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SFC publicly criticises Penta for breaches of Takeovers Code

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The Securities and Futures Commission (SFC) has publicly criticised Penta Investment Advisers Limited (Penta) for breaches of the Code on Takeovers and Mergers (Takeovers Code) as a result of its failure to disclose its dealings in relevant securities of Allied Properties (H.K.) Limited (APL) and of Tian An China Investments Company Limited (Tian An).

Between 15 September 2011 and 30 September 2011 Penta executed 14 orders in the relevant securities of Tian An on seven days (through 113 on-market executions), and 23 orders in the relevant securities of APL on 10 days (through 559 on-market executions) and failed to make public disclosure of these dealings as required by the Takeovers Code.

Penta accepted that it has failed to comply with Rule 22 of the Takeovers Code and consented to the disciplinary action taken against it. Since the breaches came to light, Penta has implemented a number of measures to ensure future compliance with the Takeovers Code.

The SFC wishes to take this opportunity to remind practitioners and parties who wish to take advantage of the securities markets in Hong Kong that they should conduct themselves in matters relating to takeovers and mergers in accordance with the Takeovers Code and particularly, associates must report their dealings in the offeree company (or offeror company in the case of a securities exchange offer) during an offer period in accordance with the Takeovers Code.

A copy of the [Executive Statement](#) and the relevant Takeovers Code provisions can be found in the Takeovers and Mergers Executive Statement section of the SFC website at www.sfc.hk.

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Takeovers Executive of the SFC criticises Penta Investment Advisers Limited in relation to breaches of the dealing disclosure requirements in Rule 22 of the Takeovers Code

Criticism on Penta Investment Advisers Limited

1. The Executive publicly criticises Penta Investment Advisers Limited (“Penta”) under section 12.3 of the Introduction to the Code on Takeovers and Mergers (“Takeovers Code”) for breaching Rule 22 of the Takeovers Code as a result of its late disclosure of dealings in the relevant securities of Allied Properties (H.K.) Limited (“APL”) and Tian An China Investments Company Limited (“Tian An”) between 15 September 2011 and 30 September 2011.
2. At all relevant times, Penta, on behalf of various funds and investors, held over 5% of the issued share capital of APL and Tian An respectively and fell within the definition of “associate” under the Takeovers Code during the relevant period.

Background and relevant provisions of the Takeovers Code

Background

3. Penta acts as investment advisor to various funds and managed accounts, including Penta Master Fund, Ltd., Penta Asia Domestic Partners, L.P. and Penta Asia Long/Short Fund Ltd.
4. Rule 22.3 of the Takeovers Code provides that *“[i]f a person manages investment accounts on a discretionary basis, relevant securities so managed will be treated, for the purpose of Rule 22, as controlled by that person and not by the person on whose behalf the relevant securities are managed.”* This means that Penta, and not its clients, will be treated as interested in any shares and other interests in shares managed by it on a discretionary basis.
5. On 14 September 2011 an offer period commenced for Tian An when Allied Group Limited, APL and Tian An jointly announced, amongst other things, that China Elite Holdings Limited, a wholly-owned subsidiary of APL, informed the board of directors of Tian An of its firm intention to make a voluntary conditional partial share exchange offer in respect of 103,180,000 shares of Tian An at the consideration of 4 APL shares for each Tian An offer share (“Rule 3.5 Announcement”).
6. The Rule 3.5 Announcement contained a clear reminder to associates (as defined in the Takeovers Code) of Tian An and APL that they should disclose their dealings in Tian An and APL in accordance with Rule 22 of the Takeovers Code.

Offer Period Tables

7. The Offer Period Tables (the “Tables”) are published on the Takeovers page of the SFC website to assist relevant parties to discharge their obligations under the Takeovers Code, including the dealing disclosure obligations under Rule 22 of the Takeovers Code and dealing restrictions under Rule 21 of the Takeovers Code. The Tables provide details of (i) new offer periods that have commenced

in the past 14 days; (ii) offer periods that have closed in the past 14 days; and (iii) all current offer periods under the Takeovers Code. The partial offer of Tian An was added to the Tables during the morning of 15 September 2011.

8. The SFC announced the publication of the Tables on the SFC website in the March 2011 Takeovers Bulletin issue no. 16. Associates of offeree companies (including persons who own or control 5% or more of any class of the relevant securities of the offeror or the offeree company) were also reminded of their reporting obligations under Rule 22 of the Takeovers Code in the Takeovers Bulletin.

Relevant provisions under the Takeovers Code

Rule 22

9. Rule 22.1(b)(i) of the Takeovers Code provides that “[d]ealings in relevant securities by an offeror or the offeree company, and by any associates, for the account of discretionary investment clients during an offer period must be publicly disclosed in accordance with Notes 5, 6 and 7 to this Rule 22.”
10. The Takeovers Code defines an “Associate” to include “a person who owns or controls 5% or more of any class of relevant securities ... issued by an offeror or the offeree company, including a person who as a result of any transaction owns or controls 5% or more.”
11. Rule 22.3 of the Takeovers Code provides that “[i]f a person manages investment accounts on a discretionary basis, relevant securities so managed will be treated, for the purpose of this Rule 22, as controlled by that person and not by the person on whose behalf of the relevant securities are managed. Except with the consent of the Executive, where more than one discretionary investment management operation is conducted in the same group, relevant securities controlled by all such operations will be treated for the purpose of this Rule 22 as those of a single person and must be aggregated.”
12. Immediately prior to the commencement of the offer period for Tian An on 14 September 2011, Penta was therefore treated, for the purpose of Rule 22 of the Takeovers Code, as owning or controlling 28.14% and 7.51% of the issued share capital of Tian An and APL respectively. Given that at all relevant times Penta was treated, for the purpose of Rule 22 of the Takeovers Code, as owning or controlling over 5% of the issued share capital of Tian An and APL, it was an associate of each of Tian An and APL and was required under Rule 22 of the Takeovers Code to disclose publicly its dealings in Tian An and APL during the offer period.

Rule 3.8

13. Rule 3.8 of the Takeovers Code provides that “When an offer period begins, the offeree company must announce, as soon as possible.... In the announcement, the offeree company, the offeror or potential named offeror should remind their respective associates to disclose their dealings in any securities of the offeree company, or in the case of securities exchange offer, any securities in the same class as the securities that are offered as consideration under an offer...”.
14. As already mentioned in paragraph 6 above the Rule 3.5 Announcement included a reminder to associates of Tian An and APL of their disclosure

obligations under Rule 22 of the Takeovers Code. It was specifically mentioned in the reminder that associates of Tian An and APL included persons holding 5% or more of a class of relevant securities of Tian An and/or APL.

Breaches of Rule 22 of the Takeovers Code

15. Between 15 September 2011 and 30 September 2011, Penta executed 14 orders in the relevant securities of Tian An on seven days (through 113 on-market executions), and 23 orders in the relevant securities of APL on 10 days (through 559 on-market executions) (collectively the "Dealings"). The Dealings changed Penta's deemed net shareholding in Tian An from 28.14% to 28.15%, and in APL from 7.51% to 8.04%. Despite the provisions of Rule 22 of the Takeovers Code and the reminder set out in the Rule 3.5 Announcement, Penta did not file disclosures with the Executive in respect of the Dealings in accordance with Rule 22.
16. Penta self-reported to the Executive on 4 October 2011 that, whilst it had complied with Part XV of the Securities and Futures Ordinance ("SFO") it had not made the required disclosures in respect of the Dealings in accordance with Rule 22 of the Takeovers Code. The requisite filings were promptly made once the omissions came to light through Penta's internal process. Penta subsequently explained that the delay in making the requisite dealing disclosures was due to an inadvertent oversight. It also acknowledged that, at that time, there was a shortcoming in its process in relation to the monitoring of disclosure obligations under the Takeovers Code.

Apology by Penta and remedial action taken

17. Penta has apologised for the breaches and submitted that it takes its regulatory obligations very seriously, as evidenced by its timely filings under the SFO. It self-reported the late disclosures to the Executive immediately after they were discovered.
18. Penta has explained that its dealings in shares of Tian An and APL were not proprietary positions held by it but were conducted for portfolio rebalancing purposes. It has confirmed that the reported transactions were consistent with the fundamental investment philosophy of its funds and not conducted with a view to obtaining control of Tian An and/or APL.
19. Penta has implemented a number of enhanced measures to ensure future compliance with Rule 22 of the Takeovers Code. These measures include, inter alia, (a) the provision of training to the staff members in its Hong Kong office responsible for monitoring Penta's disclosure obligations under the SFO to reinforce the daily checking and reporting process; (b) in addition to the review of (i) the Stock Exchange's website for issuers' announcements; (ii) the Offer Period Tables on the SFC website; and (iii) the relevant alerts from the SFC, the Stock Exchange and the Takeovers Bulletin, searches conducted by relevant staff members on Bloomberg to assist in identifying takeovers; (c) continuous assessment of the sufficiency of its resources and, if the need arises, employment of additional staff to assist in the monitoring process; and (d) the engagement of external advisors to review and comment on Penta's compliance policies and procedures with regard to its disclosure obligations under the SFO and the Takeovers Code.

20. In this regard, the Executive notes that Penta has since duly complied with the disclosure obligations under Rule 22 of the Takeovers Code.

Implications of Penta's failure to comply with Rule 22 of the Takeovers Code

21. The disclosure obligations under Rule 22 of the Takeovers Code are intentionally more onerous than those under Part XV of the SFO in that (i) Rule 22 requires filing to be made by 10:00 a.m. on the business day following the dealing; (ii) there are no *de minimis* thresholds; and (iii) Rule 22 requires the disclosure of prices paid or received for each underlying trade whilst the SFO only requires the disclosure of the highest and the average price paid or received.

22. The high degree of transparency required under the Takeovers Code is essential to the efficient functioning of the market in an offeree company's shares during the critical period of an offer. Timely and accurate disclosure of information in relation to dealings by associates and any party who may have the ability to exercise a material influence over the outcome of an offer plays a fundamental part in ensuring that takeovers are conducted within an orderly framework and that the integrity of the markets is maintained. This is in line with General Principle 6 which provides that:

"All persons concerned with offers should make full and prompt disclosure of all relevant information and take every precaution to avoid the creation or continuance of a false market. Parties involved in offers must take care that statements are not made which may mislead shareholders or the market."

23. Penta, as an associate of Tian An and APL, failed to make timely disclosure of details of its dealings in the relevant securities of Tian An and APL between 15 September 2011 and 30 September 2011 during the offer period. Penta's failure to report its Dealings as required by Rule 22 is a material breach of General Principle 6 as well as Rule 22 of the Takeovers Code, and the Executive considers that the breach merits the present disciplinary action. In reaching the decision to issue this criticism, the Executive has taken into consideration all relevant factors, including, amongst other things, the fact that Penta self-reported the breaches, its co-operation with the Executive's review of this matter, and the additional controls it has implemented to ensure future compliance with the Takeovers Code.
24. Penta accepts that it has failed to comply with Rule 22 of the Takeovers Code as described and has agreed to the disciplinary action being taken against it under section 12.3 of the Introduction to the Takeovers Code.
25. Finally the Executive wishes to take this opportunity to remind practitioners and parties who wish to take advantage of the securities markets in Hong Kong that they should conduct themselves in matters relating to takeovers and mergers in accordance with the Takeovers Code and particularly, associates with a 5% or more interest in the offeree company or offeror company must report their dealings in the offeree company (or offeror company in the case of a securities exchange offer) during an offer period in accordance with Rule 22 of the Takeovers Code.

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