

An SFC newsletter to help participants in Hong Kong's financial markets better understand the Codes on Takeovers and Mergers and Share Buy-backs

Feedback and comments:  
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## Season's Greetings

Another year has flown past and we wish our readers a happy and healthy 2017!

## Performance pledges

The Takeovers Team administers the Codes on Takeovers and Mergers and Share Buy-backs (Codes). To enhance the market's understanding of the Executive's work, we set out our performance pledges in the table on page 2.

In practice, we commence review upon receipt of an application or a document together with the relevant fees payable under the Securities and Futures (Fees) Rules, and the response time may be much shorter than as stipulated. However, in some cases, we need more time to reach an informed decision, particularly when a matter involves a complex Code issue. For 80% of transactions and applications, we aim to meet the response times set out in the following table.

## Highlights

- Season's Greetings
- Performance pledges
- Case management for Code matters
- Revised PN 1 in relation to partial offers
- Cold shoulder order imposed on Zheng Dunmu for breach of mandatory offer requirement
- Public criticism of Southwest Securities International Investment and related parties
- Quarterly update on the activities of the Takeovers Team

Category	Type	Time limit for response <sup>1</sup>
<b><i>Consultations and rulings under sections 6 and 8 of the Introduction to the Codes</i></b>		
Applications for rulings and consultations with the Executive	All ruling applications and consultations under the Codes (except for those set out below)	5 business days  If the subject matter involves complex Code issues, the time limit will be extended to 21 business days and the parties will be informed of the extension
	Applications for rulings that are conditional on obtaining shareholders' approval in a general meeting	Normally issued within 5 business days before the relevant shareholders' meeting so that the ruling can be based on up-to-date information
	Fast track EFM/EPT <sup>2</sup> applications and EFM/EPT annual confirmations	10 business days
	All other EFM/EPT applications	21 business days
<b><i>Comments and clearance of announcements and documents under Rule 12 of the Takeovers Code</i></b>		
First draft of firm intention announcement under Rule 3.5 of the Takeovers Code	No complex Code issues involved	2 business days
	Complex Code issues involved	3 business days – the parties will be informed if longer time is needed
All other announcements (including revised drafts)	No complex Code issues involved	1 business day
	Complex Code issues involved	3 business days – the parties will be informed if longer time is needed
All drafts of shareholders' documents (including offer documents, offeree board circulars, whitewash circulars, scheme documents, share buy-back circulars)		5 business days

<sup>1</sup> Unless specified, timing is calculated from the receipt of all information required to make a decision.

<sup>2</sup> EFMs and EPTs refer to exempt fund managers and exempt principal traders as defined under the Codes.

The above timeframe assumes that any announcements, documents or ruling applications submitted for our review are in an advanced form.

Section 8.1 of the Introduction to the Codes states that an application for a ruling should be in writing and be comprehensive and contain all relevant information to enable the Executive to reach a fully informed decision. Note 1 to Rule 12 provides that the first draft of the document (this includes announcements and documents sent to shareholders) submitted to the Executive should be in an advanced form and points of difficulty should be drawn to the Executive’s attention as early as possible. We encourage parties to submit the first draft of an announcement to us as early as possible and in advance of signing any relevant agreement. We may reject any announcements, documents or applications that are not in an advanced form.

For announcements, documents and ruling applications where an applicant (or its advisers) informs us that the matter does not require our immediate attention, the performance pledges will only apply once we have been informed otherwise.

Where a consultation under section 6 of the Introduction to the Codes involves complex Code issues, we encourage parties to make a written submission with full details to enable us to deal with the matter efficiently. Views expressed by the Executive during a consultation are preliminary and do not bind the Executive. Nevertheless, in order to facilitate the consultation process, parties are encouraged to provide the Executive with all relevant information at the earliest possible stage.

The performance pledges can be found in the “Regulatory functions – Listings & takeovers – Takeovers & Mergers – Performance pledges” section of the SFC website.

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## Case management for Code matters

We would like to take this opportunity to explain our case management procedures. When a new matter is received, the Executive opens a case on our electronic filing system. During the lifetime of a case, all relevant documents and correspondence are filed on the electronic system. A case is normally treated as ready to close at the following times:

<b>Transaction type</b>	<b>Time when a case is normally treated as ready to close</b>
General offer (including mandatory, voluntary and partial offers, privatisations by way of general offers and share buy-backs)	When the offer is closed
Privatisation by way of scheme of arrangement	When the scheme of arrangement becomes effective
Whitewash and off-market share buy-back transactions	On the date of the shareholders’ meeting to approve the transaction
Standalone application under the Codes	When a ruling is issued or views are provided in a consultation

## Revision of Practice Note 1 on partial offers

In recent years, it has become increasingly apparent that a partial offer made through the share register method gives rise to concerns under General Principle 1 and, as a result, any partial offers which are subject to the Takeovers Code should be made by the common pool method. We have revised Practice Note 1 (PN 1) accordingly.

Under the share register method, an offer is made for a specific proportion of each shareholder's shares that are **registered** in his name on the record date. An accepting shareholder is thereby assured that a minimum number of the shares **held by him** on the record date will be accepted by the offeror if the offer becomes unconditional. However, if an accepting shareholder holds his shares through a nominee (commonly a stockbroker who is also a Central Clearing and Settlement System participant), he may benefit from his shares being aggregated with a non-accepting shareholder who also holds shares through the same nominee. This gives rise to concerns under General Principle 1 as all shareholders would not be treated equally. For example, in a successful 40% partial offer (assuming the offeror does not hold any shares):

- A holds 100 shares registered in his own name and wishes to accept the partial offer in full. A has an assured entitlement of 40 shares, ie, 40% of the 100 shares he holds will be taken up by the offeror.
- B and C each hold 100 shares registered in the name of a nominee. B informs the nominee that it wishes to accept the partial offer in full, while C does not wish to participate. The nominee accepts the offer as the registered shareholder and would have an assured entitlement of 80 shares, ie, 40% of the aggregate of the 200 shares registered under its name. B would therefore have 80 of its shares accepted by the offeror, ie, 80% of the shares owned by B.

The same concern does not arise with the common pool method where the number of shares taken up by the offeror from each shareholder is determined by the total number of shares tendered for acceptance (the pool). As such, the proportion of shares taken up from each accepting shareholder will be the same irrespective of whether such shares are being held directly or via a nominee.

A marked up version and a clean version of the revised PN 1 can be found in the "Regulatory functions – Listings & takeovers – Takeovers & Mergers – Practice notes" section of the SFC website.

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## The Executive publicly censures Zheng Dunmu and imposes a cold shoulder order for breach of the Takeovers Code

On 22 November 2016, we publicly censured Zheng Dunmu for breaching Rule 26.1 of the Takeovers Code. We also imposed a cold shoulder order denying him direct or indirect access to the Hong Kong securities markets for 24 months until 21 November 2018.

At the relevant time, Zheng was chairman, executive director and a controlling shareholder of Changgang Dunxin Enterprise Company Limited and held a 56.25% interest in Changgang Dunxin indirectly through three companies wholly owned by him (Concert Group). Part of this interest was pledged to a lender as collateral for a loan.

On 23 February 2015, the lender sold the pledged shares, reducing Zheng's interest in Changgang Dunxin to 46.18%. Shortly after becoming aware of the disposals, Zheng personally acquired 1.01% and 2.97% of Changgang Dunxin on 26 and 27 February 2015 respectively. As a result, the Concert Group's interest increased from 46.18% to 47.18% on 26 February 2015 and crossed the 2% creeper on 27 February 2015 when the Concert Group's interest increased further to 50.16%, triggering a mandatory general offer under Rule 26.1(d) of the Takeovers Code. No offer was made.

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Zheng submitted that he was not aware of the mandatory general offer obligation and agreed to the current disciplinary action against him. Zheng's failure to make a general offer deprived Changgang Dunxin's shareholders of the right to receive an offer and violated General Principle 1 as some but not all shareholders were given the opportunity to exit.

We wish to take this opportunity to remind practitioners and parties who wish to take advantage of the securities market in Hong Kong that they should conduct themselves in matters relating to takeovers, mergers and share buy-backs in accordance with the Takeovers Code. If they fail to do so, they may find by way of sanction that the facilities of Hong Kong's securities markets are withheld in order to protect those who participate in them.

A copy of the Executive Statement dated 22 November 2016 can be found in the "Regulatory functions – Listings & takeovers – Takeovers & Mergers – Decisions & statements – Executive decisions and statements" section of the SFC website.

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## The Executive publicly criticises Southwest Securities International Investment Limited and related parties for breach of the Takeovers Code

On 14 December 2016, we publicly criticised Southwest Securities International Investment Limited (SSI Investment), Li Zhi Tao and Dong Jiang Wen for acquiring shares in Southwest Securities International Securities Limited (SSI Securities), formerly known as Tanrich Financial Holdings Limited, within six months after the close of an offer (the Restriction Period) at above the offer price in contravention of Rule 31.3 of the Takeovers Code.

SSI Investment is wholly-owned by Southwest Securities Company Limited (SWSC), a Shanghai-listed company which is ultimately controlled by the Chongqing State-owned Assets Supervision and Administration Commission. At the relevant time, Li was the General Manager of SWSC's Operations Management Department while Dong was the General Manager of both its Quantitative Investment Department and its Securities Investment Department.

On 6 January 2015, SSI Investment made an unconditional mandatory general offer in cash for the shares of SSI Securities at a price of \$0.58 per share. The offer closed on 27 January 2015.

On 9 and 10 July 2015, during the Restriction Period, SSI Investment made a series of on-market acquisitions of a total of 10,466,000 shares at prices ranging from \$0.59 to \$1.01 per share.

SSI Investment, Li and Dong submitted that the breaches were not intentional but they accepted that they breached the Takeovers Code and agreed to the current disciplinary action taken against them.

Once again, we wish to remind all those involved in takeovers and mergers in Hong Kong about the prohibition imposed by Rule 31.3 of the Takeovers Code. Rule 31.3 affords equality of treatment to shareholders in an offer in accordance with General Principle 1 of the Takeovers Code. The Rule provides shareholders with certainty that the offeror will not pay a price higher than the offer price for the shares in the offeree company in the six-month period after the close of the offer, and as a result it ensures that all shareholders of the offeree company are treated even-handedly. If there is any doubt about the application of the Takeovers Code, the Executive should be consulted at the earliest opportunity.

A copy of the Executive Statement dated 14 December 2016 can be found in the "Regulatory functions – Listings & takeovers – Takeovers & Mergers – Decisions & statements – Executive decisions and statements" section of the SFC website.

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## Quarterly update on the activities of the Takeovers Team

In the three months ended 30 September 2016, we received 21 takeovers-related cases (including privatisations, voluntary and mandatory general offers and off-market and general-offer share buy-backs), five whitewashes and 82 ruling applications.

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### Useful links

- The Codes on Takeovers and Mergers and Share Buy-backs
- Practice notes
- Decisions and statements
- Previous *Takeovers Bulletins*

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All issues of the *Takeovers Bulletin* are available under 'Published resources – Industry-related publications – *Takeovers Bulletin*' on the SFC website at [www.sfc.hk](http://www.sfc.hk).

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