



Issue 7 of 2011: December

SFC gets tough on Takeovers Code disclosures 1

Surveillance of Hong Kong's key facts statements 2

New SFC consultation on amending Code of Conduct..... 3

Form PF reporting in the US – implications for non-US managers 3

SFC gets tough on Takeovers Code disclosures

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During a takeover offer for a Hong Kong listed company, Rule 22 of the Takeovers Code requires associates of the listed company and of the offeror to disclose dealings in those parties. “Associate” includes investment managers of funds holding 5% or more of any class of voting shares of the listed company.

Such managers will have separate filing obligations under the substantial shareholder disclosure regime in Part XV of the Securities and Futures Ordinance. However, even amongst managers who comply with Part XV, breaches of the Takeovers Code disclosure requirements are not uncommon. This is in part due to lack of awareness of the requirements, as well as the extremely tight filing deadlines.

In March this year, after lobbying from various market participants, the Securities and Futures Commission (SFC) began publishing “Offer Period Tables” on its website, collating details of all listed companies subject to takeover offers:

http://www.sfc.hk/sfc/html/EN/cfd/mergers/dealing_disclosure_disclosure_table.html

As a secondary source to takeover announcements by listed companies, the webpage provides an easy way for investment managers and others to check whether any of the listed companies in which they have an interest are subject to takeover offers. However, the SFC expressly states that provision of the tables does not absolve users of their obligations under the Takeovers Code, and disclaims responsibility for the accuracy of the information. It appears that the SFC established the webpage with some hesitation, perhaps for fear it might impute some responsibility for assisting firms with their disclosure obligations.

Having now taken the trouble to publish the tables, the SFC recently has shown an assertive approach towards those who fail to use them properly. On 7 November, the SFC publicly criticised the Hong Kong office of a large global investment manager for late disclosure of its funds’ dealings in Little Sheep Group Limited during the takeover offer period:

<http://www.sfc.hk/sfcPressRelease/EN/sfcOpenDocServlet?docno=11PR141>

The dealings accounted for only 0.01% of the issued share capital and the SFC appears to have accepted that they were not conducted with a view toward obtaining control of Little Sheep. Moreover, the manager self-reported to the SFC after becoming aware of its mistake.

This disciplinary action follows public censure by the SFC of another large global investment manager on 14 December 2010:

[http://www.sfc.hk/sfc/doc/EN/cfd/mergers/panel/](http://www.sfc.hk/sfc/doc/EN/cfd/mergers/panel/Executive%20Statement%20Eng%20Final%2020101214.pdf)

[Executive%20Statement%20Eng%20Final%2020101214.pdf](http://www.sfc.hk/sfc/doc/EN/cfd/mergers/panel/Executive%20Statement%20Eng%20Final%2020101214.pdf)

In that case, the manager executed 6,439 trades in Denway Motors Limited shares during the takeover offer period, increasing its control from 13.96% to 15.47%. The manager filed the necessary Part XV disclosure notices but was not aware of the reporting requirements under the Takeovers Code, and only filed the takeovers dealing disclosures after being contacted by the SFC.

Although the Takeovers Code does not have the force of law, the SFC may impose various sanctions against persons who do not comply. Aside from public censure, the SFC may issue “cold shoulder” orders (requiring SFC licensees not to act for a person who breaches the Code), and report non-compliance to other regulatory authorities or professional bodies. In both the Little Sheep and Denway Motors cases, non-compliance by the investment managers was inadvertent. But the unintentional breach and consequent SFC criticism is a considerable embarrassment, especially as the disciplinary actions appear indefinitely and publicly against the investment managers’ names on the SFC’s register of licensed persons.

In light of recent breaches, on 25 November the SFC issued a letter to licensed fund managers reminding them of their disclosure obligations under the Takeovers Code, and asking them also to alert fund managers in their overseas offices. To facilitate better compliance, the letter suggests a number of measures including regular monitoring of the Offer Period Tables and HKEx announcements, as well as routine review of takeovers-related articles in the media. It also suggests regular and on-going staff training, in particular in relation to the meaning of “associate” and the rules concerning dealing disclosures.

Given the SFC’s recent close attention, fund managers would do well to review their position monitoring and reporting systems, and staff training procedures, to ensure they are sufficiently robust to ensure compliance with disclosure obligations under the Takeovers Code.

Surveillance of Hong Kong’s key facts statements

by Alwyn Li (alwyn.li@deacons.com.hk)

In our client alert of September 2011 entitled “KFS Update”, we noted that the Securities and Futures Commission (SFC) was undertaking a surveillance programme on product key facts statements (KFSs) and offering documents. The SFC has subsequently issued a circular on its findings. Links to these documents are provided below. The requirement for a product issuer to produce a KFS was introduced by the SFC’s Handbook for Unit Trusts and Mutual Funds, Investment-linked Assurance Schemes and Unlisted Structured Investment Products (Handbook) which came into effect on 25 June 2010.

During the surveillance exercise, the SFC reviewed a sample of KFSs against the product’s offering document, the requirements under the Handbook and other SFC guidelines. Where deficiencies were found, the SFC has imposed different remedial requirements, depending of the level of shortcomings and the issues involved. Where the SFC identified a material inconsistency between the KFS and the offering document, the issuer has been required to take immediate remedial action, including ceasing marketing efforts and ceasing to take subscriptions pending rectification of the deficiencies. Where the SFC identified less material issues, the issuer was required to rectify the inconsistencies on an expedited basis.

One issue which has provoked discussion in the industry is the treatment of financial derivative instruments (FDIs). The SFC requires that if the fund will invest in FDIs for investment purposes, then both the offering document and the KFS must disclose this information and outline whether or not such use is extensive. Any use of FDIs for non-hedging purposes will be considered as use for investment purposes. The SFC has not to date provided written guidance on what is considered “extensive” in this context, requiring issuers to rely on their own judgment and counsel.

The SFC may conduct further KFS surveillance as it deems fit.

You can read the client alert here:

http://www.deacons.com.hk/eng/knowledge/knowledge_441.htm

and the SFC circular here:

<http://www.sfc.hk/sfcRegulatoryHandbook/EN/displayFileServlet?docno=H654>

New SFC consultation on amending Code of Conduct

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On 8 November 2011, the Securities and Future Commission (SFC) issued a consultation paper on proposals to amend the Code of Conduct for Persons Licensed by or Registered with the SFC.

The SFC has proposed the changes in order to:

- facilitate the establishment of an external financial dispute resolution scheme (FDRS) to be administered by the financial dispute resolution centre (FDRC) for SFC and Hong Kong Monetary Authority regulated financial institutions (FIs) to resolve monetary disputes with individual and sole proprietorship customers; and
- make “miscellaneous” amendments to the Code as part of the SFC’s efforts to improve supervisory oversight of the financial market and strengthen effective enforcement against market misconduct.

The SFC has posed various questions in relation to the proposals and invited comments by 9 January 2012.

What will the FDRC mean for financial institutions?

The FDRS is the government’s response to the call from the investing public for an independent dispute resolution scheme to enable customers to resolve financial disputes with FIs without having to resort to formal legal proceedings. FIs can therefore expect to need additional resources to handle customer complaints in the first place and then to manage the resolution process.

In terms of internal complaints handling, the proposed amendments to the Code specifically oblige FIs to:

- review each complaint properly;
- investigate and remedy the issues if the subject matter of the complaint relates to other clients or raises issues of broader concern; and
- inform the client of its right to take the complaint to the FDRC if a complaint cannot be resolved internally.

Where the internal complaints procedure fails, FIs would be obliged to participate in and would be bound by the FDRS process. They would also be obliged to make full and frank disclosure before mediators and arbitrators and render all reasonable assistance to the FDRS.

In addition, the FI would need to notify the SFC immediately upon:

- its receipt of a client complaint to the FDRC;
- the commencement of the FDRS in response to a complaint (including documentation if requested by the SFC);
- the determination or settlement of a complaint (including details if requested by the SFC).

The “miscellaneous” amendments

The SFC has also taken this opportunity to propose the following amendments:

- order recording:
 - prohibiting the taking of orders over mobile phones (currently this is only discouraged)
 - extending the retention period for telephone recordings of client orders to six months
 - requiring IP address records of clients to be kept for six months
- requiring written authorisation to effect transactions on a client’s account
- prohibiting FIs from preventing staff from providing expert witness services to regulators

The SFC has also proposed that the obligation in paragraph 12.5 of the code for FIs to report actual or suspected material breaches by the FI or an employee, be expanded to cover such breaches by clients. In rationalising the need for this extension, the SFC has referred to the existing requirement to report transactions which appear suspicious under one of the three relevant ordinances to the Joint Financial Intelligence Unit. This controversial proposal has potentially far reaching consequences and is likely to generate heated debate.

You can read the SFC’s consultation paper here:

<https://www.sfc.hk/sfcConsultation/EN/sfcConsultMainServlet?name=FDRCCode>

Form PF reporting in the US – implications for non-US managers

by **Ethan W Johnson, Partner of Morgan, Lewis & Bockius, LLP** (ejohnson@morganlewis.com)

The US Securities and Exchange Commission (SEC) and Commodity Futures Trading Commission recently approved rules

that will require certain SEC-registered investment advisers to report on Form PF extensive information about the private funds they advise. (Note: advisers to liquidity funds and private equity funds may also have Form PF reporting obligations, which are not addressed in this article).

Who must report on Form PF? An adviser must file Form PF if it is SEC-registered (or required to be), advises one or more “private funds” (e.g., funds offered to US persons under Investment Company Act exemptions 3(c)(1) or 3(c)(7)), and has at least US\$150 million in private fund assets under management. Advisers that are exempt from registration are not required to file Form PF.

All reporting advisers must file Section 1 of Form PF but certain “large” advisers to private funds are required to submit additional information. In determining whether it meets the minimum or a “large” reporting threshold, an adviser must aggregate with its private fund assets (i) parallel managed account assets and (ii) private funds assets advised by related persons that are not operationally separate. Presumably these aggregation requirements would only apply to US accounts.

“Large” advisers include those with at least US\$1.5 billion in hedge fund assets (as of the end of any month during the prior fiscal quarter). “Hedge funds” are defined (for the purposes of Form PF only) as private funds that (i) include a performance fee that takes into account market value, (ii) are highly leveraged, or (iii) engage in short selling. Large advisers to hedge funds are required to report on Form PF (both Sections 1 and 2) quarterly within 60 days of quarter end.

Initial Filings. Large advisers to hedge funds with at least US\$5 billion in assets are required to file their initial reports within 60 days of their next quarter end after 15 June 2012 (i.e., 29 August). Hedge fund advisers that are not “large” advisers and large advisers that have less than US\$5 billion of assets must file their initial reports within 60 days after their next quarter end after 15 December 2012 (i.e., 1 March). Advisers and sub-advisers should

coordinate reporting obligations to ensure that information is reported if required.

Required Information. Although reporting advisers may only have to submit Form PF to the SEC on a quarterly or annual basis, much of the required information must be gathered monthly, including:

- **All Reporting Advisers.** Section 1 requires advisers to provide, inter alia, general identifying information as well as assets under management, leverage and performance information, information on related persons, derivative positions and counterparty exposures.
- **Large Advisers to Hedge Funds.** Section 2 requires information about hedge funds’ asset values; holdings in structured products; duration or other measures of fixed income holdings; turnover; geographical exposures, asset exposures, liquidity, concentration, cash holdings, base currency, collateral practices with counterparties, use of central clearing counterparties, risk metrics, impact from market factors, borrowing and credit support, total notional derivatives exposure and mark-to-market value of uncleared derivatives positions and, in certain circumstances, side pocket and gating arrangements.

Confidentiality of Information. Although information submitted on Form PF is nonpublic, the SEC may use the information in enforcement actions and it may be accessed by various federal departments and agencies and by self-regulatory organizations.

Implications for Non-US Advisers. Foreign SEC-registered advisers with minimal US assets under management may be able to reorganize those US assets into an isolated fund offered only to US investors, which could permit such an adviser to avoid Form PF filing requirements entirely (if it has less than US\$150 million of US assets), or minimize the filing burden by only requiring the adviser to file Section 1 of Form PF (if it has between US\$150 million and US\$1.5 billion in US assets).

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Whilst every effort has been made to ensure the accuracy of this publication, it is for general guidance only and should not be treated as a substitute for specific advice.

If you would like advice on any of the issues raised, please speak to any of the contacts listed.