SECURITIES AND FUTURES COMMISSION
證券及期貨事務監察委員會

Consultation Paper on the Review of the Disclosure of Interests Regime under Part XV of the Securities and Futures Ordinance

有關檢討《證券及期貨條例》第 XV 部的披露權益制度的諮詢文件

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EXECUTIVE SUMMARY

Introduction

The Securities and Futures Commission (the "***SFC***") is conducting a review of Part XV of the Securities and Futures Ordinance (Cap. 571) ("***Part XV***"). We have consulted market participants to determine the effectiveness of Part XV in meeting its objectives, and on any need to update the regime to keep in line with market developments. These market participants were drawn from persons obliged to make notifications, their advisors and users of the notifications.

We now seek the views of the public on certain issues and on proposed changes to Part XV.

This Consultation Paper sets out the comments of the market participants received so far.

Where practicable, our responses aim to remove undue compliance burdens without compromising the principle of market transparency.

Reasons for Review

Part XV introduced changes to the old Securities (Disclosure of Interests) Ordinance (the "***SDIO***") regime, with a lower "substantial shareholder" disclosure threshold, shorter reporting time frames, and the need to disclose cash-settled equity derivatives. In view of the new changes, the Administration pledged to maintain a close liaison with the industry and to keep the legislation in line with the latest market developments, both local and overseas. In particular, it committed to review the Part XV regime at an appropriate time in light of its actual implementation.

Objective of this exercise

The main objective of this exercise is to address the issues and concerns raised by market participants on the disclosure regime. In deciding the appropriate responses to market comments, we have kept in mind the importance of:

- balancing the need to remove unnecessary and unduly burdensome requirements while preserving transparency in the market; and

- keeping Part XV in line with developments of the Hong Kong securities market.

Principal comments and proposed changes

Generally respondents we communicated with have welcomed the greater transparency brought about by Part XV.

Most of the comments received are technical or practical in nature. Many of these involve matters of interpretation, and relate to the forms for filing notices. In other areas, we received requests for changes to take into account market practices or for greater simplification. We have sought to design ways to make it easier to make and understand

notifications. Where appropriate, we clarify certain areas with a view to reducing unnecessary compliance burdens. In other areas, we propose amending the law to take into account business practices, reduce compliance burdens and to give effect to the policy intention of Part XV in a more consistent manner.

The following is a summary of the major matters contained in this Consultation Paper.

1. Forms and Codes

A significant proposal is to add more codes for filling in forms, a narrative box, and “D” to denote derivatives in front of standard codes. This is to make filing disclosure easier and notifications clearer. We seek views on other codes and changes to the forms the public may consider useful. (Pages 8 to 10)

2. Principal Issues for further consultation

Apart from the changes to the forms, the principal areas for consultation are summarized as follows:

2.1 ***Security interests given by substantial shareholders*** : We seek views on whether the exemption for security interests should be removed or narrowed either in relation to qualified lenders or substantial shareholders and views on SFC’s proposal as a possible way forward. (Pages 11 to 16)

2.2 ***Disclosure thresholds and de minimis exception*** : We seek views on whether we should simplify the *de minimis* exception or change the trigger for disclosure from crossing a percentage level to an actual percentage change regime. (Pages 17 to 20)

2.3 ***Aggregation exemption*** : We seek views on whether the aggregation exemption should be extended to cover certain practices of qualified investment managers, and the circumstance where an entity carries out more than one business activity but with investment management behind Chinese walls. (Pages 20 to 24)

2.4 ***Stock borrowing and lending*** : We seek views on whether the “Authorised Lending Agent” regime should be expanded to cover certain activities which are currently not possible within the simplified stock borrowing and lending regime. (Pages 24 to 25)

2.5 ***Credit derivatives*** : We seek views on whether we should exempt credit derivatives or add a new code in forms for disclosure. (Pages 25 to 26)

2.6 ***Index-linked equity instruments*** : We seek views on whether the “basket” exemption should be expanded to cover instruments linked to indices other than Hang Seng Index. (Pages 26 to 27)

2.7 ***Change in nature of interest*** : We seek views on the list of situations which should be caught as a change in nature of interest. (Page 27 to 28)

3. Matters involving amendments to the law

Other areas involving changes to the law are summarized in Section 3 (Pages 28 to 34). They cover issues affecting the filing of interests, certain market specialists, short positions and directors.

4. Matters for further clarification in Outline

Section 4 sets out our views on certain comments. We propose to make further clarification on these issues in the Outline. (Pages 34 to 39)

5. Other comments and our responses

Section 5 contains our responses to other comments received. (Pages 39 to 46)

6. Views of the public on other matters (Page 46)

We invite views of members of the public on any issues raised in the paper and other matters not covered in this Consultation Paper and generally.

Consultation Period

The Securities and Futures Commission invites comments on the proposed changes and on any other issues as outlined in this Paper or on Part XV **by 28 February 2005**. Comments should be sent to:

Securities and Futures Commission
8th Floor
Chater House
8 Connaught Road Central
Hong Kong.

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

Interested persons may also provide comments by fax to (852) 2521 7917 or email to *direviewconsult@sfc.hk* or online to *http://www.sfc.hk*. This Paper is also available on the SFC website at *http://www.sfc.hk*.

Note:

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

REVIEW OF PART XV

Reasons for Review

When announcing the commencement date for the Securities and Futures Ordinance ("***Ordinance***"), the Honourable Mr. Frederick Ma, JP, Secretary for Financial Services and the Treasury, pledged to keep in close touch with industry and to keep the Ordinance in line with market developments. The Administration also made a commitment to review the Part XV regime at an appropriate time.

The objectives of amending the old Securities (Disclosure of Interests) Ordinance ("***SDIO***") were stated in the Consultation Paper on Amendments to the Securities (Disclosure of Interests) Ordinance (30 June 1998) as follows:

- To bring the Hong Kong securities disclosure regime in line with international and regional disclosure standards.

- To bring the SDIO 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 laid down by the SDIO and to introduce new statutory disclosure forms to facilitate systematic reporting of interests in shares.

The background to the amendments to the SDIO and Part XV is set out in the next section of this Paper.

After one year in operation, a review of Part XV was considered appropriate. Accordingly we first sought views from selected market participants to determine the effectiveness of Part XV in meeting its policy objectives. We also consulted on any need to update the provisions in Part XV in line with market demands and new developments. These market participants were drawn from persons obliged to make notifications, their advisors and users of the notifications. We have also consulted the SFC's Advisory Committee and the Public Shareholders Group.

Objectives of this exercise

The underlying principle behind Part XV is to improve transparency in the Hong Kong market so as to achieve a market that is better informed regarding:

- activities of insiders (directors and controlling shareholders) in relation to their holdings in a listed corporation, and

- activities of persons with significant shareholding in the listed corporation (i.e. substantial shareholders) that could have an impact on the share price.

At the same time, we recognise the need to achieve a proportionate balance between compliance burden and the benefits from requiring the disclosure. The objectives that we seek to achieve in this exercise are to address the issues and concerns raised by market participants on the disclosure regime with this in mind. Most of the changes we propose to the law involve extending exemptions or relaxing current requirements. We are also carrying out further consultation bearing in mind the importance of:

- balancing the need to remove unnecessary and unduly burdensome requirements while preserving transparency in the market; and

- keeping Part XV in line with developments of the Hong Kong securities market.

As a whole, respondents support Part XV and the greater transparency it has brought. Most of the comments received are technical or practical in nature. They involve matters of technical interpretation, and relate to the use or interpretation of the forms for filing notices. In other areas, particular segments of the market have suggested changes to take into account market practices or greater simplification.

Some of the issues raised can be addressed by further clarification through the "Outline on the Securities and Futures Ordinance (Cap.571) – Disclosure of Interests" (the "***Outline***"). We believe that most of the practical difficulties with filling in or understanding forms tend to arise in the more complex cases. For these we propose including more codes, a narrative box for complex transactions and more market education. We also contemplate including additional notes, if necessary, to explain how to fill in the form. While this may mean that the forms would be longer, it would also allow complex transactions to be better described and understood. In other cases, changes to the law may be necessary.

The framework of Part XV was based on the original SDIO regime. This was to leverage on market familiarity with the regime. We expect that over time the market will gain similar familiarity with the operation of Part XV and we will continue our market education efforts in this regard.

BACKGROUND

In June 1998, the SFC issued a "Consultation Paper on Amendments to The Securities (Disclosure of Interests) Ordinance". This set out the principal proposals to amend the SDIO, and the policy reasons for the proposals.

The major changes to the SDIO included lowering the substantial shareholder disclosure threshold from 10% to 5%, reducing the general reporting time frame from 5 to 3 business days, and requiring disclosures of cash-settled equity derivatives.

In March 1999, the "Consultation Conclusions on the Proposed Amendments to The Securities (Disclosure of Interests) Ordinance" was published, taking into account 35 responses received. The Conclusions set out the SFC's final proposals.

After consultation and various discussions with public and stakeholder groups, the final proposals were incorporated into Part XV of the Securities and Futures Bill of the Government of the Hong Kong SAR (the "***White Bill***"), which was published together with a Consultation Paper for public comments. Stakeholder groups raised concerns with the Legislative Council Subcommittee on aspects of the White Bill. These concerns related to proposals for details of positions in derivatives to be disclosed and certain compliance problems. Part XV of the Securities and Futures Bill was consequently amended to address these concerns and was published in the Blue Bill in November 2000. The amendments reduced the degree of detail that must be disclosed and the compliance burden where practicable.

We also undertook the following consultations on the proposed forms for filing, regulations and rules:

(1) In February 2001 we published a Consultation Paper on the Securities and Futures Bill – Part XV Forms Proposed for Disclosure of Interests.

(2) In December 2001 we published a Consultation Paper on the Securities and Futures (Disclosure of Interests – Securities Borrowing and Lending) Rules together with the draft rules. Consultation Conclusions were published in July 2002.

(3) In May 2002 we published a Consultation Paper on the Securities and Futures (Disclosure of Interests – Exclusions) Regulation and the Draft Securities and Futures (Disclosure of Interests – Exclusions) Regulation. Consultation Conclusions were published in July 2002.

The Blue Bill was enacted as the Ordinance on 13 March 2002 and gazetted on 28 March 2002. Part XV of the Ordinance together with the relevant subsidiary legislation came into effect on 1 April 2003.

We published the Outline on the SFC's website as a practical guide to situations in which a notice will have to be filed. As additional queries came to light about the practical application of Part XV, the Outline was revised and enlarged. The latest version of the Outline is dated 6 August 2003.

The table below gives the number of "hits" on the Hong Kong Exchanges and Clearing Limited's "Disclosure of Interests" web pages over a recent 3-month period, and gives an indication of investors' interest in these notifications.

No. of Requests (*1)				
Month	DI search pages (*2)	Daily Summaries	Others (*3)	Total No. of Requests
Nov-04	656,938	63,185	6,927	727,050
Oct-04	537,215	51,094	4,959	593,268
Sep-04	520,948	62,585	5,234	588,767

*Note:

1. "Request" refers to any hit that successfully retrieves contents.

2. "DI search pages" include the Disclosure of Interests home page, the search/result pages and the redirect page to daily summaries (excluding daily summary pages).

3. Only includes the requests for Notes, Special Reports and Disclaimer.

SFC's PROPOSED CHANGES AND RESPONSES

1. FORMS AND CODES

Many of the comments received highlighted difficulties with filling in the forms or understanding the disclosures filed, especially for complex transactions.

1.1 General

Comment

The current forms require the entry of codes to identify the nature of changes in interests, and the capacity in which the interests or short positions are held. Some commentators found practical difficulties with completing the forms and found the codes confusing. Others suggested more support and continued education to the investing public and professionals.

There are also instances of confusion arising from the notices filed. Some of these relate to the fact that Part XV requires the aggregation of derivative interests with interests in shares. Suggestions were also made for easier ways of using and understanding the forms, such as the use of drop-down boxes or a narrative box.

SFC's response

We note that in some complex transactions, it is difficult for a reader to tell what transactions have taken place from the disclosures made. This stems partly from the limited number of codes available today to indicate the capacities in which the interests are being held, or to indicate the changes in nature of interests or duplicated interests. Today these often need to be filed under the code for "Miscellaneous – other".

The apparent inconsistency between the reported shareholding and total number of shares that sometimes arises is an inevitable consequence of aggregating various interests. We will continue market education efforts on how to interpret the forms, and also believe that the market will gain more familiarity over time.

We propose to add more codes and a (optional) narrative box. This will make it easier to fill in the form, and enable the public to more readily understand the nature of the transactions giving rise to the notifications. Additional codes will include, for example, an "error" code to correct erroneous notifications. We are discussing these proposed changes with Hong Kong Exchanges and Clearing Limited (the "***Exchange***"). The following is a list of additional new codes and explanatory notes we currently propose to add to the forms.

List of Codes/Notes to be added

Forms 1, 2, 3A, 3B

Table 1 – Event or change	**Code**
Cancellation or expiration of equity derivatives without exercise	*
Pledging or charging shares of the listed corporation to an individual or corporation	*
Taking a pledge or charge over shares of the listed corporation	*
Entering into an agreement for the exchange of an instrument for another instrument in respect of the same underlying shares	*
Spouse of a substantial shareholder/ director becoming a director	*
Spouse of a substantial shareholder/ director ceasing to be a director	*
Exercise of rights under an agreement including equity derivatives by a person	*
Rights being exercised against a person under an agreement including equity derivatives	*
Lending shares under a securities borrowing and lending agreement	*
Recalling shares under a securities borrowing and lending agreement	*
Entering into an agreement for the sales of shares that a person holds	*
Taking delivery of shares from another person	*
Miscellaneous (long and short positions)	
Notice filed to correct an error in a previous notice	*
Table 2-Capacity	**Code**
Agent	*
Underwriter	*
Depositary	*
Table 4 – Category of derivatives	**Code**
Derivatives listed or traded on a Stock Exchange or traded on a Futures Exchange	
Convertible instruments	*
Other	*
Unlisted derivatives	
Convertible instruments	*
Other	*

Forms 3C, 3D

Table 2 – Event or change	Code
Cancellation of debentures of the listed corporation upon repayment	*
Pledging or charging debentures of the listed corporation to an individual or corporation	*
Taking a pledge or charge over debentures of the listed corporation	*
Exercise of rights under an agreement including derivatives by a person	*
Rights being exercised against a person under an agreement including derivatives	*
Lending debentures under a securities borrowing and lending agreement	*
Recalling debentures under a securities borrowing and lending agreement	*
Entering into an agreement for the sales of debentures that a person holds	*
Taking delivery of debentures from another person	*

* Code numbers to be determined when the final list of new codes is concluded.

We also propose an additional explanatory note as follows:

> **"Derivatives**
>
> A person who files a notice as a result of a transaction involving derivatives should use the appropriate standard code describing the relevant event and also add the letter "D" to the front of the code. All standard codes disclosing an event or change must be able to take a "D" before them to designate that the event, or change, giving rise to the notice involves derivatives."

Views sought

Question 1: ***Are there any suggestions for additional codes or changes to the forms that you would consider useful?***

2. PRINCIPAL ISSUES FOR FURTHER CONSULTATION

We have identified certain areas on which we seek further views. The discussion below outlines some background, sets out the comments received and possible responses.

2.1 Security interests given by substantial shareholders

Background

Currently under Part XV, security interests are exempt if they are held by way of security with qualified lenders (generally authorised banks or licensed brokers) ("***exempt security interests***") for transactions in the ordinary course of business of such a lender. Thus:

- Substantial shareholders who give their shares as security in favour of qualified lenders are not normally under any obligation to disclose the interests.
- Qualified lenders are not normally under any obligation to disclose the security interests that they receive.

This follows the approach taken in the UK, Australia and other major jurisdictions.

The Listing Rules of the Exchange require a controlling shareholder[1] of a newly listed issuer for a period of 12 months after listing to inform the listed issuer (a) if he pledges or charges shares in which he is beneficially interested or (b) if he receives indications, whether verbal or written, from the chargee that any pledged or charged shares will be or have been disposed of, and the listed issuer must announce this. The Listing Rules also require the issuer to make a disclosure where the controlling shareholder pledges its interest in shares in the issuer to secure debts of the issuer or other support for obligations of the issuer.

The 1998-1999 Consultation

During the financial turmoil in the late 90's, there were cases where forced sales of substantial shareholders' pledged shares caused share prices to fall or accelerated previous falls as margin calls were triggered. The question then arose as to whether there should be more market transparency of security interests. In 1998, when the SFC consulted on proposed amendments to the SDIO[2], it asked for comments on this issue.

The SFC consulted on whether there should be a new obligation on a qualified lender when a substantial number of listed shares are given to it as security. Consistently with international standards, the rationale for the law as it stood (and still stands) is that transparency on security interests is not necessary unless and until qualified lenders have exercised their powers as holders of the security.

After careful consideration of market representations, the SFC concluded that imposing a new duty on qualified lenders to disclose security interests before steps are taken to enforce the security would create an unduly heavy burden on the normal business activities of lenders. Accordingly Part XV clarified when a qualified lender would be taken to have enforced the security, but did not impose new obligations. Under Part XV a qualified lender comes under a duty to make a disclosure when:

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[1] Defined in the Rules Governing the Listing of Securities on the Stock Exchange of Hong Kong Ltd as any person or group of persons who are entitled to exercise or control the exercise of 30% (or the mandatory general offer trigger level in the Takeovers Code from time to time) or more of the voting power at general meetings or who can control the composition of the board. A similar concept applies under the GEM rules but with different detailed requirements.

[2] Consultation Paper on Amendments to the Securities (Disclosure of Interests) Ordinance (30 June 1998), pages 50 to 51

(a) it becomes entitled to exercise voting rights in respect of the security interest as a result of a default, and has evidenced an intention to exercise the voting rights or control their exercise or taken any step to do so; or

(b) the power of sale has become exercisable and it offers the shares or any part of the shares for sale.

In 1998 the SFC also consulted on whether the law should impose a new obligation on a substantial shareholder to make disclosure of security interests. The SFC noted that the law allows shareholders to use their shares to raise funds for their own use without disclosure unless and until the collateral is enforced.

There was mixed public response on the matter. After careful consideration, the SFC concluded that there was a need to balance a substantial shareholder's right to privacy in his personal financial affairs against the usefulness of the disclosures, and did not propose new obligations.

A principal reason[3] stated for not proposing new obligations was that unless the market is also aware of the financial condition of the substantial shareholder during the term of the pledge, disclosure of the security interest in itself does not provide any information on the likelihood of a forced sale.

Comments

Recently, forced sales or speculation about controlling shareholders defaulting on margin calls have caused the share price of certain companies to fall or accelerated previous falls as margin calls were triggered. These incidents have precipitated calls for disclosures of security interests. There are also suggestions that lenders could have *de facto* control over the listed corporation through security interests without this being disclosed. This has rekindled the debate on the need for greater transparency of security interests. It is also argued that reports of cases such as these (where controlling shareholders' default have led to or accelerated price falls) have a damaging effect on the reputation of Hong Kong's market. There are arguments that disclosures of security interests could forewarn the market of such possible cases.

Some suggested that information about share pledges could provide investors with a signal about which companies might have certain risks associated with share pledges. Investors might then act in time to protect their investment or to decide whether to invest in a company or not. On this argument, such information would be useful information for investors.

However other commentators have also noted the importance of focussing on the usefulness of the information provided by such disclosures. Disclosures of security interests by themselves would not tell the investor about the risk of default - which is really the information relevant to the likelihood of a forced sale and a resulting share price fall. Disclosure of security interests through Part XV would not in itself give any information about why the security has been given (for a loan to the shareholder or otherwise), the size of any loan, whether credit facilities may have been drawn on, or

[3] Page 53, "Proposed Amendments to The Securities (Disclosure of Interests) Ordinance, Consultation Conclusions (March 1999)

whether any repayments have been made. The nature of the disclosure must therefore be carefully thought through. It was suggested that the disclosure at the time when the shares were sold would be more meaningful.

It was also pointed out that most of the problems happened with illiquid stocks. In case of forced sales of a significant portion of such stocks, share prices would drop sharply because there would not be enough liquidity to absorb the selling pressure. Consequently, there were some suggestions that there could be different thresholds for reporting share pledges based on liquidity of their underlying shares.

SFC's response

The heart of the issue lies in weighing:

(a) the informational value of disclosures of security interests;

(b) the business burdens on qualified lenders and substantial shareholders and/or the privacy of substantial shareholders in relation to its financial affairs;

(c) the liquidity of the stock at the time of sale by qualified lenders;

(d) the timing of disclosure which may or may not add value to investors.

In considering the issues regarding disclosures of security interests, it is useful to look at the obligations of qualified lenders and shareholders separately.

Disclosure by qualified lenders

Qualified lenders such as authorised banks and investment banks hold collateral in the ordinary course of business for purposes other than loans to controlling shareholders. Brokers may also hold collateral from margin loan clients. The category of "exempt security interests" currently relates to more than pledges for loans to controlling shareholders, and extends to any situation in which share collateral is given for commercial transactions.

If disclosures of this category of security interests were to be required, qualified lenders would have to aggregate all security interests (from different security providers) in order to monitor disclosure requirements. However the fact of such security interests would not provide significant market information and to require disclosures in such circumstances would impose an unduly high compliance burden in relation to a qualified lender's normal commercial activities. On the other hand, any disclosure made by qualified lenders will not show where the shares came from nor the nature of the underlying transactions that require the collateral. Hence the usefulness of the disclosure will be limited.

One commentator has suggested that it may be possible to reduce the compliance burden by requiring the qualified lender only to disclose security interests from a single security provider that add up to a specified percentage or more of the relevant issued capital of the listed corporation. This would mean that a qualified lender would not have to aggregate small security interests (from different security providers) to monitor disclosure requirements, unless he is aware that security interests are also being given by persons

connected with the single security provider. Again, the disclosure would not show where the shares come from nor the nature of the underlying transaction that required the collateral and would give no indication of the likelihood of a forced sale.

Disclosures by substantial shareholders

The same issues arise today as in the original consultation in 1998, particularly in relation to the informational value of disclosures of security interests.

There are good reasons to believe that for many and possibly a majority of listed corporations, substantial shareholders would have used their shares as collateral for one reason or another. Should a disclosure obligation be imposed, a significant number of security interests would be disclosed in relation to many listed companies. These would include those cases where forced sales of security interests given by a controlling shareholder would have a significant impact on the share price. However, there would also be cases where a substantial shareholder may have used up to 100% of shares owned by him as collateral for standby facilities that may not have been drawn down, or where he has given the shares as collateral for other reasons. The two types of cases would not be distinguishable on a Part XV disclosure of security interests. Disclosures of a large number of security interests for various possible reasons would still not provide the market with information on the likelihood or impact of default. Without more information it would not be possible to draw reasonable conclusions from these disclosures, which might in fact be highly misleading.

Accordingly, certain commentators have suggested that one possible way to secure material information while minimizing compliance burdens may be to set certain thresholds above 5%, e.g. 20% or higher of the issued capital. This raises a question as to what the appropriate threshold should be. Setting the disclosure requirement at a higher threshold above 5% might narrow down the number of companies in respect of which disclosures would be made. On the other hand, commentators have also noted that focusing on particular companies in this way could send out false signals. Although investors would not have full information to enable them to assess the risks of default, some may draw unwarranted conclusions that the likelihood of default is high. This could in turn lead to panic selling. The fall in share price could then trigger margin calls on the substantial shareholder that may result in default in some cases, which is the precise situation the commentators are seeking to avoid.

Summary

In summary, the practical dilemma of balancing the interest of investors in view of the four factors is whether the benefits of the additional information on share pledges outweigh the costs of its collection. Discussions with market participants, including the Advisory Committee of the SFC, suggest that:

(a) *Informational value*: It is common market practice for substantial shareholders to pledge shares for standby credit facilities. If disclosures were to be made in relation to most or many listed companies, it would not add value to the information available in the market. The mere existence of such pledges would not inform the investor about the potential volatility of such shares in a forced sale.

(b) *Burden*: There would be significant compliance burdens because of the common market practice for substantial shareholders to pledge shares for standby credit facilities. Qualified lenders also take share collateral in the ordinary course of their businesses without involving share pledges by substantial shareholders.

(c) *Liquidity of shares at the time of sale*: Poor liquidity of certain shares may cause volatility in share prices triggered by forced sales and timing of new information regarding the sales. Low liquidity of certain shares already implies potential volatility for sudden sales.

(d) *Timing of disclosure*: Prior to the enforcement of the pledges, disclosure of pledges by itself would not enable investors to predict whether a chargee would in fact exercise its power of sale. This would depend on the financial position of the pledgor. Although currently the chargee is required to make a disclosure within 3 business days after the sales, this does not aid investors. The impact of the sales would have already been reflected in the share price by the time the disclosure is made.

There is therefore considerable market disagreement over the appropriate solution on the disclosure of share pledges.

The crux of the matter lies in securing relevant information that would properly inform the market about the financial condition of substantial shareholders. This cannot be achieved by requiring disclosures of security interests *per se*. Part XV is concerned with disclosure of interests in shares and would not provide other material information that would enable an investor to assess the likelihood of default – e.g. the size or purpose of the loan, whether a facility has been drawn upon, and the likelihood of default, and such information at the relevant point of time. These factors suggest that, if any change to the existing rules is to be made, it should take place outside the normal Part XV context and focus on improving disclosure of the financial position of substantial shareholders. This itself would, however, involve difficult issues in weighing the legitimate interest of substantial shareholders in privacy against the usefulness of the information disclosed to general investors. So far as we are aware, there is no other developed jurisdiction where such disclosure is required by law.

Proposed way forward for Hong Kong

Nevertheless, some may argue that the circumstances of Hong Kong, where many listed companies are controlled by a single shareholder, call for a different approach from other jurisdictions.

The SFC proposes that disclosure obligations be imposed such that information about impending forced sales will be disseminated as soon as possible. This would mean that market would come to know that about impending forced sales immediately, instead of three (3) business days later, as is currently the case.

The obligation would be imposed on both the lender (qualified lender and non-qualified lender) and the substantial shareholder, who has an interest of 5% or more, as follows:

(a) Today a lender will come under a duty of disclosure when:

(i) it becomes entitled to exercise voting rights in respect of a security interest as a result of a default, and has evidenced an intention to exercise the voting rights or control their exercise or taken any step to do so; or

(ii) where a power of sale has become exercisable and it offers the shares or any part of the shares for sale,

and the lender has 3 business days within which to disclose the deemed acquisition of an interest (in the case of a qualified lender) or change in nature of interest (in the case of a non-qualified lender).

Instead of three (3) business days, we propose that the Ordinance would require a lender (qualified or non-qualified lender), who has an interest of 5% or more, to *forthwith* inform the Exchange and the listed issuer of the circumstances described in (i) or (ii) and the number of shares involved (also expressed as a percentage figure of the relevant share capital). The Ordinance would also require that the listed issuer must immediately announce these details. The lender would be required to disclose the details of the change in interest or change in nature of interest within three (3) business days of such change in accordance with requirements of Part XV.

(b) The Ordinance would also require a substantial shareholder who receives indications, whether verbal or written, from the lender of any of the circumstances described in (i) or (ii) above, and to inform the listed issuer and the Exchange *forthwith* of this fact and the number of shares involved (also expressed as a percentage figure of the relevant share capital). The Ordinance would also require the listed issuer to immediately announce these details. This builds on the existing approach in the Listing Rules that currently applies only to controlling shareholders during the moratorium period.

Some commentators suggest that there could be practical difficulties with determining what "forthwith" means, and also suggest that the obligation to disclose that steps are being taken to enforce the security interest should apply to a higher disclosure threshold than 5% say, 10%.

We would welcome the view of members of the public on this subject.

Views sought

Question 2: ***Should the current exemption for security interests be removed or narrowed either in relation to qualified lenders or substantial shareholders? Do you agree with the proposal to make sure information about impending forced sales is disseminated forthwith (as described above) as a possible way forward? Do you consider "forthwith" practicable and do you have any views on requiring disclosure of the impending sales for a threshold higher than 5%? If not, please suggest other methods that would address issues highlighted above.***

2.2 Disclosure thresholds and *de minimis* exception

Background

Today, the initial disclosure threshold is 5%. When a person acquires an interest such that the percentage figure is 5% or more, a disclosure must be made. When a person makes a disposal so that the percentage figure falls below 5%, a disclosure must be made. Once a person has an interest of more than 5%, then unless the *de minimis* exception applies, every change of interest or change in the nature of an interest across a whole percentage level (i.e. 6%, 7%, 8% and so on) must be disclosed. The same applies to short positions above 1%.

The policy intent of the *de minimis* exception was to address the compliance burden that might arise where a substantial shareholder's interest fluctuated only by a small amount around a particular percentage level.

We received comments that the *de minimis* exception is complex and difficult to apply and understand. At least some substantial shareholders do not use the exception because of this.

In particular, the substantial shareholder has to keep track of preceding interests in order to continue to claim the *de minimis* exception. The conditions for *de minimis* to apply are:

(i) the new percentage level of interest held must be **less than or the same as the last notified percentage level**;

(ii) the difference between the new percentage figure and the last notified percentage figure must be less than 0.5%; and

(iii) the percentage figures of his interest must have remained **at all times** within 0.5% of the last notified percentage figure.

SFC's response

This complexity is not consistent with the original policy intent of reducing unnecessary compliance burdens. Two alternatives for reducing compliance burdens are as follows.

Alternative 1: Simplify the *de minimis* regime

The *de minimis* exception can be streamlined by:

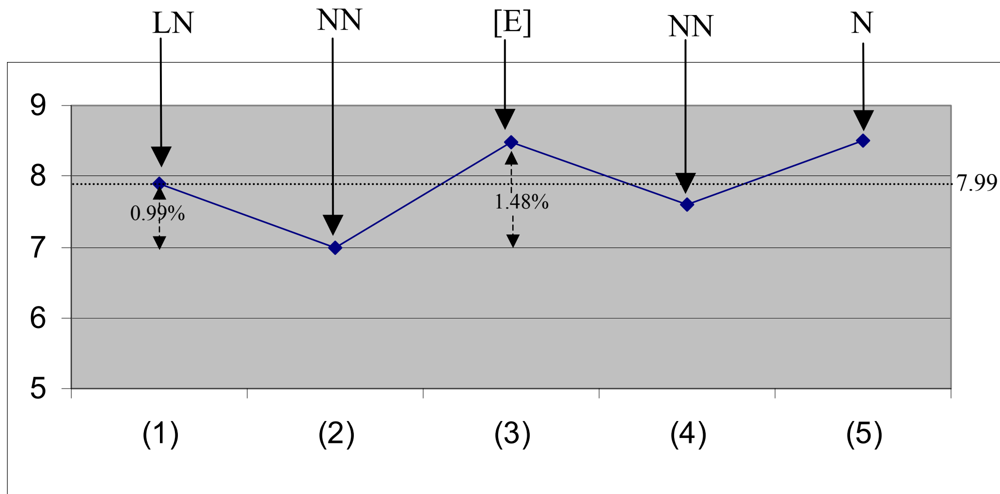
(i) removing the need to keep track of preceding interests; and

(ii) removing the prohibition against an increase of the last notified percentage figure qualifying for a *de minimis* exception.

This would mean that where an interest has changed across a percentage level, the substantial shareholder would simply compare his present percentage figure with the last notified percentage figure to see whether he is within 0.5% in order to determine whether the exception applies.

This would not unduly reduce market transparency because the maximum range within which the actual percentage figure may lie (i.e. the "level of uncertainty") as compared to the last notified percentage figure would be limited to 1.49%, as illustrated in the following example.

Proposed simplification of de minimis regime



In the diagram:

LN = Last notification	**NN = Not notifiable because of percentage band allowance**
E = Exempt because of de minimis exception	**N = Notifiable**

(1) X holds 7.99%, which he discloses as the last notified percentage figure. The last notified percentage level is 7%.

(2) X sells 0.99% bringing the interest to 7.0%. The new interest is in the same percentage level as the last notified percentage level. Thus this is not notifiable.

(3) X buys 1.48% bringing his interest to 8.48%. The new interest is not in the same percentage level as the last notified percentage level. However this qualifies for the *de minimis* exception since it is within 0.5% of the last notified percentage figure of 7.99%.

(4) X sells 0.88% bringing his interest to 7.6%. The new interest is in the same percentage level as the last notified percentage level. Thus this is not notifiable.

(5) X buys 0.9% bringing his interest to 8.5%. The new interest is not in the same percentage level as the last notified percentage level. It is also greater than 0.5% away from the last notified percentage figure. As such this is notifiable.

Alternative 2: Remove percentage level thresholds and adopt an "actual percentage change" disclosure approach

Some commentators suggested going further and significantly amending the current disclosure regime. Under this suggestion, the threshold for disclosure would remain at 5%. However, once a person's interest has passed the threshold of 5% or more, instead of requiring disclosure when an interest crosses a whole percentage level, a person would be required to make a disclosure, whenever the percentage figure of the person's interest was a certain distance from the last notified percentage figure given by him. This would also apply to changes in nature of an interest and changes in short positions.

This would greatly change the disclosure regime. Since it removes the need to consider percentage levels, it removes the need to disclose small changes around a whole percentage level. It would consequently remove any need for a *de minimis* exception.

However, there would be difficult trade-offs and policy choices to be made.

The first is the choice of the disclosure trigger level. If it is set lower, at say 0.5%, a substantial shareholder who is steadily increasing or reducing his shareholding will have to make more frequent disclosures than under the current law. In return, the "level of uncertainty" is 0.99% - lower than the one under the current law. On the other hand, if it is set higher, at say 1%, there will be a loss of market transparency in that fewer disclosures may be made in situations where a shareholding fluctuates within a "level of uncertainty" of 1.99%.

Secondly, the proposed change would put Hong Kong out of step with the approach followed in other jurisdictions that use the percentage level approach, such as the UK and Australia.

Thirdly, market participants have invested considerable time and money in developing compliance and reporting systems and training staff to operate under the current percentage band system and the cost of switching to an alternative system might be unduly high. This would run counter to our goal of reducing the compliance burden on business.

The SFC is nevertheless prepared to give this suggestion further consideration, if there is significant support for it in this consultation exercise.

Another commentator suggested that, in view of its complexity the *de minimis* exception should be scrapped. This would return the regime to the situation under the SDIO. However, it is possible to simplify the exception to make it easier to claim. In any case, we believe the exception gives considerable comfort and flexibility to market participants who choose to use it.

Views sought

Question 3: ***Should we:***

(a) simplify the de minimis exception along the lines described, or in some other way;

(b) change the Part XV disclosure regime from one where disclosure is triggered by crossing percentage bands to one that operates by reference to actual percentage changes? If so, what should be the disclosure trigger?

De minimis exception and "last notification"

There are other areas where amendments to the law will be necessary to make the *de minimis* exception more user friendly.

Comment

Today the “last notification” for the purposes of fulfilling the *de minimis* conditions is limited to a notification made due to a change in the percentage level of a person’s interest. Notifications would however also be made pursuant to a duty of disclosure that arises (i) on acquiring 5% or more interest (i.e. the initial notification) or (ii) due to a change in nature of an interest.

SFC’s response

We propose to amend the law to allow these 2 other types of notification to also qualify as a “last notification”. Similar amendments will be made for a change in nature of interest and a change in short positions. The law today does not permit *de minimis* exceptions at the 5% disclosure threshold and we do not propose to change this position.

2.3 Aggregation exemption

Background

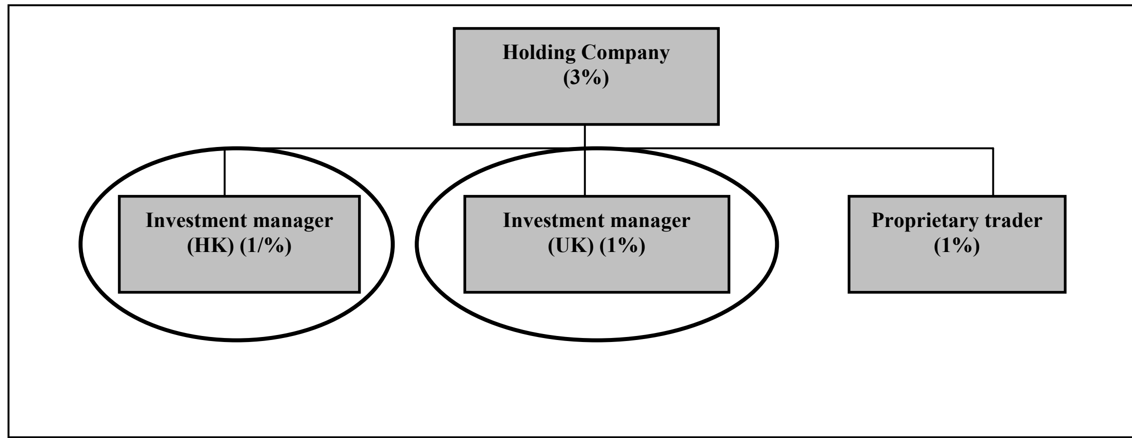
Part XV generally attributes the interests held by a corporation (a “***controlled corporation***") to a holding company if the holding company controls one third of its relevant shares. A holding company must therefore aggregate these interests with its own interests for disclosure purposes. When the SFO Bill proposed to reduce the disclosure threshold from 10% to 5% and to reduce the time for reporting interests from 5 to 3 days, there were representations that the compliance burden of holding companies would unduly increase as a result.

Part XV introduced the “aggregation exemption” in response to those representations. A holding company may disregard, and therefore “disaggregate” from its own, the interests of an investment management corporation within the group if the investment management corporation acts independently “without reference to” any other entity within the group.

The aggregation exemption operates in relation to “qualified investment managers” and only where the entity does not communicate with any other corporation within the group. The controlled corporation has to be a single legal entity carrying on investment management business. ***“Qualified investment managers”*** have to be regulated in Hong Kong or in a recognised jurisdiction with equivalent regulation e.g. U.K., Australia.

For example, in Diagram A, the Holding Company would need to aggregate its own interests (3%) only with those of the proprietary trader (1%). It may disregard the interests of the investment managers who do not communicate with each other, and no disclosure is necessary.

Diagram A: The application of the aggregation exemption today

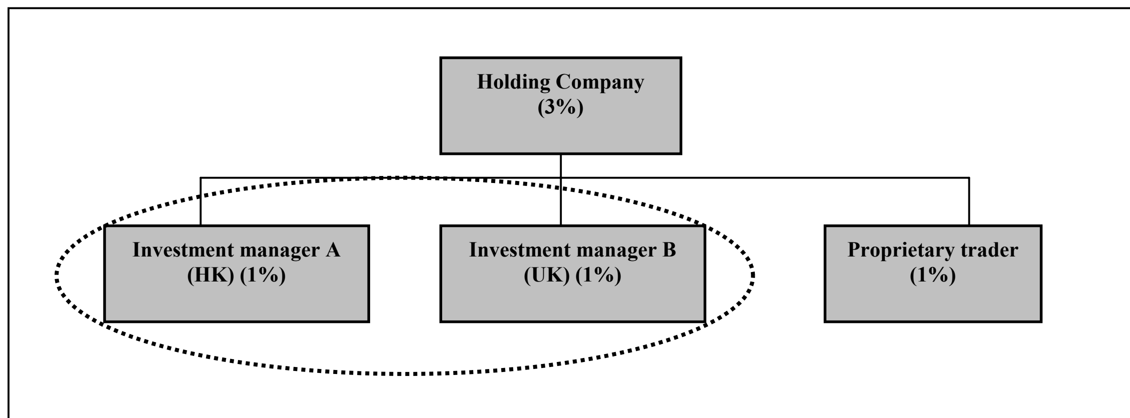


Legal entity operating without reference to the rest of the group

Comments

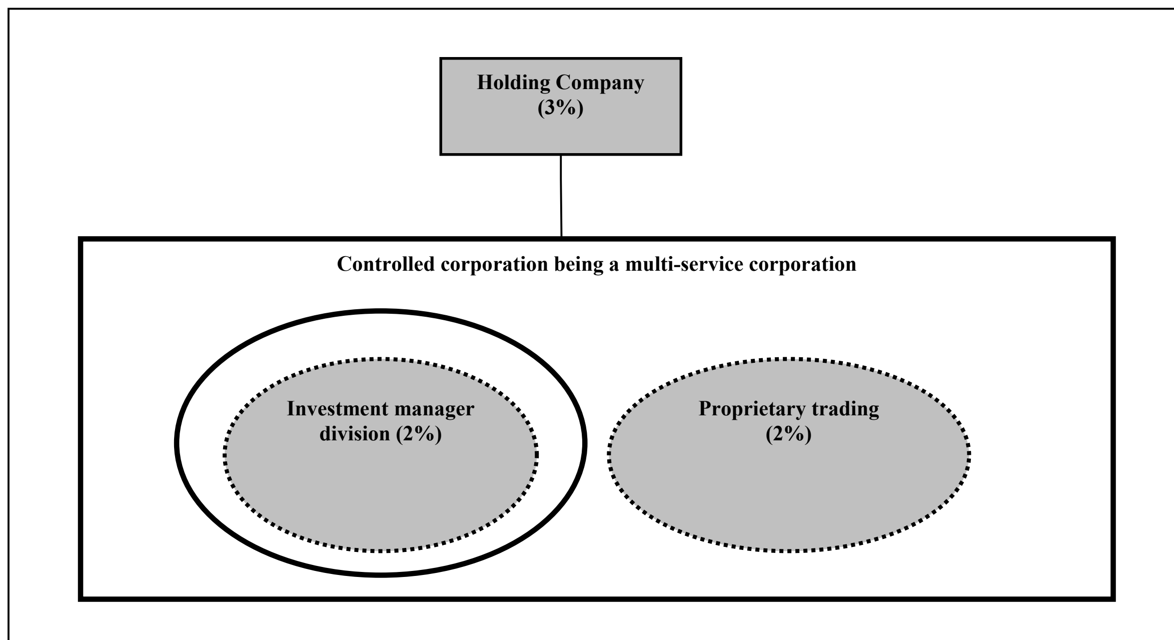
We received comments that some holding companies find difficulty in qualifying for this exemption. This is because in practice a holding company may have more than one investment management corporation within the group, who may communicate with each other on investment strategies. For example, in Diagram B below, controlled corporations A and B may communicate with each other or share common strategies. In such a case, there is an argument that the Holding Company may no longer be able to claim the aggregation exemption. Accordingly it is possible that it must disclose the aggregated interest of the group of 6%.

Diagram B: Communication among investment managers (2 legal entities referring to each other or sharing common strategies)



We have also received comments that the exemption is not available where a controlled corporation has several divisions carrying out various business functions (including investment management) within a single legal entity, even where segregation of business functions is strictly enforced. This means that in Diagram C, for example, the Holding Company must aggregate all the interests to reach a total of 7%.

Diagram C: Controlled corporation carrying on more than one business including investment management, with Chinese walls within single legal entity



We would also apply this where there was only a single company which conducted all of the operations shown above.

SFC's response

We propose extending the exemption to both these circumstances, subject to the following conditions.

Communication among investment managers (Diagram B)

We propose to amend the law so that where investment managers communicate only with each other in relation to investment strategy:

(i) The investment managers' interests should be aggregated and disclosed at the relevant thresholds, but need not be aggregated with the interests of the holding company.

(ii) To ensure proper disclosure, the holding company would continue to be responsible for reporting the aggregated interests of the qualified investment managers (separately from its own interests and other interests attributed to it). This would avoid the difficulties of assigning one of the investment managers in the group to undertake the responsibility and also avoid potentially misleading appearances.

This could result in fewer disclosures by the holding company.

Disaggregation of interests within a single company (Diagram C)

In the case where different divisions (as distinct from different companies) of the controlled corporation carry out different business functions including investment management within the same legal entity, we propose that the exemption be extended subject to the condition that the burden would fall on the person claiming the exceptions to prove that:

- there are adequate internal controls to segregate the investment management businesses, and

- the controls have been in fact observed.

If, even after applying the aggregation exemption, there is an interest exceeding 5%, a corporation would have to file a notice in respect of other interests. Thus, in Diagram C, the holding company would be attributed the 2% interest of the proprietary trading division. This, taken together with its own interest of 3%, would aggregate to 5% which must be disclosed by the holding company.

Application only to "investment managers" as defined in section 316(7)

Today the aggregation exemption only applies insofar as the qualified investment managers concerned are "investment managers" as defined under subsection 316(7) of the Ordinance. These are:

(i) intermediaries licensed or registered for a Type 9 regulated activity under the Ordinance; or

(ii) a corporation which is licensed, registered or exempt in a place outside Hong Kong recognized for the purposes of this section by the SFC for an activity which is equivalent to Type 9 regulated activity.

Comments

There are comments that this renders the exemption impracticable for groups with investment managers in jurisdictions other than those in the approved list.

SFC's response

We take the view that any exemption should continue to apply only in respect of foreign investment managers in approved jurisdictions. The basis for approving these jurisdictions is that the SFC is assured that the entities operate in a proper inspection regime, so as to be adequately supervised and the SFC can secure necessary information from the relevant authorities in that jurisdiction. This is sometimes evidenced by the signing of bilateral memorandum of understanding with the SFC or the IOSCO Multilateral Memorandum of Understanding Concerning Consultation and Cooperation and the Exchange of Information (May 2002). Therefore, although the list of approved jurisdictions is not closed, others will only be added should they meet the necessary conditions.

The same limitation would apply in relation to the proposals to extend the aggregation exemptions discussed above.

Views sought

Question 4: ***Should the aggregation exemption be extended on conditions described above to cover:***

(a) the circumstance where qualified investment managers within a group communicate with each other on investment management strategies?

(b) the circumstance where a qualified investment manager has different businesses (including investment management) that are carried out by different divisions within a single legal entity, with strict segregation of the investment management businesses?

Question 5: ***In view of the fact that aggregation exemption would not extend to investment management entities in jurisdictions outside the SFC's approved list, would the proposed changes be useful in practice?***

2.4 Stock borrowing and lending

Background

"Approved lending agents" ("***ALAs***") may operate within a simplified disclosure regime for stock borrowing and lending activities. ALAs taking advantage of this regime merely disclose changes in the percentage level of their "lending pool".

The SFC approves persons (generally custodians) as ALAs subject to certain restrictions. The restrictions are imposed for the following reasons:

(a) If the ALAs were permitted to lend shares from the lending pool to companies within the same wholly-owned group ("affiliates"), this may mean that the borrowing of shares by affiliates would not be discloseable due to the wholly-owned group exemption.

(b) Similarly, if shares in which affiliates are interested are put into or removed from the lending pool, the change in size of the lending pool would not be discloseable due to the wholly-owned group exemption.

Lending to affiliates from the lending pool is prohibited by the conditions of approval of the ALA. In addition, shares that the ALA lends on behalf of its affiliates are not treated as "qualified shares" for the purpose of the ALA exemption. Similarly, the ALA's own shares cannot be treated as "qualified shares".

Comments

There are comments that industry may wish to carry out the following activities that would be difficult due to the current restrictions:

(a) Lend shares in which an affiliate is interested in via the lending pool operated by an ALA within the same group;
(b) Lend shares from the lending pool of an ALA within the same group to an affiliate;
(c) Lend shares in which an ALA is interested via the lending pool.

In particular it is said that the prohibition from lending to affiliates places borrowing affiliates within a group at a competitive disadvantage, since these affiliates and the ALA carry on business between them at arm's length. Secondly it is said that by excluding shares of an affiliates and ALAs from being qualified shares there is no uniformity in the manner of disclosure for all lenders in a program.

SFC's response

If any exemptions were to apply, we would need to ensure that the businesses are in fact carried out at arm's length and between independent business units. In addition, the ALA Guidelines would need to prohibit the affiliate or holding company from controlling the flow of the stock borrowing and lending. The group exemptions would also not apply and borrowing from ALAs and changes in the lending pool must be disclosed.

Views sought

Question 6: ***Should the current ALA regime be amended in relation to the activities described above and if so, how?***

2.5 Credit derivatives

Background

Credit derivatives are financial instruments whose value is driven primarily by the credit risk of the underlying entities, thus enabling investors to gain or reduce exposure to credit risk. There is usually a reference asset linked to the credit derivative. This means that one party can transfer the credit risk of a "reference asset" (which it may or may not own) to another party without transferring the reference asset entirely.

For example, A, a protection buyer, may be exposed to the credit risk of holding of a bond. The protection seller, B, may be willing to assume exposure to that credit risk for a price. A and B would enter into a contract that gives A the right to transfer the credit risk to B on the occurrence of a credit event at a pre-determined price (such as the insolvency of the issuer of the bond). If the value of the bond declines on the insolvency of the issuer, A would suffer a loss as a result of holding the bond. However, on the occurrence of the credit event, B will pay A under the credit derivative. A's loss from the bond will be offset by the gain on the credit derivative.

Comments

We received comments that credit derivatives with convertible bonds or exchangeable bonds as their underlying reference asset should not be subject to disclosures. This is because in practice the equity element of the convertible or exchangeable bonds is not relevant to such instruments.

For example, a credit default by the issuer of the convertible bond means that the equity element of the underlying convertible bond would be, in all likelihood, valueless. It is therefore extremely unlikely that a person would exercise his conversion rights under the convertible bond. Hence the equity element of the reference asset is purely incidental and not taken into account when a credit derivative is entered into. In any case the delivery of the convertible or exchangeable bonds upon the occurrence of a credit event will trigger a Part XV disclosure. On this basis, the disclosure of credit derivatives would not add to transparency and might even cause confusion to the public.

SFC's response

We seek views on the argument that credit derivatives with convertible bonds or exchangeable bonds as reference assets should be exempted from disclosure. Even if the conclusion favours exemption, it is important to craft an appropriate definition that would limit the exemption to instruments where the equity element is not in fact relevant to the derivative. This is to avoid an overly wide definition of "credit derivatives" with the unintended consequence that instruments that the market should know about are not disclosed.

A possible alternative is to require disclosure but to provide a specific code for credit derivatives in the disclosure form.

Views sought

Question 7: ***Should credit derivatives with convertible bonds and exchangeable bonds be exempted from disclosures, or will a code on the forms for credit derivatives suffice?***

Question 8: ***If you favour an exemption, how should the exemption be drafted to ensure that only the appropriate credit derivatives are exempted?***

2.6 Index-linked equity instruments

Background

Part XV imposes disclosure obligations in relation to interests in the underlying shares of equity derivatives. Certain index linked instruments fall within the definition of equity derivatives. As a result persons investing in an index-linked instrument may be taken to be interested in the underlying shares of the index-linked instrument.

Today there is an exemption for equity derivatives that derive their value from a basket of shares in several listed companies and this would cover certain index-linked instruments. For this exemption to apply there should be a basket of at least 5 stocks and no one share should account for over 30% of the value of the entire basket.

Comment

As HSBC now represents over 30% in value of the Hang Seng Index, this exemption is no longer available to equity derivatives linked to the Hang Seng Index.

SFC's response

We propose to issue regulations to increase the percentage limitation in respect of each stock as a percentage of the value of the entire basket of the Hang Seng Index stocks, so that the equity derivatives linked to the Hang Seng Index would again be exempt from disclosures.

Views sought

Question 9: ***Are there any other indices in respect of which a similar exemption to that proposed for the Hang Seng Index would be appropriate?***

2.7 Change in nature of interest

Background

Part XV imposes a disclosure obligation on a person if the nature of his interest is not the same before and after the relevant time. The situations in which there is a change in the nature of an interest are very broad. However, there are six circumstances in which there is taken to be no change in the nature of a person's interest. These are set out under section 313(13)(i) to (v) of the Ordinance and in section 5 of the Securities and Futures (Disclosure of Interests – Exclusions) Regulation (L.N. 229 of 2002 ("**Exclusions Regulation**").

Comment

We received comments that the requirement to make notification in respect of a change in nature of interest creates practical difficulties. While Part XV sets out several items that are to be included in the concept of change in nature and a few others that are to be excluded, those sections are not drafted in the form of a definition. It appears that the items so listed are not exhaustive. The exceptions under section 313(13) and section 5 of the Exclusions Regulation apply only to very specific situations and are defined very narrowly. It is unsatisfactory to infer situations that are intended to be caught as giving rise to a change in nature of interest by considering the exclusions in a negative way.

SFC's response

We propose to change the law to define exhaustively situations where there will be a change in the nature of a person's interest in shares as follows:

- When a person exercises rights under an agreement including equity derivatives
- When a person has rights under an agreement including equity derivatives exercised against him
- When a person lends or recalls shares under a securities borrowing and lending agreement
- When a person enters into an agreement for the sales of shares that he holds
- When a person takes delivery of shares from another person
- Any other situations as prescribed by rules under the Ordinance.

We are also consulting on whether the exempt security interests provision should be removed. Depending on the conclusions on that issue, there may be a need to add to the circumstances that are being listed as a change in nature of interest above.

The existing exclusions would remain essentially the same as at present. However the exclusion in section 313(13)(i) would be limited in a similar manner to section 5 of the Exclusions Regulation i.e. the exemption would only be available where the shares are delivered within 4 trading days of the date on which the duty of disclosure arose. Similar amendments are proposed to the provisions relating to changes in the nature of an interest in shares applying to directors.

Views sought

Question 10: ***Are there any other situations where a change in nature of a person's interest in shares should give rise to a disclosure obligation?***

3. MATTERS INVOLVING AMENDMENTS TO THE LAW

We list below proposed changes to the law necessary to deal with issues raised by the market. They are intended to make the application of the law more consistent or to take into account business practices. They also reduce compliance burdens where possible.

3.1 Reference dates for filing notices of sales and purchases

Comment

Under the current law, the reference date for reporting a purchase of an interest is the date on which the contract is entered into (i.e. the trade date). The reference date for reporting a sale on the other hand is the date of delivery of the interests (i.e. the settlement date). Market comments are that the different reference dates are confusing.

SFC's response

We propose synchronizing the dates so that the seller and the purchaser must each make the disclosure by reference to the date he enters into the contract, so long as settlement is to take place within 4 days. Should the settlement fail, however, to take place within 4 days, the obligation to disclose on settlement will again apply. In addition, the seller who fails to deliver would have to restate his long position and disclose the change in nature of his long position. We also propose amendments so that the synchronization also works for the controller or parent company to which the interests of the seller are attributed.

3.2 Filing of notices for options on grant, exercise and completion

Comment

Today the grantor of certain options, such as a physically settled call option, may need to make 3 sets of disclosures if the option is exercised:

a. On the grant of the option, the grantor must disclose a short position, since it is under an obligation to deliver the shares if called upon to do so.

b. If the option is exercised, the grantor of the option comes under an obligation to deliver the interests. The grantor must disclose the "change in nature" of his long interest[4].

c. On completion, assuming all the interests in shares are delivered, the grantor must disclose the cessation of holding in the interest and short position (or change in percentage level, as the case may be).

SFC's response

We propose to extend the proposal to synchronize the reference dates for buyers and sellers completing a transaction within 4 days (as in paragraph 3.1 above) to physically settled options. Provided completion is to take place within 4 days from the date the option is exercised, the grantor will only have to disclose the cessation of his interest and short position (or change in percentage level, as the case may be) by reference to the events in paragraph (b). Unless the interests are not in fact delivered, he would not need to make a disclosure by reference to events taking place at settlement date. Only 2 notifications would need to be made, not 3.

3.3 Time frame to notify the Exchange and listed companies

Comment

We received comments that today a Saturday counts as a "business day" and market representatives have asked that Saturday be excluded for the purposes of filing notices.

SFC's response

Many who are obliged to file notices, as well as the Exchange, no longer carry on business on Saturdays. Therefore we propose to amend Part XV so that Saturday does not count as a business day for these purposes.

3.4 Exempt custodian interest

The effect of Part XV is that a custodian cannot retain any discretionary rights with regard to the securities held in custody if its interest is to be disregarded. The comments we received on the current exemption and our responses are as follows.

a. ***Comment***: In practice a custodian may retain a discretionary right or equitable charge to secure the payment in respect of the custodial services.

   SFC's response: We propose to amend the law so that the exemption will not be disapplied by reason only that the custodian has a right to resort to the property to satisfy any outstanding charge or lien or for the payment of any duty, tax, cost or other outgoings. This would mirror the "bare trustee" disregard.

[4] There is no requirement to disclose the short position, since a change of nature does not arise in relation to a short position

b. ***Comment***: In practice a custodian may have a limited discretion to collect its customer's entitlements or to act to prevent the extinguishment or expiry of any rights or entitlements relating to the customer's interests where the customer fails to give instructions.

SFC's response: We propose to amend the law so that the exemption would continue to apply where (i) the customer fails to give instructions in respect of its interest and (ii) the custodian is under an obligation to exercise any rights or powers it holds on behalf of its customer in respect of the interests in question to protect the customer's investments or to collect the client's entitlements on its behalf.

c. ***Comment***: In practice a custodian may hold a block of shares in the same corporation for a number of different customers. On an issue of scrip dividend, the custodian may hold residual shares so small in number that it is not possible to allocate them exactly among the different customers. This would leave the custodian with a small holding over which it may exercise rights.

SFC's response: We propose to amend the law so that where the custodian only has a discretion over a small number of shares which are impossible to allocate to customers, the existence of the newly issued shares will not affect the exemption in respect of the original holding.

3.5 Exempt security interest

Generally a qualified lender (essentially a regulated person who holds collateral against an amount due to him) need not disclose an "exempt security interest".

a. ***Comment:*** At present an interest is defined as an "exempt security interest" if it is held by a qualified lender "by way of security **only** for the purposes of a transaction entered into in the ordinary course of his business as a qualified lender" (emphasis added). We received several comments highlighting concerns over the interpretation of this definition:

   (i) Brokers providing margin financing asked that it be clarified whether or not they would be subject to notification requirements in respect of collateral pledged to secure margin facilities. There is no obligation to disclose interests that a client pledges to the broker by way of security, since a "qualified lender" includes a margin financier. However, under the current law if the interests are re-pledged to another financial institution, there is an argument that the exemption may no longer be available, as the broker would not be considered to be holding the interests "by way of security **only**".

   (ii) Securities are sometimes pooled and transferred into the name of a mortgagee bank or its nominee, or held in electronic form in the clearing system in the name of HKSCC Nominee Ltd. Commentators expressed concerns that it is not clear that it would be considered to be an "exempt

security interest **only**” if the securities are transferred into the name of a nominee.

(iii) There are also comments that if the view is taken that the exempt security interest provision does not apply if collateral is taken by way of “absolute” transfers of title, this means that the exemption is not available for a large number of derivatives transactions in which collateral is taken by way of absolute transfer.

SFC’s response: The policy intent is that the exemption should apply under the circumstances described above. Assuming the exempt security interest provision is retained, we would be willing to amend the definition to remove the word “only” from the phrase “by way of security only” in order to resolve the issues discussed above.

b. ***Comment:*** Securities are sometimes pooled and held as collateral through a security agent for a syndicated loan. If the security agent is not itself a member of the syndicate, it does not qualify for this “security interest” exemption, even if all of the members of the syndicate qualify for the exemption.

SFC’s response: We propose extending the exemption to security agents where (i) all members in the syndicate are qualified lenders and (ii) such security agents are regulated entities in recognized jurisdictions. Assuming the exempt security interest provision is retained, the definition of “security agent” would include a corporation whose business includes holding securities in safekeeping for qualified lenders.

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

(i) to exercise discretion in dealing in the interests; or

(ii) to exercise rights attached to the interests,

except where such authority is limited to –

(a) taking, maintaining or releasing the security over the interest in shares;

(b) collecting dividends payable, taking up rights or other entitlements in respect of the interests in shares or preserving the value of the security in the interests of the qualified lenders;

(c) dealing in the interests in shares, or exercising rights attaching to the interests, in circumstances where there has been an event of a default by the person providing the interest as collateral.

3.6 Qualified corporation exemption

Comment

A wholly-owned subsidiary does not need to disclose its interests in a listed corporation where the holding company discloses such interests. This exemption does not currently cover the situation where the corporation in which the subsidiary holds shares first becomes a listed corporation.

SFC's response

We propose amending the law so that the subsidiary would not need to disclose its interests at initial listing of the corporation, provided its holding company does so.

3.7 Short positions held in the same capacity as interests disregarded

Comment

There are comments that the provisions allowing certain interests to be disregarded[5] do not cover short positions that arise in the same capacity.

SFC's response

We propose amending the law to ensure that short positions are disregarded if held in the same capacity as interests in shares that are disregarded, notwithstanding there are other notifiable interests held in a different capacity.

3.8 Concert party provisions and underwriting agreements for equity derivatives

Comment

The concert party provisions require the aggregation of the interests of members of concert parties for disclosure purposes. The provisions exclude an agreement to underwrite any offer of shares in a company, provided that the purposes of the agreement are confined to the underwriting and any matters incidental to it. This exclusion does not similarly cover underwriting agreements for offers of equity derivatives such as warrants or convertible bonds.

SFC's response

We propose to allow the exclusion to also apply to offers of equity derivatives, subject to the same conditions as for offers of shares.

[5] Section 323 of the Ordinance

3.9 Director/substantial shareholder and spouse's interests

Comment

The law deems a substantial shareholder of a listed corporation to be interested in any shares that the spouse holds. This is to prevent a person who effectively controls 5% from attempting to split the interests among himself and his spouse, so that each set of interests falls below the 5% disclosure threshold.

Today a director must disclose any interests in a listed corporation. Except where that person's spouse is also a director of the same listed corporation, the person is also taken to hold the spouse's interests. In such case the total interests of the couple must therefore be reported. The exception applies where both are directors in order to avoid duplicated reporting, since each would be reporting their own interests separately as directors.

Where a person is both a director and a substantial shareholder, the person has 2 filing obligations. In such circumstances, as the filing is made in a single form, the issue arises as to whether or not the person should include the spouse's interest in the total interests if the spouse is also a director.

SFC's response

At present the effect of the law is arguably that such person (as a substantial shareholder) is also taken to hold the spouse's interests whether or not the spouse is also a director and must disclose the spouse's interests separately.

As a policy matter, where a person's spouse is also director, he or she would have to disclose his or her own interests and would be taken to include the interests of the person (unless the person is also a director). Accordingly, all the necessary information regarding their aggregated interests will already be made public. In principle, there should be no necessity for the person to take into account the interests of the spouse and make a disclosure, since the spouse will have already made the relevant disclosure.

As a practical matter, for such an exclusion to operate, we would need to address what happens when a spouse joins the board of directors. For example, a person who is a director/substantial shareholder would have disclosed his interest and his wife's total interests. If the spouse (who was not previously on the board of directors) subsequently joins the board, and the person who is a director/substantial shareholder then excludes the spouse's interests, he would appear to be reducing his interests in the corporation. Such a situation can be dealt with by an additional code in the form.

Accordingly, we propose to amend the law to make it clear that, provided that a director fulfils his or her obligations to make a disclosure, his or her spouse will not be taken to hold the interests of that director. We also propose to add a code to indicate the event that a spouse becomes a director, so that it is clear why the person is reporting a reduction in interest (whether as a shareholder or a director). Similarly, there should be a code that would indicate the event that a person's spouse resigns from the board. In such circumstances the interests of the resigning spouse would be attributed to the person who

must then report the interests of the spouse as well. Such codes would help explain why there appears to be a decrease or an increase in the total interests.

3.10 Director/Chief Executive of listed associated corporations

Comment

The law currently requires a person to disclose shareholdings of a listed corporation of which he is a director/chief executive, as well as shareholdings of the associated corporation of the listed corporation. Where the associated corporation is also a listed corporation of which he is a director/chief executive, the converse applies, and this could result in duplicated disclosures.

SFC's response

We propose amending the law to remove the need for such duplicated disclosures.

4. MATTERS FOR FURTHER CLARIFICATION IN OUTLINE

We have published an "Outline of Part XV of the Securities and Futures Ordinance" on the SFC website, as a practical guide on the situations in which a notice has to be filed We set out our views below in response to comments relating to interpretation, and will incorporate these in the Outline.

4.1 Status of the Outline

Comment

Respondents generally found the Outline useful. However commentators have concerns about the degree to which a person can rely on the Outline if there were discrepancies between the Outline and Part XV. We also received suggestions that the SFC might clarify what would constitute a "reasonable excuse" under the Ordinance. It was also suggested that there should be a transparent regime for granting concessions, including publishing them.

SFC's response

If there is a discrepancy, Part XV prevails. The determination of what is a "reasonable excuse" depends on the circumstances of each case. Hence it is difficult to give useful guidelines on what it constitutes. However, we will consider reporting useful cases as references should they arise (for example through the SFC Quarterly Bulletin).

The SFC cannot give concessions, although the Ordinance does allow for exemptions in limited circumstances under section 309 of the Ordinance. Such exemptions can only be given in accordance with published Guidelines.

4.2 Change in nature of interest and equitable interests

Comment

Today where the equitable interests of a person are notifiable or have been previously notified, the delivery of the shares is not considered a "change in nature" of an interest. There are concerns that the term "equitable interests" is too narrow. If it is interpreted to exclude interests in unidentified shares, on-market transactions (which relate to shares which are fungible within the clearing system) may not qualify for the exemption. Similarly on such an interpretation the term may not cover interests on subscription for unidentified shares. This would mean that there would be an additional disclosure obligation when shares are delivered following an on–market transaction, or when the shares are issued to the subscriber.

SFC's response

We take the view that a purposive interpretation should be taken in the context of Part XV as a whole. Accordingly we do not read the term "equitable interests" restrictively so as to exclude on-market transactions or to exclude unidentified shares on subscription. We will also consider whether it might be more appropriate to amend the Ordinance to remove the reference to "equitable".

4.3 Complex and other derivatives

Comment

Some derivatives have an equity derivative as the underlying reference asset (a "***secondary derivative***"). We received comments that it is not clear whether these must be disclosed.

We also received comments that the way in which complex products are documented might affect how disclosures are made. For example, it was said that a "call-put combo" which contains both put and call elements where only one side of the contract can ever be executed may result in different treatment depending on the form of documentation used.

There were also comments that the public might be misled into thinking that there is a change in control where there is an agreement for the exchange of an existing convertible bond for a new convertible bond. In such a case the holder would be deemed to be interested in shares that could be converted under both the old bond and the new bond. This would be the case even though the old bond would be extinguished upon issue of the new one.

SFC's response

For market transparency the intention has always been that secondary derivatives must be disclosed. We believe that such disclosures are required.

We also take the view that the disclosure treatment for derivatives should not depend on the documentation. The intention of paragraph 2.6.3.2 of the Outline is to deal with a structured derivative involving a combination of option positions. For such derivatives, a

person can either report the long and short positions by adding individual option positions together. Alternatively, the person can report the effective long and short positions of the structured derivative. Long and short positions cannot be netted off against each other.

In relation to the exchange of existing convertible bonds for new ones, we propose to provide a narrative box and/or additional codes so that the transaction can be better shown.

4.4 Persons in accordance with whose directions a company acts

Comment

The description of "persons in accordance with whose directions a company acts" in the Outline, and in the disclosure form, is too wide.

SFC's response

We note the concern. The issue is one of fact and is dependent on all the circumstances of the case. We will set out the indicia that could be taken into account in determining such control.

4.5 Short positions at initial public offering

Comment

The obligation for short positions to be disclosed at initial public offering is not clear.

SFC's response

Where a person comes under a duty to disclose any notifiable interests when the corporation is listed, he is also under an obligation to include in the form details of any short position he holds[6].

4.6 Liability of brokers as agents

Comment

Brokers may still be liable as agents under section 321 of the Ordinance requiring them to make notifications as agents, even though brokers would not be able to monitor the shareholder's percentage levels.

SFC's response

Section 321 requires a person who acquires or disposes of relevant interests or having or ceasing to have short positions (in circumstances where a duty of disclosure would arise) to procure that the agent notifies him immediately of acquisitions or disposals of interests, or having or ceasing to have short positions, effected by the agent. The liability for filing the form lies with the principal and not the agent.

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[6] Section 324 of the Securities and Futures Ordinance (Cap. 571)

4.7 Private unit trusts

Comment

Further clarification was sought as to the meaning of "interests in shares" in the private unit trust situation. We understand that this comment might have arisen because, under normal legal principles, it may not be so clear that unit holders of unit trusts (depending on the terms of the trust) would be taken to have interests in shares held by the trusts.

SFC's response

Unless specifically exempted, we believe that Part XV requires unit holders to disclose interests in shares held by the trust. In the case of private unit trusts, there is currently no such exemption. Therefore we consider that interests in shares of unit holders in a private unit trust must be disclosed.

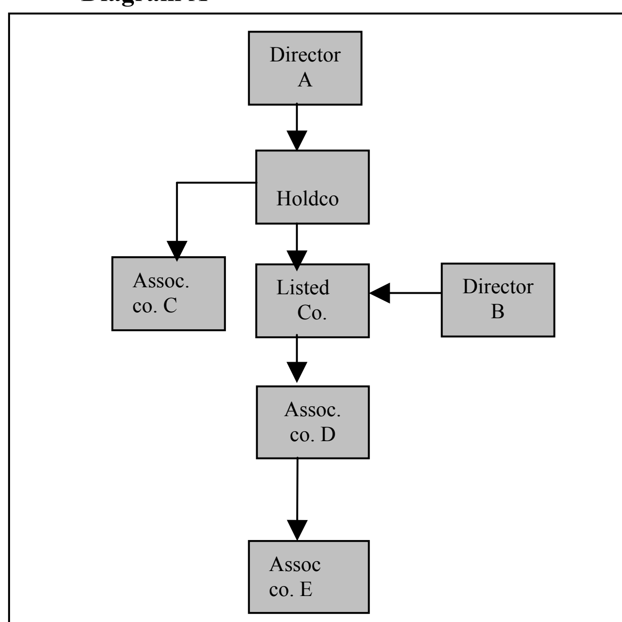
4.8 Associated corporations and attributed interests

Background

Part XV requires a person to disclose his shareholdings in a listed corporation of which he is a director/chief executive. He must also disclose his shareholdings in any associated corporation of the listed corporation.

The definition of "associated corporation" includes a corporation "... in which the listed corporation has an interest in the shares of a class comprised in its share capital exceeding in nominal value one-fifth of the nominal value of the issued shares of that class". "Interest in shares" includes deemed interests under section 344(3) of the Ordinance, which attributes interests of a company that a person controls to that person.

Diagram A



a. ***Comment:*** In the diagram, Director B is a director of a listed corporation. If the listed corporation or its directors are accustomed to act in accordance with the directions of Director B, then the listed corporation is a "controlled corporation". This could be interpreted to mean that Director B is interested in shares in which the listed corporation is interested i.e. shares in Associated Corporation D.

   SFC's response: The Outline clarifies that this is not the intention. Director B will not be taken to be interested in shares in Associated Corporation D solely because the listed corporation falls within the definition of a controlled corporation (unless Associated Corporation D is also a listed corporation). However, if Director B has a direct interest in Associated Corporation D, he will have to make a disclosure and include holdings in Associated Corporation D.

b. ***Comment:*** If a listed corporation controls Associated Corporation D, which in turn holds more than 21% of Associated Corporation E, the listed corporation will be deemed to also hold 21% of Associated Corporation E. Associated Corporation E would thus be considered to be an associated corporation of the listed corporation. This could be interpreted to mean that Director B would be required to disclose interest in Associated Corporation E (even if the associated corporation is one in which the listed corporation has minimal economic interest and over which it may have little or no control or influence).

   SFC's response: The Outline clarifies that unless the director or chief executive has a direct interest in Associated Corporation E, he would not need to disclose his interests in it. However, if he does have a direct interest in Associated Corporation E, he would have to make a disclosure. The intention is to achieve greater transparency with regard to connected party transactions.

c. ***Comment:*** We also received comments that the position is different for Director A in relation to Associated Corporation C, but that it should be the same as Director B in relation to Associated Corporation D.

   SFC's response: We take the view that Director A must file a notification each time Holdco incorporates an associated corporation including one that is a subsidiary even though Director A may not have direct interest in the subsidiary. If a listed corporation were to enter into a transaction with a subsidiary of the listed corporation (Associated Corporation D), the benefits of the transaction to the subsidiary would flow up to the listed corporation and shareholders of the listed corporation. However if the listed corporation were to enter into a transaction with its "sister" company (Associated Corporation C), the benefits of the contract would flow through the holding company up the chain to persons who may well be persons other than all the shareholders of the listed corporation. Part XV is also intended to provide information for greater transparency of connected party transactions. As such, we consider disclosures of deemed interests of a director in such "sister" companies appropriate.

4.9 Debentures

Comment

The SFC's description in the Outline of "debentures" refers to all "financial instruments". Concerns were expressed that this may include equity derivatives and also instruments such as loans and mortgages over property. On this view a holder may have to disclose certain interests twice, once as interests in shares and once as an interest in a debenture.

SFC's response

We take the view that a purposive approach should be taken in interpreting the Ordinance. Since the disclosure framework for directors makes a distinction between "shares" and "debentures", it cannot be intended that interests in shares should be disclosed again as an interest in a debenture. We will clarify this further in the Outline, and we will also consider whether additional codes would simplify filings in respect of such interests.

4.10 Exclusions Regulation

Comment

The definition of "conditional offer" in the Securities and Futures (Disclosure of Interests – Exclusions) Regulation is ambiguous.

SFC's response

We would clarify that under the definition of "conditional offer" the offer cannot also be subject to conditions other than the acceptance conditions.

5. OTHER COMMENTS AND OUR RESPONSES

5.1 Plain language

Comment

One commentator said that the provisions of Part XV appear to have achieved the policy objectives, but that the language and general framework is too convoluted and difficult and should be simplified.

SFC's response

The original SDIO was based on the UK provisions at the time of its enactment in 1988. At the time the Ordinance was being contemplated, the market was already familiar with the general requirements of the SDIO. Therefore the SFC decided to retain the basic SDIO framework to avoid unnecessary disruption to existing market understanding and practices.

At the same time we would note that the transactions that create drafting issues are always inherently complex. Difficulties would arise even with a simplified language or

framework. However today the market has achieved a degree of familiarity with Part XV. Many market participants have invested time and money to obtain professional advice and set up compliance systems for Part XV. Accordingly we are inclined to take a pragmatic approach and retain the framework without implementing fundamental changes.

5.2 Definition of "substantial shareholder" in the Listing Rules

Comment

One commentator proposed that the definition in the Listing Rules of "substantial shareholder" should be aligned with that in Part XV and that the definition take into account equity derivatives (as well as security interests). This is on the basis that those skilled in financial engineering may otherwise be able to influence the company without falling within the definition of "substantial shareholder" in the Listing Rules, and enter connected party transactions without minority shareholders' approval.

SFC's response

As this is a Listing Rules issue, we passed this comment to the Exchange. The Listing Rules have traditionally focussed on identifying conflicts of interests and connected party transactions, while Part XV focuses on market transparency and providing investors with information to enable them to make investment decisions. Accordingly it may be that the 2 regimes have different emphases.

5.3 Enforcement policies

Comment

There are requests for clarifications of the enforcement policies with regard to Part XV.

SFC's response

The Enforcement Division of the SFC does not initiate prosecution action in every case, and follows clear guidelines on action to be taken against those who have breached the provisions of Part XV.

5.4 Qualified Overseas Schemes

Comment

The qualified overseas schemes exemption extends to certain collective investment schemes, pension funds or provident fund schemes but excludes arrangements such as the following:

(a) an arrangement under which less than 100 persons hold, or have the right to hold or to become holders of, interests, that entitle them to income or property of the arrangement; and

(b) an arrangement under which less than 50 persons hold or have the right to hold or to become holders of, interests, that entitle the holders to 75% or more of the income or property of the arrangement.

Comments were made that a holder of such an arrangement will not know whether there are sufficient numbers of holders from time to time so that it would be difficult to enjoy the exemption.

SFC's response

In principle we consider the current approach reasonable. Any changes to exempt specific circumstances otherwise than as laid out in Part XV would entail amendments through guidelines under the Ordinance. Should a genuine concern arise in practice, we will consider amending the guidelines for specific waivers.

5.5 Underwriting at Initial Public Offering

Comment

Today, disclosures required at initial public offerings extend to interests and short positions of underwriters. Comments were made that these disclosures do not add to market transparency, could impact the firm's permitted stabilisation activities and are overly burdensome.

SFC's response

We are not inclined to make changes to exclude the requirement for disclosures altogether without evidence that the burden is excessive. On balance we consider that the benefits of disclosures outweigh the compliance burden.

5.6 Spouse and interests of substantial shareholder

Comment

The spouse of a substantial shareholder is taken to hold the interests or short position of the substantial shareholder. Comments were made that Part XV had increased the compliance burden and obscured market transparency.

SFC's response

This concept of attributing the interest of his or her spouse to a substantial shareholder has been in the disclosure regime from the start and is necessary. Otherwise shares can simply be placed in the name of a spouse and disclosures avoided.

5.7 Timing to notify the Exchange and the listed corporation

Comment

Generally the time frame (apart from initial listing) for filing disclosures is within 3 business days from the transaction date or from the date on which the relevant event

comes to a shareholder's knowledge (if later). On initial listing, the time frame for filing notifications is within 10 business days.

There are also comments that the 3 business days are difficult to comply with, especially where interests must be aggregated within groups operating cross-border. In addition there were concerns that the different time frames of 3 business days for general notifications and 10 business days for initial listings caused anomalies and there were suggestions that these time frames should be rationalized.

SFC's response

In the exercise to amend the SDIO, we took into account comments from industry and extended the proposed time limit from 2 to 3 business days. The fact that 3 business days is in line with international practice suggests that the present time frame is reasonable. Also, the differing time frames of 3 business days generally and 10 business days on initial listing were chosen with the intention of reducing the compliance burden and we are inclined to retain this position. However, there is no prohibition against making early disclosures.

5.8 Exempt security interest

Comment

There are also comments that the security must be taken for the purposes of a "transaction" which suggests that security interests taken by, for example, brokers over clients' accounts to cover the debts that the clients owe from time to time on the accounts cannot benefit from this exemption.

SFC's response

We would take a purposive interpretation of the law, and consider that the exempt security interest provision would still apply under such circumstances.

5.9 Other issues on forms and codes and the filing regime

The following specific issues were raised.

a. ***Comment*****:** There are concerns that misleading disclosures might arise from the way in which percentage figure of a substantial shareholder's interests is calculated. This is because the total number of issued shares as a denominator remains unchanged even though interests from options, warrants and other derivative interests are added to the numerator. This could potentially mean that a person may be disclosing a percentage figure that is over 100%. There was a suggestion that disclosures should state the percentages of equity interests and derivative interests separately.

   SFC's response: For simplicity, the conclusion following the debate on how to calculate derivative interests during the consultations in 1998 was to take the last known total number of issued shares as the denominator to calculate the percentage of derivative interests. In any case, the form has a box and codes that

allow the substantial shareholder to disclose the amount of the interests held as derivative interests. For greater clarity we are also proposing that all standard codes disclosing an event or change would be able to take a "D" before them to designate that the event, or change, giving rise to the notice involves derivatives.

b. ***Comment:*** One commentator considered that the lending pool disclosure system is confusing and it was suggested that there should be a clearer way of differentiating custodial holdings (in a lending pool) from interests held by a person in the capacity as fund managers.

SFC response: It is possible to distinguish holdings in the lending pool from fund manager holdings. In a filing, the letter "(P)" against the number of shares held by a substantial shareholder denotes "Lending Pool" while "(L)" denotes a long position and "(S)" a short position. In the forms themselves the particulars of shares held before and after the relevant event (e.g. Boxes 18 and 19 of Form 2) will distinguish shares in the lending pool from other interests. There are also codes describing the capacity in which the interests are held. For example, Box 20 of Form 2 should indicate whether shares are held, for example, as investment manager (202) or as custodian (208). In any event, we propose to add a narrative box, for providing additional information to clarify a filing.

c. ***Comment*:** There was also a comment that there are discrepancies in Code 127 of Form 3A (some aspects of option rights) and Code 147 of Form 3B (all aspects of option rights) that should be reconciled.

SFC's response: The 2 codes describe different circumstances in which notices must be filed. Code 127 in Form 3A reflects the provisions of section 341(1)(c) of the Ordinance that is only relevant to the assignment by director and chief executive of a right granted to him by the listed corporation to subscribe for shares in or debentures of the listed corporation i.e. a Form 3A situation. Code 147 in Form 3B reflects the provisions of section 341(1)(d) of the Ordinance that is relevant to the grant to director and chief executive of a right to subscribe for shares in or debentures of an associated corporation of the listed corporation, and the exercise or assignment of such a right by him i.e. a Form 3B situation. However, we intend to review the obligations on director and chief executive under Part XV in respect of shares and debentures of listed corporation and associated corporation of the listed corporation to make them consistent if necessary.

d. ***Comment:*** There was a concern that it is not clear whether a long or short position arises at the date of entering into a placing contract and thereafter at the date of closing of the agreement. In this connection, there is a comment that none of the codes specifically describes a transaction as a placement.

SFC's response: When a substantial shareholder enters into a contract to place shares, he is agreeing to sell shares. This is a change in nature of a long position (or a reduction in a "long position" if settlement is within 4 days). Equally when a substantial shareholder enters into a contract to "top-up" his shareholding he is agreeing to subscribe for new shares. This is a "long position". On the other hand, if a listed company places its shares, a substantial shareholder who subscribes to

the placement will report an increase in his shareholding and a subsequent reduction when the new shares are issued. We propose to assign a new code to describe the event of placement and top-up to separate it from the normal purchase and sale under Code 103. We propose a narrative box that would allow the substantial shareholder to include a short note explaining that the transaction being notified and the nature of the change, if desired.

e. ***Comment***: Electronic filing should be encouraged. Market participants may be reluctant to file electronically unless there is automatic generation of a receipt on submission.

SFC's response: We will endeavour to encourage electronic filings without imposing additional burdens. We note that today a receipt should already be automatically generated on submission with a reference number, date and time.

f. ***Comment***: The current method of filing disclosures does not include methods of authentication so as to exclude the risk of false filings.

SFC's response: It is not practical to impose a system to authenticate the filings without significantly increasing the compliance burden. The main concern is the accuracy of the forms and we would not generally seek to verify the identity of the filing party. Although there is an e-cert option today, imposing this would be onerous and would unduly discourage electronic filings.

g. ***Comment***: Forms should be redrafted in plain English.

SFC's response: We welcome detailed suggestions on how to achieve this. However, some of the detailed descriptions and explanations are inevitable in order to address complex transactions.

h. ***Comment***: There is a need to clarify liability where agents of the holder of the interests submit the forms and there are mistakes in relation to the disclosure.

SFC's response: Whether the SFC will attribute liability to the principal for incorrect filings by the agent would depend on the role of the principal and agent with respect to the mistake in all the circumstances of the case.

i. ***Comment***: Presentation of information contained on the Exchange database may lead to confusion, for example, where historic records have remained on the database.

SFC's response: The Exchange maintains a database of all filings of disclosures for ease of reference. For more complete information, the investor may need to refer to the listed company's register, which constitutes the official register of disclosure information. We will nevertheless explore possible ways to tidy up the present system with the Exchange, for example by cross-referencing to relevant links.

j. ***Comment***: The Exchange should maintain a list of fax numbers of listed companies for the purposes of disclosures, and should make available up-to-date

information on the number of shares in issue so that the investor can have an accurate update.

SFC's response: Both these suggestions have been brought to the Exchange's attention.

k. ***Comment***: Filings should be made with the SFC instead of the Exchange.

SFC's response: This depends on the division of responsibilities between the SFC and the Exchange in relation to disclosure of market information and can only be considered in a wider context.

l. ***Comment***: One commentator noted that it is inconvenient for shareholders who have no fax or e-mails to arrange delivery of disclosures to both the Exchange and the listed corporation.

SFC's response: We note the comment. However we are not aware of any other major jurisdiction dispensing with the lodgement of disclosures with the listed corporations. We believe that in a majority of cases, this does not raise a practical difficulty for those filing notices. Substantial shareholders who are controlling shareholders and directors comprise a significant proportion of persons filing.

m. ***Comment***: One commentator highlighted it would appear from the notes to Form 3A that directors must only disclose derivative and other interests in their initial disclosures and not subsequent ones. This makes it difficult for a reader to determine the current interests of directors without referring back to previous disclosures. Also it was noted that because Form 3A is a consolidated form for a person filing as a director and a substantial shareholder, it is difficult to ascertain the capacity in which he or she is filing and there should be ways of indicating in which capacity he or she is doing so.

SFC's response: The notes for filling in Form 3A will be amended to make sure that such details are set out in subsequent disclosures. We will also consider whether it is possible to make clear in which capacity a director /substantial shareholder is filing in respect of the interests in Form 3A. Since Form 3A is a consolidated form, in most cases the person will be filing as a director who generally has more onerous obligations than a substantial shareholder.

n. ***Comment***: One commentator highlighted an issue with the calculation of percentage figures of shares immediately before the relevant event and immediately after that event. The notes to the forms require that the number of shares in issue as at the date of the relevant event (or, if greater, the number of shares immediately after the relevant event) be used as the basis for working out the percentage. This may result in the wrong percentage figure if the relevant event involves a change in the total number of shares in issue.

SFC's response: The notes for filling in forms will be amended so that the correct percentage immediately before the relevant event and immediately after that event will be correctly calculated.

o. ***Comment***: Other comments were made on the wording of forms or notes to the forms. Commentators highlighted some inconsistency or areas which require further clarification.

SFC's response: We intend to review all forms and notes to the forms and make changes as necessary.

5.10 Fees

Comment

There are requests for the fees for applications for waivers from Part XV provisions to be removed.

SFC's response

We are prepared to consider the reduction of, or exempting the payment of fees when it is appropriate to do so.

6. VIEWS OF THE PUBLIC ON OTHER MATTERS

Views sought

Question 11: ***Do you have comments on any other matters discussed in the Consultation Paper or on any of our proposals for changes that are not covered in questions 1 to 10 above?***

Question 12: ***Do you have comments on any other matters relating to the disclosure of interests regime under Part XV of the Ordinance not dealt with in this Paper?***

CONSULTATION

The Securities and Futures Commission invites interested persons to provide comments on this Consultation Paper **by 28 February 2005.** Comments should be addressed to:

Securities and Futures Commission
8th Floor
Chater House
8 Connaught Road Central
Hong Kong

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

Comments may also be provided by fax to (852) 2521 7917 or e-mail to *direviewconsult@sfc.hk* or online to *http://www.sfc.hk*.

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

Please note that the names of the commentators and the contents of their submissions may be published on the SFC website and in other documents to be published by the SFC. In this connection, please read the Personal Information Collection Statement attached to this Consultation Paper.

You may not wish your name and/or submission to be published by the SFC. If this is the case, please state that you wish your name and/or submission to be withheld from publication when you make your submission.

Securities and Futures Commission
20 January 2005

PERSONAL INFORMATION COLLECTION STATEMENT

Personal Information Collection Statement

1. This Personal Information Collection Statement ("PICS") is made in accordance with the guidelines issued by the Privacy Commissioner for Personal Data. The PICS sets out the purposes for which your Personal Data[7] will be used following collection, what you are agreeing to with respect to the SFC's use of your Personal Data and your rights under the PDPO.

Purpose of Collection

2. The Personal Data provided in your submission to the SFC in response to the Consultation Paper on The Review of the Disclosure of Interests Regime under Part XV ("the Consultation Paper") may be used by the SFC for one or more of the following purposes:

    - to administer the relevant Ordinances, rules, regulations, codes and guidelines made or promulgated pursuant to the powers vested in the SFC
    - for the purposes of performing the SFC's statutory functions under the relevant Ordinances
    - for research and statistical purposes
    - other purposes permitted by law

Transfer of Personal Data

3. Personal Data may be disclosed by the SFC to the members of the public in Hong Kong and elsewhere, as part of the public consultation on the Consultation Paper. The names of persons who submit comments on the Consultation Paper together with the whole or part of their submission may be disclosed to members of the public. This will be done by publishing this information on the SFC website and in documents to be published by the SFC throughout and at the conclusion of the consultation period.

Access to Data

4. You have the right to request access to and correction of your Personal Data in accordance with the provisions of the PDPO. Your right of access includes the right to obtain a copy of your Personal Data provided in your submission on the Consultation Paper. The SFC has the right to charge a reasonable fee for processing any data access request.

[7] Personal Data means personal data as defined in the Personal Data (Privacy) Ordinance, Cap 486 ("PDPO")

Enquiries

5. Any enquiries regarding the Personal Data provided in your submission on the Consultation Paper, or requests for access to Personal Data or correction of Personal Data, should be addressed in writing to:

   The Data Privacy Officer
   The Securities and Futures Commission
   8/F, Chater House
   8 Connaught Road Central, Hong Kong

A copy of the Privacy Policy Statement adopted by the SFC is available upon request.