

**CONSULTATION PAPER ON PROPOSED
AMENDMENTS TO THE COMPANIES ORDINANCE
TO FACILITATE OFFERS OF SHARES AND DEBENTURES**

FINANCIAL SERVICES AND THE TREASURY BUREAU
SECURITIES AND FUTURES COMMISSION
MARCH 2003

EXECUTIVE SUMMARY

INTRODUCTION

1. The Financial Secretary highlighted in his Budget Speech in 2002 the importance of increasing liquidity through attracting more financial product issuers to Hong Kong, as well as capital and investors from the Mainland and overseas. In his Budget Speech in 2003, he said that in order to foster the development of retail bonds and other financial products, we would introduce a bill to amend the Companies Ordinance (the CO) by July 2003 to simplify the procedures for the registration and issue of prospectuses. This paper takes forward these initiatives.

HIGHLIGHTS OF MAJOR PROPOSALS

Enhanced clarity of the application of the prospectus regime (paragraphs 17 to 22 below)

2. Under the CO, any document falling within the definition of "prospectus" is required to comply with the prospectus-related requirements. We accept the market view that there should be more clarity as to the types of offers and invitations that can be made without triggering the prospectus regime and propose to exclude expressly from the definition of "prospectus" documents containing or relating to offers and invitations that fall within specified descriptions. Major examples are -
 - (a) offers to investors falling within the definition of "professional investors" in Schedule 1 to the Securities and Futures Ordinance as read together with the Securities and Futures (Professional Investor) Rules;
 - (b) offers to no more than 50 persons;
 - (c) offers in respect of which the minimum denomination of, or the minimum consideration payable by any person for, the shares or debentures is not less than \$1,000,000; and

- (d) offers in respect of which the total consideration payable for the relevant shares or debentures does not exceed \$1,000,000.

Flexible implementation of the prospectus regime
(paragraphs 23 to 25 below)

3. We propose to expand the existing exemption power of the Securities and Futures Commission (the SFC) under sections 38A and 342A of the CO by providing the SFC with an additional ground of exemption: that the exemption would not be prejudicial to the interest of the investing public; and increasing the number of provisions in respect of which exemption may be granted. Such enhanced flexibility in administering the prospectus regime is essential in a market which demonstrates and supports ongoing innovation in the form of new offering structures, offering methods and financial products.

Facilitative marketing permitted (paragraphs 26 to 28 below)

4. We propose to make clear in the legislation that it is permissible for issuers to issue "awareness advertisements" setting out basic factual and procedural information concerning the offers. We intend that such advertisements will not constitute prospectuses (or extracts or abridged versions of a prospectus) nor fall within the prohibition of section 103 of the Securities and Futures Ordinance. Necessary investor protection safeguards have been included. The purposes are to enhance investors' awareness of an offer and allow them more time to arrange their financial and other affairs in anticipation of a public offer.

Alternative prospectus regime for programme offerings
(paragraphs 29 to 30 below)

5. The standalone prospectus contemplated under the CO is not conducive to the conduct of programme offers (i.e. offers made on a repeat or continuous basis or through successive tranches) as each time an offer

in a series is made, authorization and registration of a full prospectus is required. The associated administrative burden hinders the making of timely offers responsive to market conditions and results in increased compliance cost that serves little regulatory purpose. We therefore propose to include in the CO an alternative "dual prospectus" structure whereby a prospectus may consist of (a) a "programme prospectus", (b) an "issue prospectus", and (c) an "addendum", if necessary, updating the information in the "programme prospectus" or "issue prospectus". Safeguards to ensure that investors are given access to all relevant information and other safeguards applicable to a full prospectus have been included as appropriate.

Level playing field and other miscellaneous revisions
(paragraphs 31, 32, 38 and 39 below)

6. A number of other amendments are proposed to remove the discrepancies in certain regulatory requirements applicable to offers made by companies incorporated locally and overseas; and for clarifying the application of and the requirements under certain provisions.

Prospectus liability provisions (paragraphs 33 to 37
below)

7. Under section 40 of the CO, directors, promoters and persons who authorize the issue of a prospectus are liable to pay compensation to all persons who subscribe for any shares in or debentures of the company on the faith of the relevant prospectus, for the loss or damage they have sustained by reason of any untrue statement (deemed to include a statement that is misleading) in the prospectus. We propose to make clear that (a) investors who acquire shares or debentures in a public offering (whether it is an offer for subscription or offer for sale) through or via an agent or intermediary shall be regarded as persons who subscribe for the shares or debentures; and (b) omission of material information in a prospectus would also give rise to liability.

CHAPTER I

INTRODUCTION

INTRODUCTION

8. The Securities and Futures Commission (the SFC) and the Financial Services and the Treasury Bureau (the FSTB) jointly publish this paper to consult the public on proposed legislative amendments to the prospectus regime under the Companies Ordinance (the CO). The proposed amendments are primarily for facilitating the issue of new shares in or debentures of a company and lowering the associated cost.
9. The detailed proposals for consultation are set out in Chapter III of this consultation paper. Respondents may submit their comments on or before 31 March 2003, by any of the following methods -

By mail to: Rooms 1801-4, 12/F, Edinburgh Tower,
 Tower I, The Landmark,
 Admiralty Centre, 15 Queen's Road,
 18 Harcourt Road, Central,
 Admiralty, Hong Kong
 Hong Kong

By fax to: (852) 2294 0460 (852) 2810 5385

By email to: consult@fstb.gov.hk cficonsult@hksfc.org.hk

By online <http://www.info.gov.hk/fstb> <http://www.hksfc.org.hk>
submission to:

10. Please note that the names of respondents and their comments may be posted on the website of the SFC and the FSTB or referred to in other documents we publish. If you do not wish your name to be disclosed, please state that you wish your name to be withheld from any publication when making your submission.

BACKGROUND

11. The Financial Secretary highlighted in his Budget Speech in 2002 the importance of increasing liquidity through attracting more financial product issuers to Hong Kong, as well as capital and investors from

the Mainland and overseas. In his Budget Speech in 2003, he said that in order to foster the development of retail bonds and other financial products, we would introduce a bill to amend the CO by July 2003 to simplify the procedures for the registration and issue of prospectuses. This paper takes forward these initiatives.

12. This consultation paper takes forward certain initiatives to amend the prospectus regime under the CO. They are set out in Chapter III of this paper. They represent specific changes to the prospectus regime in response to requests from market participants, which we consider acceptable from the perspective of investor protection. As a further longer term initiative, the SFC will conduct a review of all the existing laws and procedures relating to public offers of securities with reference to the framework adopted in leading jurisdictions and propose a comprehensive update. Readers can find in Chapter II information on our three-phase approach to update the prospectus regime.

CHAPTER II

OVERVIEW OF THE THREE-PHASE APPROACH TO UPDATE THE PROSPECTUS REGIME UNDER THE CO

13. Parts II and XII of the CO prescribe the regulatory framework for offers of shares in or debentures of companies incorporated in Hong Kong and overseas respectively. The basic framework was introduced decades ago and amendments made over the years do not adequately accommodate offering structures and other market practices prevalent in developed markets today. Market participants have advocated, and we support, the need for overhauling the existing regulatory framework. To take forward this enormous task, we propose a pragmatic three-phase approach with a view to putting in place a regulatory framework that provides the most efficient, competitive and fair environment for issuers and investors alike.

THE FIRST PHASE

14. Measures under the **first phase** are being made in response to specific requests from market participants and do not involve amendments to the primary legislation as they are already possible or envisaged under the current prospectus regime. Key measures are -
- (a) to increase investors' awareness of the relevant offers and allow them more time to arrange their financial and other affairs in anticipation of a public offer: publishing guidelines to make clear that it is permissible to issue awareness advertisements that set out basic factual and procedural information about a proposed public offer subject to the inclusion of prescribed responsibility and warning statements, prior and subsequent to the registration of the relevant prospectus;
 - (b) to facilitate investors' understanding of key information in a prospectus: publishing guidelines to make clear that it is permissible to issue (a) mini prospectuses providing a fair summary of the information in the relevant

prospectus, and (b) fact sheets setting out the key terms of the relevant offer, subject to the inclusion of prescribed responsibility and warning statements as well as the continued availability of the relevant prospectus, upon or after registration of the relevant prospectus;

- (c) to better accommodate the increasingly common offer structures whereby offers are made on a repeat or continuous basis or through various tranches: publishing guidelines to permit a "dual prospectus" structure under which a prospectus may consist of a programme prospectus and an issue prospectus that can be authorized, registered and issued separately, on the condition that any issue prospectus refers to the programme prospectus and the programme prospectus is readily available for the duration of any offer prescribed in an issue prospectus;
- (d) to reduce the compliance burden of issuers of prospectuses: publishing guidelines to make clear that it is permissible to submit to the SFC, in an application for authorization for registration under sections 38D(3) and 342C(3) of the CO, faxed copies of experts' consent letters and a bulk print proof of the prospectus subject to certain undertakings; and

(The three sets of guidelines referred to above were issued by the SFC and gazetted on 21 February 2003. In preparing these guidelines, the SFC confirmed its interpretation of the existing law with leading counsel. However, to provide a stronger statutory basis for the substance covered in these guidelines, we propose, in the context of our proposed **second phase** measures, to amend the CO to include, as necessary, the relevant details or framework. Please refer to paragraphs 26 to 30 under Chapter III.)

- (e) to reduce the compliance burden of issuers of prospectuses offering debentures: granting the following two class exemptions -
 - (i) exempting all prospectuses relating to

offers of debentures which are to be listed on the Stock Exchange of Hong Kong (the SEHK) in respect of (A) those content requirements in the Third Schedule to the CO that are the same as or similar to those requirements under the applicable listing rules provided that no waiver, modification or other dispensation of such requirements has been granted by the SEHK, and (B) those content requirements prescribed in the Third Schedule that the SFC considers are irrelevant for the purposes of an investor making an informed investment decision in debentures and/or unduly burdensome for the offeror to comply with; and

- (ii) exempting all prospectuses relating to offers of debentures which are not proposed to be listed on the SEHK in respect of those content requirements prescribed in the Third Schedule that the SFC considers are irrelevant for the purposes of an investor making an informed investment decision in debentures and/or unduly burdensome for the offeror to comply with.

These two class exemptions are subsidiary legislation subject to negative vetting by the Legislative Council. The SFC plans to initiate the legislative process by publishing them in the Gazette in March 2003.

THE SECOND PHASE

15. Initiatives under the **second phase**, which are again proposed mainly in response to specific requests from market participants, involve amending the primary legislation. They are the subject of this consultation paper and are detailed in Chapter III. Our target is to introduce the proposed amendments into the Legislative Council within this legislative session, i.e. before July 2003.

THE THIRD PHASE

16. In this **third and final phase**, the SFC will conduct a comprehensive review of all local laws and procedures governing public offers of securities as well as relevant regulatory reforms introduced in other leading jurisdictions¹, with a view to putting in place a framework that provides the most efficient, competitive and fair environment for issuers and investors alike. The SFC has started this comprehensive review and aims to put forward proposals for public consultation within 18 months.

¹ There is no single model for the regulation of offers of financial products but recently we have seen a rising trend towards facilitating such offers. The enactment of the Corporations Act 2001 in Australia, for example, has put in place a streamlined prospectus regime that relies heavily upon strong backend enforcement instead of pre-vetting of the offer documents. The new Securities and Futures Act 2001 in Singapore also introduces a broadly similar package for streamlining the regulation of offers of financial products. In the UK Financial Services and Markets Act 2000, market intermediaries play a key role in the regulation of offer documents.

CHAPTER III

COMMENTS SOUGHT - PROPOSALS UNDER THE SECOND PHASE

OFFERS EXCLUDED FROM THE PROSPECTUS REGIME

17. The CO requires any "prospectus" to comply with, among other things, the registration formalities and detailed content requirements prescribed in the Third Schedule to the CO. Accordingly, the term "prospectus" is crucial in determining the application of the prospectus regime.
18. "Prospectus" is defined in section 2 of the CO as any prospectus, notice, circular, brochure, advertisement or other document
- (a) offering any shares or debentures of a company *to the public* for subscription or purchase for cash or other consideration; or
 - (b) calculated to invite offers *by the public* to subscribe for or purchase for cash or other consideration any shares or debentures of a company.

Some market participants have commented that the attempt to give statutory guidance as to the meaning of "the public" in section 48A of the CO does not appear to work satisfactorily in practice and there should be more clarity as to the types of offers that can be made without triggering the prospectus regime.

19. Taking into account this market view and the fact that a similar or equivalent approach is taken in other developed markets overseas, such as the UK, we propose to exclude expressly from the definition of "prospectus" documents containing or relating to offers that fall within specified categories. The proposed exclusions are modeled closely on Schedule 11 to the UK Financial Services and Markets Act 2000. We are satisfied that excluding those offers from the prospectus regime strikes an appropriate balance between providing investor protection and reducing compliance cost. Relevant draft legislative

amendment proposals are at **Annex A**.

20. Set out below are the principal types of offers in respect of which offer documentation is proposed to be excluded expressly from the definition of "prospectus", and the justification for doing so -

- (a) offers to investors falling within the definition of "professional investors" in Schedule 1 to the Securities and Futures Ordinance as read together with the Securities and Futures (Professional Investor) Rules

Rationale: The requirement for a prospectus is designed to protect a retail investor. A more sophisticated market professional does not need the same level of protection.

- (b) offers to no more than 50 persons

Rationale: In practice, many local market practitioners have been using the numerical limit of 50 persons as a benchmark for private placings in part possibly because section 29 of the CO limits the membership of "private companies" to this number.

- (c) offers in respect of which the minimum denomination of, or the minimum consideration payable by any person for, the shares or debentures concerned is not less than a specified amount, currently proposed to be \$1,000,000

Rationale: An investor who can afford to take up such offers should be sufficiently knowledgeable to understand the risks involved or should be able to secure professional advice if considered necessary. Accordingly, such an investor does not need the protection afforded to a retail investor by a prospectus.

- (d) offers in respect of which the total consideration payable for the relevant shares or debentures shall not exceed \$1,000,000

Rationale: The cost of preparing a prospectus for a small-scale offer (which in practice will only be made to a limited section of the public)

outweighs the resulting protection to investors; and dispensing with the prospectus-related requirements in such circumstances is not considered to be prejudicial to the interest of the investing public.

- (e) offers made in connection with a genuine invitation to enter into an underwriting agreement

Rationale: The prospective underwriter should be in a position to obtain information regarding the relevant issuer before entering into an underwriting agreement.

- (f) offers made in connection with a takeover or merger which is in compliance with the Codes on Takeovers and Mergers and Share Repurchases

Rationale: This is to avoid double regulation. Code documents which amount to prospectuses are pre-vetted by the SFC.

21. We further propose that save for the two exclusions under paragraph 20(c) and (d) above, each exclusion can be used in combination with others. Thus, where an offer is structured into separate parts, provided each part falls within one exclusion, the whole offer is excluded. By way of illustration, documents making an offer to professional investors and not more than 50 other persons will not be prospectuses. Permitting aggregation in this way is in line with overseas practice.

22. On the other hand, to prevent abuse, we propose to restrict a person who acquires any shares or debentures pursuant to an excluded offer, from selling or offering to sell, or inviting offers to sell, those shares or debentures to the public, unless -

- (a) the sale or offer is the subject of a CO-compliant prospectus;
- (b) the sale or offer is made pursuant to an offer that falls within any of the exclusions; or

- (c) the sale or offer relates to shares or debentures that are of the same class as others listed on the SEHK and not less than six months have elapsed since the date on which the person first acquired them.

FLEXIBLE IMPLEMENTATION OF THE PROSPECTUS REGIME

Additional ground for exemption

- 23. The need for flexible administration of the prospectus regime is already envisaged under the existing law. Sections 38A and 342A of the CO empower the SFC to grant exemptions, either on a case-by-case basis or generally through the making of subsidiary legislation, from compliance with certain prospectus-related requirements, if it considers that compliance with them would either be irrelevant or unduly burdensome.
- 24. We take the view that the two existing grounds of exemption, namely "irrelevant" and "unduly burdensome", are no longer sufficient in a market which demonstrates and supports ongoing innovation in the form of new offering structures, offering methods and financial products. In keeping with the international trend towards a facilitative regulatory model, we propose a third ground: that the exemption would not be prejudicial to the interest of the investing public. Section 134 of the Securities and Futures Ordinance provides a similar exemption ground. As is already the case, in granting an exemption the SFC may impose conditions to safeguard investors' interests.

Expanded scope of exemption

- 25. We propose to empower the SFC to grant exemptions in respect of a wider range of CO prospectus requirements. Possible candidates include sections 38D(4)/342C(4) in relation to translation of material contracts and 44A in relation to all time limits governing applications for, and allotment of, shares and debentures. We are satisfied that such additional exemption powers would not undermine

investor protection as the SFC will only grant an exemption if the statutory criteria for an exemption are met. Exemption conditions will be imposed as necessary to safeguard investors' interests. We would welcome readers' suggestions of other prospectus-related requirements in respect of which they consider the SFC exemption power should be available.

PERMISSIBLE ADVERTISING

Awareness advertisements

26. As mentioned in paragraph 14(a) above, we see merits in making clear that awareness advertisements are permissible both prior and subsequent to the registration of the relevant prospectuses, on the basis that they (a) increase investors' awareness of forthcoming public offers of shares or debentures and (b) allow investors more time to arrange their financial and other affairs in anticipation of a public offer. On the other hand, there is a risk that the investing public may be "conditioned" by such awareness advertisements into taking up the relevant offers. It is therefore necessary to regulate their content and manner of issue in order to strike an appropriate balance between market facilitation and investor protection.
27. Having made reference to similar legislation overseas, including that in Australia and Singapore, we propose to -
 - (a) specify in a new Schedule to the CO the types of information that may be included in awareness advertisements. The intention is that the permitted contents shall mirror the contents proposed for "offer awareness materials" in the guidelines (paragraph 4.02(a) to (d)) issued by the SFC on 21 February 2003 relating to such materials;
 - (b) allow inclusion of additional information only if authorized by the SFC on a case-by-case basis. (It would also be possible to add to or alter the proposed list of permitted information by notice in the Gazette.);

- (c) require the inclusion of appropriate legends warning potential investors -
 - (i) to read the relevant prospectus for detailed information about the issuer and the proposed offering before making an investment decision;
 - (ii) that such awareness advertisement is not an offer or invitation to induce an offer; and
 - (iii) that no application for shares or debentures described in the advertisement will be accepted without the completion of a form of application or application procedure that is or will be issued with or in respect of the relevant prospectus;
- (d) require the inclusion of a statement that the advertisement is issued by the company to which the advertisement relates and that the directors of the company take responsibility for its contents;
- (e) impose the same civil and criminal liabilities for untrue statements applicable to a full prospectus; and
- (f) make clear that advertisements in compliance with these requirements do not amount to "prospectuses" nor fall within section 103 of the Securities and Futures Ordinance.

28. Draft legislative amendment proposals with respect to awareness advertisements are at **Annex B**.

"DUAL PROSPECTUS" STRUCTURE

29. The prospectus regime under the CO contemplates a single standalone prospectus. The requirement for a single standalone prospectus, however, is not conducive to the conduct of programme offers (i.e. offers made on a repeat or continuous basis or through successive tranches) as each time an offer in a series is made, authorization and registration of a CO compliant prospectus is required, notwithstanding

that all or much of the generic information about the issuer remains unchanged. The administrative burden that arises in connection with authorization and registration of a prospectus hinders the making of timely offers responsive to market conditions and results in increased compliance cost that serves little regulatory purpose. We therefore propose to include in the CO an alternative "dual prospectus" structure to facilitate programme offerings. Key features of and safeguards under the proposed "dual prospectus" structure are as follows -

- (a) a prospectus may consist of (i) a "programme prospectus", (ii) an "issue prospectus", and (iii) an "addendum", if necessary, updating the information in the "programme prospectus" or "issue prospectus";
- (b) "programme prospectus", "issue prospectus" and "addendum" must be signed or certified in accordance with section 38D(3) or 342C(3) of the CO (as the case may be);
- (c) "programme prospectus", "issue prospectus" and "addendum" can be authorized, registered and issued separately;
- (d) "programme prospectus" remains valid for not more than 12 months from the date of issue or until publication of the next annual report and accounts of the issuer, whichever is the earlier;
- (e) "programme prospectus" and "addendum", if any, should be readily available to investors throughout the period during which the shares or debentures to which it relates are being offered;
- (f) "issue prospectus" must contain a statement that the relevant offer is made on the basis of the information contained in it and the corresponding "programme prospectus" and "addendum" (if any);
- (g) "issue prospectus" and the corresponding form of application must contain a warning statement that potential investors should read the "programme prospectus" and "addendum" (if any)

for further details about the issuer and programme before making any application for the relevant shares or debentures;

- (h) when an "issue prospectus" is registered, the information in it and in the programme prospectus and addendum (if any) referred to in the issue prospectus must comply with the CO content requirements unless exempted. The "programme prospectus" together with "addendum" (if any) and "issue prospectus" are to be read together, and civil and criminal liabilities provisions regarding untrue statements will apply accordingly; and
- (i) an expert does not need to issue a fresh consent letter for information contained in a programme prospectus, the issue of which has already been consented to by the expert, at the time of issue of the corresponding issue prospectus.

30. This proposed structure broadly mirrors that set out in the guidelines issued by the SFC on 21 February 2003 relating to the "dual prospectus" structure. We would welcome any views suggesting an alternative approach that achieves the same results.

LEVEL PLAYING FIELD FOR OFFERS MADE BY LOCAL AND OVERSEAS COMPANIES AND OTHER MISCELLANEOUS REVISIONS

31. Under the CO, there are discrepancies in certain requirements applicable to offers made by companies incorporated locally and overseas. We accept the need for and desirability of a level playing field and accordingly propose to -

- (a) exempt an issuer incorporated in Hong Kong from compliance with sections 44A and 44B in cases of debentures offered for subscription or purchase;
- (b) amend section 155C such that a company incorporated in Hong Kong whose shares are listed on the SEHK is not required to send a copy of a prospectus it issues to all of its members, as has always been the case for an

overseas company;

(c) amend section 342E to the effect that prospectuses making offers for sale (i.e. not only those making offers for subscription) by an overseas company are also subject to statutory civil liability, as has always been the case for a company incorporated in Hong Kong; and

(d) require an overseas company to insert in prospectuses it issues a warning statement similar to that applicable to a company incorporated in Hong Kong under section 38(1A).

32. Other miscellaneous revisions proposed include removing the requirement in sections 38D and 342C with respect to registration of material contracts together with the prospectus, and inserting a requirement that such material contracts be on display for not less than 14 days from the date of publication of the prospectus.

PROSPECTUS LIABILITIES PROVISIONS

Persons who subscribe for any shares or debentures

33. Under section 40 of the CO, directors, promoters and persons who authorize the issue of a prospectus are liable to pay compensation to all persons who subscribe for any shares or debentures on the faith of the prospectus for the loss or damage they may have sustained by reason of any untrue statement therein.

34. However, in situations where no application forms are issued and application procedures set out in the prospectus essentially require investors to instruct an intermediary to apply for shares or debentures on their behalf, it is arguable whether the investors are "persons who subscribe for any shares or debentures on the faith of the prospectus" for the purpose of section 40. We take the view that the same investor protection should be accorded to investors whether or not they acquire the shares or debentures by instructing

intermediaries to apply on their behalf.

35. Accordingly, we propose to amend section 40 to make clear that for the purposes of the provision, persons who acquire the shares or debentures in a public offering (whether it is an offer for subscription or offer for sale) through an agent or intermediary shall be deemed to be persons who subscribe for the shares or debentures on the faith of the prospectus.

Types of misrepresentation covered

36. Sections 40 and 40A attach civil and criminal liabilities to any "untrue statement" in a prospectus in relation to offers of shares in or debentures of a company incorporated in Hong Kong, with section 41A(a) providing that a statement in a prospectus is deemed to be untrue if it is misleading in the form and context in which it is included. While we take the view that omissions of material information would render information in a prospectus misleading, we propose to amend the CO so as to put it beyond doubt that omissions of material information in a prospectus would be subject to civil and criminal liabilities. Sections 107 and 108 of the Securities and Futures Ordinance, which impose criminal and civil liabilities respectively for misrepresentation made to induce others to invest also cover misrepresentation by omission.

37. Draft legislative amendment proposals to achieve the results described in paragraphs 35 to 36 are at **Annex C**. Civil and criminal liabilities provisions applicable to overseas companies are also proposed to be similarly amended.

OTHER PROPOSED AMENDMENT

Information on "guarantor corporations"

38. In relation to offers of debentures of a company, there are cases where a related corporation has

guaranteed or has agreed to guarantee repayment to holders of such debentures. There are also cases where by way of security the proceeds from an issue of debentures are used to purchase debentures of another company, and a corporation related to that company has guaranteed the relevant repayment to the issuer. Depending on the specific circumstances of each case, in reliance on paragraph 3 of the Third Schedule², the SFC has been requiring inclusion in a prospectus of information on a guarantor corporation similar to that prescribed for an issuer. This is considered necessary as the eventual redemption of those debentures may well depend on the ability of the guarantor corporation to honour its undertaking and the investor is therefore often taking a credit risk on the guarantor corporation rather than the issuer.

39. As some market participants have questioned whether there is adequate statutory backing for the SFC's approach in this matter, we propose to remove any lingering doubt in legislation that disclosure of comprehensive information about a guarantor corporation in the cases described is required, unless the SFC has granted an exemption in respect thereof under sections 38A or 342A of the CO. Draft legislative amendment proposals are at **Annex D**.

² Paragraph 3 of the Third Schedule to the CO requires a prospectus to contain sufficient particulars and information to enable a reasonable person to form as a result thereof a valid and justifiable opinion of the shares and debentures and the financial condition and profitability of the company at the time of the issue of the prospectus.

ANNEX A

NEW SEVENTEENTH SCHEDULE

[ss. 2, 38AA,
342AB & 360]

OFFERS SPECIFIED FOR THE PURPOSES OF PARAGRAPH (b) (i)
OF THE DEFINITION OF "PROSPECTUS" IN
SECTION 2(1) OF THIS ORDINANCE

PART 1

LIST OF OFFERS, ETC. NOT FALLING
WITHIN DEFINITION

1. An offer to professional investors within the meaning of section 1 of Schedule 1 to the Securities and Futures Ordinance (Cap. 571) (including professional investors falling within paragraph (j) of the definition of "professional investor" in that section).
2. An offer to not more than 50 persons.
3. An offer in respect of which the total consideration payable for the shares or debentures concerned shall not exceed the amount specified in Part 2.
4. An offer in respect of which the minimum denomination of, or the minimum consideration payable by any person for, the shares or debentures concerned is not less than the amount specified in Part 3.
5. An offer made outside Hong Kong by a company incorporated in or outside Hong Kong to persons outside

Hong Kong.

[6.]

7. An offer in connection with a genuine invitation to enter into an underwriting agreement.

8. An offer in connection with a takeover or merger which is in compliance with the Codes on Takeovers and Mergers and Share Repurchases issued by the Commission as in force from time to time.

9. An offer of shares free of charge to any or all holders of shares in the company concerned.

[10.]

11. An offer to qualifying persons of shares in or debentures of a company by the company, or by another company which is a member of the same group of companies of which the first-mentioned company is a member, on terms that the only persons who can acquire the shares or debentures are the qualifying persons to whom they are offered or, if the terms of the offer so permit, any qualifying person.

12. An offer by -

(a) a charitable institution or trust of a public character mentioned in section 88 of the Inland Revenue Ordinance (Cap. 112);
or

(b) an educational establishment within the meaning of section 2 of the Sex

Discrimination Ordinance (Cap. 480),
where the proceeds of the offer will be applied towards
the objectives of the charitable institution or trust,
or educational establishment, as the case may be.

[13.]

[14.]

[15.]

[16.]

[17. An offer to members of a club or association -

(a) who can reasonably be regarded as having
a common interest with each other and with
the club or association in the affairs
of the club or association; and

(b) where the proceeds of the offer are to
be applied for purposes which can
reasonably be regarded as concerning the
affairs of the club or association.

18. An offer in respect of an exchange of shares in the
same company which does not result in an increase in the
issued share capital of the company.

PART 2

AMOUNT SPECIFIED FOR THE PURPOSES OF
PARAGRAPH 3 OF PART 1

[\$1,000,000]

PART 3

AMOUNT SPECIFIED FOR THE PURPOSES OF
PARAGRAPH 4 OF PART 1

[\$1,000,000]

PART 4

INTERPRETATION OF PART 1

1. A prospectus, notice, circular, brochure, advertisement, or other document, still falls within Part 1 if it falls entirely within any combination of any of paragraphs 1, 2, 5, 7, 8, 9, 11, 12, 17 or 18 of Part 1.

2. For the purposes of paragraphs 2 and 3 of Part 1, an offer is to be taken together with any other offer of the same class of shares or debentures -

- (a) which was made by the same person;
- (b) which was open at any time within the period of 12 months ending with the date on which the first-mentioned offer is first made; and

- (c) the document issued in respect of which was not a prospectus by virtue of either of those paragraphs being satisfied.

3. For the purposes of paragraph 2 of Part 1 -

- (a) the making of an offer of shares or debentures to trustees or members of a partnership or unincorporated association in their capacity as such;

or

- (b) the making of such an offer to any other two or more persons jointly,

is to be treated as the making of an offer to a single person.

4. For the purposes of paragraph 9 of Part 1, a holder of shares in a company, in relation to an offer mentioned in that paragraph, means a person who, at the close of business on a date -

- (a) specified in the offer; or

- (b) falling within the period of 60 days ending with the date on which the offer is first made,

is a holder of shares in the company.

5. For the purposes of paragraph 11 of Part 1 and this paragraph -

- (a) qualifying person, in relation to a company, means -

- (i) a bona fide employee, director, consultant, former employee, former director or former consultant of the company;
 - (ii) a bona fide dependent of any person mentioned in subparagraph (i);
- (b) consultant means a person who, pursuant to a contract for services, renders services to a company which are commonly rendered by an employee of the company or a like company;
- (c) dependent, in relation to a person, means -
 - (i) the wife, husband, widow or widower of the person;
 - (ii) any child, or stepchild, of the person under the age of 18 years.

NEW SECTION 38AA

**"38AA. Sale, etc. of shares or debentures
acquired pursuant to offer specified
in Part 1 of the Seventeenth Schedule**

(1) Where a person acquires any shares in or debentures of a company pursuant to any prospectus, notice, circular, brochure, advertisement or other document to the extent that it contains or relates to an offer specified in Part 1 of the Seventeenth Schedule as read with the other Parts of that Schedule, the person shall not sell, or offer to sell³, the shares or debentures to the public unless -

- (a) the shares or debentures are the subject of a prospectus which complies with the requirements of this Part applicable to the prospectus;
- (b) shares or debentures of the same class are listed on a recognized stock market in Hong Kong and not less than 6 months have elapsed since the date on which the person so acquired the first-mentioned shares or debentures; or
- [(c) the sale is made pursuant to an offer

³ "Offer to sell" is proposed to be defined in Section 2 of the CO to read along the lines of "in relation to any shares or debentures, includes any act calculated to invite offers by the public to subscribe for or purchase the shares or debentures."

specified in that Part or, as the case
may be, the offer is an offer specified
in that Part.]

(2) If any person acts in contravention of subsection
(1), the person shall be liable to a fine.”.

NEW NINETEENTH SCHEDULE [ss. 38B & 360]

CONTENTS AND PUBLICATION REQUIREMENTS
OF ADVERTISEMENTS MENTIONED IN
SECTION 38B(2) (e) OF
THIS ORDINANCE

1. Contents of advertisement

(1) The advertisement must contain the following mandatory particulars -

- (a) a statement that the advertisement is issued by the company to which the advertisement relates and that the directors of the company take responsibility for its contents;
- (b) a warning statement that potential investors should read the prospectus for detailed information about the company and the proposed offering before deciding whether or not to invest in the shares or debentures concerned;
- (c) a statement that the advertisement does not constitute an offer or an invitation to induce an offer by any person to acquire, purchase or subscribe for the shares or debentures concerned; and

- (d) a statement that -
 - (i) no application for any shares or debentures mentioned in the advertisement should be made by any person; and
 - (ii) no application for such shares or debentures will be accepted without the completion of an application that has been or will be issued with or in respect of the prospectus.

(2) The advertisement may contain the following discretionary particulars but, subject to section 38B(2AA) of this Ordinance, no other discretionary particulars -

- (a) the name of the company to which the advertisement relates and the place of incorporation of the company;
- (b) a description of the shares or debentures offered or proposed to be offered;
- (c) the dates on which, and the places at which, the prospectus to which the advertisement relates is or will be available to the public;
- (d) details of the administrative procedures relevant to investors that are likely to assist their participation in the offer;

and

- (e) if a listing is being applied for in Hong Kong or elsewhere, a statement that the company is seeking listing of, and permission to deal in, the shares or debentures concerned on the stock exchange or stock exchanges concerned.

2. **Language**

The advertisement may be in the Chinese language or the English language or both languages.

**AMENDMENTS TO THE THIRD SCHEDULE AND THE PROSPECTUS LIABILITIES
PROVISIONS
("OMISSION" AND "SUBSCRIBERS" RELATED)**

Amendments to sections 40, 41A, 342E and 343

Civil liability for misstatements in prospectus

Section 40 is amended by adding -

" (6) For the avoidance of doubt, it is hereby declared that, for the purposes of this section, "persons who subscribe for any shares or debentures on the faith of the prospectus" include persons who acquire the shares or debentures in an offer for subscription or offer for sale through an agent or intermediary."

Interpretation of provisions relating to prospectuses

Section 41A is amended -

- (a) by renumbering it as subsection (1);
- (b) by adding -

"(2) For the purposes of sections 40 and 40A, "untrue statement" (), in relation to any prospectus, includes a material omission from the prospectus."

Civil liability for misstatements in prospectus

Section 342E is amended by repealing "shares in or debentures of a company incorporated outside Hong Kong" and substituting "or purchase shares in or debentures of a company incorporated outside Hong Kong which is issued, circulated or distributed in Hong Kong".

Interpretation of provisions as to prospectuses

Section 343 is amended -

- (a) in subsection (1), by adding ", and the provisions of that section shall apply accordingly" after "by the company";
- (b) by repealing subsection (2) and substituting

-

"(2) For the purposes of the other provisions of this Part, a statement included in a prospectus shall be deemed to be untrue if it is misleading in the form and context in which it is included.

(2A) For the purposes of sections 342E and 342F, "untrue statement"

(), in relation to a prospectus, includes a material omission from the prospectus."

Amendments to Paragraph 3 of the Third Schedule

The Third Schedule is amended -

- (a) in paragraph 3, by adding “, taking into account the nature of the shares or debentures being offered and the company, and the nature of the persons likely to consider acquiring them” after “prospectus”.

**ADDITION OF NEW PROVISIONS AND
AMENDMENTS TO THE THIRD SCHEDULE
(IN RELATION TO "GUARANTOR CORPORATION")**

New provisions

"(1) It is hereby declared that the provisions of the Third Schedule applied by this section are also applied to a guarantor corporation of a debenture issue in the case of a guaranteed offering of a company.

(2) In subsection (1), "guarantor corporation" (), in relation to a company, means a corporation that has guaranteed or has agreed to guarantee -

- (a) the repayment of any money received or to be received by the company in response to an invitation to the public to subscribe for or purchase debentures of the company;
- (b) any other obligations of the company to the holders of debentures of the company; or
- (c) the company in relation to any amount to be obtained by the company in relation to the debentures of the company."

Amendment to the Third Schedule

The Third Schedule is amended -

(a) by repealing paragraph 31 and substituting -

"31. (1) A report by the auditors of the company with respect to -

- (a) profits and losses and assets and liabilities of the company in accordance with sub-paragraph (2) or (3), as the case required; and
- (b) the rates of the dividends, if any, paid by the company in respect of each class of shares in the company in respect of each of the 3 financial years immediately preceding the issue of the prospectus, giving particulars of each such class of shares on which such dividends have been paid and particulars of the cases in which no dividends have been paid

in respect of any class
of shares in respect of
any of those years;

and, if no accounts have been made up in
respect of any part of the period of 3
years ending on a date 3 months before
the issue of the prospectus, containing
a statement of that fact.

(2) If the company has no subsidiaries,
the report shall -

(a) so far as regards profits
and losses, deal with the
profits or losses of the
company in respect of
each of the 3 financial
years immediately
preceding the issue of
the prospectus; and

(b) so far as regards assets
and liabilities, deal
with the assets and
liabilities of the
company at the last date
to which the accounts of
the company were made up.

(3) If the company has subsidiaries,

the report shall -

(a) so far as regards profits and losses, deal separately with the company's (other than subsidiaries) profits or losses as provided by sub-paragraph (2) and, in addition, deal either -

(i) as a whole with the combined profits or losses of its subsidiaries;

(ii) individually with the profits or losses of each subsidiary;

or, instead of dealing separately with the company's profits or losses, deal as a whole with the profits or losses of the company and

with the combined
profits or losses of its
subsidiaries; and

(b) so far as regards assets
and liabilities, deal
separately with the
company's (other than
subsidiaries) assets and
liabilities as provided
by sub-paragraph (2) and,
in addition, deal
either -

(i) as a whole
with the
combined
assets and
liabilities
of its
subsidiaries,
with or
without the
company's
assets and
liabilities;
or

(ii) individually

with the
assets and
liabilities
of each
subsidiary;
and shall indicate as
respects the profits or
losses and assets and
liabilities of the
subsidiaries the
allowance to be made for
persons other than
members of the
company.”;

(b) by repealing paragraph 47.