

# **A Consultation Paper on Treasury Shares Consultation Conclusions - Hong Kong July 1999**

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## **1 . INTRODUCTION**

The Consultation Paper on Treasury Shares was issued on 30 November 1998 to invite views from the public on whether there should be any change to the law, and to provisions of the Listing Rules and the Share Repurchases Code, under which a company purchasing its own shares is required to cancel them, or to the law and other regulations which affect the process and speed of reissue of repurchased shares by listed companies.

The consultation period was originally scheduled to end on 31 December 1998, but in response to public requests was extended until 31 January 1999.

The SFC received 15 responses from consultees. As was expected in a consultation exercise of this nature, comments varied considerably in range and depth, with some respondents focussing on the broad principles behind the proposals and others on specific questions raised in the Consultation Paper. The Appendix contains a brief profile of the respondents.

The Commission has adopted and endorsed the recommendation of the Corporate Finance Division of the SFC to proceed with the proposal to amend the Listing Rules to enable all listed companies in Hong Kong to expedite the listing of new shares that are reissued following a repurchase and cancellation. It is not proposed at this time to introduce treasury shares.

The consultation conclusions set out in this document should be read in conjunction with the Consultation Paper.

The SFC wishes to thank the public for providing its views on the issues raised in the Consultation Paper.

## **2 . POLICY ISSUES AND CONSULTATION CONCLUSIONS**

### **The Consultation Paper**

2.1 The Companies Ordinance currently requires a Hong Kong incorporated company to cancel repurchased shares, thereby effectively preventing repurchased shares from being held "in treasury" for "resale" at a later date. However, after the shares have been cancelled in such circumstances they may, under the present regime, be "reissued" because the authorised capital of the company remains unaffected.

2.2 The introduction to the Consultation Paper explained that a number of listed companies had suggested that repurchased shares should not automatically be cancelled, and that they should instead be capable of being held by the company and resold when market conditions allow. This change, it was said, would give the company greater flexibility to adjust its share capital more quickly and might lead to a reduction in the company's overall cost of capital, and therefore may stimulate investment by the company. The Consultation Paper recognised, however, that any change to the law and other relevant regulations to allow shares to be held in treasury and later resold, may need to be accompanied by other changes, such as specific disclosure requirements and other safeguards, in order to ensure a fair market in a company's shares and to protect the interests of public shareholders, creditors and others who do business with a company.

2.3 The majority of companies listed on the Hong Kong Stock Exchange are not incorporated in Hong Kong and are not subject to the share repurchase provisions of the Companies Ordinance (which apply only to companies incorporated in Hong Kong). These overseas companies are, instead, subject to the share repurchase legislation in the jurisdictions in which they are incorporated. Like Hong Kong, most of those jurisdictions do not allow treasury shares at present. If Hong Kong were to change its legislative framework to allow treasury shares, Hong Kong incorporated companies would have the additional flexibility perceived to result from holding and reselling treasury shares, which companies in such other jurisdictions would lack. Unless and until legislation in such other jurisdictions is also changed to allow treasury shares, Hong Kong incorporated companies may appear in that respect to be different from those incorporated elsewhere.

2.4 Having regard to such a disparity, the Consultation Paper also consulted the public on whether making changes to the reissue provisions of the Listing Rules should be considered, in order to introduce a mechanism to enable all companies listed on the Hong Kong Stock Exchange to reissue and obtain listing more quickly for previously repurchased shares. It was intended that the appropriate changes would provide such companies with benefits that are, by and large, similar to those advocated for treasury shares, regardless of where

such companies are incorporated.

2.5 The SFC's proposal in this respect contemplates that, at any time following the passing of a resolution granting a repurchase mandate, an application may be made by the company to the Stock Exchange for a block listing of shares. The block listing will comprise the maximum number of shares that the company could reissue on the assumption that it conducts share repurchases to the fullest extent during the validity period of its current repurchase mandate. The Stock Exchange could then grant a standing confirmation for listing of up to that number of new shares comprised within the block listing application, provided that listed status would attach to specific shares only at the time of their reissue and subject to the Stock Exchange receiving one day's prior notice of any proposed issue of shares pursuant to that approval. Subsequently, upon notification by the company to the Stock Exchange of the number of shares involved in any proposed reissue of repurchased shares, such number of shares could be treated as having listed status with effect from the business day following the notification. Subject to any restrictions imposed, a listed company would be able to reissue shares at any time, in any quantity on or off market.

2.6 The Consultation Paper therefore consulted the public on the following principal issues:

- (a) should listed companies incorporated in Hong Kong be allowed to hold shares in treasury for subsequent resale?
- (b) if so, what regulatory framework should be put in place to allow treasury shares to be held and resold in the Hong Kong market?
- (c) with regard to the disparity which may result if Hong Kong incorporated companies were allowed to hold treasury shares, should the Listing Rules be amended to enable listed companies to expedite the listing of new shares that are reissued following a repurchase and cancellation?
- (d) if so, would it be necessary or desirable to introduce additional safeguards in the Listing Rules to protect shareholders and the securities market generally in cases where companies wished to take advantage of such a change?

## **Results of the Consultation**

2.7 Approximately 650 copies of the Consultation Paper were posted to a cross-section of participants in Hong Kong's securities and futures industry, including all subscribers to the Codes on Takeovers and Mergers and Share Repurchases. Several hundred further copies were collected in person from the SFC's offices. Most consultees responded by giving answers to the questions set out in the Consultation Paper, sometimes with accompanying comments. These questions and a summary of the answers are set out in section 3 below. It should be noted that not all consultees answered all questions and that some consultees, both those in favour and those opposed to one or other regime, sometimes gave

neutral responses to subsequent questions. Some consultees, while expressing a preference for one regime over another, nevertheless answered questions relating to both regimes.

2.8 As mentioned above, the SFC received 15 responses to the Consultation Paper. Given the relatively small number of responses received, the SFC believes that it is difficult to avoid concluding that there is no overwhelming pressure to change the current arrangements.

2.9 Whilst the responses show considerable support for the proposals put forward in the Consultation Paper, opinions varied between the relative merits of treasury shares and the block listing regime. Fourteen of the 15 consultees saw merit in introducing the block listing regime, whereas nine saw merit in the introduction of treasury shares. Only one consultee came out strongly in favour of treasury shares and did not favour the block listing approach, arguing that Hong Kong authorities should be encouraging Hong Kong incorporated companies over those incorporated elsewhere. Of the 14 consultees welcoming the block listing regime, four strongly preferred it over treasury shares and, of them, three went on to state that Hong Kong was not ready for treasury shares. By way of indication of relative interest between the two regimes, on average six responses were received on questions relating to treasury shares as compared with 11 for questions on the block listing proposals. Two consultees thought that both regimes should be introduced in tandem. Others suggested that introducing the block listing regime first, possibly to be followed by treasury shares later, may be the most prudent way to proceed.

2.10 Taking account of the views expressed in the responses to the consultation, the SFC has concluded that the balance of interest expressed favours adoption of the block listing regime over treasury shares, and proposes to proceed with implementation of reform on that basis. Given the proposed restrictions and controls on treasury shares as proposed in the Consultation Paper, which consultees generally endorsed, a number of consultees questioned the real commercial value, and indeed importance, to listed companies of having treasury shares. Market practices in Hong Kong do not appear to indicate much genuine pressure from listed issuers to be able to put back into the market for purposes of capital raising the comparatively small percentage of shares (probably no more than 10% of issued capital) that would be available under a treasury shares regime. The SFC believes that for those companies which do genuinely wish to raise capital by such issues or sales, the amendment of the Listing Rules and listing practices to introduce a block listing regime substantially along the lines discussed in the Consultation Paper (and as described briefly in paragraph 2.5 above) should be sufficient.

2.11 Moreover, the SFC is satisfied such a change could be introduced quickly and easily, and would better serve any market demand which prevails in current economic conditions. In contrast, the detailed statutory and regulatory changes that would be necessary in connection with treasury shares would take a longer period of time to implement. An added benefit of such an approach is that the amended Listing Rules and listing practice could be reviewed after a period, and more informed consideration could then be given to whether the more extensive

changes necessary in respect of treasury shares were called for. Useful practical experience may also be gained over such a period as to specific aspects which would justify or necessitate particular drafting attention in the context of the Hong Kong market.

2.12 In short, this approach would enable the market and the SFC to identify any problems arising under the new regime and make changes to the procedures and controls more easily than would be possible if changes to the Companies Ordinance were required. Furthermore, and as highlighted in the Consultation Paper, approaching the problem by way of changes to the Listing Rules and listing practice would maintain a level playing field for all companies listed in Hong Kong.

2.13 The SFC will accordingly now liaise closely with the Listing Division of the Stock Exchange to determine detailed procedures and Listing Rule changes in order to accommodate the block listing regime. Responses to the Consultation Paper received from consultees will be taken into account in formulating the relevant Listing Rule changes. Discussions will also take place with Hong Kong Securities Clearing Company Limited and company registrars to identify and address any potential areas of difficulty (for example, in the practical aspects of share delivery and settlement) and to ensure that necessary procedures are put in place within their operations and, as necessary, within the operations of listed issuers, to address these.

2.14 The SFC considers that a relaxation of the Listing Rules in the manner contemplated by the block listing regime will address substantially a large majority of the interest expressed in the responses to the Consultation Paper. In particular, this approach will give all Hong Kong listed issuers the ability to issue shares in smaller numbers and with greater rapidity than is currently possible and thereby react promptly to changing market conditions. As the relevant changes can be implemented without requiring alterations to statute it is expected that they will be in place within a shorter timeframe than would otherwise be possible.

### **3 . CONSULTATION RESPONSES**

3.1 This section summaries public comments received in response to the Consultation Paper. Part A deals with some of the general comments made by consultees while Part B summarises the comments received on the specific questions contained in Sections 5 and 6 of the Consultation Paper.

#### **Part A - General Comments**

3.2 The consultees favouring treasury shares over the block listing regime (or suggesting both regimes should be implemented in tandem) gave, among others, the following reasons for their preference:

- (a) A mechanism to facilitate a listed issuer buying and selling its own shares should be adopted. Whilst this may take the form of treasury

shares or a mechanism to expedite the issue and allotment of new shares, such a fundamental change in how the capital of a listed issuer could be regulated should be backed by a change in company law and not simply by a change to the Listing Rules. Upsetting the playing field should be considered in the context of the following:

- As a matter of investor protection, it is not entirely satisfactory that an offshore company is used as a vehicle for a listing in Hong Kong. Apart from differences in corporate governance and other company laws, it is more cumbersome and unpredictable to enforce process against an offshore company in an offshore jurisdiction;
- As a matter of principle, regulatory authorities in Hong Kong should encourage companies with a sole or primary listing on the Hong Kong Stock Exchange to be incorporated in Hong Kong. For Hong Kong to consolidate and develop as a financial centre for China and Asia, there is a need to develop a strong legal profession and competent judges with experience in adjudicating sophisticated commercial disputes or corporate governance matters particularly regarding Hong Kong companies. A bias in favour of Hong Kong companies may help towards that goal;
- Efforts should be made to enable Hong Kong to compete with other jurisdictions for incorporations of corporate vehicles.

(b) A proposal along the lines described in paragraph 3.23 of the Consultation Paper should be introduced to compliment, and not merely as a substitute for, the introduction of treasury shares. Treasury shares have a number of advantages which cannot be replicated by the block listing procedure e.g. (i) treasury shares can be "carried forward" to future periods and resold whereas cancelled shares cannot be reissued once the relevant general mandates have expired and (ii) because of the commercial risks involved, placings usually have to be conducted as a sale of shares by a controlling shareholder combined with a "top up" pursuant to paragraph 14.24(6)(a) of the Listing Rules (i.e. a mechanism under which the controlling shareholder effectively lends stock to the company). Using a stock of treasury shares to raise funds would allow a company to avoid having to conduct placings through this mechanism, whereas the block listing approval would only help if shares had been repurchased and cancelled during the life of the then existing general mandates.

3.3 Among the responses favouring the block listing regime over treasury shares, the following views were expressed :

- (a) Overall, we see no compelling reason to allow treasury shares. With one exception, none of the arguments put forward in Paper in favour of treasury shares is particularly powerful, especially if most advantages can be obtained by allowing for faster issue and listing of new shares. The best reason for implementing treasury shares is the ability to sell shares in small lots at full market price. However, this might also be largely achieved through an expedited listing and re-issue process. The main reasons against treasury shares are:
- increased complication, with little further benefit;
  - greater risk of manipulation;
  - increased risk from allowing companies to invest in themselves, particularly if management think the company's money is best invested in the company's own shares.

We have seen how smaller listed companies in Hong Kong have suffered by departing from their main business and investing in, particularly, property in Hong Kong or China. The same temptation may be offered by treasury shares (albeit to a more limited extent). Furthermore, an investor may have chosen to invest in a Widget company understanding that Widget companies offer a certain level of risk and return. The equation no longer works if the company re-invests in itself. If a company has additional cash, it should either be re-investing in its underlying business, or returning the cash to shareholders through dividends or share repurchases, leaving the investor with the basic strategic investment decision.

- (b) It is not appropriate for Hong Kong to be in the vanguard of jurisdictions exploring treasury shares, particularly as the US is the only major jurisdiction which presently allows them.

We are certainly in favour of a regime to allow for the expedited re-issue of shares (possibly, on an even wider basis than suggested, including an expedited process to issue and list a small number of new shares, not necessarily those which have previously been purchased). We have no fundamental objection to both regimes existing side-by-side, although there is little point in further complicating Hong Kong's legislative and regulatory system unless there is a clear need for a change. It is important to keep Hong Kong's system as simple as possible.

- (c) We are opposed to making legislative changes at this time to accommodate treasury shares. Any perceived demand by the market for this can and should be met by changes to the Listing Rules only. There are two principal reasons for objection. First, Hong Kong's corporate and securities laws are not ready for this device. Second, treasury shares is only a specific device of limited utility and in

pursuing this device in the name of "flexibility", the forest is foresaken for the tree.

As to the state of our corporate and securities law, even advocates of treasury shares would agree that there is increased risk of market manipulation and insider trading. The Paper refers to "very strict rules and regulation" for preventing the abusive use of treasury shares implemented in the US. While any proposed legislation in Hong Kong may mimic specific legislation in relation to treasury shares, it cannot by itself change (nor has the Paper proposed to make any changes in) the general regulatory landscape that holds abuses in check. For example, under US laws, the company in repurchasing its own shares is considered an insider, subject to insider trading regulations. The company in selling its shares is considered an issuer, subject to registration requirements. These bring into play a panoply of general securities laws considerably stricter than those in Hong Kong. In addition, there is a more rigorous enforcement program in the US. It is against this background of strict securities regulations that treasury shares exist subject to additional specific "strict rules and regulations".

Undoubtedly, Hong Kong should keep up with the advanced markets. But it would be suicidal only to keep up with the liberalizing trends and ignore the very strict regulations that underpin the liberal features. If rigorous laws, general and specific, and enforcement are introduced at the same time as treasury shares, the market enthusiasm for treasury shares will be abated. To the extent that there is a genuine demand and need for treasury shares, this should be accommodated by changes to the Listing Rules. This route is preferable because the status quo can be restored relatively quickly if abuses emerge.

- (d) We appreciate the increased flexibility to adjust the issued share capital of a listed company which might result from treasury shares. However, we have concerns whether adverse factors do not out-weigh the benefits, and also whether the benefits could not be made at least sufficiently available by an accelerated listing procedure such as is referred to in the Paper.

All of the concerns expressed in the Paper as to the potential adverse risks are real concerns, but some of them may have been understated. The structure of share ownership and principal shareholder percentages is very different in Hong Kong from that generally applicable in the USA or UK. Trading practices and attitudes also differ materially between the markets. What is appropriate for Hong Kong should be judged principally by reference to factors relevant to the Hong Kong market and not to the fact that treasury shares are allowed, or are under active consideration, in major overseas markets.

Many legal and technical issues would need to be addressed if treasury shares were to be introduced, and the Paper may understate some of the issues. Two points which occur to us are:

- Whether it is conceptually acceptable for treasury shares to be



authorised for listed public Hong Kong incorporated companies without being authorised for all Hong Kong incorporated companies. In respect of private or non-listed public companies, there would be potential risks of unfair treatment between different shareholders if, as appears to be envisaged by the Paper, a number of the accepted concerns are proposed to be dealt with other than by amendment of the Companies Ordinance;

- US cases involving the handling of treasury shares in relation to takeovers and mergers have led to lawsuits and considerable debate as to proper treatment allowing for the conflict of interest between shareholders and remunerated directors. Although the Takeovers Code in Hong Kong is materially different from takeover law and practice in the USA, very careful consideration would be necessary as to changes in the law as well as in the Takeovers Code in the context of takeovers and mergers.

### **Process Review Panel**

24. As mentioned earlier, decisions the Commission has to make in the course of the process for arriving at the final substantive conclusions can nevertheless have an impact on the affected persons. To subject the Commission to external scrutiny in this regard, an independent panel will be established, separately from the Composite Bill, to review aspects of the Commission's internal processes, including investigatory procedures, to ensure impartiality, consistency and accountability in this regard.
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### **Part B - Comments on specific consultation issues**

#### ***Treasury Shares***

In this part each of the questions contained in sections 5 and 6 of the Consultation Paper is set out (together with a number in parentheses indicating the paragraph of the Consultation Paper in which the questions appear), followed by a summary of answers received from consultees.

#### **3.4 *In the context of the treasury share proposal referred to in this***

*Consultation Paper, and apart from the drafting changes required specifically to provide for repurchased shares to be held and resold, do you believe that change should also be made to other provisions of company law which may be relevant to a treasury share regime? (5.2)*

All except one response either expressed no view or stated that they could not think of any specific areas which would need to change. The one response in question suggested that provisions of the Companies Ordinance dealing with voting rights, dividends and winding up may be affected and should be reviewed carefully.

*3.5 Should shares proposed to be held in treasury only be repurchased on the Stock Exchange? Should there be other controls (in addition to those contained in the Listing Rules (as to which, see paragraphs 2.19 - 2.24 in section 2 above)) on the volume, pricing and timing of repurchases of shares specifically because some or all of such shares may in future be held in treasury? (5.3)*

Six responses expressed a view on these issues. In relation to whether treasury shares could derive from off-market repurchases, five responses were in favour, one was against (but gave no explanation). All six responses stated that existing controls on repurchases were adequate notwithstanding that the shares in question may be held in treasury.

*3.6 Should shareholders, when approving a repurchase, be asked to specify whether the shares are to be held in treasury for resale or are for cancellation? If it is not specified at the time of the shareholder approval, should a company be required to announce prior to or after a repurchase whether the shares are to be held in treasury for resale or for cancellation? (5.4)*

Six responses expressed a view. All stated that shareholders should not be given the right to direct whether shares should be cancelled or held in treasury. The repurchase mandate should give the directors the choice to do as they think best at the time of repurchase. All six responses also believed an announcement of intention regarding the repurchased shares should be made post (rather than prior) repurchase.

*3.7 Should shareholders be asked to approve the price at which treasury shares are resold? How should such price be determined? Should other forms of consideration be permitted? Should resales off-market be permitted? (5.5)*

Seven responses expressed views. Most stated that shareholders should not be asked to approve the resale price. This should be left to directors acting bona fide and securing an agreement with a buyer on arm's-length terms. Two of the seven responses thought that non-cash consideration should be permitted - the others didn't address the point specifically, but the tenor of their comments suggests that directors should have discretion to decide such matters. All seven responses favoured off-market resales, but one suggested shareholders should be able to specify a range (e.g. not outside 10% of last 5 days average closing price), and one thought that any such sale should be at arm's-length.

3.8 *Should transactions in, and holdings of, treasury shares be disclosed to the extent necessary to enable persons having disclosure obligations under the Securities (Disclosure of Interests) Ordinance to comply with such obligations? Should Note 1 to Rule 33 of the Takeovers Code be extended to cover the effect of resales of treasury shares? (5.7)*

Six responses were received, all confirming that the disclosure regime should enable others to comply with the SDI Ordinance. One response stated that the company should not give prior notice of a transaction to substantial shareholders on the basis that if such shareholders were outside parties (e.g. Templeton, Fidelity or other funds) it would give them an advantage. Five of the six responses also confirmed that Note 1 to Rule 33 of the Takeovers Code should be extended to cover the effect of a resale of treasury shares (so as to exempt a substantial shareholder from the duty to notify a change in its shareholding).

3.9 *Should a repurchase of shares which are held in treasury be treated differently from a repurchase of shares for cancellation in the context of Rule 32 of the Takeovers Code, such that a general offer may not necessarily be required by reason only of an acquisition or consolidation of control in such circumstances? If different treatment can be justified, should waivers to the requirement for a general offer under Rule 26 of the Code be on the same basis as those available for general offer and off-market repurchases? (5.8)*

Six responses expressed views, but one appears to answer a different question. The remaining five responses were in favour of according the same treatment to shares repurchased for holding in treasury as applies to shares repurchased for cancellation (and accordingly giving rise to a duty to make a mandatory offer under Rule 26 in relevant circumstances). Three responses went on to state that waivers to the requirement to make an offer should be available to on-market repurchases on the same basis as those available for general offer and off-market repurchases. One of three responses qualified this by suggesting that waivers should be available if the company has entered into an underwritten agreement to place out the repurchased shares within a short period (say, one month) of the repurchase.

3.10 *Should announcements of intentions with respect to holding and resale of treasury shares be required? If so, how far in advance and how detailed should they be? What if the company changes its intention? (5.9)*

Seven responses dealt with these issues. All were against prior disclosure of intention. If any statement of intention were required it would inevitably have to be vague. Disclosure following a transaction (e.g. on the Stock Exchange's return for share repurchases (Form G)) would be sufficient. Statements of general intention could be disclosed in the interim and annual reports.

3.11 *Should the company be required to disclose particular information, for example in relation to its current trading position? (5.10)*

Six responses were received. Two favoured some limited disclosure of financial information, such as a statement of no material change. Four responses drew a

parallel between a resale of treasury shares and an issue of shares by way of placing and suggested disclosure requirements should be the same.

*3.12 Should sales of treasury shares be reported at the time to the Companies Registrar and the Stock Exchange, and in the company's annual report? (5.11)*

Six responses expressed a view on this issue, all agreeing with the disclosure regime suggested. Again, one response drew a parallel between resales of treasury shares and issues (or reissues) of shares, and thought the same regime should apply.

*3.13 Should voting rights attaching to treasury shares be suspended whilst the shares are held in treasury? (5.12)*

Again six responses were received, all of which favoured suspending voting rights whilst shares were in treasury.

*3.14 Should treasury shares be entitled to receive dividends or any other payments, such as in a winding up? Should all other rights from time to time exercisable by shareholders be suspended whilst the shares are in treasury? (5.13)*

Six responses were received, five of which agreed that rights to dividends and other payments should be suspended whilst shares are in treasury. Treasury shares should effectively be regarded as having been cancelled and therefore as having no rights whatsoever. One response disagreed, and suggested that suspending dividend rights would indirectly increase the dividend income of the shareholders and thereby benefit the substantial shareholder. Instead, the company should be entitled to receive the dividend income much as would occur if it invested in another company. The response suggested that they should also be entitled to participate in offers and rights issues.

*3.15 Should treasury shares be included in the calculation of earnings per share and other performance data? (5.14)*

Six responses were received, all of which stated that treasury shares should be disregarded (i.e. not included in the total issued capital) when calculating performance data. One response added that attempts to increase EPS or other performance data via repurchases and resales/reissues is not manipulation but exercising financial flexibility (unless other rules are breached).

*3.16 Should there be restrictions on what a company may do with treasury shares? (5.15)*

Five responses were received on this question. There was a consensus that as treasury shares would have no rights they should not have any value or be regarded as an asset (other than perhaps by the company). Certainly, they should not be capable of being pledged or used as security. One response suggested that treasury shares could be used to satisfy distributions of shares by the company

upon the exercise of share options.

3.17 *Should there be a percentage or other limit on the number of shares held in treasury and capable of resale? Should treasury shares be cancelled automatically if not resold after a specified period? Should a company be allowed to issue new shares only if any holding of treasury shares is used first? (5.16)*

Seven responses were received on these issues, but views diverged on how best to deal with them. Three responses said treasury shares should be capped at 10% of issued capital. One qualified this by stating that the cap should be set at the number of shares authorised for repurchase at the last AGM. Two responses suggested that there should be no maximum number of treasury shares. One of these suggested that the control should instead be imposed on the aggregate number of shares being resold (from treasury) and/or reissued (following cancellation), at 10% of issued capital.

In relation to possible cancellation of treasury shares after a specified period of time, three responses said there should be a maximum validity period, but the suggested duration varied from one year or next AGM if sooner, to 24 months. Four responses suggested there should be no maximum validity period, as this would be arbitrary, would take no account of market conditions/cycles, and if treasury shares had no rights and were tantamount to cancelled shares anyway it was difficult to see what difference it would make.

In relation to the possible need to dispose of any holding of treasury shares first before an issue of new shares, four responses favoured this, whilst two were against.

3.18 *Bearing in mind certain of the stated advantages of treasury shares outlined in section 3 above, should the method of resale or other disposal of treasury shares be controlled or regulated, such as pursuant to a shareholders mandate? Should there be restrictions on any category of person (such as connected persons) to whom treasury shares may be sold? Should any treasury shares held by a company be capable of being added to other shares at the disposal of the directors? (5.19)*

Six responses were received on these questions. There was no general wish to see additional controls imposed on resales of treasury shares (other than those mentioned in earlier questions or already subject to restrictions under the Listing Rules). One response, however, suggested that the resale price should exceed the purchase price. There was also a general view that no specific restriction on sales to connected persons should be imposed provided the existing connected transaction rules applied.

In relation to aggregating sales of treasury shares with other issues of shares (including pursuant to the general mandate), five responses expressed a view. Four saw no problem in aggregating, provided treasury shares were capped at 10%. *It is unclear in some cases whether the responses appreciated that the general mandate could amount to approximately 30% of issued capital as at the*

*date of the authorising resolution, since such responses referred to "the 20% mandate" . However, one response specifically recognised the mandate as potentially 30% and saw no problem in aggregating treasury shares to the mandate even in such circumstances. Only one response was against aggregating treasury shares with the general mandate.*

*3.19 Should companies be prohibited from reselling treasury shares at price sensitive times? (5.20)*

Five responses commented on this and confirmed that sales at price sensitive times should be prohibited.

*3.20 Should the prohibition on making or announcing a new issue of shares for a period of 30 days after any repurchase of shares apply also to resales of treasury shares? (5.21)*

Six responses expressed a view. All were in favour of the prohibition applying, including one which suggested that the period should be longer (between three to six months).

*3.21 Should companies be restricted from reselling treasury shares when subject to a takeover, delisting proposal or privatisation? (5.22)*

Seven responses addressed this issue and were supportive of the restriction also applying to treasury shares. One went on to state that it was also important that an offeror should not be required to pay for any shares held in treasury. This may otherwise encourage companies to accumulate treasury shares as a potential defensive "poison pill".

*3.22 Would you consider that changes to the financing aspects of the repurchase of shares regime should be considered if treasury shares are introduced? If so, do you have particular recommendations? (5.23)*

Only three responses attempted to deal with this issue but none answered the questions raised.

*3.23 Should treasury shares be presented in a consolidated balance sheet as a one-line adjustment of equity? (5.25)*

Five responses addressed this issue, of which four were in support of the IASCs recommendations. The remaining response believed profits and losses on resales of treasury shares should be recognised in the profit and loss account provided there was sufficient disclosure and these results were distinguished from operating profits/losses.

*3.24 Do you agree with this proposed treatment? (5.26)*

Three responses dealt with this. Two agreed with the proposed treatment, whereas one referred to its alternative approach described in the answer to the

question in paragraph 3.23 above.

*3.25 Should subsidiaries be able to purchase, hold and resell shares in their parent companies? (5.27)*

Six responses addressed this issue. Five stated that subsidiaries should not be able to hold shares in their parent (whether as treasury shares or otherwise). Some thought it would unnecessarily complicate matters. One consultee thought that to allow this would give companies a little more flexibility, but that any such subsidiary should be a special purpose vehicle and only one such subsidiary should be used.

*3.26 As the focus of this Consultation Paper is on listed public companies, the SFC has not considered the position of unlisted or private companies. However, comments are also invited on whether the law should be changed to give unlisted or private companies the ability to hold treasury shares for resale. Would unlisted or private companies be disadvantaged if changes were made to allow treasury shares to be held by listed public companies only? (5.28)*

Six responses addressed this issue. Four thought that private and unlisted public companies would not be disadvantaged if changes were made to allow treasury shares to be held by listed companies only. Two thought that it may be inappropriate to restrict a treasury share regime to listed companies notwithstanding the little practical value to private/unlisted companies in having them.

### ***Block listing regime***

*3.27 Do you believe that a proposal along the lines described in paragraph 3.23 of section 3 above would be a workable alternative to treasury shares? (6.1)*

Eleven responses expressed a view on this question, most of which were positive. Two suggested that as (i) the mechanism, inter alia, does not give the company the opportunity to invest in its own shares, and (ii) treasury shares can be "carried forward" to future periods and resold whereas cancelled shares cannot be reissued after the relevant general mandates have expired, it does not constitute a workable alternative to treasury shares.

Two others suggested the proposed mechanism should be relaxed further such that companies should be allowed to repurchase and reissue, as freely as possible - and specifically free of the restrictions in Listing Rule 10.06(2)(a) (subject, however, to maintaining the minimum public float) and Takeovers Code Rule 32 and 33 - a pre-approved block of shares. Two further responses also suggested that it may be appropriate to consider pre-approval of listing for a block of unissued *new* shares (i.e without reference to previous repurchases).

*3.28 Do you believe there are matters unrelated to the granting of listing which may make this proposal unattractive or unworkable? (6.2)*

Eight responses dealt with this matter. Two reiterated the preference for treasury shares, believing that it would simply be more cumbersome to conduct new issues of shares on market unless done in block. Two responses more specifically suggested the physical process of issuing the shares, issuing certificates and/or depositing them in CCASS (all within the T+2 settlement period) may in practice restrict the speed of reissue. Two responses suggested that the requirements under the Takeovers Code and SDI Ordinance should also be reviewed in the light of the proposals.

*3.29 Do you believe that the restriction contained in Rule 10.06(3) should be modified, and if so, to what extent? (6.3)*

Eleven responses were received, of which nine proposed no change to Rule 10.06(3) (except for one which suggested exempting issues of scrip dividends, in line with the Note to Rule 9 of Share Repurchase Code). Two suggested the period should be shortened from 30 to 14 days.

*3.30 Do you believe that such arrangements are appropriate and/or adequate? (6.4)*

Eleven responses address this question, eight of which consider that the measures are appropriate and adequate for Hong Kong. The remaining three are generally in support, but express a desire for treasury shares as well, or consider the proposal has merit but should be examined further. One response suggests providing for (i) automatic, deemed approval for "reissued shares", such approval to be in effect until the next AGM (with similar notice/reporting requirements) and (ii) withdrawal of listing approval for unissued shares in the event of abuse of relevant rules. Another suggestion is to permit the rapid issue of new shares, including those which have *not* previously been repurchased (for, say, 5-10% of the directors' general mandate).

*3.31 The SFC does not see any need for any additional authority from shareholders before the directors issue shares within the block listing approval, but would welcome the public's views in this respect. (6.6)*

Eleven responses were received on this issue, all of which agreed that no additional shareholder approval should be required. One consultee suggested that the Explanatory Statement to shareholders for renewal of a repurchase mandate should specify whether the company proposed to apply to the Hong Kong Stock Exchange for the block listing approval.

*3.32 Should Note 1 to Rule 33 apply so as to remove any need for disclosure of any disposal of voting rights resulting from an issue of shares by the company? Do you consider that the disclosure arrangements described in this paragraph are suitable? Assuming that the connected transaction provisions of the Listing Rules will continue to apply to us at present, should there nevertheless be any restriction on the persons to whom shares are issued? (6.7)*

Eleven responses were received on this issue, all of which accepted the logic of extending Note 1 to cover issues of shares. However, although those responses



favoured simply exempting a disclosure by shareholders in such circumstances, two believed disclosure should still be required and that the company should notify its substantial shareholders of any repurchase/issue of shares and even possibly make any necessary filing on their behalf. However, it was acknowledged that this would not help shareholders who rise across the 10% threshold as a result of a repurchase of shares. One response noted that the SDI forms are deficient in only accommodating a reference to number of shares held, since that detail would commonly remain unchanged during a repurchase or reissue of shares by the company while affecting the percentage that such shares represent of the total issued capital. Two responses suggest substantial shareholders should be given an extra day to comply with the disclosure requirements under Rule 33.

Eight responses dealt with the question of possible restrictions on the identity of persons to whom shares could be issued. While one suggested that issues to connected persons should be prohibited, the other seven thought that they should be permitted provided the connected transactions rules were complied with.

*3.33 Should a listing document be required when shares are issued pursuant to the block listing approval? If so, what minimum information should it contain? How and when should any such information be disseminated to the potential allottees of new shares and to the public? (6.8)*

Again eleven responses dealt with this matter. All believed that requiring publication of a listing document would defeat the advantages of the proposal. A similarity was drawn with placings where no document is currently required (two responses expressed this as maintaining the present documentary requirements relating to new issues, which are driven primarily by whether such issues constitute a private placing or an issue to the public).

*3.34 Do you agree that the matters discussed in paragraphs 5.20 and 5.21 are relevant also in the context of the expedited reissue of shares? Do you believe any other areas (whether or not discussed in relation to treasury shares) may be of concern? (6.9)*

Eleven responses dealt with this. All accepted that the matters raised in paragraphs 5.20 ( *restrictions on issues at price sensitive times* ) and 5.21 ( *restriction on announcing new issue for 30 days after repurchase* ) should also apply to reissues of shares. Three responses went further. Two suggested that the issue of *any* shares (rather than just "reissued" shares) during the specified periods should be restricted. One of these responses suggested that all issues of shares to connected persons should be prohibited from the fiscal year end to the date of the preliminary announcement. Again, a reference was made to considering relaxing these requirements on any issue of shares pursuant to a scrip dividend proposal.

## APPENDIX

## Profile of Respondents

<i>Nature of Respondents</i>	<i>Number</i>
Listed Companies	4
Corporate Finance Practitioners	3
Fund Manager and Financial Analysts	2
Lawyers	2
Regulators	2
Others 1	2

1 "Others" comprised an institution of higher education and a chamber of commerce.