



# Takeovers Bulletin

## Highlights

- Application of Rule 35.4 on EPTs
- Preservation of confidentiality
- Public censure of Fu Kwan for breaches of dealing restrictions
- Public criticism of CICC Financial Trading Limited and China International Capital Corporation Limited for dealing disclosure breaches
- New online DoD submission platform
- Quarterly update on the activities of the Takeovers Team

## Restrictions on voting by connected EPTs under Rule 35.4 of the Takeovers Code

Rule 35.4 of the Takeovers Code provides that *"[s]ecurities owned by an exempt principal trader connected with an offeror or the offeree company must not be voted in the context of an offer."*

In a recent privatisation by way of a scheme of arrangement, the Executive was consulted on whether the voting rights attached to shares held by certain connected exempt principal traders (EPTs) in their capacities as custodians for and on behalf of non-discretionary clients could be exercised at the relevant court meeting. The EPTs also confirmed that they had no voting discretion over the shares in question.

The starting point under Rule 35.4 is that the securities owned by a connected EPT must not be voted in the context of an offer.

The Executive recognises that there are circumstances in which the Executive may, on a case-by-case basis, regard Rule 35.4 as not applicable to the voting rights held by a connected EPT where:

- (1) the connected EPT holds the shares (the Relevant Shares) as a simple custodian for and on behalf of non-discretionary clients; and
- (2) there are contractual arrangements in place between the connected EPT and its clients that strictly prohibit the EPT from exercising any voting discretion over the Relevant Shares. All voting instructions shall originate from the client only, and if no instructions are given, then no votes shall be cast for the Relevant Shares held by the connected EPT.

In situations described above but subject to the caveat below, the Executive would normally consider that Rule 35.4 would not apply to the Relevant Shares.

In the privatisation case mentioned above, the connected EPT in question held Relevant Shares as a simple custodian for and on behalf of non-discretionary clients and over which that EPT did not have any voting discretion. During the course of consultation with the Executive, that EPT failed to disclose that some of its underlying clients were in fact concert parties of the offeror and were not entitled to vote on certain resolutions (as the shares attributable to the concert parties of the offeror would not be counted as disinterested shares under Rule 2.10 of the Takeovers Code). The concert party relationships of those underlying clients were only identified and disclosed after further enquiries by the Executive.

Where a connected EPT seeks the Executive's confirmation that Rule 35.4 does not apply in the circumstances described above, the connected EPT should demonstrate to the Executive's satisfaction that it had conducted reasonable due diligence and made appropriate enquiries with its underlying clients on whose behalf it holds the Relevant Shares and confirm that the underlying clients are entitled to vote in the context of the offer in question.

### Confirmations required

Going forward, in cases where a connected EPT acts as a simple custodian for and on behalf of non-discretionary clients and that EPT considers that Rule 35.4 does not apply to shares held for and on behalf of such non-discretionary clients, the Executive will require the connected EPT to provide a written confirmation to the Executive of the matters set out in points (1) and (2) above and whether the underlying clients are entitled to vote in the context of the offer. The EPT should also confirm in the results announcement published after the relevant meeting that the connected EPT did not exercise the voting rights attached to the shares owned by them (other than those shares held by such EPT as a simple custodian for and on behalf of non-discretionary clients who are entitled to vote in the context of the offer and over which such EPT has no voting discretion) in the context of the offer.

Parties or their advisers are encouraged to consult the Executive at the earliest opportunity if any of the above arrangements are being contemplated.

Pursuant to Paragraph 7.3 of Practice Note 9, where a client of a group's corporate finance department is involved in an offer or a whitewash transaction, the Executive requires the group to submit details of the group's aggregate holdings of relevant securities of the offeree company and, in the case of a securities exchange offer, the offeror, as at the close of business on the day the offer period commences or the whitewash transaction is announced. In addition to its long and short positions of relevant securities, details of relevant securities held by EPTs as a simple custodian for and on behalf of non-discretionary clients and over which the EPTs have no voting discretion should also be included when such arrangement exists. The submission should be made by 5:00pm on the day after the offer period commences or the whitewash transaction is announced. In cases of difficulty, the Executive should be consulted.

Amendments to paragraph 7.3 will be made in the next published version of Practice Note 9.

### Preservation of confidentiality and taking reasonable precautions

The Executive has noted that in a small number of recent cases, inside information relating to the possibility of a Code transaction might have been leaked to the media. In particular, press articles indicated that information was obtained from "*sources familiar with the transaction*". In view of this, we would like to remind parties and their advisers once again of the importance of preserving confidentiality prior to a firm intention announcement.

Rule 1.4 of the Takeovers Code sets out the confidentiality obligation of parties to a transaction. The parties (including advisers) must take all necessary steps to ensure there is no leakage of information prior to the announcement of a firm intention to make an offer. This is particularly important when parties are only in negotiations and the relevant transaction may or may not materialise. It follows that as long as all parties keep matters confidential and that all applicable regulatory requirements are met, there should not be a need to issue a “talks” announcement under Rule 3.7 of the Takeovers Code. It would be undesirable to commence an offer period for an offeree company when discussions are only preliminary – parties will also be subject to the restrictions and compliance obligations under the Takeovers Code that take effect upon commencement of an offer period. The market price of the offeree company’s securities may also be affected by the publication of a talks announcement. Similarly, the execution of a non-legally binding memorandum of understanding, in itself, does not justify the publication of an announcement under Rule 3.7 of the Takeovers Code.

In a recent decision by the Market Misconduct Tribunal (MMT) on Magic Holdings International Limited, the MMT considered whether there was a breach of the requirements under Part XIVA of the Securities and Futures Ordinance arising from L’Oreal S.A.’s proposed acquisition of Magic in 2013. The MMT examined the conduct of Magic’s officers as well as Magic’s internal systems and policies against the SFC’s Guidelines on Disclosure of Inside Information. For example, whether Magic had any established controls to identify potential inside information, audit trails of meetings and discussions concerning the assessment of inside information, training for employees in the corporation’s policies and procedures, disclosure duties and obligations, etc. We believe that the MMT’s decision provides useful and practical guidance for parties and their advisers on the reasonable precautions that they are expected to take in preserving the confidentiality of any inside information at the outset of a Code-related transaction. These would help

avoid the need to issue any announcements when discussions are still preliminary or ongoing.

However, if the obligation to make an announcement under Rule 3.7 of the Takeovers Code does arise, we would normally expect such announcement to be relatively short and to disclose no more than the fact that talks are taking place. Parties should note that trading halts and the issuance of a Rule 3.7 announcement should not be used to mitigate the risk of a leakage or as a matter of convenience, especially when there has been no leakage in the first place. The Executive may in appropriate cases conduct an investigation or take disciplinary action where there is a leakage of information.

### Public censure of Fu Kwan for breaches of dealing restrictions

On 11 June 2020, we publicly censured Fu Kwan, the chairman of Macrolink Capital Holdings Limited, for acquiring the company’s shares within six months after the close of an offer at above the offer price in breach of Rule 31.3 of the Takeovers Code.

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

A copy of the Executive Statement can be found in the “*Listings & takeovers – Takeovers & mergers – Decisions & statements – Executive decisions and statements*” section of the SFC website.

## Public criticism of CICC Financial Trading Limited and China International Capital Corporation Limited for dealing disclosure breaches

On 18 June 2020, we publicly criticised CICC Financial Trading Limited and China International Capital Corporation Limited for breaching the dealing disclosure requirements under Rule 22 of the Takeovers Code.

A copy of the Executive Statement can be found in the "*Listings & takeovers – Takeovers & Mergers – Decisions & statements – Executive decisions and statements*" section of the SFC website.

The disclosure obligations under Rule 22 of the Takeovers Code are intentionally onerous to reflect the fact that a high degree of transparency is essential to the efficient functioning of the market in an offeree company's shares, and in the case of a securities exchange offer, an offeror company's shares as well, during the critical period of an offer or possible offer. Timely and accurate disclosure of information in relation to dealings by an offeree company's or an offeror company's associates including EPTs plays a fundamental role in ensuring that takeovers are conducted within an orderly framework and that the integrity of the markets is maintained. Parties who wish to take advantage of the securities markets in Hong Kong should conduct themselves in matters relating to takeovers, mergers and share buy-backs in accordance with the Codes. In case of doubt as to the application of Rule 22, the Executive should be consulted.

## New online platform for submission of Documents on Display

Currently, documents required to be put on display (DoD) under Note 1 to Rule 8 of the Takeovers Code are submitted to the Executive in electronic form using a recordable CD or DVD. The Executive will then arrange for publication on the SFC's website.

To streamline the DoD submission process and increase efficiency, we will be moving it to the SFC's WINGS (Web-based INteGrated Service) portal. The procedure to prepare all documents in PDF format and the preparation of the DoD Submission Form remain largely the same, but these documents are no longer required to be copied to a CD or DVD for submission. These documents will be submitted online via WINGS instead. We target to commence the new procedure in August 2020.

## Quarterly update on the activities of the Takeovers Team

In the three months ended 31 March 2020, we received 16 takeovers-related cases (including privatisations, voluntary and mandatory general offers and off-market and general-offer share buy-backs), two whitewashes and 65 ruling applications.

### Useful links

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

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

Feedback and comments are welcome and can be sent to [takeoversbulletin@sfc.hk](mailto:takeoversbulletin@sfc.hk).

If you want to receive the *Takeovers Bulletin* by email, simply click Subscribe at [www.sfc.hk](http://www.sfc.hk) and select Takeovers Bulletin.

Securities and Futures Commission  
35/F, Cheung Kong Center  
2 Queen's Road Central  
Hong Kong

(852) 2231 1222  
[enquiry@sfc.hk](mailto:enquiry@sfc.hk)  
[www.sfc.hk](http://www.sfc.hk)