

CPD Day 2016

Session 08-Disclosure of interests and short position reporting for asset managers

Speakers:

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Introduction

- Overview
- Disclosure of interests under SFO
 - Who? What? When?
 - Exemptions
 - How to file and what if you don't?
- Takeovers Code
- Short position reporting

Overview

- Disclosure of Interests
 - Part XV of the Securities and Futures Ordinance (Cap. 571)
 - Effective since 1 April 2003
 - SFC guidance:
 - Outline of Part XV of the SFO – Disclosure of Interests
 - Guidelines for the exemption of listed corporation from Part XV

- Rule 22 Takeovers Code

- Short Positions Reporting – dual regime:
 - Part XV of the Securities and Futures Ordinance (Cap. 571)
 - Securities and Futures (Short Position Reporting) Rules

Disclosure of Interest under SFO

- Provide investors and regulators with information about those with interests in Listed Companies
- Enable regulators to regulate/monitor compliance
- Enable investors to make informed decisions

Who?

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Who needs to disclose?

■ Substantial shareholders

- Long position (5%)
 - An interest of any kind whatsoever in a class of voting shares of a company listed on the SEHK (including classes not listed on the SEHK)
 - Includes interest in the underlying shares of equity derivatives e.g. options, warrants, convertible bonds, ADRs and stock futures
 - Can mean disclosure of an interest in unissued shares e.g. subscription warrants if they give you the right to obtain shares in the future
- Short position (1%) but only if you already have a long position of 5%

■ Directors and Chief Executives

- all interests and short positions, all changes

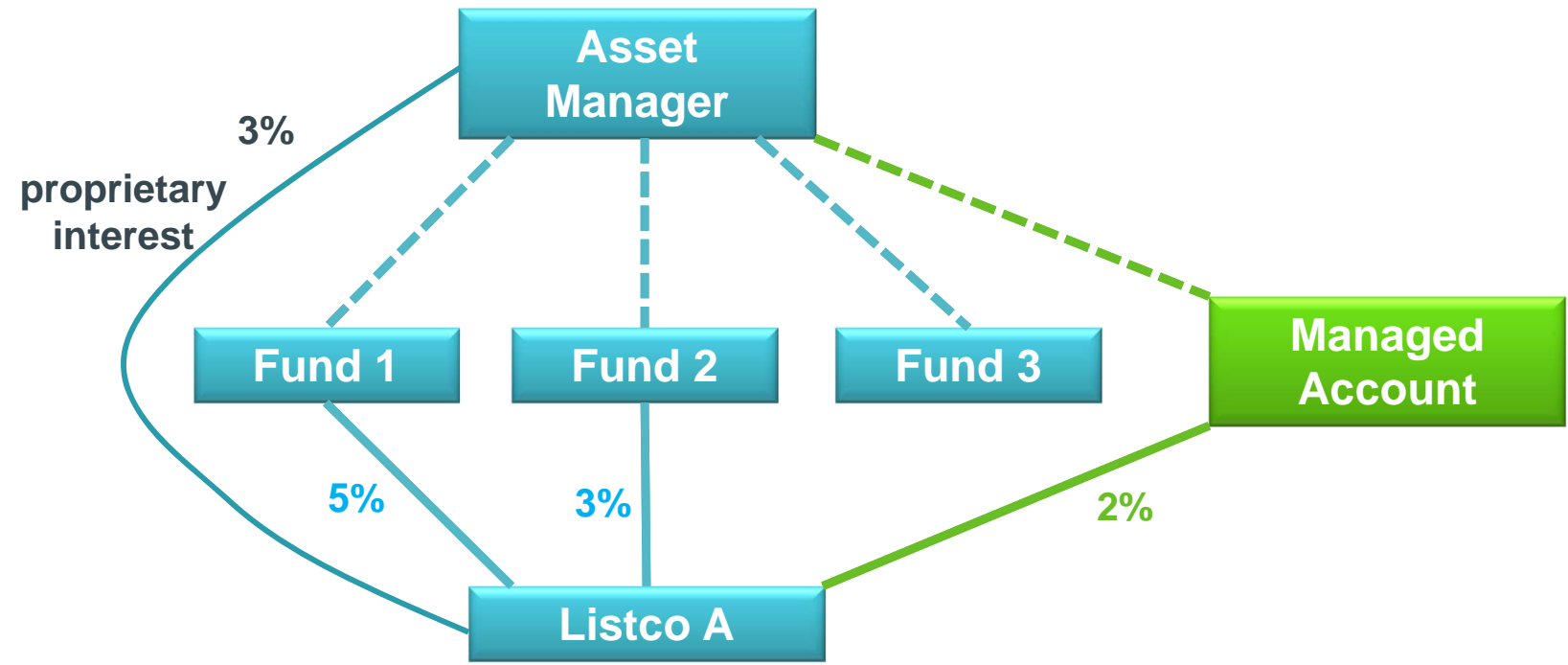
Short Positions

- 1% or more short position disclosable
- BUT only if you have a 5% or more long position
- No netting of long and shorts

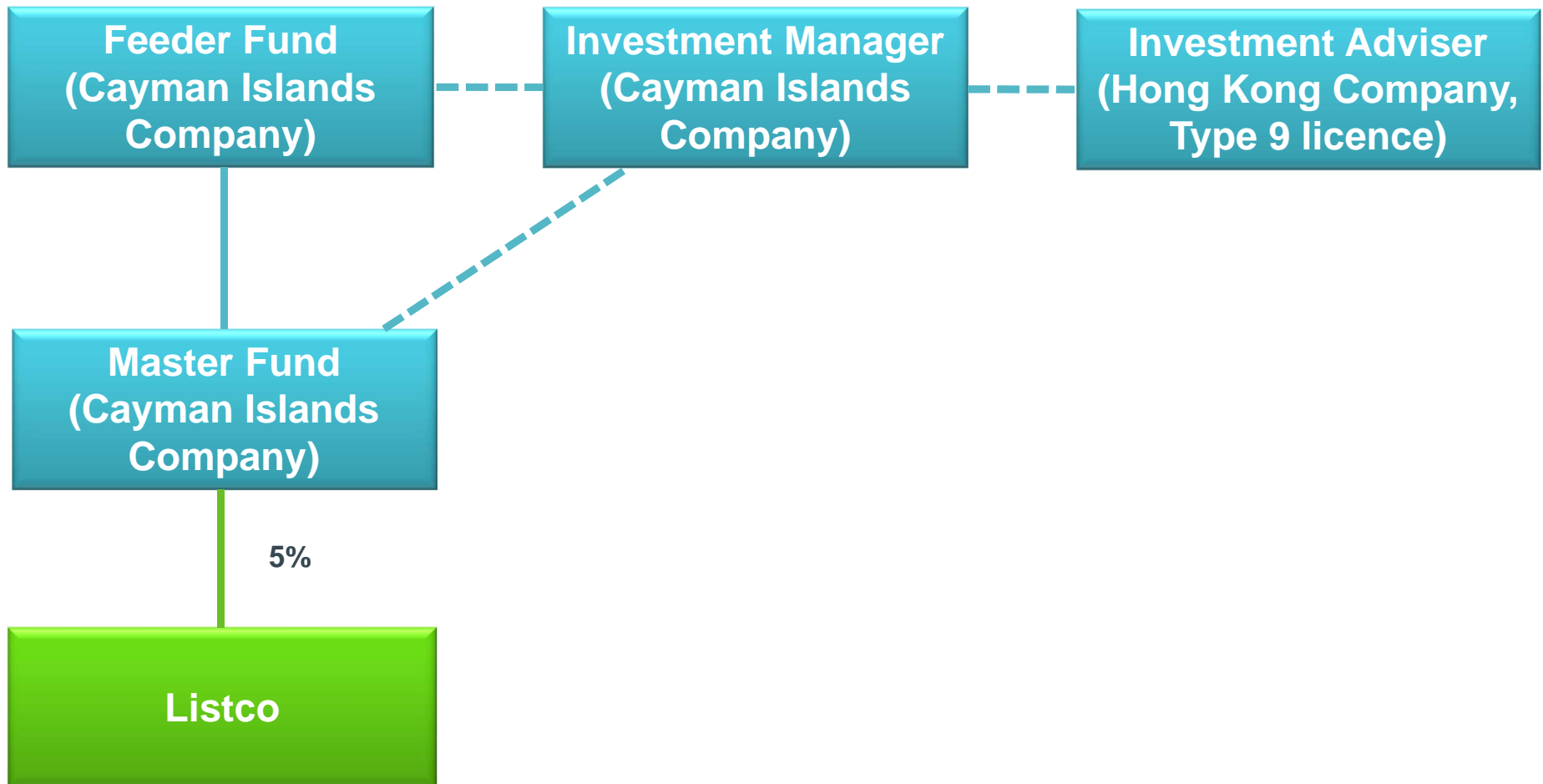
Discretionary Fund Managers

- Control the exercise of voting rights of multiple funds
 - Aggregate holdings of funds and discretionary accounts and report
 - Each fund / account holder also subject to separate disclosure obligations
 - Non aggregation group exemption

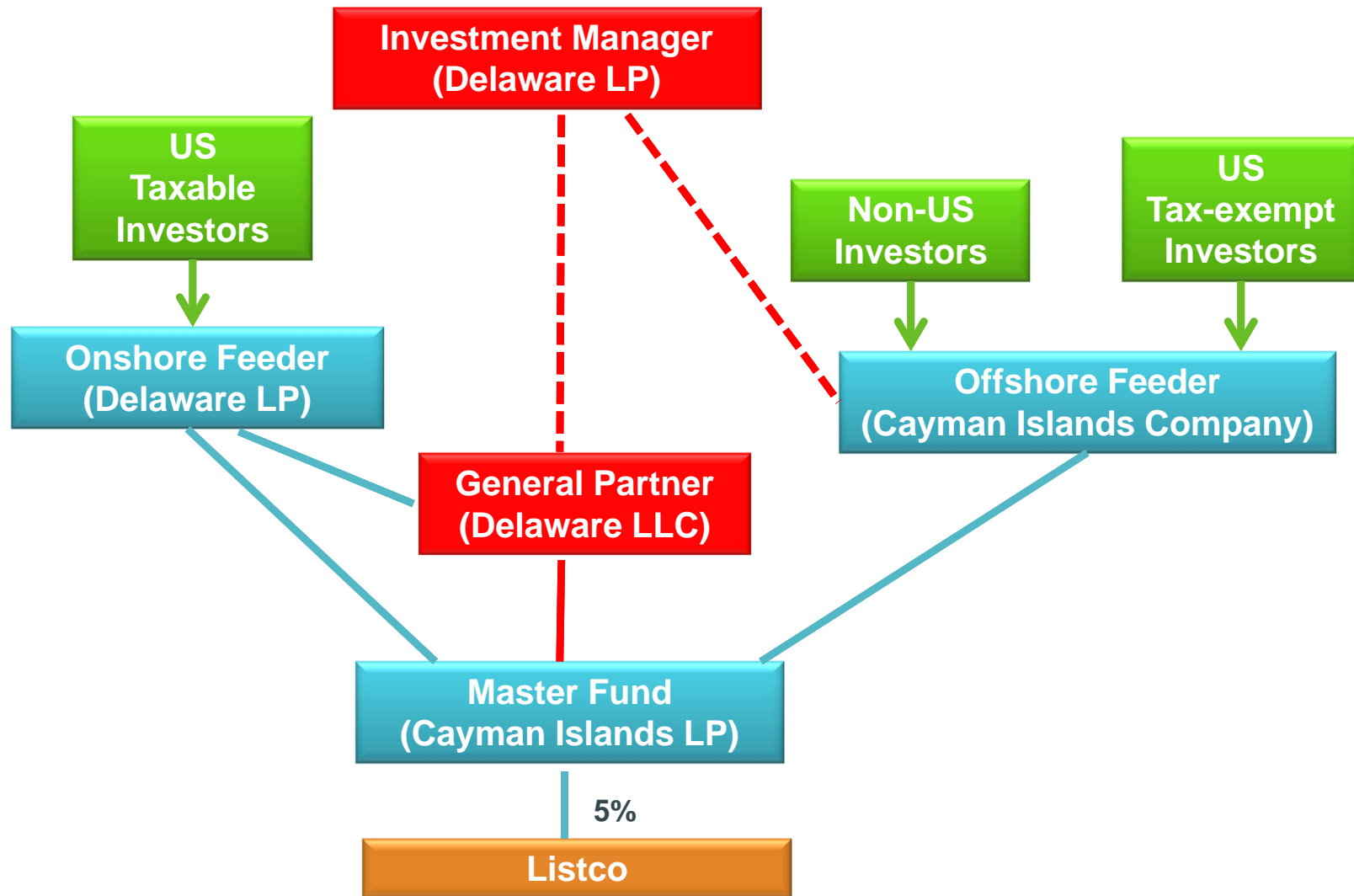
Discretionary Fund Managers



Master Feeder Hedge Fund



LP / LLP / LLC



What?

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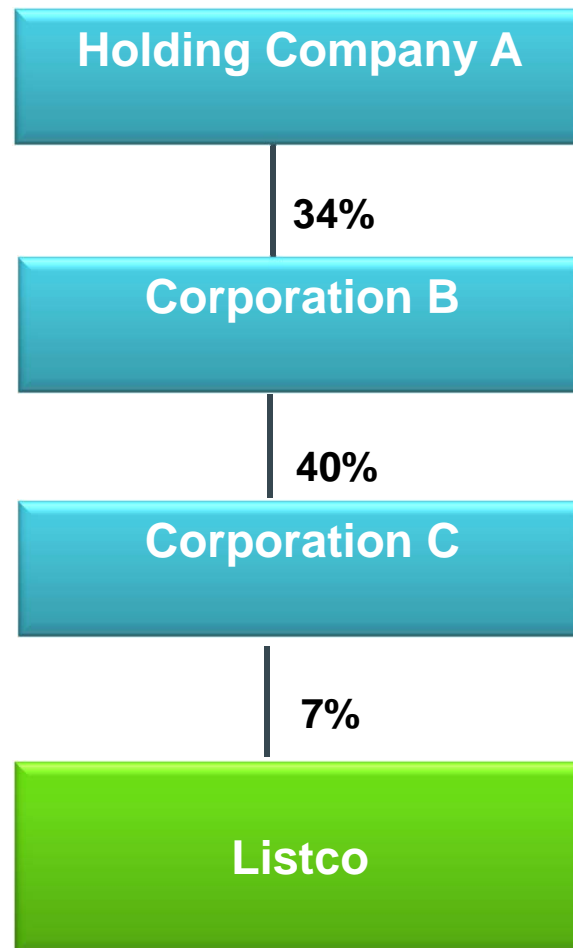
“Interest”

- Interest of any kind whatsoever in shares
 - Name on register
 - Shares held for you by another person e.g. stockbroker, custodian
 - Deemed interest
 - Contract (e.g. equity derivatives) that give you the right to shares, a right of first refusal to shares or to a payment in the event of a change in price of shares
 - Shares held as security
 - Entitlement to exercise rights attaching to shares or control their exercise e.g. fund managers

Deemed interests

- Substantial shareholders must also disclose deemed interests and deemed short positions
- Spouse, children under 18
- Controlled corporation (1/3 test)
 - Corporation (or its directors) are accustomed or obliged to act in accordance with that person's directions or instructions OR
 - Person is entitled to exercise or control the exercise of one third or more of the voting power at a general meeting; nominate directors; veto, amend, modify, limit or add conditions to any resolutions at general meetings
 - includes interests of a corporate fund manager (i.e. shares held by the funds managed by the manager) controlled by such person
- Trust interests
- Concert party agreements

Controlled Corporations



Calculations

- “Voting shares” – shares of a class that carry a right to vote in all circumstances in general meetings of a listed corporation. Also include unissued shares which, if issued, would have such rights.
- Calculation
 - $$\frac{\text{Number of shares (issued or unissued) interested/short position}}{\text{Number of shares of the same class in issue}} \times 100$$
- No rounding up for 5% level
 - a 4.9999% holding/interest is not disclosable
- Restriction or restraints are disregarded
 - eg. Transactions which are subject to conditions or shareholders’ approval
- Same class of shares
 - eg. “H” shares and “A” shares not aggregated

When?

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Timing

- 3 business days, except for “Initial Notification”
- By midnight on third business day after the “Relevant Event” / the day you know of the “Relevant Event”
- Saturdays are not business days e.g. Relevant Event on Friday, file by midnight on following Wednesday

Relevant Events

- Seven events triggering disclosure
 1. Acquiring a “notifiable interest” (5% or more)
 2. Ceasing to have a notifiable interest (going below 5%)
 3. Crossing a whole percentage level (6.8% to 7.2% or 8.1% to 7.4%)
 4. Change in nature of interest
 5. You have a notifiable interest and you come or cease to have a short position of 1% or more
 6. Short position crosses a % level
 7. On listing
 8. If the 5% threshold or the 1% threshold for short position is reduced

- 7 and 8 are “Initial Notifications”

Crossing whole percentage level

- Percentage **figure** is rounded to two decimal points
 - However, not necessary to round percentage figure to 2 decimal places when working out whether notice needs to be filed e.g. 4.99999 % is not rounded to 5 % percentage level:

- Percentage **level** is a whole % rounded down
 - E.g. An interest of 5.99% is at percentage level 5
 - Percentage figure: disclose to 2 decimal places
 - E.g. For an interest of 5.9991%, disclose 5.99%

- Crossing across a whole percentage level
 - Increase from 6.83% to 7.25% (from a percentage level of 6 to 7)
 - Decrease from 6.83% to 5.92% (from a percentage level of 6 to 5)

Change in nature of interest

- Relevant Event = triggers duty of disclosure just by virtue of change of nature
- E.g. exercising an option
- Before exercise, interested in option to buy the shares (underlying shares)
- On exercise, interested in same number but now have title to shares
- No disclosure required if % level of interest that has not changed and % level of interest at last notification are the same (“same percentage level exemption”) S. 313(8)(a)

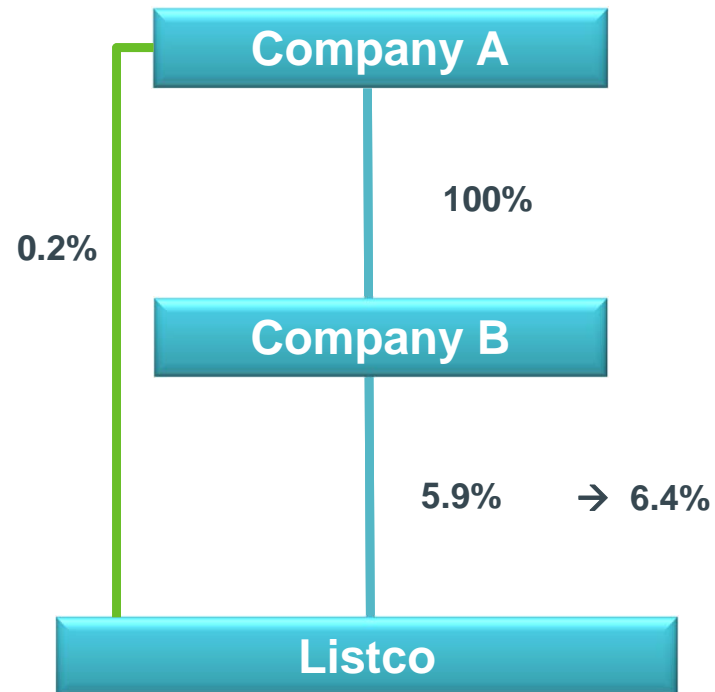
Exemptions

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Wholly owned group exemption

- Exempts wholly owned subsidiary if its ultimate holding company “complies with the duty of disclosure”
- Exemption not available on an Initial Notification
- Transfers within 100% group are exempt

Wholly-owned Group Exemption



Non-Aggregation Exemption

- Holding company does not have to aggregate interests of controlled corporations that hold their interest in their capacity as an investment manager, custodian or trustee that manage their interests independently
- Controlled company must invest in, manage, deal in or hold interests on behalf of its customers in ordinary course of its business as a “licensed” investment manager, a custodian or a trustee (conditions attached)
 - “Investment Manager” =
 - corporation licensed / registered in Hong Kong for Type 9 regulated activity
 - corporation licensed / registered / exempt for asset management in recognised jurisdictions – Australia, France, Germany, Guernsey, Ireland, Isle of Man, Jersey, Luxembourg, Switzerland, UK and USA
 - Authorised to manage investment in securities for another person under a written agreement

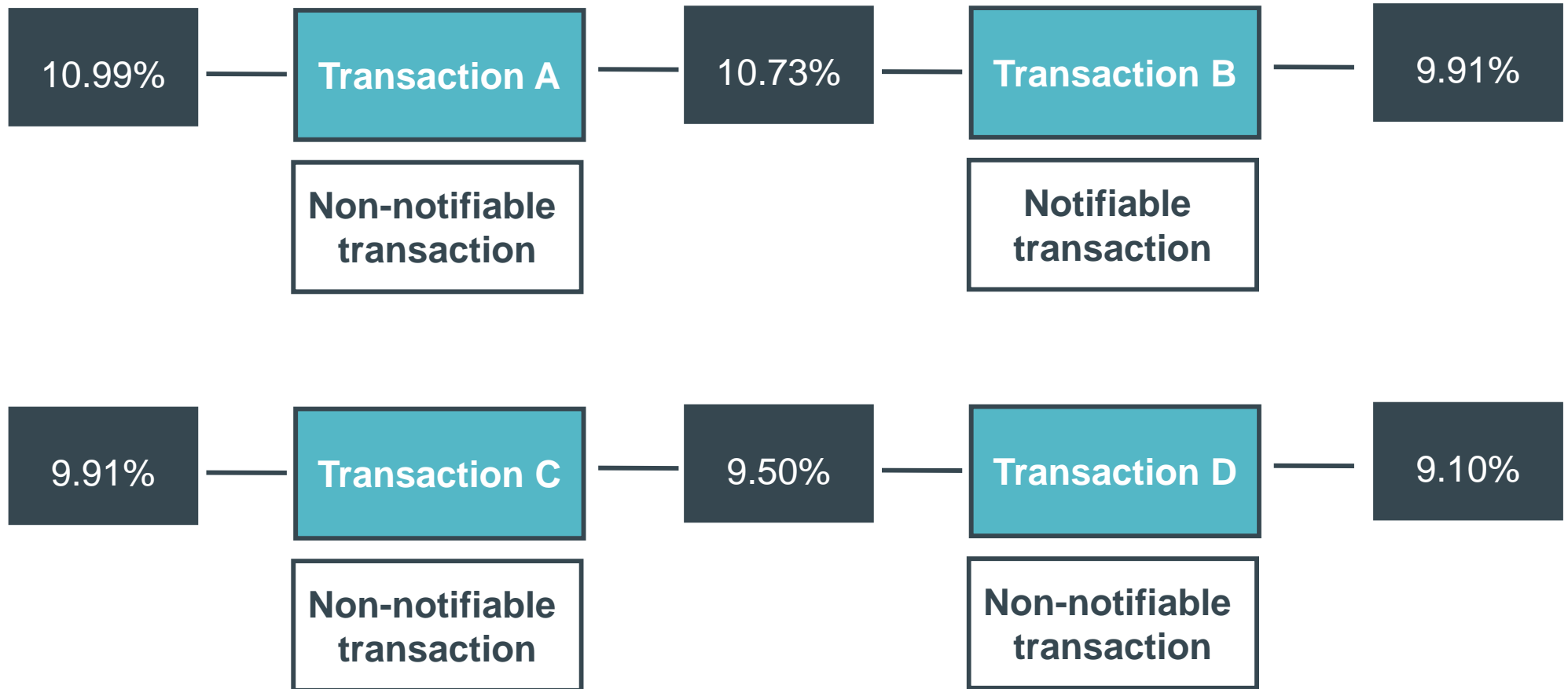
Non-Aggregation Exemption (Cont'd)

- Voting rights exercisable without reference to holding company or group co.
- Powers of controlled company exercised independently without any reference to holding company or any corporation within the same group (question of fact)

De minimis exemption

- Applies to substantial shareholders' disclosures only, does not apply on directors' disclosures
- Two limbs:
 - The percentage level is the same as or less than the percentage level of the last notification; AND
 - The difference between the percentage figure of shareholder's last notification due to change in % level over 5% and the percentage figure of shareholder's interest at all times since the last notification is less than 0.5%
 - The last notification must be a notification due to a change of percentage level above 5% (i.e. notification given when first crossing the 5% threshold and a notification of change of interest do not qualify)

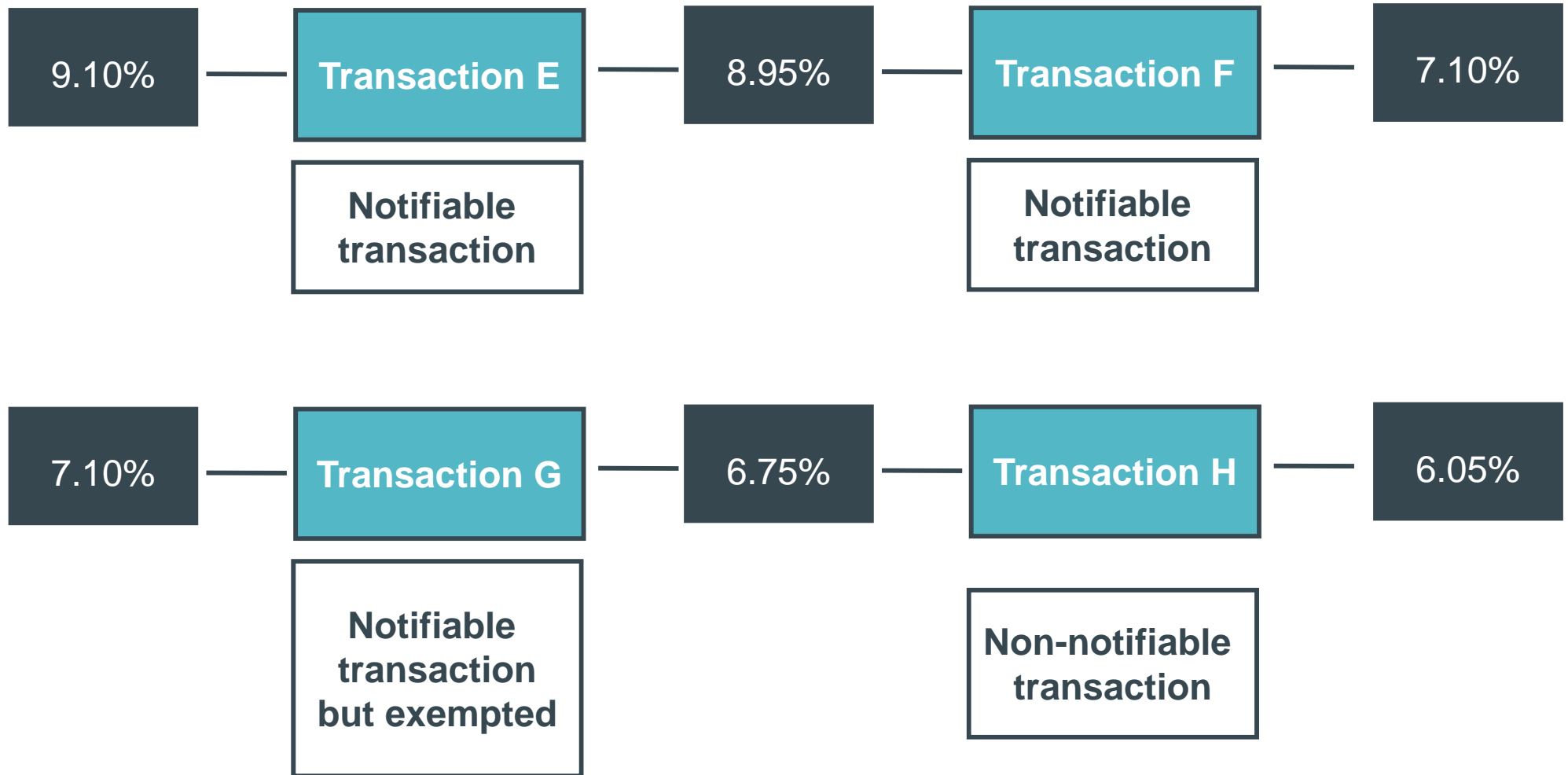
Polling Question: Are these transactions notifiable? 1 – Yes, 2 - No



Polling Question:

Are these transactions notifiable?

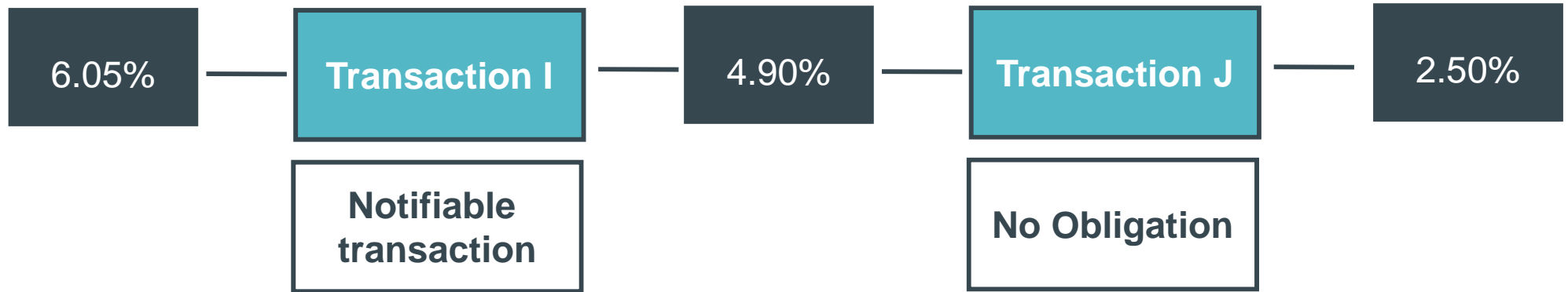
1 – Yes, 2 – No



Polling Question:

Are these transactions notifiable?

1 – Yes, 2 - No



Change in nature: exemptions

- Change in nature, but no filing in five circumstances S. 313(13) Part XV + S. 5 Exclusions Regulations
- Purchase of shares. When you enter into a SPA you get equitable interest. This is a Relevant Event so you need to file a disclosure
- When you complete a SPA, your equitable interest changes to a legal one.
- Change in nature of your interest? YES
- Filing? No change in the nature of interest for the purpose of disclosure (s.313(13))

Change in Nature Interest – five exemptions

No change in nature of interest to be disclosed

1. On completion for purchaser of shares on delivery of shares if purchaser has disclosed acquisition of equitable interest when contracting to buy shares
2. For vendor of shares on entering into contract for sale if sale is required to be completed within 4 days on which stock exchange is open for business
3. Exercise of rights to subscribe for shares granted as part of rights issue and delivery of those shares on completion of rights issue
4. For holding company if change due to acquisition of an interest by its wholly owned subsidiary from another wholly owned subsidiary
5. For holder of derivatives if change in terms on which rights may be exercised because of a change in the number of underlying shares in issue

Collective Investment Schemes

- Interests of holders, trustee or custodian of units or shares in a HK authorised collective investment scheme, certain pension or provident fund schemes or a qualified overseas scheme are disregarded
- Interest of the manager of the fund is not disregarded
- If not disregarded, interest in all shares held by a trust must be disclosed by unit holder as unit holder is deemed to have an undivided share in the whole portfolio of the unit trust

Other Exemptions

- Basket of Shares
- Dual listing
- Issuers of structured products
- Qualifying issues
- Transient interests of dealers in securities
- Exempt custodian interest

How to file and what if you don't?

How to make a disclosure?

- 6 forms on <https://sdinotice.hkex.com.hk> or the SFC website <https://www.hksfc.org.hk>
- Fax, post, on-line filing to address and fax numbers provided in Notes to forms
- Electronic filing proposed in 2008 consultation (supposed to be mandatory) but not yet in force

Consequences of breaching Part XV of SFO

- Four categories of breach:
 - Late disclosure
 - Failing to complete the form in accordance with the instructions in the relevant forms
 - Including false or misleading information in the forms
 - Failing to make disclosure

- Possible actions by the enforcement division of the SFC
 - No action
 - Issue warning letter
 - Refer the matter for investigation with a view to prosecution
 - Liable on conviction to a maximum fine of HK\$100,000 and imprisonment for up to two years (s.328 and s. 351)

Takeovers Code



Rule 22 of the Takeovers Code

Disclosure of dealings during offer period

- Rule 22 requires disclosure of dealings by associate of an offeror or offeree during an offer period
- Associate
- Offer Period

Rule 22 of the Takeovers Code (Cont'd.)

- **Aggregation Requirement:**
 - For the purposes of Rule 22, the holdings of various discretionary investment managers within the same group will be aggregated.
- **Requirement to disclose details of each trade and the balance holdings**
- **Timing**
 - 10:00 am the next business day (must act promptly)
- **SFC Guidelines to fund managers on dealing disclosure obligations under Rule 22 of the Takeovers Code (29 December 2011)**
 - Identify relevant companies in an offer period
 - Ongoing training of staff
 - Proper compliance systems

Rule 22 of the Takeovers Code (Cont'd.)

■ Sanctions

- The possible sanctions for a breach of the Takeovers Code include (but not limited to):
 - private reprimand
 - issuance of a public statement which involves criticism
 - public censure
 - reporting the offender's conduct to the SFC or other regulatory authority in Hong Kong, e.g. the HKEx, Hong Kong Monetary Authority and any professional body or to an overseas regulatory authority
 - cold shoulder order

Short selling

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Short selling

- Naked (i.e. uncovered) short selling is prohibited
- Covered short selling only permitted in relation to “Designated Securities”

Dual reporting regime – Part XV SFO

- Only applies to “Substantial Shareholders” (5% or more long position)
- 1% or more short position disclosable
- No netting of long and shorts

Dual reporting regime – Weekly Short Position Reporting

- Introduced in 2012
- Additional layer of reporting obligations
- Applies to all shareholders (does not have to be substantial shareholder)
- “Specified Shares”
 - Constituents of Hang Seng Index
 - Constituents of Hang Seng China Enterprises Index
 - Shares that are both “Designated Securities” and classified as “financial stocks” by Hang Seng Indexes Company Limited

Dual reporting regime – Weekly Short Position Reporting

- Net short position in “Specified Shares” that amounts to or exceed lower of
 - HK\$30 million
 - 0.02% of value of total number of Specified Shares at the end of last trading day of each week

- “Net Short Position” =
 - (Number of Specified Shares beneficially owned **LESS** the number of Specified Shares sold short on the SEHK)
 - **MULTIPLIED** by the Closing Price per Specified Share on the SEHK at close of trading on the last trading day of the relevant week

- Only applies to net short positions resulting from trading on SEHK and other trading venues (including Alternative Trading Services)

- Does not apply to short positions resulting from trading on another stock exchange, or created via OTC trading or derivative positions

Dual reporting regime – Weekly Short Position Reporting

- Who must report?
 - Beneficial owner of net short position (e.g. each fund established as a company, corporate “umbrella” funds should report separately)
 - Trustee (not beneficiary of trust)
 - May appoint agent to report (e.g. investment adviser) but the principal (i.e. the fund) remains legally responsible
 - Investment manager / adviser do not need to aggregate short positions of funds it manages

Dual reporting regime – Weekly Short Position Reporting

- Report must be submitted electronically by the second business day after the last trading day of each week (usually the following Tuesday)
- Reports should be made every week until the value of that net short position falls below threshold
- Each person making a report must register for its own Short Position Reporting Identification Number (“SPRID”)
- Consequences of non-compliance:
 - Criminal offence
 - Up to HK\$100,000 and 2 years imprisonment

Dual reporting regime – Weekly Short Position Reporting

- Consultation Conclusions in relation to expanding the scope of short position reporting (February 2016)
 - effective 15 March 2017
 - Expanding the scope of short position reporting to cover all “Designated Securities”
 - Collective investment schemes - HK\$30 million threshold
 - Operational changes
 - foreign currency
 - expansion of reporting channels (pending)

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Rolfe has extensive experience in all types of collective investment schemes, including ETFs, hedge funds, private equity funds, guaranteed funds and listed investment companies.

He has advised on offshore closed and open ended corporates, units trusts and limited partnerships as well as licensing, regulatory and securities issues connected with asset management generally in Hong Kong and Asia.

Rolfe also has experience in bank regulation under the Banking Ordinance, mergers by way of private ordinance, SFC licensing issues as well as disclosure of interests under the Securities and Futures Ordinance.

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Ivy advises on the establishment, authorisation and ongoing compliance issues of authorised (listed and unlisted) investment funds, as well as on unauthorised investment funds including hedge funds. She also has experience on advising asset managers on issues relating to their disclosure of interests obligations and short position reporting obligations.



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