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# Regulatory Implications of Offering Securities to Employees in Hong Kong

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# REGULATORY IMPLICATIONS OF OFFERING SECURITIES TO EMPLOYEES IN HONG KONG

## A. INTRODUCTION

This article considers the Hong Kong laws regulating the offering of securities in Hong Kong in relation to an offering of shares of a company incorporated outside Hong Kong to an employee in Hong Kong.

## B. SECURITIES LAWS

There are two regimes governing offers of shares in Hong Kong, the Companies (Winding Up and Miscellaneous Provisions) Ordinance (**C(WUMP)O**) prospectus regime (**C(WUMP)O Prospectus Regime**) and the “offers of investments” regime under Part IV of the Securities and Futures Ordinance (**SFO Regime**).

### 1. C(WUMP)O Prospectus Regime

A document which offers **to the public** for purchase or subscription the **shares** or **debentures** of a company incorporated outside Hong Kong is a prospectus which must be authorized for registration in accordance with the requirements of the CO, unless an exemption applies.

#### Offer to the Public

The CWUMPO Prospectus Regime applies where there is an “offer to the public” which is defined to include an offer to any section of the public. An offer to a company’s employees in Hong Kong is *prima facie* an offer to the public.

#### Exemptions

The following exemptions from the C(WUMP)O requirements are available:

#### (a) Private Placement Exemption in Hong Kong

An exemption is available where an **offer** is made to **not more than 50 persons** provided that the document(s) making the offer contain a warning statement (**Specified Warning Statement**), in a prominent position, in the following form:

“WARNING

The contents of this document have not been reviewed by any regulatory authority in Hong Kong. You are advised to exercise caution in relation to the offer. If you are in any doubt about any of the contents of this document, you should obtain independent professional advice.”

If the offer is to be limited to single employee, the private placement exemption can be relied on provided that the Specified Warning Statement (above) is included in a prominent position (i.e. on the front page) of any documents offering the shares

provided to the Hong Kong employee.

In determining whether the 50 person limit has been exceeded, an offer is taken together with other offers of the same class of shares made by the same company which were open at any time in the previous 12 months which relied on the same exemption. Thus, if there are any future offers to other Hong Kong employees, those offers will be within the private placement exemption only if the total number of offers under the existing offer and any future offers within the next 12 months does not exceed 50.

#### Restricting Distribution of Offering Document

If the private placement exemption is to be relied on, any documentation relating to the share offer can only be given to the single employee in Hong Kong. In addition:

- (i) the offering document should be addressed to the relevant offeree. Ideally, the offering document to be delivered in Hong Kong should be annotated with the name of that employee;
- (ii) The offering document must contain the Specified Warning Statement;
- (iii) The offering document should also contain a warning that it cannot be copied or passed to any other person.
- (iv) Subscription must only be accepted from the relevant employee; and
- (v) There should be no public advertising at all in Hong Kong in relation to the shares. The issue of promotional material in Hong Kong must be strictly limited to the single employee. In particular, the offering document must not be posted on a website as this will amount to an offer to the public for which SFC authorisation is required.

#### **Offer to Qualifying Persons Exemption**

An exemption is also available where a company offers its shares to persons who are **qualifying persons** of that company or of another company, which is a member of the same group as the company<sup>1</sup>.

“Qualifying persons” are defined<sup>2</sup> to include (i) current and former directors, employees, officers and consultants and the dependents of such persons; and (ii) trusts established by the company or any group member which can hold shares for any of

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<sup>1</sup> Section 8 of Part 1 of the Seventeenth Schedule to C(WUMP)O.

<sup>2</sup> Section 6 of Part 4 of the Seventeenth Schedule to the Companies Ordinance.

the persons mentioned in (i) above. A “dependent” means the wife, husband, widow or widower of the person or any child or stepchild under the age of 18.

A company will be a member of the same group as another company if the latter (i) controls more than half the voting power of the first company; (ii) holds more than half of other company’s issued share capital; or (iii) controls the composition of its board of directors.

### **Conditions for Reliance on the Qualifying Persons Exemption in Hong Kong**

There are 2 conditions for reliance on the Qualifying Persons Exemption:

- (i) the offer must be made on terms that the only persons who can acquire the shares are the qualifying persons to whom they are offered or, if the terms of the offer so permit, any qualifying person. ; and

It would not therefore be possible to rely on the exemption if the employee is able to assign his rights to the shares to another person, except if the assignment is to a qualifying person and this is permitted under the terms of the employee share scheme.

- (ii) Any documents offering the shares must contain, in a prominent position, the Specified Warning Statement in the same form as is required for the private placement exemption (please see above).

## **2. SFO Regime**

### **Prohibition on Unauthorised Invitations to the Public**

In the absence of an applicable exemption, the issue of any advertisement, invitation or document (**investment advertisement**) containing an invitation **to the public** to acquire securities must be authorised by the Securities and Futures Commission (**SFC**) before it is issued. An invitation to employees of HKCo potentially constitutes an invitation to the public. Under the SFO, advertisements and invitations include an invitation or advertisement made in a document, verbally or produced electronically.

### **Exemptions**

An exemption is available in respect of any investment advertisement which relates to an offer which is exempt under the C(WUMP)O Prospectus Regime.

Thus provided the conditions are met for reliance on either the private placement exemption or the qualifying persons exemption, any documents issued in relation to the Shares will be exempt from the requirement for SFC authorisation under the SFO Regime.

### 3. **The Licensing Requirement under Part V of the Securities and Futures Ordinance**

Although logically an offer of shares should not require the issuer to be licensed under the regime for participants in the Hong Kong securities industry (contained in Part V of the SFO), Hong Kong's licensing regime has no specific exemptions to make clear that securities issuers do not need to be licensed, as is the case in other jurisdictions.

The SFO prohibits the carrying on of a business in a regulated activity unless the entity is licensed by the SFC. "Carrying on a business" is construed widely.

"Dealing in securities" is a regulated activity and is widely defined. A person "deals in securities" if he makes or offers to make an agreement with another person, or induces or attempts to induce another person to enter into or to offer to enter into an agreement (i) to acquire, dispose of, subscribe for or underwrite securities; or (ii) the purpose or pretended purpose of which is to secure a profit to any of the parties from the yield of securities or by reference to fluctuations in the value of securities.

An offer of shares by a non-Hong Kong company to its Hong Kong employees potentially constitutes dealing in securities by the company.

An exemption is available where a person as **principal** (as opposed to as agent) **disposes** of securities. If the issue of shares to a Hong Kong employee amounts to "dealing in securities" under the SFO, it would be within this exemption.

More problematic is any solicitation or marketing activity conducted in relation to the shares which will amount to "dealing in securities", but will not be within the above exemption which is restricted to "disposals". There is no exemption from the licensing requirement for offers which are exempt under the CO Prospectus and SFO Regimes and thus there is no private placement exemption in the case of the licensing requirement.

However, if the solicitation activities do amount to "dealing in securities", this should not normally require a securities issuer to be licensed under the SFO on the basis that it should not be regarded as "carrying on a business" in dealing in securities. In the case of a one-off offer to a single employee, this will be easier to argue than where a series of offers are made to multiple employees. However, this may not necessarily be the case, for example if the issuer is in the business of securities dealing.

Assuming that a non-Hong Kong company is not in the business of dealing in securities, its solicitation activities in respect of shares to be offered to a single Hong Kong employee should not require it to be licensed under Part V of the SFO.

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