

For information

**Legislative Council Panel on Financial Affairs
Meeting on 3 April 2006**

**Agenda Item IV
Conflict of interest issue and other financial issues involved in and after the
listing of the Link Real Estate Investment Trust**

The Link Real Estate Investment Trust (The Link REIT) was listed on the Stock Exchange of Hong Kong (SEHK) on 25 November 2005.

The questions raised by the Panel related to specific operational issues and follow-up actions that the SFC might have on the Link REIT, the manager of the Link REIT and its board members. The SFC has considered these requests and is of the view that it is not in a position to provide specific information on these questions given the confidentiality obligation imposed on the SFC at law.

The SFC is an independent statutory securities regulator that administers and enforces the Securities and Futures Ordinance. In order to preserve the integrity of procedures, and to ensure a proper discharge of the SFC's regulatory function, information obtained by the SFC including those from enquiries or investigations has to be kept in strict confidence.

It is of paramount importance that the SFC is able to enforce the law and any relevant codes and guidelines against licensed intermediaries in a fair and impartial manner. Disclosure of confidential information that falls within the remit of the SFC's regulatory function may compromise the due process and fair hearing afforded to firms and individuals.

The SFC follows due process and fair procedures to ensure that it remains accountable to the public despite the need to preserve secrecy under the law. The internal procedures of the SFC in processing any applications, enquiries or even investigations are subject to the scrutiny by the Process Review Panel (PRP). The PRP is comprised of 12 members including a Legislative Council member (Hon Audrey Eu), academics, persons from the financial sector, persons from the legal and accountancy professions, a Law officer, an SFC Non-Executive Director and the SFC Chairman.

Regulatory requirements on REITs and REITs managers

The SFC is mindful of the need to enhance the transparency in its administration and enforcement of the laws and regulations in respect of the securities industry including the newly developed REITs market. By way of this briefing paper, the SFC explains in general terms the regulatory principles governing REITs and REITs managers.

REITs and REITs managers

1. In general, real estate investment trusts (REITs) are required to comply with the disclosure requirements and ongoing reporting and compliance requirements in the Code on Real Estate Investment Trusts (REIT Code), and to disclose information pertinent to them on a timely basis.
2. Prior to listing, a REIT has to make adequate disclosure of relevant and material information about its operations in the offering circular. Whether a piece of information is material has to be construed in its specific facts and circumstances of the case.
3. Subsequent to listing, the REIT and its management company (REIT Manager) have to ensure that the market is kept informed of any price sensitive information to avoid the creation of a false market.
4. The REIT Manager, being a licensee of the SFC, is required to conduct its business in a manner consistent and in compliance with the REIT Code and its compliance manual. It has to ensure that there are procedures in its compliance manual to deal with issues of conflicts of interests.
5. The structure and operation of the board of directors of the REIT Manager are comparable to those of the board of directors of a listed company. The board is required to observe good corporate governance principles in conducting their activities, including setting up systems for disclosure of interests by directors, and putting in place measures in avoidance of conflict of interest.
6. The REIT Manager, which is a licensee under the SFO, is subject to the regulation of the REIT Code and the relevant codes of conduct and guidelines. The SFC will not hesitate to take actions against those licensees if their conduct casts doubt on their overall fitness and properness.
7. As a licensed corporation, the REIT manager has to ensure that it has at least two responsible officers to be supervising its regulated activity. Like all other licensed corporations under the SFO, executive directors of a REIT manager are required to be licensed as responsible officers.
8. In addition, the REIT Code requires a REIT to be structured as a unit trust governed by the provisions of a trust deed. As a unit trust, the REIT has to appoint an independent trustee, who apart from having the fiduciary duty to hold the assets of a scheme in trust for the benefit of the holders, has to oversee the activities of the REIT Manager for compliance with the relevant constitutive documents of, as well as the regulatory requirements applicable to, the REIT.

Conflicts of interest and corporate governance

9. The REIT Manager has to satisfy the SFC that it has put in place sufficient internal systems of controls and measures to ensure the compliance with all regulatory requirements that are commensurate with its specific business operations and personnel management. A REIT manager is generally

expected to adopt measures that are capable of upholding good corporate governance principles and managing possible conflict of interests in order to safeguard investors' interests. The REIT Manager, as a licensed corporation, is subject to the application of the relevant codes of conduct and guidelines, including the Code of Conduct and the Fit and Proper Guideline for Licensees, issued by the SFC from time to time.

10. The SFC will monitor the REIT Manager on an on-going basis to ensure its compliance with the Code on REITs. The Manager is required to remain fit and proper as a licensed corporation like other intermediaries and is expected to monitor and manage from time to time issues arising out of real, potential or perceived conflicts of interest. It is incumbent on the manager to devise its own internal risk management programmes and controls and internal reporting requirements that best suit its operational mode.

Disclosure requirements for significant unit-holders

11. In response to the development concerning significant acquisitions of REIT units and widespread market interest in information about substantial interest in the units in REITs, SFC announces its policy regarding notification of interests in REITs on 15 December 2005.
12. The SFC announced on 15 December 2005 that provisions substantially equivalent to those in Part XV (Disclosure of Interests) of the SFO be adopted in trust deeds of REITs. As a result, holders of units in REITs are required to submit to the relevant REIT manager and the SEHK notifications of interests upon the attainment of the 5% disclosure threshold and other changes thereto in accordance with the provisions of the relevant trust deed. In order to enhance transparency of and public access to information regarding interests in units in REITs and to promote orderly trading in the market, such notifications received by SEHK will be posted on its website, in the same manner as the disclosure of interests in shares of listed companies.