a listed company's shares. The SFC wishes to seek views on extending the scope of the Ordinance to cover the derivative products referred to in paragraph 11 of this Paper.

4. Focus of the Ordinance: Control -v- Transparency

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[10] *ibid, note (6) above.*

[11] *Section 13(5) of the Ordinance.*

[12] *In the U.K., for example, a discussion paper on the "Regulation of the United Kingdom Equity Markets" was issued by the Securities and Investment Board in February 1994 which discussed whether regulations should be introduced to require disclosure of 3% economic interests in U.K. public companies which are held through equity options and other contracts for differences. Further, in a consultative document issued by the U.K. Department of Industry and Trade in April 1995 on "Proposals for Reform of Part VI of the Companies Act 1985", the need to extend the disclosure regime to cover warrants and convertibles was also discussed.*

As mentioned in the Hay Davison Report, one of the objectives of the Ordinance was to *"look through corporate interests to get at the reality of the controlling shareholder"*.[13]

Certain market participants have interpreted this to mean that the scope of the Ordinance should be confined to identifying *"insiders"* and persons who have *"control"* of a listed company. These participants believe that the Ordinance should limit itself to require the disclosure of *"beneficial interests"* only. Any provision which may deviate from this would, in their view, unduly increase the administrative and financial burden of all concerned.[14]

The SFC wishes to point out that since 1991, the principal function of the Ordinance is to provide information to the market and to listed companies on persons who have significant interests in listed companies, their dealings in such interests, and on the interests in shares and debentures held by directors. Several points should be emphasised:

(i) The concept of *"interest in shares",* even when it was first introduced in the 1987 Securities (Disclosure of Interests) Bill, has been wider than the concept of *"beneficial interest"* in shares.[15]

(ii) To be caught by the existing Ordinance, it is not necessary that one must have *"control"* of a listed company (whether it is control in the sense of having the beneficial interest in shares, the statutory or de facto control of a listed company, or control over 35% or more of the voting rights of a listed company as referred to in the Takeovers Code). Control of a listed company is not presently essential in the application of the Ordinance.

(iii) The Ordinance has always aimed to provide more information or *"transparency"* to the market, the ultimate objective of which is to discourage insider dealing and to create a fair and efficient market for Hong Kong[16] : a market which gives participants adequate information and equal access to information in order to make informed investment decisions.

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[13] *ibid, note (1) above.*

[14] *These market participants support their views by referring to U.S. laws which only require the disclosure by any person who is the "beneficial owner" of 5% or more of equity securities listed or registered with a U.S. securities exchange. It is, however, important to note that "beneficial owner" is widely defined under the U.S. Securities Exchange Act 1934. As defined, the term includes any person who, directly or indirectly, through any contract, arrangement, understanding, relationship or otherwise, has (i) voting power (which includes the power to vote or to direct the voting) of security or (ii) investment power (which includes the power to dispose or to direct the disposal) of security.*

[15] *"Interest in shares" shall be read to "include an interest of any kind whatsoever in shares". Section 13(2) of the Ordinance.*

[16] *Promotion of market transparency has been recognised as one of the objectives of the Ordinance: "The Ordinance ... forms a pivotal link in the legislative and regulatory framework designed to ensure market transparency and to provide a level playing field for all participants ...." - "The Securities Ordinance : A Suitable Time for Review", in Volume 4, No. 5 of "Company Secretary" at pp.34-37.*

The SFC believes that the objectives of the Ordinance in 1998 should remain substantially the same as those identified in the Hay Davison Report. The difference lies only in the scope of application of the Ordinance principally in two respects :

(a) the extent to which the concept of *"interest in shares"* should cover; and

(b) the kind of information that should be disclosed in order to provide adequate information to the market.

As the Hong Kong market becomes more sophisticated and more diversified ways have been used to conceal interests in shares, the SFC believes that for investors to make informed investment decisions in 1998 and beyond, it is not sufficient that they only have information on the identity of substantial shareholders/directors and the number of shares they are interested in. Information which are likely to affect investment decisions includes:

- information on persons who may have indirect control over shares (e.g. settlors of discretionary trusts);

- information on persons who have an *"economic interest in shares"* (see paragraph 3 above);

- information on persons who have discretion to deal with interests in shares or exercise rights attached to shares (e.g. fund managers and trustees);

- information on the price at which substantial shareholders and directors acquire or dispose of interests in shares; and

- particulars of off-exchange acquisitions or disposals of interests in shares made by substantial shareholders and directors.

The promotion of transparency for the Hong Kong market remains a principal objective of the Ordinance. The SFC believes that a revision of the Ordinance should take into account recent market developments, and aim to offer more transparency to the market in relation to price, securities dealings and persons having an interest in shares.

The SFC is seeking comments on the proposed amendments as set out in the following section, and on the policy objectives and the direction of the Ordinance as set out in this section.

THE PROPOSED AMENDMENTS

1. Substantial shareholding disclosure threshold

The Current Position

The Ordinance provides that any person who has an interest in shares in a listed company which is equal to or more than 10% of its issued share capital of any class carrying rights to vote at general meetings, is obliged to disclose his interest under the Ordinance.[(17)]

The Proposed Changes

It is proposed that the 10% disclosure threshold be reduced to 5%. There are several reasons for this.

The Securities Review Committee recommended, as early as in May 1988, that the disclosure threshold be reduced to 5% because :

"(a) 5% falls in line with international practice;

(b) 10% of a company's capital in Hong Kong is likely to be a much higher percentage of the free float than in other countries and consequently 10% of the free float wields a disproportionate amount of influence to its size;

(c) 10% makes it too easy for large investors to hide significant shareholdings and consequently to conceal their dealings in those shares; and

(d) 5% would be more effective in stamping out material insider trading."[(18)]

In a paper issued by the SEHK in March 1994 entitled *"The Way Forward for The Stock Exchange of Hong Kong",* the 10% threshold was considered to be too high given the limited free float in many Hong Kong stocks.[(19)]

In 1994, the Asian Development Bank commissioned a comparative study of the securities regulations and practices of 13 countries in Asia including Hong Kong. In the discussion paper issued by the study group in July 1994, "*Securities Market Regulation & Supervision"* (the ***"ADB Paper***"**),** it was recommended that countries in the Asian region should adopt a 5% disclosure threshold.[(20)] The reasons given for this recommendation are very similar to those referred to in the Hay Davison Report.

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(17) *Sections 3(1), 4(2) and 6(1) of the Ordinance.*

(18) *Paragraph 12.13 of the Hay Davison Report at pp.316-317*

(19) *Paragraph 4.2.11 of "The Way Forward for the Stock Exchange of Hong Kong" at p.21. This was a consultation paper prepared by the SEHK following many exploratory meetings between representatives of the Exchange and the market institutions and professionals named in the appendix of the paper. The paper incorporated as far as possible the views of these market participants.*

(20) *Section E of the ADB Paper at p.29.*

Furthermore, a review of the securities regulations of other jurisdictions shows that Hong Kong's 10% threshold is the highest among international and regional centres :

•	The U.K. :	3%[21]	The U.S. :	5%[22]
•	Australia :	5%[23]	New Zealand :	5%[24]
•	Japan :	5%[25]	Singapore :	5%[26]
•	Malaysia :	5%[27]	Thailand :	5%[28]
•	Indonesia :	5%[29]	The P.R.C. :	5%[30]

For the purpose of meeting international and regional standards and addressing the concerns raised by the Securities Review Committee, it is proposed that the initial disclosure threshold for substantial shareholding be reduced to 5%.

2. Notification period

The Current Position

The Ordinance requires a person under a duty of disclosure to perform that duty within 5 calendar days next following the day on which the duty arises.[31] Therefore, if a duty of disclosure arises on the 1st day of a particular month, notification must be made to the SEHK and the listed company concerned no later than on the 6th day of that month.

The Proposed Changes

It is proposed that the 5 days notification period be shortened to 2 business days because the current notification period is too long to provide adequate information to the Hong Kong market.[32] This means that if a duty of disclosure arises on the 1st day of the month, notification must be made on or before the 3rd day of that month.

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[21] *Section 199(2) of the U.K. Companies Act 1985.*
[22] *Section 13(d)(1) of the U.S. Securities Exchange Act 1934, as amended.*
[23] *Section 708 of the Australian Corporations Law.*
[24] *Sections 2 and 20 of the New Zealand Securities Amendment Act 1988.*
[25] *The Securities and Exchange Law, Cabinet Order for the Enforcement of the Securities and Exchange Law, and Ordinance of the Ministry of Finance Concerning the Disclosure of the State of Large Holdings of Shares.*
[26] *Section 81 of the Singapore Companies Act.*
[27] *Section 69D of the Malaysian Companies Act 1965.*
[28] *Section 246 of the Securities and Exchange Act B.E. 2535.*
[29] *Article 87 of the Capital Market Law 1995 of Indonesia.*
[30] *Article 47 of the Interim Regulations on the Administration of Stock Issuance and Trading promulgated by the State Council in April 1993.*
[31] *Section 7(1)(a) of, and Paragraph 14(1) of the Schedule to, the Ordinance.*
[32] *See also paragraph 4.2.11 of "The Way Forward for the Stock Exchange of Hong Kong" at p.21.*

The ADB Discussion Paper also recommends that a 2 days notification period be adopted.[33]

The notification period adopted by other jurisdictions is as follows :

- The U.K. : 2 business days[34]
- The U.S. : 10 days[35]
- The P.R.C. : 3 working days[36]
- Singapore : 2 days[37]
- Malaysia : 14 days[38]
- Indonesia : 10 days[39]
- Thailand : 1 business day[40]
- Australia : 2 business days[41]
- New Zealand : Notification must be given as soon as the person knows, or ought to know, that he is or ceases to be a substantial security holder, or as soon as he knows, or ought to know, that any change in his interest takes place.[42]

The majority of the above jurisdictions do not have more than a 2 business days notification period. It is important to note that the P.R.C. already has a shorter notification period than that of Hong Kong.

In view of the growing globalisation of securities markets and advancements in technological and telecommunications development, a 5 days notification period offers very limited transparency to the Hong Kong market.

Concerns have been raised that in view of the T+2 settlement period, it would be difficult for substantial shareholders and directors to provide the necessary details to the SEHK and listed companies within 2 business days. Two points should be borne in mind in this respect.

First, a substantial shareholder or a director is not obliged to make a notification under the Ordinance unless he has knowledge, or is aware, of his having acquired or ceasing to have an interest in shares or of his change in interest.[43] Therefore, the notification period does not start to run until the person is aware of his own position. Secondly, if a person is aware of his obligation to disclose under the Ordinance on the transaction day, the

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(33) *Section E of the ADB Paper at p.29.*
(34) *Sections 202(1) and 220(2) of the U.K. Companies Act 1985.*
(35) *Section 13(d)(1) of the U.S. Securities Exchange Act 1934, as amended.*
(36) *Article 47 of the Interim Regulations on the Administration of Stock Issuance and Trading promulgated by the State Council in April 1993.*
(37) *Sections 82 to 84 of the Companies Act of Singapore.*
(38) *Sections 69E, 69F and 69G of the Companies Act of Malaysia.*
(39) *Article 87 of the Company Law of Indonesia.*
(40) *Section 246 of the Securities and Exchange Act of Thailand.*
(41) *Sections 709(4), 710(4) and 711(4) of the Australian Corporations Act.*
(42) *Sections 20(4), 21(4) and 22(4) of the New Zealand Securities Amendment Act 1988.*
(43) *Sections 3(1) of, and Part II of the Schedule to, the Ordinance.*

information which would be difficult for him to disclose during a 2 business days notification period would be the details of the registered shareholders (since settlement takes place on the same day as the expiry date of the notification period). As one of the proposals is to remove the requirement that details of registered shareholders be disclosed, complying with the disclosure obligation within 2 business days should not pose a practical problem.[(44)]

In proposing the shortening of the notification period, the SFC has considered the practicality of compliance in view of the different time zones in which substantial shareholders and directors may operate. With the benefits of modern telecommunications developments, the SFC believes that compliance within a 2 business days notification period is practicable.

3. Timing to notify SEHK and listed companies

The Current Position

The Ordinance provides that disclosure under the Ordinance must be effected in such a manner as to ensure that it is received by the SEHK before it is received by listed companies.[(45)] The original objective of this provision was to ensure that listed companies would not receive information before the SEHK (which has been entrusted with the duty of releasing the information to the public).[(46)]

This requirement, however, has created considerable practical difficulties for all concerned, in particular, company secretaries. According to representations made to the SFC[(47)], it is common for directors and substantial shareholders to ask company secretaries or other staff of listed companies to complete and file notifications on their behalf. The act of completing and filing notifications by listed companies staff, however, technically contravenes the requirement that the SEHK must receive information prior to listed companies.

The Proposed Changes

It is proposed that notification to the SEHK be made at the same time as, or immediately following, notification to listed companies. This would address the technical problem mentioned above.

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(44) *See paragraph 5 on details of registered shareholders below.*

(45) *Section 7(1)(b)(ii) of the Ordinance (in relation to substantial shareholders) and paragraph 14(3) of Part II of the Schedule to the Ordinance (in relation to directors).*

(46) *Section 17(2) of the Ordinance.*

(47) *"The Securities Ordinance : A Suitable Time for Review", see note (5) above.*

4. De minimis change exemption

The Current Position

At present, the Ordinance requires a substantial shareholder to make a notification where any change in his interest in shares in the relevant share capital of a listed company results in a change in the *"percentage level"* of his interest.[(48)] Where the percentage figure representing the interest of a substantial shareholder is not a whole number, the substantial shareholder is required to round the figure down to the next whole number in order to arrive at the relevant *"percentage level"*: the *"rounding down rule"*.[(49)]

By way of illustration, the current system works as follows : If a person's original interest in shares in the relevant share capital of a listed company is 11.3%, and this interest subsequently increases to 11.9%, he is not required to disclose the increase to the SEHK or the listed company. This is because pursuant to the rounding down rule, the *"percentage level"* applicable to him before and after the increase is, in both cases, 11%. However, if this person's interest further increases from 11.9% to 12%, he will be under a duty of disclosure. This is because the *"percentage level"* applicable to him before and after the increase involves a change from the 11% percentage level to the 12% percentage level.

As a result of the rounding down rule, there are many cases in which a change in interest of as little as 0.01% would trigger a duty of disclosure (e.g. from 10.99% to 11%), but the building up of as much as 0.99% interest is not subject to disclosure (e.g. from 10% to 10.99%).

Representations have been made that the rounding down rule has created significant compliance burden for substantial shareholders whose interests in shares fluctuate in a small amount around a particular percentage level (e.g. percentage interest changes from 10.9% to 11% and then reduces to 10.8% : these changes give rise to two separate duties of disclosure involving only 0.1% and 0.2% percentage change respectively).

The Proposed Changes

The SFC agrees that the disclosure of changes in interest in a de minimis amount around a particular percentage level offers little to the market by way of information, but would create undue compliance work for substantial shareholders. To address this, it is proposed that substantial shareholders be exempted from making a notification if their interest in shares ***fluctuates within a 0.5% range around the same percentage level***.

Under this proposal, where any change in a person's interest in shares involves a cross over of a percentage level (the *"trigger point"),* the person

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(48) *Section 4(5)(b) of the Ordinance.*
(49) *Section 5(1) of the Ordinance.*

will be obliged to disclose the new interest held by him unless the following conditions are satisfied :

(i) he has filed a notification of interest pursuant to the Ordinance before the change (the *"last notification")* and the last notification was given because of a change in his interest due to the cross over of the same trigger point; and

(ii) the difference between the new interest and the interest disclosed in the last notification is less than 0.5% of the issued share capital of the listed company concerned.

The following example ***(Figure 1*)** may assist in explaining how the proposal would operate in practice :

(1) Assuming that X has a 6.9% interest in a listed company, he will be obliged to disclose his interest under the amended Ordinance because the initial disclosure threshold is at 5% (the first notification).

(2) If X's interest is then reduced from 6.9% to 5.1% (the crossed over percentage number or *"trigger point"* being 6%), he will be obliged to disclose his new interest at 5.1% (the second notification). In this case, condition (i) above is not satisfied because the first notification was filed as a result of the 5% initial threshold and not because of a cross over of the trigger point of 6%; and condition (ii) above is also not satisfied because the difference in interest between the first notification at 6.9% and the new interest at 5.1% is more than 0.5%.

(3) If X's interest is then increased from 5.1% to 6.2% (the trigger point being 6% again), he should also disclose the new interest of 6.2% (the third notification). This is because condition (i) is satisfied (6% being the same trigger point of the previous notification), but condition (ii) is not satisfied (the difference between 6.2% and 5.1% is more than 0.5%).

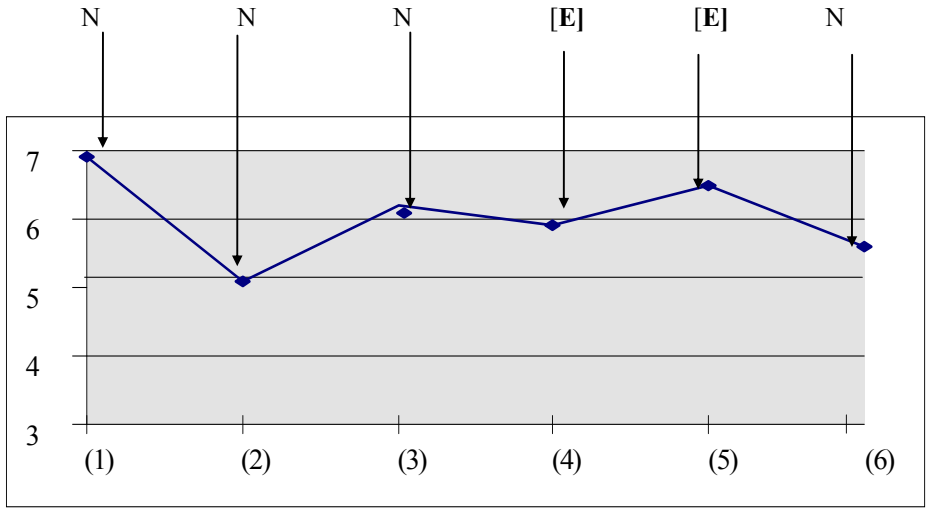
(4) Assuming that X now sells 0.3% interest so that his interest decreases from 6.2% to 5.9% (the trigger point being 6% as in the last or the third notification), he will **not** be required to disclose his new interest at 5.9% as a result of the proposed changes mentioned above. This is because both conditions (i) and (ii) are satisfied.

(5) If X then buys another 0.6% interest so that his interest increases from 5.9% to 6.5% (the trigger point being 6% as in the third notification), he is again ***not*** required to disclose because both conditions (i) and (ii) are satisfied. Condition (ii) is satisfied because the difference between 6.5% (the new interest) and 6.2% (the interest disclosed in the last notification) is less than 0.5%.

(6) If X subsequently sells 0.9% interest so that his interest reduces from 6.5% to 5.6% (the trigger point being 6% as in the third notification),

he will be required to disclose his interest at 5.6%. This is because condition (ii) is not satisfied (the difference between 5.6% (the new interest) and 6.2% (the interest disclosed in the last notification) is more than 0.5%).

Figure 1



N : Notification required **[E] : Notification exempted**

The proposed changes would relieve substantial shareholders of their obligations to disclose de minimis fluctuations of interest across a particular percentage level. Compliance costs would be reduced as a result. The public is asked to comment on this proposal including the need for such an exemption generally.

5. Details of registered shareholders

The Current Position

When performing a duty of disclosure, a substantial shareholder is currently required to include in his notification, so far as known to him when the notification is made, (i) the identity of each registered holder of shares; and (ii) the number of shares held by each registered holder.[(50)] If the substantial shareholder is not aware of these particulars at the time of notification, he must provide the particulars to the SEHK and the listed company concerned within 5 days from the date on which he later becomes aware of them. In addition, if there is any change in the particulars of registered holders previously notified, a substantial shareholder is further required to disclose the change within 5 days.[(51)]

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(50) *Section 7(6) of the Ordinance.*
(51) *Section 7(7) and (8) of the Ordinance.*

These provisions have been criticised for imposing a heavy burden on substantial shareholders as even very minor changes (such as the sale of one board lot of shares involving a change in the legal title, or the re-registration of stock following settlement by physical delivery) will need to be disclosed under the Ordinance.[52] The provisions are considered to be particularly onerous because a change in registered shareholders does not necessarily involve a change in the percentage level of a substantial shareholder's interest in shares.

The Proposed Changes

It is proposed that the existing provisions requiring substantial shareholders to disclose particulars and shareholdings of registered holders and any change in their particulars be removed. Compliance costs would be reduced as a result.

In proposing such change, the SFC has considered whether market transparency would be affected. The SFC believes that market transparency would not be significantly reduced after having regard to the following factors:

- The proposed change will lessen the compliance burden of substantial shareholders who choose to appoint a nominee to be the registered shareholder. It does not exempt a substantial shareholder who is also the registered shareholder from disclosing his interest.

- Listed companies will continue to have details of all registered shareholders under general company law.

- The power of listed companies to require information from persons having interests in them (as are currently provided in section 18 of the Ordinance) will remain unchanged. Such power is sufficiently wide to enable listed companies to obtain information on the identity of persons interested in shares including the identity and details of registered holders of shares should they consider it desirable.

- The powers of the Financial Secretary and the SFC to investigate the ownership of shares (as are currently provided under Part IV of the Ordinance) will also remain unchanged. Such powers are sufficiently wide to require the disclosure of the identity and details of registered shareholders.

At present, securities regulations in the U.K., U.S., Australia, New Zealand and Singapore still require the disclosure by substantial shareholders of details of registered holders.

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[52] *ibid, see note (5) above.*

6. Disclosure of consideration and agreements

The Current Position

The Ordinance does not currently require substantial shareholders to disclose consideration paid or received by them in relation to their acquisitions or disposals of interests in shares. However, it does require directors of listed companies to disclose consideration when they become, or cease to be, interested in shares or debentures.[(53)]

Securities regulations in a number of other jurisdictions require substantial shareholders to disclose consideration. These regulations also require substantial shareholders to disclose agreements or the material terms of agreements pursuant to which they become, or cease to be, interested in shares. These jurisdictions include :

- ***The U.S***.: U.S. laws require detailed particulars to be disclosed by substantial security holders. These include the source and the amount of funds or other consideration used, or to be used, in the purchase of securities. Substantial security holders are also required to classify the source of funds and to file copies of all written agreements, arrangements, understanding or proposals relating to the borrowing of funds, acquisition of control or transfer of securities.[(54)]

- ***Australia*** : Australian regulations[(55)] require substantial shareholders to disclose the consideration they paid in the acquisition of interest in voting shares and with respect to any change in such interest. With respect to interests acquired off-exchange, substantial shareholders are required to provide a copy of the contract, scheme or arrangement that gives rise to the duty of disclosure. If the relevant interest was acquired other than because of a contract, scheme or arrangement or where such contract, scheme or arrangement was not in writing, a memorandum must be attached to the notification disclosing full particulars of the circumstance giving rise to the duty of disclosure.

- ***New Zealand*** : Where the substantial security holder is a beneficial owner of voting securities, New Zealand regulations[(56)] require him to disclose the consideration and other terms of any transaction as a result of which he becomes a beneficial owner. If the person concerned is not a beneficial owner of voting securities, he is required to provide a copy of each contract, agreement or instrument pursuant to which he becomes interested in the relevant securities. Where there is no such

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(53) *Section 28(2)(a) to (d) of, and Part III of the Schedule to, the Ordinance.*

(54) *Section 13(d)(1)(B) of the U.S. Securities Exchange Act 1934, as amended and Schedule 13D.*

(55) *Forms 603, 604 and 605 prescribed for the purposes of sections 709 to 711 of the Corporations Law and Part 6.7 of the Corporations Regulations of Australia.*

(56) *Forms 2 and 3 prescribed for the purposes of sections 20 and 21 of the Securities Amendment Act 1988 of New Zealand.*

document, he is required to provide a memorandum specifying the material terms of any trust, agreement, arrangement or understanding pursuant to which the interest arises.

The Proposed Changes

So far as Hong Kong is concerned, the SFC does not see any particular justification for substantial shareholders to be treated differently than directors with respect to the obligation to disclose consideration.

For the purpose of improving market transparency and bringing Hong Kong's disclosure regime closer to international standards, the following is proposed:

(i) Substantial shareholders are required to disclose the consideration (in cash or otherwise) payable or receivable by them with respect to their acquiring or ceasing to have an interest in shares or with respect to a change in their interest in shares:

  (a) Where the acquisition or disposal of interests in shares took place *"on-exchange",* the highest and the average price of the shares should be disclosed.

  (b) Where the acquisition or disposal of interests in shares took place *"off-exchange",* the amount and nature of consideration should be disclosed.

  (c) With respect to the initial notification of a substantial interest, it is proposed that a person be only required to disclose consideration paid for the relevant interest acquired in the four months before the day he became a substantial shareholder.

(ii) In addition to the disclosure of consideration, where the acquisition or disposal of interest in shares took place *"off-exchange",* both substantial shareholders and directors are required to provide copies of contracts, agreements or documents in relation to the interest they acquire, or cease to have; and if there are no written contracts or agreements, to provide a memorandum specifying the material terms of any agreement, scheme, arrangement or understanding pursuant to which they acquire, or cease to have, the relevant interest in shares.

Several points should be highlighted in relation to the above proposals:

(a) General

If the proposed amendments are adopted, Hong Kong's disclosure regime would be more in line with that of the U.S., Australia and New Zealand (where consideration and terms of agreements are required to be disclosed). It would be relatively more comprehensive than the British and Singaporean regime (where no disclosure of consideration or terms of agreements are required).

(b) "On-exchange"-v- "Off-exchange" transactions

A distinction is made between *"on-exchange"* and *"off-exchange"* transactions because where transactions are made in the ordinary course of trading of a recognised stock exchange or futures exchange, standard contract specifications normally exist. Therefore, market transparency with respect to *"on-exchange"* transactions would not be an issue.

"Off-Exchange" transactions

"Off-exchange" acquisitions/disposals or transactions as used in this context, is a short-form reference to any transaction, arrangement or circumstance under which a person becomes, or ceases to be, interested in shares where the transaction or circumstance takes place otherwise than in the ordinary course of trading of a stock market of a recognised stock exchange or of a futures market of a recognised futures exchange. It is envisaged that *"stock market", "futures market, "recognised stock exchange"* and *"recognised futures exchange"* would be defined in substantially the same way as those terms are defined in the draft Composite Securities and Future Bill. *"Ordinary course of trading"* in this context does ***not*** include transactions carried out as a *"cross"* or *"special"* under the rules of the relevant exchange. Reference is made to *"futures market"* and to *"recognised futures exchange"* because it is proposed that *"interest in shares"* should be extended to derivatives on listed securities. Proposed amendments with respect to derivatives are discussed in detail in paragraph 11 below.

"On-exchange" transactions

As mentioned in sub-paragraph (i) of this paragraph 6, it is not proposed that the price in relation to each on-exchange transaction made by substantial shareholders be disclosed: only the highest and the average price would need to be disclosed. In this way, the time and administrative work involved in completing notification forms could be minimised, and the market would be given a general indication as to the price range within which substantial shareholders deal in securities.

7. <u>Shareholding structure of corporate substantial shareholders</u>

The Current Position

Under the Ordinance, a person is deemed to be interested in shares if a corporation is interested in them and :

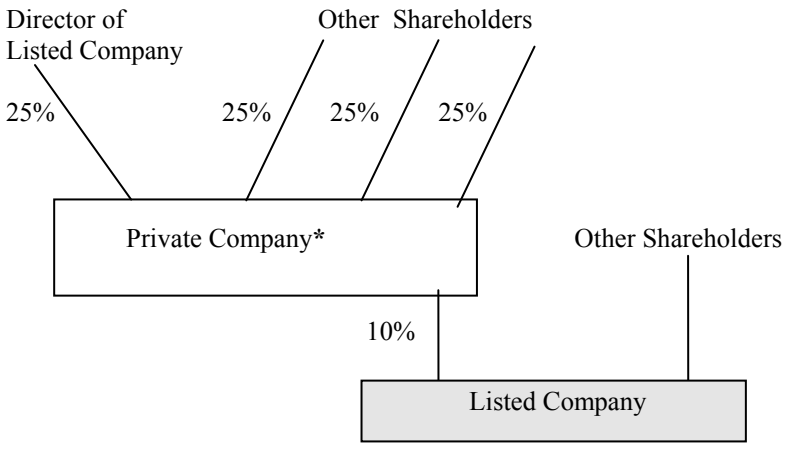
- that corporation or its directors are accustomed to act in accordance with his directions; or

- he is entitled to exercise or control the exercise of one-third or more of the voting power at general meetings of that corporation: the *"one-third rule"*[(57)].

In addition, where a person (*"Y"*) is entitled to exercise or control the exercise of one-third or more of the voting power at general meetings of a corporation (the *"first corporation"),* and that corporation is in turn entitled to exercise or control the exercise of one-third or more of the voting power at general meetings of another corporation (the *"second corporation"),* then for the purposes of the Ordinance, the voting power of the second corporation is also deemed to be exercisable by Y as well as by the first corporation.[(58)] Accordingly, for the purposes of disclosure under the Ordinance, any interest in shares held by the second corporation must also be aggregated with those held by Y and the first corporation. If the second corporation's interest in shares is equal to or more than 10% of the issued share capital, then each of Y, the first corporation and the second corporation, is obliged to disclose interests under the Ordinance.

The current provisions, however, are not adequate in dealing with the prevalent use of *"family-controlled"* companies in Hong Kong which has the effect of splitting shareholdings into small parcels and making information available to the market opaque. It is common for private companies to be established to hold substantial shareholdings in listed companies. For example, a father and three or more adult sons/daughters become shareholders of a private company with each of them having substantial shareholding in the company and collectively control it. The private company then directly or indirectly holds 10% or more interest in a listed company **(*Figures 2 and 3*).**

Figure 2



*** Notification required**

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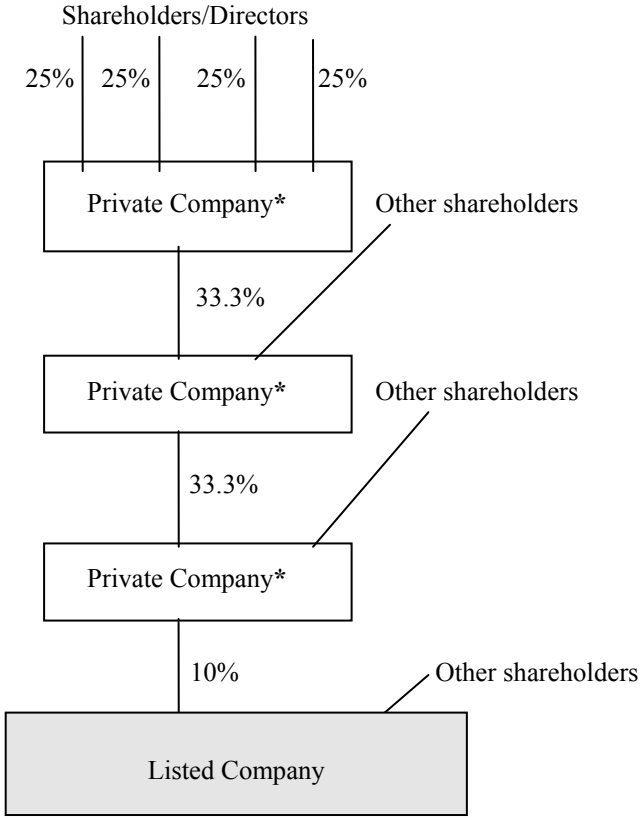
(57) *Section 8(2) of the Ordinance (in relation to substantial shareholders) and paragraphs 4 and 5 of the Schedule to the Ordinance (in relation to directors).*

(58) *Section 8(3) of the Ordinance (in relation to substantial shareholders) and paragraph 5 of the Schedule to the Ordinance (in relation to directors).*

Figure 3



Under the current Ordinance, provided that no single individual controls one-third or more of the voting power of the private company or its board, none of the family members (even if they were directors of the listed company) is obliged to disclose their interests under the Ordinance. Therefore, notifications filed under the Ordinance only disclose the name of the private company or a chain of private companies which directly or indirectly hold substantial shareholding in a listed company. Disclosure of the names of private companies is of limited use especially where the companies are incorporated overseas.[(59)]

The Proposed Changes

For the purpose of promoting market transparency, it is proposed that where an unlisted company is a substantial shareholder of a listed company, the notification filed by it must state:

(i) the substantial shareholder's issued share capital;

(ii) the name and address of any person who has 10% or more interest in its issued share capital;

[(59)] *Certain market participants considered the inability of the Ordinance to require disclosure of family controlled companies as a "loophole" - ibid, see note (5) above.*

(iii) the name and address of any person in accordance with whose directions the substantial shareholder or its directors are accustomed (whether legally or otherwise) to act; and

(iv) where any shareholder of the substantial shareholder is a director of the listed company concerned, the name of the director and his shareholding in the substantial shareholder (regardless of the amount of shareholding held by the director).

These details are in addition to other information required to be disclosed by substantial shareholders under the Ordinance. In considering the proposed changes, two points should be noted:

(a) Is this an extension of the one-third rule?

The proposed disclosure of shareholdings in corporate substantial shareholders must not be confused with the one-third rule mentioned above. The SFC does not wish to extend or introduce any changes to the current one-third rule. The difference between the one-third rule and the above proposal is as follows:

- Under the one-third rule, a person who is deemed to have a corporate interest in shares will, as a result of that, be obliged to file a notification under the Ordinance (e.g. where the aggregate of his personal interest and the deemed corporate interest reaches the initial disclosure threshold of 5%).

- Under the above proposal, however, the person who has a 10% or more interest in the issued share capital of an unlisted corporate substantial shareholder will ***not*** be required to file a notification under the Ordinance. The proposal only requires an unlisted corporate substantial shareholder to disclose details referred to in paragraphs (i) to (iv) above. ***The duty of disclosure will only be imposed on the substantial shareholder and not on the persons having 10% or more interests in it.***

(b) Subject of Application

It is intended that the disclosure obligation be applied to corporate substantial shareholders the shares of which are not listed on the SEHK or on an exchange recognised for the purposes of the revised Ordinance. An exchange would be recognised for such purposes if the jurisdiction in which it is established has a disclosure regime comparable to that of Hong Kong. The proposed changes, therefore, would apply to private companies the shareholdings of which are split into small parcels, and to public companies which are listed in jurisdictions the disclosure regime of which is not comparable to that of Hong Kong.

8. Discretionary trusts

The Current Position

The Ordinance treats substantial shareholders and directors differently in so far as persons associated with discretionary trusts are concerned.

The existing position with respect to substantial shareholders is as follows :

- Any person who knows, or becomes aware, that he has an *"interest in shares"* in a listed company which is equal to or more than 10% of its issued share capital carrying rights to vote at general meetings, is obliged to disclose his interest.[(60)] *"Interest in shares"* is widely defined to include an interest of any kind whatsoever in shares.[(61)] Where property is held on trust and an interest in shares is comprised in the property, section 13(3) of the Ordinance provides that a beneficiary of the trust is taken to have an interest in the shares.

- Section 14(1)(a), however, provides that where an interest in shares is held on trust, *"any discretionary interest"* is to be disregarded. At present, therefore, persons who are beneficiaries or objects of a discretionary trust are not required to file notifications under the Ordinance.

The existing position with respect to directors is as follows :

- A director of a listed company who knows or becomes aware that he is *"interested in shares or debentures"* of a listed company is under a duty to notify the company and the SEHK of his interest.[(62)] *"Interest in shares or debentures"* is widely defined to include any interest of any kind whatsoever in shares or debentures.[(63)] Where property is held on trust and an interest in shares is comprised in that property, paragraph 2 of the Schedule to the Ordinance also provides that a beneficiary of the trust is taken to have an interest in the shares.

- Unlike substantial shareholders, there is no equivalent of section 14(1)(a) for directors. Because of this, a director who knows that he is a beneficiary[(64)] or an object of a discretionary trust (which has an interest in a listed company) is obliged to disclose that interest regardless of whether the trustee of the discretionary trust has distributed or declared any interest in shares in favour of the director.

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(60) *Sections 3(1), 4(2) and 6(1) of the Ordinance.*

(61) *Section 13(2) of the Ordinance.*

(62) *Section 28 of, and Part II of the Schedule to, the Ordinance.*

(63) *Paragraph 1 of the Schedule to the Ordinance.*

(64) *Doubts have been expressed as to whether an object of a discretionary trust can be regarded as a "beneficiary" within the meaning of paragraph 2 of the Schedule. The Commission has taken the view that "beneficiary" is a widely used term referring to any person for the benefit of whom property is being held on trust. Black's Law Dictionary defines "beneficiary" to include "a person who has any present or future interest, vested or contingent". See also Underhill and Hayton on Law of Trusts and Trustees (14th Edition) at p.3.*

Previous discussions on the treatment of discretionary trusts

The existing *"discretionary interest"* exemption given to substantial shareholders is modelled on a similar provision in the U.K. Companies Act 1985.[(65)] The exemption was subject to much criticism when the 1987 Securities (Disclosure of Interests) Bill was issued for public consultation. The main criticism then was that it provided a ready vehicle for persons interested in shares to avoid the disclosure requirements in the form of discretionary trusts.

The exemption was considered in detail when the Monetary Affairs Branch (predecessor of the Financial Services Branch) issued a consultative document in April 1990 seeking comments on certain recommendations made by the Standing Committee on Company Law Reform. The consultative document made the following observations :

"It has not been suggested that there is anything inherently wrong with discretionary trust arrangements which are in fact common in Hong Kong in the context of tax planning and the conservation of family assets. It has been argued however that such an arrangement can and will be abused by those seeking to avoid the disclosure provisions under Part II of the Ordinance. It is argued that a substantial shareholder can set up a discretionary trust and divest himself of the legal ownership of the shares in question while still being able to retain control in practice over the exercise of the voting power of the shares...

Control in practice may be achieved by several means. First, the settlor may appoint himself to be one of the trustees. Secondly, he will have appointed the trustees and they are likely to listen to his views. Thirdly, the settlor can make it a condition precedent to the exercise of the trustees' discretion that consent from a specified person (including himself) to the exercise of the discretion be obtained by the trustees before the discretion is exercised.

Most often, however, the settlor can exercise influence over the trust by way of a non-legally binding "statement of wishes" which sets out the settlor's views on the ways in which he hopes the trustees will exercise their discretion. In general, trustees are expected to have little or no interest in exercising their discretion contrary to the settlor's wishes.

Although there is nothing untoward in settlors seeking to influence trustees or in trustees having recourse to the wishes of the settlor, there is scope for abuse in that the settlor of a discretionary trust (or others through him) may manage in practice to control the trustees' discretion....

The Standing Committee on Company Law Reform has considered this question. After careful consideration of the relevant arguments, the Committee concluded that there should not be a requirement for genuine discretionary objects to disclose their discretionary interests... However, the Standing Committee also accepted that the exemption of discretionary interests should not provide a loophole for avoidance of the disclosure requirements. The Committee recommended that the best approach would be -

(a) to retain the existing exemption for discretionary interests in section 14(1)(a) of the Ordinance, but

(b) to set out the circumstances in which an arrangement would be deemed not to be a discretionary interest for the purposes of the Ordinance.

We [the then Monetary Affairs Branch] envisage that the circumstances referred to in (b) above should include the situation where any person retains a measure of control over the

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[(65)] *Section 209(1)(a) of the U.K. Companies Act 1985.*

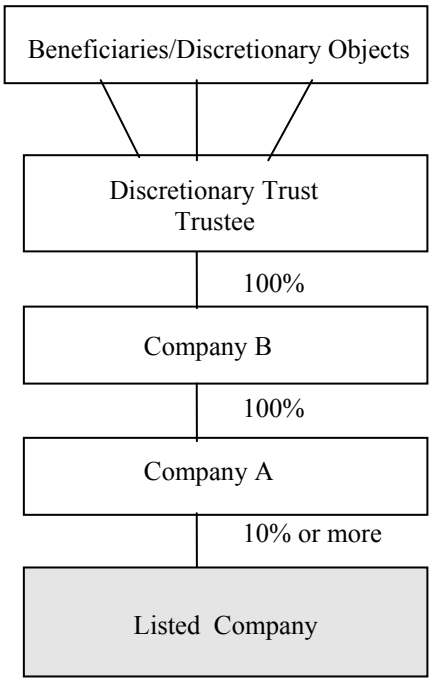
capital of a beneficiary trust or in accordance with whose instructions as to the management of the capital assets of the trust, the trustees are accustomed to act. The case where trustees are accustomed to act in accordance with a person's instructions relating only to payment of dividends received on the shares concerned should however be excluded..."

Out of the 11 submissions made in response to the 1990 consultation, 8 were in favour of the proposal in principle and 3 were against. The Monetary Affairs Branch decided in 1991 that there was no urgent need to amend the Ordinance in relation to discretionary interests and that the best course was to review the matter in a year's time in the light of experience gained after the Ordinance was put into operation.

Use of Discretionary Trusts

The Ordinance has now been in operation for over 6 years. The SFC notes that discretionary trusts have been commonly and increasingly used by substantial shareholders and directors to hold their interests in listed companies. There are generally two kinds of discretionary trust schemes being used in Hong Kong. The first kind involves a discretionary family trust holding substantial shareholding in a listed company either directly or indirectly through private companies owned by the trust *(Figure 4*).

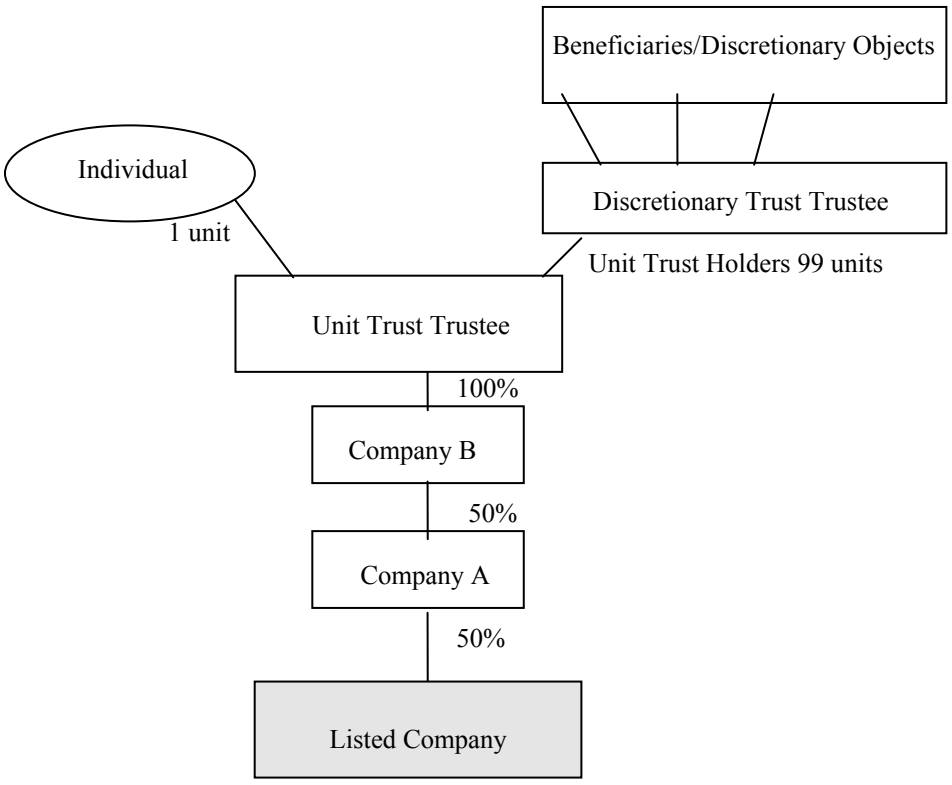
Figure 4 : Simple Discretionary Trust Scheme



Trustees of discretionary trusts are given extensive discretions to deal with trust property and to apply income or capital for the benefit of discretionary objects. They usually have the power to decide who are to receive benefits and in what proportion the benefits should be made.

The second type of discretionary trust scheme involves a private unit trust being interposed between the discretionary family trust and the listed company. In a typical scheme of this type, the shares of a listed company are held by the trustee of a private unit trust directly, or through companies owned by the unit trust. The majority (commonly up to 99%) of the units issued under the unit trust are held by the trustee of the discretionary trust and the remaining units by an independent individual *(Figure 5)*.

Figure 5: Unit Trust/Discretionary Trust Scheme



A common feature of this type of schemes is that two trust deeds would be executed: a trust deed for the discretionary trust (which creates a discretionary trust similar to that described above) and a trust deed for the unit trust. The initial trust property of the unit trust is often provided by the trustee of the discretionary trust who will then become the majority unit trust holder. The unit trust trustee would hold the property on trust for the unit holders, and would be given extensive powers to invest and deal with trust assets. Unlike the trustee of a discretionary trustee, the trustee of a unit trust does not normally have the power to decide who are to be benefited and in what proportion. However, it does have power to decide whether income should be accumulated, and when and how much income should be distributed. Once

the trustee makes a determination to distribute income, unit holders would receive income proportionately depending on the number of units held by them. No distribution in specie would normally be made to unit holders.

In Hong Kong, discretionary trust schemes are mainly used for tax planning purposes and for the conservation of family assets.[(66)] The popularity of discretionary trusts is also due to the flexibility that they can provide for the distribution of income and assets among members of the family, whilst at the same time, permitting the person who causes the trust to be established to have either direct or indirect control over assets which have become the property of the family members.

The SFC notes that in most cases, the primary purpose of establishing discretionary trusts is not to avoid the provisions of the Ordinance. However, as highlighted in the consultative document of the Monetary Affairs Branch, there does exist room for abuse under the current regime. The common use of discretionary trust schemes has the effect of obscuring the control of listed companies and reducing market transparency.[(67)] The SFC, therefore, proposes that the existing provisions be tightened to improve transparency with respect to discretionary trusts.

The Proposed Changes

Certain market participants have asked for the removal of the *"discretionary interest"* exemption currently granted to substantial shareholders on the basis that they should not be treated differently from directors.[(68)] These participants believe that the exemption allows a non-director shareholder to secretly accumulate substantial shareholding in a listed company by way of a discretionary trust, thus avoiding the need to make full disclosure.

The SFC has considered these representations. It has, at the present stage, come to the view that the exemption given to substantial shareholders should be retained, but additional provisions should be introduced to require further disclosure with respect to persons associated with discretionary trusts (see below). The reason for this is that, in the SFC's view, there is good reason for a director shareholder to be subject to more stringent disclosure requirements than a non-director shareholder because the former is a corporate insider. As many of the discretionary objects would not receive any interest in shares or other distributions under discretionary trusts, revealing their identities would

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(66) *The Hong Kong tax position must be contrasted with that of the U.K. where complex anti-avoidance provisions have been put in place so that the setting up of discretionary trusts does not provide significant advantage in terms of tax planning. This probably explains why discretionary trusts are less common in the U.K. than in Hong Kong.*

(67) *The problems in identifying control of shares held by discretionary trusts are, for example, highlighted in Mr. Nicholas Allen's report on Allied Group Limited and certain other companies published in August 1993 pursuant to his appointment as inspector under section 143(1)(c) of the Companies Ordinance. Among the matters investigated by Mr. Allen was the control of certain shares of Allied Group Limited owned by Minty Hong Kong Limited, the shares of which were in turn held by, or for the benefit of, a discretionary trust named the S.H. Trust, a family trust of Mr. Lee Ming Tee. (c/o the Allen Report paras. 4.55 to 4.100).*

(68) *ibid, note (5) above.*

provide the market with a great deal of information that may be meaningless and confusing. The SFC agrees with the Standing Committee on Company Law Reform that genuine non-director discretionary objects should not be required to disclose their discretionary interests in shares held through a discretionary trust.

With regard to the concern that non-director substantial shareholders may be able to make use of discretionary trusts to hide their interests in shares and the lack of transparency in the identity of persons who are, or are most likely to be, in control of discretionary trusts, the SFC proposes the following :

(i) In performing a duty of disclosure under the Ordinance, a substantial shareholder who is a trustee of a discretionary trust should be required to disclose the identity of the *"settlor"*. The same applies to a director of a listed company who is also a trustee of a discretionary trust.

(ii) A person who knows, or becomes aware, that a discretionary trust in relation to which he is a *"settlor"* has a notifiable interest, is ***for the purposes of the Ordinance only***, deemed to be interested in the shares held by that trust. The same applies to a director of a listed company who is also a *"settlor"* of a discretionary trust. This means that if a discretionary trust holds a 5% interest in the issued share capital of a listed company, the settlor of the trust will be deemed to be a substantial shareholder and be subject to a duty of disclosure.

(iii) It is proposed that the term *"settlor"* be defined for the purposes of the revised Ordinance as follows:

"Settlor", in relation to a discretionary trust, means a person who is responsible, either directly or indirectly, for the creation of the trust and includes any person -

(a) who directly or indirectly has provided, or undertaken to provide, property for the purpose of the trust;

(b) who has entered into a reciprocal arrangement with another person leading, directly or indirectly, to the creation of the trust, or who has procured another person, directly or indirectly, to create the trust;

(c) whose consent is required as a condition precedent (whether legally or otherwise) to the exercise by any trustee of his discretion in connection with the trust property; or

(d) in accordance with whose wishes (whether legally or otherwise) any trustee is accustomed, or would expect, to act,

but does not include a person employed or otherwise engaged by another person solely for the purpose of assisting in the creation of the trust."

Several points should be noted in relation to this proposal:

(a) The "settlor" approach

Unlike the recommendation put forward by the Standing Committee on Company Law Reform in 1990, the SFC does not seek to set out the circumstances under which an arrangement would be deemed not to be a discretionary trust. That approach, it is believed, is more rigid and if adopted, may run the risks of interfering with the proper administration of genuine discretionary trusts.

The SFC proposes that persons who are or are most likely to be, in control of, associated with, or in a position to, influence the management of discretionary trusts, be subject to a duty of disclosure. The term *"settlor",* as drafted, is defined by reference to the person who creates or sets up a discretionary trust and by describing the characteristics of such a person. Under most circumstances, these characteristics are strong indicators of the source of control of discretionary trusts. By requiring trustees to disclose the identity of the settlor, and by imposing an obligation to disclose on the settlor himself, the SFC believes that the market would be provided with more information on the principal persons associated with, and the sources of control of, discretionary trusts. The new provisions (if adopted) would not affect the tax position of discretionary trusts or persons associated with them or affect their position under existing trusts law.

(b) Meaning of "discretionary trust"

The term *"discretionary trust"* is not currently defined in the Ordinance. It is not intended that a definition be introduced. The term would be interpreted in accordance with current trust law. Normally, *"discretionary trust"* means a trust in which a beneficiary has no absolute current right to direct the trustees to pay him an ascertainable part of the trust property or net income.[(69)] Therefore, it should be sufficiently wide to cover a typical discretionary family trust described in Figure 4 above as well as the unit trust described in Figure 5 above.

(c) Practical implications of the proposed amendments

If the proposed amendments are adopted, the persons who would be required to file notifications in Figures 4 and 5 above are:

- ***Figure 4*** - Company A, Company B, trustee of the discretionary trust, settlor(s) of the discretionary trust, and if the beneficiaries include a director of the listed company, the director.

- ***Figure 5*** - Company A, Company B, trustee of the unit trust, the individual holding 1 unit and the trustee of the discretionary trust[(70)], settlor(s) of the discretionary trust, and if the

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(69) *Underhill and Hayton on Law of Trusts and Trustees (14th Edition) at p.30.*

(70) *Depending on how the trust deed of the unit trust is drafted, the unit trust may be a fixed trust or a discretionary trust. If the unit trust is a fixed trust, the trustee of the discretionary trust and the individual holding 1 unit would be required to disclose their interests as beneficiaries under*

beneficiaries of the discretionary trust include a director of the listed company, the director.

9. "Concert party" agreements

The Current Position

One of the avoidance devices used to circumvent notification requirements in the U.K. had been the formation of a *"concert party"* whereby persons acting in concert together amass a substantial shareholding without any person individually becoming obliged to notify his interest. The U.K. Companies Act 1985 contains stringent anti-avoidance measures designed to reveal such concerted action. These provisions were introduced into Hong Kong in the form of sections 9 to 11 of the Ordinance. In general, these provisions aim to prevent surreptitious *"warehousing"* of shares.

Section 9 concerns agreements between two or more persons which provides for the acquisition by one or more of the parties of interests in shares in a company: the *"target company"*. For the section to apply, the agreement must:

- include provisions imposing obligations or restrictions on one or more of the parties with respect to their use, retention or disposal of interests in the target company's shares acquired in pursuance of the agreement; and

- result in one or more of the parties acquiring an interest in that company's shares.

"Agreement" in the context of section 9 is widely defined so that it does not only include *"agreement"* in the formal sense. The term includes *"any agreement or arrangement"* and *"provisions of an agreement"* include *"undertakings, expectations or understandings operative under any arrangement ... and any provisions, whether express or implied and whether absolute or not"*.[71] Agreements which are not legally binding are not included unless they involve *"mutuality in the undertakings, expectations or understandings of the parties"*.[72]

Once the parties in concert are identified, they are each assumed (for the purposes of the Ordinance) to be interested in all the shares in the target company in which any other party to the agreement is interested apart from the agreement.[73] Thus, a reporting shareholder must notify the company and the SEHK as to his own interest (under the agreement or otherwise), but also as to all the interests of other parties to the agreement.

section 13(3) of the Ordinance. If the unit trust is a discretionary trust, the proposed amendments (if adopted) would require the trustee of the discretionary trust (and the individual holding 1 unit if he fits into the definition of "settlor") to disclose their interests as settlor(s) of the unit trust. In this case, the trustee of the unit trust would also be required to disclose the identity of the discretionary trust trustee (and probably the individual holding 1 unit) as settlor(s) of the unit trust.

(71) *Section 2(6) of the Ordinance.*

(72) *Section 9(6) of the Ordinance.*

(73) *Section 10 of the Ordinance.*

The Proposed Changes

The SFC notes that there has been a number of initial public offerings in which the 25% public float requirement of the SEHK was breached or avoided by a controlling shareholder or director indirectly funding the acquisition of shares by another person, and then controlling the shares so acquired through such person. As the objective of these indirect funding and acquisition arrangements is usually to warehouse listed shares for controlling shareholders/directors, the SFC takes the view that the existing provisions on *"concert party"* agreement should be tightened to specifically apply to these arrangements.

Accordingly, the SFC proposes that an agreement to which section 9 applies should include an agreement or arrangement under which a *"controlling shareholder"* (see below) or a director of a listed company provides a loan, or security for a loan, to any person on the understanding or with the knowledge that such loan or security will be used or applied by that person for the acquisition of an interest in the relevant share capital of a listed company. The above provisions, however, do not apply to a *"controlling shareholder"* or director who extends financing to any person within the ordinary course of its/his business:

(a) as an *"authorised institution"* as defined in the Banking Ordinance (i.e. licensed banks, restricted licensed banks and registered deposit taking company);

(b) as a *"money lender"* licensed under the Money Lenders Ordinance; or

(c) as a "*stockbroker", "registered dealer"* or *"exempt dealer"* within the meaning of the Securities Ordinance.

A *"controlling shareholder"* in this context means any person who is entitled to exercise, or control the exercise of, 35% (or such lower amount as may from time to time be prescribed) or more of the voting power at general meeting of the company.

The effect of the amendment is that any funding and acquisition arrangement mentioned above would be treated as a *"concert party"* agreement for the purposes of section 9. Hence, the *"funder-shareholder"* and any person who accepted the loan or security and who subsequently acquired the shares are

deemed to be parties to a concert party agreement. The *"funder-shareholder"* would be deemed to be interested in those shares the acquisition of which it helped fund, and would have to disclose details thereof as is currently required under sections 9 to 11 of the Ordinance.

In addition, it is proposed that parties to a *"concert party"* agreement be required to provide a copy of the agreement; and if the agreement is not reduced in writing, to produce a memorandum of its material terms.

10. Investment managers and trust companies

The Current Position

As in the case of other substantial shareholders, an investment manager or a trust company is (unless exempted) currently obliged to file notifications under the Ordinance if its interest in shares reaches the 10% disclosure threshold.

At present, section 14(1)(f) of the Ordinance and regulation 3(2) of the Securities (Disclosure of Interests)(Exclusions) Regulations disregard interests held by investment managers. Section 14(1)(f) and regulation 3(1)(c) of the same Regulations disregard interests held by trust companies.

Investment Managers

Section 14(1)(f) of the Ordinance and Regulation 3(2) of the Securities (Disclosure of Interests)(Exclusions) Regulations disregard interests held by an investment manager if :

(i) the interest concerned is an interest in shares listed on the SEHK;

(ii) such interest arises only by virtue of the fact that (not being the registered holder of the shares), the investment manager is entitled to dispose, or direct the disposal, of the shares pursuant to a written agreement to manage investments for another person; and

(iii) he is a stockbroker (i.e. a member of the SEHK), a registered or exempt securities dealer, a registered or exempt investment adviser, or a representative of a registered dealer or a registered investment adviser representative, within the meaning of the Securities Ordinance.

In practice, the scope of Regulation 3(2) is very limited. Since an interest in shares seldom arises exclusively because of an investment manager's power to dispose of shares (see paragraph (ii) above), the exemption is very rarely used. Investment management agreements usually contain provisions which give managers discretion to vote at general meetings (if clients fail to give instructions), take up rights issues, elect for scrip dividends or take certain other actions.

Certain market participants have proposed that Regulation 3(2) be amended :

- by extending the exemption to all investment managers, whether or not they are registered under the Securities Ordinance or are members of the SEHK (i.e. remove the requirements set out in paragraph (iii) above); and

- by providing that interests held by investment managers would be disregarded so long as the management agreement does not give them any power whatsoever in the exercise of voting rights, except in cases where managers are directed by beneficial owners to do so in relation to a specified proposal (i.e. remove the requirements set out in paragraph (ii) above).[(74)]

The Proposed Changes

The SFC has considered the above representations. Instead of widening the exemption currently made available to investment managers, the SFC is inclined to remove the exemption. There are several reasons for this :

(a) The existence of a block of shares representing 5% or more of the issued share capital of a company that could be disposed of or dealt with at the discretion of a single person (e.g. a fund manager or a stockbroker) would be of informational value to the market. The holding of or dealing in the shares may also have material effect on the liquidity of the company's shares and cause the share price to become more volatile. Widening of the existing exemption would obscure market transparency.

(b) The existing exemption does not serve any useful purpose as few investment managers could in practice take advantage of it. Its removal would level the playing field among investment managers.

(c) The exemption, if widened, would obscure transparency in the holding and dealing of securities by investment managers. The removal of the exemption would, on the other hand, improve market transparency.

(d) Extension of the exemption would be contrary to current international practices. Most other international financial centres provide no exemptions to investment managers :

- In the U.K., no exemption is given to investment managers. The initial disclosure threshold applicable to U.K. authorised investment managers, operators of U.K. authorised unit trusts and recognised schemes and certain E.C. collective schemes and any other persons whose interests in shares are deemed to have derived from such managers or operators, is 10% instead of the usual 3%.[(75)]

- In the U.S., no exemption is given to investment managers. Investment companies registered under the U.S. Investment Company Act of 1940, investment advisers registered under the U.S. Investment Advisers Act of 1940 and in certain circumstances, their respective groups and holding companies

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[(74)] *ibid, see note (5) above.*
[(75)] *Section 199(2), (2A), (6), (7) and (8) of the U.K. Companies Act 1985.*

are (subject to conditions) allowed to file short form disclosure statement within an extended notification period.[(76)]

- No exemption is given in Australia and New Zealand.

Trust companies

Section 14(1)(f) of the Ordinance and Regulation 3(1)(c) of the Securities (Disclosure of Interests)(Exclusions) disregard interests held by :

(i) a bank, deposit-taking company or an insurance company which is registered as a trust company under the Trustee Ordinance;

(ii) a subsidiary of a company referred to in paragraph (i) above;

(iii) a subsidiary of a Hong Kong incorporated bank, deposit-taking company or insurance company, where the subsidiary is registered as a trust company under the Trustee Ordinance; or

(iv) a subsidiary of a Hong Kong incorporated company, where such company is the holding company of a Hong Kong incorporated bank, deposit-taking company or insurance company; and where the subsidiary is a registered trust company under the Trustee Ordinance,

provided that the company or subsidiary referred to above is incorporated in Hong Kong and has a place of business in Hong Kong; and the interest held by it are held in its capacity as trustee or personal representative of any trust or estate.

Therefore, not all trust companies or their subsidiaries which have interests in Hong Kong listed shares are able to take advantage of the exemption provided by Regulation 3(1)(c). The exemption only applies to locally incorporated trust companies which belong to a group that conducts banking, deposit-taking or insurance business.

This exemption has been criticised for being too narrow. For asset protection reasons, it is common for trust companies to be incorporated overseas. These companies manage a great number of trusts the assets of which comprise interests in Hong Kong listed shares, but they cannot presently take advantage of the exemption.

Accordingly, certain interested groups have suggested that the exemption be extended to apply to all trust companies which are incorporated in *"reputable jurisdictions"* outside Hong Kong, or which are members of a *"reputable group of companies"*.

The Proposed Changes

[(76)] *Rule 13d-1(b)(1) of Regulation 13D of the U.S. Securities Exchange Act, 1934, as amended.*

The SFC has considered the above representations. Instead of widening the exemption, it is inclined to remove it. There are several reasons for this :

(a) In removing the exemption, a level playing field would be ensured for all trust companies.

(b) If the exemption were to be extended to trust companies incorporated in *"reputable jurisdictions"* or which are members of a *"reputable group",* many practical problems would arise in determining which jurisdictions or groups should be regarded as *"reputable"*.

(c) Widening the current exemption would be contrary to international practice. Most other international financial centres either provide no exemptions to trust companies or grant exemption that is equally (if not more) restrictive than that provided by the Ordinance:

- In the U.K. and U.S., no exemption is given to trust companies.

- In Australia, exemption is only given to a trustee when the relevant interest is held by him as a bare trustee or where the beneficiary of a trust is deemed to have a relevant interest in shares because he has a presently enforceable and unconditional right as against the trustee.[(77)]

- In New Zealand, exemption is given to locally authorised trust corporations which have been designated by the Securities Commission as a person to whom the exemption from disclosure applies.[(78)]

For the purpose of promoting market transparency, meeting international standards and creating a level playing field amongst trust companies, it is proposed that regulation 3(1)(c) of the Securities (Disclosure of Interests)(Exclusions) Regulations be repealed.

[(77)] *Section 39 of the Australian Corporations Law.*
[(78)] *Section 6(1)(e) of the Securities Amendment Act 1988 of New Zealand.*

11. Derivatives

When the Securities (Disclosure of Interests) Bill was published in 1987, there were no listed derivative warrants, exchange-traded stock options, or stock futures on Hong Kong listed shares. Subscription warrants i.e. warrants issued by a listed company to subscribe for shares to be issued by itself, were the only common derivative product in Hong Kong at that time.

The Ordinance in its existing form catches derivative warrants and exchange-traded stock options in some circumstances but excludes subscription warrants. It is difficult to justify this result. A full review of the Ordinance in this respect is necessary.

The above discrepancy was identified by the SFC and the SEHK and the Listing Rules were amended in November 1993 by adding paragraph 11 to the *"Model Code for Securities Transactions by Directors of Listed Companies"* (Appendix 10), which provides that:

> *"11. Every director shall notify to the Exchange and the company his interests in and dealings in warrants to subscribe for equity securities of the company at the same time and in the same manner as if the provisions of the SDI Ordinance relating to interests in shares were intended to include interests in rights to subscribe for shares."*

This amendment to the Listing Rules was intended to foreshadow amendment of the Ordinance in this respect.

The Current Position

- ***Subscription Warrants***

  The Ordinance now only requires disclosure of interests in respect of issued shares by substantial shareholders. Normally, subscription warrants issued by listed companies in Hong Kong are rights to subscribe for shares that have not been issued. This means that interests in subscription warrants issued by a listed company on its shares do not have to be disclosed by substantial shareholders.

  Regarding the position of directors' or chief executives' obligation to disclose their interests in subscription warrants, Part I of the Schedule to the Ordinance at paragraph 6(2) states that rights to subscribe for shares or debentures are not interests that require disclosure. The SFC takes the view that directors and chief executives are not required by the Ordinance to disclose their interests in subscription warrants issued by the listed company of which they are officers.

- ***Derivative Warrants and Stock Options***

  As at the end of March 1998, there were 248 SEHK-listed derivative warrants in respect of shares in listed companies. Of these, 228 were call warrants and 20 were put warrants. The first batch of derivative put warrants was listed on the SEHK in March 1996.

Unlike subscription warrants, interests in call derivative warrants are in respect of issued shares and disclosure by substantial shareholders, directors and chief executives is currently required.

The requirements of the Ordinance in relation to both call and put derivative warrants and call and put stock options under different circumstances are complex.

As with derivative warrants, exchange-traded stock options and most OTC stock options are in respect of issued shares. The disclosure of interests implications under the Ordinance on the holders and writers of this kind of products under different circumstances are analysed in Appendix 1. The following table is a summary of the current position under the Ordinance applicable to derivative warrants and stock options as set out in Appendix 1.

Position	***Do they constitute notifiable interest in shares under the Ordinance?***	
	For substantial shareholders	**For directors and chief executives**
Call		
• a person takes a call	Yes	Yes
• a holder assigns a call	Yes	Yes
• a holder exercises a call	Unclear	Yes
• a holder does not exercise a call on expiry	Unclear	Yes
• a person writes a call	No	Yes
• a writer of a call assigns the call	No	Yes
• a writer has a call exercised against him	No	Yes
• a writer whose call option lapses upon expiry	No	Yes
Put		
• a person takes a put	No	Yes
• a holder assigns a put	No	Unclear
• a holder exercises a put	No	Unclear
• a put expires without exercise by the holder	No	Unclear
• a person writes a put	Yes	Yes
• a writer of a put assigns the put	Yes	Yes
• a writer has a put exercised against him	Unclear	Unclear
• a writer whose put option lapses upon expiry	Yes	Yes

- ***Convertible Debt Securities issued by a Listed Company***

As most convertible debt securities are in respect of unissued shares of a listed company, the current position under the Ordinance is the same as that of subscription warrants discussed above, i.e. they do not constitute notifiable interests in shares.

- ***Stock Futures***

They are instruments with rights which do not involve acquisition or delivery of issued shares and therefore do not constitute *"interest in shares"* under the current Ordinance.

Position in other jurisdictions

- ***Australia***

The following is advice which we received from the Australian Securities Commission ("***ASC***"), based on Part 6.7 of the Corporations Law:

Position	Substantial Shareholder[(79)] For those answers with "yes" below, they mean that a substantial shareholder taking the position set out in the left hand column either acquires a relevant interest in the securities, or is required to make disclosure in relation to the position.
Call[(80)]	
• a person takes a call	Yes. If the substantial shareholder takes a call from a person who he knows holds shares to cover the call if it is made, then he should lodge a notice because his relevant interest will have increased.

[(79)] *Under the substantial shareholding provisions there is generally no greater requirement on directors and chief executives than other substantial shareholders. There are lesser requirements in other parts of the Corporations Law, but directors may fulfil them by complying with the substantial shareholding provisions.*

[(80)] *There is uncertainty currently over treatment of exchange traded options and futures in that the call holder and put writer will not know who their counterparty is and therefore will not know whether their counterparty has shares with which to cover the call or exercise the put. Many traders assume that they therefore cannot be aware of the relevant interest of the counterparty so do not have to lodge a notice. The ASC's current preferred position is that these persons should exercise caution and assume that their counterparty will have shares to cover the call or exercise the put and declare options accordingly. This is not widely accepted. There is a similar position in non-exchange traded options, but the holder will have more knowledge of the identity of their counterparty and the counterparty's share holdings. Therefore there will be less uncertainty, although it may still arise.*

Position	Substantial Shareholder For those answers with "yes" below, they mean that a substantial shareholder taking the position set out in the left hand column either acquires a relevant interest in the securities, or is required to make disclosure in relation to the position.
Call *(continues)*	
• a holder assigns a call	Yes. If the holder has no further contractual interest in the call he would be taken to have disposed of any shares which were the subject of the call. But if the assignment still relies on the original holder enforcing against the writer of the call then the holder would not have disposed of his interest in the shares. It is arguable whether the changed nature of the holder's interest in the shares subject of the call should be notified.
• a holder exercises a call	The holder would probably not have been taken to increase his relevant interest, so he would not be required to submit a new notice. It is arguable whether the changed nature of the holder's interest in the shares subject of the call should be notified. It would constitute a *"Notifiable Change in Entitlement"* under s708(6) because an associate's (the writer's) relevant interest would change.
• a holder does not exercise a call on expiry	Yes.
• a person writes a call	Probably no, because the person's entitlement would not change.
• a writer of a call assigns the call	No.
• a writer has a call exercised against him	Yes, when the writer delivered the shares to the holder of the call.
• a writer whose call option lapses	No.
Put	
• a person takes a put	No.
• a holder assigns a put	No.

Position	Substantial Shareholder For those answers with "yes" below, they mean that a substantial shareholder taking the position set out in the left hand column either acquires a relevant interest in the securities, or is required to make disclosure in relation to the position.
Put *(continues)*	
• a holder exercises a put	Yes, when the holder delivers the shares to the writer, the taker's relevant interest will drop.
• a holder allows a put option to expire	No.
• a person writes a put	Yes. If the substantial shareholder writes a put to a person who the writer knows holds shares to cover the put if he chooses to exercise the put, then he should lodge a notice because his relevant interest will have increased. This is based in part on s34 of the Corporations Law which accelerates a future transaction to the time of entering into the agreement.
• a writer of a put assigns the put	Yes. If the writer has no further contractual interest in the put he would be taken to have disposed of his interest in any shares which the holder might have required him to acquire under the put. But if the assignment still relies on the writer enforcing the put against the assignee of the put then the writer would not have disposed of his interest in the shares. It is arguable whether the changed nature of the writer's interest in the shares subject of the put should be notified.
• a writer has a put exercised against him	No. The writer had a relevant interest in the shares already.
• a writer of a put has the put lapsed unexercised	Yes. The writer's liability to take the shares lapses, so does his relevant interest.
Futures	
• a person takes a long futures position	Yes. The buyer of the future should expect to be able to demand delivery at the expiry date.
• a person takes a short futures position	No.

- ***The U.K.***

  As Part II of the Ordinance was *"borrowed"* from the Companies Act 1985 of the U.K., the disclosure requirements relating to interests in derivatives imposed on substantial shareholders are similar to those in Hong Kong. The U.K. position in respect of directors is different from

that in Hong Kong as section 323 of the 1985 Act prohibits a director from dealing in derivatives in respect of shares in his company.

As mentioned in footnote (6) in the section headed *"Direction for Change",* in a report entitled *"Regulation of the United Kingdom Equity Markets"* issued by the U.K. SIB in June 1995, it was commented that transparency was considered to be of fundamental importance to investor protection and market integrity. The report also proposed that *"purchases of put options"* and *"dealings in contracts for differences"* be required to be disclosed under the 1985 Act, and stated that most respondents answered this question (which was contained in a previous discussion paper) in the affirmative.

After the controversial use of equity derivatives by Trafalgar House in its bid for Northern Electric in 1995, the London Takeover Panel amended the Takeover Code extending the restrictions on dealings in the securities of the offeree company to cover dealings in derivatives. The new rules also change the rules on disclosure of dealings during an offer period. The parties to an offer, their associates and 1% shareholders in the offeree company now have to disclose dealings in derivatives in respect of securities of the offeree company, including details of the terms of the transactions. The London Stock Exchange also amended its rules in July 1995 so that market-makers are now required to disclose their holdings (including derivative positions) if they are above certain thresholds.

In the most recent report released by SIB in June 1996, it was said that in the light of the respective rule changes by the Takeover Panel and the London Stock Exchange, SIB has decided not to undertake further work for the present on extending the rules on disclosure of 3% interest to cover indirect stakes (i.e. derivative interests).

SFC enquiries suggest that OTC derivatives dealings by substantial or controlling shareholders have a significant influence on trading in shares in many listed companies with smaller market capitalization in Hong Kong and provide the explanation for changes in price and volume which are otherwise unexplained. In the interests of transparency and of deterring manipulative conduct the SFC believes that it is essential that the derivative dealings of substantial shareholders be fully declared to the market in a timely fashion.

Practical Difficulties

- ***Basis of Calculation***

  If derivative interests in respect of unissued share are required to be disclosed, a decision needs to be made on how to calculate the percentage of a substantial shareholder's share interests.

As explained in the document *"Proposals for Reform of Part VI of the Companies Act 1985"* (the ***"U.K. Reform Proposals"***) released in 1995, one major reason for originally excluding derivative interests in respect of unissued shares from the Act in 1985 was that it would be extremely difficult for the holders of warrants and convertibles to disclose their interests because they would not be able to determine accurately the company's future total issued share capital, i.e. the denominator for calculating their percentage interest.

However, the U.K. Reform Proposals commented that it might be helpful to companies, e.g. in a takeover situation, to know who has the potential to influence the companies' affairs by virtue of holding of warrants or convertibles. This information may also be of interest to the markets.

The document went on to say that, although a mathematically precise figure would be difficult to produce, one way of achieving a general indication would be for the holders of warrants and convertibles to be obliged to take these potential interests into account by using as the denominator the last known total relevant share capital figure.

In the U.S. (pursuant to Regulation 13D), disclosure of interest in derivatives in respect of unissued shares is required. However, Regulation 13D adopts a different formula in calculating the percentage of relevant interests. Regulation 13D provides that:

"Any securities not outstanding which are subject to such options, warrants, rights or conversion privileges shall be deemed to be outstanding for the purpose of computing the percentage of outstanding securities of the class owned by such person but shall not be deemed to be outstanding for the purpose of computing the percentage of the class by any other person."

The SFC prefers the proposal mentioned in the U.K. Reform Proposal document to the U.S. approach, so that the last known total relevant share capital (or total exercisable voting rights) figure is taken as the denominator for calculation of any relevant percentage of a shareholder. The reasons are:

- It is relatively simple to administer (from both shareholders' point of view and the regulators' point of view).

- The objective of the legislation is moving from disclosure of voting rights (takeovers oriented) to disclosure of dealing by deemed *"insiders"* (market transparency oriented), and accordingly the importance of having extreme accuracy of the percentage calculation has been reduced.

- This is especially true if the Ordinance is to cover derivatives in respect of unissued shares. Any particular formula is bound to be based on certain assumptions (e.g. the U.S. approach assumes that a certain class of derivatives is fully exercised) and the percentage figure becomes not particularly relevant.

- ***How to aggregate different types of derivative interests?***

If the Ordinance were to be amended to include derivative interests in respect of unissued shares (e.g. subscription warrants and stock futures), and to include the writing of a call and the holding of a put as *"interests in shares",* one technical difficulty is how to aggregate all these positions held by a shareholder. In particular, there are some derivative interests which carry the characteristics of a *"buy"* or *"long"* position, e.g. the taking of a long future, holding of a call and writing of a put, whilst some derivative interests carry the characteristics of a "sell" or "short" position, e.g. the taking of a short future, writing of a call and holding of a put. Should these interests be netted-off against each other?

There are three possible methods to address this technical issue:

(i) ***<u>Option 1</u>***

(a) The holding of a call, writing of a put and taking of a long future (derivative interests which carry the characteristics of a *"buy"* or *"long"* position) will be deemed interests in shares and will be included for the purpose of calculating the percentage of shareholding.

(b) If the aggregate of the above crosses over 5% or thereafter has 1% band movements, disclosure will be required.

(c) The writing of a call, holding of a put and taking of a short future (derivative interests which carry the characteristics of a *"sell"* or *"short"* position) are not *"interests in shares"* and will not be included for the purpose of calculating the percentage of shareholding but will be required to be disclosed if a person is making disclosure under (b) above and at the time of disclosure is still holding such positions.

(d) By way of example, if a person holds 2% shares in a listed company and 2% equivalent derivative call warrants in respect of such shares, and then holds 1.9% equivalent put stock options, he is not a substantial shareholder as the 1.9% holding of put options will not be included for such purpose. But equally this 1.9% holding of put options cannot be netted-off against any other interest in shares. However, if he then further acquires 1% shares (which makes him a 5% interest substantial shareholder), he is required to disclose the 1.9% holding of put options held by him at the time of disclosure.

(ii) ***<u>Option 2</u>***

(a) All derivative interests (including those carrying *"short"* or *"sell"* characteristics i.e. the writing of a call, holding of a put and taking of a short future) are *"interests in shares"* and will be aggregated for calculating the percentage of shareholding for disclosure purposes.

(b) Accordingly there will be no netting-off between different positions of derivative interests.

(c) By way of example, if a person holds 2% shares in a listed company and 2% equivalent derivative call warrants, and then writes 2% equivalent call options in respect of such shares, his aggregated interests in shares is 6% and he becomes a substantial shareholder (holding 5% or more) and disclosure is required. It should be noted that his holding of 2% call cannot be netted-off by his writing of 2% call.

(iii) Option 3

(a) For the purpose of calculating whether a person's interests in shares hit the 5% threshold so as to determine whether he becomes a substantial shareholder, only his shareholding and derivative interests carrying the characteristics of a *"long"* or *"buy"* position (i.e. holding of a call, writing of a put and taking of a long future) will be aggregated; thereafter, every 1% band change of shareholding aggregating with these derivative interests requires disclosure. No netting-off is allowed.

(b) A substantial shareholder is also required to disclose all his derivative interests carrying the characteristics of a *"short"* or *"sell"* position (i.e. writing of a call, holding of a put and taking of a short future) after he hits the 5% threshold under (a) above. Every 1% band change of these derivative interests carrying the characteristics of a *"short"* or *"sell"* position will be aggregated separately and require separate disclosure.

(c) By way of example, if a person holds 2% shares in a listed company, and 2% call warrants and holds 1.9% put options in respect of such shares, he is not a substantial shareholder since the 1.9% holding of put options will not be included for such purpose. However, if he then takes a 2% equivalent long future in respect of such shares, he becomes a substantial shareholder and is deemed to have 6% interests in shares of the listed company. He is then required to disclose his 1.9% interest of the holding of puts separately. If he then further writes 0.2% call in respect of such shares, that will make his *"short"* or *"sell"* positioned derivatives 2.1% in aggregate and further disclosure is required due to the 1% band change (i.e. his *"short"* or *"sell"* positioned derivative interest crosses over *"2%",* from 1.9% to 2.1%).

On the whole, it seems Option 2 offers most transparency as it deems more interests discloseable. However, some people may think that it would be unfair to aggregate a shareholder's *"short"* or *"sell"* positioned derivative interests, i.e. writing of a call, holding of a put and taking of a short future, with his shareholding and other derivative interests. Option 1 is less complex and is relatively easier for a shareholder to understand and administer but it offers less transparency. The disclosure of a substantial shareholder's interests in *"short"* or *"sell"* positioned derivatives, i.e. writing of a call, holding of a put and taking of a short future, under this option will be piecemeal and may not reflect a full picture of dealings in derivatives by the substantial shareholder, because he may have actively dealt in these derivatives and then disposed of such derivative interests before a disclosure obligation arises. Amongst the three options, Option 3 offers more adequate transparency and more meaningful information to the market, but is complex in terms of drafting and understanding of the legislation.

The SFC proposes that "sell" or "short" positioned derivatives (i.e. the writing of calls, holding of puts and taking of short futures) be required to be disclosed by substantial shareholders. The SFC would like to seek the market's views on this issue and which option the market would prefer. Public views on the practicality and compliance implications of the three options are also sought. Both the SFC and the SEHK prefer Option 3.

The Proposed Changes

The SFC proposes the following changes be made to the Ordinance in relation to derivative interests:

(a) All derivative interests in respect of unissued shares be required to be disclosed as in the case of derivatives in respect of issued shares. As a result, interests in subscription warrants and convertible debt securities issued by a listed company, as well as stock futures will be required to be disclosed.

(b) All dealings by directors or chief executives of derivative interests in respect of shares in a listed company of which they are officers are required to be disclosed. The only difference between this proposed change and the current Ordinance is that it is unclear at present whether disclosure is required in the cases where there is an assignment, exercise or expiry of a put held by a director. The position after the proposed changes will be less onerous than the position in the U.K., which totally prohibits a director from dealing in derivatives in respect of his company's shares.

(c) The last known issued relevant share capital will be taken as the denominator for the purpose of calculating the percentage of share interests.

(d) Regarding the treatment of *"sell"* or *"short"* positioned derivatives (i.e. the writing of calls, holding of puts and taking of short futures), and the method of aggregation of derivative interests, it is proposed to adopt one of the three options set out at pages 46 to 47 of this Paper. At the moment, both the SFC and the SEHK prefer Option 3.

(e) All changes in the nature of a derivative interest, whether resulting from an exercise or expiry or otherwise, are required to be disclosed even if the percentage of share interests remains unchanged.

Particulars required to be disclosed

The particulars in relation to derivative interests which are required to be disclosed are more particularly set out in the draft disclosure form in Appendix 2. In brief, the following details are, among others, required to be disclosed:

- type of share capital in relation which the derivative interest relates i.e. issued/unissued share capital;
- nature of interest e.g. writer/holder of call option;
- change in nature of interest e.g. exercise or conversion of derivatives.

12. Disclosure Forms

It is proposed that two sets of disclosure forms be prescribed to be used in relation to the revised Ordinance: one set for substantial shareholders and a separate set for directors. Further, for administration and clarity purposes, it is proposed that substantial shareholders and directors be asked to complete different forms depending on the circumstances under which their duty of disclosure arises. It is hoped that by doing so, the notification process could be streamlined.

With respect to substantial shareholders, therefore, four forms are proposed to be adopted as follows:

- ***Form 1*** - For use by substantial shareholders at a date to be fixed by the revised Ordinance, i.e. the effective date on which all persons interested in 5% or more of the issued share capital of a listed company is obliged under the revised Ordinance to disclose their interests. This takes into account the transition from the disclosure requirements of the existing Ordinance to those of the new Ordinance.

- ***Form 2*** - For use by substantial shareholders after the effective date referred to above. This form should be used by all persons who become interested in 5% or more of the issued share capital of a listed company after the effective date.

- ***Form 3*** - For use by substantial shareholders when there is any change in the notifiable interest previously disclosed. This form will be used when there is a change in the percentage level of the substantial shareholder's interest previously disclosed under Form 1 or 2.

- ***Form 4*** - For use by persons who have ceased to be a substantial shareholder.

With respect to directors, three forms are proposed to be adopted as follows:

- ***Form 1*** - For use by persons who become directors of listed companies after the date on which the revised Ordinance takes effect.

- ***Form 2*** - For use by directors when there is any change in their interest previously disclosed under Form 1 or disclosed before the date on which the revised Ordinance becomes effective.

- ***Form 3*** - For use by persons who have ceased to be a director.

A draft substantial shareholder Form 2 regarding initial disclosure is set out in Appendix 2 for comment. As the other forms are similar in nature and in a number of other respects, the SFC believes that it would be more appropriate to prepare the other notification forms in light of comments received as a result of this consultation.

The draft Form is unavoidably longer than the notification forms currently in use because additional information is required to be disclosed under the revised Ordinance, if adopted. However, in preparing the draft Form, the objective is to make it as self-contained and as user-friendly as possible: self-contained in the sense that the need to refer to the revised Ordinance could be minimised during the form completion process; and user-friendly in the sense that the Form is prepared in plain language. The statutory forms currently in use in other jurisdictions have been reviewed prior to designing this Form. When considering this draft Form, please note that the General Notes serve as general guidelines for completion of the Form and the Specific Notes serve as specific guidelines for completion of specific items of the Form.

Disclosure on a group basis is encouraged particularly for companies within the same corporate structure. It is intended that the forms, if adopted, will become prescribed forms for the purposes of the Ordinance.

For illustration purposes, two examples are included in Appendix 2 to show how the draft Form is intended to be completed, if adopted.

13. Disclosure of Share Pledges

During the financial turmoil at the end of 1997, share prices of several listed companies fell dramatically because banks and creditors holding shares pledged by substantial shareholders enforced security under loan agreements

by selling the pledged shares in the market. The question was raised as to whether more transparency should be given to the market with respect to share pledges made by substantial shareholders: should banks be required to disclose interests under the Ordinance when substantial listed shares are pledged to them, or should substantial shareholders be required to disclose share pledges and mortgages?

The current position under the Ordinance is as follows:

- Substantial shareholders who pledge shares as security for loans are not normally under any obligation to disclose the pledge. This is because on pledging their shares, shareholders do not usually cease to have interest in, or reduce the percentage holding of, their shares.

- Lenders are exempted from disclosure under the Ordinance (i) if they are authorised banks or licensed stockbrokers; (ii) if shares are held by them as security only for the purposes of the loan; and (iii) if the loan is provided to the shareholder in the ordinary course of their business. This is set out in section 14(1)(d) and 14(4) of the Ordinance. Lenders who do not satisfy these conditions are not exempted under section 14, and are obliged to disclose their interest in the shares if the pledged shares represent, in aggregate, 10% or more of the issued share capital of any listed company.

- If a substantial shareholder fails to pay any amount due under a loan and the lender enforces its rights under the pledge by taking/asserting possession and selling the shares in open market, the lender (even if it is exempted under section 14(1)(d)) would be under a duty to disclose its interest if the shares seized/sold by it constitute 10% or more of the issued shares of a listed company. This duty of disclosure would normally arise (i) at the time when the lender enforces its rights as mortgagee to take possession of the shares (i.e. acquisition of an interest in shares), and (ii) at the time when the sale of the shares is completed (i.e. ceasing to have an interest in shares). In such circumstances, the substantial shareholder is also under an obligation to disclose: the duty of disclosure would arise at the time when the lender exercises its rights to enforce security.

Banks

Banks are, therefore, required to disclose their interests in listed shares under the Ordinance. This is, however, not a disclosure of the pledges as such. The Ordinance currently acknowledges that transparency on share pledges is not necessary unless and until banks have exercised their powers as mortgagees or pledgees. The position is similar in the U.K. and in most other jurisdictions.
As the existing provisions are in line with international standards and the imposition of a duty on banks to disclose share pledges before enforcement of security might create undue burden on their normal business activities, it is not currently the SFC's intention to change the Ordinance in this respect. The SFC, however, welcomes any views on the subject.

Substantial shareholders

The question was also raised as to whether an obligation should be imposed on substantial shareholders to disclose any shares pledged.

In the *Report on Financial Market Review* issued by the SAR Government in April 1998, the SFC and the SEHK recommended that transparency on the financial position of listed companies should be enhanced in cases where loans are extended to listed companies subject to conditions that are out of their control. Such conditions include, for example, where the loan agreement contains an undertaking that the controlling/controlling shareholder must maintain a minimum shareholding in the listed company.[(81)] This matter is expected to be the subject of a separate public consultation.

It is acknowledged that substantial shareholders are entitled to pledge listed shares to raise funds for their own use and the existing Ordinance permits such activities without the need for disclosure until the shares are enforced by creditors to settle shareholders' indebtedness. The informational value of the pledge itself may not serve particularly useful purpose without the knowledge of the financial position of the substantial shareholder at a particular point in time. The SFC, however, welcomes any views in this connection.

14. Stock Lending and Borrowing

Since the Ordinance has come into operation, questions have been raised on whether a disclosure obligation would arise for a lender or a borrower of stock. The analysis of a standard stock lending and borrowing agreement suggests that it is likely that the borrower is deemed to have acquired an interest in the borrowed shares, and as a result, would need to disclose his interest as a substantial shareholder should his interest in shares represents 10% or more of a listed company's issued share capital. As far as the SFC is aware, this has not caused any particular practical problem because genuine stock lending and borrowing activities rarely build up to the 10% disclosure threshold. The SFC would, however, like to seek views on whether the proposed reduction of the initial disclosure threshold to 5% and the other proposed changes to the Ordinance mentioned in this Paper would create any particular obstacles for bona fide stock borrowing and lending activities.

[(81)] *At page 85, paragraph 4.144 of the Report on Financial Market Review.*

CONSULTATION

The Securities and Futures Commission invites interested persons to provide comments on this Consultation Paper **by 31 August 1998**. Comments should be addressed to :

The Securities and Futures Commission
12th Floor, Edinburgh Tower
The Landmark, 15 Queen's Road Central
Hong Kong.

For the attention of the Secretary to the Securities and Futures Commission.

Comments may be provided by E-mail to enquiry@hksfc.org.hk.

This Consultation Paper is also available on the SFC website at http://www.hksfc.org.hk.

Securities and Futures Commission

30 June 1998

Illustration of how draft Form 2 is intended to be completed

Example 1 - Substantial Shareholder holding derivatives

Hong Kong listed company XX Holdings Limited (stock code 10002) has a total issued share capital of HK$10,000,000 divided into 100,000,000 ordinary shares of HK$0.10 each. It also has 10,000,000 subscription warrants listed on the SEHK convertible into 10,000,000 ordinary shares at the exercise price of HK$2.00 each.

ABC Limited carries on business as a proprietary trader in securities. Through transactions made on 5 May 1999, it becomes interested in 5% of the issued shares of XX Holdings.

ABC Limited is 100% owned by an individual named T.K.Chan.

Acquisition History of ABC Limited between 24 April to 5 May 1999:

1. Between 24 to 28 April, acquired 1,500,000 subscription warrants of XX Holdings Limited on-exchange:

   - 500,000 warrants on 24 April at the average price of $0.50 and the highest price of $0.7 per warrant;

   - 1,000,000 warrants on 28 April at the average price of $0.51 and the highest price of $0.8 per warrant;

2. On 5 May, acquired 500,000 shares of XX Holdings on-exchange at $2.20 per share.

3. On 5 May, ABC Limited wrote put options in respect of 3,000,000 shares of XX Holdings to several institutional investors. The exercise price was fixed at $2.10 per share. The options are for a period of 6 months and the consideration received for the issue is $0.40 per option.

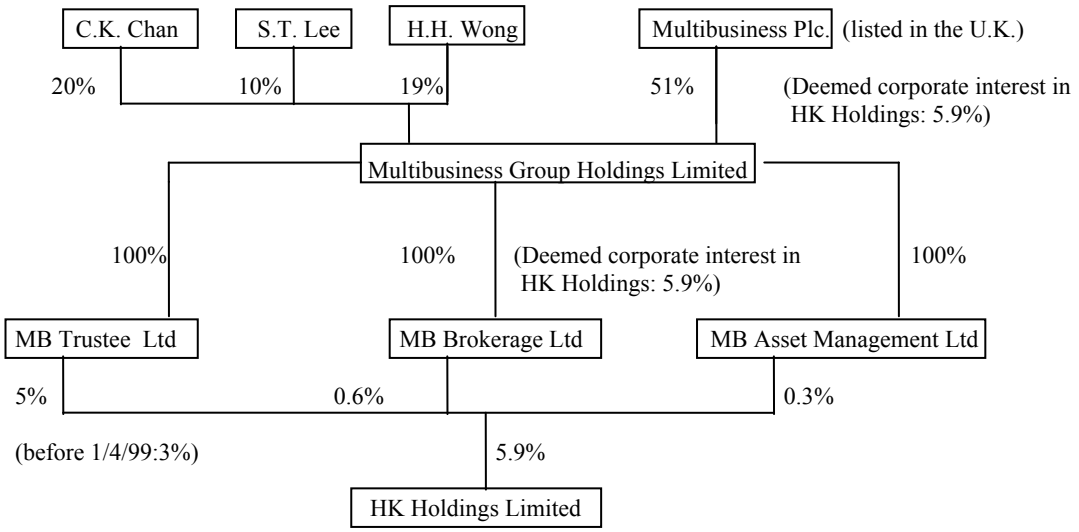
Illustration of how draft Form 2 is intended to be completed

Example 2 - Diverse Business Group

Hong Kong listed company HK Holdings has a total issued share capital of HK$50,000,000 divided into 50,000,000 ordinary shares of HK$1.00 each.

Multibusiness Group Holdings Limited is the holding company of a diverse business group providing professional trustees, brokerage and other services. Through acquisitions by its trustee arm of HK Holdings shares on 1 April 1999, the Group is deemed to be interested in 5.9% of HK Holdings. The Group's stake in HK Holding has been built up since August 1998. Details of its interests are as follows:

Corporate Chart of Multibusiness Group as at 1 April 1999:



Acquisition History of Multibusiness Group from August 1998 to 1 April 1999:

MB Trustees - Holds 2,500,000 (5%) HK Holdings shares as follows:

1. Appointed as the trustee of the AC Trust holding 1,000,000 HK Holdings shares on 1 August 1998, a trust established for the grand daughter of Amy Chan, deceased. On 2 March, the trust acquired additional 200,000 shares on-exchange at the average price of $2.8 and the highest price of HK$3.00. On 23 March, the trust acquired a further 300,000 shares off-market from an old friend of Amy Chan at the price of HK$3.00.

2. Appointed as the trustee of Ng Family Trust (a discretionary trust established for the family members of Peter Ng) on 1 April. On the same date, the trust was settled with 1,000,000 HK Holdings shares.

MB Brokerage - Holds 300,000 (0.6%) HK Holdings shares as broker/nominee for its clients.

MB Asset Management - Holds 150,000 (0.3%) HK Holdings shares as fund manager for various clients.

APPENDIX 2

FORM 2 - INITIAL SUBSTANTIAL SHAREHOLDER NOTICE

Please refer to the General Notes for general guidance. For completion of specific items, please refer to the Specific Notes. References to Specific Notes are marked [SN#] for ease of reference.

To : The Stock Exchange of Hong Kong Limited

Listed Company name : *XX Holdings Limited* **Stock Code : *10002***

From : Substantial Shareholder *[SN1]*

English & Chinese name (surname first) : *ABC Limited and T.K.Chan, disclosure on group basis*

Address : *For ABC Limited see below. For T.K. Chan: Flat G, 3rd, Floor, Richman Building, Hong Kong* Contact no: *For T.K. Chan: 2500123* HKID/Passport No.: *For T.C. Chan: P24680*

Additional information required from corporate Substantial Shareholder: *# For ABC Limited only:*

Business registration no. : *A1234* Place of Incorporation : *Hong Kong*
Registered office : *10th Floor, KK Building, Central, Hong Kong*
Principal place of business : *Same as above*
Person to whom enquiries can be directed : *T.K. Chan* Contact no. : *2500123*
Listing status: (a) ☐ listed on SEHK or other recognised exchange(s) (b) ☐ listed on other exchange(s) (c) ☒ Not listed *(If (a) applies, go to Paragraph 1; if (b) or (c) applies, complete the following.)*
Issued share capital: *HK$10,000 divided into 10,000 shares of HK$1.00 each*
Is any of the Substantial Shareholder's shareholder a director of the Listed Company: ☐ Yes ☒ No
If yes, state name(s) of the director shareholder(s) and his shareholding in the Substantial Shareholder:
Not Applicable

State name and address of person(s) holding 10% or more of the Substantial Shareholder's issued shares and/or persons in accordance with whose directions the Substantial Shareholder or its directors are used to act:

Name	*Address*	*% of shares held*
T.K. Chan	*Flat G, 3rd Floor, Richman Building, HK*	*100%*

1. The Notifiable Interest *[SN2]*

each of ABC Limited and T.K. Chan

Notice is given that the Substantial Shareholder ∧ has on *5 May 1999* (the "***Relevant Date***") an interest in *5,000,000* shares representing *5*% of the issued share capital of the Listed Company (the "***Notifiable Interest***"). In calculating this interest, the issued share capital of the Listed Company is taken to be *HK$10,000,000* divided into *100,000,000* shares of nominal value *HK$0.10* each.

2. Particulars of the Notifiable Interest

(i) Class of issued/unissued* share capital to which the Notifiable Interest relates: *[SN3]*
Issued ordinary shares and unissued ordinary shares

(ii) Number of shares in the Notifiable Interest that are held through derivatives or the interest of which are derived from derivatives: *[SN4]* *4,500,000 shares*

(iii) Circumstance(s) under which the duty of disclosure arose *(tick the relevant box(es)):*

For ABC Limited ☐ aquisition made on-exchange *[SN5]*
For ABC Limited ☐ acquisition made off-exchange
acquisition by way of gift
by being a trustee (other than a bare trustee)
by being a bare trustee or a nominee of another person
by being a beneficiary of a trust other than a discretionary trust
by enforcement or exercise of security
through a rights issue
through a scrip dividend issue
through share repurchases made by the Listed Company
due to family interest being attributed to Substantial Shareholder under Section [•]
For T.K. Chan ☐ due to corporate interest being attributed to Substantial Shareholder under Section [•]
by being a party to an agreement to acquire interest in the Listed Company as mentioned in Section [•]
by being a controlling shareholder providing cash or other consideration to facilitate acquisition of shares by another person as mentioned in Section [•]
by being a settlor of a discretionary trust *[SN6]*
Others _____ *(please specify)*

(iv) The capacity in which the Notifiable Interest is held by the Substantial Shareholder: *(please complete the relevant part(s)) [SN6]*

	Nature of interest	No. of shares concerned
For ABC Limited	(a) as the beneficial owner	*5,000,000*
For ABC Limited	(b) as the legal or registered owner	*5,000,000*
	(c) as a trustee (other than a bare trustee)	
	(d) as a bare trustee or a nominee of another person	
	(e) as a beneficiary of a trust not being a discretionary trust.....	
	(f) family interest being attributed to Substantial Shareholder under Section [•]	
For T.K. Chan	(g) corporate interest being attributed to Substantial Shareholder under Section [•].....	*5,000,000*
	(h) as a party to an agreement to acquire interest in the Listed Company as mentioned in Section [•]	
	(i) as a controlling shareholder providing cash or other consideration to facilitate acquisition of shares by another person as mentioned in Section [•]	
	(j) as a settlor of a discretionary trust	
	(k) others _____ *(please specify*)	

3. Consideration

(i) Please specify the consideration for the Notifiable Interest or any part of that Interest in Table (a) and/or (b) below. *(If any part of the Notifiable Interest arose or was acquired before the Relevant Date, include information up to four months before the Relevant Date).*

(a) Regarding interests in shares other than interests held through derivatives (if any):

#For T.K. Chan, nil consideration. For ABC Limited, see tables (a) and (b) :

Acquisition Date/ Date interest arose	*On-exchange (state name of exchange)*	*Off-exchange*	*no. of shares*	*Highest price*	*Average price*	*non-cash consideration*
5/5/1999	*SEHK*	*N/A*	*500,000*	*N/A*	*$2.20 fixed*	*N/A*

(b) Regarding interests in shares held through derivatives (if any):

Acquisition Date/Date interest arose	*On-exchange (state name of exchange)*	*Off-exch.*	*Description of derivatives (include stock code, if any)*	*No. of units of derivatives*	*Highest price*	*Average price*	*non-cash consider-ation*
24/4/99	*SEHK*	*N/A*	*Stock code 10101*	*500*	*$0.7/unit*	*$0.5/unit*	*N/A*
28/4/99	*SEHK*	*N/A*	*same as above*	*1,000*	*$0.8/unit*	*$0.51/u.*	*N/A*
5/5/99	*N/A*	*Yes*	*#Additional Sheet*	*#*	*#*	*#*	*N/A*

(ii) For off-exchange transactions disclosed above, please attach to this Form copies of contracts, agreements, scheme or understanding pursuant to which the Notifiable Interest arose. If there are no such written documents, please attach to this Form a memorandum specifying the material terms of any contracts, agreement, scheme, arrangement or understanding pursuant to which the Notifiable Interest arose. If any part of the Notifiable Interest arose or was acquired before the Relevant Date, include information up to four months before the Relevant Date. *[SN7]*

 # Additional Sheet

4. <u>Additional Information on Interest held through Derivatives</u>

If Paragraph 2(ii) applies, please indicate the capacity in which the derivatives are held by the Substantial Shareholder: *(please complete the relevant part(s))* *[SN8]*
#For T.K. Chan, not applicable. ABC Limited only, see below:

<u>Nature of interest</u>
<u>No. of shares concerned</u>

(a) as writer of call option on issued shares..... _____
(b) as holder of call option on issued shares..... _____
(c) as writer of put option on issued shares *3,000,000*
(d) as holder of put option on issued shares..... _____
(e) as holder of derivative call warrants..... _____
(f) as issuer of derivative call warrants ..... _____
(g) as holder of derivative put warrants ..... _____
(h) as issuer of derivative put warrants ..... _____
(i) as holder of convertible securities ..... _____
(j) as holder of subscription warrants *1,500,000*
(k) long of stock futures ..... _____
(l) short of stock futures ..... _____
(m) others _____ *(please specify)* _____

5. **Additional Information in relation to Family Interest** *# Not Applicable*

If Paragraph 2(iv)(f) applies, please provide information on the spouse and/or children under 18 whose interest in shares in the Listed Company is attributed to the Substantial Shareholder:

Name	*Address*	*Number of shares*

6. **Additional Information in relation to Corporate Interest** *# For ABC Limited, not applicable. For T.K. Chan, see below:*

If Paragraph 2(iv)(g) applies, please provide information on the corporation(s) whose interest in shares in the Listed Company is attributed to the Substantial Shareholder:

Name	*Address*	*Number of shares*
ABC Limited	*10th Floor, KK Building, Central, HK*	*5,000,000*

7. **Additional Information with respect to Interest being held Jointly** *# Not Applicable*

If the Substantial Shareholder holds any part of the Notifiable Interest jointly with any other person(s), please provide information on the other joint holders and their interest in shares in the Listed Company:

Name	*Address*	*Number of shares*

8. **Additional Information from Trustee of a Discretionary Trust** *# Not Applicable*

If the Substantial Shareholder holds any part of the Notifiable Interest as a trustee of a discretionary trust, please provide information on the trust and settlor(s) of the trust: *[SN9]*

Name of the trust	*No. of shares held by the trust*	*Name and address of settlor*

9. **Additional Information from a Party to an Agreement under Section [●]** *# Not Applicable*

(i) If Paragraph 2(iv)(h) or (i) applies, please provide information on the other parties to the agreement:

Name	*Address*

(ii) Please attach to this Form a copy of the relevant agreement. If there is no written agreement, please attach to this Form a memorandum specifying the material terms of the relevant agreement, arrangement or understanding.*[SN7]*

10. Declaration

I/~~We~~ declare that, to the best of my/our knowledge and belief, the information contained in this notice is true and accurate. *The number of pages that are annexed to this notice is *five*.

*I/~~We~~ *T.K. Chan* of *Flat G, 3rd Floor, Richman Building, HK* am/~~are~~ giving this notice *on my/~~our~~ own behalf. *and* as the agent of *ABC Limited* and hereby confirm and represent that I/~~we~~ have been duly authorised to give this notice.

Dated this *6* day of *May 1999*

[In the case of a notice given by an individual:] # By T.K. Chan as substantial shareholder:.

Signature###

[Usual Signature]
Tin King Chan *[Full name]*
P24680 *[HKID or Passport No.]*

[In the case of a notice given by a body corporate :]

This notice is given on behalf of ABC Limited [Name of body corporate] by T.K. Chan [Name of person signing the notice], director [position], who is duly authorised by the board of directors to give this notice.

Signature### *[Usual Signature]*
Tin King. Chan *[Full name]*
P24680 *[HKID. or Passport No.]*

** Delete as appropriate*

Additional Sheet

Disclosure by ABC Limited:

Re paragraph 3(i)(b):

Acquisition Date: 5 May 1999, off-exchange acquisition

Description of derivatives: to: Over the counter option in respect of 3,000,000 XX Holdings shares issued several institutional investors (details see attached agreement).

Price: Issue at $0.40 per option, exercise price at $2.10 per share, option term, 6 months. For details, see attached agreement.

Re paragraph 3(ii):

Copy of over the counter option agreement attached.

Certified as true and accurate by T.K. Chan on behalf of ABC Limited

Signature

Dated 6 May 1999

APPENDIX 2

FORM 2 - INITIAL SUBSTANTIAL SHAREHOLDER NOTICE

Please refer to the General Notes for general guidance. For completion of specific items, please refer to the Specific Notes. References to Specific Notes are marked [SN#] for ease of reference.

To : Listed Company name : HK Holdings Limited Stock Code :10001
The Stock Exchange of Hong Kong Limited

From : Substantial Shareholder *[SN1]*

English & Chinese name (surname first) : *Multibusiness Plc (Co.1) , Multibusiness Group Holdings Limited (Co.2), MB TrusteeLtd. (Co.3) Disclosure on a group basis : Corporate Chart attached*
Address: Additional sheet
Contact no: *see below* HKID/Passport No. *Not Applicable*

Additional information required from corporate Substantial Shareholder:

Business registration no. : *Additional Sheet* Place of Incorporation : *Additional Sheet*
Registered office : *Additional Sheet*
Principal place of business: *Additional sheet*
Person to whom enquiries can be directed : *M.M. Tsui* Contact no. *29001001*
Listing status: (a) ☒ listed on SEHK or other recognised exchange(s) (b) ☒ listed on other exchange(s)
(c) ☒ Not listed *(If (a) applies, go to Paragraph 1; if (b) or (c) applies, complete the following.)*
Issued share capital: *Additional sheet*
Is any of the Substantial Shareholder's shareholder a director of the Listed Company: ☒ Yes ☒ No
If yes, state name(s) of the director shareholder(s) and his shareholding in the Substantial Shareholder:
Not applicable

State name and address of person(s) holding 10% or more of the Substantial Shareholder's issued shares and/or persons in accordance with whose directions the Substantial Shareholder or its directors are used to act:

#For Co.2 only:

Name	*Address*	*% of shares held*
C.K. Chan	*No. 23 The Peak, HK*	*20%*
S.T. Lee	*No.1111 Repulse Bay Road, HK*	*10%*
H.H. Wong	*No 10 May Mansion, HK*	*19%*
Multibusiness Plc	*21 High Street, London, U.K.*	*51%*

#For Co. 3: sole shareholder is Multibusiness Group Holdings Limited. For Co.1, not applicable

1. The Notifiable Interest *[SN2]*

Co.1 and Co.2, each

Notice is given that the Substantial Shareholder has on *1 April 1999*
(the "***Relevant Date***") an interest in *2,950,000* shares representing *5.9*% of the issued share capital of the Listed Company (the "***Notifiable Interest***"). In calculating this interest, the issued share capital of the Listed Company is taken to be *HK$50,000,000* divided into *50,000,000* shares of nominal value *HK$1.00* each.
#For Co.3, it has on 1 April 1999 2,500,000 shares representing 5% of the issued share capital of Listed Company. The issued share capital is also taken to be HK$50,000,000.

2. Particulars of the Notifiable Interest

(i) Class of issued/unissued* share capital to which the Notifiable Interest relates*: [SN3]* *ordinary issued share capital*

(ii) Number of shares in the Notifiable Interest that are held through derivatives or the interest of which are derived from derivatives: *[SN4]* *Not applicable*

(iii) Circumstance(s) under which the duty of disclosure arose *(tick the relevant box(es)):*

- ☙ acquisition made on-exchange *[SN5]*
- ☙ acquisition made off-exchange
- ☙ acquisition by way of gift

For Co. 3

- ☙ by being a trustee (other than a bare trustee)
- ☙ by being a bare trustee or a nominee of another person
- ☙ by being a beneficiary of a trust other than a discretionary trust
- ☙ by enforcement or exercise of security
- ☙ through a rights issue
- ☙ through a scrip dividend issue
- ☙ through share repurchases made by the Listed Company
- ☙ due to family interest being attributed to Substantial Shareholder under Section [•]

For Co.1 and 2

- ☙ due to corporate interest being attributed to Substantial Shareholder under Section [•]
- ☙ by being a party to an agreement to acquire interest in the Listed Company as mentioned in Section [•]
- ☙ by being a controlling shareholder providing cash or other consideration to facilitate acquisition of shares by another person as mentioned in Section [•]
- ☙ by being a settlor of a discretionary trust *[SN6]*
- ☙ Others _____ *(please specify)*

(iv) The capacity in which the Notifiable Interest is held by the Substantial Shareholder: *(please complete the relevant part(s)) [SN6]*

		Nature of interest	*No. of shares concerned*
	(a)	as the beneficial owner	_____
	(b)	as the legal or registered owner	_____
For Co.3	(c)	as a trustee (other than a bare trustee)	*2,500,000*
	(d)	as a bare trustee or a nominee of another person	_____
	(e)	as a beneficiary of a trust not being a discretionary trust.....	_____
	(f)	family interest being attributed to Substantial Shareholder under Section [•]	_____
For Co.1 and 2	(g)	corporate interest being attributed to Substantial Shareholder under Section [•].....	*2,950,000*
	(h)	as a party to an agreement to acquire interest in the Listed Company as mentioned in Section [•]	_____
	(i)	as a controlling shareholder providing cash or other consideration to facilitate acquisition of shares by another person as mentioned in Section [•]	_____
	(j)	as a settlor of a discretionary trust	_____
	(k)	others _____*(please specify*)	_____

3. Consideration

(i) Please specify the consideration for the Notifiable Interest or any part of that Interest in Table (a) and/or (b) below. *(If any part of the Notifiable Interest arose or was acquired before the Relevant Date, include information up to four months before the Relevant Date).*

(a) Regarding interests in shares other than interests held through derivatives (if any):

 # For Co.1 and Co.2, nil consideration paid, see paragraph 6 below. For Co.3, see table:

Acquisition Date/ Date interest arose	*On-exchange (state name of exchange)*	*Off-exchange*	*no. of shares*	*Highest price*	*Average price*	*non-cash consideration*
2/3/99	*SEHK*	*N/A*	*200,000*	*$3.00*	*$2.80*	*N/A*
23/3/99	*N/A*	*Yes*	*300,000*	*nil*	*fixed $3.00*	*N/A*
1/4/99	*N/A*	*Yes*	*1,000,000*	*nil*	*nil*	*N/A*

(b) Regarding interests in shares held through derivatives (if any): *#Not Applicable*

Acquisition Date/Date interest arose	*On-exchange (state name of exchange)*	*Off-exch.*	*Description of derivatives (include stock code, if any)*	*No. of units of derivatives*	*Highest price*	*Average price*	*non-cash consider-ation*

(ii) For off-exchange transactions disclosed above, please attach to this Form copies of contracts, agreements, scheme or understanding pursuant to which the Notifiable Interest arose. If there are no such written documents, please attach to this Form a memorandum specifying the material terms of any contracts, agreement, scheme, arrangement or understanding pursuant to which the Notifiable Interest arose. If any part of the Notifiable Interest arose or was acquired before the Relevant Date, include information up to four months before the Relevant Date. *[SN7]*

 # see Additional Sheet

4. <u>Additional Information on Interest held through Derivatives</u> *#Not Applicable*

If Paragraph 2(ii) applies, please indicate the capacity in which the derivatives are held by the Substantial Shareholder: *(please complete the relevant part(s)) [SN8]*

	<u>Nature of interest</u>	*<u>No. of shares concerned</u>*
(a)	as writer of call option on issued shares.....	_____
(b)	as holder of call option on issued shares.....	_____
(c)	as writer of put option on issued shares	_____
(d)	as holder of put option on issued shares.....	_____
(e)	as holder of derivative call warrants.....	_____
(f)	as issuer of derivative call warrants	_____
(g)	as holder of derivative put warrants	_____
(h)	as issuer of derivative put warrants	_____
(i)	as holder of convertible securities	_____
(j)	as holder of subscription warrants	_____
(k)	long of stock futures	_____
(m)	others _____ *(please specify*)	_____

5. <u>Additional Information in relation to Family Interest</u> *# Not Applicable*

If Paragraph 2(iv)(f) applies, please provide information on the spouse and/or children under 18 whose interest in shares in the Listed Company is attributed to the Substantial Shareholder:

Name	*Address*	*Number of shares*

6. Additional Information in relation to Corporate Interest

If Paragraph 2(iv)(g) applies, please provide information on the corporation(s) whose interest in shares in the Listed Company is attributed to the Substantial Shareholder: *# See Attached Corporate Chart*

 # For Co.2:

Name	*Address*	*Number of shares*
MB Trustee Ltd	*12/F, Hong Kong Tower, HK*	*2,500,000*
MB Brokerage Ltd	*13/F, Hong Kong Tower, HK*	*300,000*
MB Asset Management Ltd	*14/F, Hong Kong Tower, HK*	*150,000*

 # For Co.1: All the above companies (details same as above) and Multibusiness Group Holdings Limited at 12 Broad Street, Guernsey. The number of attributed shares is 2,950,000. For Co.3, not applicable.

7. Additional Information with respect to Interest being held Jointly *# Not Applicable*

If the Substantial Shareholder holds any part of the Notifiable Interest jointly with any other person(s), please provide information on the other joint holders and their interest in shares in the Listed Company:

Name	*Address*	*Number of shares*

8. Additional Information from Trustee of a Discretionary Trust

If the Substantial Shareholder holds any part of the Notifiable Interest as a trustee of a discretionary trust, please provide information on the trust and settlor(s) of the trust: *[SN9]*

 # For Co. 3 only:

Name of the trust	*No. of shares held by the trust*	*Name and address of settlor*
Ng Family Trust	*1,000,000*	*Peter Ng at Flat B, 10/F, King's Court, Wanchai,*
		Hong Kong.

 # Co.1 and 2, not applicable.

9. Additional Information from a Party to an Agreement under Section [●] *#Not Applicable*

(i) If Paragraph 2(iv)(h) or (i) applies, please provide information on the other parties to the agreement:

Name	*Address*

(ii) Please attach to this Form a copy of the relevant agreement. If there is no written agreement, please attach to this Form a memorandum specifying the material terms of the relevant agreement, arrangement or understanding.*[SN7]*

10. Declaration

I/We declare that, to the best of my/our knowledge and belief, the information contained in this notice is true and accurate. *The number of pages that are annexed to this notice is *five*.

*I/We *MB Trustee Ltd of 12/F, Hong Kong Tower, H.K.* am/are giving this notice *on my/our own behalf. and as the agent of *Multibusiness Plc and Multibusiness Group Holdings Limited* and hereby confirm and represent that I/we have been duly authorised to give this notice.

Dated this *2nd* day of *April 1999*

[In the case of a notice given by an individual:]

_____ *[Usual Signature]*
_____ *[Full name]*
_____ *[HKID or Passport No.]*

[In the case of a notice given by a body corporate :]

This notice is given on behalf of Co.1, Co.2 and Co.3 [Name of body corporate] by M.M.Tsui of MB Trustee Ltd [Name of person signing the notice], Company Secretary [position], who is duly authorised by the board of directors to give this notice.
# of Co.1, Co.2 and Co.3

Signature### [Usual Signature]
Man Man Tsui [Full name]
P123456 [HKID. or Passport No.]

** Delete as appropriate*

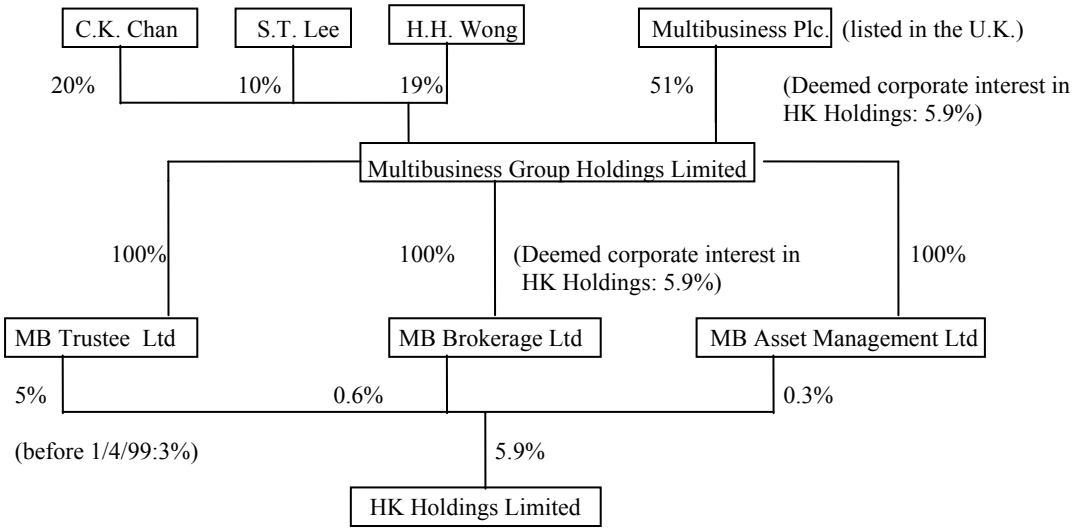
Additional Sheet

On Substantial Shareholders:

Keys: Co.1 - Multibusiness Plc
Co.2 - Multibusiness Group Holdings Limited
Co.3 - MB Trustees Ltd.

Business Registration No:	Co.1 - P10301, Co.2 - D123001, Co.3 - 455637A
Place of incorporation:	Co.1 - U.K., Co.2 - Guernsey, Co.3 - Hong Kong
Registered Office :	Co.1 - 1 High Street, London, U.K.
	Co.2 - 12 Broad Street, Guernsey.
	Co.3 - 12/F, Hong Kong Tower, H.K.
Principal place of business:	All same as above.
Listing Status:	Co.1 - (a) listed on the LSE, Co. 2 and Co.3, (c) - Not listed.
Issued Share Capital:	Co. 1 - L200,000,000 divided into 200,000,000 shares of L1.00 each.
	Co.2 - US$1,000,000 divided into 1,000,000 shares of US$1.00 each.
	Co.3 - HK$5,000,000 divided into 50,000,000 shares of $0.1 each.

Corporate Chart:



Re Paragraph 3(ii)

1. See attached sale and purchase agreement dated 23 March 1999 made between AC Trust as buyer and C.C. Chan as seller of 300,000 shares of HK Holdings Limited at the fixed price of $3.00.

2. See attached deed of settlement by Peter Ng in favour of MB Trustee Ltd as trustee of the Ng Family Trust.

Date: 2 April 1999

Certified as true and accurate and signed by M.M. Tsui, Company Secretary of MB Trustee Ltd for and on behalf of Co.1, Co.2 and Co.3

Appendix 1

Summary of current position under the Ordinance applicable to derivatives

The analysis below applies to both derivative warrants and stock options. For the purpose of this Appendix, the word *"writer"* (of an option) includes an *"issuer"* (of a warrant), and the words *"taker"* or *"holder"* include *"warrantholder"*. The terms *"writing", "taking"* and *"holding"* are to be understood accordingly.

Call

(i) The taking of a call by a person

(a) *If the person is a substantial shareholder*:

Under section 13(5)(b) of the Ordinance, normally the taking of a call is "an interest in shares" and will be aggregated to a person's notifiable percentage and disclosure is required by of substantial shareholder dealings in such instruments (whether or not together with other "interests in shares") that would take him through a 1% band.

(b) *If the person is a director or chief executive*:

The taking of a call by a director or chief executive is required to be disclosed under rule 6(1)(b) of Part I of the Schedule of the Ordinance, which is identical with section 13(5)(b).

(ii) The assignment of a call by a holder

As the taking of a call is regarded as "interest in shares", the subsequent assignment of a call by a director or chief executive in any amount, or by a substantial shareholder in an amount that would take him through a 1% band, is required to be disclosed.

(iii) The exercise of a call by a holder or lapse of such call without exercise

(a) An expiry of a call without exercise by a holder means that his "interest in shares" lapses upon expiry of the call. Disclosure is therefore required if the holder is a director, chief executive or a substantial shareholder (for any 1% band change).

(b) A question arises if a holder who is also a substantial shareholder exercises a call and shares are delivered to him afterwards but his percentage of shareholding, as a result of such exercise, does not change. In some circumstances, this may be covered by section 7(7) of the Ordinance, which provides that:-

"A person who has an interest in shares comprised in a listed company's relevant share capital, that interest being notifiable under section 3, is under a duty to notify the listed company and the Exchange Company in writing [any change in the particulars of the identity of each registered holder of shares]...".

Where an exercise of a call involves delivery of shares and a change of the identity of the registered holder, disclosure is required. If shares are delivered from the writer to the holder in "street names" without changing the identity of the registered holder, disclosure will not be required.

(c) If an exercise of a call involves cash settlement, the call option holder's interest in shares lapses and disclosure is required as in the case of an expiry of a call without exercise (see paragraph (a) above).

(d) In the case where a director or chief executive exercises a call, disclosure is required pursuant to rule 12 of Part I of the Schedule.

(iv) <u>The writing of a call by a person</u>

(a) *If the person is a substantial shareholder*:

It appears that under the current Ordinance the writing of a call does not increase or reduce the percentage of interest of underlying shares, and as a result disclosure is not required. There is no provision under Part II of the Ordinance (applicable to substantial shareholders) which is similar to section 28(2)(b) (applicable to directors and chief executives, see below).

(b) *If the person is a director or chief executive*:

As mentioned above, disclosure is required by virtue of section 28(2)(b) which provides that:

"(2) A director ... is under a duty to notify the company and the Exchange ... of the following events:-
(b) the entering into by him of a contract to sell any shares [in the company]; ...".

(v) <u>A writer has a call exercised against him or a writer has such call lapsed without being exercised</u>

(a) *If the writer is a substantial shareholder*:

Since the writing of a call carries no interest in the underlying shares, the termination (whether through exercise or expiry) of a call against a writer, from the writer's point of view, imposes no disclosure

requirement. However, upon an exercise by a holder, a writer may be required to deliver shares to the holder and thus the writer's reduction of interest in shares as a consequence of the exercise may have disclosure implications.

(b) *If the writer is a director or chief executive*:

Disclosure is required for the following reasons:-

- by virtue of section 28(2)(b), the writing of a call by a director or chief executive is interest in shares and is required to be disclosed; and

- by virtue of rule 12 of Part I of the Schedule, if a writer has a call exercised against him (or has such call lapsed without being exercised) by a holder, it would be deemed to be cessation of interest in shares.

Put

(vi) <u>The taking of a put by a person</u>

(a) *If the person is a substantial shareholder*:

The taking of a put by a substantial shareholder is not interest in shares and no disclosure is required.

(b) *If the person is a director or chief executive*:

It appears that section 28(2)(b) (the entering into of a contract to sell shares) covers such situation and disclosure is required.

(vii) <u>The assignment of a put by a holder</u>

(a) *If the holder is a substantial shareholder*:

As the taking of a put is not interest in shares, the subsequent assignment by the holder of a put does not have any disclosure implications.

(b) *If the holder is a director or chief executive*:

Section 28(2)(b) only refers to the "entering" of a contract by a director or a chief executive, and it can be argued that it may not be interpreted to cover "subsequent sale" or "assignment" of such a contract. On the other hand, it may be argued that cessation of the entering of a put contract means cessation of the director's or chief executive's interest in shares and disclosure would be required. The

effect of section 28(2)(b) is unclear in the case where a director or chief executive assigns a put.

(viii) ***<u>The exercise of a put by a holder or lapse of such put without exercise</u>***

(a) *If the holder is a substantial shareholder*:

Under the current Ordinance, the exercise of a put (or lapse of the put without exercise) is not of itself required to be disclosed. However, if actual delivery of shares takes place which reduces the substantial shareholder's holding through a 1% band, or makes his shareholding fall below the notifiable percentage, disclosure is required.

(b) *If the holder is a director or chief executive*:

Similar to the case where a director or chief executive sells a put, it is unclear whether a director or chief executive, when he exercises a put (or allows the put to expire without exercise), is required to disclose such "cessation of interest" under section 28(2). It seems rule 12 of Part I of the Schedule is also not wide enough to cover this situation, as it only refers to "contract for purchase" and "right to call for delivery of shares" but not "contract for sale" and "right to sell shares". However, if actual delivery of shares takes place, the director or chief executive is required to disclose his reduction of interest.

(ix) ***<u>The writing of a put by a person</u>***

(a) *If the person is a substantial shareholder*:

The writing of a put is "an obligation to take an interest in shares" under section 13(5)(b) and constitutes "an interest in shares which is to be notified".

(b) *If the person is a director or chief executive*:

Rule 6(1)(b) of Part I of the Schedule is identical with section 13(5)(b) and disclosure is therefore required.

(x) ***<u>A writer has a put exercised against him or a writer has such put lapsed without being exercised</u>***

(a) The writing of a put by a director, chief executive or substantial shareholder is "interest in shares" under the Ordinance. Therefore, from the writer's point of view, an expiry of a put (or lapse of the put) written by him without being exercised is cessation of interest in shares and disclosure is required if the writer is a director, chief executive or substantial shareholder (for any 1% band change).

(b) Similar to the case where a holder exercises a call, a writer's interest does not cease if a put is exercised and shares are delivered to him. It is only the nature of his interest which has changed. Again, section 7(7) of the Ordinance does not apply if the shares are delivered in "street names". Therefore, if the writer is a substantial shareholder, the current position is unclear.

(c) If the writer is a director or chief executive, the current position is not as straightforward as in the case where a director or chief executive who is a holder and exercises his call because rule 12 of Part I of the Schedule to the Ordinance only refers to "contract for purchase" and "right to call for delivery of shares" but not "contract for sale" and "obligation to sell shares".

APPENDIX 2

FORM 2 - INITIAL SUBSTANTIAL SHAREHOLDER NOTICE

Please refer to the General Notes for general guidance. For completion of specific items, please refer to the Specific Notes. References to Specific Notes are marked [SN#] for ease of reference.

To : Listed Company name : _____ Stock Code :_____
The Stock Exchange of Hong Kong Limited

From : Substantial Shareholder *[SN1]*

English & Chinese name (surname first) : _____
_____
Address : _____
_____ Contact no: _____ HKID/Passport No._____

Additional information required from corporate Substantial Shareholder:

Business registration no. :_____ Place of Incorporation :_____
Registered office : _____
Principal place of business : _____
Person to whom enquiries can be directed : _____ Contact no. : _____
Listing status: (a) ☐ listed on SEHK or other recognised exchange(s) (b) ☐ listed on other exchange(s) (c) ☐ Not listed *(If (a) applies, go to Paragraph 1; if (b) or (c) applies, complete the following.)*
Issued share capital: _____
Is any of the Substantial Shareholder's shareholder a director of the Listed Company: ☐ Yes ☐ No
If yes, state name(s) of the director shareholder(s) and his shareholding in the Substantial Shareholder:
_____
_____
State name and address of person(s) holding 10% or more of the Substantial Shareholder's issued shares and/or persons in accordance with whose directions the Substantial Shareholder or its directors are used to act:

Name	*Address*	*% of shares held*

1. The Notifiable Interest *[SN2]*

Notice is given that the Substantial Shareholder has on _____ (the "***Relevant Date***") an interest in _____ shares representing _____% of the issued share capital of the Listed Company (the "***Notifiable Interest***"). In calculating this interest, the issued share capital of the Listed Company is taken to be _____ divided into _____ shares of nominal value _____ each.

2. Particulars of the Notifiable Interest

(i) Class of issued/unissued* share capital to which the Notifiable Interest relates: *[SN3]* _____
_____

(ii) Number of shares in the Notifiable Interest that are held through derivatives or the interest of which are derived from derivatives: *[SN4]*_____

(iii) Circumstance(s) under which the duty of disclosure arose *(tick the relevant box(es)):*

- ☐ acquisition made on-exchange *[SN5]*
- ☐ acquisition made off-exchange
- ☐ acquisition by way of gift
- ☐ by being a trustee (other than a bare trustee)
- ☐ by being a bare trustee or a nominee of another person
- ☐ by being a beneficiary of a trust other than a discretionary trust
- ☐ by enforcement or exercise of security
- ☐ through a rights issue
- ☐ through a scrip dividend issue
- ☐ through share repurchases made by the Listed Company
- ☐ due to family interest being attributed to Substantial Shareholder under Section [•]
- ☐ due to corporate interest being attributed to Substantial Shareholder under Section [•]
- ☐ by being a party to an agreement to acquire interest in the Listed Company as mentioned in Section [•]
- ☐ by being a controlling shareholder providing cash or other consideration to facilitate acquisition of shares by another person as mentioned in Section [•]
- ☐ by being a settlor of a discretionary trust *[SN6]*
- ☐ Others _____ *(please specify)*

(iv) The capacity in which the Notifiable Interest is held by the Substantial Shareholder: *(please complete the relevant part(s)) [SN6]*

	Nature of interest	*No. of shares concerned*
(a)	as the beneficial owner	_____
(b)	as the legal or registered owner	_____
(c)	as a trustee (other than a bare trustee)	_____
(d)	as a bare trustee or a nominee of another person	_____
(e)	as a beneficiary of a trust not being a discretionary trust.....	_____
(f)	family interest being attributed to Substantial Shareholder under Section [•]	_____
(g)	corporate interest being attributed to Substantial Shareholder under Section [•].....	_____
(h)	as a party to an agreement to acquire interest in the Listed Company as mentioned in Section [•]	_____
(i)	as a controlling shareholder providing cash or other consideration to facilitate acquisition of shares by another person as mentioned in Section [•]	_____
(j)	as a settlor of a discretionary trust	_____
(k)	others _____ *(please specify*)	_____

3. Consideration

(i) Please specify the consideration for the Notifiable Interest or any part of that Interest in Table (a) and/or (b) below. *(If any part of the Notifiable Interest arose or was acquired before the Relevant Date, include information up to four months before the Relevant Date).*

(a) Regarding interests in shares other than interests held through derivatives (if any):

Acquisition Date/ Date interest arose	*On-exchange (state name of exchange)*	*Off-exchange*	*no. of shares*	*Highest price*	*Average price*	*non-cash consideration*

(b) Regarding interests in shares held through derivatives (if any):

Acquisition Date/Date inte arose	*On-exchange (state name of exchange)*	*Off-exch.*	*Description of derivatives (include stock code, if any)*	*No. of units of derivatives*	*Highest price*	*Average price*	*non-cash consider-ation*

(ii) For off-exchange transactions disclosed above, please attach to this Form copies of contracts, agreements, scheme or understanding pursuant to which the Notifiable Interest arose. If there are no such written documents, please attach to this Form a memorandum specifying the material terms of any contracts, agreement, scheme, arrangement or understanding pursuant to which the Notifiable Interest arose. If any part of the Notifiable Interest arose or was acquired before the Relevant Date, include information up to four months before the Relevant Date. *[SN7]*

4. Additional Information on Interest held through Derivatives

If Paragraph 2(ii) applies, please indicate the capacity in which the derivatives are held by the Substantial Shareholder: *(please complete the relevant part(s))* *[SN8]*

	Nature of interest	*No. of shares concerned*
(a)	as writer of call option on issued shares.....	_____
(b)	as holder of call option on issued shares.....	_____
(c)	as writer of put option on issued shares	_____
(d)	as holder of put option on issued shares.....	_____
(e)	as holder of derivative call warrants.....	_____
(f)	as issuer of derivative call warrants	_____
(g)	as holder of derivative put warrants	_____
(h)	as issuer of derivative put warrants	_____
(i)	as holder of convertible securities	_____
(j)	as holder of subscription warrants	_____
(k)	long of stock futures	_____
(l)	short of stock futures	_____
(m)	others _____ *(please specify*)	_____

5. Additional Information in relation to Family Interest

If Paragraph 2(iv)(f) applies, please provide information on the spouse and/or children under 18 whose interest in shares in the Listed Company is attributed to the Substantial Shareholder:

Name	*Address*	*Number of shares*

6. Additional Information in relation to Corporate Interest

If Paragraph 2(iv)(g) applies, please provide information on the corporation(s) whose interest in shares in the Listed Company is attributed to the Substantial Shareholder:

Name	*Address*	*Number of shares*

7. Additional Information with respect to Interest being held Jointly

If the Substantial Shareholder holds any part of the Notifiable Interest jointly with any other person(s), please provide information on the other joint holders and their interest in shares in the Listed Company:

Name	*Address*	*Number of shares*

8. Additional Information from Trustee of a Discretionary Trust

If the Substantial Shareholder holds any part of the Notifiable Interest as a trustee of a discretionary trust, please provide information on the trust and settlor(s) of the trust: *[SN9]*

Name of the trust	*No. of shares held by the trust*	*Name and address of settlor*

9. Additional Information from a Party to an Agreement under Section [●]

(i) If Paragraph 2(iv)(h) or (i) applies, please provide information on the other parties to the agreement:

Name	*Address*

(ii) Please attach to this Form a copy of the relevant agreement. If there is no written agreement, please attach to this Form a memorandum specifying the material terms of the relevant agreement, arrangement or understanding.*[SN7]*

10. Declaration

I/We declare that, to the best of my/our knowledge and belief, the information contained in this notice is true and accurate. *The number of pages that are annexed to this notice is_____.

*I/We _____ of _____ _____ am/are giving this notice *on my/our own behalf. / as the agent of _____and hereby confirm and represent that I/we have been duly authorised to give this notice.

Dated this _____day of _____

[In the case of a notice given by an individual:]

_____ *[Usual Signature]*
_____ *[Full name]*
_____ *[HKID or Passport No.]*

[In the case of a notice given by a body corporate :]

This notice is given on behalf of _____[Name of body corporate] by _____ [Name of person signing the notice], _____ [position], who is duly authorised by the board of directors to give this notice.

_____ *[Usual Signature]*
_____ *[Full name]*
_____ *[HKID. or Passport No.]*

** Delete as appropriate*

General Notes

1. *This Form 2 is to be used by a person (individual or corporation) who, after [•], becomes interested in 5% or more of the issued share capital for the time being of a Hong Kong listed company. Please use Form 1 if a person is interested in 5% or more of the issued share capital of a Hong Kong listed company as at [•]; Form 3 if a person's notifiable interest changes by one percentage level; and Form 4 if a person ceases to have an interest in 5% or more of the issued share capital of a listed company.*

2. *References to "Ordinance" is to [Part [•] of the Securities and Futures Ordinance][the Securities (Disclosure of Interests) Ordinance] (Chapter [•] of the Laws of Hong Kong); references to "Section" are to sections of the Ordinance; and references to "Paragraph" are to paragraphs of this Form.*

3. *The term "Substantial Shareholder" is not defined in the Ordinance but is used in this Form and these General and Specific Notes for descriptive purposes only. A substantial shareholder is a person who has an interest in 5% or more of the issued share capital of the listed company named in the Form.*

4. *When making disclosure under this Form, please satisfy yourself on the requirements of the Ordinance, and if in doubt, please seek appropriate legal advice. These General Notes and the Specific Notes are for guidance only.*

5. *Please use block letters (preferably type-written) when completing this Form. If there is insufficient space, please complete your disclosures on separate sheets. Additional sheets must be securely annexed to this Form, clearly marked as "Additional Sheet" and signed by or on behalf of the Substantial Shareholder. Please detach these Notes from the Form prior to submitting it to the listed company and the SEHK.*

6.. *A signed copy of this Form must be filed with the listed company at its registered office or principal place of business in Hong Kong. A separate signed copy of this Form must also be filed with The Stock Exchange of Hong Kong Limited ("SEHK") using one of the following methods :*

<u>By Post</u> -	*<u>By Hand</u> -*
The SDI Unit	*The SDI Unit*
Regulation Division	*Regulation Division*
The Stock Exchange of Hong Kong Ltd.	*The Stock Exchange of Hong Kong Ltd.*
G.P.O. Box 10023	*Tower I & II, Exchange Square*
Hong Kong]	*Central, Hong Kong*

<u>By Fax</u> - Fax No. [•]

7. *The G.P.O. Box set out above is a dedicated P.O. Box for use by the SDI Unit only. Please do not use the general SEHK P.O. Box. For security reasons, no other SEHK fax number should be used. Telephone confirmations of fax notification can be obtained from [•]. Please restrict use of this service to significant or price sensitive notifications.*

8. *Steps should be taken to ensure that a signed copy of this Form reaches the SEHK at the same time as, or immediately after, a similar copy reaches the listed company. A duty of disclosure must be performed within 2 business days next following the day on which the duty arises.*

Specific Notes

1. *<u>Notes on "Substantial Shareholder"</u>*

Information on the Substantial Shareholder and Paragraphs 1, 2, 3 and 10 must be completed in each case. Whether Paragraphs 4 to 9 need to be completed depends on the circumstances of each case.

The section on "Substantial Shareholder" should contain details of the Substantial Shareholder - the person performing a duty of disclosure. This Form may be completed and issued on behalf of a Substantial Shareholder by its duly authorised agent. In such circumstances, the name and details of the agent must also be

provided in Paragraph 10. The Substantial Shareholder remains primarily responsible for the information provided.

Notification on a group basis (e.g. on behalf of a corporate group or members of the same family) can be made by using this Form. If notification is given on such basis, all the persons having a duty of disclosure (each being a Substantial Shareholder) must be clearly identified. Details of all such persons and their Notifable Interest as required in this Form must be disclosed in a clear and orderly manner to ensure clarity and facilitate public dissemination of disclosed information by the SEHK. If appropriate, a corporate or family chart may be annexed showing how each Substantial Shareholder is interested in the interest being disclosed, and their relationship with respect to each other.

2. *Note to Paragraph 1*

The Relevant Date refers to the date on which the duty of disclosure arises. If the Substantial Shareholder has or is deemed to have an interest in unissued shares through derivatives, such shares should be taken into account in determining the amount and percentage of the Notifiable Interest. Reference to the "issued share capital" of the Listed Company means the total nominal value of the issued share capital of the Company as at the Relevant Date.

3. *Note to Paragraph 2(i)*

If any part of the Notifiable Interest relates to both the issued and unissued shares of the Listed Company, please specify the class of share capital to which the issued and unissued shares relate.

4. *Note to Paragraph 2(ii)*

If any part of the Notifiable Interest consists of interest in shares held through or derived from derivatives, disclose the number of underlying shares to which the derivatives relate. If Paragraph 2(ii) applies to the Substantial Shareholder, Paragraph 3(i)(b) and 4 must be completed.

5. *On-exchange -v- off-exchange acquisitions*

An acquisition is made "on-exchange" when the transaction took place in the ordinary course of trading of a stock market of a recognised stock exchange or of a futures market of a recognised futures exchange. The reverse applies to an "off-exchange" acquisition."Ordinary course of trading" in this context, does not include transactions carried out as a "cross" or "special".

6. *Note to Paragraph 2(iv)*

If the Substantial Shareholder holds the Notifiable Interest in more than one capacity, please specify the nature of his interest and indicate the number of shares to which the nature of interest relates.

7. *Notes to Paragraph 4(e) and 9(ii)*

If a memorandum is attached specifying the material terms of any agreement, arrangement or understanding, the material terms should include the name and address of the parties to the agreement, arrangement or understanding. In the case of unlisted derivatives, principal terms such as exercise or conversion price, expiration date and exercise period should be disclosed. The memorandum must be certified as the true copy of the original by the Substantial Shareholder or the duly authorised agent responsible for filing this Form.

8. *Notes to Paragraph 4(i)*

If derivatives are held by the Substantial Shareholder in more than one capacity, please specify the nature of his interest and indicate the number of underlying shares to which the nature of interest relates.

9. *"Settlor" of a discretionary trust*

The term "settlor" is defined in the Ordinance.