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SFC publicly censures two units of Bank of America Merrill Lynch Group for breaches of Takeovers Code

29 Jun 2016

The Securities and Futures Commission (SFC) has publicly censured Bank of America, National Association (BANA) and Merrill Lynch International (MLI), units of the Bank of America Merrill Lynch Group (BofAML Group), as a result of their failure to disclose dealings in relevant securities in two transactions (Transactions) in 2015 as required under the Code on Takeovers and Mergers (Takeovers Code).

The Transactions related to the partial offer for China Resources Beer (Holdings) Company Limited (CRB Partial Offer) and the privatisation of Power Assets Holdings Limited (Power Assets Privatisation) in which Merrill Lynch (Asia Pacific) Limited (MLAP) – a unit of the BofAML Group – acted as financial advisors (Notes 1 & 2).

At the material time, BANA and MLI executed equity swaps during the Transactions, but they failed to comply with the disclosure obligations under the Takeovers Code (Note 3).

In deciding the sanction, the SFC took into account BofAML Group's full cooperation and the remedial measures it has now put in place to ensure future compliance with the Takeovers Code.

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

A copy of the [Executive Statement](#) is available on the SFC website.

End

Notes:

1. MLAP is an institution licensed to carry out Type 1 (dealing in securities), Type 4 (advising on securities) and Type 6 (advising on corporate finance) regulated activities under the Securities and Futures Ordinance.
2. MLAP acted as the financial advisor to the offeror - CRH (Enterprise) Limited - in the CRB Partial Offer and to the offeree - Power Assets Holdings Limited - in the Power Assets Privatisation.
3. BANA and MLI fell within the definition of "associate" of the offeror in the CRB Partial Offer and of the offeree in the Power Assets Privatisation for the purposes of the Takeovers Code. Both BANA and MLI were also deemed acting in concert with the offeror in the CRB Partial Offer under the Takeovers Code.

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Takeovers Executive of the SFC publicly censures Bank of America, National Association and Merrill Lynch International in relation to breaches of Rule 22 of the Takeovers Code

Disciplinary action against Bank of America, National Association and Merrill Lynch International

1. The Executive publicly censures Bank of America, National Association (“**BANA**”) and Merrill Lynch International (“**MLI**”) under section 12.3 of the Introduction to the Codes on Takeovers and Mergers and Share Buy-backs (“**Codes**”) as a result of their failure to disclose dealings in the relevant securities in two transactions governed by the Code on Takeovers and Mergers (“**Takeovers Code**”) in 2015.
2. Both BANA and MLI were (i) associates and parties acting in concert with CRH (Enterprise) Limited (“**CRH**”) in its partial offer for China Resources Beer (Holdings) Company Limited (“**CRB**”) and (ii) associates of Power Assets Holdings Limited (“**Power Assets**”) in its privatisation by Cheung Kong Infrastructure Holdings Limited (“**CKI**”) for the purposes of the Takeovers Code.

Background and relevant provisions of the Takeovers Code

3. BANA, MLI and Merrill Lynch (Asia Pacific) Limited (“**MLAP**”) are all members of the Bank of America Merrill Lynch Group (“**BofAML Group**”), a major international financial institution. Three entities within the BofAML Group, including MLI, are recognised as exempt principal traders (“**EPT**”) by the Executive. MLAP is licensed to carry out a number of regulated activities under the Securities and Futures Ordinance including advising on corporate finance.

CRB Partial Offer

4. An offer period commenced for CRB on 20 April 2015 when CRB and CRH jointly announced a possible partial offer for CRB (“**CRB Partial Offer**”). MLAP was already advising the offeror, CRH, in respect of the CRB Partial Offer prior to the commencement of the offer period.

Power Assets Privatisation

5. On 8 September 2015, an offer period commenced for Power Assets when Power Assets and CKI jointly announced the privatisation of Power Assets by CKI by way of a securities exchange offer (“**Power Assets Privatisation**”). MLAP was mandated on 30 September 2015 to act for the offeree company, Power Assets, on the privatisation.

Breach of Rule 22 of the Takeovers Code

6. Rule 22 of the Takeovers Code requires parties to an offer and their respective associates (as defined in the Codes) to disclose their dealings in relevant securities (as defined in Note 4 to Rule 22 of the Takeovers Code) of the offeree company (and of the offeror in a securities exchange offers) conducted for themselves or on behalf of clients during an offer period. The relevant provisions of Rule 22 are set out in full in the Appendix to this statement.

7. The Takeovers Code defines an “associate” to include “*any bank and financial and other professional adviser... to an offeror [or] the offeree company... including persons controlling, controlled by or under the same control as such banks, financial and other professional advisers*”.

Power Assets Privatisation

8. BANA executed a total of 36 and 12 cash-settled equity swaps in respect of CKI shares and Power Assets shares respectively during the offer period after it was mandated. These swaps were entered between 2 October 2015 and 13 November 2015. For each equity swap, a corresponding swap was entered into between BANA and MLI. Where relevant, MLI would then undertake the market activities to hedge the equity swaps as permitted activities relying on its EPT status (“**Back-to-Back Arrangement**”).
9. On 12 October 2015, MLAP consulted the Executive about the nature of the Back-to-Back Arrangement in the context of the Power Assets Privatisation and the applicable disclosure requirements in the scheme document. It became apparent then that BANA and MLI should have made requisite disclosures of the equity swaps between (i) BANA and its clients and (ii) BANA and MLI in compliance with Rule 22.
10. During the period from 2 October 2015 to 29 October 2015, BANA failed to file disclosures for (i) 19 equity swaps for CKI shares and (ii) 7 equity swaps for Power Assets shares. While MLI made disclosures of the equity swaps which resulted in permissible market activities under its EPT status, it failed to make disclosures for (i) 14 equity swaps for CKI shares and (ii) 1 equity swap for Power Assets shares pursuant to Rule 22.

CRB Partial Offer

11. BANA entered into 198 cash-settled equity swaps with its clients in respect of CRB shares between 21 April 2015 and 8 October 2015. Similar to the Power Asset Privatisation, the Back-to-Back Arrangement was put in place and BANA entered into a corresponding swap with MLI for each equity swap BANA had with its clients.
12. Despite the provisions of Rule 22 of the Takeovers Code, BANA did not file disclosures for any of the above equity swaps entered into with its clients or with MLI. In addition, MLI also failed to make dealing disclosures for 45 equity swaps in accordance with the Takeovers Code, all being equity swaps which did not result in any market activities save in respect of one trade. MLAP self-reported the non-compliance on 19 October 2015 following its consultation with the Executive on 12 October 2015 in the context of the Power Asset Privatisation referred to in paragraph 9 above.

Apology by BofAML Group and Remedial Action Taken

13. BofAML Group accepts the oversight of the disclosure obligations of BANA and MLI in both transactions and that there were shortcomings in its disclosure compliance system. It has apologised for the Rule 22 breaches and emphasised that it takes the matter extremely seriously as evidenced by its investigation into the incident, the remedial measures adopted and the fact that the matter was escalated to senior levels within BofAML Group.

14. To address the shortcomings in its compliance with the Takeovers Code and to ensure future compliance, BofAML Group has implemented a number of remedial measures including the following:
- (a) compliance procedures and manuals have been reviewed and enhanced requiring (i) confirmations from traders that all derivatives in the relevant securities and relevant hedges are to be executed and booked in entities with EPT status only and (ii) improved pre-trade clearance notifications from traders;
 - (b) from the commencement of an offer period in a takeovers transaction relevant trades in the relevant securities are now cleared on a trade-by-trade basis by the Compliance Department in accordance with newly established guideline and no standing approval will be given;
 - (c) from the commencement of an offer period for takeovers transactions a log of pre-cleared relevant trades in the relevant securities is maintained by the Control Room and is provided to the disclosure team in the Compliance Department on a daily basis for reconciliation;
 - (d) reporting systems have been revamped to capture all relevant trading activities that require disclosure under the Takeovers Code;
 - (e) a compliance advisory bulletin has been issued to relevant staff globally outlining key provisions of the Takeovers Code;
 - (f) refresher training has been provided to compliance staff on the procedures for pre-clearing trades that relate to takeovers transactions; and
 - (g) training has been provided to relevant equities staff in Hong Kong on the intermediation business effected through BANA and its implications under the Takeovers Code and to relevant staff in the US and the UK.

Executive's comments

15. The disclosure obligations under Rule 22 of the Takeovers Code are intentionally onerous to reflect the fact that a high degree of transparency is essential to the efficient functioning of the market in an offeree company's shares and/or offeror company's shares in the case of a securities exchange offer during the critical period of an offer or possible offer. Timely and accurate disclosure of information in relation to dealings by the offeree company's or the offeror company's associates including advisers plays a fundamental role in ensuring that takeovers are conducted within an orderly framework and that the integrity of the markets is maintained. This is in line with General Principle 6 which provides that:

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

16. The Executive has taken into account BofAML Group's full cooperation with the Executive's review of the matter. The Executive is also pleased to note that BofAML Group has introduced enhanced compliance policies and procedures

and rectified the deficiencies in its reporting system to ensure future compliance with the Takeovers Code. However, BANA's and MLI's failure to report their dealings in equity swaps in accordance with Rule 22 in both the CRB Partial Offer and the Power Assets Privatisation is a material breach of General Principle 6 and Rule 22 of the Takeovers Code and the Executive considers the breach to be serious and to merit the present disciplinary sanction.

17. The Executive is particularly concerned that the involvement of BANA in intermediating equity swaps did not come to light until 6 October 2015 in the context of the Power Assets Privatisation. This led to the consultation on 12 October 2015 and the self-report by BofAML Group for non-compliance with the Takeovers Code on 19 October 2015 in the CRB Partial Offer which was five months after the commencement of the offer period for CRB.
18. BofAML Group should have taken reasonable care to establish and maintain procedures and systems to guard against non-compliance with the Takeovers Code. In particular, three of its members including MLI are recognised as EPTs by the Executive and are required to submit a confirmation to the Executive on an annual basis confirming that, among other things, suitable compliance procedures are in place.
19. Where an adviser is part of a financial group, the presumption of acting in concert extends to all entities within a group, including fund managers and principal traders. A financial advisor to an offeror and/or persons in the same group as the advisor should be prudent in their dealings in an offeree company's securities during an offer period which may affect the nature of consideration offered and/or result in a higher offer price. Fund managers and principal traders should consider applying for exempt status under the Codes at an early stage if they foresee the need to deal in the securities of an offeree and/or offeror during an offer period where another member of the financial group may be advising.
20. The Executive wishes to take this opportunity to remind practitioners and parties who wish to take advantage of the securities markets in Hong Kong that they should conduct themselves in matters relating to takeovers, mergers and share buy-backs in accordance with the Codes. In any cases of doubt as to the application of Rule 22, the Executive should be consulted.

29 June 2016

Appendix

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

Rule 22.1(a)

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

Rule 22.4

Dealings in relevant securities by an exempt principal trader connected with an offeror or the offeree company should be aggregated and disclosed, in accordance with Note 6(a) to this Rule 22, not later than 10.00 a.m. on the business day following the date of the transactions, stating the following details:–

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

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

Note 4 to Rule 2

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

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

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

Note 5 to Rule 22

Disclosure must be made no later than 10.00 a.m. on the business day following the date of the transaction. Where dealings have taken place on stock exchanges in the time zones of the United States and there may be difficulty in disclosing dealings by 10.00 a.m., the Executive should be consulted.