

**A CONSULTATION PAPER ON  
THE DRAFT SECURITIES AND FUTURES  
(PRICE STABILIZING) RULES**

February 2002

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The Securities and Futures Commission invites market participants and interested parties to submit written comments on the proposals discussed in this consultation paper or to comment on related matters that might have a significant impact upon the proposals **no later than 8 March 2002**. Any person wishing to comment on the proposals should provide details of any organization whose views they represent.

**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.**

Written comments may be sent

By mail to: SFC Price Stabilizing Rules  
Securities and Futures Commission  
12/F Edinburgh Tower  
The Landmark  
15 Queen's Road Central  
Hong Kong

By fax to: (852) 2810 5385

By on-line submission: <http://www.hksfc.org.hk>

By e-mail to: [cfconsult@hksfc.org.hk](mailto:cfconsult@hksfc.org.hk)

For further information, please contact the Corporate Finance Division at (852) 2840 9216 or 2840 9235.

Additional copies of the consultation paper may be obtained from the above address of the SFC. A copy of this paper can also be found on the SFC website at <http://www.hksfc.org.hk>.

Corporate Finance Division  
Securities and Futures Commission  
Hong Kong

February 2002

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### **Purpose of Collection**

2. The Personal Data provided in your submission to the SFC in response to the Consultation Paper on the Draft Securities and Futures (Price Stabilizing) Rules (“the Consultation Paper”) may be used by the SFC for one or more of the following purposes:
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  - for the purpose 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.

### **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:

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<sup>1</sup> Personal Data means personal data as defined in the Personal Data (Privacy) Ordinance, Cap 486 (“PDPO”)

The Data Privacy Officer  
Securities and Futures Commission  
12/F, Edinburgh Tower  
The Landmark  
15 Queen's Road Central  
Hong Kong

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

## Introduction

1. The Securities and Futures Bill (the “Bill”) defines certain behaviour in relation to securities as market misconduct in Parts XIII and XIV. Price stabilizing, rigging or pegging, the maintaining of the price of a security, the creation of a false market and insider dealing fall within the meaning of market misconduct under the Bill. Under Part XIII, a Market Misconduct Tribunal will be established which will be empowered to impose penalties on persons engaged in market misconduct. Separately under Part XIV of the Bill, market misconduct is also liable to criminal consequences with proof of criminal intent.
2. The Bill gives rule-making powers to the SFC under sections 273(1) and 297(1) to prescribe safe harbour rules in respect of the market misconduct provisions in Part XIII and the criminal offences provisions under Part XIV of the Bill after consultation with the Financial Secretary.
3. The SFC considers that it is in the public interest to prescribe the Price Stabilizing Rules (the “PS Rules”) to permit and regulate price stabilizing action connected with public offerings. The purpose of this consultation paper is to seek the views of the public on the proposed regulatory approach and the practical implications of implementing the PS Rules under the Bill. The draft PS Rules will be prepared on the basis of the proposal in this consultation paper, subject to any amendments consequential to the public response, and will be tabled before the Legislative Council for approval as subsidiary legislation.
4. The purpose of the PS Rules is to facilitate public offers of securities so that issuers or underwriters of newly issued securities may conduct stabilizing action to prevent or retard the decline of the price of the newly offered securities, and rely on the PS Rules as a defence in respect of market misconduct under Parts XIII and XIV of the Bill. The PS Rules are not intended to allow downward stabilization, that is, capping the market price of a security.
5. The PS Rules will apply to public offers of shares and debentures for cash in Hong Kong which meet a certain threshold amount, currently proposed at HK\$200 million. A stabilizing manager must be appointed in Hong Kong to oversee compliance with the PS Rules for stabilizing activities that would otherwise be regarded as market misconduct under the Bill. The stabilizing manager has to ensure that proper disclosure is made and records of stabilizing actions are properly kept and made available for inspection by the issuer and the SFC.
6. It is proposed that under the PS Rules, the stabilizing manager may purchase securities in the secondary market to stabilize. Stabilising bids, if effected in relation to equity securities, will be subject to a pricing limit mechanism and the maximum stabilizing bid should not exceed the public offer price. It may do so without having to create a prior short position with the securities. This means a stabilizing manager is able to hold a “net long” position pursuant to the PS Rules.

## Background

7. Transactions may be undertaken to stabilize the price of securities either to prevent them from declining or rising. Stabilization is potentially manipulative because it seeks to maintain or support the price of a security at a certain level and therefore distorts the price which would otherwise obtain as a result of a natural supply and demand of the security in the market.
8. Unlike the UK or the US, Hong Kong does not have price stabilizing rules which permit certain types of stabilizing actions to be undertaken in prescribed circumstances. The SFC, however, issued policy statements on stabilizing actions by way of the Joint Announcement with the SEHK on 4 November 1994 and further elaborated its views in the Conclusion Paper for the Consultation on Offering Mechanisms in 1998. A copy of the 1994 announcement and the excerpts from the 1998 Conclusion Paper are attached in **Annex I**. In short, the SFC took the view that genuine purchases in the market effected solely to cover over-allotment would not of themselves infringe the relevant provisions of the Securities Ordinance which prohibit market manipulation by pegging or stabilizing the price of the securities.
9. Stabilization has been practised in the Hong Kong market in a restricted sense in connection with initial public offerings (“IPOs”). These actions usually appear in the form of over-allotment by the underwriters, related securities borrowing transactions backed by over-allotment options granted by the issuer (“greenshoe”) and the satisfaction of over-allotments by purchases of securities in the secondary market.
10. Under the market misconduct regime under the Bill, actions to support or maintain the price of a security will be prohibited. In view of the enactment of the Bill later this year, this is an opportune time to review the way stabilizing action related to public offerings is regulated in Hong Kong. It is also intended that the PS Rules, to be proposed as subsidiary legislation under the Bill, can provide a regulatory framework for stabilizing and ancillary actions so that they may be conducted in an open, transparent and accountable manner without compromising investor protection.
11. In formulating the PS Rules, we have considered recent regulatory developments in other major financial centres, particularly the UK and the US. We take the view that the PS Rules should to a large extent commensurate with the international standard so as to facilitate global offerings of securities conducted in Hong Kong and in other markets. Having regard to the similarity in the regulatory framework for securities transactions and mechanisms for securities offerings, we propose to model the PS Rules closely on the UK Price Stabilizing Rules issued pursuant to the Financial Services and Markets Act 2000.

## Regulatory approach

*What is the policy thinking behind the PS Rules?*

12. In the past few years, the Hong Kong market has seen a significant number of large scale IPOs and an increase in global offerings, including multiple listings on the SEHK and overseas markets like NYSE and Nasdaq.
13. Stabilizing activities as described in paragraph 9 above are said to facilitate these corporate fund raising exercises. In particular, upward stabilization conducted in relation to public offers addresses short-term fluctuations resulting from the sudden increase in supply in the secondary market.
14. The PS Rules enable stabilizing activities effected for the purpose of upward stabilization to be carried out in an open, transparent and accountable manner. Following this rationale, we believe that the PS Rules should also apply to secondary offers in so far as these offers are of a public character and are made for corporate fund raising. In addition, it will be in line with current market practice and consistent with good corporate governance principles that issuers should not be involved in stabilizing the price of their own securities. Accordingly, only lead managers and underwriters for public offerings may conduct stabilization and be the persons acting as or appointing stabilizing manager.

*What types of securities are covered by the PS Rules?*

15. As discussed above, the primary purpose of stabilization is to facilitate capital raising by corporations. The most common types of securities publicly offered for this purpose in Hong Kong are broadly shares and debentures. Whilst it is possible that in future other types of securities may become increasingly used, we would propose confining the application of the PS Rules to shares and debentures only. The PS Rules are new to the market and in the initial stage, a prudent regulatory approach should be adopted to afford greater investor protection.
16. Under the PS Rules, a stabilizing manager can only stabilize the price of a security by effecting transactions prescribed in the PS Rules in the same type of security. In practice, this means that a stabilizing manager may not stabilize the price of a share of an issuer by purchasing securities such as derivatives or convertible debt securities relating to the share.
17. The SFC may in the future review whether it is in the public interest to amend the PS Rules to extend the range of securities in respect of which stabilizing action may take place.

**Q 1: What is your view on stabilizing action being permitted only in respect of the same type of security as the one being publicly offered but not in respect of its “associated” securities?**

*What sort of stabilizing actions are permitted under the PS Rules?*

18. As mentioned above, the SFC believes that under the PS Rules, only upward stabilization should be permitted. Accordingly, stabilizing actions that depress or attempt to depress the price of a security in the market cannot claim safe harbour under the PS Rules.
19. In upward stabilization for public offerings, stabilization takes place where the stabilizing managers purchase the security in the secondary market to support its price. We consider that purchases of the relevant securities in the secondary market by the stabilizing manager are core stabilizing actions. These purchases should be permitted, whether or not conducted for the purpose of covering over-allotments. This means that “net long” positions may be held by underwriters for stabilization purposes under the PS Rules. This relaxes the SFC’s position in respect of the Securities Ordinance that purchases in the secondary market may only satisfy the short position created by underwriters due to over-allotment backed by a greenshoe.
20. Due to legal constraints under the Securities Ordinance (and the Bill), underwriters cannot hold “naked short” positions. In order to cover the short position, underwriters would have the benefit of a greenshoe and usually a securities borrowing arrangement with a controlling shareholder, and in some cases both. The creation of a prior short position by the underwriters is therefore covered, and can be satisfied by subsequent stabilizing action, i.e. purchases in the secondary market. The SFC considers that these activities are ancillary stabilizing actions and should be allowed under the PS Rules.
21. If under the PS Rules, “net long” positions are held by the stabilizing managers, the SFC is of the view that purchases must be made for the account of the stabilizing managers and not the issuer. No stabilizing actions should be undertaken by an issuer through a repurchase of its issued securities.
22. Stabilizing managers holding “net long” positions may wish to unwind their holdings. The SFC proposes that stabilizing managers may liquidate their “long positions” achieved through core stabilizing actions conducted in compliance with the PS Rules. Liquidation will be regarded as permitted ancillary stabilizing action under the PS Rules.

**Q 2: Should stabilizing managers be allowed to hold “net long” positions and to liquidate such positions?**

*What kinds of securities offerings will fall within the PS Rules?*

23. In order to rely on the PS Rules as a safe harbour, the issuer must be able to meet the following conditions in respect of its offer of securities:
  - The offer must be public in character;
  - The offer must be the subject of a prospectus issued in connection with the offer;



- The securities must be either listed on a relevant stock exchange or traded on an authorised automated trading system (“ATS”);
  - The size of the offer in Hong Kong shall not be less than HK\$200 million; and
  - The offer of securities must be made for cash. This would exclude securities exchange offers normally encountered in takeover transactions.
24. The requirement that securities be listed on the Stock Exchange of Hong Kong or admitted for trading on an authorised ATS ensures transparency.
  25. The threshold amount of HK\$200 million is proposed based on experience of overseas markets and the SFC may, subject to results of the public consultation, review the threshold.
  26. If a threshold amount is adopted under the PS Rules, some smaller issuers making offers to the public may not be able to take advantage of the stabilization safe harbour.
  27. Over-allotment and the exercise of a greenshoe to satisfy this over-allotment, but without transactions in the secondary market, are not in isolation price stabilization. However, underwriters should ensure that prior disclosure to the investing public is made in respect of the over-allotment size and the greenshoe. The SFC has been and still is of the view that any over-allotment should be limited in size by the greenshoe.
  28. On the other hand, in the absence of a stabilization safe harbour under the PS Rules, underwriters who want to purchase securities in the market to cover a short position created by over-allotment, or to satisfy outstanding obligations pursuant to securities borrowings, may contravene the market misconduct provisions of the Bill.

**Q 3: What is your view about the proposal to impose a threshold amount of HK\$200 million for public offers under the PS Rules?**

*What is the period within which stabilizing actions may be conducted under the PS Rules?*

29. Stabilizing actions under the PS Rules will broadly be divided into core stabilizing actions (as mentioned in paragraph 19) and permitted ancillary stabilizing actions (as mentioned in paragraph 20). It is proposed that core stabilizing actions are allowed only during the stabilizing period, that is, a 30-day period from the date of the prospectus. It is proposed that no time limit will be imposed on permitted ancillary stabilizing actions.
30. Ancillary stabilizing action such as granting the greenshoe and its exercise, and the liquidation of “net long” positions, may take place in different time-frames. They may occur before the date of the prospectus or after 30 days from the date of the prospectus. To impose time limits for ancillary stabilizing

actions may seem unreasonable and in some cases unrealistic. Stabilizing managers may wish to liquidate their “net long” positions by selling at a favourable price. Decisions to dispose of securities depend on the market conditions. So long as these ancillary stabilizing actions are carried out in connection with core stabilizing actions under the PS Rules, they need not be carried out within the stabilizing period but are expected to be carried out as soon as practicable thereafter.

**Q 4: What is your view on the adoption of a 30-day time limit for core stabilizing actions but not for ancillary stabilizing actions?**

*What are the restrictions for conducting stabilizing actions under the PS Rules?*

31. The SFC proposes certain restrictions for stabilizing actions to be undertaken under the PS Rules. No stabilizing actions may be undertaken in the following circumstances:
- When the price of the security is, to the knowledge of the stabilizing manager, already artificially affected.
  - With respect to convertible debt securities if their conversion terms have not been publicly announced.
  - When the stabilizing manager or its associates, in respect of the offer, hold any options over the security which is to be stabilized, the terms of which have not been disclosed to the public in accordance with the PS Rules. This prohibition addresses conflicts of interest on the part of the stabilizing manager.

*Will there be pricing limits on the core stabilizing actions?*

32. Pricing limits are proposed for core stabilizing actions for offers of equity securities. We propose that the upper price limit for core stabilizing actions should be the public offer price (“A”). A stabilizing manager is allowed to make any stabilizing bid (“B”) which is at or below the public offer price, A. Stabilizing managers may subsequently stabilize at or below the initial stabilizing price B. If an independent deal is done on the principal market for that security (which does not necessarily have to be in Hong Kong) at a price (“C”) higher than B but below A, the stabilizing manager then have a new maximum price C, so that it may stabilize at or below C.
33. The pricing limit described in paragraph 32 does not apply to stabilizing actions for offers of debentures. Pricing limits for stabilizing debentures are unlikely to be applicable due to different pricing mechanisms for shares and debentures. The focus of pricing a bond or other debentures is usually the spread over a benchmark bond at which the new bond is expected to trade. Underwriters are more concerned about maintaining or reducing the spread

between the bond and the benchmark bond, whereas in equity securities, the focus is more normally on the price of the stock.

**Q 5: What is your view on the pricing limits for stabilizing equity securities?**

**Q 6: Do you agree that stabilizing actions for offerings of debentures need not be subject to pricing limits?**

*What is the management requirement for stabilization under the PS Rules?*

34. To oversee the compliance with the PS Rules including prior disclosure of stabilizing actions in communications with the public, and proper record keeping of all such actions, the PS Rules will require the appointment of a stabilizing manager. A stabilizing manager shall either be a licensed corporation such as a licensed securities dealer or a registered institution, e.g. a licensed bank in the context of the Bill.
35. In undertaking stabilizing action, the stabilizing manager may appoint agents, local and overseas, but it would remain ultimately responsible to the issuer and be accountable for compliance with the PS Rules. In the case of a global offering where an issuer's securities are offered in overseas jurisdictions as well as in Hong Kong, stabilizing managers appointed under the PS Rules are required to ensure that local and overseas stabilizing records are properly kept so that overseas records can be re-constituted in Hong Kong within a period of 48 hours after they are requested for inspection.

**Q 7: What is your view about the role of a stabilizing manager under the PS Rules? Do you foresee any practical difficulties for the stabilizing manager to discharge its role as described?**

*What are the disclosure requirements for stabilizing actions?*

36. The SFC proposes that prior disclosure of stabilizing actions be made when the offer of securities is publicly announced, and be continued to be made throughout the period up to the commencement of the stabilizing period. This period will be the "introductory period" in the PS Rules. To forewarn investors of forthcoming stabilizing actions, in particular in the case of secondary offerings, we believe that appropriate disclosure of the potential stabilizing actions should be made in all communications issued during the introductory period. These may include screen-based statements, press announcements and teletext. The SFC, however, proposes that detailed disclosure and prior warnings need only be made in the prospectus. Wording suggested for detailed disclosure and prior warnings to be made by an issuer in its prospectus is contained in **Annex II**.
37. Apart from warning statements, it would be useful for the investing public to be informed of the extent of the forthcoming stabilizing actions. We propose

that a summary of possible stabilizing actions to be undertaken by the stabilizing manager such as size of over-allotment option, and the possibility of holding “net long” positions should be included in the prospectus to which the public offering relates.

38. We have considered whether a stabilizing manager should identify and disclose its stabilizing bid to the market in the course of its stabilizing actions. A requirement to inform the market of a stabilizing bid on a real time basis by the stabilizing manager (“flagging”) is found in the US Rules. Whilst simultaneous disclosure may increase transparency, we note that some market practitioners hold a different view. Accordingly, we would like to invite public comments on the suitability of imposing a simultaneous disclosure requirement for stabilizing bids.

**Q 8: What is your view about simultaneous “flagging” to the market of the stabilizing bid placed by the stabilizing manager?**

*What are the record keeping requirements for stabilizing actions?*

39. The stabilizing manager is required to keep a register of stabilizing actions, available for inspection by the SFC and the issuer upon notice.
40. The register should contain all the transaction details about stabilizing actions for each offer of securities including the type of security, price, time, volume, and the details of the counterparty. It should also contain details about allotment of the security and the names of agents engaged for stabilizing actions.
41. The register should be kept for a period of 7 years from the end of the stabilizing period for SFC inspection. This proposed time-frame is consistent with the record keeping period for intermediaries under the Bill. The issuer is allowed to inspect the register within a 3-month period from the end of the stabilizing period.

*Recognition of overseas price stabilizing rules*

42. In global offerings, securities offered may be traded on an overseas market as well as in the Hong Kong market. Underwriters for the overseas portion of the offering may wish to conduct stabilization in the overseas market, which may affect the price of the securities traded on the Hong Kong market. In view of this and in order to facilitate global offerings, we believe it would be useful if the PS Rules recognise that stabilization actions effected in accordance with the stabilization rules in certain recognised jurisdictions, which provide similar regulatory safeguards against market manipulation, would not for the purpose of the Bill be regarded as market misconduct.

### *Transitional arrangements*

43. As the market misconduct provisions are not intended to have retroactive effect, the SFC takes the view that in the case where a public announcement of the offer with the offer price stated has been made before the commencement date of the PS Rules, an issuer and the underwriter for the public offer of the issuer's security may continue stabilizing actions described in paragraph 9 above provided that these actions are consistent with SFC's policy statements about stabilization in the Joint Announcement on Offering Mechanisms in 1994 and its views expressed in the Consultation Conclusion Paper for Offering Mechanisms in 1998.

### **Way Forward**

44. The public is invited to furnish us with their comments on regulatory approach as specified in this paper, in particular, your replies to the questions set out in **Annex III**. The Draft PS Rules are set out in **Annex IV**. This public consultation is open from now to 8 March 2002. Upon conclusion of this consultation, the SFC will publish a conclusion paper together with the draft PS Rules which will be tabled before the Legislative Council for approval.
45. Following the effective date of the PS rules, the SFC may contact issuers and stabilizing managers who have conducted stabilizing activities under the PS Rules to solicit their feedback on the practical implications of the PS Rules and any difficulties encountered in complying with the Rules. Information so obtained would form part of the database on which we can rely to conduct future reviews of the PS Rules.

## Annex I (1)

### (1) 1994 Joint Announcement of the SFC and the SEHK

THE STOCK EXCHANGE OF HONG KONG LIMITED

SECURITIES AND FUTURES COMMISSION

#### **Joint Policy Statement on Offering Mechanisms**

The Stock Exchange of Hong Kong Limited (the "Exchange") and the Securities and Futures Commission ("SFC") have recognized that global equity offerings, which involve the tapping of funds from both the domestic and international markets, have become more common for large scale new issues in Hong Kong. Accordingly, a joint Working Party was set up by the two authorities earlier this year to study the subject of offering mechanisms. Set forth below is a synopsis of the views and conclusions of the Working Party which have been endorsed by the Exchange and the SFC.

The Working Party was established to review whether the Hong Kong fixed price public offer method disadvantages Hong Kong in the context of participating in multi-jurisdictional equity offerings and whether Hong Kong should adopt alternative forms of offering mechanisms. In pursuing this goal, both the Exchange and the SFC had in mind to introduce greater flexibility for the public distribution of securities in equity offerings while ensuring that the interests of local investors are not disadvantaged by this approach.

In the case of a simultaneous dual listing in Hong Kong and another overseas market where the placing or book-building system is used and where the commencement of trading is to occur on the same day, issuers have encountered difficulties in reconciling the timing for the commencement of trading of the Hong Kong fixed price subscription tranche and the U.S. placing tranche.

The Working Party consulted a number of merchant banks who have participated in recent global equity offerings and in particular, studied the U.S. system of book-building, stabilization and distribution system as a whole. The Exchange is of the view that there are feasible solutions, although still subject to refinement, for reconciling the offering timetables of an offer for subscription and a book-built placing which do not require amendments to the existing Listing Rules. For example, if trading in Hong Kong can commence within 5 days after a range price public offer is closed, then, coupled with a price fixing on a weekend in the U.S., it would appear that the timing problem can be resolved.

The task of finding an optimal schedule which reconciles the needs of international investors with those of local subscribers is ultimately a commercial one and there is little need for regulatory intervention. For the purposes of enhancing market transparency and minimizing grey market activities however, it would be preferable in the case of dual listings for trading in Hong Kong to commence as soon as possible after allocation and at least simultaneously with or before the commencement of trading on overseas exchanges.

In order to achieve simultaneous dual listings, the Hong Kong initial public offering timetable has to be shortened to accommodate the practice of dealing immediately after allocation under the U.S. book-building system, or at the very least, to minimize the period of time between allocation and commencement of trading. The Exchange and the SFC have identified a number of feasible options to achieve this. It is up to an issuer and its underwriter to decide whether to adopt one of these acceptable ways or to come up with some other methods. One way to achieve this is to publish in some form the identities of the successful applicants in newspapers so that they become aware of their respective allotments and would be able to trade immediately provided arrangements are made to meet settlement obligations. Another option is to require all applicants to subscribe shares through brokers by using yellow application forms only. Since the allotted shares are deposited directly into CCASS, successful allottees can commence trading once allocation is complete and can withdraw the physical scrips at a later date if they so desire. A third option is to allow only successful yellow form applicants to trade on the day immediately after price fixing with the white form applicants (i.e. those who want their shares to be registered under their own names) to commence trading upon receipt of the scrips. None of these suggested options require amendments to the Listing Rules.

In a global offering involving a simultaneous Hong Kong subscription and an international placing, it is up to the issuer and the underwriter to determine the size of the Hong Kong subscription tranche and the international placing tranche(s). The Exchange does not intend at this time to stipulate a minimum dollar value or percentage of a new issue that must be allocated for public subscription in Hong Kong. This is a matter for the issuer and its underwriter to decide. However, the Exchange expects underwriters and issuers to have due regard to the interests of local retail investors in any new listing in developing offering mechanisms that are suitable for their issues at the time.

Inter-tranche flow of allocations between the local and the international tranche should be permitted so that securities may be allocated to markets where real demand lies. The objective is to facilitate optimal equilibrium between the primary market supply and demand and to minimize market imbalance. In the case where the inter-tranche flow may be effected, whether through a claw-back formula or otherwise determined by the issuer and the underwriter, such disclosure should be clearly made in the offering documents.

The Exchange and the SFC recognize the need to accept alternative offering mechanisms. Underwriters and issuers who wish to offer shares through other methods in addition to the traditional public subscription are encouraged to seek early consultation with the Exchange.

Where shares of the Hong Kong public offer tranche are sold by way of an offering method other than the traditional subscription method, issuers are expected to ensure that the alternative method does not disadvantage retail participation and that the allocation of shares is made independent of the applicant's identity, the time of application and any business relationship between the applicant and the issuer or any of its advisers, but should only be a function of the number of shares applied for and, if any, bid price(s).

As part of the study, the SFC has examined the need for rules permitting stabilization during the initial public offering period in Hong Kong in the context of the Securities Ordinance and Hong Kong's participation in global offerings. The SFC's position is that where underwriters have over-allotted in an offering (with or without the benefit of an over-allotment option), genuine purchases in the secondary market effected solely for the purpose of covering such over-allotment (short covering) would not of themselves infringe the relevant provisions of

the Securities Ordinance which prohibit market manipulation in the form of pegging or stabilizing the price of securities. This means that an underwriter of a global offering, who is short shares in a new issue due solely to over-allotment, can cover its short position in the Hong Kong secondary market, even though the distribution might not be completed in other markets, so long as the underwriter's trading does not constitute manipulation as contemplated in the Securities Ordinance.

If the underwriters wish to reserve the right to over-allot it is important that this fact be disclosed in the prospectus, together with details of any over-allotment option granted by the company to the underwriters. The prospectus should also include a statement that the underwriters may cover the over-allotment either by purchasing the shares in the secondary market or by exercising the over-allotment option or a combination of both.

From discussions between the SFC and underwriters of global offerings, it appears that the ability for underwriters to short cover in Hong Kong obviates any need to bring in rules permitting stabilization during the initial public offering period.

For and on behalf of  
The Stock Exchange of Hong Kong Limited  
Herbert Hui  
Executive Director  
and Head of Listing

For and on behalf of  
Securities and Futures Commission  
Laura M. Cha  
Member of the Commission  
and Executive Director

4th November, 1994

## **Annex I (2)**

### **(2) Excerpts from 1998 Conclusion Paper for the Consultation Paper on Offering Mechanisms**

#### **VI. Extent of over-allocation of shares**

34. In the consultation paper the SFC clarified that the extent of over-allocation of shares should be limited to that provided under the over-allotment option.
35. Many commentators argued that market stabilisation activities benefit investors and issuers. Major markets such as New York and London allow stabilisation activities provided these are carried out within clearly defined limits. Commentators argued that over-allocation gives underwriters a legitimate and effective tool to assist in an orderly after market, particularly one that is experiencing selling pressure. Genuine purchases in the after market not only serve to cover underwriter's over-allocations but also reduce the excess supply created by investors selling into the after market. Investors, whether retail or institutional, benefit from and are protected by an orderly and efficient after market and benefit from stabilisation activities by underwriters.
36. The SFC has reconsidered whether the powers of the SFC to make rules under Section 137 of the Securities Ordinance are sufficient to enable the enactment of rules governing stabilisation activities, and concluded that there is scope under current legislation to enact rules governing stabilisation activities. The SFC will review such activities and determine whether as a matter of policy it would be appropriate to enact rules under Section 137 relating to stabilisation activities.
37. In the absence of any such rules being enacted, the SFC's position is that the creation of short positions without the benefit of an over-allotment option, or creating short position, in excess of the limit under which shares could be allocated pursuant to such option is, prima facie, subject to the scrutiny of the SFC. The SFC would take necessary action should there be evidence of the creation of a false market. Hence, underwriters should restrict the extent of over-allocation of shares to the limit permitted under the over-allotment option.



## Annex II

### Suggested wording for disclosure of stabilization

1. *“In connection with this [issue] [offer], [name of the stabilizing manager] [or any person acting for him] may over-allot or effect transactions with a view to supporting the market price of [description of the relevant securities] at a level higher than that which might otherwise prevail for a limited period after the issue date. However, there may be no obligation on [name of stabilizing manager] [or any of his agent] to do this. Such stabilizing, if commenced, may be discontinued at any time, and must be brought to an end after a limited period.”*
2. *“The stabilizing manager may, in connection with the stabilizing action, maintain a long position in the relevant securities, and there is no certainty as to the extent and time period for which the stabilizing manager will maintain a long position. Investors should be warned of the possible impact of any liquidation of the long position by the stabilizing manager.”*
3. *“Stabilization cannot be used to support the price of a security for longer than the stabilization period. After this period, when any stabilization must end, demand for the security – and therefore its price could fall.”*
4. *“Investors should be aware that the price cannot be assured to stay at or above its offer price by way of stabilization.”*
5. *“Stabilization can be done at any price below the offer price. This means that it could be at a price below the offer price or the price the investor has paid in acquiring the security.”*

## Annex III

### Summary of questions for public consultation on Price Stabilizing Rules

- Q 1: What is your view on stabilizing action being permitted only in respect of the same type of security as the one being publicly offered but not in respect of its “associated” securities?*
- Q 2: Should stabilizing managers be allowed to hold “net long” positions and to liquidate such positions?*
- Q 3: What is your view about the proposal to impose a threshold amount of HK\$200 million for public offers under the PS Rules?*
- Q 4: What is your view on the adoption of a 30-day time limit for core stabilizing actions but not for ancillary stabilizing actions?*
- Q 5: What is your view on the pricing limits for stabilizing equity securities?*
- Q 6: Do you agree that stabilizing actions for offerings of debentures need not be subject to pricing limits?*
- Q 7: What is your view about the role of a stabilizing manager under the PS Rules? Do you foresee any practical difficulties for the stabilizing manager to discharge its role as described?*
- Q 8: What is your view about simultaneous “flagging” to the market of the stabilizing bid placed by the stabilizing manager?*

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**Annex IV**

**SECURITIES AND FUTURES (PRICE STABILIZING) RULES**

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**PRICE STABILIZING RULES**

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**SECURITIES AND FUTURES COMMISSION**

**(PRICE STABILIZING RULES)**

Made by the Securities and Futures Commission under sections 273(1) and 297(1) of the Securities and Futures Ordinance (xx of 2002) in the public interest, after consultation with the Financial Secretary.

**PART I**

**PRELIMINARY**

**1. Commencement**

These Rules come into operation on the day appointed for the commencement of Part XIII and Part XIV of the Securities and Futures Ordinance (      of 2002).

**2. Interpretation**

In these Rules, unless the context otherwise requires-

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"ancillary stabilizing action" ( ) means action ancillary to stabilizing action, permitted under section 9;

"associate" ( ) means "associate" as defined in section 237(1) and section 277(1) of the Ordinance;

"commission" ( ) means any form of commission, including a benefit of any kind, offered or given in connection with regulated activities;

"debt securities" ( ) means debentures issued by, or which it is reasonably foreseeable will be issued by a corporation;

"equity securities" ( ) means shares issued by, or which it is reasonably foreseeable will be issued by a corporation, but does not include any interest in any collective investment scheme;

"initial stabilizing price" ( ) means the price determined by the stabilizing manager at which the initial stabilizing action in relation to relevant securities may be taken subject to the limits in Schedule 2;

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"introductory period" ( ) means the period starting at the time of the first public announcement from which it could reasonably be deduced that the offer was intended to take place in some form and at some time, and ending with the beginning of the stabilizing period;

"offer" ( ) means an offer or an invitation to make an offer and (except in section 6(1)(b) and section 9(1)(d)), an issue;

"offer for cash" ( ) means an offer which satisfies the conditions set out in section 5;

"offer price" ( ) means the specified price at which the relevant security is offered to the public without deducting any selling concessions or commission;

the "Ordinance" ( ) means the Securities and Futures Ordinance ( of 2002);

"prospectus" ( ), in relation to an offer, means the prospectus authorised for registration pursuant to the Companies Ordinance, where the offer is in respect of relevant securities in -



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- (a) a company, pursuant to section 38D of the Companies Ordinance; and
- (b) a company incorporated outside Hong Kong, pursuant to section 342C of the Companies Ordinance.

"public announcement" ( ) means any communication made by or on behalf of the issuer or the stabilizing manager being a communication made in circumstances in which it is likely that members of the public will become aware of the communication;

"public offer" ( ) means an offer to the public;

"relevant securities" ( ) means equity securities and debt securities;

"stabilizing action" ( ) means any action contemplated by section 6 or section 9;

"stabilizing manager" ( ) means the single person responsible for stabilizing action under these Rules;

"stabilizing period" ( ), in relation to an offer of a relevant security, means the period:

- (a) beginning with the date of the prospectus issued in respect of the offer; and

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(b) ending on the thirtieth day after date of the prospectus issued in respect of the offer;

"stabilizing price" ( ) means the initial price (at or below the offer price) up to which the stabilizing manager has determined that he may wish to take stabilizing action; and if the effect of Schedule 2 to these Rules is to raise that price above the initial stabilizing price, then "stabilizing price" thereafter means that new, higher, price.

**3. Conduct not to constitute "market misconduct" under Part XIII of the Ordinance**

For the purpose of section 273(1), any conduct effected in conformity with these Rules in respect of the relevant securities will not be regarded as constituting market misconduct under Part XIII of the Ordinance.

**4. Conduct not to constitute certain offences under Part XIV of the Ordinance**

For the purpose of section 297(1), any conduct effected in conformity with these Rules in respect of the relevant securities will not be regarded as constituting

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an offence under Part XIV (other than sections 292 or 294) of the Ordinance.

### 5. Application

These Rules apply to an offer for cash, that is, an offer of relevant *securities*:

- (a) where the offer for cash is to be, or has been, made at a specified price payable in Hong Kong dollars or another currency;
- (b) where those securities are traded or have been admitted to trading, or are the subject of an application for admission for trading, on a recognised stock market or by means of authorised automated trading services;
- (c) where the total cost of the securities subject to the offer at the offer price is at least [HK\$200 million] (or its equivalent in another currency); and
- (d) where the offer is a public offer and is to be, is, or has been subject of a prospectus.

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**PART II**

**PRICE STABILIZATION**

**6. Stabilizing action**

(1) During the stabilizing period, the stabilizing manager may do any or all of the following:

(a) purchase, or agree to purchase, any of the relevant securities for the sole purpose of preventing or minimising any reduction in the market price of the relevant securities; and

(b) offer or attempt to do anything in subsection (1)(a) for the sole purpose of preventing or minimizing any reduction in the market price of the relevant securities.

(2) Notwithstanding subsection (1), these Rules may not be relied on for the purpose of section 3 or 4 if, at the time of the relevant act or omission under subsection (1), the stabilizing manager knew or should reasonably have known that:

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- (a) disclosure had not been made in accordance with section 7(1)(a) and the operator of the relevant recognized stock market or overseas stock market or the authorized provider, as the case may be, had not been informed in accordance with section 7(1)(b); or
- (b) records are obliged to be but have not been or are not being kept in accordance with section 7(1)(c); or
- (c) the price of any relevant securities was already artificial or maintained at a level that is artificial (whether or not it was previously artificial).

**7. Disclosure of stabilizing action**

(1) The stabilizing manager may not take any stabilizing action in any relevant securities under these Rules unless:

- (a) from the commencement of the introductory period, adequate disclosure is made of the

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fact that stabilizing action may take place in relation to the offer;

(b) any requirement of the operator of the recognised stock market or overseas stock market on, or the person authorised to provide automated trading services by means of, which the relevant securities are or will be traded to inform it that stabilizing action in those securities may take place during the stabilizing period has been complied with; and

(c) the stabilizing manager has established the register required by section 12(1) for recording each stabilizing action effected by him in the relevant securities and the matters required to be recorded by section 12(2) in relation to it.

(2) For the purpose of subsection (1)(a), adequate disclosure is regarded as having been made for communications specified in Schedule 1 to these Rules, by or on behalf of the issuer or the stabilizing manager, if disclosure is made in the manner specified in that Schedule.

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**8. Restrictions on stabilizing action**

(1) The stabilizing manager may not take stabilizing action in any case where:

(a) at the time when the offer price of the relevant securities was determined, the market price of the relevant securities or of rights to them, was or could reasonably be anticipated to be an artificial price; and

(b) the stabilizing manager knew or should reasonably have known that the artificiality in the market price was or would be attributable in whole or in part to any act or course of conduct on the part of any person which constitutes market misconduct under Part XIII or an offence under Part XIV of the Ordinance.

(2) The stabilizing manager may not take stabilizing action in any case where:

(a) the relevant securities are debt securities;

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(b) there are equity securities into which those debt securities can be converted or to the purchase of which those debt securities give rights; and

(c) the terms of conversion, purchase or subscription have not yet been publicly announced.

(3) The stabilizing manager may not take stabilizing action in any case where:

(a) he or an associate of his has, in connection with the offer, an option or other right to subscribe for relevant securities from the issuer; and

(b) that option or right may be exercised or relied on after the start of the introductory period and during or after the remainder of the stabilizing period;

unless the existence and principal terms of the option or right have been disclosed in the relevant prospectus, and, in any public announcement in respect of the offer prior to the date of the prospectus.



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**9. Permitted ancillary stabilizing action**

(1) Subject to subsection (2), the stabilizing manager may:

(a) for the sole purpose of preventing or minimizing any reduction in the market price of the relevant securities by action under section 6:

i) make allotments of a greater number of the relevant securities than the number that will be offered in the public offer; or

ii) sell or agree to sell relevant securities so as to establish a short position in them;

(b) purchase or subscribe for or agree to purchase or subscribe for relevant securities in order to close out any position established under subsection (1) (a); or

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(c) sell or agree to sell relevant securities acquired by the stabilizing manager in the course of stabilizing action in order to liquidate any position that has been established by such action; or

(d) offer or attempt to do anything permitted by subsection (1)(a)(ii), (b) or (c).

(2) Ancillary stabilizing action under subsection (1)(b) may be taken without regard to the limits on pricing in section 10 and Schedule 2 to these Rules.

**10. Limit on pricing in stabilizing action**

(1) No bid may be made or transaction effected in the case of action described in section 6 at a price higher than any relevant price indicated in accordance with Schedule 2 to these Rules (including any relevant notes thereto).

(2) The prohibition in subsection (1) does not apply to stabilizing action related to debt securities.

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**11. Management of stabilization**

(1) The stabilizing manager must be a licensed corporation or a registered institution.

(2) It will be the duty of the stabilizing manager to ensure -

(a) that the disclosure requirements specified in Schedule 1 to these Rules are complied with;

(b) any requirements of the operator of the recognised stock market or overseas stock market on, or the person authorised to provide automated trading services by means of, which the relevant securities are or will be traded to inform it that stabilizing action in those securities may take place have been complied with; and

(c) any person appointed by the stabilizing manager to act as its agent for the purpose of effecting any bid or transaction in the course of stabilizing action complies with these Rules.

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(3) No bid may be made or transaction effected in the course of stabilizing action unless the stabilizing manager:

- (a) has established the relevant register in compliance with section 12;
- (b) is in compliance with the registration requirements in section 12 in respect of all earlier transactions effected in the course of stabilizing action in connection with the offer in question.

(4) No bid may be made or transaction effected in the course of stabilizing action except by:

- (a) the stabilizing manager itself; or
- (b) a person appointed by the stabilizing manager to act as its agent on terms which:
  - (i) make the agent responsible to the stabilizing manager; and
  - (ii) make the stabilizing manager responsible to others for the acts or omissions of the agent as if they had

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been done or omitted by the stabilizing manager.

(5) The stabilizing manager may not during the stabilizing period enter into any dealing as principal in relevant securities with any agent of its appointed under subsection (4) (b).

(6) Subsection (5) does not apply if, at the time of the transaction, neither the stabilizing manager nor the agent knew or should reasonably have known the identity of its counterparty.

**PART III**

**REGISTER OF STABILIZING ACTION**

**12. Record keeping for action taken**

(1) The stabilizing manager must establish and keep a register in respect of each offer of securities covered by these Rules.

(2) The stabilizing manager must ensure that the register referred to in subsection (1) contains, either

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in real time or updated on a daily basis (from business day to business day):

- (a) the names of all agents appointed under section 11 and details of the terms of the appointment of each;
- (b) the general parameters (including the initial stabilizing price) laid down by the stabilizing manager for his agents and the date and time of their communication, variation or revocation;
- (c) each transaction effected in the course of the stabilizing action including:
  - i) the type of security;
  - ii) the unit price;
  - iii) the size;
  - iv) the date and time; and
  - v) details of the counterparty;
- (d) details of the allotment of relevant securities (allottee and amount allotted);  
and

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(e) details (so far as known to the stabilizing manager) of transactions which are effected at a price above the then current stabilizing price for the purposes of Schedule 2 to these Rules (pricing after independent deals).

(3) The register must be kept in Hong Kong, or else be capable of being brought to, or reconstituted in, Hong Kong within 48 hours of a request for access from anyone entitled to inspect it pursuant to section 13.

(4) If the register is not kept in either English or Chinese, it must be capable of being converted into either language within the 48-hour period mentioned in subsection (3).

### **13. Maintenance and Inspection of register**

(1) During the 3 months from the end of the stabilizing period, the issuer is entitled to inspect that part of the register which is kept under section 12(2)(c)(i) to (c)(iv) and without prejudice to section 12(3), the stabilizing manager must make that part of the register available for inspection within a reasonable

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time of being notified by the issuer that it wishes to make the inspection.

(2) The register must be maintained for a period of at least 7 years from the date of the end of the stabilizing period.

(3) The Commission is entitled to inspect the register and to take copies thereof at any time and without prejudice to section 12(3), the stabilizing manager must make the register available to the Commission or a person authorized in writing by the Commission.

**PART IV**

**MISCELLANEOUS**

**14. Overseas Stabilization**

(1) A person who, in a place outside Hong Kong, carries out any conduct in respect of relevant securities

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(a) for the sole purpose of preventing or minimising any reduction in the market price of the relevant securities;



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(b) in conformity with such provisions made by an authority or regulatory organisation outside Hong Kong as are set out in Schedule 3; and

(c) and in relation to an offer which is governed by the laws of the country (or the state or territory in a country) in which the authority or regulatory organization is situated;

is to be treated for the purposes of sections 273(1) and 297(1) of the Ordinance as acting or engaging in such conduct for that purpose and in conformity with these Rules.

(2) For the purposes of subsection (1), "market price" is the market price of the relevant securities on an overseas market in the relevant country (or the state or territory).

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**Schedule 1**

**Relevant Communications**

Item	Communication	Relevant Notes (see below)
1	Any screen based statement	a,b,d
2	Press announcement (or other public announcement)	c,d
3	Invitation telex (or similar)	b
4	Prospectus	e

*Notes:*

- (a) Item 1 extends to any statement made by the stabilizing manager or issuer on screen facilities (whether provided by the stabilizing manager or not) conveying prices for a purchase or sale of the relevant securities.
- (b) For items 1 and 3, adequate disclosure is given if the communication contains some indication of the fact that the offer may be stabilized in accordance with these Rules. For this purpose - (i) the term "stabilization/SFO"; or (ii) during the introductory period, a reference to "details of intended stabilization/SFO in prospectus"; is sufficient.
- (c) For item 2, adequate disclosure is given if the announcement includes a statement of the fact that the offer may be stabilized in accordance with these rules. For this purpose- (i) a statement in the following terms: "This offer may be stabilized in accordance with the Price Stabilizing Rules made under the Securities and Futures Ordinance"; or (ii) during the introductory period, a reference to " the details of the intended stabilization and how it will be regulated under the Securities and Futures Ordinance will be contained in the prospectus"; is sufficient.
- (d) Items 1 and 2 apply from the beginning of the shorter of the following two periods, that is:
  - (i) the introductory period; or

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- (ii) the period beginning 45 days before the day proposed for the issue of the relevant securities and ending with the start of the stabilizing period.
- (e) For item 4, adequate disclosure is given if the communication contains:
- (i) wording substantially similar to the following:

"In connection with this [issue] [offer], [name of the stabilizing manager] [or any person acting for him] may over-allot or effect transactions with a view to supporting the market price of [description of the relevant securities] at a level higher than that which might otherwise prevail for a limited period after the issue date. However, there may be no obligation on [name of stabilizing manager] [or any of his agent] to do this. Such stabilizing, if commenced, may be discontinued at any time, and must be brought to an end after a limited period."
  - (ii) a summary of the possible stabilizing action to be undertaken under section 6 or section 9;
  - (iii) warnings to the effect that:
    - (1) the stabilizing manager may, in connection with the stabilizing action, maintain a long position in the relevant securities;
    - (2) there is no certainty regarding the extent and time period for which the stabilizing manager will maintain such a position;
    - (3) investors should be warned of possible impact in the case of liquidation of the long position by the stabilizing manager;
    - (4) stabilization cannot be used to support the price of a security for longer than the stabilization period which is 30 days from the date of the prospectus. After this period, when any stabilization must end, demand for

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the security, and therefore its price could fall;

- (5) investors should be aware that the price of the security cannot be assured to stay at or above its offer price by way of stabilization;
- (6) stabilizing bids may be made or transactions effected in the course of stabilization at any price below the offer price. This means that stabilizing bids may be made or transactions effected at a price below the price the investor has paid for the security.

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**Schedule 2**

**Pricing Limits**

Time of action	Maximum Price
1. Initial stabilizing action	The offer price
2. After the initial stabilizing action, there has been a deal done (transaction effected) at a price above the stabilizing price on the relevant market	The offer price, or the price at which that deal was done, whichever is lower
3. Alternatively, if after the initial stabilizing action, there has been no deal mentioned in paragraph 2 above	The offer price, or the initial stabilizing price, whichever is the lower

*Notes:*

- (a) For the purpose of paragraph 2 above, a deal done does not include a deal done by or on the instructions of the stabilizing manager.
- (b) For the purpose of this Schedule, "relevant market" means the relevant recognised market, authorised automated trading services, or relevant overseas market which the stabilizing manager believes to be the principal market on which those securities are dealt in at the time of the transaction.
- (c) Where the price of any relevant securities on the relevant market is in a currency other than the currency of the price of the securities to be stabilized, stabilizing bids may be made or transactions effected at a price that reflects any change in the relevant rate of exchange; but this does not permit stabilizing action at a price above the equivalent, in the other currency, of the offer price in the currency of the relevant exchange.

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**Schedule 3**

**Overseas Stabilization**

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Chairman  
Securities and Futures  
Commission

Date 2002

**Explanatory Note**

These Rules are made by the Securities and Futures Commission under sections 273(1) and 297(1) of the Securities and Futures Ordinance ( of 2002) for the purpose of excluding price stabilization conducted in accordance with these Rules from the application of the market misconduct provisions in Parts XIII and XIV of the Ordinance. They prescribe the circumstances in which the prices of certain securities offered to the public may be stabilized for a limited period and the type of stabilizing action which may be undertaken and the requirements for disclosure of such action.