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證券及期貨事務監察委員會

Consultation Conclusions on the Consultation Paper on Possible Reforms to the Prospectus Regime in the Companies Ordinance

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Consultation Conclusions on the Consultation Paper on Possible Reforms to the Prospectus Regime in the Companies Ordinance (“Consultation Conclusions”)

PART A – EXECUTIVE SUMMARY

1. In August 2005, the Securities and Futures Commission (“Commission”) released a Consultation Paper on Possible Reforms to the Prospectus Regime in the Companies Ordinance (“Consultation Paper”) for a 4-month consultation period. The Consultation Paper, issued as a “concept release”, invited public discussion and feedback on a series of possible reform initiatives presented as 21 proposals. The overriding purpose of the various initiatives is to modernise the regime governing the public offering of shares and debentures in the Companies Ordinance (“CO”) to encourage capital raising and the issuance of securities in Hong Kong, while ensuring satisfactory standards of investor protection.
2. The Consultation Paper received a total of 26 responses, mainly from banks, securities dealers, corporate finance advisers, issuers, lawyers and accountants.
3. In arriving at a decision on which initiatives to pursue, the Commission has taken into consideration the responses received and in due course one or more draft bill consultation paper(s) containing draft statutory provisions pertaining to the specific proposals will be issued for further comment. Pending the publication of such draft bill consultation paper(s) attaching proposed legislative amendments, these Consultation Conclusions are designed to inform the public and the market as to which initiatives will be pursued, which initiatives will not be taken forward at this stage and which initiatives have been revised in light of market comment requiring further consultation.
4. The initiatives which the Commission has decided to pursue in principle are:
 - (a) *Proposal 1* — to transfer the provisions in the CO relating to the public offering of shares and debentures to the Securities and Futures Ordinance (“SFO”) as a discrete part separate from the investment advertisement regime in Part IV of the SFO;

- (b) *Proposal 2* — to change the focus of the CO prospectus regime¹ from a “document-based” approach to a “transaction-based” approach such that all public offers of shares and debentures will need to comply with the requirements of the regime unless they fall within an exemption. The substance of the existing safe harbours set out in the Seventeenth Schedule to the CO will be retained and new safe harbours will be introduced as a result of the adoption of a transaction-based approach;
- (c) *Proposal 3* — to clarify that the CO prospectus regime applies to offers of options or other rights in or over shares or debentures, where the issuer of the option or other right is in the same group of companies as the issuer of the underlying shares or debentures;
- (d) *Proposal 4* — to provide that the requirements of the CO prospectus regime apply without regard to the place of incorporation of the issuer and apply to “bodies” rather than “companies”;
- (e) *Proposal 6* — to exempt from the CO prospectus regime offers made to holders of shares or debentures in the context of a takeover or merger or under a compromise or scheme of arrangement provided that the offer is in compliance with the laws and regulatory requirements of the company’s home jurisdiction and any principal stock exchange on which it is listed;
- (f) *Proposal 8* — to alter the scope of the CO prospectus liability regime to include (i) the issuer and/or the offeror of the shares or debentures; and (ii) each person who accepts, and is stated in the prospectus as accepting responsibility for the prospectus, and remove (iii) “promoters”; and (iv) persons who “authorise the issue of a prospectus”. In view of the market response and the new Guidelines for Sponsors and Compliance Advisers

¹ For the sake of convenience, these Consultation Conclusions will continue to use the expression “CO prospectus regime” to refer to the current and future prospectus regime and to distinguish it from the SFO investment advertisement regime. These Consultation Conclusions will also continue to make reference to the “Seventeenth Schedule to the CO” which, as part of the CO prospectus regime, will be transferred to the SFO.

issued by the Commission which will come into effect on 1 January 2007, the Commission believes that it would be premature to impose prospectus liability on sponsors;

- (g) *Proposal 11* — to provide that the “reasonable belief” defence in the liability provisions is subject to a requirement that such belief is founded on all inquiries which were reasonable in the circumstances having been made;
- (h) *Proposal 12* — to move the “overall disclosure standard” for a prospectus into the body of the legislation adjacent to the liability provisions and supplement this standard with prescribed content requirements in subsidiary legislation that distinguish between equity and debt offerings;
- (i) *Proposal 13* — to provide that a prospectus for rights issues and issues of shares or debentures that are uniform with listed shares or debentures should comply with reduced (rather than negligible) content requirements;
- (j) *Proposal 14* — to introduce an enabling provision in the CO prospectus regime to allow “incorporation by reference” of information located outside the prospectus, provided the omitted information is identified in the prospectus and easily accessible;
- (k) *Proposal 16* — to require the issuer of a prospectus to publish a supplemental prospectus if it becomes aware of a new circumstance that has arisen since the prospectus date but prior to the announcement of the results of allocation, which would have been required to be disclosed in the prospectus had it occurred prior to the prospectus date and which is materially adverse from the perspective of prospective investors. In such circumstance, the issuer would also need to notify investors of the availability of the supplemental prospectus, and provide a right to withdraw their allocations and be repaid in full. The requirement to extend the offer period will not be taken forward at this stage as such requirement may further complicate and increase the process risk for the overall withdrawal and refund process.

The broad statutory framework for the withdrawal mechanism proposed in Part B of these Consultation Conclusions has largely been devised with reference to the withdrawal mechanism contemplated in the offering circular dated 14 November 2005 (the “Link REIT OC”) in respect of the initial public offering of units in The Link Real Estate Investment Trust (“Link REIT”). The Commission will discuss with market participants (including issuers, sponsors, investment banks, brokers, registrars, lending banks, Hong Kong Securities Clearing Company Limited (“HKSCC”), Hong Kong Exchanges and Clearing Limited (“HKEx”) and the Hong Kong Monetary Authority) the feasibility of the proposed framework and the detailed logistics before drafting the statutory provisions implementing this proposal. Contribution from relevant parties should reduce the process risk associated with the implementation of the withdrawal mechanism. The public and the market will be given an opportunity to comment on the draft statutory framework for the withdrawal mechanism in a draft bill consultation paper; and

- (1) *Proposal 19* — to repeal the requirements relating to statements in lieu of prospectus.

Further modification and refinement of these proposals may be necessary in the course of preparing the draft legislation. The public will be given an opportunity to comment on the draft legislation implementing these proposals in the draft bill consultation paper(s).

5. In light of the feedback from the market, the Commission has decided to revise some of the proposals in the Consultation Paper. The Commission will consult the market on the following revised proposals, together with the draft statutory provisions, in the draft bill consultation paper(s):

- (a) *Proposal 5* — the Commission’s original proposal was to merge the CO prospectus regime into the SFO investment advertisement regime and create a unified offering regime. Whilst there was widespread support for harmonising the legal and regulatory treatment of investment arrangements and instruments having similar characteristics, there was a divergence of views on whether the

CO prospectus regime and the SFO investment advertisement regime should be merged and unified. The dissenting view questioned the appropriateness of unification given the different nature of direct investments in equity and debt as opposed to derivative products. The Commission acknowledges that a derivative issuer could not reasonably be expected to give the same level of information on the underlying asset as the issuer of the underlying asset itself when it engages in fund-raising. In recognition of this inherent difference, the Commission proposes that the legal and regulatory treatment of financial products with similar risk and reward exposure (irrespective of their legal form) be harmonised without seeking to merge the CO prospectus regime and the SFO investment advertisement regime. This will be done by (i) amending the definition of “debenture” where it appears in the CO prospectus regime and the SFO investment advertisement regime to the effect that all “structured products” (i.e. products which, in addition to exposure to the credit or default risk of the issuer (or guarantor where applicable), contain an exposure to an underlying asset, opportunity or risk that is usually unrelated to the issuer or the guarantor) will fall outside the definition of a “debenture”, with the intention of subjecting public offers of structured products to regulation under the SFO investment advertisement regime; and (ii) formulating non-statutory product codes or guidelines tailored for products with similar characteristics to supplement the SFO investment advertisement regime.

It is hoped that this proposed clarification would help reduce market distortion and regulatory arbitrage as public offers of all structured products would fall within the investment advertisement regime in Part IV of the SFO, leaving plain vanilla debenture offers and share offers to be regulated under the CO prospectus regime;

- (b) *Proposal 7* — the Commission’s original proposal was to adjust the anti-avoidance mechanism by providing that an offer for sale of shares or debentures within 12 months of their initial issue requires a prospectus to be prepared by the offeror if: (i) the original issue of securities was made pursuant to a particular exemption; (ii) there are reasonable grounds for concluding that the securities were issued or acquired with the purpose of on-

sale; and (iii) no exemption would have been available had the issuer offered the securities directly to the offerees. In response to the negative feedback from the market and further internal review, the Commission has revised its proposal on the anti-avoidance mechanism and intends to focus on those safe harbours which are prone to abuse, i.e. the “50 persons private placement” exemption and the “HK\$5 million small-scale offering” exemption. The Commission proposes to introduce an aggregation provision whereby (i) closely related offers made within a period of 12 months (even if not made by the same entity) will be aggregated when determining the offeree / offer size limits and (ii) the Commission be empowered to aggregate closely related offers within such period when determining whether the particular safe harbour has been abused. It is proposed that the criteria for determining whether offers are “closely related” will be set out in guidelines to be issued by the Commission; and

- (c) *Proposal 15* — after further internal deliberation, the Commission believes that its policy concerns regarding inequality of information and inaccurate information would not be fully addressed by prohibiting the issue of **written** pre-deal research reports by connected analysts² (coupled with the requirement for publication of leaked verbal pre-deal research and commentary by the issuer of an IPO prospectus) as originally proposed in the Consultation Paper. Moreover, some market participants have indicated that the requirement to publish leaked pre-deal research would be very disruptive to the initial public offering (“IPO”) process and of little value to prospective investors.

In recognition of the role pre-deal research reports play in price discovery in the IPO process, the Commission will not at this stage impose a ban on pre-deal research (whether oral or written) but will extend (and expand where appropriate) the scope of paragraph 16 of the Code of Conduct for Persons Licensed by or Registered with the SFC (“Code of Conduct”) to ensure independence and objectivity of research analysts. It is envisaged that, subject to compliance with the internal control and compliance procedures, an

² For the purposes of these Consultation Conclusions, “connected analysts” means analysts who are employed by a sponsor, manager or underwriter to the offering (or by a related company).

advanced draft prospectus may be provided to selected analysts (which may include connected analysts) for the purposes of preparing the research report.

In addition, the Commission proposes to require that the red-herring prospectus be made available to the public after the relevant listing application has been heard and the in-principle approval has been granted by the Listing Committee of The Stock Exchange of Hong Kong Limited (“SEHK”).

6. The following proposals will not be taken forward at this stage:
 - (a) *Proposal 9* — to extend the classes of persons who may claim compensation for a misstatement in a prospectus to subsequent purchasers who buy in the secondary market;
 - (b) *Proposal 10* — to remove the requirement for claimants to prove that they have actually read and relied on the prospectus when making a claim for compensation;
 - (c) *Proposal 17* — to extend the 3-day waiting period before allotments of shares or debentures in the case of initial public offers of shares or debentures and the removal of the 3-day waiting period for allotments in the case of public offers of shares or debentures of a class already listed;
 - (d) *Proposal 18* — to provide that an application form or procedure for shares or debentures may not be distributed or implemented by any person unless it is accompanied by or contained in a prospectus which complies with the prospectus provisions or is exempted from them;
 - (e) *Proposal 20* — to introduce a separate regulatory regime to regulate offers to employees and their dependants, including a requirement for a declaration of solvency and going concern by the directors and auditors of the company; and

(f) *Proposal 21* — to provide that an issue or sale of securities in contravention of the law should be void or voidable.

7. Part B of the Consultation Conclusions contains a summary of the key responses received by the Commission on each of the 21 proposals, the Commission's responses to them and the way forward. Part C outlines the next steps and timing in relation to the review and reform exercise.

PART B – SUMMARY OF RESPONSES TO THE CONSULTATION PAPER

8. The Commission issued the Consultation Paper on 29 August 2005 for a 3-month consultation period, which was extended to 31 December 2005 due to market request. The Commission continued to receive responses from the market up to mid-January 2006. In total, the Commission received 26 submissions from industry participants, professional bodies, as well as individuals. All submissions (except one) have been published on the Commission's website at <http://www.sfc.hk>. One respondent provided its submission to the Commission on a confidential basis and requested that its submission be withheld from publication.

9. The following is a summary of the key submissions received from the market on each of the 21 proposals, the Commission's responses to them and the way forward. The Commission has also identified areas requiring further clarification, amendment or, in some cases, a different approach.

Proposal 1 – to transfer the provisions in the CO relating to the public offering of shares and debentures to the SFO

10. The Commission explained in the Consultation Paper that it saw no particular disadvantage in moving the legislation relating to the public offering of shares and debentures (i.e. the CO prospectus regime) out of the CO and transferring it into the SFO, thereby consolidating all securities laws in a single piece of legislation.

Comments from the public:

11. Most respondents enthusiastically welcomed this proposal, supporting the view that consolidation would help ensure conformity of regulatory philosophy and removal of technical inconsistencies between the CO and the SFO.

The Commission's response:

Based on the overwhelming support for this proposal, the Commission will pursue the proposal to move the CO prospectus regime for share and debenture offers to the SFO as a discrete part separate from the investment advertisement regime in Part IV (offers of investments) of the SFO.

Whilst some respondents argued that there should be a comprehensive review of the regulation of securities offerings including Part IV of the SFO, the Commission wishes to point out that:

- (i) a detailed review of Part IV of the SFO was carried out before the implementation of the SFO in April 2003 and as such, we should allow it to operate for a certain length of time before another comprehensive review. Furthermore, the respondents did not identify any specific areas in Part IV of the SFO for review; and*
- (ii) the current review is the final phase of a three-part review and reform exercise designed to modernise the regime for the public offering of shares and debentures. Phase 1 was completed in March 2003 when three SFC guidelines and two class exemptions were issued³. Phase 2 was completed in December 2004 when Schedule 1 and Part 1 of Schedule 3 of the Companies (Amendment) Ordinance 2004 containing prospectus-related amendments came into effect⁴. All three phases of the prospectus regime reform exercise*

³ For further particulars of the Phase 1 reforms, see SFC Press Releases dated 21 February 2003 and 28 March 2003 on the SFC's website www.sfc.hk under tab "General and Enforcement News".

⁴ For further particulars of the Phase 2 reforms, see SFC Press Releases dated 10 March 2003, 12 June 2003 and 3 December 2004 on the SFC's website www.sfc.hk under tab "General and Enforcement News". Schedule 1 and Part 1 of Schedule 3 of the Companies (Amendment) Ordinance 2004 can be

have been limited to reviewing the public offering regime in the CO and, as such, a detailed review of Part IV of the SFO is beyond the scope of this exercise.

Comments from the public:

12. One respondent commented that, in the event the Commission decides to move the CO prospectus regime to the SFO, there should be clarity on how mutual funds, unit trusts and other types of collective investment schemes would be treated under the combined regime. It also urged the Commission to clarify whether the safe harbours set out in the Seventeenth Schedule to the CO should be extended to funds.

The Commission's response:

The Commission sees no material regulatory issues in applying the safe harbours in the Seventeenth Schedule to the CO, where applicable, to funds whether they are constituted as mutual funds or unit trusts. The Commission intends to consult the public and the market in this regard.

Proposal 2 – to shift the focus of the CO prospectus regime from “document-based” to “transaction-based”

13. The Commission expressed its intention in the Consultation Paper to provide for greater certainty in the law by regulating the act of offering rather than a document containing the offer. This would reduce the potential for structuring transactions to fall outside the CO prospectus regime and therefore increase investor protection.

accessed via www.info.gov.hk under tab “Gazette” in “General Information” as Ord. No. 30 of 2004 in Legal Supplement No. 1 gazetted on 23 July 2004.

Comments from the public:

14. The Commission received overwhelming support on its proposal that no public offer of shares or debentures should be made unless it is contained in a compliant prospectus or falls within a specified exemption.
15. One respondent was concerned about the effect of the shift to a “transaction-based” approach may have on placements as a time and cost efficient method of fund raising by listed issuers.

The Commission’s response:

The Commission does not agree that the shift will have any significant effect on placings (including e.g. top-up placings) as issuers/offerors would still be able to make use of the safe harbours contained in the Seventeenth Schedule to the CO, for example, by making offers to “professional investors” (within the meaning of section 1 of Part 1 of Schedule 1 to the SFO) and/or to “not more than 50 persons”. The proposed “transaction-based” approach will regulate cases where the issuer/offeror seeks to extend the offer to retail investors beyond what is permitted under the safe harbours.

Comments from the public:

16. There was concern among some respondents about the necessity of requiring a prospectus to be prepared for each capital raising exercise. It was argued, on the basis that there are robust ongoing disclosure requirements in respect of issuers whose equity securities are listed on the SEHK (especially if statutory backing of the Rules Governing the Listing of Securities on the SEHK (“Listing Rules”) in relation to disclosure of price-sensitive information, annual and periodic financial reports and notifiable / connected transactions is implemented), that the CO prospectus regime should only apply to the first solicitation by an issuer and that it should not be necessary to require a prospectus to be prepared for each subsequent capital raising exercise other than to disclose material information regarding that exercise (e.g. offer size (and hence, dilution) and use of proceeds). It was also

argued that investors who purchase existing listed securities from offerors (albeit via an offer to the public) should not be afforded greater protection than those who acquire securities through the Automatic Order Matching and Execution System (“AMS”) of HKEx.

The Commission’s response:

Whilst there is some merit in the above arguments put forward by the respondents, the Commission is also concerned with regulating the issue of a document or a verbal communication containing an offer or calculated to invite an offer where the document / verbal communication does not comply with the requirements for prospectuses in the CO and does not carry prospectus liability. The Commission is of the view that the shift to a “transaction-based” approach should be pursued such that all offers to the public, whether documented or undocumented and whether in the form of offers for subscription or offers for sale, should be regulated and prohibited unless made with a compliant prospectus or exempted under the Seventeenth Schedule to the CO.

Phase 2 of the review and reform exercise on the regime for the public offering of shares and debentures included a detailed review of the types of documented offers which can be made outside the prospectus regime on the basis that an appropriate balance needs to be struck between providing investor protection and reducing compliance cost. The safe harbours, set out in the Seventeenth Schedule to the CO, came into effect in December 2004 but they were framed with the current document-based system in mind. As a result of the change to a “transaction-based” approach, new exemptions will be included in the Seventeenth Schedule for:

- (i) an offer communicated by an exchange participant in the ordinary course of trading on a recognized stock market. The Commission believes that, in respect of listed shares and debentures, on-market offers made in the ordinary course of trading on the HKEx should be distinguished from off-market offers for sale by offerors on the basis that in the former case, orders are matched through the AMS whereas in the latter case there is*

potential for the off-market offerors to induce prospective investors to enter into the transaction;

- (ii) an offer communicated by a licensed intermediary where it is acting as agent if such offer is made in relation to an offer contained in a registered prospectus. This will preserve the well-established method of intermediaries taking orders over the phone where they are acting as agents of issuers / offerors, but the issuer and/or the offeror (i.e. the principal) would need to issue a compliant prospectus unless the offer falls within a safe harbour; and*
- (iii) offers made by or on behalf of the Government of the Hong Kong Special Administrative Region of the People's Republic of China ("HKSAR Govt") in respect of debentures issued by it⁵.*

The Commission will invite public comments in a draft bill consultation paper on the new exemptions above and whether other exemptions are necessary as a result of the shift to a "transaction-based" approach to avoid unintentionally capturing activities within the CO prospectus regime which do not raise regulatory concerns.

On the basis that there are robust ongoing disclosure requirements for listed issuers, the Commission agrees that the prospectus content requirements for a secondary issue may be significantly less than the content requirements for an IPO prospectus. This consideration will be taken into account when drafting the content requirements for secondary issues.

Comments from the public:

17. The Commission also received comments that it would be inappropriate for public offers of shares or debentures by persons other than the issuer to be subjected to the full CO prospectus regime.

⁵ See the Commission's response in the Consultation Conclusions in relation to proposal 4.

The Commission's response:

The Commission feels that from an investor protection perspective, if an offer constitutes an offer to the public, it ought to be subject to the CO prospectus regime unless it is exempted. Insofar as the disclosure standard is concerned, the Commission notes that an offeror, where it is not the issuer or part of the management of the issuer, may have an “all reasonable inquiries made” defence⁶. However, the Commission recognises that this only goes towards establishing a defence when there are claims for compensation for loss arising from misstatements or omissions and does not deal with the level of disclosure for non-issuer offerors. Therefore, the Commission intends to invite comments in a draft bill consultation paper on whether a “knowledge” element should be adopted in the prospectus content requirements similar to that used in the United Kingdom (“UK”), Australia and Singapore. In Australia, a prospectus is required to contain all the information that investors and their professional advisors would reasonably require to make an informed assessment of the prescribed matters only to the extent it is reasonable for investors and their professional advisers to expect to find the information in the prospectus and only if a person whose knowledge is relevant actually knows the information or in the circumstances ought reasonably to have obtained the information by making enquiries⁷. Similar to the Australian approach, both the UK and Singaporean regimes qualify the general disclosure standard with knowledge⁸. Furthermore, similar to our comment above regarding secondary issues, on the basis that there are robust ongoing disclosure requirements for listed issuers, the prospectus content requirements for a secondary offer for sale may be significantly less than the content requirements for an IPO prospectus.

⁶ See sections 40(2)(d) and 40A(1) of the CO.

⁷ See section 710(1)(b) of the Australian Corporations Act (“CA”).

⁸ See section 80(3) of the U.K. Financial Services and Markets Act 2000 (“FSMA”) and section 243(2)(b) of the Singapore Securities and Futures Act (“SFA”).

Proposal 3 – to clarify that the CO prospectus regime applies to offers of options or other rights in or over shares or debentures, where the issuer of the options or other rights is in the same group of companies as the issuer of the underlying shares or debentures

18. The Commission explained in the Consultation Paper that the current CO prospectus regime is silent on the treatment of offers of options or other rights in or over shares or debentures, although it is generally assumed to apply to them. The Commission intends to address this by expressly providing for such offers.

Comments from the public:

19. Whilst there was widespread support for this proposal, a handful of respondents suggested that the Commission should extend the meaning of the “same group of companies” to cover companies under the common control or substantially under the common control of the directors.

The Commission’s response:

Proposal 3 will be adopted but the Commission does not intend to require the aggregation of shareholdings of the different directors within the same group of companies as it is likely to give rise to grave difficulty in defining the extended meaning with certainty.

Proposal 4 – to provide that the requirements of the CO prospectus regime apply without regard to place of incorporation of the issuer and apply to “bodies” rather than “companies”

20. The Commission explained in the Consultation Paper that investors’ interests would be enhanced under a framework that requires all public offers having particular characteristics to conform to a prescribed standard without regard to the place of incorporation or legal form of the issuer.

Comments from the public:

21. Although the Commission received no objection to this proposal, many respondents commented that the proposal to apply the CO prospectus regime to “bodies” rather than “companies” should be accompanied by carefully thought through exemptions. They also asserted that there should be some degree of flexibility to cater for different types of entities.

The Commission’s response:

The Commission has taken on board the comments from the respondents and intends to (i) exempt from compliance with the CO prospectus regime offers made by the HKSAR Govt in respect of debentures issued by it and (ii) impose reduced disclosure requirements for offers of debentures issued by States (other than the HKSAR Govt), State corporations and Supranationals consistent with the approach adopted in the Listing Rules⁹.

Proposal 5 – to merge the CO prospectus regime into the SFO investment advertisement regime and create a unified offering regime

Comments from the public:

22. There was widespread support for the proposal that investment arrangements and instruments providing investors with broadly similar risk and reward should be subject to equivalent regulatory treatment and some respondents provided the Commission with useful suggestions on how best to achieve harmonisation. Most of those suggestions spelt out high-level principles and the key submissions are as follows:

- it was commented that the unified regime should establish basic statutory requirements in relation to compulsory disclosure of all material information, on an initial and on-going basis, and regulatory authorisation of such

⁹ See Chapters 31 to 33 of the Listing Rules.

disclosures. The compulsory disclosure requirement should be a general one, leaving the prescriptions to non-statutory product specific codes; and

- concern was expressed over how a statutory disclosure standard could be drafted with sufficient generality to apply to all products without becoming too vague and uncertain which may render compliance difficult.

23. Some respondents queried the appropriateness of merging the CO prospectus regime into the SFO investment advertisement regime as an offer of shares and debentures for fund raising purposes is inherently different from an offer of financial products in the ordinary course of business of the issuer for revenue generation purposes.

The Commission's response:

Whilst the respondents in general agreed with the proposal to harmonise the legal and regulatory treatment of investment arrangements and instruments with similar characteristics, there was a divergence of views on whether the CO prospectus regime and the SFO investment advertisement regime should be merged and unified. The dissenting view questioned the appropriateness of unification given the different nature of direct investments in equity and debt as opposed to derivative products. The Commission acknowledges that a derivative issuer could not reasonably be expected to give the same level of information on the underlying asset as the issuer of the underlying asset itself when it engages in fund-raising. In recognition of this inherent difference, the Commission has revised its proposal such that the legal and regulatory treatment of financial products with similar risk and reward exposures irrespective of their legal form will be harmonised without seeking to merge the CO prospectus regime and the SFO investment advertisement regime. Instead, the Commission will implement proposal 1 (i.e. to move the CO prospectus regime into the SFO as a discrete part separate from the SFO investment advertisement regime) and proposes to harmonise the two regimes by amending the definition of "debenture" as outlined below.

24. The Commission also invited comments on whether the definition of “debenture”¹⁰ where it appears in the CO prospectus regime or SFO investment advertisement regime should be clarified by replacing the reference to “*other securities*” with “*other debt securities*”.

Comments from the public:

25. The Commission received broad support for clarifying the definition of “debenture” along the lines suggested in the above paragraph.

The Commission’s response:

The broad support for the proposed amendment to the definition of “debenture” as described in paragraph 24 above is encouraging. However, this amendment would not reduce the potential for issuers to bring within the CO prospectus regime any investment arrangement or instrument that they structure as a debenture. Accordingly, the potential for regulatory arbitrage would remain.

In an endeavour to harmonise the regulatory regimes for investment arrangements with similar characteristics, the Commission proposes to (i) amend the definition of “debenture” where it appears in the CO prospectus regime and the SFO investment advertisement regime to the effect that all “structured products” (i.e. products which, in addition to exposure to the credit or default risk of the issuer (or the guarantor where applicable), contain an exposure to an underlying asset, opportunity or risk that is usually unrelated to the issuer or guarantor) will fall outside the definition of a “debenture” and (ii) to subject public offers of structured products to regulation under the SFO investment advertisement regime. The Commission also intends to formulate non-statutory product codes or guidelines tailored for products with similar characteristics to supplement the SFO investment advertisement regime.

It is hoped that this proposed clarification would help reduce market distortion and regulatory arbitrage as all public offers of structured products would fall within the

¹⁰ “Debenture” is defined in section 2 of the CO as including “*debenture stock, bonds and any other securities of a company whether constituting a charge on the assets of the company or not.*”

investment advertisement regime in Part IV of the SFO, leaving plain vanilla debenture offers and share offers (including offers of options or other rights in or over shares or debentures in cases where the issuer of the option or other right is in the same group of companies as the issuer of the underlying shares or debentures) to be regulated under the CO prospectus regime. The Commission will invite the market and the public to comment on this revised proposal in a draft bill consultation paper.

Proposal 6 – to exempt from the CO prospectus regime offers made to holders of shares or debentures in the context of a takeover or merger or under a compromise or scheme of arrangement provided that the offer is in compliance with the laws and regulatory requirements of the company’s home jurisdiction and any principal stock exchange on which it is listed

26. The Commission explained in the Consultation Paper that globalisation of business and ready access to information on-line are increasingly exposing Hong Kong investors to investment opportunities in securities markets of other jurisdictions. In seeking to diversify their investment portfolio, investors may wish to hold shares or debentures in entities that are not listed or traded in Hong Kong. Such investors would be disadvantaged if the requirements for a prospectus were to discourage the relevant company, or the person making a takeover or merger offer, from allowing them to participate.

Comments from the public:

27. Whilst there was overwhelming support from respondents for introducing the new safe harbour in the Seventeenth Schedule to the CO as it would lower compliance costs, concern was expressed over the appropriateness of a blanket exemption. A handful of respondents suggested that the relevant takeover or merger should only be exempted if the laws and regulatory requirements of the company’s home jurisdiction and of any principal stock exchange on which its shares or debentures are listed are no less onerous than, if not comparable to, the laws and regulatory requirements of Hong Kong in terms of corporate governance and investor protection.

The Commission's response:

To address the concerns of the respondents, the Commission intends to introduce a “recognised jurisdiction” concept whereby the Commission will compile a list of jurisdictions with disclosure requirements in their applicable laws and regulations that are comparable to the disclosure requirements in the Code on Takeovers and Mergers (the “Takeovers Code”). The Takeovers Code remains applicable only to public companies in Hong Kong and companies with a primary listing of their equity securities in Hong Kong. The Commission does not intend to regulate the terms of takeovers or mergers via the CO prospectus regime where the Takeovers Code does not apply. This is consistent with the rationale behind the proposal which is to ensure that investors in Hong Kong are given the opportunity to participate in these overseas takeovers rather than being excluded from them.

Proposal 7 – to adjust the anti-avoidance mechanism by providing that an offer for sale of shares or debentures within 12 months of their initial issue requires a prospectus to be prepared by the offeror if (i) the original issue of securities was made pursuant to a particular exemption; (ii) there are reasonable grounds for concluding that the securities were issued or acquired with the purpose of on-sale and (iii) no exemption would be available had the issuer offered the securities directly to the offerees. To introduce a series of exemptions to the proposed new provision

28. The Commission stated in the Consultation Paper its policy intention underlying the proposal, which is its strong desire to prevent indirect issues to investors who require the protection of a regulated offer.

Comments from the public:

29. Slightly less than half of the respondents agreed in principle with the proposal. Among these responses, some made the following observations:-

- it may be unnecessary to extend the time period between the allotment of the shares or debentures and the subsequent offer for sale for the purposes of triggering the anti-avoidance rule¹¹;
- the objective “and/or” intention test as set out in paragraph 13.4(b) of the Consultation Paper¹² is inappropriate. The test should focus on the issuer’s intention to abuse an exemption; and
- although it may be unfair for the issuer to be put in breach as a result of actions of persons who acquire shares or debentures who are unknown to the issuer, it may equally be unfair to require an offeror in an on-sale to prepare a prospectus as it will rarely be in a position to issue a prospectus that complies with all relevant content requirements relating to the issuer.

30. One respondent felt strongly against the proposal and argued that its implementation would adversely affect placements, thus limiting the fund raising alternatives of listed issuers and hampering the development of the capital market. It further contended that:-

- to require an offeror of securities acquired pursuant to a private placement exemption to issue a prospectus is inappropriate because all investors acquire securities with an intention to dispose them at a profit eventually;
- imposing a time limit is not feasible as market conditions can change drastically over a short period of time; and

¹¹ Section 41 of the CO deems a document by which offers of shares or debentures for sale are made to the public to be a prospectus issued by the company if such company allots with a view to all or any of such shares or debentures being offered for sale to the public. Unless the contrary is proved, Section 41(2)(a) of the CO deems an allotment of shares or debentures to be made with a view to the shares or debentures being offered for sale to the public if the offer of shares or debentures for sale to the public was made within 6 months after the allotment. See footnote 12 for a summary of paragraph 13.4 of the Consultation Paper.

¹² Paragraph 13.4 of the Consultation Paper proposed to adopt an anti-avoidance mechanism whereby an offer for sale of shares or debentures within 12 months of their initial issue would require a prospectus to be issued by the offeror where: (a) the issuer issued such shares or debentures pursuant to a relevant exemption; (b) there are reasonable grounds for concluding that the issuer issued the shares or debentures, or the person to whom they were issued acquired them, with the purpose of selling or transferring them; and (c) no exemption would have been available if the issuer had offered the shares or debentures directly to the offerees.

- investors who acquire securities of an existing listed issuer by way of placement require no additional protection over those who deal in securities of the same listed issuer through the secondary market.

It suggested that improving the quality and timeliness of the existing disclosure regime of listed issuers would be a more efficient and effective way to protect investors.

The Commission's response:

In response to the comment that it may be unfair to require an offeror in an on-sale to prepare a prospectus, as discussed earlier in the Commission's response under proposal 2, an offeror in an offer for sale will be subject to reduced disclosure requirements and a "knowledge" element will be introduced in the prospectus content requirements. Investors who acquire shares from a listed issuer by way of placement should be distinguished from investors who acquire shares in the ordinary course of trading through the HKEx as there is no element of inducement from the offeror (other than the offer price) in the latter case.

After due consideration of the comments from the respondents, as well as lengthy internal review of the proposal, the Commission saw the need to clarify its policy intention behind the anti-avoidance proposal and to re-consider its approach.

Following the change to a "transaction-based" approach, the Commission believes that the existing section 41 of the CO should be retained in order to prevent possible avoidance of the CO prospectus regime by issuers separating the issue and distribution of shares or debentures by a follow-on documented offer but the question remains whether additional anti-avoidance provisions need to be introduced to prevent abuse of any exemptions contained in the Seventeenth Schedule to the CO. As pointed out by one of the respondents, the Commission recognizes that the exemptions which are open to potential abuse are the "private placement – offers to no more than 50 persons" exemption and the "small scale offers – HK\$5 million" exemption. The

other safe harbours contained in the Seventeenth Schedule to the CO do not appear to offer the same scope for abuse.

The Commission has referred to the approaches adopted in the UK, Australia and Singapore and notes that in both Australia¹³ and Singapore¹⁴, “closely related offers” are aggregated when determining the offeree / offer size limits in order to capture “cascading structures”. For example, an issuer may seek to circumvent the prospectus regime by (a) making an initial offer pursuant to an exemption under the Seventeenth Schedule to the CO (e.g. an offer to not more than 50 persons and/or to professional investors) then (b) organizing numerous follow-on offers each of which, if viewed on its own, would constitute an exempted offer (i.e. each follow-on offer, on a standalone basis, falling within the “not more than 50 persons” exemption or the “small scale offering” exemption), where no exemption would have been available to the issuer had it offered the shares or debentures directly to all the offerees. The Australian and Singaporean approach would aggregate such “closely related” offers thereby depriving the issuer of the safe harbours in such circumstances. The Commission is inclined to follow this approach and proposes to introduce an aggregation provision whereby (i) closely related offers made within a period of 12 months (even if not by the same entity) will be aggregated when determining the offeree / offer size limits and (ii) similar to the Australian approach, the Commission be empowered to aggregate closely related offers¹⁵ within such period when determining whether the particular safe harbour has been abused. It is proposed that the criteria for determining whether offers are “closely related” will be set out in guidelines to be issued by the Commission and the Commission will invite public comments in a draft bill consultation paper on this revised approach¹⁶.

As the Commission does not intend to proceed with the general anti-avoidance mechanism set out in paragraph 13.4 of the Consultation Paper, the proposed carve-

¹³ See section 740 of the CA.

¹⁴ See sections 272A(5) and 272B(3) of the SFA.

¹⁵ Under section 740 of the CA, The Australian Securities and Investments Commission (“ASIC”) may make a determination aggregating the transactions of bodies that ASIC considers to be closely related.

¹⁶ The Commission notes that under the SFA, a person may seek the determination of the Monetary Authority of Singapore (“MAS”) for offers not to be regarded as “closely related” **before** the offer is made.

outs from the anti-avoidance mechanism set out in paragraph 13.5¹⁷ of the Consultation Paper will no longer be relevant.

Proposal 8 – to alter the scope of the CO prospectus liability regime to include (i) the issuer and/or the offeror of the shares or debentures, (ii) the “sponsor” of an issue or offer and (iii) each person who accepts, and is stated in the prospectus as accepting, responsibility for the prospectus, and remove (iv) “promoter” and (v) persons who “authorise the issue of” a prospectus. The Consultation Paper also asked whether the market considers that the same classes of persons should be subject to both civil and criminal liability for misstatements in prospectuses (with experts liable only in respect of untrue statements in their reports)

31. The Commission stated in the Consultation Paper its intention to define more clearly persons who should be held responsible for prospectus disclosures.

(a) In relation to the proposal to extend prospectus liability to issuers and offerors:

Comments from the public:

32. Although only a handful of respondents commented on the proposed extension of liability to issuers, they mostly agreed that issuers should bear primary responsibility as they are best placed to know whether a statement is true or not.

The Commission’s response:

The Commission intends to extend liability to issuers on the basis that the net proceeds from a new issue go to the issuer and the directors may not have sufficient funds to pay successful compensation claims. The Commission also intends to extend liability to offerors in offers for sale on the same basis. Where the offeror is a “body” or “company”, directors of the offeror should also be liable.

¹⁷ Paragraph 13.5 of the Consultation Paper contains a list of secondary offers that the Commission originally proposed to exempt from the anti-avoidance mechanism set out in paragraph 13.4 of the Consultation Paper.

(b) In relation to the proposal to extend prospectus liability to sponsors:

Comments from the public:

33. The Commission noted that the proposed extension of liability to sponsors was one of the most controversial topics of the Consultation Paper. Two respondents agreed with our proposal, four respondents partially agreed or agreed with reservations and nine respondents were strongly against it. Among the dissenting respondents:-

- some argued that placing primary responsibility on sponsors would encourage litigation against them;
- it was also argued that to shift the burden to sponsors would misrepresent their role which is to assist the issuer with its listing application and advise it as to the Listing Rules requirements, not to guarantee the accuracy of the information provided. There was concern about the “misconception” that due diligence would avoid inaccurate prospectuses, especially if information was deliberately concealed from them; and
- some queried the statement in the Consultation Paper that the interest of the sponsor in the success of an offer is closely aligned with that of the issuer. Unlike underwriters whose commission is calculated on a percentage basis and therefore more closely aligned with those of the issuers, these respondents contended that sponsors do not have a significant economic interest in the success of the offer as they typically receive a fixed fee irrespective of the success of the offer.

The Commission’s response:

Although sponsors are perceived to have “deep pockets” and therefore are prone to become litigation targets, this alone does not justify not imposing liability on them. Sponsors are required under Practice Note 21 of the Listing Rules to conduct the

necessary due diligence and assess suitability of a listing applicant before bringing the company to the market.

With respect to the assertion that sponsors do not have a significant economic interest in the success of an offer, the Commission notes that although sponsors typically receive a fixed fee (for IPOs of shares to be listed on the SEHK), the sponsors, rather than the underwriters, are the ones required under the Listing Rules¹⁸ to conduct due diligence and be closely involved in the preparation of listing documents.

The Commission notes that it released the consultation conclusions to the consultation paper on the regulation of sponsors and compliance advisers in April 2006 which attached the guidelines for sponsors and compliance advisers (“Sponsor Guidelines”). The new regulatory regime will be inserted as part of the Fit and Proper Guidelines and will become effective on 1 January 2007. This new regulatory regime aims to assess the overall suitability of corporate finance advisory firms to act as sponsors. Only corporate finance advisory firms that meet the specific eligibility criteria as set out in the Sponsor Guidelines will be accepted to act as sponsors. The onus will also be on the firm and its management to ensure that the firm satisfies all necessary requirements of the Sponsor Guidelines.

In view of the new regulatory regime for sponsors, the Commission believes that, at this stage, it would be premature to impose prospectus liability on sponsors.

(c) In relation to extending prospectus liability to persons accepting responsibility for the prospectus:

34. Given that there was no strong dissent from the market, the Commission will proceed with this proposal.

(d) In relation to the proposal to remove promoters from the CO prospectus liability regime:

¹⁸ See Chapter 3A of the Listing Rules in particular, Rule 3A.11 which requires a sponsor to, among other things, be closely involved in the preparation of the new applicant’s listing documents; and conduct reasonable due diligence inquiries to put itself in a position to be able to make the declaration required under Rule 3A.13 of the Listing Rules.

Comments from the public:

35. With respect to the proposed removal from the prospectus liability regime of “promoters”, the Commission received more favourable responses than dissenting opinions. Most of those who disagreed argued that to “promote” a company is still a common practice in other jurisdictions e.g. the PRC, and that it would be unfair to remove the liability of promoters who typically stand to gain substantially from an issue.

The Commission’s response:

Although to “promote” a company is still common practice in other jurisdictions, the Commission understands that promoters do not have any meaningful role to play from the perspective of a Hong Kong IPO e.g. they are not responsible for verification of information and have no control over the content of the prospectus. As such, the Commission will proceed to remove “promoters” from the prospectus liability regime.

(e) In relation to the proposal to remove persons who “authorise the issue of” a prospectus:

36. Given that the majority of those who responded was in favour, the Commission will proceed with this proposal.

Comments from the public:

37. In relation to the proposal to subject the same classes of persons to both civil and criminal liability for misstatements in prospectuses, the Commission received extensive opposition. Most of the respondents contended that criminal liability should not be imposed unless there is fraud or recklessness i.e. a distinction ought to be made between professional mistakes and deliberate fraudulent acts or reckless behaviour.

The Commission's response:

The Commission agrees that mens rea should be present before criminal liability can be imposed. Therefore, it intends to amend section 40A of the CO¹⁹ to incorporate a mens rea element so that criminal liability would not be imposed unless there is intent or recklessness. The Commission notes that this proposed amendment would be in line with the criminal liability standard in the SFO.

Proposal 9 – to extend the classes of persons who may claim compensation for a misstatement in a prospectus to subsequent purchasers who may buy in the secondary market

38. The Commission stated in the Consultation Paper its policy intention underlying the proposal – that it saw no reason why secondary purchasers who suffer loss as a result of an untrue statement should not be entitled to compensation, as an untrue statement or a material omission in connection with an IPO may only come to light after secondary trading has begun and may as a result affect secondary market purchasers.

Comments from the public:

39. Market practitioners offered mixed views on this proposal and many of the respondents who agreed with the proposal set conditions to their agreement. For instance, a significant number of respondents commented that there should be limits on the types of investors that can institute claims, the scope of the claim, the amount recoverable and the time within which the purchaser in the secondary market must have acquired the shares after the IPO in order to be able to claim compensation. Others suggested that there should be a clear mechanism as to how loss should be quantified.

¹⁹ Section 40A of the CO provides that where a prospectus includes any untrue statements, any person who authorized the issue of the prospectus shall be liable to imprisonment and a fine, unless he proves either that the statement was immaterial or that he had reasonable grounds to believe and did up to the time of the issue of the prospectus believe that the statement was true.

40. Among the dissenting respondents, it was argued that as there is no contractual relationship between a sponsor, underwriter or issuer with a secondary market purchaser, there is little justification in allowing such an investor to bring a claim for compensation for loss. Lawyers in particular contended that the proposal is contrary to the fundamental principle of the law of misrepresentation and that it is out of line with international practice.

41. There was also concern that focus should instead be placed on deterrence rather than compensation of aggrieved secondary market investors as the proceeds of sale from secondary market purchasers are not received by the issuer. It was argued that by diminishing the issuer's assets, the compensation would in effect come unfairly at the expense of the issuer's continuing shareholders.

The Commission's response:

The Commission notes the respondents' concerns and comments and, after due consideration, has decided not to pursue at this stage the proposal to extend the classes of persons who may claim compensation for a misstatement in a prospectus to subsequent purchasers who buy in the secondary market.

Proposal 10 – to remove the requirement for claimants to prove that they have actually read and relied on the prospectus when making a claim for compensation

42. The Commission expressed in the Consultation Paper the rationale behind the proposal, that it should not be necessary to prove actual reading of or reliance on the prospectus provided that a causal connection between the loss sustained and an untrue statement in a prospectus is established.

Comments from the public:

43. Over three quarters of the respondents commented on this proposal and the Commission noted that the response was largely not supportive. Most disagreement was premised on the general principle that investors should be

encouraged to study the prospectus and that there must be a nexus between the reliance placed and the loss suffered in proving causation.

The Commission's response:

As a result of the negative feedback and the difficulty of proving causation without reliance, the Commission has decided to retain the notion of reliance.

Proposal 11 – to provide that the “reasonable belief” defence in the liability provisions is subject to a requirement that such belief is founded on all reasonable inquiries having been made

44. The Commission stated in the Consultation Paper its intention to clarify that the reasonable belief defence in sections 40(2)(d)(i), 40(3)(c) and 40A(1) of the CO²⁰ should be subject to the requirement that such belief is to be founded on all inquiries which were reasonable in the circumstances having been made.

Comments from the public:

45. Less than half of those who responded to this proposal disagreed with what the Commission proposed. They argued that the “all” inquiries requirement is too onerous and in the absence of an objective and comprehensive due diligence standard or guideline, the implementation of the proposal may open a floodgate of actions.

46. Of those who agreed, many were of the opinion that the requirement should be that the belief must be founded on all inquiries that were both reasonable at that time and in the circumstances then prevailing.

²⁰ Section 40(2)(d)(i) of the CO provides that no person shall be civilly liable for misstatements in a prospectus if he proves that as regards every untrue statement not purporting to be made on the authority of an expert or a public official document or statement, he had reasonable grounds to believe, and did up to the time of the allotment of the shares or debentures believe that the statement was true. Experts have a similar defence contained in section 40(3)(c) of the CO in respect of statements that they were competent to make and reasonably believed to be true. The defence contained in section 40A(1) of the CO in respect of criminal liability also involves reasonable belief on the part of the defendant that an untrue statement in the prospectus was true.

The Commission's response:

The Commission notes the above comments but it considers that proposal 11 merely clarifies that the reasonable belief defence must be founded on all inquiries which were reasonable in the circumstances having been made. Moreover, what is "reasonable in the circumstances" must be determined by reference to the time and circumstances then prevailing. Accordingly, the Commission believes that the existing wording in proposal 11 should adequately address the perceived difficulty in satisfying the "all" inquiries requirement. The public and the market will be given an opportunity to comment on the draft statutory provisions in relation to this proposal in the draft bill consultation paper(s).

Proposal 12 – to move the overall disclosure standard for a prospectus into the body of the legislation adjacent to the liability provisions and supplement this standard with prescribed content requirements in subsidiary legislation that distinguish between equity and debt offerings

Comments from the public:

47. The majority of those who responded to the proposal were supportive of the proposal. Among these responses, some commented that the disclosure standard should provide sufficient flexibility across a broad range of products. A significant number of respondents however contended that if the disclosure standards were too vague, market practitioners may advise issuers to insert into prospectuses more information than is necessary in order to err on the safe side as a standard that is not entirely certain will make it difficult if not impossible to assess the likelihood of committing any breach. This may result in the prospectus being too bulky and user-unfriendly.

48. Less than half of the respondents gave substantive comments on the proposal regarding devising specific content requirements differentiating between shares and debentures. Some suggested that there should also be a simultaneous, detailed comparative analysis of the Third Schedule to the CO and the Listing Rules content requirements to resolve any overlaps and inconsistencies.

The Commission’s response:

The Commission will pursue the proposal to move the “overall disclosure standard”, along the lines set out in paragraph 23.3 of the Consultation Paper²¹, into the body of the CO prospectus regime adjacent to sections 40 and 40A of the CO. We disagree that such general standard is necessarily unclear. An overall standard (although slightly different from the proposed standard set out in paragraph 23.3 of the Consultation Paper) is already contained in paragraph 3 of the Third Schedule to the CO and each of Australia²², Singapore²³ and the UK²⁴ imposes a similar general disclosure obligation on issuers of prospectuses in primary legislation. The proposal seeks to amend the existing overall disclosure standard and move it into the body of the CO prospectus regime to give it prominence and tie the standard to the liability provisions.

The overall disclosure standard will be supplemented by prescribed content requirements in subsidiary legislation differentiating between debt and equity offerings, IPOs and rights issues and issues of shares or debentures which are uniform in all respects with listed shares or debentures. The Commission will further consult the market on the specific content requirements.

Proposal 13 – to provide that a prospectus for rights issues and issues of shares or debentures that are uniform with listed shares or debentures should comply with reduced (rather than negligible) content requirements

49. The Listing Rules impose specific disclosure requirements in the case of rights issues relating to listed shares and the Commission saw no reason why legislation

²¹ Paragraph 23.3 of the Consultation Paper proposed that the relevant provision would require that a prospectus should contain all such information that investors and their professional advisers would reasonably require, and reasonably expect to find there, for the purpose of making an informed assessment of (a) the assets and liabilities, financial position, profits and losses, and prospects of the issuer of the shares or debentures; and (b) rights attaching to the shares or debentures, taking into account the nature of the shares or debentures being offered and the nature of the issuer, and the nature of the persons likely to consider acquiring them.

²² See section 710 of the CA.

²³ See section 243 of the SFA.

²⁴ See sections 87A(2), (3) and (4) of the FSMA.

with respect to rights issues relating to unlisted shares should be different. As explained in the Consultation Paper, the Commission's policy behind this proposal was that shareholders and debenture holders to whom rights are offered should also be entitled to protection as investors. However, given that they already hold shares or debentures in the issuer, the amount of information they would need (in addition to the information which is already provided to them as shareholders or debenture holders) to assess the offer may be significantly less than that needed to assess an IPO.

Comments from the public:

50. Almost all of those who responded to this proposal agreed with the Commission's policy intention. Only a handful of respondents felt that the proposal is unnecessary as they were of the view that the current regime suffices. These respondents argued that issuers are already required to periodically issue financial reports, announcements and circulars and existing shareholders and prospective investors should be assumed to have sufficient information to make investment decisions.

The Commission's response:

The Commission will proceed with this proposal. However, it does not intend to codify the full content requirements for rights issues under the Listing Rules, but to confine the statutory disclosure requirements to the core requirements.

The Commission is mindful that it needs to impose the same disclosure standard on rights issues and placings by the issuer. Otherwise, imposing more regulation on one type of offer e.g. rights issues might tilt the playing field in favour of placings which would be contrary to the principle of pre-emptive rights of existing shareholders. In due course, the Commission will invite public comments on the specific disclosure requirements for rights issues and placings in a draft bill consultation paper.

Proposal 14 – to introduce an enabling provision in the CO prospectus regime to allow “incorporation by reference” of information located outside the prospectus, provided that the omitted information is identified in the prospectus and easily accessible

51. The Commission explained in the Consultation Paper that the proposal should encourage shorter prospectuses by relaxing the requirement for all relevant information to be in the physical document, without compromising the availability of more detailed or technical information to those who want it.

Comments from the public:

52. The Commission received no substantive objection to the proposal. One respondent commented that there should be control over where the incorporated information can be placed. It was also suggested that reference be made to the UK guidelines on incorporation by reference – e.g. where a summary is included in the prospectus, it should not incorporate information by reference.

The Commission’s response:

The Commission considers that information incorporated by reference should be limited to information filed with the relevant regulatory authority and displayed on the authority’s website. The Commission will invite public comments on the types of information that could be incorporated by reference in a prospectus.

As a further means of promoting shorter prospectuses, the Commission would like to encourage lawyers and issuers to use plain language when preparing prospectuses. In this connection, the Commission will seek the market’s views in a draft bill consultation paper on whether to include, in the CO prospectus regime, the requirement for information in prospectuses to be worded and presented in a clear and concise manner. In Australia, the information in a disclosure document must be “worded and presented in a clear, concise and effective manner” and whilst contravention of this provision is not an offence, ASIC may order that no offers,

*issues, sales or transfers of the securities be made while the order is in force*²⁵. Similarly, in the UK, the necessary information in prospectuses must be presented in a form that is comprehensible and easy to analyse and if the Financial Services Authority has reasonable grounds for suspecting that this provision has been infringed, it may require the offeror to suspend the offer for a period not exceeding 10 working days²⁶.

Proposal 15 – to prohibit the issue of written pre-deal research reports by analysts connected with the sponsors, managers or underwriters and to require publication of leaked pre-deal research by connected analysts coupled with commentary by the issuer

53. The Commission explained in the Consultation Paper that its policy intention behind this proposal is to reduce or eliminate dissemination to the public of non-prospectus information prior to and during the offer period. The implementation of the proposal would also standardise market practice which is currently lacking as Hong Kong securities legislation does not expressly deal with pre-deal research reports.

Comments from the public:

54. The Commission received substantial comments on this proposal and it is the most controversial topic in the Consultation Paper. Some respondents went further to provide detailed alternatives to the suggestions made by the Commission.

55. It appeared from the comments received that many of the respondents thought that the original proposal set out in the Consultation Paper contained alternatives, i.e., that it was *either*: (i) a requirement to publish leaked pre-IPO research by connected analysts coupled with commentary by the company in the prospectus on information that does not already appear in the prospectus; *or* (ii) a prohibition on the issue of written pre-IPO research reports by connected analysts. However, the Commission wishes to clarify that paragraphs (i) and (ii) above are not

²⁵ Section 715A of the CA.

²⁶ Sections 87A(3) and 87K of the FSMA.

alternatives, but two limbs of the single proposal on pre-IPO research set out in the Consultation Paper. The Commission's original proposal to prohibit the issue of *written* pre-IPO research reports by connected analysts was premised on the view that research communicated verbally is likely to have less credibility with the media than written research. The first limb of the proposal (i.e., the requirement for the publication of leaked pre-IPO research by connected analysts coupled with commentary by the company) sought to deal with the possibility of leakage of pre-IPO research by connected analysts communicated verbally or through the use of visual media such as flip charts.

56. Only a couple of respondents agreed with requiring issuers to publish leaked pre-deal research by connected analysts coupled with commentary by the issuer in the prospectus on information that does not already appear in the prospectus. The vast majority of those who responded objected to the first limb of the proposal mainly because:-

- it would have the undesirable effect of forcing the issuer, sponsors and other professional advisers to make their commentaries legal gibberish and non-comprehensible to average investors;
- issuers should not be responsible for making clarifications of comments made by analysts. It would also unfairly impose a burden on issuers to monitor research reports;
- the requirement unnecessarily distracts the issuer's management team which should be focusing on marketing shares at that stage and widespread publication may shift the focus from the prospectus to the research reports, thereby undermining the status of the prospectus as the sole offer document; and
- it adds little value mandating publication of pre-deal research then disclaiming it. The mere inclusion into the prospectus of such information may stoke speculation and result in greater market confusion.

57. One respondent even suggested that the Commission be given an express power to require an issuer to postpone its deal for up to a month in the event of serious leaks which in its view have originated from the issuer, its advisers or their respective associates.
58. Less than half of those who responded agreed to a ban on written pre-deal research by connected analysts. Of those who agreed, a handful welcomed the proposed distribution of “red-herring” prospectuses to the general public which may serve to alleviate some of the consequences of the ban.
59. The remaining respondents disagreed, mostly arguing that the second limb of the proposal would be contrary to the fundamental principle of freedom of information and would discourage professional analysis.
60. Some respondents argued that, if the Commission were to continue to allow verbal communications with institutional investors, the unlevel playing field would continue which is unfair and clearly disadvantages the small, local retail investors.
61. Many respondents argued that the key question is how best to protect investors without destroying the efficiency of financial institutions. They contended that investors should be able to make an informed and reasoned judgment provided that analysts adhere to the principles of independence and objectivity. Some also suggested that the Commission should encourage independent research.
62. One respondent submitted that the interests of the investing public would be better served by imposing a minimum set of standards on investment banks in accordance with international best practices to safeguard analyst independence and to control the distribution of research reports. The respondent recommended that only those connected analysts who are able to demonstrate sufficiently robust internal controls and policies to safeguard their independence and to control the distribution process of their research should be able to publish pre-deal research. The criteria for consideration suggested by the respondent include:

- (a) imposing a blackout period on connected analysts, prior to the commencement of the road show or public offer, in order to reduce any perception of market conditioning;
- (b) prohibiting any written or verbal discussions by the issuer of profit forecasts or other earnings estimates in a specific or quantitative manner during the syndicate analyst briefing presentations;
- (c) establishing effective Chinese Walls and controlling communication between analysts and investment banks;
- (d) imposing stricter controls on the dissemination of research reports; and
- (e) extending the scope, where applicable, of paragraph 16 of the Code of Conduct to include pre-deal research.

The Commission's response:

The Commission's concern on pre-deal research reports by connected analysts is two-fold:

- (i) *inequality of information —due to their “connection” with the sponsor, manager or underwriter to the IPO, connected analysts may obtain access to information which is not contained in the prospectus. To the extent that research reports prepared by connected analysts contain or are derived from non-prospectus information, professional investors (who have access to such research reports) will be provided with more information than retail investors to make their investment decision; and*
- (ii) *inaccurate information — information contained in research reports does not form part of the prospectus and the directors of the issuer assume no responsibility for it under the CO prospectus regime. Pre-IPO research reports produced by connected analysts could therefore become a vehicle for the company to disseminate material information relating to an offer*

(such as a longer-range profit forecast) without formal prospectus liability. There is great potential for the wide dissemination of such non-prospectus information in the local environment where “leaked” research by connected analysts generates substantial media interest.

*The Commission believes that its policy concerns regarding inequality of information and inaccurate information would not be fully addressed by prohibiting the issue of **written** pre-deal research reports by connected analysts (coupled with the requirement for publication of leaked verbal pre-deal research and commentary by the issuer of an IPO prospectus) as originally proposed in the Consultation Paper. Moreover, some market participants have indicated that the requirement to publish leaked pre-deal research would be very disruptive to the IPO process and of little value to prospective investors.*

In recognition of the role pre-deal research reports play in price discovery in the IPO process, the Commission tends to agree with the respondent referred to in paragraph 62 above and will not at this stage impose a ban on pre-deal research (whether oral or written). Instead, the Commission will, as suggested, extend (and expand where appropriate) the scope of paragraph 16 of the Code of Conduct²⁷ to ensure independence and objectivity of analysts in relation to pre-IPO research.

In particular, paragraph 16 of the Code of Conduct would need to be expanded to prohibit analysts from obtaining: (i) any forward looking information (both qualitative and quantitative forecasts) about the prospective issuer; and (ii) any material information not already contained in the draft prospectus or in the public domain. In addition, the Corporate Finance Adviser Code of Conduct (“CFA Code of Conduct”) may need to be amended to require a sponsor of a listing applicant to (i) be present at all meetings between the listing applicant and analysts and (ii) confirm that no forward looking information (whether qualitative or quantitative), or material information not already contained in the draft prospectus, has been disclosed or provided to analysts at such meetings²⁸.

²⁷ Paragraph 16 of the Code of Conduct already governs the independence of analysts in relation to investment research on securities that are traded in Hong Kong.

²⁸ There are similar requirements in the Takeovers Code – see Rule 8.

It is envisaged that, subject to compliance with the internal control and compliance procedures, an advanced draft prospectus may be provided to selected analysts (which may include connected analysts) for the purposes of preparing the research report. Such analysts may use the information contained in the draft prospectus to form their own assessment including making forecasts as to the financial position of the issuer based on their own valuation models.

In addition, the Commission proposes to require that the red-herring prospectus be made available to the public after the relevant listing application has been heard and the in-principle approval has been granted by the Listing Committee of the SEHK. The Commission will liaise with the SEHK on the mechanisms for implementation of this proposal. The Commission will also invite comments from the market on the procedures and the draft statutory provisions for implementing this proposal in a draft bill consultation paper.

As noted above, any such selected analysts may be provided with an advanced draft of the prospectus prior to the red-herring prospectus being made available to other analysts and retail investors. However, strict compliance with the internal policies and control procedures regarding independence, objectivity and ban on access to forward looking information in accordance with the expanded scope of paragraph 16 of the Code of Conduct should:

- (a) place these selected analysts on a level playing field with other analysts as all analysts will only be able to rely on information contained in the draft prospectus and other information in the public domain. Equality of source information is also ensured as between institutional investors and retail investors since the selected analysts (and institutional investors who have access to their research reports) would not obtain non-prospectus information (in particular, any forward looking information whether qualitative or quantitative); and*
- (b) remove any concern that research reports prepared by selected analysts constitute a “prospectus” within the CO prospectus regime.*

Comments from the public:

63. Most of the respondents said that their comments on pre-IPO research also applied to pre-deal research issued with respect to follow-on offers to the public by listed issuers. One respondent did not consider that pre-deal research in the case of a follow-on offering gives rise to the same concerns as pre-IPO research described above. On-going research coverage on *listed* securities is already subject to and governed by paragraph 16 of the Code of Conduct. The respondent also noted that retail investors commonly do not participate in follow-on offerings.

The Commission's response:

The Commission tends to agree with the respondent's comments above and accordingly, does not propose to treat pre-deal research in the case of a follow-on offering in the same way as pre-IPO research.

Proposal 16 – to require the issuer of a prospectus to publish a supplemental or replacement prospectus if it becomes aware of a significant change affecting prospectus disclosures or a significant new matter arises which would have been required to be disclosed in the prospectus; and then to extend the offer period, notify investors of the availability of the supplemental prospectus, and provide a right to withdraw their applications and be repaid in full

64. The Commission explained in the Consultation Paper that it intended to address the current lack of an express requirement on issuers of prospectuses to publish a supplemental prospectus if it becomes aware of a significant change affecting any of the prospectus disclosures, or a significant new matter arises which would have been required to be disclosed in the prospectus.

65. The Commission also asked readers whether the obligation should apply until the close of the offer period or the actual allotment and issue of the applicable shares or debentures and whether applicants should be given the right to withdraw their applications in the light of the new development.

Comments from the public:

66. There was widespread support for this proposal and many of those who responded were of the view that the obligation should apply until the actual issue or allotment of shares or debentures. A few respondents objected, arguing that the proposal is impractical and that there is no material time gap between the availability of prospectuses and the time the investment decision is made.

The Commission's response:

After having reviewed the comments made by the respondents and drawing reference from the withdrawal mechanism contemplated in the Link REIT OC, the broad statutory framework for the withdrawal mechanism is proposed to be as follows:

(a) occurrence of a material adverse change (“MAC”) before the day results of allocation are announced — *if, before the day results of allocation are announced, an issuer becomes aware of a new circumstance that:-*

- (i) has arisen since the prospectus date;*
- (ii) would have been required to be disclosed in the prospectus had it occurred prior to the prospectus date; and*
- (iii) is materially adverse from the perspective of prospective investors,*

the issuer must publish a supplemental prospectus where the IPO is not otherwise terminated. The issuer will also be required to publish an announcement (in English and Chinese) to inform prospective investors of where and when copies of such supplemental prospectus may be obtained. The issuer must in the supplemental prospectus grant investors a right to withdraw their allocations and be repaid in full but the offer period will not be required to be extended or re-opened, as the case may be. The latest time for publication of the supplemental prospectus is the date of commencement of the withdrawal period.

It should be noted that the MAC should be limited to new developments occurring after the publication of the prospectus. That is, the supplemental prospectus and the withdrawal mechanism cannot be used as a vehicle to rectify material mistakes or inaccuracies in the prospectus which existed as at the date of the prospectus;

*(b) **occurrence of MAC on or after the day results of allocation are announced**— where a MAC occurs on or after the day results of allocation are announced, a statutory obligation will not be imposed on issuers to publish a supplemental prospectus or grant investors a withdrawal and repayment rights. The offer period will also not be required to be re-opened. This will allow the refund date for surplus application moneys and unsuccessful / partially unsuccessful applications to remain unchanged so as to avoid locking-up large amounts of surplus application moneys in the monetary system;*

*(c) **withdrawal of allocations not applications** — Under the withdrawal mechanism contemplated in the Link REIT OC, to enable refunds for wholly or partially unsuccessful applications to proceed as scheduled under the original timetable, the right to withdraw would only be exercisable by successful applicants for a specified period of not less than seven business days following publication of the results of allocations by tendering a duly completed withdrawal form together with the unit certificate / allocation letter to the relevant parties.*

Although the Consultation Paper contemplated a withdrawal of applications, the Commission tends to agree that until allocations are made, there would be no register (or equivalent) containing details of those successful applicants against which withdrawal instructions can be processed.

Under this revised approach, allocations would be made based on original applications and before taking into account possible withdrawals. This enables identification of applicants and the immediate refund of surplus application monies to all entitled applicants on the original scheduled refund date;

- (d) **no partial withdrawal** — if an investor decides to withdraw, he must do so in respect of all the shares allocated to him. Partial withdrawals will not be permitted;
- (e) **withdrawal period** — drawing reference from the Link REIT OC, the Commission is inclined to impose a withdrawal period of seven business days to allow investors sufficient time to read the supplemental prospectus and to decide whether to withdraw their allocations; and
- (f) **impact on IPO timetable** — the statutory framework will prescribe : (i) the latest time by which a supplemental prospectus must be issued; and (ii) the length of the withdrawal period. The procedures and detailed timetable and logistics for the withdrawal mechanism will need to be devised by the issuer, the sponsor, share registrar and other relevant parties on a case-by-case basis, with the sponsor being responsible under the CFA Code of Conduct to ensure that an IPO and all matters ancillary thereto are conducted in a fair, timely and orderly manner²⁹. Such procedures and timetable should be clearly set out in the supplemental prospectus.

The Commission is also mindful that the introduction of the withdrawal mechanism may give rise to the following issues:-

- (a) **treatment of withdrawn allocations** – the statutory framework will not prescribe how withdrawn allocations should be treated. Subject to compliance with the Listing Rules, this should be a matter for the issuer and its advisers on a case-by-case basis. In the Link REIT IPO, it was provided in the Link REIT OC that to the extent allocations under the local public offering tranche were withdrawn, such withdrawn allocations would be re-allocated to the international offering tranche instead of to retail investors as part of the local public offering. The rationale for adopting such approach as stated in the Link REIT OC was that (i) a second public application process for any withdrawn allocations would result in additional delay which would be unfairly prejudicial to investors who had not

²⁹ See paragraph 5.3 of the CFA Code of Conduct.

exercised the right to withdraw; and (ii) there would be practical difficulties associated with the re-allocation process at a time when refunds for wholly or partially unsuccessful applications were being made; and

*(b) **brokerage** – in a typical IPO, brokerage of 1% is payable by a person subscribing for or purchasing the relevant shares being offered. In respect of every successful application, the brokerage paid by the applicant will be passed on by the issuer to the relevant brokers through whom the application is made or arranged, or to HKEx (depending on whether the application form bears the chop of a broker), in accordance with paragraph 7 of Appendix 8 to the Listing Rules. Where an application is wholly or partially unsuccessful, applicants will be refunded their application moneys (or the relevant portion thereof) together with related brokerage and other applicable levies.*

In the event of the implementation of the withdrawal mechanism in an IPO, as noted above, investors who exercise the right of withdrawal will be repaid in full. Brokers, issuers and underwriters will also need to work out arrangements (including with HKEx) regarding the brokerage, if any, in respect of withdrawn allocations on a case-by-case basis.

The broad statutory framework for the withdrawal mechanism will be set out in the draft statutory provisions implementing this proposal. Although such framework has largely been devised with reference to the withdrawal mechanism contemplated in the Link REIT OC, the withdrawal mechanism was not triggered in the IPO of Link REIT and the framework has not been tested. The Commission will discuss with market participants (including issuers, sponsors, investment banks, brokers, registrars, lending banks, HKSCC, HKEx and the Hong Kong Monetary Authority) the feasibility of the proposed framework and the detailed logistics before drafting the statutory provisions implementing this proposal. Contribution from relevant parties should reduce the process risk associated with the implementation of the withdrawal mechanism. The public and the market will be given an opportunity to comment on the draft statutory framework for the withdrawal mechanism in a draft bill consultation paper.

Proposal 17 – to remove the 3-day waiting period before allotments of shares or debentures of a class already listed. To ask whether in the case of other offers the 3-day period should be extended to provide prospective investors with a longer period in which to read the prospectus

67. The Commission explained in the Consultation Paper that the proposed extension will allow the press to comment on, and the general public to obtain advice on, to consider and to apply for the shares or debentures on offer.

Comments from the public:

68. The majority of respondents objected to the extension of the 3-day waiting period in the prospectus regime for allotments in the case of initial public offers of shares or debentures. The reasons for the objection include: (i) an extension is likely to increase market risk for the underwriters; (ii) the real problem is not the length of the minimum waiting time but the amount and usefulness of the information in the prospectus; and (iii) the 3-day waiting period is a minimum period which may be extended should the issuer wish to do so where necessary or appropriate.

69. The Commission noted that respondents are generally agreeable to its proposal to repeal the 3-day waiting period to offers of shares or debentures that are in the same class to those already listed.

The Commission's response:

The Commission sees merit in the arguments against the extension of the 3-day waiting period in the case of initial public offers of shares or debentures. Although the Commission is aware that investors often find prospectuses too lengthy and legalistic, to some extent, it agrees with the respondents that allowing investors more time to read the prospectus is unlikely to resolve their complaint. As such, the Commission does not intend to proceed with the proposal at this stage in view of its

*suggestion to include in the CO prospectus regime a requirement for information in prospectuses to be worded and presented in a clear and concise manner*³⁰.

The proposal to repeal the waiting period for offers of shares or debentures that are in the same class as those already listed will also not be taken forward at this stage. The Commission notes that this proposal is inter-related with proposal 2 (to shift the focus of the CO prospectus regime from “document-based” to “transaction-based”) and 13 (to impose reduced disclosure requirements for offers of shares or debentures that are in the same class as those already listed) and given our intention to pursue proposal 13, prospective investors should be given a reasonable amount of time to read the prospectus.

In any event, the Commission notes that it has power under section 38A or 342A³¹ of the CO to grant exemptions from compliance with section 44A(1) which should provide it with the required flexibility.

Proposal 18 – to provide that an application form or procedure for shares or debentures may not be issued or implemented by any person unless it is accompanied by or contained in a prospectus which complies with the prospectus provisions or is exempted from them

70. The Commission expressed its intention to clarify the current uncertainty of the scope of the prohibition contained in sections 38(3) and 342(3) of the CO which prohibits the issue of any form of application for shares or debentures unless the form is issued with a prospectus that complies with the requirements of the CO prospectus regime. In particular, the Commission seeks to extend the scope of regulation regarding the distribution of application forms for shares or debentures

³⁰ See the Commission’s comments on the response to Proposal 14 on page 34 of these Consultation Conclusions.

³¹ Section 38A of the CO provides that where it is proposed to offer any shares in or debentures of a company incorporated in Hong Kong to the public by a prospectus or class of prospectuses issued generally, there may, in the request of the applicant, and subject to such conditions (if any) as the Commission thinks fit, be issued by the Commission a certificate of exemption from compliance with any or all of the requirements of the relevant provisions (including section 44A(1)) if, having regard to the circumstances, the Commission considers that the exemption will not prejudice the interest of the investing public and compliance with any or all of those requirements (a) would be irrelevant or unduly burdensome; or (b) is otherwise unnecessary or inappropriate. A similar provision applicable to offers of shares or debentures by companies incorporated outside Hong Kong is set out in section 342A of the CO.

to any type of application form or application process and to any person engaging in their distribution or implementation.

Comments from the public:

71. Whilst most of the respondents welcomed this proposal, one disagreed that intermediaries should share the responsibility of ensuring delivery of prospectuses to prospective investors.

The Commission's response:

Despite the support for the proposal and our desire to ensure that investors subscribing or purchasing through an intermediary receive the prospectus making the offer, the Commission is aware that there may be logistical problems in connection with printing and delivery. With the introduction of the transaction-based approach (proposal 2), all offers of shares and debentures to the public (unless within a safe harbour) will require a prospectus to be issued. Once a compliant prospectus is issued and is available to the public, intermediaries should not be responsible for delivering hardcopies of the prospectuses to investors. This would also be consistent with the increasing popularity of Internet access to prospectuses available on HKEx's website. Accordingly, the Commission will not pursue this proposal at this stage.

Proposal 19 – to repeal the requirements relating to statements in lieu of prospectuses in section 43 of the CO

72. The Commission expressed in the Consultation Paper its intention to repeal section 43³² of the CO since it believed this provision to be redundant as the concern it was intended to address was believed to be covered by the existing anti-avoidance provision in section 41 of the CO.

³² Section 43 of the CO provides that a company that has not issued a prospectus on its formation, or has issued such a prospectus but has not proceeded to allot any of the shares offered to the public for subscription upon it, is prohibited from allotting any of its shares or debentures until it has registered a statement in lieu of prospectus signed by every person who is named therein as a director or a proposed director of the company or by his agent authorized in writing, in the form and containing the particulars set out in Part I of the Fourth Schedule to the CO and, in the cases mentioned in Part II of that Schedule, setting out the reports specified therein.

Comments from the public:

73. The Commission noted that the majority of respondents agreed with the proposal.

The Commission's response:

After further deliberation, the Commission believes that section 43 was originally intended to ensure that at least one prospectus (or statement in lieu of a prospectus) would be issued by a public company incorporated in Hong Kong on its formation. This would ensure that there is some information about the company in the public domain for which it has taken liability (in addition to the annual report and accounts which public companies are required to file with the Companies Registry). Given the level of support and the following reasons, the Commission intends to repeal section 43:-

- (i) since Phase 2 of the CO reform, the Commission's regulatory philosophy has been focused on "offers to the public". Accordingly, if there is no offer to the public or if the offer falls within the safe harbours in the Seventeenth Schedule to the CO, such offer should not be subject to the CO prospectus regime;*
- (ii) there is no equivalent section in Part XII of the CO³³ in respect of overseas-incorporated companies. The repeal of section 43 would be in line with proposal 4 to standardise the requirements of the CO prospectus regime without regard to the place of incorporation of the issuer; and*
- (iii) the move to a transaction-based regime with specific anti-avoidance provisions directed at specific safe-harbours most prone to abuse would capture the issues section 43 was intended to address.*

³³ Part XII of the CO concerns restrictions on sale of shares and offers of shares for sale by companies incorporated outside Hong Kong.

Proposal 20 – to introduce a separate regulatory regime to regulate offers to employees and their dependants, including a requirement for a declaration of solvency and going concern by the directors and auditors of the company

74. The Commission explained in the Consultation Paper the rationale behind this proposal – that it undertook to consult on a suggestion of the Bills Committee, which is responsible for the scrutiny of the Companies (Amendment) Ordinance 2004, whether to introduce separate measures to regulate offers to employees and their dependants to avoid the risk of exploitation of their interests.

75. The Commission noted that there was overwhelming opposition to this proposal.

The Commission’s response:

After due consideration of the arguments raised by the respondents, the Commission has decided not to proceed with the proposal at this stage.

Proposal 21 – to provide that an issue or sale of securities in contravention of the law should be void or voidable

76. The Commission explained in the Consultation Paper its reason behind the proposal – that it undertook to consult the market on another suggestion made by the Bills Committee, namely, whether to introduce the concept of rendering an issue or sale of securities in contravention of the law as a void or voidable transaction.

77. Most of those who responded objected to this proposal, arguing that this measure would be draconian and is likely to discourage capital raising activities by undermining certainty in the offering process.

The Commission’s response:

The Commission has decided not to proceed with this proposal at this stage.

78. The Commission would like to thank all parties who have assisted during the initial consultation process. A list of the respondents is provided in Annex I.

PART C – NEXT STEPS AND TIMING

79. Further to the publication of these Consultation Conclusions, the Commission will discuss with the Financial Services and the Treasury Bureau regarding the proposed legislative amendments with a view to publishing one or more draft bill consultation paper(s). These draft bill consultation paper(s) will set out the proposed draft amendments to the relevant provisions of the CO and the SFO and invite public comments on the draft statutory provisions concerning the proposals which the Commission has decided to pursue as well as the revised proposals described in Part B of the Consultation Conclusions. As we pointed out in the Consultation Paper, given the relative complexity of implementing the various proposals, it is not possible to predict whether or when any specific legislative proposals that emerge may become law. It is possible that some of the more specific proposals which are capable of being adopted in isolation without affecting the other proposals may proceed towards the legislative stage of the reform process ahead of those proposals which are inter-related.

Annex I – List of respondents to the Consultation Paper

Category A – Commentator has no objection to publication of name and content of submission (in alphabetical order).

- Allen & Overy
- BNP Paribas Peregrine Capital Limited
- Charltons (representing Altus Capital Limited, Anglo Chinese Corporate Finance, Limited, AMS Corporate Finance Limited, CIMB-GK Securities (HK) Limited, Tai Fook Capital Ltd and Quam Limited)
- Deacons
- First Shanghai Capital Limited
- Freshfields Bruckhaus Deringer and Linklaters (representing ABN AMRO Bank N.V., Hong Kong Branch, Bear Stearns Asia Limited, BOCI Asia Limited, China International Capital Corporation (Hong Kong) Limited, Citigroup Global Market Asia Limited, CLSA Asia-Pacific Markets, Credit Suisse (Hong Kong) Limited, DBS Asia Ltd., Deutsche Bank AG, Hong Kong Branch, Goldman Sachs (Asia) L.L.C., J.P. Morgan Securities (Asia Pacific) Limited, Merrill Lynch (Asia Pacific) Limited, Morgan Stanley Dean Witter Asia Limited, Nomura International (Hong Kong) Limited and UBS Securities Limited)
- Guotai Junan Capital Limited
- Hong Kong General Chamber of Commerce
- Hong Kong Institute of Certified Public Accountants
- Hong Kong Investment Funds Association
- Hong Kong Stockbrokers Association Ltd.
- HSBC Broking Securities (Asia) Limited
- John Maguire and Cecilia Ng
- Mallesons Stephen Jaques
- PricewaterhouseCoopers
- Standing Committee on Company Law Reform
- The Chamber of Hong Kong Listed Companies
- The Chinese General Chamber of Commerce
- The Hong Kong Association of Banks
- The Hong Kong Institute of Chartered Secretaries
- The Hong Kong Institute of Financial Analysts and Professional Commentators Limited
- The Hong Kong Society of Financial Analysts Limited
- The Law Society of Hong Kong
- Timothy Loh Solicitors

Category B – Commentator requested submission to be published on a “no-name” basis.

- One submission

Category C – Commentator requested submission not to be published

- One submission