

Corporate Finance



A teacher in arts and design, Ms Wong Ko Pui, uses modern Chinese painting techniques to portrait a butterfly over a bloom. She outlines the objects in watermark before applying colours. The SFC seeks to raise the standards of corporate governance in the market, which will then prosper and where all participants may thrive.



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

- Implemented Dual Filing
- Participated in the extensive revision of the SEHK's Listing Rules covering a number of corporate governance matters as well as initial listing criteria and continuing listing obligations
- Issued a joint consultation paper with the SEHK on regulation of sponsors and independent financial advisers
- Participated in the Code on Corporate Governance Practices for listed companies exposed by the SEHK for comments
- Played a key role in introducing prospectus-related amendments under the Companies (Amendment) Bill 2003 to the LegCo
- Participated in the Government's Consultation on Proposals to Enhance the Regulation of Listing

This Chapter Is About

- Takeovers matters
- Facilitating market development and compliance
 - Prospectus regime
- Enhancement of corporate governance
 - Revision of Listing Rules
 - Regulation of sponsors
 - Shareholders Group
- Upholding standards
 - Implementation of the Dual Filing regime
 - Enhancing the regulation of listing

WHAT WE DO

- >> **Administer the Takeovers and Mergers Code and Share Repurchases Code;**
- >> **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 and company legislation relating to listed and unlisted companies;**
- >> **Recommend changes to laws and regulations and facilitate the development of effective, fair and efficient capital markets;**
- >> **Review prospectuses of unlisted issuers for authorisation under companies legislation and administer the grant of 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 listed companies.**

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 can be resolved at an early stage.

The Executive had another record year in terms of the numbers of general offer transactions and applications under the Codes (see Table 1 on page 32). The Executive is reviewing various provisions of the Codes with a view to consulting the public on proposed amendments later in 2004.

Major Rulings and Disciplinary Action

Takeovers Panel upheld an Executive ruling concerning on-market share repurchases by CLP Holdings Ltd

In November 2003 the Executive ruled that Rule 32 of the Takeovers Code did not enable a whitewash waiver mechanism to be used to waive general offer obligations triggered by on-market share repurchases. At that time the Kadoorie family held a 34.84% shareholding interest in CLP and a share repurchase of 11 million shares would have caused it to cross the 35% threshold and hence incur a general offer obligation. The former 35% mandatory bid threshold applied to the Kadoorie family under transitional provisions of the Takeovers Code as it had held between 30% and 35% shareholding interest in CLP in October 2001. CLP applied to the Panel for a review of the Executive's ruling. On 11 December 2003 the Panel upheld the Executive's ruling stating that it was clear from the wording of Rule 32 that it did not provide for whitewash waivers triggered by on-market share repurchases. The Panel also decided that the particular circumstances in this case did not justify the exercise of any discretion which the Takeovers Panel may have to modify or relax the application of Rule 32.

Takeovers Executive sanctioned Hui Chuen Kin, Daniel and Lui Bing Kin, Michael, executive directors of International Capital Network Holdings Ltd (ICN)

On 24 April 2003 the Executive publicly censured Mr Hui Chuen Kin, Daniel and Mr Lui Bing Kin, Michael and imposed a 24-month "cold shoulder order" denying them direct or indirect access to the securities markets. Hui surrendered his licence with the SFC as a deemed licensed representative for the same period. The sanctions concerned a voluntary offer for ICN by Koffman Securities Ltd that was announced in early September 2002. On 17 September 2002 ICN issued an announcement advising shareholders not to take any action in response to the offer until they had received advice from ICN's board and its financial advisers. In the same announcement ICN informed shareholders that its cash reserve of some \$40 million was being kept under the control of a wholly owned subsidiary of ICN. In the months that followed ICN refused to issue a document in response to the offer despite rulings of the Executive and the Panel for it to do so. On 19 November 2002 ICN announced for the first time that its cash reserve had been reduced to \$3.6 million, mainly as a result of two transactions. The offer lapsed on 9 December 2002. ICN did not issue a response document throughout the offer period. The Executive considered that Hui and Lui had breached the Takeovers Code in connection with the two transactions. The Executive also found that Hui and Lui had breached the Takeovers Code and a ruling of the Panel in failing to ensure that ICN issued a response document during the offer period.

Facilitating Market Development and Compliance

➤ Prospectus Regime

The first phase of a market development project focused initially on retail bonds and other debt-related products and involved the issue of three sets of SFC guidelines under the prospectus regime to facilitate the conduct of public offerings of securities and two class exemptions in relation to prospectuses for debenture offerings. With completion of the first phase in May 2003, the second phase continued with the introduction of the Companies (Amendment) Bill 2003 to the LegCo in the following month.

The part of the Bill dealing with the prospectus regime seeks to level the playing field between different types of offers and/or issuers and put the SFC guidelines mentioned above on a statutory footing. Scrutiny of the relevant provisions by the Bills Committee was largely completed in January 2004. It is hoped that the part of the Bill dealing with the prospectus regime will be enacted in the summer of 2004.

The third phase involves an overall review of existing provisions of the Companies Ordinance relating to public offers of shares and debentures, including a study of equivalent legislation in leading overseas jurisdictions. Work is now under way to formulate proposals to modernise Hong Kong's public offering regime. It is expected that a consultation paper setting out our recommendations for reform will be issued in the third quarter of 2004.

Enhancement of Corporate Governance

➤ Revision of Listing Rules

We worked closely with the Listing Division of the Stock Exchange of Hong Kong (SEHK) in the extensive revision of Listing Rules announced in January 2004. These changes covered a number of corporate governance matters and the SEHK's minimum criteria for companies seeking an initial listing.

The SEHK also exposed for comments a Code on Corporate Governance Practices and proposed Corporate Governance Report. It is intended that the major part of this Code will apply to issuers' financial years beginning 1 January 2005. The Commission

believes that the Code will represent a significant enhancement of corporate governance standard among Hong Kong listed companies.

➤ Regulation of Sponsors

In May 2003 we issued a joint consultation paper with the SEHK on the regulation of sponsors and Independent Financial Advisers (IFAs). The paper proposed that the SEHK would maintain a list of acceptable sponsors and IFAs, as well as standard of conduct to be adhered to by them — in particular due diligence work to be carried out by sponsors in IPOs.

The consultation responses indicate that the market believes strongly that decisions on whether a firm licensed under the SFO may be allowed to engage in a particular type of business should be determined by the SFC alone, to avoid "double regulation". The SFC is now considering changes to the existing regulatory regime for licensed and registered persons under the SFO to cater specifically for sponsors and IFAs. It is also reviewing measures that would help strengthen regulatory oversight over these intermediaries. In doing so, the SFC is mindful that any regulatory regime must be effective and pragmatic.

Separately, in light of comments received from the market, HKEx is preparing amendments to the Listing Rules to clarify HKEx's expectation of sponsors and IFAs, in particular a sponsor's role in advising applicants for listing and in conducting due diligence.

Shareholders Group

The Shareholders Group is a standing committee under Section 8 of the SFO to engage investors and harness their views on issues relating to shareholders' rights and interests. The Group consists of 13 members from different constituencies including retail and institutional investors, professionals, academics, market commentators, advocates of investors' rights, and a Consumer Council representative.

During the year, seven meetings were held where members discussed various issues and advised on regulatory proposals. Their views have assisted the Corporate Finance and other divisions of the SFC in performing their functions more effectively. Topics discussed included:

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- Consultation Paper on the Regulation of Sponsors and IFAs;
- Straight-Through-Processing for Investor Participant Accounts;
- Revised Code of Best Practices and Proposed Corporate Governance Report;
- Disclosure-based Securities Regulation;
- Review on Tick Size Reduction by HKEx;
- Consultation Paper on Proposals to Enhance the Regulation of Listing; and
- Exposure Draft of the Code of Corporate Governance Practices and Corporate Governance Report.

Upholding Standards

➤ Implementation of the Dual Filing Regime

Under the Dual Filing regime, listing application materials as well as listed company disclosure are now required to be filed with both the SFC and the SEHK. Since its implementation on 1 April 2003, the regime has been operating smoothly and effectively and has been well received by the market.

In May 2003, we appointed nine members to the Dual Filing Advisory Group, which advises on treatment of cases under the regime and the relevant regulatory provisions, as well as on related policy issues. In 2003-2004, the Group met three times.

The SFC's emphasis is on the quality of corporate disclosure. We identify major disclosure issues at the beginning of the listing process and provide comments. This approach has been endorsed by the Group as the right way to administer disclosure-based regulation.

To ensure transparency, the SFC gives quarterly detailed updates on the implementation of Dual Filing. Our average response time was seven working days. In 2003-2004, we received 117 new listing applications. We have commented on 54 of them. Dual Filing has not caused any additional compliance burden on listing applicants who have prepared adequate draft prospectuses. Going forward, we will continue to work in full co-operation with the SEHK to ensure that the Dual Filing arrangement is market-friendly and the interest of investors is sufficiently protected.

Matters handled by Corporate Finance		Table 1	
Codes on Takeovers and Mergers and Share Repurchases	2003-2004	2002-2003	
General and partial offers under Takeovers Code	43	29	
Privatisations	7	9	
Whitewash waiver applications	34	31	
Other applications under Takeovers Code	301	255	
Off-market and general offer repurchases	7	8	
Other applications under Share Repurchases Code	1	9	
Total	393	341	
Disciplinary cases dealt with by the Executive	0	2	
Takeovers and Mergers Panel			
Reviews of Executive rulings by Panel	1	2	
Referral by the Executive	0	1	
Disciplinary hearings	0	1	
Special meetings for review of the Takeovers and Share Repurchases Codes	0	0	
Total number of Panel meeting days	1	4	
Companies Ordinance (CO) and Securities and Futures Ordinance (SFO)			
Applications for exemption under Section 309 of the SFO (in 2002-2003: Securities (Disclosure of Interests) Ordinance)	460 ¹	290	
Authorisation under Section 105 of the SFO (in 2002-2003: Section 42(g) of the Protection of Investors Ordinance)	5	10	
Unlisted companies' prospectuses authorised for registration by the Registrar of Companies	49	14	
Certificates of Exemption under Sections 38A and 342A of CO	69 ²	27 ²	
Applications for listing of shares on the Stock Exchange	117	N/A ³	

¹ With 1,007 warrants listed, 7 equity-linked instruments, 2 debt instruments and 2 shares issued.

² Each certificate issued can include more than one CO exemption.

³ The SFC began to review listing applications under the Dual Filing regime from 1 April 2003.

➤ Enhancing the Regulation of Listing

Following the release of the Expert Group Report in March 2003, the Government issued a Consultation Paper on Proposals to Enhance the Regulation of Listing in October 2003.

On 29 January 2004, the SFC submitted its views on the consultation paper. We fully agree with the Government that we must continue to upgrade our market quality by improving the listing regime, and in doing so consider market development needs and local circumstances. The SFC's approach is to advocate pragmatic, feasible, technical solutions that will ensure that Hong Kong's system of listing regulation matches international financial centre standards.

On 26 March 2004, the Government issued its consultation conclusions paper. The main proposals involve a phased and focused approach to give statutory backing to the more important listing requirements which will be made and enforced by the SFC under the SFO. In Phase I, rules will be prepared by the SFC under Section 36 of the SFO dealing with:

- financial reporting and other periodic disclosure (e.g. annual and interim reports) by listed companies;
- disclosure of price sensitive information by listed companies; and
- shareholders' approval for certain notifiable transactions.

Phase I will involve exposure of draft Section 36 rules for public consultation before an SFO Amendment Bill is introduced to the LegCo, targeted for the first quarter of 2005. The Amendment Bill seeks to establish a three-pronged regime to deal with breaches of the new statutorily backed rules involving direct civil sanctions by the SFC — namely reprimands and disqualification orders imposed on issuers, directors and corporate officers and/or referral to the Secretary of Justice for possible criminal prosecution or civil proceedings before the Market Misconduct Tribunal (MMT). Expansion of the new rules to cover other important aspects of the Listing Rules will be dealt with in Phase II.

To enhance the transparency of the listing regulatory process, and as one of the Government's recommendations in its consultation conclusions, we will prepare audit reports on HKEx's performance for publication.

These reforms represent a major step forward in effort to enhance the regulation of listed companies and the Commission is committed to ensuring that they will be effective and in the interest of issuers and investors, and for the continued development of Hong Kong as an international financial centre.