



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

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

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EXECUTIVE SUMMARY

Introduction

On 20 January 2005 the Securities and Futures Commission (the “*SFC*”) published a Consultation Paper on the Review of the Disclosure of Interests Regime under Part XV of the Securities and Futures Ordinance (the “*Consultation Paper*”). The Consultation Paper asked for views of the public on proposals and issues identified in an earlier “soft” consultation. The consultation period ended on 28 February 2005.

To date we have received a total of 34 responses to the Consultation Paper, with one supplemental set of comments from one respondent. Out of the 34 responses, five submissions are the same comments from the same group of companies and two industry groups have identical comments. 11 investment banks submitted one consolidated response through a law firm. For the purposes of this paper, the five submissions made by the same group of companies will be counted as one. Accordingly the total number of responses will be taken to be 30. This Paper summarises the responses.

Except for one area, the Paper sets out our final proposals and our rationale. The one particular area relates to the disclosure of security interests, and further discussions will be necessary before making a final policy decision.

This Executive Summary provides an overview of the policy conclusions reached, and our approach in formulating such conclusions.

Objective of the Review

The primary objective of our review of the Part XV regime (the “*Review*”) is to address concerns raised by market participants and the public. We have made our final policy conclusions keeping in mind the importance of -

- balancing the need to remove unnecessary and unduly burdensome requirements while preserving transparency in the market; and
- keeping Part XV in line with developments of the Hong Kong securities market.

Consultation Conclusions

The Consultation Paper invited the public to comment on certain specific issues raised, and on Part XV generally. The SFC has re-examined these issues.

With the benefit of comments expressed, the SFC has reached the following principal conclusions -

A. Principal issues for further consultation

Section 1 of the Consultation Paper

Section 1 Forms and Codes

A significant proposal in the Consultation Paper was to add more codes for filling in forms, an optional narrative box, and “D” to denote derivatives in front of standard codes. This is with the intention of making filings easier and notifications clearer. We sought views on what other codes or changes to the forms the public may consider useful.

***Final proposal:** Respondents generally support the proposal for more codes. Although there are mixed views on the narrative box, the box will be introduced as an optional feature for those who wish to use it. Accordingly we will add more codes and an optional narrative box as originally proposed.*

However some commentators consider that the use of the letter “D” to denote derivatives in front of standard codes would be confusing. Certain transactions may not be primarily an “equity derivative” as the market would know them. Accordingly we will not implement the proposal for the use of “D” for derivatives. Instead, we propose that the letter “C” be used for complex transactions. The narrative box may be used to better explain the nature of the complex transaction in question. We will continue the dialogue with market participants to fine-tune this proposal.

Sections 2.1 to 2.7 of the Consultation Paper

Section 2.1 Security interests given by substantial shareholders

We sought views on whether the exemption for security interests should be removed or narrowed either in relation to qualified lenders or substantial shareholders and if so, how. We also sought views on a proposal, which would entail accelerating the time frame within which disclosures will be made once steps are taken to enforce the security interests.

***Further consideration necessary:** 21 out of 24 respondents who commented on the question of whether the exempt security interests provision should be removed or narrowed oppose the disclosure of share pledges by substantial shareholders. However there have also been several comments in the press supporting disclosures of share pledges by substantial shareholders. There is also general opposition to any change to the current exempt security interest provision. On the proposal to accelerate disclosures of impending forced sales, many commentators consider that this would cause practical difficulties and do not support it.*

Some respondents also point out that there may be potential damaging consequences if a fundamentally new approach were to be adopted without thorough consideration of its implications.

Accordingly we propose setting up a working group with market participants, investors and the lending industry to consider if there are better alternatives that would be beneficial to all. Until we have discussed the matter further with the industry, we do not propose at this stage to recommend changes in this area. We explain this further on pages 11 to 12 below.

Section 2.2 Disclosure thresholds and *de minimis* exception

We sought views on whether we should simplify the *de minimis* exception as proposed (“Alternative 1”) on the basis of the existing disclosure regime or change the trigger for disclosure from crossing a percentage level to a regime based on disclosures triggered by a specified actual percentage change, e.g. 0.5% or 1% (“Alternative 2”).

Final proposal: *Several commentators prefer Alternative 2 because of its simplicity. However, the majority of those who express a view prefer Alternative 1. Among other reasons, the commentators prefer Alternative 1 because they had spent time, costs and resources setting up a system based on the existing regime. They also object to Alternative 2, which would entail a fundamental change to the existing disclosure of interests regime. Having regard to the comments received, we consider that a simplification of the current *de minimis* exemption along the lines of Alternative 1 should be adopted.*

Section 2.3 Aggregation exemption

We sought views on whether the aggregation exemption should be extended to cover certain practices of qualified investment managers, and the circumstance where an entity carries out more than one business activity but with investment management behind Chinese walls. We also asked if the exemption would be useful in practice, given that it will not apply with respect to investment managers who are not in jurisdictions approved by the SFC.

Final proposal: *Most commentators support the proposal and consider it useful, even if it is not extended to investment managers in non-approved jurisdictions. Accordingly we propose to recommend that the law be changed as originally proposed.*

Several commentators ask that the exemption be extended to investment managers in non-approved jurisdictions. We consider it important that the SFC should be in a position to readily obtain material information from the jurisdictions in which the investment managers run their business. We expect that more jurisdictions will also sign the relevant International Organization of Securities Commissions (IOSCO) memorandum of understanding that would allow the SFC to be in a position to recognize them as approved jurisdictions. We will work with market participants to consider what alternatives may be available.

Section 2.4 Stock borrowing and lending

We sought views on whether the “Authorized Lending Agent” regime should be expanded to cover certain activities which are currently not possible within the simplified stock borrowing and lending regime.

***Final proposal:** 11 investment banks reverted with views that the regime should be expanded. Two other commentators note that they have no objections to changes. One commentator considers that no change is necessary, and two more consider that there should be a level playing field and there should be full disclosure of stock borrowing and lending activities. The original request for expansion of the regime was made by the Pan Asia Securities Lending Association, which represents the stock borrowing and lending industry in Asia. As the 11 investment banks are parties who would be most affected by changes support them, we propose to proceed with appropriate changes.*

Section 2.5 Credit derivatives

We sought views on whether we should exempt credit derivatives with convertible or exchangeable bonds as the reference security, or whether we should add a new code in forms for disclosure.

***Final proposal:** A significant number of commentators consider that credit derivatives with convertible or exchangeable bonds as the reference security should be exempted from disclosures. We propose to recommend that the law be amended to exempt credit derivatives. This will be subject to the condition that the value of the credit derivative is determined by reference to the creditworthiness in relation to the issuer of the reference security without any regard to the equity conversion or exchange value of the reference security.*

Section 2.6 Index-linked equity instruments

We sought views on whether the proposed change on the “basket” exemption should be expanded to cover instruments linked to indices other than Hang Seng Index.

***Final proposal:** Commentators support the proposal for amending the law so that the “basket” exemption once again covers the Hang Seng Index. One respondent suggests that the exemption be expanded to all Hang Seng Category Indices. 11 respondents suggest that this should be expanded to cover all baskets having HSBC as a constituent. We believe this may go too far. Accordingly we will recommend that the law be changed as originally proposed. We do not propose at this stage to expand the exemption to cover other indices.*

Section 2.7 Change in nature of interest

We sought views on the list of situations that should be caught as a change in nature of interest.

Final proposal: Many commentators welcome the proposal to exhaustively list the situations that will be caught as a change in nature of interest. We will recommend the amendment of the law accordingly, and take into account the views of the commentators on the details. This is described in further detail on pages 17 to 19 below.

B. Matters involving amendments to the law

Sections 3.1 to 3.10 of the Consultation Paper

A few comments were raised on certain aspects of the proposals to amend the law. However there is general support for all of these proposals. Our responses to specific comments raised are set out on pages 19 to 27 below.

Final proposal: Having considered public comments, we propose to recommend the original proposals for amendments to the law without major changes.

C. Matters for further clarification in the Outline

Sections 4.1 to 4.10 of the Consultation Paper

Generally the public welcomes our proposals to clarify the Outline of Part XV of the Securities and Futures Ordinance (Cap.571) - Disclosures of Interests (the “**Outline**”). Some areas received more attention than the others. Our responses to specific comments raised are set out on pages 27 to 33 below.

Final proposal: We will amend the Outline after taking into account comments received. Further discussions with the market to clarify the comments will be held as and when needed. We intend to regularly update the Outline to incorporate clarification of our views on matters as they develop. However, for practical reasons, we are not in a position to provide ad hoc guidance on queries raised on Part XV.

D. Other comments and SFC’s responses

Sections 5.1 to 5.10 of the Consultation Paper

The Consultation Paper included responses to certain matters raised during the soft consultation, and our responses to those matters. Some comments were received and they are set out on pages 33 to 37 below. *We intend to clarify some of the matters raised in the Outline.*

Apart from the matters raised in the Consultation Paper, the public has commented on certain other aspects of Part XV. The principal comments and our responses are also summarised in this Paper (pages 38 to 40).

E. General Matters

The SFC is working with the Administration towards enacting relevant amendments to the Securities and Futures Ordinance (the “*Ordinance*”) and related subsidiary legislation in the 2004-2005 legislative session.

The SFC wishes to thank the public for providing its views in relation to the review of Part XV.

Note:

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

INTRODUCTION

The SFC issued a Consultation Paper on the Review of the Disclosure of Interests Regime under Part XV of the Securities and Futures Ordinance (the “*Consultation Paper*”) on 20 January 2005. It consulted the public on several principal issues regarding the disclosure of interests regime of Hong Kong, contained some proposals to amend the Ordinance, and set out certain areas for further clarification through the “Outline of Part XV of the Securities and Futures Ordinance (Cap. 571) - Disclosure of Interests” (the “*Outline*”). The Paper also provided responses to certain comments in respect of which no further action is considered necessary.

The consultation period ended on 28 February 2005.

To date the SFC has received 34 written responses in total with one supplemental set of comments from one respondent. Out of the 34 responses, five submissions are the same comments from the same group of companies and two industry groups have identical comments. 11 investment banks submitted a consolidated response through a law firm. For the purposes of this paper, the five submissions made by the same group of companies will be counted as one. Accordingly the total number of responses will be taken to be 30. *Appendix 1* contains brief descriptions of the respondents and a summary of the responses received.

Most comments were made on specific proposals put forward in the Consultation Paper, or other issues raised in the Consultation Paper. The final proposals set out in this paper have been adopted and endorsed by the Securities and Futures Commission (the “*SFC*”).

Except for one area, the Paper sets out our final proposals and our rationale. The one particular area relates to the disclosure of security interests, and further discussions will be necessary before making a final policy decision.

The following consultation conclusions should be read in conjunction with the Consultation Paper. For ease of reference, section numbers in this paper correspond with the section numbers on the same subject in the Consultation Paper.

GENERAL POLICY CONSIDERATIONS

Objectives of the Disclosure Regime and our Final Proposals

The SFC notes that one respondent suggests that the objective of the regime should be reconsidered and limited to avoidance of insider dealing, as in the United States.

We discussed the objectives of the regime extensively in the Consultation Conclusions on the Proposed Amendments to The Securities (Disclosure of Interests) Ordinance (March 1999). The final decision was that the overriding objective of the Securities and Futures Ordinance (the “*Ordinance*”) is to provide investors with more detailed and better quality information to enable them to make investment decisions.

In particular, the Ordinance should provide a disclosure regime which would (i) enable investors to identify persons who control (or are in a position to control) interests in listed shares (ii) meet international and regional standards (iii) not be difficult to comply with in practice.

On the whole, commentators have generally welcomed the transparency that Part XV has brought about, and consider that our policy objectives have been met. To change the fundamental objective of the Ordinance at this stage would now be counter-productive and confusing. Accordingly, we continue to adhere to the original policy objectives of the disclosure regime and our final policy decisions in this Paper are made with these underlying objectives in mind.

Objectives of the Review

In the Consultation Paper, the SFC identified main objectives of our review, i.e. to address the issues and concerns raised by market participants on the disclosure regime. In deciding the final proposals, we have kept in mind the importance of -

- balancing the need to remove unnecessary and unduly burdensome requirements while preserving transparency in the market; and
- keeping Part XV in line with developments of the Hong Kong securities market.

CONSULTATION AREAS

This section summarises public comments received on certain matters raised in the Consultation Paper. It also sets out our final recommendations for amendments to the regime, taking into account public views.

In this section, references to the “*proposed changes*” mean the changes to the regime as proposed in the Consultation Paper. References to the “*final proposals*” mean the SFC’s final decision on proposals to change the regime.

The principal objective of the following sections is to enable the public to understand the SFC’s policy considerations in formulating the final proposals. Descriptions of the final proposals may be broad and conceptual. Technical issues will be fine-tuned in draft legislation or in the Outline as the case may be.

A. Principal Issues for Further Consultation

Section 1. Forms and Codes

The Proposed Changes

The Consultation Paper proposed the following changes in respect of forms, and the codes to fill in the forms -

- (i) to add more codes for filling in forms,
- (ii) a narrative box, and
- (iii) “D” to denote derivatives in front of standard codes.

This is to make filing disclosure easier and notifications clearer. The Consultation Paper also sought the views on other codes and changes to the forms, which the public may consider useful.

Public Comments

Seven commentators support the proposed changes for additional codes, and four commentators expressly support the optional narrative box. One commentator suggests reverting to a narrative box system, or, assuming the code system, allowing a box to cater for more than one code. 11 investment banks disagree with the addition of more new codes, except for an error code. They also disagree that the optional narrative box will be helpful for investors, issuers or those making the disclosures. It suggests that the SFC should instead give more clarification as to the use of existing codes so as to increase the level and accuracy of the disclosure made in relation to the existing codes.

There are some reservations, in particular in respect of transactions involving derivatives. 13 commentators disagree with the use of the letter “D” to denote transactions involving derivatives. This was on the basis that it might be confusing to the market. For example, possible confusion might arise if transactions that are not

primarily equity derivatives (as the market would know them) are denoted with “D” for disclosure purposes.

Respondents (who generally support the proposed changes) have the following further comments and suggestions –

- (i) Respondents ask for clarification as to whether the notice to be filed to correct an error should include all previous information filed or only in relation to the error made in the previous notice.
- (ii) In relation to Table 2 (capacity in Forms 1, 2, 3A and 3B), respondents suggest that this code should state whether the underwriter’s interest in the listed corporation is directly or indirectly (such as through its subsidiaries) held by it.
- (iii) In relation to proposed codes relating to Table 2 (event or change in Forms 3C and 3D) respondents ask that the words “deriving from the debentures” should be added after the words “including derivatives” for Forms 3C and 3D.

The Final Proposals

In view of public comments -

- (i) We propose to make changes to provide additional codes including the error code.
- (ii) Although 11 respondents disagree with the proposal to add a narrative box, we propose to go ahead with the box as originally proposed. The narrative box is an optional feature and we believe we should make it available to those who wish to use it.
- (iii) However we will not implement the proposal to use “D” to denote derivatives. Instead, we propose that the letter “C” be used for complex transactions. The narrative box may be used to better explain the nature of the transaction in question.

We will continue the dialogue with market participants to fine-tune this proposal.

In response to specific public comments or suggestions -

- (i) We would clarify that the notice to be filed to correct an error should include information normally required in a notification so as to provide an accurate and complete representation of the position at the time of the previous notice.
- (ii) We note the comments in respect of Table 2 and underwriters. We will consider the suggestion further, but we also note such a requirement to distinguish direct interests from indirect interests would have to apply to interests held in all capacities and not limited to underwriters only.

- (iii) In Table 2 (Forms 3C and 3D), we will add the words “deriving from the debentures” as suggested.

Section 2.1 Security interests given by substantial shareholders

The Proposed Changes

The Consultation Paper sought views on -

- (i) whether the exemption for security interests should be removed or narrowed in relation to qualified lenders or substantial shareholders;
- (ii) views on the SFC’s proposal as a possible way forward i.e. the proposal that there should be disclosure obligations on substantial shareholders and lenders, such that information about impending forced sales will be disseminated as soon as possible. This would mean that market would come to know about impending forced sales immediately, instead of three (3) business days later, as is currently the case.

Public Comments

There were mixed responses on this issue.

- (i) 21 out of 24 respondents who have commented on the question of whether the exempt security interests provision should be removed or narrowed object to changes to the exempt security interests provision. The three who support changes support disclosures by substantial shareholders when their shares are pledged.
- (ii) Comments in the press support disclosures by substantial shareholders when a security interest is given.
- (iii) On the proposal to accelerate disclosures of impending forced sales, many commentators consider that this would cause practical difficulties and do not support it. Some consider that such disclosures would not materially improve transparency. There are also concerns that an immediate disclosure may cause market panic and accelerate fall in market price.

Some respondents point out that there may be potential damaging consequences if a fundamentally new approach were to be adopted without thorough consideration of its implications.

We set out in *Appendix 2*, tables summarising the pros and cons of four possible ways of addressing the issue, which include the arguments received for or against disclosure.

Further consideration necessary

In view of the lack of consensus on resolving this issue among the various interest groups, the practical considerations which need to be addressed in respect of all

possible solutions and the tight time frame for introducing amendments to the Ordinance in the 2004/2005 legislative session, we do not recommend including any final proposals to change the exempt security interest provision (apart from the technical amendments in section 3.5 below) in this round of proposed amendments to the law.

We propose setting up a working group with market participants, investors and the lending industry to consider if there are better alternatives that would be beneficial to all. This would also allow us more time to reach consensus and make a thoroughly considered decision.

Section 2.2 Disclosure thresholds and *de minimis* exception

The Proposed Changes

The Consultation Paper sought views on whether we should -

- (i) simplify the current *de minimis* exception (Alternative 1) on the basis of the existing disclosure regime, or
- (ii) change the entire conceptual approach to disclosure by changing the “trigger” for disclosure obligations to an “actual percentage” movement regime (the “actual percentage change” approach) (Alternative 2).

Public Comments

The public had mixed views on this proposal. Of the comments that we received -

- (i) 14 respondents support Alternative 1 (simplifying the current *de minimis* change exception as proposed), and object to Alternative 2.
- (ii) Six respondents support the actual percentage change approach.

Respondents who agree to Alternative 1

Respondents who agree to the proposed simplification of the exemption do so for the following reasons -

- (i) Time, costs and resources have been spent setting up a system based on the existing regime.
- (ii) Alternative 2 would entail a fundamental change to the existing disclosure of interests regime and would entail additional time, costs and resources to change current systems.
- (iii) Departing from the existing rule that operates by reference to percentage level changes would put Hong Kong out of step with approaches in the UK and Australia.

11 respondents also suggest that the *de minimis* exception should apply at the five percent disclosure threshold.

Respondents who agree to the proposed simplification also support the proposed amendments to “last notification” in this context.

Respondents who agree to Alternative 2

Respondents who support the new approach to replace the exception with the actual percentage change approach do so for the following reasons -

- (i) It would simplify the filing process and would not unduly reduce market transparency. It also simplifies computation with a single and straightforward formula and reduces computation and human error.
- (ii) It is less burdensome for both the substantial shareholders and the market.

On the trigger level, the respondents have the following comments –

- (i) A 1% trigger level would be an appropriate balance, taking into account the compliance burden and usefulness of the information to investors.
- (ii) The trigger level should be meaningful, and be set within the band of 0.5% to 1%.

The Final Proposals

As the majority of those who express a view support Alternative 1, we consider that a simplification of the current *de minimis* exemption along the lines of Alternative 1 should be adopted. We also propose to recommend that the law be amended so that “last notification” is extended as originally proposed in the Consultation Paper.

We will however not recommend the extension of the *de minimis* exception to a five percent threshold, as we regard information about when a person becomes a substantial shareholder or ceases to be a substantial shareholder to be important to the market.

Section 2.3 Aggregation exemption

The Proposed Changes

We sought views on whether the aggregation exemption should be extended on conditions to cover -

- (i) the circumstance where qualified investment managers within a group communicate with each other or share common investment management strategies;
- (ii) the circumstance where a qualified investment manager has different businesses (including investment management) that are carried out by

different divisions within a single legal entity, with strict segregation of the investment management businesses.

We also sought views as to whether the proposed changes would be useful in practice, in view of the fact that the aggregation exemption would not apply in respect of investment management entities in jurisdictions outside the SFC's approved list.

Public Comments

Most commentators support the proposal and consider it useful, even if it is not extended to investment managers in non-approved jurisdictions. Several commentators asked that the exemption be extended with regard to investment managers in non-approved jurisdictions.

Commentators who support the proposed exemptions with the conditions also have the following comments and suggestions –

- (i) The wording of the condition for the extended exemption on page 22 of the Consultation Paper should be amended as follows: That is where investment managers communicate only with each other in relation to investment strategy “and share common strategies on that particular stock”. This is so that there would be no need to aggregate interests of investment managers who communicate with each other unless the investment manager also does not invest independently.
- (ii) There are suggestions that if the aggregation exemption would not extend to investment management entities in jurisdictions outside the SFC's approved list, the holding company should be able to apply for a waiver and the SFC should review if the exemption could be applicable on a case by case basis.

Some commentators have some other technical comments and suggestions regarding the proposed expansion of the exemption.

The Final Proposals

We will recommend that the law be amended as originally proposed.

In response to public comments -

- (i) We are not inclined to recommend the addition of the words “and share common strategies on that particular stock” as part of the condition, since in reality it would be difficult to establish when this does not occur, and we consider the original proposal a simpler approach.
- (ii) On the requests that the exemption be extended to investment managers in non-approved jurisdictions, we consider it important that we should be in a position to readily obtain material information from the jurisdictions in which the investment managers run their business. We expect that more jurisdictions will also sign the relevant International Organization of Securities Commissions (IOSCO) memorandum of understanding that would allow us to

be in a position to recognize them as approved jurisdictions. We will need to work with market participants to consider what alternatives may be available.

- (iii) We also intend to hold further discussions with respondents to address other technical comments raised.

Section 2.4 Stock borrowing and lending

The Proposed Changes

We sought views on whether the “Authorized Lending Agent” regime should be expanded to cover certain activities that are not currently possible within the simplified stock borrowing and lending reporting regime under Part XV.

Public Comments

The original request for expansion of the regime was made by the Pan Asia Securities Lending Association, which represents the stock borrowing and lending industry in Asia. 11 investment banks reverted with views that the regime should be expanded.

Two others have no objections to changes, one considers that no change is necessary, and two more consider that there should be full disclosure of stock borrowing and lending activities. One respondent suggests that the SFC should consider relaxing the criteria for the approval of Authorized Lending Agents, and where possible, change the existing approval process to a registration process. There are also certain other comments relating to the disclosure of interests under the simplified stock borrowing and lending reporting regime.

The Final Proposals

As the 11 investment banks are parties who would be most affected by changes support them, we propose to proceed with the necessary changes.

We would also clarify that in practice the approval process requires the applicant to assert that it complies with the guidelines to secure an approval. Accordingly we do not consider any further relaxation necessary. We propose to further discuss the other comments received with the industry with a view to determining what changes to the regime are necessary and appropriate.

Section 2.5 Credit derivatives

The Proposed Changes

We sought views on whether we should exempt credit derivatives linked to convertible bonds or exchangeable bonds or whether we should add a new code in forms for disclosure. We also sought views from those in favour of the exemption as to how any such exemption should be drafted to ensure that only the appropriate credit derivatives are exempted.

Public Comments

Of the respondents -

- (i) 18 respondents support the exemption. Some of these respondents offered their support to help draft an appropriate exclusion in relation to credit derivatives linked to convertible or exchangeable bonds.
- (ii) One respondent considers that the exemption would be reasonable but does not think it possible to craft an exemption that would meet our objectives and therefore supports a code to indicate such derivatives.
- (iii) Three respondents consider that such credit derivatives should be disclosed.

Final proposals

We will recommend that the law be amended to exempt credit derivatives with convertible bonds or exchangeable bonds as the reference security. This will be - subject to the condition that the value of the credit derivative is determined by reference to the creditworthiness in relation to the issuer of the reference security without any regard to the equity conversion or exchange value of the reference security.

Section 2.6 Index-linked equity instruments

The Proposed Changes

We sought views on whether the proposed change on the “basket” exemption should be expanded to cover instruments linked to indices other than the Hang Seng Index.

Public Comments

Respondents generally support the proposal to amend the law so that the proposed change on the “basket” exemption once again covers the Hang Seng Index. One respondent suggests that it could be appropriate to extend the exemption to the Category Index of the Hang Seng Index. Another 11 respondents suggest that the exemption should be expanded to cover all baskets with HSBC as one of the constituent stocks.

Final Proposals

As proposed in the Consultation Paper, we will recommend that the law be amended so that the law once again exempts the relevant instruments relating to the Hang Seng Index. We do not however propose at this stage to expand the exemption to cover other indices or baskets as suggested, as we believe that the suggestions may have too broad a reach.

Section 2.7 Change in nature of interest

The Proposed Changes

We proposed to exhaustively list the situations that will be caught as a “change in nature” of interest. We sought views as to whether there would be any other situations where a change in nature of a person’s interest in shares should give rise to a disclosure obligation.

Public Comments

Many commentators welcome the proposal to exhaustively list the situations that will be caught as a change in nature of interest. Commentators who support the proposals also have the following comments and ask for clarification in the following areas –

- (i) The proposed changes to “rights ... under an agreement including equity derivatives” giving rise to disclosable circumstances are too wide. This is because the relevant right being exercised may have nothing to do with the equity derivative element, and further, these circumstances do not appear to focus sufficiently on the nature and materiality of the right being exercised (e.g. where equity derivatives documentation requires certain information to be provided, exercise of that right should not give rise to a change in nature disclosure).
- (ii) It is noted that the disclosure on giving of security by substantial shareholders to non-qualified lenders is not included in the proposed list.
- (iii) It is suggested that it would be helpful to clarify how these changes affect attributed interests.
- (iv) On stock borrowing and lending, it is noted that there should be a change in nature when the lender actually receives the shares back, rather than when calls for return of the shares are made or when the lender becomes obliged to take a redelivery of the shares.
- (v) In relation to the “entry into an agreement for the sale of shares” it is noted that -
 - This will at some stage give rise to a short position in any event, so it is duplicative to require a change of interest to be disclosed, so the commentator questions whether this is necessary, and
 - It is suggested that the words “or in which he is interested” be included at the end of the sentence, to cover circumstances such as the beneficial owner contracting to sell shares the legal title to which is held by a nominee.
- (vi) In relation to “taking delivery of shares from another person”, this should be subject to numerous exceptions (e.g. taking delivery as a bare trustee or if his

equitable interest has already been disclosed – subject to concerns about the concept).

One commentator also suggests the following additional circumstances -

- (a) A person should make a disclosure when he comes to be the (or a joint) beneficial owner of shares where he was not one before, or ceases to be such an owner, subject to appropriately worded exclusions.
- (b) A person who already had a disclosable interest should make a disclosure when he comes to have the right to control or direct the exercise of voting rights attaching to shares, subject to appropriate exclusions.

The Final Proposals

We will recommend that the law be amended, taking into account the views of the commentators on the details as follows -

- (i) On equity derivatives, our intention is that the circumstances will be tied to the exercise of rights under equity derivatives to take delivery of shares or to deliver shares, and we will ask that this be reflected in the draft legislation. In addition, in order to cover the delivery of shares, we will recommend that the following additional circumstances be included in the list of circumstances of a change in nature of an interests -
 - Where a person exercises rights under equity derivatives to require another person to take delivery of shares;
 - Where rights under equity derivatives are exercised against a person to require him to deliver shares to another person;
- (ii) Today there is a change in nature of interest on giving of security by substantial shareholders to non-qualified lenders, and when a non-qualified lender takes steps to enforce the security interest. The intention in the Consultation Paper was not to exclude these as circumstances constituting changes in nature of interest. However these were not included in view of our then discussion on disclosure of security interests. In light of the discussion in section 2.1 above, we will recommend that each of the following circumstances will comprise a change in nature of interest -
 - Where a person provides an interest in the shares as security;
 - Where steps are taken against a person to enforce a security interest;
 - Where steps are taken by a person to enforce his security interest in the shares;
- (iii) In relation to attributed interests, we would clarify that the specified changes would be disclosable by the person holding the interest directly, as well as by the other persons to whom that interest is attributable.

- (iv) In relation to stock borrowing and lending, we will recommend that the law be amended to make it clear that there will be a change in nature when the lender actually receives the shares back, rather than when calls for return of the shares are made or when the lender becomes obliged to take a redelivery of the shares. Similarly, there will be a change in nature when the lender delivers the shares to the borrower, rather than when he commits to lend the shares.
- (v) In relation to the “entry into an agreement for the sale of shares” –
 - Our view is that unless the agreement is an equity derivative it does not give rise to a short position.
 - In relation to the words “in which he is interested”, the intention is that the law will cover the concern expressed.
- (vi) In relation “taking delivery of shares from another person”, we do not intend to recommend that the law should include more exceptions than exist today.
- (vii) For directors, we will recommend similar circumstances in relation to change in nature of interests in relation to debentures.

As to the suggestions for additional circumstances that should constitute a “change in nature” of interest, our intention is to limit the circumstances that give rise to disclosure with an exhaustive list. Where there is no disclosure obligation as to the capacity in which the person holds an interest in the first place (e.g. whether he has voting rights or not), we do not intend that there should be a general change in nature disclosure obligation when the nature of the interest changes (e.g. when he comes to have voting rights). Accordingly we do not intend to recommend that such circumstances be included in the list.

B. Matters Involving Amendments to the Law

Section 3.1 Reference dates for filing notices of sales and purchases

The Proposed Changes

The Consultation Paper proposed -

- (i) Synchronizing the dates so that the seller and the purchaser must each make the disclosure by reference to the date he enters into the contract, so long as settlement is to take place within four (4) days.
- (ii) Should the settlement fail to take place within four (4) days, the obligation to disclose on settlement will again apply. In addition, the seller who fails to deliver would have to restate his long position and disclose the change in nature of his long position.

- (iii) The synchronization should also work for the controller or parent company to which the interests of the seller are attributed.

Public Comments

Respondents support the proposal. One respondent suggests that either these new provisions should apply to on-market transactions only, or it should be made clear how an off-market transaction which is conditional (but initially intended to be settled within four (4) days – e.g. a placing) should be dealt with.

11 investment banks ask that –

- (i) The SFC formalise its approach to allowing disclosures to be made on the basis of the end-of-the day position.
- (ii) The forms be amended to allow multiple transactions to be reported as a “block”.
- (iii) The proposals should not be restricted to situations where settlement is to take place within four (4) days.

The Final Proposals

We will recommend that the law be amended so that if the shares are required by the contract to be delivered within four (4) trading days, Part XV -

- (i) would suspend the duty of the vendor to notify a change in nature of the interest that takes place at the time of entry into the agreement to sell shares; and
- (ii) instead impose a duty of disclosure on a vendor to notify a cessation (or reduction) of an interest within three (3) days of the date of entering into the contract (instead of within three (3) days of the date of delivery).

This means that both the purchaser and the vendor would make a notification by reference to the date of entering into the contract, provided delivery must take place within the following four (4) trading days.

We will recommend that the law should address the situation where a notice has been filed by a vendor reporting that he has ceased to be interested in shares (in the manner outlined above) but delivery fails to take place within the four (4) trading days. If, within four (4) trading days of entering into the contract, delivery does not in fact take place, the vendor will be required – within three (3) days of the 4th trading day - to file the following additional notifications -

- (i) a notification of an “acquisition” of the interest (if previously he has reported a reduction of his interest), and

- (ii) a notification of a change in nature of that interest where he remains under an obligation to deliver the interest (since this was not previously reported). There will be a code in the form for a “change in nature following a fail”.

In response to public comments –

- (i) We confirm that disclosures may be made on the basis of the end-of-the day position. We will clarify in the Outline that the position at the day-end can be the net position after offsetting increases and decreases in shareholding within the same day.
- (ii) Where there are multiple transactions, we would ask that these be filed with “C” to denote a “complex transaction” and the person filing can use the optional narrative box to explain the nature of the transaction.
- (iii) We do not intend to extend the proposal to cover situations where the settlement is to take place more than four (4) days later.

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

The Proposed Changes

The Consultation Paper proposed -

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

Public Comments

Respondents support the proposal, with the same comments from a respondent as for section 3.1 above.

The Final Proposals

We will recommend that the law be amended as originally proposed in the Consultation Paper. As for section 3.1, if, within four (4) trading days of the exercise of the right, delivery does not in fact take place, the grantor of the option will be required to make disclosures similar to those described in section 3.1 above.

Section 3.3 Time frame to notify the Exchange and listed companies

The Proposed Changes

We proposed to amend Part XV so that Saturday does not count as a business day for these purposes.

Public Comments

Respondents support the proposal, with one respondent suggesting that the definition be amended to mean any day on which the Stock Exchange of Hong Kong Limited (the “*Exchange*”) opens for trading.

The Final Proposals

The days on which the Exchange is open for trading do not coincide with the definition of “business day”. In light of public comments the term “trading day” will be used to avoid confusion with “business day”. Accordingly we will recommend that the law be amended so that a person must make a disclosure within a relevant number of “trading days” (excluding Saturday), as opposed to “business days”.

Section 3.4 Exempt custodian interest

The Proposed Changes

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

Among other matters, we proposed to amend the law so that the exemption would continue to apply where (i) the customer fails to give instructions in respect of its interest and (ii) the custodian is *under an obligation* to exercise any rights or powers it holds on behalf of its customer in respect of the interests in question to protect the customer’s investments or to collect the customer’s entitlements on its behalf.

Public Comments

Respondents support the SFC proposal, with one respondent asking if the words “under an obligation” above are too narrow, and should contemplate circumstances where an action is within the trustee’s powers and considered by it to be appropriate in the client’s interests.

The Final Proposals

We will recommend changes to the law as originally proposed. We have earlier discussed the matter with custodians and take the view that the words “under an obligation” should be adequate to meet their needs. We are not inclined to recommend expansion of the exemption such that it could cover wider circumstances than intended.

Section 3.5 Exempt security interest

The Proposed Changes

a. The SFC proposed to recommend changes to the law to reflect the policy intent that an interest continues to be an “exempt security interest” under the following circumstances -

- (i) Where a broker providing margin financing re-pledges interest that his client has pledged to the margin financier to another financial institution.
- (ii) Where securities are pooled and transferred into the name of a nominee (e.g. mortgagee bank or its nominee, or in the clearing system in the name of HKSCC Nominee Ltd).
- (iii) Where collateral is taken by way of “absolute” transfers of title.

This would be effected by amending the definition of “exempt security interest” so as to remove the word “only” from the phrase “by way of security only”.

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

We proposed extending the exemption to security agents where (i) all members in the syndicate are qualified lenders and (ii) such security agents are regulated entities in recognized jurisdictions. The definition of “security agent” would include a corporation whose business includes holding securities in safekeeping for qualified lenders.

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

- (i) to exercise discretion in dealing in the interests; or
- (ii) to exercise rights attached to the interests,

except where such authority is limited to –

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

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

Public Comments

Respondents generally support the proposals, with the following questions and suggestions –

- (i) One commentator notes that it is common in the market that the 1995 Credit Support Annex (English law) being a title transfer collateral arrangement is also registered at the Stamp Office as a stock borrowing and lending agreement for stamp duty purposes. He seeks the SFC's confirmation that the Credit Support Agreement also having a stock lending and borrowing feature should not have any bearing on the availability of the exemption, since the underlying function of the Credit Support Agreement is the same as other arrangements which grant security interests.
- (ii) Another commentator notes that any holding of shares as security by a subsidiary of a bank, whether or not the subsidiary is a qualified lender, should be exempted.
- (iii) One respondent asks if it is necessary for the security agent to be a regulated entity whose business involves holding securities in safekeeping for qualified lenders. Qualified lenders themselves ought to be eligible as in some cases the syndicated loan agent itself may be one of the lenders who would not necessarily be regulated in the holding of securities (i.e. it might be regulated as a bank or financial institution).
- (iv) 11 respondents question whether it is necessary to reserve the exemption to persons identified in the Ordinance as "qualified lenders".
- (v) It is also suggested that the exemption should apply if the majority of lenders or the majority in value are qualified lenders.

The Final Proposals

We propose implementing changes as originally proposed. In response to public comments, we note -

- (i) On the Credit Support Agreement, the person claiming the exemption should show that it is holding the collateral by way of security and not for other reasons. We will clarify the position further in the Outline.
- (ii) A subsidiary of a bank will only be exempt if it is also a regulated entity who qualifies as a security agent.
- (iii) Our proposal is that the security agent must be (i) an authorized financial institution or (ii) a corporation authorized under the law of any place outside Hong Kong recognized for the purposes of sections 313(13), 317(6), 317(7) or

341(5) by the SFC to carry on business as a bank, and holding security for a syndicated loan as agent on behalf of participants in the syndicated loan, whether or not it is itself a participant in the syndicated loan. Accordingly this will not preclude financial institutions.

- (iv) We consider it necessary that the exemption should be limited to persons identified in the Ordinance as “qualified lenders”.
- (v) On the suggestion that the exemption should apply if the majority of lenders or the majority in value is or are qualified lenders, we are of the view that all members of the syndicate should be qualified lenders.

Section 3.6 Qualified corporation exemption

The Proposed Changes

Today a wholly-owned subsidiary does not need to disclose its interests in a listed corporation where the holding company discloses such interests. This exemption does not currently cover the situation where the corporation in which the subsidiary holds shares first becomes a listed corporation. We proposed that the subsidiary would not need to disclose its interests at initial listing of the corporation, provided its holding company does so.

Public Comments

Respondents generally support the proposals, with one respondent suggesting that the exemption should also cover initial notifications, and that we establish procedures to remove from the register the wholly owned subsidiaries that no longer have disclosable interests. One respondent asked whether we would extend this to any company where section 316(2) applies to require the parent company or ultimate controller to make a notification.

The Final Proposals

We will recommend changes to the law as originally proposed.

We note the suggestion that the exemptions should also cover initial notifications when the law first came into effect. However, since these notifications would have been made already, we do not consider it practicable to now exempt them. We will nevertheless clarify in the Outline that wholly owned subsidiaries can voluntarily remove the filings made where they no longer have notifiable interests.

We are not inclined to recommend expansion of the exemption to cover non-wholly owned subsidiaries.

Section 3.7 Short positions held in the same capacity as interests disregarded

The Proposed Changes

In response to comments that the provisions allowing certain interests to be disregarded may not cover short positions that arise in the same capacity, we proposed recommending changes to the law so it is clear that short positions are disregarded if held in the same capacity as interests in shares that are disregarded, notwithstanding there are other notifiable interests held in a different capacity.

Public Comments

There is general support for the proposal.

The Final Proposals

We will recommend changes to the law as originally proposed.

Section 3.8 Concert party provisions and underwriting agreements for equity derivatives

The Proposed Changes

The concert party provisions require the aggregation of the interests of members of concert parties for disclosure purposes. The provisions exclude an agreement to underwrite any offer of shares in a company, provided that the purposes of the agreement are confined to the underwriting and any matters incidental to it. We proposed to allow the exclusion to also apply to offers of equity derivatives, subject to the same conditions as for offers of shares.

Public Comments

There is general support for the proposal.

The Final Proposals

We will recommend changes to the law as originally proposed.

Section 3.9 Director/substantial shareholder and spouse's interests

The Proposed Changes

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

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

Public Comments

There is general support for the proposal.

The Final Proposals

We will recommend changes to the law as originally proposed.

Section 3.10 Director/Chief Executive of listed associated corporations

The Proposed Changes

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

Public Comments

There is general support for the proposal.

The Final Proposals

We will recommend changes to the law as originally proposed.

C. Matters for Further Clarification in Outline

We have published the Outline on the SFC website as a practical guide on the situations in which a notice has to be filed. Section 4 of the Consultation Paper sets out our views in response to earlier comments relating to interpretation, and noted that our views will be incorporated in the Outline.

We have received the comments in certain areas in this section as follows.

Section 4.1 Status of the Outline

SFC's Clarification

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

Public Comments

One respondent considers that the reporting of developments in practice or knowledge and their regular incorporation into updates of the Outline would be beneficial. 11 respondents have the following comments –

- (i) If a person does what the SFC described in the Outline as acceptable, that person should not be subject to the risk of subsequent enforcement action.
- (ii) The SFC should provide *ad hoc* guidance on market participants' queries.

By way of general comments, there are also suggestions that the SFC should include more illustrative examples in the Outline that demonstrate the common relevant events that give rise to a filing obligation and how the corresponding form should be compiled under such circumstances.

There are also representations that there should be an avenue for market practitioners/substantial shareholders/directors to communicate with or enquire with the Exchange/SFC in order to assist them in completing the forms correctly, and that preferably this should be done verbally since the time limit to submit forms is only three (3) business days.

SFC's Response

We note the comments and would note the following -

- (i) The Outline cannot override the law. It can only set out the SFC's understanding of what the law requires. The SFC will endeavour as far as practicable to remove inconsistencies between the Outline and the law.
- (ii) We propose to review and update the Outline on a regular basis especially on significant issues causing difficulties for practitioners.
- (iii) However for practical reasons we are not in the position to give *ad hoc* responses on specific issues.

Section 4.2 Change in nature of interest and equitable interests

SFC's Clarification

Today where the equitable interests of a person are notifiable or have been previously notified, the delivery of the shares is not considered a "change in nature" of an interest. There are concerns that the term "equitable interests" is too narrow and may exclude –

- (i) interests in unidentified shares, including on-market transactions (which relate to shares which are fungible within the clearing system),
- (ii) interests on subscription for unidentified shares.

We clarified that we take the view that a purposive interpretation should be taken in the context of Part XV as a whole. Accordingly we would not read the term “equitable interests” restrictively so as to exclude on-market transactions or to exclude unidentified shares on subscription.

Public Comments

Two commentators, while welcoming the clarification, express the preference that the law should be amended to clarify the position. Eleven other commentators support the removal of the word “equitable interests” from section 313(13)(i).

SFC’s Response

We note the comments. We will consider further whether an appropriate concept to replace “equitable interests” would be possible.

Section 4.3 Complex and other derivatives

SFC’s Clarification

We clarified that -

- (i) For market transparency, the intention has always been that secondary derivatives must be disclosed.
- (ii) The disclosure treatment for derivatives should not depend on the documentation. The intention of paragraph 2.6.3.2 of the Outline is to deal with a structured derivative involving a combination of option positions. For such derivatives, a person can either report the long and short positions by adding individual option positions together. Alternatively, the person can report the effective long and short positions of the structured derivative. Long and short positions cannot be netted off against each other.

Public Comments

One respondent notes that netting off would be likely to make the regime more complicated, and/or make it optional how to make disclosures, with a reduction in consistency and transparency. The respondent notes that the addition of the ability to insert explanatory notes into disclosure forms should reduce some of the current problems with confusing disclosures.

Another respondent agrees that short and long positions should not be netted off as a general rule. However it agrees that a person should be allowed to disclose its effective position and submits that, in some cases, in order to calculate one’s effective position, netting off is inevitable and is the most logical way of disclosure. The respondent suggests that the SFC should provide a statement that while general netting is not allowed, it would allow netting off to achieve disclosure of a person’s effective long and short position in the following two cases -

- (i) For different option strategies over the same specified number of shares. For example, a call put combo which contains both put and call elements over the same specified number of shares where only one side of the contract can ever be executed. It may result in different disclosure treatment depending on the form of documentation used. The respondent considers that if a single document is used then it may (depending on particular terms and appropriate use of formulae) be possible to avoid having any disclosable interest. However, if the more traditional approach of using separate documents for each side of a trade involving both put and call elements is used then multiple disclosure obligations are likely to arise. As only one side of a trade can be executed, disclosing interests of more than the specified number of shares would be misleading and would make no commercial sense.
- (ii) Some netting of positions in paired trades could be allowed. This is because it is not uncommon in the market that, in order to reverse a trade (e.g. X sells a put option from Y), participants enter into squaring transactions (e.g. Y sells X a put option on completely identical terms having the same economic effect). This is a more common approach in the market as compared to the termination of the trade via the execution of a confirmation. However, due to the difference in documentation style, the current disclosure treatment between the two approaches is different.

SFC's Response

We take the view that the disclosure treatment of complex derivatives should be determined by the underlying commercial reality of the transaction, and not by its form. This will be clarified in the Outline. However, in view of market comments, we also intend to hold further discussion with the market, and will also consider providing further guidance on the disclosure of complex derivatives.

Section 4.4 Persons in accordance with whose directions a company acts

SFC's Clarification

We noted the concern that the description of “persons in accordance with whose directions a company acts” in the Outline, and in the disclosure form, is too wide. We also clarified that the issue is one of fact and is dependent on all the circumstances of the case, and proposed to set out the indicia that could be taken into account in determining such control.

Public Comments

One respondent notes that these descriptions (in the disclosure forms and the Outline) are wider than consistent with the law. Another respondent proposes that this be defined by reference to an exhaustive list of persons.

SFC's Response

We will look at the descriptions further and amend the Outline and the forms if necessary. However, we do not propose to provide an exhaustive list since the issue is

one that is dependent on the facts and circumstances of each case. As originally proposed, we will set out guidelines as to what indicia of control we will take into account.

Section 4.5 Short positions at initial public offering

One respondent notes but there are no comments on the SFC's clarification that, where a person comes under a duty to disclose any notifiable interests when the corporation is listed, he is also under an obligation to include in the form details of any short position he holds¹. We will clarify in the Outline as originally proposed.

Section 4.6 Liability of brokers as agents

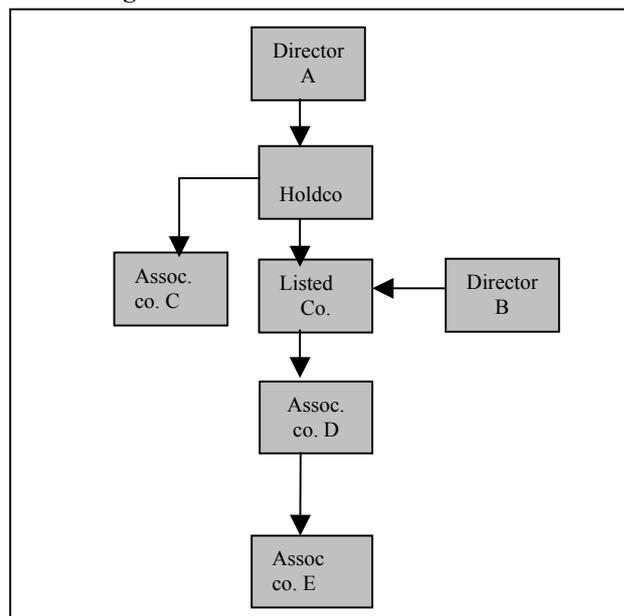
One respondent notes but there are no comments on the SFC's clarification on section 321. We will clarify in the Outline that the liability for filing the form lies with the principal and not the agent.

Section 4.7 Private unit trusts

One respondent notes but there are no comments on the clarification that, unless specifically exempted, Part XV requires unit holders to disclose interests in shares held by the trust. Therefore interests in shares of unit holders in a private unit trust must be disclosed. We will clarify this in the Outline as originally proposed.

Section 4.8 Associated corporations and attributed interests

Diagram A



The SFC clarified that -

¹ Section 324 of the Securities and Futures Ordinance (Cap. 571)

- a. Director B as a director of a listed corporation is not interested in shares in which the listed corporation is interested i.e. shares in Associated Corporation D solely because the listed corporation falls within the definition of a controlled corporation. However, if Director B has a direct interest in Associated Corporation D, he will have to make a disclosure and include holdings in Associated Corporation D.
- b. Director B would not be required to disclose interest in Associated Corporation E (including the situation where the associated corporation is one in which the listed corporation has minimal economic interest and over which it may have little or no control or influence), unless the director has a direct interest in Associated Corporation E.
- c. Director A must file a notification each time Holdco incorporates an associated corporation including one that is a subsidiary even though Director A may not have direct interest in the subsidiary. If a listed corporation were to enter into a transaction with a subsidiary of the listed corporation (Associated Corporation D), the benefits of the transaction to the subsidiary would flow up to the listed corporation and shareholders of the listed corporation. However if the listed corporation were to enter into a transaction with its “sister” company (Associated Corporation C), the benefits of the contract would flow through the holding company up the chain to persons who may well be persons other than all the shareholders of the listed corporation. Part XV is also intended to provide information for greater transparency of connected party transactions.

Public Comments

One respondent generally agrees with the SFC’s responses. However some respondents consider that the requirement in paragraph (c) above is at times very onerous and note the following -

- (i) This interpretation leads to the result that, whenever the holding company incorporates a subsidiary (which may have nothing to do with the listed issuer), a disclosure obligation arises.
- (ii) The provision is inadequate to address investor protection concerns, as the director may have interests in all sorts of other companies that are not disclosable.
- (iii) A substantial shareholder is not subject to such requirement that is only applicable to director.
- (iv) Extensive connected party provisions are more appropriately placed elsewhere and has already been provided for in the Listing Rules.

Respondents ask the SFC to consider whether there are real benefits in these requirements.

SFC's Response

We note the comments and will give them further consideration once the provisions for statutory backing to the Listing Rules have been put in place.

Section 4.9 Debentures

SFC's Clarification

To address concerns that the description in the Outline of “debentures” refers to all “financial instruments” would result duplicated disclosures (as an equity derivative and as instruments such as loans and mortgages over property), we clarified that we would take a purposive approach in interpreting the Ordinance.

Public Comments

One respondent considers that this is a particularly problematic area of the law because of –

- The inclusion of the words “and other securities” in the definition of “debenture”; and
- The equation of this term with “financial instruments” in the Outline.

The respondent urges the SFC to make revisions to the law and the Outline so that “debentures” is defined to be equivalent to “debt securities” so as to clearly exclude anything equity-related and anything such as a loan or a mortgage which is not in the nature of a security as generally understood.

SFC's Response

We consider that the words “and other securities” are necessary in the definition of “debenture” in the law. However we intend to address the concerns over the description of “debentures” in the Outline.

Section 4.10 Exclusions Regulation

One respondent notes but there are no comments on the clarification that under the definition of “conditional offer” the offer cannot also be subject to conditions other than the acceptance conditions. We will clarify this in the Outline as originally proposed.

D. Other Comments and Our Responses

Section 5 of the Consultation Paper contained our responses to other comments received in our earlier soft consultation.

Section 5.1 Plain language

SFC's Earlier Responses

We noted that the transactions that create drafting issues are always inherently complex and that difficulties would arise even with a simplified language or framework. Because the market has already achieved a degree of familiarity with Part XV we proposed to take a pragmatic approach and retain the framework without implementing fundamental changes.

Public Comments

Three respondents are of the view that the Ordinance is difficult to understand and interpret, and the information received by the market as a result may not necessarily be helpful. They consider that the language and general framework should be simplified.

Another respondent is of the view that Part XV is excessively complicated. However it also agrees that it is so technical in concept that it is inevitable that it is technically worded. Accordingly it does not agree that it is practicable to express it in much plainer language. 11 other commentators consider that if changes would help clarify the rule, it should be done but changes should not be carried out just in order to simplify the language.

SFC's Final Response

For the reasons set out in the Consultation Paper, we are still inclined to take a pragmatic approach and retain the framework without implementing fundamental changes.

Section 5.2 Definition of “substantial shareholder” in the Listing Rules

One respondent notes but no comments were made on the SFC's response to the suggestion that the definition in the Listing Rules of “substantial shareholder” should be aligned with that in Part XV and that the definition take into account equity derivatives (as well as security interests). As noted in the Consultation Paper, we have passed the comment to the Exchange.

Section 5.3 Enforcement and Part XV

SFC's Earlier Responses

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

Public Comments

13 respondents have comments on this matter and two request that the SFC publish guidelines on this matter.

SFC's Final Response

In response to public comments, our Enforcement Division will publish a note on the SFC's policy regarding investigations of cases involving suspected breach of the Disclosure of Interests provisions in Part XV of the Ordinance.

Section 5.4 Qualified Overseas Schemes

SFC's Earlier Responses

In response to comments that a holder of such an arrangement will not know whether there are sufficient numbers of holders from time to time so that it would be difficult to enjoy the qualified overseas schemes exemption, we stated that we consider the current approach reasonable. Any changes to exempt specific circumstances otherwise than as laid out in Part XV would entail amendments through guidelines under the Ordinance. We also stated that should a genuine concern arise in practice, we will consider amending the guidelines for specific waivers.

Public Comments

One respondent notes that the concerns raised are genuine and create problems in practice. The current law is deficient, and the respondent notes the Inland Revenue Department's Departmental and Practice Note 20 of June 1998 as supporting this.

SFC's Final Response

We will discuss further with the industry to ascertain the problems in practice and consider whether any measures are necessary to address the problems.

Section 5.5 Underwriting at Initial Public Offering

SFC's Earlier Responses

Today, disclosures required at initial public offerings extend to interests and short positions of underwriters. Comments were made that these disclosures do not add to market transparency, could impact the firm's permitted stabilisation activities and are overly burdensome. We noted that we are not inclined to make changes to exclude the requirement for disclosures altogether without evidence that the burden is excessive. On balance we consider that the benefits of disclosures outweigh the compliance burden.

Public Comments

12 commentators consider that under the present rules, in respect of an initial public offering on the Exchange, the underwriter must usually make a disclosure of the underwritten shares, the over allotment option, shares in respect of the stock borrowing and lending agreement and on the purchase and sale of shares for stabilisation activities. Additionally the underwriter must also make a disclosure when the over allotment option is exercised and when the allotment option lapses. The

respondents believe that the present rules and regulations that require underwriters of initial public offerings to disclose their interest and short positions do not add to market transparency, impact the underwriter's permitted stabilisation activities and are overly burdensome.

11 investment banks also comment that the SFC should allow an "end-of-day" approach so that positions may be disclosed on a net basis at the end of the day in respect of primary and secondary offerings, top-up placings and block-trades. They have also raised other issues in relation to the obligations of underwriters at initial public offering.

SFC's Final Response

We have considered the matter and we remain of the view that we should not make changes to exclude the requirement for underwriters to file disclosures altogether. However, we agree to the "end-of-day" approach and will clarify this in the Outline. We will also provide clarification in the Outline on some of the issues raised, after further discussion with the industry.

Section 5.6 Spouse and interests of substantial shareholder

One respondent notes but there are no comments on our clarification that this concept of attributing the interest of his or her spouse to a substantial shareholder has been in the disclosure regime from the start and is necessary. Otherwise shares can simply be placed in the name of a spouse and disclosures avoided.

Section 5.7 Timing to notify the Exchange and the listed corporation

We noted that following the original Part XV consultation exercise, we had taken into account comments from the industry and extended the proposed time limit from two (2) to three (3) business days. As the requirement to file within three (3) business days is in line with international practice, this suggests that the present time frame is reasonable.

One respondent notes that the present time frame is at times hard to comply with and the Hong Kong requirements are much more demanding than the international norm. That said, the respondent considers that the present time frame is probably necessary. (Note, in addition that, as proposed in section 3.3, we will recommend that "trading day" be used instead of "business day".)

Section 5.8 Exempt security interest

SFC's Earlier Responses

Security interests must be taken for the purposes of a "transaction" to be exempted under the exempt security interests provision. To address concerns that that security interests taken by, for example, brokers over clients' accounts to cover the debts that the clients owe from time to time on the accounts cannot benefit from this exemption, we noted that we would take a purposive interpretation of the law, and we would

consider that the exempt security interest provision would still apply under such circumstances.

Public Comments

13 respondents consider that the Ordinance should be amended rather than relying on an approach of interpretation which may or may not be followed by the courts. Another respondent considers that it is probably worth clarifying this in the Outline.

SFC's Final Response

We consider that it is reasonable to interpret the law as we originally proposed, and will clarify this in the Outline.

Section 5.9 Other issues on forms and codes and the filing regime

We set out our detailed responses on specific issues that were raised by commentators in the Consultation Paper. We also noted our intention to review all forms and notes to the forms and make changes as necessary.

In particular we noted that, for simplicity, the policy decision following consultations in 1998 was that derivative interests would be calculated by taking the last known total number of issued shares as the denominator to calculate the percentage of derivative interests. In any case, the form has a box and codes that allow the substantial shareholder to disclose the amount of the interests held as derivative interests.

One respondent notes in relation to the calculation of derivative interests that while imperfect, the current position is the least bad available (and has the vast benefit of operational simplicity) and should be retained.

No other comments were received on the SFC's other specific responses.

SFC's Final Response

Our responses remain as originally stated in the Consultation Paper.

Section 5.10 Fees

We noted that we are prepared to consider the reduction of, or exempting the payment of fees for waivers from Part XV provisions, when it is appropriate to do so. One respondent notes that flexibility in this case is appropriate and another 11 welcome our response.

OTHER COMMENTS

This section sets out the principal additional comments raised by respondents. Some of the more technical issues are not included but will be addressed, where necessary, after further consideration, when drafting the Bill for the revised Ordinance, through amendments to the forms or clarification in the Outline as appropriate.

(A) Reconciliation of Boxes 17, 18 and 19 of Form 2

Public Comment

11 investment banks sought clarification on how to complete and reconcile the information in Boxes 17, 18 and 19 of Form 2. The respondents note that the main difficulty arising from completing these boxes is that the numbers in these boxes cannot be reconciled where disclosures are made on an end-of-day basis. The investment banks request that the SFC clarify that the end-of-day approach is acceptable, on the basis that it is the only practical disclosure method for any large financial institution.

SFC's Response

In response to public comments, the SFC confirms accepting the use of end-of-day information for filing disclosure forms. Accordingly the information provided in Boxes 18 and 19 should reflect the end-of-day positions on the day prior to the relevant event and the day of the relevant event. Firms could then disclose in Box 17 the most significant transaction for the relevant day, and it would not be necessary to reconcile Boxes 17, 18 and 19. This will be further clarified in the Outline.

(B) Simplification of Box 20 on Form 1 and Box 22 on Form 2

Public Comment

11 investment banks also request that we consider simplifying Box 20 of Form 1 and Box 22 of Form 2. This is on the basis that it is redundant to include in these boxes the names of the intermediate holding companies which are only regarded as having interests/short positions under s.316. It considers that only those companies which hold a direct interest/short position in the relevant shares and the ultimate holding company/controller should be required to be disclosed in these boxes.

It is suggested that the forms could require the person filing the form to indicate 'yes/no' as to whether there were other group companies between the person filing the form and the company having the direct position. This is in order to clearly flag the fact that the position is held within a group of more than just the latter two persons. Issuers may require detail of the intermediate holding companies' positions if necessary.

SFC's response

We will consider this further, and if appropriate, amend the forms.

(C) Notification by substantial shareholders of interests in controlled corporations

Public Comment

One respondent (an Association) requests for clarification on how to file notice on changes in the interest held by a shareholder in an intermediate holding company which holds shares in a listed corporation, in particular, Box 14 of Forms 1, 2 and 3A. The respondent also asks how pledges of the intermediate company by shareholders should be disclosed.

SFC's response

We will hold further discussion with the respondent and clarify the issue in the Outline.

(D) Intra-group transactions

11 investment banks ask for an express exemption in Part XV for intra-group transactions. Currently, there is only a limited exemption for a holding company in relation to changes in nature of interest (s.313(13)(v)) arising out of an acquisition of an interest by one wholly-owned subsidiary from another wholly-owned subsidiary. When taken together with s.313(10), this means that there is an exemption for transfers of interests between wholly-owned subsidiaries. However, the respondent considers exemptions do not adequately cover all transactions. For example, the exemptions do not address whether a holding company should disclose a short position under an equity derivative where one subsidiary holds some shares and sells a physically-settled call option over those shares to another subsidiary.

While we have stated in paragraphs 2.12.9.2 and 2.13.18 of the Outline that intra-group transactions generally do not give rise to disclosures, the respondent asks for this to be included as a formal exemption in the Ordinance.

SFC's response

We understand that exemptions for intra-group transactions among wholly owned subsidiaries as clarified in the Outline are widely used by market participants. We will hold further discussions with the market to assess whether it is necessary for any amendments to the law.

(E) Disclosure of directors/chief executives' interests in associated corporations

Public Comment

One commentator proposes a *de minimis* threshold for disclosure of directors/chief executives' interests in associated corporations at five percent should be set.

SFC's response

We appreciate that there may be burdens disclosing interests in associated companies in certain circumstances and discuss these in section 4.8 above. However we do not propose at this stage to change the threshold for disclosures of interests in associated corporations.

(F) Privacy issues

Public Comment

We have received comments that the Personal Data (Privacy) Ordinance will apply in relation to proposed new disclosures by substantial shareholders, and that due consideration should be given to the extent of data disclosure (and hence the level of privacy intrusiveness) which should be proportionate to the benefit derived from the disclosure. To prevent subsequent misuse of these publicly obtained personal data, a clearly spelt out purpose statement laid down by statute may serve useful purpose in quelling any uncertainty as to the lawful boundaries of use. Consequent upon any legislative amendments to the Ordinance affecting personal data, it is noted that appropriate administrative measures should also be put in place to safeguard the proper handling and safekeeping of the personal data collected.

SFC's response

We note these comments and will bear them in mind when recommending legislative changes.

APPENDIX 1

Descriptions of the respondents and a summary of the responses received.

<u>Nature of Respondents</u>	<u>Number</u>
Listed companies	5 (including 1 industry group, 1 listed company group with financial services arms)
Commercial banks	3 (including 1 industry group)
Investment banks and brokers	14 (including 11 investment banks who submitted 1 consolidated response through a law firm and 1 industry group)
Accountants	1 (an industry group)
Lawyers	2 (including 1 industry group)
Regulators	1
Other industry groups	4
Total	30 (see note b below) ---

Notes:

- (a) *Industry groups represent the following professions, businesses and other interests i.e. financial analysts, fund managers, stockbrokers, commercial banks, derivative users and dealers, accountants and lawyers, businesses and commerce.*
- (b) *One listed company group submitted five separate submissions with identical contents, and include in the group brokerage and asset management businesses. For the purposes of the consultation conclusions, the listed group is counted as one respondent instead of five. Hence the total number is 30 instead of 34.*
- (c) *The submissions of two industry groups are identical.*

**1. Summary of Responses
regarding Forms and Codes**

	<u><i>Issues for consultation</i></u>	<u><i>Public Responses</i></u>			
		<i>Agreed</i>	<i>Disagreed</i>	<i>Mixed views</i>	<i>No comment</i>
1.	More codes	7	1	13	9
2.	Optional narrative box	4	11	-	15
3.	“D” for derivatives	-	13	-	17

**2. Summary of Responses
regarding security interests by substantial shareholders**

	<u><i>Issues for consultation</i></u>	<u><i>Public Responses</i></u>			
		<i>Agreed</i>	<i>Disagreed</i>	<i>Comment</i>	<i>No comment</i>
1.	Obligations on qualified lenders to disclose pledges of shares	-	23	1	6
2.	Obligations on substantial shareholders to disclose pledges of shares	3	21	1	5
3.	SFC’s proposed way forward	-	21	2	7

**3. Summary of Responses
regarding the disclosure threshold and de minimis exception**

	<i>Preferred Alternative</i>		<i>Neither sufficient /mixed views</i>	<i>No comment</i>	
	<i>1</i>	<i>2</i>			
1.	The 2 options relating to <i>de minimis</i> exemption	14	6	3	7

**4. Summary of Responses
regarding other issues for consultation**

	<u>Issues for consultation</u>	<u>Public Responses</u>			
		<i>Agreed</i>	<i>Disagreed</i>	<i>Mixed views</i>	<i>No comment</i>
1.	Expansion of aggregation exemption	21	-	1	8
2.	Changing the stock borrowing and lending regime	13	1	2	14
3.	Exemption of credit derivatives	18	3	-	9
4.	HSI Index-linked instruments to be exempt again	18	-	-	12
5.	Changes in nature of interest	17	-	-	13

**5. Summary of Responses
regarding proposals involving changes to the law**

	<u>Issues for consultation</u>	<u>Public Responses</u>		
		<i>Agreed</i>	<i>Disagreed</i>	<i>No comment</i>
1.	Reference dates for filing notices of sales and purchases	13	-	17
2.	Filing of notices for options on grant, exercise and completion	12	-	18
3.	Time frame to notify the Exchange and listed companies	13	-	17
4.	Exempt custodian interest	12	-	18
5.	Exempt security interest	14	-	16
6.	Qualified corporation exemption	13	-	17
7.	Short positions held in the	12	-	18

	same capacity as interests disregarded			
8.	Concert party provisions and underwriting agreements for equity derivatives	12	-	18
9.	Director/substantial shareholder and spouse's interests	1	-	29
10.	Director/Chief Executive of listed associated corporations	1	-	29

**6. Summary of Comments
on matters for further clarification in the Outline**

SFC Clarification

Public Responses

		<i>Comment</i>		<i>No comment</i>
1.	Status of Outline	22		18
2.	Change in nature of interests and equitable interests	13		17
3.	Complex and other derivatives	13		17
4.	Persons in accordance with whose instructions a company acts	12		18
5.	Short positions at initial public offering	1		29
6.	Liability of brokers as agents	1		29
7.	Private unit trusts	1		29
8.	Associated corporations and attributed interests	3		27
9.	Debentures	1		29
10.	Exclusions Regulation	1		29

**7. Summary of Comments
on SFC's Response to Comments**

<u>SFC Responses</u>		<u>Public Responses</u>			
		<i>Agreed</i>	<i>Agreed with comments</i>	<i>Disagreed</i>	<i>No comment</i>
1.	Not to change to plain language	12	-	3	15
2.	The definition of "substantial shareholder" in listing rules	1	-	-	29
3.	Statement on enforcement policies	-	-	13	17
4.	Qualified Overseas Schemes	-	-	1	29
5.	Underwriting at Initial Public Offering	-	-	12	18
6.	Rationale for disclosing interests of spouse of substantial shareholder	1	-	-	29
7.	Timing to notify Exchange and listed corporation	1	-	-	29
8.	Exempt security interest	-	14	-	16
9.	Other issues on forms and codes and the filing regime	-	1	-	29
10.	Fees	12	-	-	18

APPENDIX 2

Summary of pros and cons of ways to address issue of disclosing security interests

1. Requiring a disclosure on giving of security interests by substantial shareholders

PROS	CONS
Supported by various commentators in the press and three respondents.	Opposed by 21 respondents.
<ul style="list-style-type: none"> • May serve as a signal of potential for forced sales, or speculation about controlling shareholders defaulting on margin calls. • Provides investors with a signal about which companies might have certain risks associated with share pledges. Investors can choose to act to protect their investment or decide whether to invest in a company or not. 	<ul style="list-style-type: none"> • Disclosure of security interests of themselves does not tell investors about the risk of default, unless a lot more information on the personal financial position of the substantial shareholder is provided in addition. A requirement to disclose such additional information is viewed as an unacceptable erosion of the substantial shareholder's privacy rights. • Likelihood that there will be many disclosures, as shareholders frequently give security interests even when not in financial difficulty. Disclosure of security interests alone is not likely to help investors distinguish between companies. • Share pledges by substantial shareholders do not relate to the listed company's daily operations. • Speculation about the possibility of a substantial shareholder's share being sold (e.g. where he initiates the sale himself or a sale by the lender) and what a substantial shareholder may or may not do with his shares (on the buy side or the sell side) is an inherent and fundamental part of any free security market. Such speculation is not a problem peculiar to security interests. • The current regime adequately addresses the needs of various market users. The proposal tips the scale towards speculators possible at the expense of investors. • Poor liquidity already implies potential volatility for sudden sales.
Reports on sudden price drop arising from enforcement of security interest cause damage to the reputation of Hong Kong as a major financial centre.	<ul style="list-style-type: none"> • Cases in respect of which there was speculation about margin calls in the past year have been isolated to 3 cases. There is no need to disrupt the operation of the entire market to cater for a small number of potential incidents.
The spirit of disclosure is to let market participants have the information to act on and it is common that different investors interpret differently.	<ul style="list-style-type: none"> • Disclosure may cause a negative impact on the share price especially when the market is falling generally or when the shares are falling in price for reasons not relate to the listed company's financial condition. • It is likely that disclosure will in itself cause

	<p>market fluctuations.</p> <ul style="list-style-type: none"> • Disclosure may be a misleading indication if it is taken as an automatic sign of financial weakness. • There will be possible panic selling by investors if unwarranted conclusions are made from the fact of disclosure. Panic selling may lead to sudden sharp fall in share prices. This will trigger margin calls and may result in default in some cases, the precise situation that we are seeking to avoid. • Speculators are likely to capitalize on the opportunity and sell to create more market volatility. • Some new risks may be opened up by disclosure and it is inappropriate for a regulatory regime to create such speculative risks and the following consequences: <ul style="list-style-type: none"> o A potential false market by raising possible unfounded speculation. o Acts of speculators (e.g. sales and short sales) may have the effect of pushing the share price lower. o Increased chance of a margin call.
Substantial shareholders should bear the responsibility for disclosure of security interests on the basis of transparency and good governance.	<ul style="list-style-type: none"> • Disclosure of share pledges infringes on privacy right of substantial shareholders. • Disclosure imposes heavy compliance burden to the market without a corresponding balancing benefit to the market. • Disclosure would prejudice many shareholders who provide adequate security and regularly service their debts.
Taiwan and Shanghai Stock Exchange ask for disclosure of share pledges by substantial shareholders.	No major jurisdiction requires disclosure of share pledges with qualified lenders.
	Part XV is not the correct mechanism for disclosing to the market the financial condition of borrowing shareholders and inability to repay loans. If this information is of importance to the listed company's future, business etc., then the company should disclose it under the Listing Rules.
	Likely to be transitional issues to address if imposed as there are likely to be security interests with qualified lenders today that would suddenly need to be disclosed.
	The proposal is out of step with other developed markets. In a world where several financial markets are increasingly competing for new listings, imposing additional burdens on substantial shareholders and lenders alike will not enhance Hong Kong's attractiveness as a place in which to seek a listing.

2. Keeping the exempt security interest provision

PROS	CONS
Supported by those who oppose disclosure of share pledges.	Opposed by the media and those who support disclosure of share pledges.
See Cons of Option 1 above.	See Pros of Option 1 above.
Perceived “problem” has been limited to 3 cases that may or may not have involved enforcement of share pledges given by substantial shareholders. This does not warrant a revamp of the existing disclosure regime.	Media complaints that regulators are not doing enough to protect the interests of general investors.
Disclosure would prejudice creditors who may need to aggregate all interests held (whether as collateral or not) and this would undermine rationale for the disclosures. Separate reporting may impose administrative burdens and could provide an information overload.	

3. Accelerated disclosures on taking steps to enforce

PROS	CONS
Supported as reported in the press by a few commentators.	Opposed by 23 respondents.
Provides a more focussed solution in that it affects only companies where a substantial shareholder has defaulted.	<ul style="list-style-type: none"> • Immediate disclosure may cause market panic and accelerate a fall in market price. • The disclosure will lead to sell down by other lenders that would affect the share price. • May prejudice the creditors’ ability to recover the loan from selling the shares and prejudice the substantial shareholders with a worse price to pay off the loan. • Regulators should balance interests of investors and business parties. • Lenders may also price the risk of panic selling into their lending criteria and be less flexible about enforcing security interests. • The proposal will add an administrative burden to make disclosure when the bank is busy in negotiating settlement with borrower. • Announcing a default as it occurs would immobilise the market and prevent a restructuring of the company involved. • Disclosure will definitely force lender to liquidate the position immediately and thus cause unnecessary disruption to the market.

	<ul style="list-style-type: none"> • Disclosure may send a wrong signal to the market and may cause unnecessary chaos or panic selling.
Allows the market to know what's happening and corrects false rumours at an earlier time than today.	<ul style="list-style-type: none"> • Investors may not be in any better position, since the price of shares (especially those which are thinly traded) will in any event fall on disclosure. • Hong Kong is an efficient market and people would be aware that something had happened when the shares were disposed of. • It is likely that all would happen very quickly and before the issuer had made an announcement. • Alternatively, if the price falls low enough, lenders may elect to refrain from selling till the price has improved, effectively creating an overhang depressing the price for some time to the detriment of all the shareholders.
Investors have the right to know what is happening.	<ul style="list-style-type: none"> • Trading may be suspended pending announcement and this will unfairly prevent the forced sale. • Disclosure will prevent lenders from selling the position outside the listed market privately at the best obtainable price. • The actions of qualified lenders are enforcement actions that are merely consequences of taking security interest. Sales of securities by qualified lenders should not be seen as insider dealing and do not need to be so strictly controlled. • No reasons why qualified lenders should be treated differently from investment managers or other substantial shareholders who are selling shares.
	Potential for avoiding requirement if substantial shareholder negotiates with the lender for a structured "voluntary" sale of the relevant interest (by him or at his instructions) that would not trigger such accelerated disclosure.
	Places interests of other shareholders (other than substantial shareholders) ahead of the (a) substantial shareholder (b) the security holder, and (c) potentially, other creditors of the substantial shareholders. There is no rationale for giving precedence to one group of stakeholders in a listed company over other interests.
	Some technical issues to be resolved. There is a need to clarify the meaning of "forthwith" or state a specified period of time, and what is considered to be "evidencing an intention to exercise voting rights".

4. Disclosure of security interests only where the interest held is for example, 30% or more

PROS	CONS
More targeted than disclosure for interests over 5%.	Probably still affects many companies. It is unlikely that substantial shareholders will let their shares sit idle.
	Companies are even more singled out by the disclosures, resulting in worse speculations and there is potential for panic selling.