equity derivatives) that:

> "If it is *not possible* to determine the number of shares in which you are taken to be interested (or have a short position) at the date when you first acquire an interest in the underlying shares through an equity derivative then you need not file a notice. However, you should file a notice when you first become aware of the number of shares that will be delivered to you/will be required to be delivered by you. For example, if the number of shares that you will receive under an equity derivative is determined by the price of the shares on a given date in the future (and there is no minimum or maximum number that you are bound to get) then no duty of disclosure arises on entering into the derivative. Once the number of shares that you will receive is known a duty of disclosure arises. If the derivative specifies a minimum then disclose the minimum figure. If the derivative specifies only a maximum then disclose the maximum figure. If the derivative specifies both a maximum and a minimum then disclose the figure which is most appropriate."

While perhaps a bit opaque, this is a very sensible and helpful clarification. The logic of this analysis should also extend to other categories of interest, for instance an agreement to acquire interests in a number of shares which has not yet been fixed.

By analogy, contingent interests (or short positions) in an unknown number of shares pursuant to adjustment provisions in convertible bonds, warrants and other equity derivatives, and pursuant to "top-up" provisions under security documents, will not be disclosable until such time as an adjustment or top-up actually happens (or, if earlier, is required to happen, for instance as a result of a triggering event such as a further share issue) and a revised number of shares can be identified.



# E. Interests and Short Positions to be Disregarded

Unlike the position in relation to the interests and short positions to be taken into account, the interests and short positions of substantial shareholders, directors and chief executives which are to be disregarded are so different as to need to be explained separately.

## 1. Interests and short positions to be disregarded for Substantial Shareholder Disclosure Requirements

The following interests and short positions are to be disregarded for the purposes of the Substantial Shareholder Disclosure Requirements (other than investigations under section 329). Most of these items only relate to interests in shares, and are not relevant for assessing whether any potential short positions can be disregarded.

See also Chapter L for a description of the exemptions from Part XV which are available.

(a) Certain interests under trusts: Where property is held on trust and an interest in shares is comprised in that property[1]:

*This provision does not apply to short positions.*

(i) an interest in **reversion or remainder**;

*This means the residue of trust property which either reverts to the original owner (a reversion), or passes to someone other than the original owner (a remainder), after the determination of some particular estate (typically an interest in possession such as a life interest). Strictly, the interests of residual or "fall back" beneficiaries under discretionary trusts are not normally interests in reversion or remainder as the principal discretionary beneficiaries do not commonly have terminable interests in possession. Such residual beneficiaries (typically charities) do not normally disclose any interests, however, not least because they will usually be unaware that they have them.*

(ii) an interest of a **bare trustee**; and

*The Outline of Part XV[2] states that "to be a bare trustee the trustee must have no authority to exercise discretion in dealing in the interest in shares, or in exercising rights attached to the interest, and must deal with the interest solely in accordance with the instructions of the beneficiary. A bare trustee into whose name an absolute owner transfers shares is*

1. SFO section 323(1)(a).
2. Paragraph 2.12.12.1.

*sometimes called a nominee. [This must be distinguished from the situation where trustees vest shares in a nominee in order to facilitate share dealings. Such a person is in effect an agent of the trustees and must disclose his interest in the shares.] A custodian trustee is not a bare trustee, as he is not a mere name or "dummy" for the trustees or for the beneficiaries." We broadly agree with this, other than the words in square brackets, for which there does not appear to be support in the SFO or the general law. The question of whether a nominee is in such a case a bare trustee or some other form of trustee or an agent must depend on the facts. The fact that it is trustees who have transferred shares to the nominee should not itself be decisive as to whether or not that nominee is a bare trustee.*

*The Outline of Part XV*[3] *also states that the seller of unascertained shares still retains an interest in the shares prior to completion of the sale – he is not a bare trustee for the purchaser. If the purchaser does not pay the purchase price and the sale is not completed, the seller has the right to sell the shares to another person; the seller is not required to deal with the interest solely in accordance with the instructions of the purchaser and therefore cannot be holding the shares as a bare trustee. This should not be taken as implying that a seller of specified shares under an unconditional contract should be treated for these purposes as a bare trustee (and thus technically be required to disclose a cessation of a notifiable interest at the time he becomes a bare trustee, although he could voluntarily continue to disclose that interest). Under general principles, the seller would become a bare trustee for the purchaser following payment of the purchase price in full*[4]*. It is probably appropriate to treat a seller as ceasing to have an interest following receipt of the purchase price (as a result of his becoming a bare trustee), and thus not being required to make any disclosure upon his ceasing to have legal title to the shares upon registration of the transfer.*

*Under general legal principles, a "bare trustee":*

- *is a person who holds property in trust for the absolute benefit and at the absolute disposal of another person who is of full age and* sui juris*;*
- *has himself no present beneficial interest in the trust property;*
- *must have no duties to perform in respect of the relevant property except to convey or transfer it to persons entitled to hold it; however, the statement in the Outline of Part XV quoted above, which appears to allow a nominee to be required to collect dividends and vote or exercise rights attaching to the relevant shares in accordance with the beneficiary's instructions (but not otherwise), overrides this position and should be followed; and*
- *may originally have had duties in respect of the trust property which have since ceased or which have been superseded by a request from the persons entitled to the trust property to convey it to them.*

*The above principles appear to be overridden to a degree by the SFO*[5]*, which provides that a person shall not be considered as not being a bare trustee in respect of any property by reason only that:*

3. ibid.
4. At this point the buyer becomes entitled to direct how the shares are voted: up to then, the seller had that right, so could not have been a bare trustee. See *Musselwhite v CH Musselwhite & Son Ltd. [1962] Ch 964(UK).*
5. Section 323(8).



- *the person for whose benefit the property is held is not absolutely entitled thereto as against the trustee only because he is a minor or is a person under a disability; or*
- *the trustee has the 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.*

(iii) any **discretionary interest** (although a person who is also a director or chief executive would have to disclose such an interest under the Directors' Disclosure Requirements).

(b) An "exempt custodian interest": An interest in shares held by a corporation which carries on a business (this does not have to be the only or main business) of holding securities in custody for another person (whether in trust or by contract) and which has no authority to exercise discretion in dealing in the interest, or in exercising rights (i.e. not just voting rights) attached to the interest[6].

*This will be available to custodians who do not have voting or dealing discretions in respect of the investments of the relevant fund or other owners.*

*The Outline of Part XV*[7] *states that, if a bank retains a discretionary right to set off any other obligations/liabilities of a client against any securities held in custody for that client, the bank will not satisfy the requirement that the corporation "has no authority to exercise discretion in dealing in the interest, or in exercising rights attached to the interest". Similarly, the exemption is not available if a bank retains the discretionary right to take up or retain unclaimed or fractional dividends (cash and/or scrip) (the meaning of this is unclear).*

*Further, custodian agreements may authorise the custodian to sell securities or close out transactions in an emergency; they may also authorise the custodian to realise assets to pay their own fees or debts owned to them or reimburse their expenses. Trust deeds may require trustees to realise trust property on termination. Such provisions will usually preclude the custodian/trustee from relying on this exemption.*

*The Outline of Part XV*[8] *also states that the custodian exemption is not establishing a new wide exemption for custodians. It is intended to parallel the regime for a "bare trustee", simply extending the bare trustee exemption to custodians by contract.*

*This provision does not apply in respect of short positions.*

(c) Certain interests in public collective investment schemes: An interest of a holder, trustee or custodian of what we call a "public collective investment scheme", which is a collective investment scheme authorised under section 104 of the SFO, or a pension scheme or provident fund scheme registered under section 21 or 21A of the Mandatory Provident Fund Schemes Ordinance or a qualified overseas scheme, in shares comprised in the property under that scheme[9].

6. SFO sections 323(1)(b) and (3).
7. Paragraph 2.12.13.2.
8. ibid.
9. SFO section 323(1)(c).

*This exception will not apply to ORSO schemes, pooled institutional arrangements or any other unauthorised schemes. (The reference to "pension scheme or provident fund scheme registered under section 21 or 21A of the MPF Ordinance" is anomalous, as that Ordinance makes no reference to "pension schemes".) It appears that ORSO schemes have been deliberately excluded from this category as they are not available for public subscription, or subject to significant regulatory requirements as to the composition of their assets, and are thus different from the other schemes in this category. Beneficiaries of ORSO schemes are, however, covered by the exemption described at (j)(i) below.*

*Note the significant difficulties with the definition of "qualified overseas scheme" discussed at Chapter A, paragraph 5.11.*

*The definition of "custodian" (but not of "trustee") is subject to the issues described at Chapter F, paragraph 3.3.*

*An interest which would otherwise fall to be disregarded must not be disregarded if the holder, trustee or custodian (as the case may be) is also a manager of the scheme*[10].

*This exemption does not apply, in the context of schemes which are in corporate form (e.g. mutual funds), to the relevant corporate vehicle itself.*

*Where the scheme is not in corporate form, it is necessary that "holder" is taken to mean an investor in or beneficiary of the scheme, in order for this exemption to make sense. This is supported by the Outline of Part XV*[11]*, so far as units in unit trusts are concerned, but the position is otherwise somewhat uncertain.*

*This provision does not apply in respect of short positions.*

(d) Certain charitable interests and interests of judicial officers on decease: An interest of a person subsisting by virtue of:

(i) a charitable scheme made by order of any court of competent jurisdiction; or

(ii) the vesting of a deceased's estate in any judicial officer between the time of death of the deceased and the grant of letters of administration[12].

(e) Life interests: An interest for the life of himself, or of another, of a person under a settlement the property comprised in which consists of or includes shares, where the following conditions are satisfied:

(i) the settlement is irrevocable; and

(ii) the settlor has no interest in any income arising under, or property comprised in, the settlement[13].

10. SFO section 323(4).
11. Paragraph 2.12.19.
12. SFO section 323(1)(d).
13. SFO section 323(1)(e).



(f) An "exempt security interest": An interest in shares which is held by a qualified lender by way of security only for the purposes of a transaction entered into in the ordinary course of business as such a qualified lender[14].

*See Chapter A, paragraph 5.10, for a discussion of the definition of "qualified lender".*

*This exemption appears to apply in respect of security interests in equity derivatives, but does not apply in respect of short positions.*

*An interest in shares ceases to be an exempt security interest and the qualified lender holding the interest in the shares by way of security (the **"lender"**) will be taken to have acquired that interest for the purposes of the Substantial Shareholder Disclosure Requirements, when:*

*(i) the lender:*

- *becomes entitled to exercise voting rights in respect of the interest in the shares held as security as a result of, or following, a default by the person giving the interest in the shares as security; and*
- *has evidenced an intention to exercise the voting rights or control their exercise, or taken any step to exercise the voting rights or control their exercise; or*

*(ii) the power of sale in respect of the interest in the shares held as security becomes exercisable, and the lender or its agent offers the interest in the shares held as security, or any part of that interest, for sale*[15].

*This provision needs to be monitored carefully in the event of a possible default, enforcement or restructuring of secured indebtedness.*

*This exemption will not apply to arrangements where the lender acquires title to (and the unfettered right to deal with) shares, as opposed to a limited security interest, for instance pursuant to security structured as a securities lending and borrowing arrangement*[16].

*Issues can arise for a trustee who holds the shares as security trustee for a group of lenders. Depending on the circumstances, and in particular the identity and business of the trustee (and whether the transaction can be said to be entered into in the ordinary course of its business as a "qualified lender"), the trustee may not be able to take advantage of this exemption and thus, unless any other "disregard" is available, it would have an interest in the relevant shares.*

(g) Recognised clearing house: An interest in shares of HKSCC, HKFE Clearing Corporation Limited and The SEHK Options Clearing House Limited as recognised clearing houses[17].

*This provision does not apply in respect of short positions.*

14. SFO sections 323(1)(f) and (6).
15. SFO section 323(7).
16. See Outline of Part XV paragraph 2.12.16.6.
17. SFO section 323(1)(g), Schedule 1, Part 1, paragraph 1 and Schedule 10, paragraph 6.

### 3.3 Knowledge of companies

Whether a matter is know to a company can often be in issue. What counts as the knowledge of a company is a complicated area of law detailed discussion of which is beyond the scope of this book. However, it is worth mentioning here the UK Privy Council case of *Meridian Global Fund Management Asia Ltd. v Securities Commission*[21], which laid the foundations for a move away from looking for one central directing mind and will for all purpose toward identifying the person whose acts may be regarded as constituting the acts of the company for a particular purpose. In this case, which related to a failure to make disclosure under New Zealand disclosure laws, the knowledge of an investment management company's chief investment officer (who acquired an interest with the authority of the company) was deemed to count as the knowledge of that company for the relevant purposes.

21. *[1995] TLR 372 (UK).*



# H. Information to be Disclosed – Disclosure Forms

## 1. Sources of requirements about information to be disclosed

Part XV specifies the detailed information which must be disclosed when a disclosure obligation arises, as described below. Further, such other information as may be required in the disclosure forms must be disclosed[1], and this effectively incorporates the extensive requirements in the disclosure forms into the SFO and makes failure to comply with these requirements a criminal offence. The Outline of Part XV modifies and supplements the requirements in Part XV and the disclosure forms, as described below.

## 2. The disclosure forms and codes; complexity and opacity

Various disclosure forms have been specified for use when making disclosure. Credit is due for the endeavours which have gone into attempting to make the disclosure forms as clear and user-friendly as possible.

The disclosure forms are revised from time to time. See 3.14 below for information on how to obtain the current versions of the forms.

Use of the disclosure forms is compulsory, and the forms are not allowed to be modified or adapted[2]. There is no provision for explanatory notes, which are discouraged[3]. It is possible to add explanations of complex disclosures on the continuation sheets provided for in the disclosure forms, although the disclosure forms discourage even that[4], and it should be done so as to leave the disclosure form unmodified. As the Stock Exchange's technology does not currently enable such information to be displayed electronically, this would have limited value (other than to make any imputation of misleading disclosure harder to sustain). (A notification which deviates from the specified form will not, however, cease to be regarded as being in that specified form if the deviation does not affect the substance of the form[5].) Given the complexity of the disclosures required under the SFO, this can be problematic. One of the world's most complicated disclosure regimes has been created, but form has been given priority over substance in the actual disclosure

1. SFO sections 326(1)(k) and 349(1)(m).
2. SFO sections 324(6)(a) and 347(6)(a) and Outline of Part XV paragraph 4.3.1.
3. See Outline of Part XV paragraph 4.3.1.
4. See, for instance, the note on Box 25 to Form 1.
5. SFO sections 324(7) and 347(7).

process, so that the fundamental goal of clear, meaningful disclosure has not necessarily been achieved. This is to an extent an understandable consequence of the dictates of the e-world and a desire to ensure that information is capable of being processed and disclosed electronically in a standard format with which users can become familiar. Nonetheless, it is regrettable.

In order to be treated as having complied with applicable disclosure obligations, the form must be completed, signed, executed and authenticated (and accompanied by specified documents, which will include copies of section 317 agreements) in accordance with the instructions in the form[6]. The forms do not in fact currently require to be signed.

Given that non-compliance is a criminal offence, the complexity and detail of the disclosure obligations and forms should rightly be a matter of concern for people on whom duties of disclosure may fall.

Separate forms must be used for disclosure of substantial shareholders' and directors' and chief executives' interests, for directors' and chief executives' interests in shares or

**Disclosure forms**

***Substantial shareholders***

Form 1 Notification by an individual with an interest in 5% or more of the relevant share capital of a Hong Kong listed company (who is not a director or chief executive of the listed company).

Form 2 Notification by a company with an interest in 5% or more of the relevant share capital of a Hong Kong listed company.

***Directors and chief executives***

Form 3A Notification in respect of shares of the listed company of which a person is a director or chief executive.

Form 3B Notification in respect of shares of any associated corporation of the listed company of which a person is a director or chief executive.

Form 3C Notification in respect of debentures of the listed company of which a person is a director or chief executive.

Form 3D Notification in respect of debentures of any associated corporation of the listed company of which a person is a director or chief executive.

6. Sections 324(6) and 347(6).



debentures in the listed company or its different associated corporations and in all cases for different classes of shares and debentures. The various disclosure forms are as follows:

A director or chief executive who is also a substantial shareholder is required to use Form 3A only in respect of all his interests in the listed company[7]. While this is intended to reduce duplication, problems can arise in that the interests which are disclosable (and the information to be disclosed) can be different as between substantial shareholders and directors/chief executives. An example of this is discretionary interests under trusts, which are disclosable under the Directors' Disclosure Requirements but not under the Substantial Shareholder Disclosure Requirements. Form 3A does not really cater for these sorts of complexities.

With the exception of some points of particular interest, this book does not examine the detailed contents of the disclosure forms, which generally explain or supplement the requirements of Part XV.

The notes to the disclosure forms should be read and complied with carefully in all cases. The Outline of Part XV contains a lot of helpful information on the detail of the forms and how to make disclosure.

For ease and consistency of use, the disclosure forms specify various codes to describe certain types of information, such as the event giving rise to the disclosure and the capacity in which an interest is held. The Outline of Part XV and the disclosure forms contain information about these codes and their uses[8]. These codes can be problematic, in that the range of codes available can be inapplicable to particular circumstances. Because use of the codes is compulsory, there is no choice but to opt for the nearest approximation or use codes such as "117-Miscellaneous-other" to describe a relevant event for which there is not an applicable code.

## 3. General points about making disclosure, the information to be disclosed and calculations

### 3.1 No netting off of long and short positions: different timing for disclosures of purchases and sales

Short positions must not be set off against long positions in calculating the number of shares in which a person is interested. If a person has bought and sold shares on the same day:

- he will not normally come to have and cease to have interests in the respective shares on that date (except in the case of unusual off-market transactions which are settled on the same date as signing); and

7. Outline of Part XV paragraph 4.5 and disclosure forms.
8. Paragraph 4.7.5.

- the number of shares sold (i.e. his short position) cannot be deducted from the shares bought to determine the number of shares in which that person is interested at the end of that day[9].

The following is an example of the likely disclosure obligations in such a situation.

**Different possible disclosures for a person who buys and sells shares on market on the same date**

**1. Purchase of 10m shares, sale of 10m shares**

He has acquired an interest in the purchased shares which he will have to aggregate with his interest in the shares he has agreed to sell. He may have to make disclosure.

He has a short position in the sold shares, which he may have to disclose. This cannot be set off against his "long" position. (He is not required to disclose the change in the nature of his interests in the sold shares as a result of Exclusions Regulation 5.)

**2. Two business days later – settlement of the purchase and sale**

There is a change in the nature of his interest in the purchased shares, which he may have to disclose (the exemption in section 313(13)(i) appears not to apply in respect of on-market transactions – see Chapter B, paragraph 2.1(b)(iii)(A)).

He has ceased to be interested in, or to have a short position in, the sold shares. He may have to disclose a reduction in his total interests, and the cessation of his short position.

This extends to derivatives transactions: straddles (a combination of put and call options) and squaring transactions (economically identical but opposite transactions) give rise to both long and short positions which are potentially separately disclosable[10]. The same principle applies to single structured derivatives involving a combination of long and short positions, although the Outline of Part XV[11] appears to offer alternative ways of reporting these.

In the case of a director or chief executive, acquisitions and disposals have to be disclosed separately, so, even if he buys shares and sells shares (and completes the sale on the same day), he cannot deduct the number of shares sold from the number of shares bought and report the net amount as a purchase or cessation of interest, as the case may be. He must

9. Outline of Part XV paragraphs 2.6.1 and 3.12.2.
10. Outline of Part XV paragraph 2.6.3.1.
11. Outline of Part XV paragraph 2.6.3.2 (the language here is fairly opaque).



file 2 notices reporting the acquisition and cessation of an interest separately[12].

### 3.2 Different relevant events and different capacities of interest in shares: codes in disclosure forms

**Relevant events**: Only one code from the table of codes in the instructions for completing the relevant disclosure form should be used to describe the relevant event, even if more than one code may apply to the circumstances. The code which best describes the relevant event should be used (if, however, the same event gives rise to both increased levels of interests (or changes in the nature of interests) and short positions, the rows in the relevant disclosure forms relating to both long and short positions may be completed, despite the warning generated in the electronic form)[13]. As a result of inadequacies with the Stock Exchange's technology, however, the short position side of the box describing the relevant event will be blank on the disclosures which are available electronically to the public.

There is some complexity regarding whether one disclosure form can be used, or two should be used, where there is a single event (such as signing one agreement which has several consequences), or two different events on the same day, which give rise to obligations to disclose both changes in the percentage levels of a peron's interest (or short positions) and in the nature of his interest. The wording of the definition of "relevant event" and of the disclosure forms (including the wording described above), appears to require that separate disclosures are made, using separate disclosure forms, of changes in levels of a person's interests and of the nature of his interests, if they are caused by separate events. The position is less clear where one event gives rise to both a change of level, and in the nature, of an interest, as this one event could be said to give rise to different "relevant events" (as defined), and the terminology used becomes somewhat confusing in this context. The better view is, however, probably that the same event (eg. signing an agreement) constitutes one single "relevant event" (even though it has implications under more than one sub-section of the SFO), so one form should be used but the code which best describes the relevant event should be used, as stated above.

**Capacities**: A person can have different capacities of interest (which could also be said to be natures of interest) in respect of different blocks of shares within a holding. In these circumstances, the numbers of the relevant shares, and the capacities in which the interests are held, should be identified separately.

Issues can arise as to the most appropriate way of making disclosure where a person has interests in the same shares in more than one capacity (i.e. of more than one nature). In these circumstances, the code in the disclosure form which best describes the relevant circumstances should be selected and only one such code may be used[14]. The disclosure forms state that if a person is or was the beneficial owner of shares but also holds or held

12. Outline of Part XV paragraph 3.12.3.
13. Outline of Part XV paragraph 4.4.2 and the notes to the disclosure forms.
14. Outline of Part XV paragraphs 2.11.4 and 4.4.3. While paragraph 3.14 does not (in the context of the Directors' Disclosure Requirements) include the equivalent to paragraph 2.11.4, the intention must be that the same principle should apply in all cases.