

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

- Revised the Codes on Takeovers and Mergers and Share Repurchases
- Issued a consultation paper on possible reforms to the prospectus regime in the Companies Ordinance
- Analysed responses to the consultation paper on amendments to the Securities and Futures (Stock Market Listing) Rules (SMLR) to give statutory backing to major listing requirements, worked with stakeholders on developing the proposals
- Supported the Government's proposals to establish a Financial Reporting Council
- Worked with the SEHK on its proposal to review its decision-making structure for listing matters
- Reviewed and reported on the SEHK's performance in its regulation of listing matters

This Chapter Is About

- Takeovers matters
- Prospectus related matters
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 - Prospectus authorisation for unlisted retail structured note issues

- Upholding standards
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 - Enhancing the regulation of listing
 - Quality of financial reporting and regulation of auditors
 - Review of the SEHK's decision-making structure for listing matters
 - Review of the SEHK's performance of its regulation of listing matters
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- The Public Shareholders Group

What We Do

- Administer the Codes on Takeovers and Mergers and Share Repurchases
- Promote 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 and grant exemptions for prospectuses issued by listed and unlisted issuers under companies legislation
- Administer the Dual Filing regime under the SFO to enhance the quality of disclosure by listing applicants and listed companies

What We Did

Takeovers matters

The Takeovers Executive, comprising staff of the Corporate Finance Division, 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. Following public consultation on proposed code amendments, and in consultation with the Takeovers and

Mergers Panel, we published the consultation conclusions in August 2005. The amended Codes were issued in October 2005.

During the year, the Takeovers and Mergers Panel met two times to consider the public's responses to proposed code amendments.

The SFC criticised the Board of Directors of ITC Corporation Ltd

On 15 November 2005, the SFC publicly criticised the board of directors of ITC for breaching Rule 21.3 of the Takeovers Code, which restricts share dealings and transactions by an offeror and parties acting in concert with it during securities exchange offers.

The background concerned a possible voluntary securities exchange offer to be made by Hanny Holdings Ltd for all shares of Group Dragon Investments Ltd, a company to be established following completion of the group reorganisation of China Strategic Holdings Ltd, which was announced by Hanny on 19 April 2005. As a result an offer period commenced under the Takeovers Code. As ITC held over 20% of the shares in Hanny, it was presumed to be acting in concert with Hanny under the Takeovers Code and hence was subject to the restrictions in Rule 21.3 during the offer period.

On 21 October 2005, a wholly-owned subsidiary of ITC acquired 11 million Hanny shares for \$44 million, increasing ITC's shareholding in Hanny from 20.61% to 25.48%. This acquisition of shares by ITC constituted a breach of Rule 21.3 of the Takeovers Code. The board of directors of ITC admitted the breach and agreed to the SFC issuing the public criticism under section 12.3 of the Introduction to the Codes.

Prospectus related matters

✓ Prospectus regime review

The release in August 2005 of the consultation paper on possible reforms to the prospectus regime in the Companies Ordinance marked the launch of the third and final phase of a project to modernise the regime for public offerings of shares and debentures.



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The first two phases were completed in May 2003 and December 2004 respectively. The final phase involves an overall review of the public offering regime, and the consultation paper put forward 21 “concept” proposals covering regulatory harmonisation, enhancement of investor protection, pre-deal research reports, and incorporation by reference etc. The consultation ended on 31 December 2005 and we are considering the submissions.

✓ Prospectus authorisation for unlisted retail structured note issues

Under the Companies Ordinance prospectus regime, SFC authorisation is required for prospectuses in respect of unlisted public offerings of shares and debentures.

In 2005-06, we authorised 134 prospectuses in respect of retail structured note issues, representing an 18% increase from 114 prospectuses a year ago. The aggregate issue size represented by retail note issues with an issue date falling within 2005-06 was approximately \$13,137 million.

Our authorisation is also required for any advertisements in relation to retail note prospectuses. We processed 103 applications in 2005-06.

Upholding standards

✓ Dual Filing

Under the Dual Filing regime, which took effect on 1 April 2003, listing application materials and listed company announcements filed with the SEHK are also filed via the SEHK with 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. The Group met once in 2005-06.

In 2005-06, we received 86 new listing applications and issued comments on 41 of them. Of these 41 applications, 13 remained active as at 31 March 2006, 11 had lapsed or been rejected or withdrawn, and 17 had been listed.

70.2% of the total applications were submitted during the first half of 2005-06 (i.e. from April to September), compared to 60.6% in the first half of 2004-05. There was a higher proportion of applications with planned offer size of over \$500 million (41.9% compared to 25.4% in 2004-05). Our average response time was seven working days. To ensure transparency, the SFC publishes quarterly updates on applications.

We continue 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 concerns including deficient disclosure of key factual information relating to the ownership, business and industry of the applicant, and its relationship with related parties, and inconsistencies between the English and the Chinese versions of a prospectus.

After consultation with the Dual Filing Advisory Group regarding one application, we advised the SEHK that we intended to exercise our power to object to the listing. 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.

✓ 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 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.

The SFC supports the Government's proposals, including the proposals to empower the SFC to fine. Civil fines will enable the SFC to take swift action to uphold its regulatory objectives of maintaining a fair and transparent market and protecting investors. The SFC is working with the Government to finalise the proposals.

The 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.

Our consultation ended on 31 March 2005. We have analysed the responses to the consultation and discussed the proposals with the Government, the SEHK and market stakeholders. Discussions are continuing.

We believe these 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. 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 a 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, HKEx, 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. Recently, we have also agreed to double a one-off contribution to \$5 million as contingency funding.

✓ Review of the SEHK's decision-making structure for listing matters

The SEHK consulted the public on a new structure for decision-making on listing matters in February 2005. We worked closely with the SEHK on its proposals.

Subsequent to the consultation period, the SEHK decided to address the proposals in its consultation paper in two phases. In the first phase, the SEHK amended the Listing Rules to increase the number of Listing Committee members to at least 28, cap their term of office to six years, and include more investor representatives on the committee. The SEHK will review the other consultation proposals in phase two.

✓ Review of the SEHK's performance of its regulation of listing matters

Section 21 of the SFO requires the SEHK to ensure, as far as reasonably practicable, an orderly, informed and fair market. Section 5(1)(b)(i) of the SFO requires the SFC to supervise, monitor and regulate the activities carried on by the SEHK. The SEHK and the SFC have agreed in a Memorandum of Understanding signed on 28 January 2003 that the SFC shall periodically review the SEHK's performance in its regulation of listing matters.

The Government recommended, in its March 2004 Consultation Conclusions on Proposals to Enhance the Regulation of Listing, that the SFC prepare annual reports on its reviews of the SEHK's performance in its listing functions and submit them to the Financial Secretary.

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In the first half of 2005, we reviewed the SEHK's procedures in key listing-related functional areas. We concluded that the procedures in the areas examined were adequate to enable it to discharge its statutory obligation to maintain an orderly, informed and fair market. We also recommended certain areas for improvement to the SEHK for consideration, including ways it can improve the transparency of its policies and practices. A report was published by the Government in October 2005 and is available on the SFC website.

✓ Regulation of business valuers

We are concerned about the standards of business valuations used in financial reporting and have called for better regulation and higher standards of professionals who provide business valuation services to listed companies.

In response to our calls, the Hong Kong Institute of Surveyors, the Hong Kong Society of Financial Analysts and the Royal Institution of Chartered Surveyors formed the Hong Kong Business Valuation Forum in September 2005. The Forum's objectives are to set standards and requirements that each of these professional bodies will apply to its members.

The 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 14 members: retail and institutional investors, market commentators, advocates of investors' rights, academics and a Consumer Council representative.

During the year, members met five 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 independent financial advisers;
- the Government's Financial Reporting Council Bill;
- proposals on possible reforms to the prospectus regime in the Companies Ordinance;
- proposed reforms to the derivative warrants market; and
- SEHK policy issues relating to profit forecasts.

Matters handled by Corporate Finance

Types of application	2005-06	2004-05
Applications for listing on the SEHK	86	122
Codes on Takeovers and Mergers and Share Repurchases		
General and partial offers under the Takeovers Code	34	24
Privatisations	15	3
Whitewash waiver applications	32	32
Other applications under the Takeovers Code	204	184
Off-market and general offer repurchases	5	3
Other applications under the Share Repurchases Code	5	5
Total	295	251
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	2	4
Statements issued by the Panel ²	0	0
Companies Ordinance and Securities and Futures Ordinance		
Exemptions granted under section 309 of the SFO ³	767	529
Authorisations granted under section 105 of the SFO	142	52
Authorisations granted to register prospectuses under the CO in respect of unlisted shares and debentures	134	114
Exemptions granted from the CO prospectus content requirements for prospectuses in respect of shares and debentures	158	130

1. Pursuant to section 12.3 of the Introduction to the Codes on Takeovers and Mergers and Share Repurchases.

2. Pursuant to section 16.1 of the Introduction to the Codes on Takeovers and Mergers and Share Repurchases.

3. Each certificate of exemption issued can include more than one warrant or structured product. 2,080 warrants and 8 debt instruments were listed during the year.