21 November 2019

Statement on the Disclosure of Actual Controllers or Beneficial Owners of Counterparties to a Transaction

Purpose

The Securities and Futures Commission (**SFC**) emphasizes the importance for listed issuers to ensure that announcements, statements, circulars and other documents made or issued by them or on their behalf do not include materially false, incomplete or misleading information regarding their counterparties in a transaction.

The SFC has noted that, in the announcements of certain corporate transactions, the identities of the listed issuers' counterparties in the transactions were not disclosed even where such information appeared to be necessary to enable investors to make an informed assessment of the issuer's activities.

In some cases, circular definitions of the counterparties were used. For example, borrowers were defined as "*the borrower under the loan agreement, being an individual and an independent third party"* or *"the customer of the lender".* Such definitions are not meaningful and do not help investors' assessment.

In other cases, disclosure of the counterparties was limited to the names of the entities used to consummate the transaction without disclosure of the controllers or beneficial owners of the entities. Before adopting such an approach, an issuer must be reasonably satisfied that disclosure of the actual controllers or beneficial owners is not necessary for the investing public to make an informed assessment of the issuer or its activities, assets and liabilities or financial position. Where the identity of a counterparty is necessary for such an assessment to be made, the non-disclosure of the identities of the controllers or beneficial owners may mean that the document in question includes materially incomplete information. In serious cases, the SFC will use its powers under the Securities and Futures (Stock Market Listing) Rules (**SMLR**) to intervene in order to protect the investing public.

The SFC is concerned that special purpose entities are being misused as part of wider schemes to engage in illicit activities, to perpetuate market misconduct or to avoid laws, rules or regulations. The SFC previously issued a circular to intermediaries regarding the use of "nominees" and "warehousing" arrangements to facilitate market and corporate misconduct[1]. Where a listed issuer or its controllers are found to have committed a material breach under the Securities and Futures Ordinance (**SFO**), the SFC will take appropriate action against them[2].

[1] Circular to Intermediaries – Use of "nominees" and "warehousing" arrangements in market and corporate misconduct dated 9 October 2018
[2] Sections 213, 214, 277, 298 and 384 of the SFO

Set out below are non-exhaustive examples of circumstances where the identities of the actual controllers or beneficial owners of a counterparty to a transaction may be required:

Acquisitions, disposals, capital injections, and formation of joint ventures

In cases where listed issuers acquire or dispose of entire or partial interests in target companies, form joint ventures, or inject capital into target businesses, the identities of the actual controllers or beneficial owners of the counterparty(ies) may be important information that is necessary to enable investors to make an informed assessment of the issuer's activities, for example, by informing investors as to the background, experience, resources or strategy of the party(ies) with whom the issuer is entering into a long term business arrangement. Such information may also be material if the controller or beneficial owner is a prominent business or political figure or entity, or a person who has close business dealings with the issuer, its controlling shareholder or management.

Money lending

In recent years, the SFC has noted an increase in the number of listed issuers[3] engaged in money lending as part of their business. When the amount of a single loan (or a series of related loans) is material, and the borrower is a privately held entity that is not generally known to the market, disclosure of the controllers or beneficial owners of the borrower, and their background and financial standing, may be necessary to enable the investing public to make an informed assessment of the issuer's activities.

Issuance of shares, convertible bonds and options

The Listing Rules[4] require the identities of persons acquiring the securities of listed issuers to be disclosed under some circumstances.

For example, in cases of private placements of new shares or issuance of convertible bonds, a listed issuer must disclose the names of the allottees if there are fewer than six allottees. The SFC has noted some cases where the identities of the subscribers were required to be disclosed, but the disclosure was limited to the names of the corporate vehicles used to consummate the transaction without disclosure of the controllers or beneficial owners.

Listed issuers are also required to publish an announcement as soon as possible upon the granting of stock options. Many announcements simply state that the stock options were granted to "eligible participants", who were not named, and the number of options granted to each recipient is undisclosed. This approach may not provide investors with the necessary information to make an informed assessment particularly as many option plans define "eligible participants" very broadly to include any director, employee, consultant, professional, customer, supplier, agent, partner or adviser of or contractor of the listed issuer.

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[3] These listed issuers have obtained a licence under the Money Lenders Ordinance to engage in money lending business. For the avoidance of doubt, the listed issuers are not an authorized institution as defined in the Banking Ordinance nor a company authorized to carry out insurance business under the Insurance Ordinance.

[4] The Rules Governing the Listing of Securities on the Stock Exchange of Hong Kong Limited

When a proposed transaction involves the issuance of listed securities, issuers are reminded to consider section 3 of the SMLR[5] when preparing their announcements and other documents in relation to the proposed issuance. The SFC may use its powers to require further information or to object to the listing of the relevant securities where it appears that the listing application does not comply with a requirement under section 3[6].

Private funds and similar arrangements

The SFC has noted that some listed issuers employ private fund structures to engage in proprietary transactions, including investments, acquisitions, share buybacks and lending. Set below are non-exhaustive examples:

(i) the listed issuer was the sole investor in, or provided the vast majority of the capital for, the private fund;

(ii) the listed issuer was one of a handful of investors in a private fund which invested exclusively in one company or a single investment (e.g. a loan to an individual);

(iii) the listed issuer subscribed to numerous private funds managed by different persons, but each fund invested all or the majority of their capital in the same investment and, together, the funds held 100% of that investment;

(iv) the listed issuer subscribed to a private fund which in turn, through multiple tiers of other private funds, invested in a wholly-owned subsidiary of the listed issuer; and

(v) the listed issuer disposed of an asset to a private fund that was in turn majority-owned by the listed issuer itself.

In some cases, the private fund is managed by the listed issuer itself or a connected person of the listed issuer. A number of these arrangements or transactions have no conventional commercial rationale or were unduly convoluted, which raise concerns that they may have been entered into for reasons that have not been fully disclosed.

Many of these transactions were announced by listed issuers as if they were ordinary course investments with minimal disclosure regarding the private fund and the underlying transaction or investment.

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[5] Section 3 of the SMLR: An application for the listing of any securities issued or to be issued by the applicant shall—
(a) comply with the rules and requirements of the recognized exchange company to which the application is submitted (except to the extent that compliance is waived or not required by the recognized exchange company);
(b) comply with any provision of law applicable; and
(c) contain such particulars and information which, having regard to the particular nature of the applicant and the securities, is necessary to enable an investor to make an informed assessment of the activities, assets and liabilities and financial position, of the applicant at the time of the application and its profits and losses and of the rights attaching to the securities.

[6] Section 6 of the SMLR

Listed issuers are reminded that they should not employ private fund structures, discretionary accounts or complex arrangements with a view to obfuscating the nature of the transaction and its risk, avoiding or to contravening laws, rules or regulations.

Where it appears to the SFC that (i) any materially false, incomplete or misleading information has been included in any listing document, announcement or other document made or issued by a listed issuer in connection with its affairs, or (ii) it is necessary or expedient in the interest of maintaining an orderly and fair market in any listed securities, or (iii) it is in the interest of the investing public or in the public interest, or it is appropriate for the protection of investors generally or for the protection of investors in any listed securities, the SFC may direct a suspension in dealings of the relevant securities[7].

The SFC today issued a circular to licensed corporations regarding dubious private fund and discretionary account arrangements or transactions and highlighted potential "red flags" that may indicate the existence of such arrangements or transactions. Among other things, the circular cautions licensed corporations not to disregard dubious private fund and discretionary account arrangements or transactions, which may facilitate their clients or other entities in avoiding or contravening laws, rules or regulations such as the SFO, the Codes on Takeovers and Mergers and Share Buy-backs and the Listing Rules.

[7] Section 8(1)(a) of the SMLR