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

SFC
證監會

Consultation Paper on (1) the proposal to extend the application of the Codes on Takeovers and Mergers and Share Repurchases to SFC-authorised real estate investment trusts and related amendments and (2) the proposal to extend Parts XIII to XV of the Securities and Futures Ordinance to listed collective investment schemes

January 2010

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Introduction

The Securities and Futures Commission (**SFC**) invites comments from market participants and interested parties on the proposals discussed in this consultation paper.

This consultation paper consists of two sections. Section A relates to the application of the Codes on Takeovers and Mergers and Share Repurchases (**Codes**) to SFC-authorised real estate investment trusts (**REITs**) and related amendments to the Codes and the Code on Real Estate Investment Trusts (**REIT Code**). Section B discusses the proposals to extend the application of Parts XIII and XIV of the Securities and Futures Ordinance (**SFO**) to all listed collective investment schemes (**CIS**) (including REITs) and Part XV of the SFO to all listed CIS (other than listed open-ended CIS).

Section A

With the gradual development of the Hong Kong REIT market and taking into account developing international practice, the SFC is of the view that the time has come for a review of the regulatory regime with a view to expanding the application of the Codes to REITs.

The relevant proposed changes to the REIT Code and the Codes as set out in this paper have been prepared in consultation with the Committee on REITs and the Takeovers Panel respectively.

Section A is set out in three parts.

Part 1 - sets out the background and rationale for the proposal.

Part 2 - seeks the public's view on the proposal to amend the REIT Code to (i) require takeover and merger activities concerning REITs to be conducted in compliance with the Codes; (ii) bring the requirements regarding the appointment and removal of management companies on a par with those applicable to directors of listed companies; and (iii) clarify the regulatory requirements applicable to delisting of REITs.

Part 3 - seeks the public's view on the proposals to extend the application of the Codes to REITs and the introduction of a REIT Guidance Note (new Schedule IX) to the Schedules of the Codes to provide guidance on how the Codes would apply to REITs.

Any respondents who wish to suggest alternative approaches are encouraged to submit the proposed text of possible amendments that would be necessary to incorporate their suggestions into the Codes and the REIT Code.

After the consultation period, we will analyse the comments received carefully and aim to adopt a balanced and pragmatic approach for the purposes of enhancing investor protection and assisting the further development and growth of the Hong Kong REIT market. A Consultation Conclusions Paper will be published after the end of the consultation period. All changes to the REIT Code and the Codes will be set out in full in the Consultation Conclusions Paper to be published after the end of the consultation period.

Holders of REITs and potential investors are reminded that some or all of the proposed changes to the REIT Code and the Codes may or may not be implemented. Accordingly, they should exercise caution in dealing in units or related securities of REITs. Where there is any doubt

about the application of any of the provision of the REIT Code and/or the Codes, the SFC should be consulted at the earliest opportunity.

The possible amendments discussed in this paper are marked up against the current version of both the REIT Code and the Codes in **Appendix 1** and **Appendix 2** respectively.

Section B

Separately, the SFC would like to take this opportunity to consult the public on possible legislative changes to clarify and enhance the regulation of market conduct in relation to the dealings in listed CIS (including REITs). Section B sets out the proposal to:

(a) amend Parts XIII and XIV of the SFO to make it explicit that they are applicable to all listed CIS in whatever form they take; and

(b) amend Part XV of the SFO to apply to all listed CIS with an exemption for listed open-ended CIS.

Consultation period

A number of specific questions are raised throughout this paper. A full list of these questions is set out in **Appendix 3**.

The consultation period will last for two months until 8 March 2010. Any person wishing to submit comments on behalf of an organisation should provide details of that organisation. Comments may be submitted as follows:

By mail to:	The Securities and Futures Commission 8/F Chater House 8 Connaught Road Central Hong Kong Re: Consultation on (1) the proposal to extend the application of the Codes on Takeovers and Mergers and Share Repurchases to SFC-authorised real estate investment trusts and related amendments and (2) the proposal to extend Parts XIII to XV of the Securities and Futures Ordinance to listed collective investment schemes
By fax to:	(852) 2877-0318
By online submission at:	http://www.sfc.hk
By e-mail to:	reitsconsult@sfc.hk

Please note that the names of respondents and the contents of their submissions may be published, in whole or in part, on the SFC's website and in other documents to be published by the SFC. In this connection, please read the Personal Information Collection Statement attached to this consultation paper.

You may not wish your name and/or submission to be published by the SFC. If this is the case, please state that you wish your name and/or submission to be withheld from publication when you make your submission.

Personal information collection statement

1. This Personal Information Collection Statement (PICS) is made in accordance with the guidelines issued by the Privacy Commissioner for Personal Data. The PICS sets out the purposes for which your Personal Data[1] will be used following collection, what you are agreeing to with respect to the Commission's use of your Personal Data and your rights under the Personal Data (Privacy) Ordinance (Cap. 486) (the PDPO).

Purpose of collection

2. The Personal Data provided in your submission to the Commission in response to this consultation paper may be used by the Commission for one or more of the following purposes:

   (a) to administer the relevant provisions[2] and codes and guidelines published pursuant to the powers vested in the Commission;

   (b) in performing the Commission's statutory functions under the relevant provisions;

   (c) for research and statistical purposes; or

   (d) for other purposes permitted by law.

Transfer of personal data

3. Personal Data may be disclosed by the Commission to members of the public in Hong Kong and elsewhere as part of the public consultation on this consultation paper. The names of persons who submit comments on this consultation paper, together with the whole or any part of their submissions, may be disclosed to members of the public. This will be done by publishing this information on the Commission website and in documents to be published by the Commission during the consultation period or at its conclusion.

Access to data

4. You have the right to request access to and correction of your Personal Data in accordance with the provisions of the PDPO. Your right of access includes the right to obtain a copy of your Personal Data provided in your submission on this consultation paper. The Commission has the right to charge a reasonable fee for processing any data access request.

Retention

5. Personal Data provided to the Commission in response to this consultation paper will be retained for such period as may be necessary for the proper discharge of the Commission's functions.

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[1] Personal Data means personal data as defined in the Personal Data (Privacy) Ordinance (Cap. 486).

[2] Defined in Schedule 1 of the Securities and Futures Ordinance (Cap. 571) (SFO) to mean provisions of the SFO and subsidiary legislation made under it; and provisions of Parts II and XII of the Companies Ordinance (Cap. 32) so far as those Parts relate directly or indirectly, to the performance of functions relating to prospectuses; the purchase by a corporation of its own shares; a corporation giving financial assistance for the acquisition of its own shares etc.

Enquiries

6. Any enquiries regarding the Personal Data provided in your submission on this consultation paper, or requests for access to Personal Data or correction of Personal Data, should be addressed in writing to:

The Data Privacy Officer
The Securities and Futures Commission
8/F Chater House
8 Connaught Road Central
Hong Kong

A copy of the Privacy Policy Statement adopted by the Commission is available upon request.

Section A

Proposal to extend the application of the Codes on Takeovers and Mergers and Share Repurchases to SFC-authorised REITs and related amendments

Part 1

Background

1. The Codes currently apply to Hong Kong public companies and companies with a primary listing of their equity securities in Hong Kong. The Codes do not apply to REITs, which are legally constituted in the form of trusts.

2. Rule 11.12 of the REIT Code provides that where a REIT undertakes any form of merger, takeover, amalgamation and restructuring, the REIT's trustee and/or management company shall as soon as practicable consult with the SFC on the manner in which such activities could be carried out so that it is fair and equitable to all unitholders. The REIT Code does not otherwise contain any detailed regulatory framework for conducting such activities.

3. The REIT Code was first issued in August 2003. At that time experience from overseas markets indicated that there would not be active takeover and merger activities immediately following the launch of REITs. Given this the SFC decided to observe the development of the REIT market in Hong Kong in order to determine the most appropriate regulatory framework to govern takeovers and mergers of REITs in Hong Kong[3].

4. Since the launch of the first REIT in 2005, the SFC has seen increased corporate activities amongst REITs including asset acquisitions and on-market unit repurchases conducted by their management companies on their behalf.

5. In light of the development of REITs markets in Hong Kong and other parts of Asia over recent years and the increased level of interests in merger and acquisition activities in the REITs space, the SFC believes this is an appropriate time to review the regulatory regime governing takeovers and mergers of REITs with a view to putting in place a regulatory framework to better protect minority unitholders' interests in takeover situations as soon as possible.

Application of the Codes to REITs

6. For the reasons set out below, the SFC believes that takeovers and mergers of REITs (subject to appropriate amendments being effected to the REIT Code) should be governed by the regime under the Codes as that would be the most appropriate framework to govern takeovers and mergers of REITs.

7. REITs are organised as unit trusts. A typical structure of a REIT is set out in **Appendix 5** to this paper. Unlike traditional CIS but more akin to listed companies, REITs assets are not fungible. All SFC-authorised REITs are listed and traded on the Main Board of

[3] See paragraph 68 in Consultation Conclusions on The Draft Code on The Draft Code on Real Estate Investment Trusts issued by the SFC in July 2003

The Stock Exchange of Hong Kong Limited[4]. From an investor's perspective, a REIT and a listed property company are in substance very similar to each other economically and in terms of the basic rights and interests attached to units in a REIT and shares in a listed company, despite their different legal form and structure. Furthermore, the merger and acquisition activities of REITs and listed companies present similar commercial features.

8. The Codes provide a well-established takeovers regime for public companies in Hong Kong which is administered by the Executive. The Codes represent a consensus of opinion of those who participate in Hong Kong's financial markets and the SFC regarding standards of commercial conduct and behaviour considered acceptable for takeovers and mergers. The purpose of applying the regime under the Codes to takeovers and mergers of REITs is to provide minority unitholders better protection in the event of such activities happening. Once the Codes are applicable to REITs, the protection and safeguards under the Codes and the market standards and practices that have built up around the Codes, such as transparency and sufficiency in information furnished, prompt and full disclosure of information to market and obligations imposed on the offeree's management not to take "frustrating action" during an offer period, will be available to ensure that minority unitholders would be treated even-handedly in a takeover situation.

9. The Commission has sought the views of the Committee on REITs. Members are generally supportive of the proposal to extend to REITs the general principles and regulations currently applicable to listed company takeovers, mergers and share repurchases under the Codes. The Takeovers Panel is also supportive of the proposal to amend the Codes (subject to appropriate changes to the REIT Code) to extend the application of the Codes to REITs.

10. In order to apply the Codes to REITs, certain changes would have to be made to both the REIT Code and the Codes. These include the proposals that amendments be made to the REIT Code regarding the appointment and removal of REIT managers. Details of such changes are discussed in Parts 2 and 3 of Section A of this paper.

11. The proposed application of the Codes to REITs would also bring the Hong Kong regulatory regime on REITs in line with the regulatory approach regarding takeovers and mergers of REITs in comparable international markets, such as Australia, the US, the UK and Singapore.

12. In recent years, both Australia and Singapore extended their takeovers regimes to apply to REITs.

13. The implementation of a set of well-established rules should assist the further development and growth of the Hong Kong REIT market. Current market conditions coupled with the proposed takeovers regime should ensure that management companies remain competitive.

[4] Under Rule 3.6 of the REIT Code, a REIT must be listed on The Stock Exchange of Hong Kong Limited. The average daily turnover of the 7 REITs in Hong Kong was approximately HK$178 million for the 11 months ended 30 November 2009, representing approximately 0.3% of the total average daily turnover of all listed securities.

Part 2

Changes to the REIT Code

Purpose

14. The purpose of Part 2 of this Section A is to seek the public's view on possible changes to the REIT Code to:

    (a) expressly require takeover and merger activities to be conducted in compliance with the Codes;

    (b) bring the requirements regarding the appointment and removal of management companies on a par with those applicable to directors of listed companies to enable the application of the Codes to REITs and to align such requirements with those of other comparable international markets; and

    (c) clarify the regulatory requirements applicable to delisting of REITs.

    The proposed changes to the REIT Code are formulated after considering comments from the Committee on REITs.

Proposed changes to the REIT Code

Application of the Codes to REITs

15. Rule 11.12 of the REIT Code currently provides that where a REIT undertakes any form of merger, takeover, amalgamation and restructuring, the REIT's trustee and/or management company shall as soon as practicable consult with the SFC on the manner in which such activities could be carried out so that it is fair and equitable to all holders.

16. In order to apply the Codes to REITs, it is proposed that, subject to the relevant amendments to the REIT Code as detailed in paragraph 28 to paragraph 31 below, Rule 11.12 be amended to expressly require takeover and merger activities concerning REITs to be conducted in compliance with the Codes. This would mean that, for example, any person (including a substantial unitholder of a REIT) acquiring 30% or more of the units of a REIT which are issued and outstanding would be required to make a mandatory offer to the other unitholders pursuant to the provisions of the Takeovers Code to ensure all unitholders are treated even-handedly so as to protect minority unitholders' interests.

Question 1: Do you have any comments on the proposed amendments to the REIT Code to expressly require takeover and merger activities concerning REITs to be conducted in compliance with the Codes?

Removal and appointment of the management company

Existing requirements

17. The existing requirements and voting thresholds for appointment and removal of REIT managers under the REIT Code as compared to those for the appointment and removal of directors of listed companies under the Listing Rules can be summarised as follows:

	Removal		**Appointment**	
	REIT manager	Director of listed company	REIT manager	Director of listed company
Voting percentage	≥ 75%	> 50%	N/A	> 50%
Who can vote	All except disenfranchised unitholders	All shareholders	N/A	All shareholders
Trustee's consent	X (although the REIT manager is formally removed by the trustee by notice in writing)	N/A	√	N/A

18. The different control structure of a REIT compared to that of a listed company is a significant issue relating to the application of the Codes to REITs. As already stated, the Codes do not apply to REITs in their current form. The Takeovers Panel has noted that it is a prerequisite that the control structure of REITs must be aligned with that of listed companies in order that the Codes could apply to REITs.

19. Unless the voting thresholds for appointment and removal of REIT managers in the REIT Code are brought into line with those applicable to directors of listed companies, a number of the fundamental disciplines in the Codes would be rendered redundant in the context of a REIT. This would include percentage thresholds such as the 30% general offer triggering point, the 2% creeper, the 50% minimum acceptance level for offers, voting requirements relating to special deals and frustrating action.

Removal of the management company

20. Currently under Rule 5.14 of the REIT Code, the management company of a REIT may be removed by the trustee by notice in writing if:

    (a) the management company goes into liquidation, becomes bankrupt or has a receiver appointed over its assets or any part thereof; or

    (b) for good and sufficient reason(s), the trustee states in writing that a change in management company is desirable in the interest of the holders; or

(c) holders representing at least 75% in value in the units outstanding (excluding those held or deemed to be held by the management company, as well as by any holders who may have an interest in retaining the management company), deliver to the trustee a written request to dismiss the management company.

21. This means at least 75% in value of the outstanding units (other than the disenfranchised units) is required to remove a management company.

22. When REITs were first introduced into the market, it was generally considered to be appropriate to adopt a 75% threshold for a unitholders' resolution to remove the management company, having regard to the nascent stage of the Hong Kong REIT market, so that it would be less disruptive for newly formed REITs. The requirement to count the absolute number of units outstanding and to exclude "disenfranchised" units derived from a similar requirement for removal of managers of traditional collective investment schemes under the Code on Unit Trusts and Mutual Funds[5].

23. With the advance of the REITs market in Hong Kong, the SFC considers it necessary to revisit the current requirements in the REIT Code for the removal of management companies.

24. In Australia, the issue of whether a REIT manager should be "entrenched" was discussed at some length in the takeover policy paper published as part of the Corporate Law Economic Reform Program in 1997. It suggested that the better approach would be to replicate the model applicable to listed companies, so that the manager of a listed managed investment scheme could be replaced on the same basis as a company director, namely by simple majority of unitholders who vote at a duly convened meeting, without any restriction on who could vote. The Corporations Law in Australia was subsequently amended accordingly[6].

25. Singapore has also adopted this approach after a public consultation conducted in 2005[7]. In the feedback statement issued by the Monetary Authority of Singapore (**MAS**), the MAS concluded that, on balance, such approach would be more equitable and would serve to align economic interests with controlling interests of share ownership.

Appointment of the management company

26. Under the current rules, a REIT manager must be appointed by the trustee subject to the SFC's prior approval[8] and not by unitholders directly.

27. In contrast, shareholders of a listed company may appoint directors to the board by way of an ordinary resolution where all shareholders are entitled to vote.

Proposed amendments to the REIT Code

28. In view of the above, the SFC proposes to make both the appointment and removal of REIT managers subject to approval by way of ordinary resolution of unitholders where all unitholders would be entitled to vote, provided that in the case of the appointment of

[5] See Rule 5.11(c) of the Code on Unit Trusts and Mutual Funds.

[6] See Corporate Law Economic Reform Program Act 1999

[7] Consultation Paper "Review of the Regulatory Regime Governing REITs" published by the Monetary Authority of Singapore (the "MAS") in June 2005 and "Response to Feedback Received - Review of the Regulatory Regime Governing REITs " published by the MAS in October 2005

[8] See Rule 5.17 of the REIT Code

REIT managers, the consent of the trustee would still be required. As well, the SFC requires the REIT manager to be licensed with the SFC, with the qualification of being able to manage a REIT.

29. The proposed requirements and voting thresholds for appointment and removal of REIT managers under the REIT Code as compared to those for the appointment and removal of directors of listed companies under the Listing Rules would be as follows:

	Removal		**Appointment**	
	REIT manager	Director of listed company	REIT manager	Director of listed company
Voting percentage	**≥ 50%**	> 50%	**≥ 50%**	> 50%
Who can vote	**All unitholders**	All shareholders	**All unitholders**	All shareholders
Trustee's consent	X (although the REIT manager is formally removed by the trustee by notice in writing)	N/A	√	N/A

30. The proposal would align our regulations with other comparable international markets such as Australia and Singapore. The proposal would also be consistent with the equivalent scenarios of removing one or more directors of listed company. The SFC believes that the proposal would better align the economic interests of controlling stake of ownership in a REIT.

31. To bring the requirements with regard to appointment and removal of REIT managers on a par with those applicable to directors of listed companies, the SFC proposes to amend Rules 5.14(c), 5.17 and 9.9(f) of the REIT Code. The proposed amendments are set out in **Appendix 1** to this consultation paper.

Question 2: Do you have any comments on the proposed amendments to the REIT Code to bring the requirements with regards to appointment and removal of REIT managers on a par with those applicable to directors of listed companies?

Delisting of REITs

32. A takeover may sometimes result in the delisting of a REIT. The Listing Rules currently contain detailed voting and other requirements applicable to the withdrawal of the listing of listed companies.[9]

33. In order to clarify the regulatory requirements applicable to delisting of REITs, it is proposed that a new Rule 11.13 be added in the REIT Code to provide that where a delisting of a REIT from the Exchange is proposed, all rules and principles as applicable to listed companies under the Listing Rules regarding withdrawal of listing should be

[9] See Rules 6.11 to 6.16 of the Listing Rules.

complied with in substance, with necessary changes being made, as if such rules and principles were applicable to the REIT[10]. The REIT's trustee and/or management company would be required, as soon as practicable, to consult with the SFC on the detailed application of such rules and principles with respect to the particular situation.

Question 3: Do you have any comments on the proposed amendments to the REIT Code in relation to delisting of REITs?

34. The proposed amendments to the REIT Code are set out in full in **Appendix 1** to this paper.

Related issues

Privatisation of REITs

35. In Hong Kong, the privatisation of listed companies is commonly undertaken by way of either one of the following two routes, namely:

    (a) by way of a general offer followed by a statutory compulsory acquisition provided that the bidder has acquired the requisite percentage of shares; or

    (b) by way of a scheme of arrangement.

36. Both of the above two routes are made possible by way of statutory provisions in the case of Hong Kong-incorporated listed companies under the Companies Ordinance. Since REITs are not companies to which the Companies Ordinance applies, these statutory mechanisms do not apply to REITs.

(A) Privatisation of a company by a general offer followed by compulsory acquisition

37. Under section 168 of and the Ninth Schedule to the Companies Ordinance, if a bidder has already acquired at least 90 per cent of the shares of a Hong Kong-incorporated listed company for which an offer was made, it can acquire the remaining 10 per cent from the minority shareholders compulsorily provided that certain conditions are fulfilled. The compulsory acquisition provisions under the Companies Ordinance do not apply to REITs, which are established as trusts.

38. In Australia, the compulsory acquisition provisions under the Corporations Act were expressly extended to listed managed investment schemes in March 2000[11]. Singapore also passed legislation to establish a statutory compulsory acquisition regime applicable to REITs in January 2009[12].

39. As there is no equivalent statutory compulsory acquisition mechanism for REITs in Hong Kong, privatisation by way of a general offer followed by a compulsory acquisition would not be applicable to REITs.

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[10] These include the requirements set out in Rules 6.11 to 6.16 of the Listing Rules which in some cases require, among other things, that the approval of withdrawal of the listing must be given by at least 75% of the votes attaching to any class of listed securities held by holders voting either in person or by proxy at the meeting and that the number of votes cast against the resolution is not more than 10% of the votes attaching to any class of listed securities held by holders permitted to vote in person or by proxy at the meeting.

[11] Chapter 6A of Corporations Act 2001

[12] Securities and Futures (Amendment) Act 2009

(B) Privatisation of a company by way of scheme of arrangement

40. A scheme of arrangement is a statutory mechanism through which a listed company may privatise or conduct a group restructuring.

41. A scheme of arrangement is essentially an arrangement entered into between a company and its shareholders and/or creditors (as the case may be) which must be sanctioned by the Court in order to become effective. In sanctioning the scheme, the Court will generally ensure that the relevant statutory requirements have been complied with, the majority has acted bona fide and the arrangement is fair. Once sanctioned, the scheme would be binding upon all shareholders and/or creditors of the company.

42. Under section 166 of the Companies Ordinance, a scheme of arrangement involving a Hong Kong-incorporated company may take any form provided that it is approved by a majority representing 75 per cent in value of the creditors (or class of creditors) or members (or class of members), as the case may be, present and voting in person or by proxy at a court meeting and sanctioned by the Court.

43. The scheme of arrangement provisions under the Companies Ordinance do not apply to REITs, which are established as trusts.

44. The SFC understands that some market practitioners have raised the point as to whether it would be feasible to effect a privatisation of REIT in Hong Kong by way of a "scheme of arrangement" through contractual (as opposed to the statutory framework for companies) arrangements with unitholders. In the absence of any statutory framework or case law, it appears that there remains a high degree of uncertainty as to whether Hong Kong courts would give sanction to a scheme of arrangement concerning Hong Kong REITs without legislative requirements similar to those in section 166 of the Companies Ordinance.

45. Without any statutory or other form of court sanction of the scheme approval process undertaken by a REIT, investors' interests may not be properly protected to the same extent as shareholders of a listed company that undertakes a scheme of arrangement under section 166 of the Companies Ordinance. As such, schemes of arrangement may not really be viable in the case of REITs.

(C) Application of Note 7 to Rule 2 of the Takeovers Code

46. It should be noted that if the SFC's proposal to apply the Codes to REITs were implemented following this consultation, Note 7 to Rule 2 of the Takeovers Code[13] would apply where a REIT proposes to dispose of its assets[14] and/or operations and as a result of such proposed disposal

    (a) the REIT may not be regarded as suitable to remain authorised by the SFC under section 104 of the SFO[15]; or

[13] See Paragraph 3(a) of the REIT Guidance Note set out in the proposed new Schedule IX to the Codes

[14] Any such disposal of assets must also comply with all other applicable requirements under the REIT Code such as production of a valuation report, unitholders' approval and the rules governing connected party transactions if applicable.

[15] For example, under the Rule 3.2 of the REIT Code, a REIT seeking authorisation from the SFC must have dedicated investments in real estate that generate recurrent rental income and the greater proportion of its income must be derived from rentals of real estate. In the case where a REIT disposes all or a substantial part of its assets, it would have to demonstrate to the SFC how it would continue to comply with this requirement.

(b) there is a proposal to withdraw the listing of the units of the REIT on the Stock Exchange.

Rule 11.13 of the REIT Code and Note 7 to Rule 2 of the Takeovers Code together would mean that Rule 2.10 and other applicable requirements of the Takeovers Code would normally apply.

47. In short, this means that if the Takeovers Code were to apply to REITs, then in the case of a disposal of the assets and/or operations resulting in either of the situations in (a) or (b) above, unitholders' resolution would have to be obtained in much the same way as listed corporations need to in the context of a privatisation under Rule 2.10. This would mean that any such disposal would have to be approved by at least 75% of the votes attaching to the disinterested units that are cast at the unitholders' meeting and no more than 10% of the votes attaching to all the disinterested units were voted against it.

48. The SFC is mindful that such disposal of assets followed by delisting would logically result in the termination of the REIT in most cases. As such, we would generally regard such disposal proposal as a proposal to terminate a REIT in substance in order to ensure unitholders would be afforded all the safeguards set out in Chapter 11 of the REIT Code in respect of termination of schemes. These would include the requirement to dispose all real estate through public auction or any form of open tender under Rule 11.8 of the REIT Code (**Public Auction Requirement**).

49. Subject to public consultation on the current proposals, in view of the safeguards already afforded to unitholders in such situation under the Takeovers Code (particularly its Note 7 to Rule 2) and the new Rule 11.13 of the REIT Code, the SFC would be prepared to consider, upon application by the relevant REIT manager and submission of a reasonable justification, granting a waiver from strict compliance with the Public Auction Requirement subject to compliance with Rule 11.13 of the REIT Code and the applicable provisions in the Takeovers Code.

Question 4: Do you have any comments on our proposal regarding application of Note 7 to Rule 2 of the Takeovers Code and the new Rule 11.13 of the REIT Code?

Part 3

Changes to the Codes

Purpose

50. The purpose of Part 3 of this Section A is to seek the public's view on (subject to the changes to the REIT Codes as discussed in the relevant paragraphs in Part 1 and Part 2 of this Section A being implemented):

    (a) possible related changes to section 4.1 of the Introduction to the Codes to extend the application of the Codes to REITs; and

    (b) the introduction of a REIT Guidance Note (new Schedule IX) to the Schedules of the Codes.

51. The possible amendments to the Codes are set out in full in **Appendix 2** to this paper.

Changes to the Codes

52. We have reviewed the Codes in order to identify appropriate amendments that might be made if the control structure of REITs in Hong Kong is brought into line with listed companies. Whilst some provisions of the Codes may need modification in general we believe that the Codes may be applied to REITs, subject to appropriate amendments to the REIT Code as discussed in the relevant paragraphs in Part 1 and Part 2 of this Section A. Part 3 considers the proposed changes in further detail. All the changes discussed below are based on the premise that the substantive changes to the REIT Code described in the relevant paragraphs in Part 1 and Part 2 of this Section A are implemented.

Section 4.1 of Introduction to the Codes

53. It is proposed that section 4.1 be amended to extend the application of the Codes to REITs as follows:-

    "4.1 The Codes apply to takeovers, mergers and share repurchases affecting public companies in Hong Kong, ~~and~~ companies with a primary listing of their equity securities in Hong Kong <u>and real estate investment trusts (REITs) with a primary listing of their units in Hong Kong</u>. As a result, although it is generally the nature of the offeree company, the potential offeree company, or the company in which control may change or be consolidated that is relevant, there are also circumstances, specified in Rule 2 of the Takeovers Code, in which it is necessary to consider the treatment of the offeror's shareholders in order to carry out the objective of the Takeovers Code. The Executive will normally grant a waiver from the requirements of the Share Repurchase Code for companies with a primary listing outside Hong Kong provided that shareholders in Hong Kong are adequately protected."

    Under the REIT Guidance Note, the term "company" as used in the Codes should be taken as a reference to a REIT and/or a company as the context requires. As the Codes apply to public companies in Hong Kong, the same principles should apply to REITs which are listed in Hong Kong as well as REITs which are not listed but fall

within the concept of public companies. Section 4.2 of Introduction to the Codes would apply in deciding whether a REIT should be treated as an equivalent of a public company for this purpose.

Question 5: Subject to the implementation of appropriate modifications to the REIT Code as discussed in the relevant paragraphs in Part 1 and Part 2 of Section A of this paper being implemented do you agree that the Codes should apply to REITs? If not, please give reasons and any suggestion that you may have.

Section 1.5 of Introduction to the Codes

54. Section 1.5 sets out the parties to whom the Codes apply. If the Codes were to apply to REITs the parties to whom the Codes apply should include the trustee of a REIT as well as the management company and its directors. It is therefore proposed to amend section 1.5 as follows:

"The responsibilities provided for in the Codes apply to:-

(a) directors of companies that are subject to the Codes;
(b) management companies (and their directors) and trustees of real estate investment trusts (REITs) that are subject to the Codes;
~~(b)~~(c) persons or groups of persons who seek to gain or consolidate control of companies that are subject to the Codes;
~~(c)~~(d) their professional advisers;
~~(d)~~(e) persons who otherwise participate in, or are connected with, transactions to which the Codes apply; and
~~(e)~~(f) persons who are actively engaged in the securities market."

Question 6: If the Codes were to apply to REITs, do you agree with the proposed amendments to section 1.5 which would impose the responsibilities provided for in the Codes on management companies, their directors and trustees?

REIT Guidance Note

55. It is proposed to introduce a REIT Guidance Note (see **Appendix 2**) as new Schedule IX of the Codes to provide guidance as to how the Codes would apply to REITs. The rationale behind the more material modifications is discussed below.

Definition of "shares" and "shareholders"

56. In Hong Kong REITs have to be structured as trusts. The REIT issues investors with units that are listed on The Stock Exchange of Hong Kong Limited which allows those investors to share the benefits and risks of owning the real estate assets held by the REIT. From the investor's point of view, there is little difference between holding shares in a company and units in a REIT in terms of their rights as to voting, dividend distributions and trading of securities. Given this and in order to apply the provisions of the Codes to REITs with minimal consequential changes to the Codes, it is proposed to clarify in the REIT Guidance Note (see **Appendix 2**) that the terms *"shares"* and *"shareholders"* as used in the Codes should be taken as references to *"units"* and *"unitholders"* respectively in the context of a REIT. Accordingly, *"share capital"*, *"issued share capital"*, *"equity share capital"* or *"equity shares"* as used in the Codes will be taken, in the context of a REIT, as references to units of a REIT which are issued and outstanding from time to time.

57. It should be noted that the term *"securities"*, whilst frequently used in the Codes, is not a defined term. It is nonetheless widely accepted that the term *"securities"* includes shares. The proposed cross-reference between *"share"* and *"unit"* will therefore result in REIT units, when used in the context of a REIT, falling within the term *"securities"*.

Question 7: If the Codes were to apply to REITs, do you agree with the proposal to cross reference "*shares*" and "*shareholders*" to "*units*" and "*unitholders*"?

Definition of "board" and "directors"

58. The management company of a REIT manages a REIT in similar fashion to a listed company's board of directors and owes similar duties. The management company of a REIT is in substance equivalent to the board of directors of a limited company. As such, we recommend that the provisions in the Codes that apply to the *"board"* or *"directors"* of a company should apply equally to the management company and/or its board of directors and/or any one or more of the management company's directors. It is therefore proposed to clarify, in the context of REITs, that the term *"board"* in the Codes should be taken to include the management company and/or its board of directors and the term *"director(s)"* should be taken to include the management company and/or any one or more of its directors (including shadow directors).

Question 8: If the Codes were to apply to REITs, do you agree with the proposal to extend the meaning of *"board"* and *"director(s)"* in the context of REITs?

59. In line with the reasoning in paragraph 58 we propose to clarify that classes (2) and (6) of the presumptions of *"acting in concert"* should also apply to the management company (together with persons controlling, controlled by or under the same control as the management company in addition to individual directors (together with their related parties as envisaged under the current definition) of the management company).

60. Given this we propose to add the following note to the definition of *"director(s)"* in the REIT Guidance Note:

> *"With respect to classes (2) and (6) of the presumptions of acting in concert set out under in the Definitions section of the Codes, references to "directors" will also be taken as references to include the management company of a REIT (together with persons controlling, controlled by or under the same control as the management company)."*

Definition of "acting in concert" – new class 10 presumption

61. For the reasons discussed below it is proposed to introduce a new class of presumed concert party so that the management company, its directors and the trustee will be presumed to be acting in concert with the related REIT.

REIT presumed to be acting in concert with its management company

62. Under class 2 of the presumption of acting in concert a company is presumed to be acting in concert with its directors. Given the similarities between the management company (and its directors) of a REIT and a company's board/directors it is believed a REIT should be presumed to be acting in concert with its management company and the directors of the management company.

REIT presumed to be acting in concert with its trustee

63. The trustee of a REIT is required to fulfill the duties imposed on it under the general law of trusts[16]. It is also responsible for, among other things, overseeing the activities of the management company for compliance with the relevant constitutive documents of, and regulatory requirements applicable to, the REIT[17].

64. Although it is a requirement under the REIT Code[18] that the trustee and the management company are independent of each other, the trustee is required to carry out the instructions of the management company in respect of investments unless they are in conflict with the provisions of the offering or constitutive documents or the REIT Code or under general law[19].

65. At present, the trustee is nominated by the management company at the time when the management company established the REIT. In addition, under the trust deeds of existing REITs, the management company may remove the trustee if the trustee goes into liquidation, ceases to carry on business, defaults in performing its obligations or if the unitholders have resolved by way of a special resolution to remove the trustee. In such cases, the management company shall, with the prior approval of the SFC, appoint another person as the trustee of the REIT.

66. It is also noted that in practice, if the management company intends to make an acquisition, it would normally consult the trustee to obtain its consent before making the acquisition as the trust assets are held by the trustee and the trustee has a duty to oversee the activities of the management company. Even though the trustee is not likely to make any active business decisions itself, it can influence, and in extreme cases, veto the decisions of a management company where it considers such decisions would contravene the constitutive documents, the REIT Code or the general law.

67. In view of the close relationship between the REIT, its management company (and its directors) and the trustee, we believe they should be presumed to be acting in concert.

Extension of presumption to other group entities

68. Typically trustees, and in some cases perhaps also management companies, are part of a larger financial group. Applying the same logic as presumption (5) of acting in concert it follows that the presumption of acting in concert should extend to all entities within that group including its fund managers and principal traders. Given this it is recommended that all relevant group entities are presumed to be acting in concert except in the case of a trustee, group entities which have been granted exempt status (see paragraphs 71 to 77 below for further discussion).

69. We therefore recommend introducing a new class (10) to the definition of "*acting in concert*" as set out below (subject to the proviso of not taking into account the voting rights held by the trustee for unrelated trusts as set out in paragraph 70 below). **Appendix 4** illustrates the scope of this presumption (10).

[16] See Rule 4.1 of the REIT Code.
[17] See Rule 4.1A of the REIT Code.
[18] See Rule 4.8 of the REIT Code.
[19] See Rule 4.2(e) of the REIT Code.

"(10) a REIT, its trustee (together with persons controlling[#], controlled by or under the same control as the trustee (except in the capacity of an exempt principal trader and an exempt fund manager)), its management company (together with persons controlling[#], controlled by or under the same control as the management company) and any director (together with their close relatives, related trusts and companies controlled[#] by any of the directors, their close relatives or related trusts) of such management company."

Question 9: If the Codes were to apply to REITs, do you agree that the REIT, the management company (and its directors) and the trustee should be presumed to be acting in concert as proposed?

70. As mentioned, at present there are only two professional trustee companies acting as trustees of the 7 REITs currently listed in Hong Kong. In the context of an offer, in particular a competing offer by two REITs, it is likely therefore that the possible offerors will share a common trustee. Paragraph 4.2(a) of the REIT Code requires a trustee to ensure that all the assets of the REIT are properly segregated. Given this segregation and the respective duties of a trustee to exercise all due diligence and vigilance in carrying out its function and duties and in protecting the rights and interests of unitholders we believe that it is fair to treat such assets as separate from one another in particular in determining aggregate concert group holdings. As each case will depend on its own particular facts, it is proposed that the Executive should be consulted where there is a common trustee for the parties to an offer. We recommend introducing the following note to the new presumption (10).

"Note:

1. The Executive must be consulted where a trustee acts at the same time in its capacity as trustee for more than one of the following:-
(i) offeror or possible offeror;
(ii) competing offeror or possible competing offeror; and
(iii) offeree company.

2. For the purpose of calculating the voting rights held by a group acting in concert, the voting rights held by a trustee in its capacity as trustee for unrelated trusts will not normally be counted. In case of doubt, the Executive must be consulted."

Question 10: If the Codes were to apply to REITs, do you agree that the Executive should be consulted where there is common trustee for the parties to an offer?

Notes to the definitions of exempt fund manager and exempt principal trader

71. Note 2 to the definitions of exempt fund manager and exempt principal trader states that:

"2. When a principal trader or fund manager is connected with an offeror or the offeree company, exempt status is relevant only where the sole reason for the connection is that the principal trader or fund manager controls[#], is controlled by or is under the same control as a financial or other professional adviser (including a stockbroker) to an offeror or the offeree company. References in the Codes to exempt principal traders or exempt fund managers should be construed accordingly. (See also Rule 21.6 regarding discretionary fund managers.)"*

72. Note 2 to the definition of exempt fund manager and exempt principal trader restricts the application of exempt status under the Codes to a fund manager or a principal trader where the connection is **solely** because it is in the same group as a financial or other professional adviser to a party to the Code transaction concerned. In other words, if a connected party is not acting **solely** as a financial adviser or a professional adviser, its group entities will not be able to benefit from their exempt status.

73. In the context of a REIT, group entities of the management company or the trustee of a REIT would be presumed to be acting in concert with the REIT under the new proposed class 10 presumption. This gives rise to the question of whether Note 2 should apply to such group entities. If Note 2 were to apply, group entities (including exempt fund managers and exempt principal traders) of both the management company and the trustee of a REIT would be presumed to be acting in concert with the REIT with resulting implications under the Codes.

74. It is believed that in view of:

(a) the similarities of the respective roles of a management company and a board of directors of a listed company;

(b) the active role played by a management company in managing a REIT and formulating the investment strategy and policy of the REIT; and

(c) the likely active role that a management company would play in an offer,

a management company should not be regarded as a financial adviser or professional adviser for the purpose of Note 2 to the Notes to the definitions of exempt fund manager and exempt principal trader. This would mean that group entities (including exempt fund managers and exempt principal traders whose exempt status would not apply) of the management company of a REIT would be presumed to be acting in concert with the REIT with resulting implications under the Codes.

75. It is however proposed to adopt a more relaxed approach towards a trustee for the purpose of Note 2 in recognition of the fact that a trustee:

(a) is usually a professional company; and

(b) plays a more passive role in the management of a REIT than the management company.

76. In the context of a REIT, we would propose to regard a trustee as if it were a professional adviser under Note 2. This would mean that a trustee's group entities which have been granted with exempt status under the Codes would NOT be presumed to be acting in concert with the REIT during an offer. They would nonetheless be subject to the restrictions in Rule 35 of the Takeovers Code which prohibit an exempt principal trader from carrying out dealings or securities borrowing and lending transactions for the purpose of assisting the offeror or the offeree company (as the case may be). Please refer to paragraph 3(n) of the REIT Guidance Note.

77. Finally it should be noted that Rule 21.6 of the Takeovers Code provides guidance regarding dealings by connected discretionary fund managers and principal traders before and during an offer period. Rule 21.6 would apply equally to a management company and a trustee of a REIT.

Question 11: If the Codes were to apply to REITs, do you agree that group entities, including exempt fund managers or exempt principal traders, of the management company should be presumed as concert parties of the REIT (offeror or offeree) and therefore exempt status would not be relevant?

Question 12: If the Codes were to apply to REITs, do you agree that group entities of a trustee with exempt fund manager or exempt principal trader status should not be presumed as concert parties of the REIT (offeror or offeree) during an offer?

Question 13: If the Codes were to apply to REITs, do you agree that Rule 21.6 would apply to a connected management company and a connected trustee in an offer?

Definition of "associate"

78. The presumption of acting in concert is extended to cover the management company and the trustee, it follows that both the management company and trustee of a REIT would fall within the term *"associate"*. The definition of *"associate"* states that it *"will cover all persons acting in concert with an offeror"* (see the definition of *"associate"* under the Codes).

79. In any event they would still fall within the remaining part of the definition of "*associate*" as they "*directly or indirectly own or deal in the relevant securities of an offeror or the offeree company in an offer and who have… an interest or potential interest… in the outcome of the offer*".

80. In view of this, it is proposed to introduce new classes (8) and (9) to the definition of *"associate"* as set out below:

> *"(8) any trustee (together with persons controlling[#], controlled by or under the same control as the trustee) of an offeror, the offeree company or any company in class (1); and*
> *(9) any management company (together with persons controlling[#], controlled by or under the same control as the management company) of an offeror, the offeree company or any company in class (1)."*

Question 14: If the Codes were to apply to REITs, do you agree that the management company and the trustee should be included in the definition of "*associate*"?

Action of, voting rights and assets owned, controlled or held by a trustee, a management company and/or its directors and/or special purpose vehicle(s) of a REIT

81. In the context of a limited company the directors may meet together to dispatch business. At common law, directors can only exercise their powers collectively by passing resolutions at a properly convened meeting of the board of directors. The directors have no power to act individually as agents for the company. However a company's articles will usually empower the board of directors to delegate its powers to individual directors or to committees of directors. REITs are in a similar position. The management company is responsible for managing the REIT in accordance with its constitutive documents.

82. One of the most fundamental differences between a limited company and a REIT is that the former exists as a separate legal entity, which is subject to statutory requirements, whereas the latter does not. A limited company can therefore own assets as a legal person while a REIT (or a trust in general) holds assets through its trustee or special purpose vehicles (the issued share capital of which is held by the trustee) set up specifically for such purpose.

83. In view of the structure of a REIT, it is proposed to include an express statement in the REIT Guidance Note that action by the management company (and its directors) and/or the trustee (in its capacity as trustee of the REIT) should be deemed to be action taken by the REIT concerned. This should help avoid arguments that the management company or the trustee is not prohibited from or obliged to take certain action under the Codes on the basis that such prohibitions or obligations are imposed on the REIT (as offeror or offeree) rather than on the management company or the trustee. For example, the obligation imposed under Rule 6 of the Takeovers Code (equality of information to competing offerors) that an offeree should provide the offeror with all relevant information should extend to the management company and the trustee of a REIT.

84. As mentioned earlier a REIT does not hold assets by itself (they are held through the REIT's trustee or its special purpose vehicles). Unlike a limited company which can hold shares in another company, the concepts of parent/subsidiary relationship, fellow subsidiaries and associated companies do not strictly apply to REITs. This would result in a number of the provisions of the Codes being rendered inapplicable to REITs. For example, if a REIT is an offeror, the special purpose vehicle(s) (which would be held by the trustee) would not be deemed to be acting in concert with the REIT and hence any units of the target REIT held by a special purpose vehicle would not be included in the aggregate holdings of the offeror's concert group. This is undesirable. To address this concern it is proposed that any voting rights or assets held by the trustee (in its capacity as trustee for that REIT), or the management company or the special purpose vehicles should be deemed, for Code purposes, to be held by the REIT concerned.

85. It is also believed that the concept of parent, subsidiary, fellow subsidiary and associated company should apply to REITs. It is therefore recommended that the following notes are added to the end of the definition section in the REIT Guidance Note:

"Notes to Definitions:-

1. *Action by a trustee, a management company and/or any of its directors*
   Where an action is taken by a trustee (in its capacity as trustee for a REIT) or a management company and/or any of its directors (in their respective capacity on behalf of a REIT), that action will be deemed to be an action taken by such REIT. In case of doubt, the Executive must be consulted.
2. *Voting rights owned, controlled or held by a trustee, a management company and/or any of its directors*
   Any voting rights owned, controlled or held by a trustee (in its capacity as trustee for a REIT) or a management company and/or any of its directors (in their respective capacity on behalf of a REIT) will be deemed to be voting rights owned, controlled or held by such REIT of which any of the trustee/the management company and/or any of its directors acted on its behalf. In case of doubt, the Executive must be consulted.
3. *Assets owned, controlled or held by special purpose vehicle(s)*
   Any assets owned, controlled or held by any special purpose vehicle(s) will be deemed to be assets owned, controlled or held by the REIT that owns or

controls the special purpose vehicle(s) in accordance with the REIT Code. In case of doubt, the Executive must be consulted."

Question 15: If the Codes were to apply to REITs, do you agree with the proposal to introduce the concepts of parent, subsidiary, fellow subsidiary and associated company to REITs? If you do not agree, your reasons and your suggestions as to how to apply these concepts to REITs are particularly important.

Frustrating action under Rule 4

86. Rule 4 of the Takeovers Code restricts the offeree company's board from taking certain action that might effectively result in an offer being frustrated when a bona fide offer has been communicated to the board of the offeree company or the board has reason to believe that a bona fide offer may be imminent. In line with the discussion in paragraph 58, we recommend that this restriction should apply to the management company and its directors and the trustee (see paragraph 87). Similarly, *"service contract"* referred to in Rule 4(d) should therefore cover both contracts between the REIT and the management company (see paragraph 88 for further elaboration) and contracts between the management company and its directors.

Question 16: If the Codes were to apply to REITs, do you agree that Rule 4 should apply to the management company as well as its directors?

87. Furthermore, given the role played by the trustee of a REIT, it follows that the restrictions in Rule 4 should apply to the trustee as well.

Question 17: If the Codes were to apply to REITs, do you agree that Rule 4 should apply to a trustee?

Service contracts

88. References are made to *"service contracts"* of directors in Rule 4, Rule 8.5, Note 1(j) to Rule 8 and paragraph (13) of Schedule II to the Codes. The terms of engagement of the management company are set out in the trust deed constituting the REIT. It should be noted that, based on past experience, a REIT does not generally enter into a separate management contract with the management company. In this respect, we recommend that the term *"service contract"* in the Codes should be interpreted widely in the context of a management company to cover *"service contract in whatever form"* including the terms of the trust deed. This is reflected in paragraph 3(e) of the REIT Guidance Note.

Question 18: If the Codes were to apply to REITs, do you agree that the term *"service contract"* in Rule 4, Rule 8.5, Note 1(j) to Rule 8 and paragraph (13) of Schedule II should be interpreted widely to cover *"service contract in whatever form"*?

Appointment and resignation of the management company and/or its directors

89. Rule 7 of the Takeovers Code restricts the earliest time a management company can resign from its office. Rule 26.4, in the context of mandatory general offer, restricts the earliest time a management company can be appointed. Given the appointment of a management company requires the prior approval of the SFC and is subject to unitholders' vote, it is possible that the parties might have difficulty in engaging a new management company in time following resignation of the current management

company. In cases where difficulties arise regarding the application of Rules 7 and 26.4 the Executive should be consulted at the earliest opportunity.

Dividend forecast

90. Rule 7.12 of the REIT Code requires a REIT to distribute to its unitholders each year by way of dividends an amount not less than 90% of its audited annual net income after tax. With a dividend forecast figure, the floor and ceiling of a REIT's profits can easily be worked out using the 90% formula. Dividend forecasts are therefore subject to substantially the same requirement as profit forecasts under the REIT Code. Given the close correlation between a dividend forecast and a profit forecast, we believes that a dividend forecast of a REIT should be considered a profit forecast which is subject to Rule 10 of the Takeovers Code. This is reflected in paragraph 3(i) of the REIT Guidance Note.

Question 19: If the Codes were to apply to REITs, do you agree that a dividend forecast should be treated as a profit forecast which is subject to Rule 10 of the Takeovers Code?

Appropriate offers for convertible securities under Rule 13

91. Rule 13 of the Takeovers Code provides that where an offer is made for the equity share capital of an offeree company, appropriate offers have to be made for the outstanding convertible securities of the offeree company. This requirement extends to any warrants, options or subscription rights outstanding in respect of the equity share capital of the offeree company. In the context of REITs, convertible securities are at present issued by the REIT's special purpose vehicle(s) that are convertible into units of and guaranteed by the REIT (through the trustee). Nonetheless to ensure consistency of treatment under the Codes it is believed that appropriate offers should also be made for the convertible securities of a REIT. It follows that Rule 13 should include convertible securities carrying conversion rights into units of a REIT issued by the special purpose vehicles of that REIT. Please refer to paragraph 3(j) of the REIT Guidance Note.

Question 20: If the Codes were to apply to REITs, do you agree that appropriate offers should be made for the convertible securities of a REIT? If so, do you agree to extend the meaning of *"convertible securities"* of the offeree in Rule 13 to include convertible securities issued by special purpose vehicles of a REIT?

Section B

Proposal to extend Parts XIII to XV of the SFO to listed collective investment schemes

Purpose

92. The purpose of Section B is to consult the public on possible legislative changes to clarify and enhance the regulation of market conduct in relation to the dealings in listed CIS (including REITs). Section B sets out the proposal to:

(a) amend Parts XIII and XIV of the SFO to make it explicit that they are applicable to all listed CIS in whatever form they take; and

(b) amend Part XV of the SFO to apply to all listed CIS with an exemption for listed open-ended CIS.

Proposed changes to the SFO

Parts XIII and XIV of the SFO

93. Parts XIII and XIV of the SFO relate to market misconduct. In view of the considerable growth of the Hong Kong listed CIS market in recent years, we propose to amend Parts XIII and XIV of the SFO to make it explicit that they are applicable to all listed CIS in whatever form they take. This would eliminate any doubts in the legislation. If implemented, this will be consistent with the regulatory approach adopted in the UK, Australia and Singapore.

Part XV of the SFO

94. Part XV of the SFO relates to disclosure of interests. It explicitly refers to shares and debentures of a listed corporation and therefore does not apply to CIS which are constituted in the form of trusts or other non-corporate forms, even if they are listed.

95. We propose to amend Part XV of the SFO to apply to all listed CIS with an exemption for listed open-ended CIS, which are mostly exchange traded funds (**ETFs**) at present.

96. The closed-ended CIS currently listed in Hong Kong are mostly REITs[20]. To an investor, there is also little difference between a REIT and a listed property holding company economically. Currently the Commission requires that provisions substantially equivalent to those in Part XV of the SFO be adopted in trust deeds of REITs[21]. With the gradual development of the REITs market in Hong Kong, we consider this is now an appropriate time to extend the disclosure of interests provisions in Part XV of the SFO to cover REITs in order to codify the existing practice.

97. As explained in the Consultation Paper on the Proposed Amendments to the Guidelines for the Exemption of Listed Corporations from Part XV of the Securities and Futures

[20] HSBC China Dragon Fund is the only closed-ended CIS currently listed in Hong Kong not being a REIT. This fund invests in listed securities (mainly A shares and H shares) and does not offer a right of redemption to unitholders which is similar to the case of a listed corporation or an investment company listed under Chapter 21 of the Listing Rules. We therefore believe they should also be subject to the same disclosure of interests requirements as other listed companies under Part XV of the SFO.

[21] See press release on "Notification of Interests in REITs" dated 15 December 2005.

Ordinance (Disclosure of Interests) issued in May 2008, it is not the Commission's policy intent to cover open-ended CIS under Part XV of the SFO[22].

98. As such, we propose to formalise this policy intent and include an exemption in the SFO so that a listed open-ended CIS authorised by the SFC under section 104 of the SFO is exempted from compliance with the disclosure of interests requirements. We also propose to give the Financial Secretary the power to expand the ambit of this exemption to other listed CIS and new products as and when appropriate by notice in the Gazette. Such flexibility can ensure the legislation can be more responsive to market changes and development.

99. Our proposed approach in respect of disclosure of interests is generally in line with the regulatory approach adopted in the UK, Australia and Singapore.

Question 21: Do you have any comments on the proposal to amend Parts XIII and XIV of the SFO to make it explicit that they are applicable to all listed CIS in whatever form they take?

Question 22: Do you have any comments on the proposal to amend Part XV of the SFO to apply to all listed CIS with an exemption for listed open-ended CIS?

[22] On the basis that the total number of outstanding shares of an open-ended corporate form CIS is constantly changing, due to the frequent subscription and redemption of shares by investors, requiring compliance by an open-ended corporate form CIS and its corporate insiders with Part XV may result in additional costs without contributing to an informed market for its shares. We believe that the same is also true for open-ended non-corporate form CIS.

Appendix 1

Proposed amendments to the REIT Code

Chapter 1: Administrative Arrangements

1.1 The Commission has delegated its powers under section 104 of the SFO with respect to REITs to its Executive Director (Policy, China and~~Intermediaries and~~ Investment Products) and any of its delegates appointed pursuant to the SFO.

Chapter 2: Interpretation

2.24A "Takeovers Code" means the Codes on Takeovers and Mergers and Share Repurchases issued by the Commission (as amended from time to time).

Chapter 5: Management Company, Auditor, Listing Agent and Financial Adviser

Retirement of a Management Company

5.14 The management company shall be removed by the trustee by notice in writing in any of the following events:

(c) an ordinary resolution is passed by the holders to dismiss the management company.~~holders representing at least 75% in value of the units outstanding (excluding those held or deemed to be held by the management company, as well as by any holders who may have an interest in retaining the management company), deliver to the trustee a written request to dismiss the management company.~~

Notes: *All holders, including the management company and its associates, are entitled to vote their units on the ordinary resolution to dismiss the management company and be counted in the quorum for the purposes of passing such ordinary resolution.~~Units held by holders who are (i) directors, senior executives or officers of the management company; or (ii) associates of the persons in (i); or (iii) controlling entity, holding company, subsidiary or associated company of the management company or any holders who may have an interest in retaining the management company, are units deemed to be held by the management company or holders, as the case may be.~~*

5.17 Upon the retirement or dismissal of the management company, the trustee shall appoint a new management company as soon as possible whose appointment ~~has been~~shall be subject to holders' approval by ordinary resolution and the prior approval of the Commission.

Notes: *All holders, including the new management company and its associates, are entitled to vote their units on the ordinary resolution to appoint the management company and be counted in the quorum for the purposes of*

passing such ordinary resolution

Chapter 9: Operational Requirements

Meetings

9.9 A scheme shall arrange to conduct general meetings of holders as follows:

(f) holders shall be prohibited from voting their own units at, or counted in the quorum for, a meeting at which they have a material interest in the business to be contracted and that interest is different from the interests of all other holders;

Notes: *Notwithstanding the foregoing, all holders are entitled to vote their units on an ordinary resolution to dismiss or appoint the management company and be counted in the quorum for the purposes of passing such ordinary resolution.*

Chapter 11: Termination or Merger of a REIT

11.8 In the case of termination, the trustee shall oversee, as soon as practicable after the scheme falls to be wound up, the realisation of the real estate of the scheme by the management company, and ensure that, after paying all outstanding liabilities and providing adequate provisions for liabilities, the proceeds of that realisation are distributed to the holders proportionately to their respective interests in the scheme at the date of the termination of the scheme.

Notes: *(1)* *All real estate held by the scheme shall be disposed of through public auction or any form of open tender. The disposal shall be conducted at arm's length and in the best interests of the holders. The disposal price shall be the best available price obtained through public auction or open tender. Where appropriate, the Commission may consider granting a waiver from strict compliance with such public auction or open tender requirement where 11.13 and the applicable provisions in the Takeovers Code have been duly complied with in the circumstances.*

(2) *The trustee shall ensure that the liquidation exercise is completed within twelve months from the date the termination takes effect. Where the trustee considers it is in the best interests of the holders, the liquidation exercise may be completed for such longer period (in total not to exceed 24 months) as the trustee deems appropriate. Holders shall be informed by way of announcement.*

(3) *All cash proceeds derived from the liquidation of the scheme shall be distributed to holders on a pro rata basis. Where the liquidation exceeds six months, an interim distribution shall be made in respect of the sale proceeds received by the end of every six-month period, except where no sales were made during such period. Upon completion of the liquidation, a one-off distribution*

shall be made within one month from the date of completion.

(4) Distributions to holders upon termination of the scheme shall be made in cash only.

11.12 Where a scheme is involved in ~~the scheme undertakes~~ any form of merger, takeover, amalgamation or~~and~~ restructuring ~~other than a termination as stated in 11.1~~, the Takeovers Code must be complied with and the scheme's trustee and/or management company shall as soon as practicable consult with the Commission on the manner in which such activities could be carried out so that it is fair and equitable to all holders.

11.13 Where a delisting of a scheme from the Exchange is proposed, all rules and principles as applicable to listed companies under the Exchange's Listing Rules regarding withdrawal of listing should be complied with in substance, with necessary changes being made, as if such rules and principles were applicable to the scheme. The scheme's trustee and/or management company shall as soon as practicable consult with the Commission on the detailed application of such rules and principles with respect to the particular situation.

Appendix D

Contents of Trust Deed

6. Management Company

(b) A statement that the management company shall be appointed, removed or retire as set out in Chapter 5.

Appendix 2

Proposed amendments to the Codes

Amended section 1.5 of the Introduction section of the Codes

The responsibilities provided for in the Codes apply to:-

(a) directors of companies that are subject to the Codes;

(b) management companies (and their directors) and trustees of real estate investment trusts (REITs) that are subject to the Codes;

~~(b)~~(c) persons or groups of persons who seek to gain or consolidate control of companies that are subject to the Codes;

~~(c)~~(d) their professional advisers;

~~(d)~~(e) persons who otherwise participate in, or are connected with, transactions to which the Codes apply; and

persons who are actively engaged in the securities market.

Amended section 4.1 of the Introduction section of the Codes

"4.1 The Codes apply to takeovers, mergers and share repurchases affecting public companies in Hong Kong, ~~and~~ companies with a primary listing of their equity securities in Hong Kong and real estate investment trusts (REITs) with a primary listing of their units in Hong Kong. As a result, although it is generally the nature of the offeree company, the potential offeree company, or the company in which control may change or be consolidated that is relevant, there are also circumstances, specified in Rule 2 of the Takeovers Code, in which it is necessary to consider the treatment of the offeror's shareholders in order to carry out the objective of the Takeovers Code. The Executive will normally grant a waiver from the requirements of the Share Repurchase Code for companies with a primary listing outside Hong Kong provided that shareholders in Hong Kong are adequately protected."

New Schedule IX

SCHEDULE IX

REIT GUIDANCE NOTE

1. Introduction

(a) The provisions of the Codes including the parts of the Codes respectively entitled "Introduction", "Definitions", "General Principles", "Takeovers Code", "Share

Repurchase Code" and "Schedules" apply to REITs subject to the modifications set out in this Guidance Note.

(b) This Guidance Note is intended to provide all those involved in REITs with guidance as to how the Codes apply to REITS. The guidelines are not exhaustive. The Panel and the Executive will apply this Guidance Note in accordance with its spirit as well as its letter so as to achieve the underlying purpose.

(c) The General Principles of the Codes apply equally to a transaction involving a REIT.

2. Definitions

Unless the context otherwise requires in the context of a REIT -

"**Acting in concert**": In addition to the presumptions set out in the Definitions section of the Codes, persons in the following class will be presumed to be acting in concert with others in the same class unless the contrary is established:-

(10) a REIT, its trustee (together with persons controlling[#], controlled by or under the same control as the trustee (except in the capacity of an exempt principal trader or an exempt fund manager)), its management company (together with persons controlling[#], controlled by or under the same control as the management company) and any director (together with their close relatives, related trusts and companies controlled[#] by any of the directors, their close relatives or related trusts) of such management company.

Note:

1. *The Executive must be consulted where a trustee acts at the same time in its capacity as trustee for more than one of the following:-*
   (i) offeror or possible offeror;
   (ii) competing offeror or possible competing offeror; and
   (iii) offeree company.

2. *For the purpose of calculating the voting rights held by a group acting in concert, the voting rights held by a trustee in its capacity as trustee for unrelated trusts will not normally be counted. In case of doubt, the Executive must be consulted.*

"**Associate**": In addition to the persons listed under the definition of "associate" in the Definition section of the Codes, the term associate normally includes the following:-

(8) any trustee (together with persons controlling[#], controlled by or under the same control as the trustee) of an offeror, the offeree company or any company in class (1); and

(9) any management company (together with persons controlling[#], controlled by or under the same control as the management company) of an offeror, the offeree company or any company in class (1).

"**Board**": should be taken as a reference to include a management company and/or its board of directors.

"**Company**": should be taken as a reference to a REIT and/or a company as the context requires.

"**Constitutive documents**": has the meaning attributed to such term by the REIT Code.

"**Director(s)**": should be taken as a reference to include a management company and/or any one or more of its directors and/or persons with whose instructions a management company or its directors or a director of such management company is accustomed to act.

Note:

With respect to classes (2) and (6) of the presumptions of acting in concert set out in the Definitions section of the Codes, references to "directors" will also be taken as references to include the management company of a REIT (together with persons controlling, controlled by or under the same control as the management company).

"Employee share scheme": includes any employee share scheme of a management company adopted in connection with the REIT it manages.

"**General meeting**": should be taken as a reference to a meeting of the unitholders of a REIT held in accordance with the REIT's constitutive documents.

"**Management company**": has the meaning attributed to such term in the REIT Code.

"**Pension funds**": includes any pension funds of a management company established in connection with the REIT it manages.

"**Provident funds**": includes any provident funds of a management company established in connection with the REIT it manages.

"**REIT**": has the meaning attributed to such term by the REIT Code.

"**REIT Code**": means the Code on Real Estate Investment Trusts.

"**Shares**": should be taken as a reference to the units of a REIT.

"**Share capital**", "**Issued share capital**", "**Equity share capital**" or "**Equity shares**": should be taken as references to the units of a REIT which are issued and outstanding from time to time.

"**Shareholders**": should be taken as a reference to unitholders of a REIT.

"**Special purpose vehicles**" has the meaning attributed to such term by the REIT Code.

"**Trustee**": means a person appointed to act as trustee of a REIT.

Notes to Definitions:-

1. *Action by a trustee, a management company and/or any of its directors*

   Where an action is taken by a trustee (in its capacity as trustee for a REIT) or a management company and/or any of its directors (in their respective capacity on

behalf of a REIT), that action will be deemed to be an action taken by such REIT. In case of doubt, the Executive must be consulted.

2. *Voting rights owned, controlled or held by a trustee, a management company and/or any of its director*s

   Any voting rights owned, controlled or held by a trustee (in its capacity as trustee for a REIT) or a management company and/or any of its directors (in their respective capacity on behalf of a REIT) will be deemed to be voting rights owned, controlled or held by such REIT of which any of the trustee/the management company and/or any of its directors acted on its behalf. In case of doubt, the Executive must be consulted.

3. *Assets owned, controlled or held by special purpose vehicle(s)*

   Any assets owned, controlled or held by any special purpose vehicle will be deemed to be assets owned, controlled or held by the REIT that owns or controls the special purpose vehicle(s) in accordance with the REIT Code. In case of doubt, the Executive must be consulted.

3. Clarification of various provisions of the Takeovers Code

(a) Clarification of the application of Note 7 to Rule 2 of the Takeovers Code

In the context of a REIT, paragraph (i) of Note 7 to Rule 2 of the Takeovers Code should be replaced by "as a result of such proposal the REIT may not be regarded as suitable to remain authorised by the SFC under section 104 of the Securities and Futures Ordinance (Cap. 571); or".

(b) Directors of a company (Rule 2.8 and Note 2 to Rule 7 of the Takeovers Code)

For the purpose of Rule 2.8 and Note 2 to Rule 7 of the Takeovers Code, “director(s)” of a company will be construed as “director(s) of the relevant management company”. In case of doubt, the Executive must be consulted.

(c) Announcement of firm intention to make an offer (Rule 3.5(b) of the Takeovers Code)

In cases where the offeror is a REIT, in addition to disclosing the relevant information under Rule 3.5(b) of the Takeovers Code, the relevant announcement must also contain the identity of each of the management company and the trustee of such REIT.

(d) No frustrating action (Rule 4 of the Takeovers Code)

In accordance with Rule 4 of the Takeovers Code and its notes, in cases where the offeree company is a REIT, no frustrating action should be taken by any of the offeree REIT, the management company and/or any of its directors and/or the trustee (in its capacity as trustee for such offeree REIT). In particular, in addition to the matters set out under Rule 4 of the Takeovers Code, the relevant parties must not, without the approval of the unitholders of the offeree REIT, do or agree to do the following:-

(a) alter the terms of engagement between the offeree REIT and its management company; or

(b) enter into, or alter the terms of, the service contracts between the management company of the offeree REIT and any of its directors otherwise than in the ordinary course of business.

(e) Service contracts (Rule 4, Rule 8.5, Note 1(j) to Rule 8 and paragraph (13) of Schedule II to the Takeovers Code)

References to "directors' service contracts or service contracts of the directors" will be construed to include (i) any service contract between the management company and each of its directors; and (ii) any service contract in whatever form with the management company of the REIT in its capacity as such. In case of doubt, the Executive must be consulted.

(f) Availability of information – information issued by associates (Note 4 to Rule 8.1 of the Takeovers Code)

With respect to Note 4 to Rule 8.1 of the Takeovers Code, attention should also be drawn to classes (8) and (9) of the definition of associates under this Guidance Note.

(g) Resignation and appointment of the management company and its directors (Rule 7 and Rule 26.4 of the Takeovers Code)

In cases where any management company and/or any of its directors have difficulty in complying with Rule 7 and Rule 26.4 of the Takeovers Code due to compliance with any other rules, regulations and/or the constitutive documents of the REIT such management company manages, the Executive must be consulted.

(h) Documents to be on display (Note 1 to Rule 8 of the Takeovers Code)

In cases where the offeror or the offeree company is a REIT, in addition to the documents set out in Note 1 to Rule 8 of the Takeovers Code, copies of the relevant constitutive documents must also be made available for inspection in accordance with such note.

(i) Dividend forecasts (Rule 10.6(d) of the Takeovers Code)

A dividend forecast of a REIT is normally considered a profit forecast under Rule 10. In case of doubt, the Executive should be consulted.

(j) Appropriate offers for convertibles, warrants etc (Rule 13 of the Takeovers Code)

References to convertible securities in the context of a REIT in Rule 13 of the Takeovers Code will be construed to include those convertible securities issued by a REIT's special purpose vehicle(s) that are convertible into units of and guaranteed by such REIT (through its trustee acting in its capacity for such REIT).

(k) Requisitioning shareholder meetings after an offer becomes unconditional in all respects (Rule 31.5 of the Takeovers Code)

In cases where the offeree company is a REIT, the trustee (in its capacity as trustee for such offeree REIT) must also comply with Rule 31.5(ii). In case of doubt, the Executive should be consulted.

(l) Intentions regarding the offeree company (Paragraph 3 of Schedule 1 and paragraph 4 of Schedule 3 to the Takeovers Code)

If the offeree company is a REIT, instead of the disclosure requirements under paragraph 3 of Schedule 1 or paragraph 4 of Schedule 3 (as the case may be), the offeror's intentions regarding the following should be disclosed:-

(i) the continued operation of the REIT;
(ii) any major changes to be made to the operation of the REIT, including any redeployment of the assets of such REIT;
(iii) any major changes to be made to the investment policy of the REIT;
(iv) any plan to remove the current management company (and/or its directors) and appoint a new management company (and/or its directors); and
(v) the long-term commercial justification for the proposed offer.

(m) Further information in cases of securities exchange offers (Paragraph 17 of Schedule 1 to the Takeovers Code)

If the offeror is a REIT, instead of the disclosure requirements under paragraph 17 of Schedule 1, the date of establishment and the governing law of the offeror should be disclosed.

(n) Notes to the definitions of exempt fund managers and exempt principal trader

In the context of a REIT, its trustee would be regarded as if it were a professional adviser for the purpose of Note 2 to the definitions of exempt fund manager and exempt principal trader. Subject to the restrictions under Rule 35, the group entities of a trustee with exempt fund manager status or exempt principal trader status will therefore not be presumed as parties acting in concert with the REIT.

4. Early consultation

Consultation with the Executive at an early stage is essential.

Appendix 3

List of specific questions raised in the consultation paper

Question 1: Do you have any comments on the proposed amendments to the REIT Code to expressly require takeover and merger activities concerning REITs to be conducted in compliance with the Codes?

Question 2: Do you have any comments on the proposed amendments to the REIT Code to bring the requirements with regards to appointment and removal of REIT managers on a par with those applicable to directors of listed companies?

Question 3: Do you have any comments on the proposed amendments to the REIT Code in relation to delisting of REITs?

Question 4: Do you have any comments on our proposal regarding application of Note 7 to Rule 2 of the Takeovers Code and the new Rule 11.13 of the REIT Code?

Question 5: Subject to the implementation of appropriate modifications to the REIT Code as discussed in the relevant paragraphs in Part 1 and Part 2 of Section A of this paper being implemented do you agree that the Codes should apply to REITs? If not, please give reasons and any suggestion that you may have.

Question 6: If the Codes were to apply to REITs, do you agree with the proposed amendments to section 1.5 which would impose the responsibilities provided for in the Codes on management companies, their directors and trustees?

Question 7: If the Codes were to apply to REITs, do you agree with the proposal to cross reference "*shares*" and "*shareholders*" to "*units*" and "*unitholders*"?

Question 8: If the Codes were to apply to REITs, do you agree with the proposal to extend the meaning of *"board"* and *"director(s)"* in the context of REITs?

Question 9: If the Codes were to apply to REITs, do you agree that the REIT, the management company (and its directors) and the trustee should be presumed to be acting in concert as proposed?

Question 10: If the Codes were to apply to REITs, do you agree that the Executive should be consulted where there is common trustee for the parties to an offer?

Question 11: If the Codes were to apply to REITs, do you agree that group entities, including exempt fund managers or exempt principal traders, of the management company should be presumed as concert parties of the REIT (offeror or offeree) and therefore exempt status would not be relevant?

Question 12: If the Codes were to apply to REITs, do you agree that group entities of a trustee with exempt fund manager or exempt principal trader status should not be presumed as concert parties of the REIT (offeror or offeree) during an offer?

Question 13: If the Codes were to apply to REITs, do you agree that Rule 21.6 would apply to a connected management company and a connected trustee in an offer?

Question 14: If the Codes were to apply to REITs, do you agree that the management company and the trustee should be included in the definition of "*associate*"?

Question 15: If the Codes were to apply to REITs, do you agree with the proposal to introduce the concepts of parent, subsidiary, fellow subsidiary and associated company to REITs? If you do not agree, your reasons and your suggestions as to how to apply these concepts to REITs are particularly important.

Question 16: If the Codes were to apply to REITs, do you agree that Rule 4 should apply to the management company as well as its directors?

Question 17: If the Codes were to apply to REITs, do you agree that Rule 4 should apply to a trustee?

Question 18: If the Codes were to apply to REITs, do you agree that the term *"service contract"* in Rule 4, Rule 8.5, Note 1(j) to Rule 8 and paragraph (13) of Schedule II should be interpreted widely to cover *"service contract in whatever form"*?

Question 19: If the Codes were to apply to REITs, do you agree that a dividend forecast should be treated as a profit forecast which is subject to Rule 10 of the Takeovers Code?

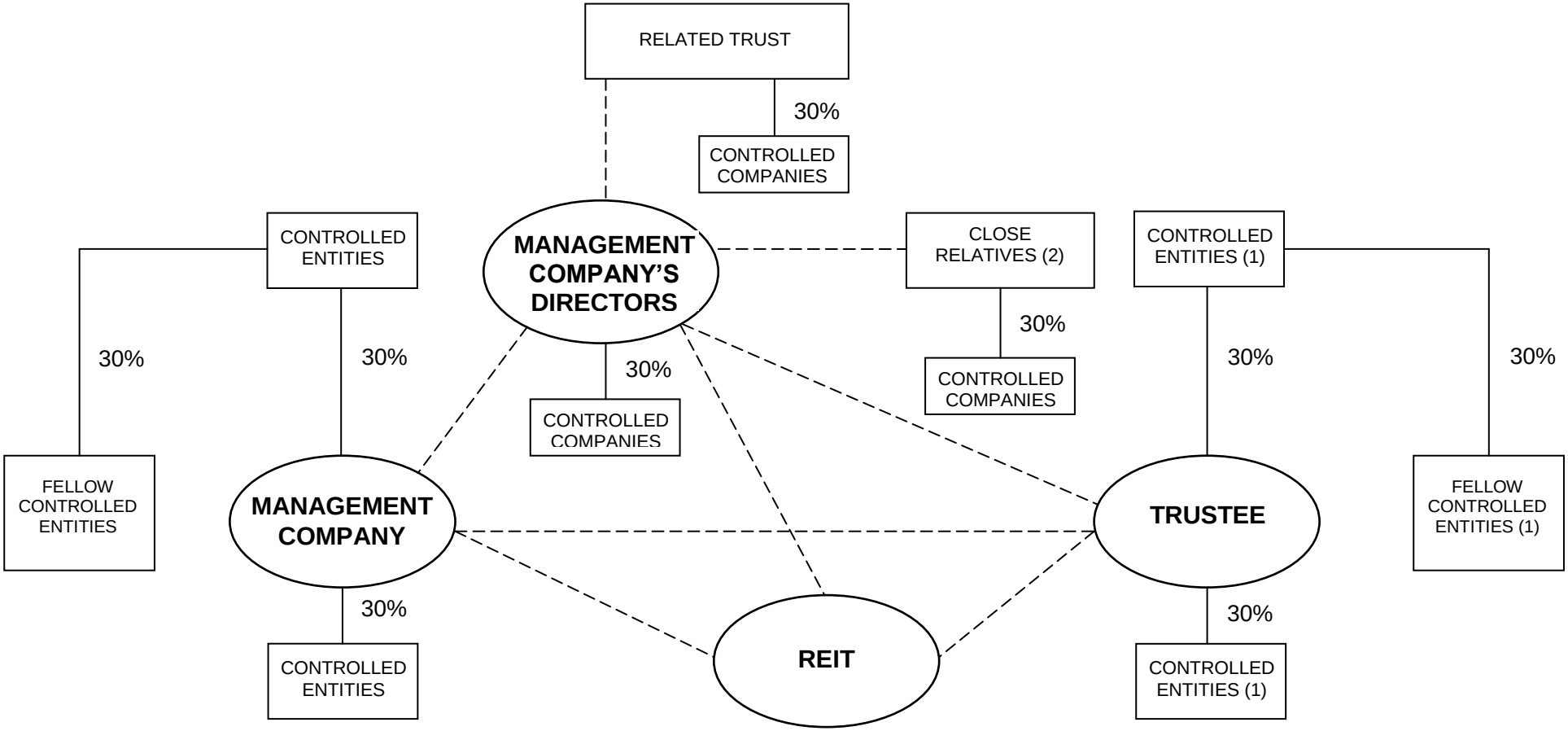
Question 20: If the Codes were to apply to REITs, do you agree that appropriate offers should be made for the convertible securities of a REIT? If so, do you agree to extend the meaning of *"convertible securities"* of the offeree in Rule 13 to include convertible securities issued by special purpose vehicles of a REIT?

Question 21: Do you have any comments on the proposal to amend Parts XIII and XIV of the SFO to make it explicit that they are applicable to all listed CIS in whatever form they take?

Question 22: Do you have any comments on the proposal to amend Part XV of the SFO to apply to all listed CIS with an exemption for listed open-ended CIS?

Appendix 4

Scope of new class (10) to the definition of "*acting in concert*"



Notes:
(1) Other than in the capacity of an exempt principal trader or an exempt fund manager
(2) Close relatives – spouse, de facto spouse, children, parents and siblings
– – – – – – – – – Shows relationship, (other than shareholding relationships) arising out of the new class (10) presumption

Appendix 5

Typical structure of a REIT