

Corporate Finance

Our mission is to enhance the disclosure-based regulatory regime, improve corporate governance, and promote changes to law and regulation encouraging the development of efficient markets.

[Achievements]

- Issued consultation conclusions jointly with HKEx on the regulation of sponsors and independent financial advisers
- Worked with SEHK on its Code on Corporate Governance Practices and the Corporate Governance Report
- Implemented prospectus related amendments in the Companies (Amendment) Ordinance 2004
- Issued a consultation paper to review the Codes on Takeovers and Mergers and Share Repurchases
- Issued a consultation paper on proposed amendments to the Securities and Futures (Stock Market Listing) Rules and worked with the Government on giving statutory backing to major listing requirements
- Supported the Government regarding its proposals to establish a Financial Reporting Council
- Worked with SEHK on its proposal to review its decision-making structure for listing matters

[This Chapter Is About]

- Takeovers matters
- Prospectus regime review
- Enhancement of corporate governance
 - Revision of Listing Rules
 - Regulation of sponsors
 - Public Shareholders Group
- Upholding standards
 - Dual Filing
 - Enhancing the regulation of listing
 - Quality of financial reporting
 - Review of the SEHK's decision-making structure for listing matters

Investors First



Year 2 undergraduate Mr Calvin Lou has not invested before, but is interested in the financial markets.



Ms Olivia Fung finds online trading convenient and user-friendly.



First-time investor Mr Walter Leung has recently subscribed for shares in an IPO.

What We Do

- Administer the Codes on Takeovers and Mergers and Share Repurchases;
- Raise standards of investor protection and corporate governance;
- Oversee the SEHK's listing-related functions and responsibilities;
- Review and recommend changes to the Listing Rules;
- Administer securities legislation relating to listed and unlisted companies;
- Recommend changes to laws and regulations to facilitate the development of effective, fair and efficient capital markets;
- Review prospectuses of unlisted issuers for authorisation under companies legislation and grant exemptions for prospectuses issued by listed and unlisted issuers; and
- Administer the Dual Filing regime under the SFO to enhance the quality of disclosure by listing applicants and listed companies.



Mr Peter Au-Yang (centre), ED of Corporate Finance, explains the Takeovers Code review at a media briefing. Accompanying him are Mr Brian Ho, Senior Director, and Ms Gail Humphries, Director.

What We Did

Takeovers Matters

The Takeovers Executive administers all takeovers transactions relating to public companies under the Codes on Takeovers and Mergers and Share Repurchases. The Codes are designed to ensure fair treatment for shareholders who are affected by takeovers, mergers and share repurchases. The Executive comments on takeovers announcements and documents, gives rulings and interpretations under the Codes, monitors share dealings and movements during an offer period, and is available for consultation on the application of the Codes so that issues can be addressed and problems resolved at an early stage.

The Executive believes it is important to keep the Codes up-to-date with market developments and international practices in order to ensure all shareholders are treated equally. A review of the Codes was conducted in consultation with the Takeovers Panel, taking into account the Executive's experience in its day-to-day administration of the Codes and comments from market practitioners.

A consultation paper proposing amendments to the Codes was published in November 2004. The public consultation ended in March 2005 and elicited 12 responses. We aim to publish the consultation conclusions in the second half of 2005.

During the year, the Takeovers and Mergers Panel met four times to consider Code amendments.

Corporate Finance

Takeovers Executive Sanctioned GP NanoTechnology Group Limited and its Directors



On 18 October 2004, the Executive publicly censured GP Nano and seven directors (Mr Fung Chiu, Mr Lian En Sheng, Mr Ong Hong Hoon, Mr Chow Chun Kwong, Mr Chiang Chi Kin, Stephen, Mr Siu Siu Ling, Robert and Mr Feng Hui Liu). The Executive also imposed a 24-month "cold shoulder order" on Fung and Lian denying them direct or indirect access to the securities markets. The sanctions were imposed under section 12.3 of the Introduction to the Codes.

The background concerned a voluntary offer for GP Nano by Right Field Holdings Limited, which posted an offer document to shareholders of GP Nano on 10 September 2003. Despite repeated requests by the Executive to do so, GP Nano and its directors never issued an offeree circular to shareholders in response to the offer, on the pretext that GP Nano was in financial difficulties and that the offer was unsolicited and unappealing. The Executive ruled that GP Nano and all its seven directors at the time had breached a fundamental requirement under the Takeovers Code, denying shareholders and the investing public access to GP Nano's latest corporate and financial information, a board recommendation and advice of an independent financial adviser with respect to the offer.

The Executive imposed more severe sanctions on Fung and Lian to reflect the fact that they initiated and led the company's decision not to issue the response circular whereas the remaining directors collectively and individually failed to take any action to prevent the breach.

Prospectus Regime Review

The commencement of the prospectus-related amendments in the Companies (Amendment) Ordinance 2004 in December 2004 completed the second phase of a project to improve the public offering regime. The first phase, completed in May 2003, involved the issuance of guidelines and class exemptions by the SFC to facilitate securities offerings. Major reforms in the second phase included 12 new exemptions from the prospectus regime, a new advertising regime for public offers and increased scope for use of the SFC's exemption power.

In the second half of 2004-2005, we began the third phase of the market development project.

This involves an overall review of the regime, having regard to equivalent legislation in leading overseas jurisdictions. The principal purpose is to modernise the regime. We hope to consult the public on our recommendations in mid-2005.

Enhancement of Corporate Governance

■ Revision of Listing Rules

We had worked closely with the SEHK on the Code on Corporate Governance Practices for listed companies, the prescribed Corporate Governance Report and the related Listing Rules changes. They came into effect in January 2005. Issuers are required to report compliance and explain any non-compliance with the Code in the annual report for the accounting period commencing on 1 January 2005.

■ Regulation of Sponsors

We received 129 responses to the Joint Consultation Paper on the Regulation of Sponsors and Independent Financial Advisers (IFAs) issued in May 2004. There was strong market consensus for the SFC, as the statutory regulator, to be responsible for assessment of eligibility, continuing supervision, discipline and enforcement of the conduct of corporate finance advisers who act as sponsors and IFAs; whereas the SEHK, as the market operator, should continue to be responsible for implementation and administration of the Listing Rules requirements, including the practice note on due diligence.

In October 2004, we published the consultation conclusions and the Listing Rules amendments jointly with the SEHK. The amendments clarified what the SEHK and the SFC expect of sponsors and IFAs. Firms not meeting the regulators' expectations must improve their compliance arrangements or face regulatory consequences. We will also consider introducing specific eligibility criteria for sponsor or IFA work into the existing licensing regime. (see chapter on Intermediaries and Investment Products for details).

■ Public Shareholders Group

The Public Shareholders Group is a standing committee under section 8 of the SFO to provide investors' views on issues relating to shareholders' rights and interests. The Group consists of 13 members: retail and institutional investors, professionals, market commentators, advocates of investors' rights, an academic and a Consumer Council representative.

During the year, members met eight times to discuss various issues and advise on regulatory proposals. They have assisted the SFC in performing its functions more effectively. Topics discussed include:

- regulation of sponsors and IFAs;
- SEHK's proposal regarding Main Board companies' publication of announcements in newspapers;
- SFC's and SEHK's enforcement policies;
- a review of the disclosure of interests law;
- a review of the Investor Compensation Fund;
- statutory backing for important listing requirements; and
- SEHK's proposed new structure for listing decision-making.

Upholding Standards

■ Dual Filing

Under the Dual Filing regime, which took effect on 1 April 2003, listing application materials and listed company announcements are filed with the SEHK and, via the SEHK, the SFC.

The Dual Filing Advisory Group, a standing committee established under section 8 of the SFO, advises us on treatment of cases and policy issues under the regime. During the year, in anticipation of more Dual Filing work pursuant to proposals to enhance regulation of listed companies, we expanded the Group to 12

members by appointing three more members. The Group met three times in 2004-2005.

As part of our efforts to ensure transparency, the SFC published quarterly updates on the implementation of Dual Filing. In 2004-2005, we received 122 new listing applications and commented on 64 of them. Of these 64 applications, 26 remained active as at 31 March 2005, 33 had lapsed or been rejected or withdrawn, and five had been listed. There was a marked increase in the number of applications with planned offer size of over \$100 million (88 of such cases as compared to 54 cases in 2003-2004). Our average response time was seven working days.

The SFC continues to focus on the quality, not quantity, of disclosure by listing applicants and listed companies. We identify and comment on major disclosure issues at the beginning of the listing process. The Dual Filing Advisory Group has endorsed this approach.

During the year, we identified disclosure concerns including: unusual or undisclosed relationships between a listing applicant and its suppliers or customers, heavy reliance on a few distribution agents, and acquisition or disposal of significant business shortly before the listing application. After consultation with the Dual Filing Advisory Group regarding one application, we advised the SEHK that we would exercise our power to object to the listing, and the application subsequently lapsed. We will continue to work closely with the SEHK to ensure that Dual Filing operates smoothly and the interests of investors are sufficiently protected.

In addition, we have worked with other divisions of the SFC on cases arising from deficient disclosure in both listing applications and listed company announcements. For example, the SFC successfully completed the first prosecution under Dual Filing for the provision of false and misleading information, against a listed company and its director.

Corporate Finance

■ Enhancing the Regulation of Listing

Following the Government's March 2004 Consultation Conclusions on Proposals to Enhance the Regulation of Listing, the Government and the SFC separately consulted the public in January 2005 on proposals to give statutory backing to major listing requirements.

The Government proposed amendments to the SFO to enable the SFC to make rules and prescribe important listing requirements and continuing obligations of listed companies. It also consulted on the proposed sanctions for breaches:

- civil sanctions by the SFC against issuers, directors and officers, including civil fines of up to \$5 million on issuers and directors;
- civil sanctions by the Market Misconduct Tribunal against issuers, directors and officers, including civil fines of up to \$8 million on issuers and directors; and
- criminal prosecution.

The Commission supports the Government's proposals, including the proposal to empower the SFC to impose fines. Civil fines would enable the SFC to take swift action to uphold its regulatory objectives of maintaining a fair and transparent market and protecting investors. However, the Commission is concerned that a maximum fine of \$5 million for the SFC and \$8 million for the Market Misconduct Tribunal (MMT) may not be adequate to address serious cases. The Commission has submitted to the Government that more realistic fining levels of up to \$10 million for the SFC and unlimited fines for the MMT should be considered. In order for Hong Kong to have a credible regulatory regime of international standard, the SFC needs to have the power to impose civil fines in amounts that the listed sector will take seriously and consider a deterrent so as to encourage compliance with the Securities and Futures (Stock Market Listing) Rules (SMLR).

The Commission has also written to the Legislative Council's Panel on Financial Affairs before the Panel's meeting on 4 April 2005 to discuss the proposals to give statutory backing to major listing requirements. We pointed out in the Note to the Panel that it is essential for the SFC to have power to impose civil fines to enable the SFC to tailor regulatory action proportionately to misconduct. Reliance on the MMT fines alone would deny the SFC a key enforcement tool. Without the power to levy fines, the SFC may be compelled to refer a large number of cases to the MMT, which is not equipped to deal with a high volume of cases or to process them at the speed required for the proper regulation of the listed sector.

The accompanying SFC consultation proposed amendments to the SMLR to codify important listing requirements covering the following three areas:

- disclosure of price-sensitive information and specific events;
- disclosure/publication of annual and periodic reports, including annual and interim accounts; and
- disclosure of, and shareholders' approval for, notifiable transactions and connected transactions.

The SFC consultation period ended on 31 March 2005. We believe that the Government's and the SFC's proposals are a major step forward in our continuing effort to strengthen backend enforcement action against false or misleading disclosure and non-disclosure. The proposed measures would bring Hong Kong's listing regulatory regime further into line with international markets. We will continue to work with the Government and the SEHK to develop the proposals further in the light of responses received. The SFC is committed to improving the quality of the Hong Kong market.

■ Quality of Financial Reporting and Regulation of Auditors

The Government published a Consultation Paper on Legislative Proposals to Establish Financial Reporting Council (FRC) in February 2005. The proposed FRC would oversee an Audit Investigation Board (AIB) and a Financial Reporting Review Committee (FRRC). The AIB would investigate suspected irregularities concerning auditors, while the FRRC would look into suspected non-compliance of listed company accounts and financial statements with legal and accounting requirements.

The Government, the SEHK, the Hong Kong Institute of Certified Public Accountants and the SFC have agreed to fund the FRC on an equal share basis. Each will contribute \$2.5 million per annum in the first three years of the FRC's existence, plus a one-off contribution of up to \$2.5 million as a reserve.

■ Review of the SEHK's Decision-Making Structure for Listing Matters

The Listing Division discussed with us its proposals to revise the SEHK's decision-making structure for listing matters. HKEx issued a consultation paper on its proposals in February 2005.

Matters Handled by Corporate Finance



Types of application	2004-2005	2003-2004
Applications for listing on the SEHK	122	117
Codes on Takeovers and Mergers and Share Repurchases		
General and partial offers under the Takeovers Code	24	43
Privatisations	3	7
Whitewash waiver applications	32	34
Other applications under the Takeovers Code	184	301
Off-market and general offer repurchases	3	7
Other applications under the Share Repurchases Code	5	1
Total	251	393
Executive's Statements		
Sanctions imposed with parties' agreement ¹	1	1
Takeovers and Mergers Panel		
Meetings for review of the Takeovers and Share Repurchases Codes	4	0
Statements issued by the Panel ²	0	1
Companies Ordinance (CO) and Securities and Futures Ordinance (SFO)		
Applications for exemption under Section 309 of the SFO	529 ³	460 ⁴
Applications for authorisation under Section 105 of the SFO	52	5
Applications for authorisation to register prospectuses under the CO in respect of unlisted shares and debentures	114	49
Applications for exemption from the CO prospectus content requirements for prospectuses in respect of shares and debentures	130 ⁵	69 ⁵

1. Pursuant to paragraph 12.3 of the Introduction to the Codes on Takeovers and Mergers and Share Repurchases.
2. Pursuant to paragraph 16.1 of the Introduction to the Codes on Takeovers and Mergers and Share Repurchases.
3. Each certificate issued can include more than one warrant or structured product. 1,394 warrants listed, 4 equity-linked instruments and 10 debt instruments were listed during the year.
4. Each certificate issued can include more than one warrant or structured product. 1,007 warrants listed, 7 equity-linked instruments, 2 debt instruments and 2 shares issued were listed during the year.
5. Each certificate issued can include more than one CO exemption.