

SFC publicly criticises CICC Financial Trading Limited and China International Capital Corporation Limited for breaches of Takeovers Code

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The Securities and Futures Commission (SFC) has publicly criticised CICC Financial Trading Limited (CICCFT) and China International Capital Corporation Limited (CICCL) for breaches of the Code on Takeovers and Mergers (Takeovers Code).

In transactions related to mandatory general offers for the H shares of Dalian Port (PDA) Company Limited and Maanshan Iron & Steel Company Limited in 2019, China International Capital Corporation Hong Kong Securities Limited (CICCHKSL) (Note 1), a member of the China International Capital Corporation Group (CICC Group), was the financial adviser to the offerors (Note 2).

CICCFT and CICCL dealt in the relevant securities of Dalian Port and Maanshan Iron during the transactions but failed to make timely disclosure of their dealings in relevant securities under Rule 22 of the Takeovers Code (Note 3).

CICCFT and CICCL accepted that they failed to comply with the Takeovers Code and agreed to the disciplinary action taken against them. In deciding the sanction, the SFC paid considerable regard to the prompt actions taken by CICC Group following the discovery of the breach. The SFC also considered CICC Group's full cooperation and a number of measures which it has put in place to ensure future compliance.

The disclosure obligations in the Takeovers Code are intentionally onerous to reflect the fact that a high degree of transparency is essential to the efficient functioning of the market in the critical period of an offer or possible offer for a company's shares. Timely and accurate disclosure of information in relation to relevant dealings, including those of advisers, plays a fundamental role in ensuring that takeovers are conducted within an orderly framework and the integrity of the markets is maintained.

A copy of the [Executive Statement](#) can be found in the "[Takeovers and mergers – Decisions & statements – Executive decisions and statements](#)" section of the SFC website.

End

Notes:

1. CICCHKSL is licensed to carry out Type 1 (dealing in securities), Type 2 (dealing in futures contracts), Type 4 (advising on securities), Type 5 (advising on futures contracts) and Type 6 (advising on corporate finance) regulated activities under the Securities and Futures Ordinance.
2. CICCHKSL and CICCFT are wholly-owned subsidiaries of CICCL and all of them are members of CICC Group. CICCFT and CICCL are also recognised as exempt principal traders under the Takeovers Code. CICCFT and CICCL therefore fell within the definition of "associate" of the offerors in both of the offers.
3. Rule 22.1(a) of the Takeovers Code provides that "*[d]ealings in relevant securities by an offeror or the offeree company, and by any associates of either of them, for their own account during an offer period must be publicly disclosed...*".
Note 5 to Rule 22 further provides that "*[d]isclosure must be made no later than 12.00 noon on the business day following the date of the transaction...*".

Takeovers Executive of the SFC publicly criticises CICC Financial Trading Limited and China International Capital Corporation Limited in relation to breaches of Rule 22 of the Takeovers Code

Criticism on CICC Financial Trading Limited and China International Capital Corporation Limited

1. The Executive publicly criticises CICC Financial Trading Limited (“**CICCFT**”) and China International Capital Corporation Limited (“**CICCL**”) under section 12.3 of the Introduction to the Codes on Takeovers and Mergers and Share Buy-backs (“**Codes**”) for breaching Rule 22 of the Code on Takeovers and Mergers (“**Takeovers Code**”) as a result of their late disclosure of dealings in the relevant securities in two transactions governed by the Takeovers Code in 2019.
2. For the purposes of the Takeovers Code, both CICCFT and CICCL were (i) associates of Broadford Global Limited (“**Broadford**”) in its mandatory general offer for the H shares of Dalian Port (PDA) Company Limited (“**Dalian Port**”); and (ii) associates of Baosteel Hong Kong Investment Company Limited (“**Baosteel**”) in its mandatory general offer for the H shares of Maanshan Iron & Steel Company Limited (“**Maanshan Iron**”).

Background and relevant provisions of the Takeovers Code

Dalian Port Offer

3. An offer period commenced for Dalian Port on 4 June 2019 when Broadford and Dalian Port jointly announced a possible mandatory general offer for Dalian Port (“**Dalian Port Offer**”). China International Capital Corporation Hong Kong Securities Limited (“**CICCHKSL**”) acted as the financial adviser to Broadford, the offeror.

Maanshan Iron Offer

4. An offer period commenced for Maanshan Iron when it published an announcement under Rule 3.7 of the Takeovers Code on 2 June 2019. Subsequently, Maanshan Iron and Baosteel jointly announced a possible mandatory general offer for Maanshan Iron on 22 July 2019 (“**Maanshan Iron Offer**”). CICCHKSL was the financial adviser to Baosteel, the offeror.

Parties

5. CICCHKSL is licensed to carry out a number of regulated activities under the Securities and Futures Ordinance including advising on corporate finance.
6. CICCHKSL and CICCFT are wholly-owned subsidiaries of CICCL. Each of CICCHKSL, CICCFT and CICCL is a member of the China International Capital Corporation group (“**CICC Group**”).
7. Both CICCFT and CICCL are recognised as exempt principal traders (“**EPT**”) by the Executive under the Takeovers Code.

Relevant provisions under the Takeovers Code

8. Rule 22 of the Takeovers Code requires parties to an offer and their respective associates (as defined in the Codes) to disclose their dealings in relevant

securities (as defined in Note 4 to Rule 22 of the Takeovers Code) of the offeree company (and of the offeror in a securities exchange offer) conducted for themselves or on behalf of clients during an offer period. The relevant provisions of Rule 22 are set out in full in the **Appendix** to this statement.

9. The definition of “associate” under the Takeovers Code covers “*any financial and other professional adviser... [to an offeror or the offeree company] ... and persons controlling, controlled by or under the same control as the advisers...*”. It also includes “*any exempt principal trader... which is controlling, controlled by or under the same control as the financial and other professional adviser to [an offeror or the offeree company]...*”.
10. The Takeovers Code also defines an “exempt principal trader” as a person who trades as a principal in securities only for the purpose of derivative arbitrage or hedging activities such as closing out existing derivatives, delta hedging in respect of existing derivatives, index related product or tracker fund arbitrage in relation to the relevant securities during an offer period.
11. The note to the definition of derivative provides that “*...it is not the intention of the Codes to restrict dealings in, or require disclosure of, derivatives which have no connection with an offer... The Executive will not normally regard a derivative which is referenced to a basket or index including relevant securities as connected with an offeror or potential offeror if at the time of dealing the relevant securities in the basket or index represent less than 1% of the class in issue and less than 20% of the value of the securities in the basket or index...*”.

Breaches of Rule 22 of the Takeovers Code

Trades executed by CICCL

12. CICCL is a designated liquidity provider of a pre-existing A-share index-tracking exchange traded fund (“**ETF**”) listed on the Shenzhen Stock Exchange (“**SZSE**”). In performing its pre-existing obligations as a liquidity provider, it creates and redeems ETF units (“**ETF Trades**”). The creation of ETF units involves the acquisition by CICCL of a basket of underlying securities listed on the Shanghai Stock Exchange (“**SSE**”) and SZSE (“**Acquisitions**”) which will then be delivered to an ETF provider in exchange for a block of ETF units with the same market value. Upon unsolicited client request for redemption of the ETF units, CICCL delivers the ETF units to the ETF provider in return for an equivalent basket of the underlying securities. CICCL will then dispose of these underlying securities in the market (“**Disposals**” together with the Acquisitions, the “**ETF-related Hedging Trades**”).
13. CICCL also executed index arbitrage activities which involved taking short positions in an A-share index futures product (“**Index Futures Trades**”) and entering into related hedging transactions. The hedging transactions required acquisition of the underlying constituent stocks of the index (“**Index-related Acquisitions**”) or related ETF units. In the case where ETF units were acquired for hedging, when squaring its position, CICCL might request for redemption and disposal of the underlying stocks afterwards (“**Index-related Disposals**”, together with Index-related Acquisitions, the “**Index-related Hedging Trades**”).
14. The A shares of Dalian Port and Maanshan Iron were underlying constituent stocks in the ETF and the index futures product. According to the definition of EPT, EPTs are permitted to execute the ETF Trades, the Index Futures Trades

and their respective related hedging transactions (collectively, the “**Permitted Trades**”) during an offer period. As the ETF Trades and the Index Futures Trades (together, the “**Derivative Trades**”) are trades relating to derivatives which were referenced to a basket or index including the relevant securities of either Dalian Port or Maanshan Iron that represented less than 1% of their respective class in issue and less than 20% of their respective value of the securities in the basket or index (“**Threshold**”), the Derivative Trades were not considered as having a connection with the Dalian Port Offer or the Maanshan Iron Offer (together, the “**Offers**”). Therefore, no disclosure for the Derivative Trades was required.

15. However, the ETF-related Hedging Trades and the Index-related Hedging Trades (collectively, the “**Relevant CICCL Trades**”) were trades that involved the underlying relevant securities of Dalian Port and Maanshan Iron and not derivatives that were unconnected to the Offers. It follows that CICCL should have made public disclosures of the Relevant CICCL Trades no later than 12:00 noon on the business day following the date of each of the Relevant CICCL Trades in compliance with Rule 22 of the Takeovers Code.
16. In relation to the A shares in Dalian Port, CICCL executed, in respect of the ETF Trades, 8 ETF-related Hedging Trades, and in respect of the Index Futures Trades, 6 Index-related Hedging Trades during the period between 4 June 2019 and 25 June 2019. As regards A shares of Maanshan Iron, CICCL executed, in respect of the ETF Trades, 11 ETF-related Hedging Trades, and in respect of the Index Futures Trades, 6 Index-related Hedging Trades during the period between 3 June 2019 and 25 June 2019.

Trades executed by CICCFT

17. CICCFT executed swap transactions involving a basket of stocks which included the A shares of Dalian Port and Maanshan Iron (“**Swap Trades**”). CICCFT also conducted the related delta-one hedging trades of the underlying securities to fully hedge its proprietary positions in the Swap Trades by taking opposite positions in the market through CICCHKSL as its broker (“**Swap Hedging Trades**”).
18. Similar to the Derivative Trades, the Swap Trades were permitted trades under the definition of EPT involving relevant securities of Dalian Port and Maanshan Iron with the relevant percentages falling below the Threshold. The Swap Trades were therefore considered not connected to the Offers and were exempted from the disclosure requirements.
19. However, CICCFT should have made timely public disclosures in respect of the Swap Hedging Trades which involved acquisitions or disposals of the relevant securities of Dalian Port or Maanshan Iron during the relevant period.
20. CICCFT, through CICCHKSL as its broker, executed a total of 28 and 33 Swap Hedging Trades involving the A shares of Dalian Port and Maanshan Iron respectively during the period between 3 June 2019 and 26 June 2019.

Consultation with the Executive

21. On 27 June 2019, the compliance team of CICCHKSL consulted the Executive about the general nature of hedging trades in the context of the Offers, and the applicable disclosure requirements under Rule 22 of the Takeovers Code. While the Derivative Trades and the Swap Trades do not require disclosure as they are

not considered “connected with an offer”, it became apparent then that CICCFT and CICCL should have made requisite disclosures of: (i) the Relevant CICCL Trades; and (ii) the Swap Hedging Trades (collectively, the “**Relevant Trades**”) in compliance with Rule 22 of the Takeovers Code.

22. Following its consultation with the Executive on 27 June 2019, CICCFT and CICCL immediately self-reported the non-compliance with the Takeovers Code and submitted all requisite disclosures on 28 June 2019.

Apology by CICC Group and Actions Taken

23. CICC Group accepts the oversight of the disclosure obligations of CICCFT and CICCL in respect of the Relevant Trades and that there were shortcomings in its disclosure compliance system. It has apologised for the Rule 22 breaches and emphasised that it takes the matter extremely seriously as evidenced by its prompt action to make the submissions, the measures adopted and the fact that the matter was escalated to senior levels of the CICC Group.

Enhanced measures to ensure compliance in future

24. To address the shortcomings in its compliance with the Takeovers Code and to ensure future compliance, CICC Group implemented a number of measures including the following:
- (a) CICC Group’s internal reporting control has been enhanced with the reporting staff requiring to reconcile trades approved by the compliance control room to the relevant operations reports and vice versa;
 - (b) CICC Group has engaged an external counsel to:
 - (i) review its existing compliance manual for the purpose of the Takeovers Code;
 - (ii) assist in reviewing the existing merger and acquisition control list and to provide technical advice on CICC Group’s review of the reporting system with a view to enhancing compliance with the disclosure requirements under the Takeovers Code; and
 - (iii) provide a series of additional training for all relevant staff on takeovers matters including disclosure of dealings and compliance with the Takeovers Code;
 - (c) internal compliance reminders to traders and relevant operation teams to remind them of the reporting obligations; and
 - (d) for each Code-regulated transaction, equities line compliance team will additionally remind traders and operations teams of the relevant trade restrictions and reporting obligations and monitor their trades to ensure compliance with the Takeovers Code.
25. CICC Group has also committed to put in place the following enhancement measures :
- (a) CICC Group will establish a centralised reporting information technology system to cover its trading operations where practicably viable through

which the reporting staff can extract data directly from the system instead of relying on operations teams' email reporting;

- (b) CICC Group will streamline its operations systems such that trade details can be centralised into one or two back office systems for easy co-ordination; and
- (c) CICC Group will strengthen its internal notification and compliance procedures whereby the internal guideline will be reviewed to set out more explicitly the reporting obligation for all products, in particular the more complex products.

Executive's comments

26. The disclosure obligations under Rule 22 of the Takeovers Code are intentionally onerous to reflect the fact that a high degree of transparency is essential to the efficient functioning of the market in an offeree company's shares and/or offeror company's shares in the case of a securities exchange offer during the critical period of an offer or possible offer. Timely and accurate disclosure of information in relation to dealings by the offeree company's or the offeror company's associates including advisers plays a fundamental role 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."

27. CICCFT and CICCL, as associates of Broadford and Baosteel, failed to make timely disclosure of details of their dealings in the relevant securities of Dalian Port and Maanshan Iron between 3 June 2019 and 26 June 2019 during the offer period. The late filings of dealings in relation to the Relevant Trades under Rule 22 of the Takeovers Code by CICCFT and CICCL is a breach of General Principle 6 as well as Rule 22 of the Takeovers Code. The Executive considers that the breach merits the present disciplinary action.
28. In reaching the decision to issue this public criticism, the Executive paid considerable regard to the prompt submission of all requisite disclosures by CICCFT and CICCL the next day following consultation with the Executive. The Executive has also taken into consideration all other relevant factors, including, among other things, the Relevant Trades are Permitted Trades, the relative short period of breach, CICC Group's full co-operation with the Executive on the review of this matter, and the additional controls and measures CICC Group has since implemented and committed to put in place to ensure future compliance with the Takeovers Code.
29. CICCFT and CICCL accept that they failed to comply with Rule 22 of the Takeovers Code as described and have agreed to the disciplinary action being taken against them under section 12.3 of the Introduction to the Codes.
30. The Executive wishes to take this opportunity to clarify that while disclosures for dealings in certain derivatives which are not considered as having a connection with an offer or potential offer are not required, this should not be interpreted to mean that disclosures for their related hedging activities are similarly not required.

Holdings by parties related to an offer are material information in the context of an offer. Parties and particularly EPTs which are required to submit an annual confirmation to the Executive confirming that, among other things, suitable compliance procedures are in place, should pay regard and analyse the nature and circumstances of their trading activities carefully in determining whether disclosures under the Takeovers Code are required during an offer period. If in doubt, the Executive should be consulted.

31. 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 Codes. In any cases of doubt as to the application of Rule 22, the Executive should be consulted.

18 June 2020

Appendix

The relevant provisions of Rule 22 are set out in full below:

Rule 22.1(a)

Dealings in relevant securities by an offeror or the offeree company, and by any associates of either of them, for their own account during an offer period must be publicly disclosed in accordance with Notes 5, 6 and 7 to this Rule 22.

Rule 22.4

Dealings in relevant securities by an exempt principal trader connected with an offeror or the offeree company should be aggregated and disclosed, in accordance with Note 6(a) to this Rule 22, not later than 12.00 noon on the business day following the date of the transactions, stating the following details:–

- (i) total purchases and sales;
- (ii) the highest and lowest prices paid and received; and
- (iii) whether the connection is with an offeror or the offeree company.

In the case of dealings in options or derivatives, full details should be given so that the nature of the dealings can be fully understood (see Note 7 to this Rule 22).

Note 4 to Rule 22

Relevant securities for the purpose of this Rule 22 include:–

- (a) *securities of the offeree company which are being offered for or which carry voting rights;*
- (b) *equity share capital of the offeree company and, in a securities exchange offer only, of an offeror or of a company the securities of which are to be offered as consideration for the offer (as the case may be);*
- (c) *securities of an offeror or of a company the securities of which are to be offered as consideration for the offer (as the case may be) which carry the same or substantially the same rights as any to be issued as consideration for the offer;*
- (d) *securities carrying conversion or subscription rights into any of the foregoing; and*
- (e) *options and derivatives in respect of any of the foregoing.*

The taking, granting, exercising, lapsing or closing out of an option (including a traded option contract) in respect of any of the foregoing or the exercise or conversion of any security under (d) above whether in respect of new or existing securities and the acquisition of, entering into, closing out, exercise (by either party) of any rights under, or issue or variation of, a derivative will be regarded as a dealing in relevant securities (see also Notes 7 and 9 to this Rule 22).

Note 5 to Rule 22

Disclosure must be made no later than 12.00 noon on the business day following the date of the transaction or, where dealings have taken place in the time zones of the United States no later than 12.00 noon on the second business day following the date of the transaction. The Executive should be consulted at the earliest opportunity if there is difficulty in meeting the deadlines set.

Note 6(a) to Rule 22

Dealings should be disclosed in writing to the Executive using the prescribed forms available on the SFC's website. The Executive will arrange for the posting of the disclosure on the SFC's website and on the Stock Exchange's website.

Persons proposing to engage in dealings should also acquaint themselves with the disclosure requirements of Part XV of the Securities and Futures Ordinance (Cap. 571).

If any person chooses to make an announcement regarding dealings in addition to making formal disclosure, that person must ensure that no confusion results.

Public disclosure may be made by the person concerned or by an agent acting on its behalf. Where there is more than one agent (e.g. a merchant bank and a stockbroker), particular care should be taken to ensure that the responsibility for disclosure is agreed between the parties and that it is neither overlooked nor duplicated.