

Corporate Finance Division



(seated, left to right):
Barbara Shiu, Senior Director
Laura M Cha, Executive Director
(to 31 December 1998)
David Stannard, Executive Director
(from 1 January 1999)
(standing, left to right):
Brian Ho, Director
Pinky Tse, Director
Charles Grieve, Director
Christine Wong, Director
(not in picture)

Mrs Laura M Cha was Deputy Chairman and Executive Director responsible for the Corporate Finance Division until 31 December 1998 when she relinquished responsibilities for the Corporate Finance Division.
Mr David Stannard was appointed Executive Director responsible for the Corporate Finance Division on 1 January 1999.

Highlights

- ❖ Derivative warrant holders now able to exercise warrants via the clearing system with settlement within five days
- ❖ Revision of the Takeovers Code; ❖ SFC public consultation on review of SDIO
- ❖ SFC public consultation on treasury shares;
- ❖ SEHK public consultation on improving financial disclosure by listed companies
- ❖ Assisting SEHK with development of rules for the Growth Enterprise Market (GEM)
- ❖ SEHK releases Practice Note 19 dealing with specific circumstances that may require timely disclosure under the general disclosure obligation

FUNCTIONS

- ❖ administers the Takeovers and Mergers Code and Share Repurchases Code;
- ❖ seeks to ensure there is full and timely disclosure of relevant information affecting the value of securities of public companies;
- ❖ seeks to ensure fair and equal treatment of public shareholders;
- ❖ seeks to maintain and improve investor protection standards by developing fair and clear rules for listed companies, and promoting the development of good and sound business practices;
- ❖ oversees the performance by the SEHK of its listing-related functions and responsibilities;
- ❖ reviews and recommends changes to the Listing Rules;
- ❖ facilitates the development of effective and efficient capital markets in both equity and debt issues; and
- ❖ facilitates the development of Hong Kong as the preferred market for the listing and trading of securities of Mainland enterprises.

1. LISTING POLICY

1.1 China Initiatives

In December 1998, the State Council authorised eight more Mainland companies to list their shares

overseas, bringing the total of such companies to 85. As a result of the Asian financial crisis, only one company completed its listing this year. To date, 43 Mainland incorporated companies are listed outside the Mainland, 41 of them in Hong Kong.

Following the success of an earlier seminar, the SFC, the TDC and the SEHK held a seminar in Dalian in May 1998 to promote the securities markets of Hong Kong. To promote awareness and understanding within the Mainland of various aspects of the securities regulations of Hong Kong, the SFC also took part in a number of other seminars and courses held on the Mainland and in Hong Kong for officials of the Mainland government and senior executives of listed and non-listed companies.

In addition to the above, regular meetings were held with the Chinese Securities Regulatory Commission (CSRC), the two Mainland stock exchanges and the SEHK to discuss issues which are of mutual concern.

During the year, the Listing Rules applicable to Mainland issuers were also modified to reflect practices adopted by the SEHK on certain requirements of the Listing Rules.



1.2 Securities (Disclosure of Interests) Ordinance

The SFC issued a consultation paper on proposed amendments to the SDIO on 30 June 1998. The paper consulted the public on 14 specific areas with a view to bringing Hong Kong's securities disclosure regime in line with international and regional standards and to up-date the Ordinance in light of recent market developments. The consultation period ended on 30 September 1998. During this period, the SFC received 35 responses from the public. With the benefit of public comments, the SFC has formulated its final proposals on the amendment of the Ordinance. These

are set out in a Consultation Conclusions paper published by the SFC in April 1999.



- ❖ required disclosure by issuers of the number of warrants placed with the largest five places; and
- ❖ introduced procedures to prevent undue concentration of the launch and termination of derivative warrants on the same underlying company's shares.

From 26 October 1998 the SEHK required all issuers of derivative warrants to allow warrant holders to settle by using the central clearing system. In response to a request from the SEHK and the SFC, HKSCC established new procedures allowing settlement using the central clearing system. Initially settlement via the central clearing system will take no longer than five days. The SEHK intends to reduce this period once market practitioners develop experience of the new system. This compares to 18 days required for physical settlement outside the clearing system.

1.3 The Growth Enterprise Market

In May 1998, the SEHK issued a Consultation Paper on a Proposed New Market for Emerging Companies. The SFC was involved in providing comments to the SEHK on the preparation of this paper. After the consultation period ended in July 1998, the SEHK formed a Second Market Working Group comprising market practitioners and representatives of the SEHK and the SFC to consider public responses and develop relevant rules for the new market. The Second Market Working Group has adopted "The Growth Enterprise Market" or "GEM" as the name of the new market and is currently working on the draft listing rules for GEM.

1.4 Changes to the Listing Rules

Derivative Warrants

In June 1998 the SEHK announced revisions to the Listing Rules regarding derivative warrants that:

- ❖ raised the existing suitability criteria for issuers of derivative warrants;

Practice Note 19

In November 1998 the SEHK released Practice Note 19 dealing with specific circumstances that may require timely disclosure under the general disclosure obligation of paragraph two of the Listing Agreement. Practice Note 19 deals with disclosure by listed companies of:

- ❖ exposure to a single group,
- ❖ commitments to provide financial assistance to associated companies and joint ventures; and
- ❖ conditions in loan agreements that are outside the control of a listed company, specifically:
 - pledging of shares by the controlling shareholder to secure a loan to the issuer;
 - loan agreements with covenants relating to specific performance by the controlling shareholders, e.g. maintenance of minimum level of shareholding in the listed company.

Sundry Changes to Listing Rules

In March 1999 the Commission approved a number of changes to the Listing Rules including:

- ❖ permitting H-share companies to retain the services of a sponsor for only one year after listing, not three;
- ❖ requiring controlling shareholders to undertake to inform the SEHK of any pledge of their shares made within a year of the initial listing; and
- ❖ ignoring a listing applicant's share of profits from its associated companies in determining whether an applicant has met the track record requirement.

Public Consultation on Improving Financial Disclosure by Listed Companies

In December 1998 the SEHK released a public consultation paper on improving financial disclosure by listed companies. The paper asked for views on a number of matters including proposals:

- ❖ for interim financial reports to include substantially the same information as the annual report, and asked for views on whether interim reports need to be audited;
- ❖ for financial conglomerates to comply with disclosure requirements similar to those expected of banks under the Hong Kong Monetary Authority's Best Practice Guide for Authorised Institutions;
- ❖ to specify areas that must be discussed by listed companies in the section of their annual reports that provides analysis of and comments on their financial position; and
- ❖ to specify certain situations where listed companies would be expected to make immediate disclosure to the market in order to comply with the general disclosure obligation.

2. TAKEOVERS AND MERGERS

2.1 Review of the Hong Kong Code on Takeovers and Mergers

As mentioned in last year's annual report, the Division, together with the Takeovers and Mergers Panel (Panel) and Special Adviser to the SFC,

Mr Christopher de Boer, a former Chairman of the Panel, has conducted a review of the Takeovers Code. A consultation paper was released in February 1998 and the consultation period ended on 27 March 1998.

A total of 26 submissions were received from the public. The submissions were reviewed and refinements to the proposed amendments were adopted by the Panel and approved by the Commission.

The principal areas of amendments:

- ❖ a modified voting level was added to Rule 2.10 relaxing the requirements for privatisations by way of scheme of arrangement; and
- ❖ a new Whitewash Guidance Note consolidating relevant Takeovers Code provisions for waivers of general offer obligation under whitewash transactions.

The revised Takeovers Code took effect on 1 August 1998.

2.2 Treasury Shares

In December 1998, the Commission released a public consultation paper on the desirability of introducing treasury shares in Hong Kong. Treasury shares are issued shares in a company that are repurchased and held by the company in treasury without being cancelled and are available for resale at a later date. The introduction of treasury shares would require changes to be made to existing company law in Hong Kong. Such changes would only apply to Hong Kong incorporated companies, not those incorporated overseas. In light of this, the consultation paper also explored whether there should be non-legislative regulatory changes, such as to the provisions of the Listing Rules, which affect the



process and speed of reissue of shares which have been repurchased and cancelled. Any such changes would be designed to provide some of the perceived benefits and flexibility of treasury shares to all companies listed on the SEHK, whatever their place of incorporation.

The consultation period ended on 31 January 1999. The Division is considering the replies it has received and aims to develop a policy proposal for consideration and approval by the Commission in the second quarter of 1999.

2.3 Administration of the Takeovers Code and Share Repurchases Code

The general fall in stock prices has reduced the number and changed the nature of transactions that come under the auspices of the Takeovers Code and the Share Repurchases Code. Many of the transactions handled by Corporate Finance Division in the year relate to complex restructurings or rescues of companies in financial difficulties. The reduction in the absolute number of matters handled was balanced by the increase in complexity of the cases.

2.4 Decisions of the Takeovers Panel

Golden Power International Holdings Limited (Golden Power)

In April 1998, the Panel reviewed a ruling of the Executive in relation to Golden Power. In 1993, three individuals sought and obtained a ruling from the Executive that they were acting in concert while using a holding company to acquire shares in Golden Power. In November 1997, on the liquidation of the holding company, Golden Power shares were distributed to the three individuals. In 1998 one of these individuals sought confirmation that he was no longer a member of the concert party. The Panel upheld the Executive's refusal to give this confirmation as, notwithstanding the liquidation of the initial holding company, the applicant had not satisfied the Code requirement that he present clear evidence that the concert party had broken up.

Far East Aluminium (Holdings) Limited (Far East Aluminium)

The Panel met on 30 March 1999 to consider an application under the Takeovers Code in relation to Far East Aluminium. The issue in question was whether payments made by guarantors to discharge their guarantee obligations on top of the acquisition price should be taken into consideration in determining the resulting general offer price.

China National Aero-Technology Import & Export Corporation Limited (CATIC) and Cheung Kong (Holdings) Limited (Cheung Kong) are two indirect shareholders of Far East Aluminium.

They proposed to acquire, through their respective wholly owned subsidiary, a controlling block of shares in Far East Aluminium and to extend a general offer at the same price. The same shares formed the collateral to a loan for which CATIC and Cheung Kong also acted as guarantors. As the loan outstanding exceeded the purchase consideration, CATIC and Cheung Kong would have to honour their guarantee obligations for the shortfall before acquiring the shares. Based on the facts and circumstances of this particular case, the Panel concluded that payments made under the guarantees need not affect the offer price. However, the Panel cautioned that this decision should not be taken as a precedent for future cases.

2.5 Takeovers Appeal Committee

In a written decision issued on 8 April 1999 the Takeovers Appeal Committee upheld the public reprimand previously imposed by the Panel on Mr Jim Wong Tim Yue and Mr Danny Chan Tak Tim arising out of their involvement in the purchase of shares in Shun Ho Resources Holdings Limited by certain parties in breach of the Takeovers Code.

In January 1994, the Panel found that, in November 1988, Mr William Cheng Kai Man had acted in concert with Ms Geraldine Wong Pui Ching in acquiring more than 35% of the shares in Shun Ho without making a general offer. In respect of Mr Wong, the Panel had found that in September 1990, Mr Wong had been prepared to be involved in certain share dealings which would clearly have been a breach of the Code had it not been for the peculiar situation that Mr Cheng was already in breach of the Code in November 1988.

Mr Wong's conduct clearly breached the spirit of the Code. In respect of Mr Chan, the Panel found that Mr Chan had granted Mr Cheng an option at a price well below the then market price of the shares of Shun Ho and that this option was a device to enable Mr Cheng to exceed the 35% threshold at a low price and at a time convenient to him. Such a device clearly breached the spirit of the Code.

Takeovers Code and Share Repurchases Code

	1 Apr 1998 to 31 Mar 1999	1 Apr 1997 to 31 Mar 1998
General Offers under Takeovers Code	19	34
Privatisations	1	3
Whitewash waiver applications	14	12
Other applications under Takeovers Code	172	254
Applications under Share Repurchases Code	8	9
Exemptions under Securities (Disclosure of Interests) Ordinance	180	269
Takeovers Panel :		
Reviews of Executive rulings by Panel	1	0
Referral by the Executive	1	0
Disciplinary hearings	1	0
Special meetings for review of the Takeovers and Share Repurchases Code	2	8
Total number of Panel meeting days	10	8
Cases dealt with by the Takeovers Appeal Committee	1	0