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# SFC Publishes Consultation Conclusions On Possible Reforms To The Companies Ordinance Prospectus Regime

## Introduction

The Securities and Futures Commission (the **SFC**) has published its conclusions on the proposals set out in its August 2005 Consultation Paper for the modernisation of the prospectus regime governing the public offering of shares and debentures. The full text of the Consultation Conclusions is available on the SFC's website at [www.sfc.hk](http://www.sfc.hk/web/EN/index.html).

Of the Consultation Paper's 21 proposals, 12 will be taken forward and 3 have been revised in light of public comments. The purpose of this note is to provide a summary of the principal proposals to be taken forward by the SFC. To see a detailed note on all the findings of the Consultation Conclusions, please click [here](43556v2.doc).

## Proposals That Will Be Taken Forward

### 1. Transfer CO prospectus regime to the SFO

The provisions of the Companies Ordinance (the **CO**) relating to the public offering of shares and debentures will be moved to the Securities and Futures Ordinance (the **SFO**) as a discrete part separate from the investment advertisement regime in Part IV of the SFO.

### 2. Shift of focus to "transaction-based" approach

The focus of the CO prospectus regime will be changed from a "document-based" to a "transaction-based" approach by regulating the act of offering rather than the document containing the offer. Under the revised approach, all public offers of shares or debentures will be required to be contained in a CO compliant prospectus unless they fall within one of the exemptions set out in the Seventeenth Schedule to the CO. The Consultation Conclusions include the following specific proposals:

1. Secondary issues of shares listed on the SEHK: the prospectus content requirements for secondary issues of shares listed on the SEHK will be significantly less than those for an IPO prospectus;
2. New Safe Harbours: new exemptions will be added to the Seventeenth Schedule for (a) offers communicated by an exchange participant in the ordinary course of trading on a recognised stock market; (b) offers communicated by licensed intermediaries where they are acting as agent provided that the offer is made in relation to an offer contained in a registered prospectus; and (c) offers made by or on behalf of the Government of the Hong Kong Special Administrative Region of the People's Republic of China in respect of debentures issued by it; and
3. Offers by persons other than the issuer: the SFC is considering the adoption of a "knowledge" element in the prospectus content requirements.

### 3. Options and other rights

It will be clarified 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.

### 4. Scope of the regime: bodies and place of incorporation

The application of the CO prospectus regime will be extended to "bodies" rather than "companies" and without regard to their legal form or place of incorporation.

### 5. Unification of CO and SFO Regimes

The SFC will not proceed with its proposed merger of the CO prospectus regime and the SFO investment advertisement regime due to the different nature of direct investments in equity and debt as opposed to derivative products.

The definition of "debenture" will be amended so that all "structured products" (i.e. products which, in addition to exposure to the credit risk or default risk of the issuer (or guarantor), contain an exposure to an underlying asset, opportunity or risk that is usually unrelated to the issuer or guarantor) will fall outside the definition. Public offers of structured products will then be subject to regulation under Part IV of the SFO, whereas 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) will be regulated under the CO prospectus regime. This is intended to reduce regulatory arbitrage. The SFC also proposes to formulate non-statutory product codes or guidelines tailored for products with similar characteristics to supplement the SFO investment advertisement regime.

### 6. New safe harbour for takeover and merger offers and schemes of arrangement in compliance with laws of a company's home jurisdiction

Offers made to holders of shares or debentures of a company incorporated in a "recognised jurisdiction" in the context of a takeover or merger or under a compromise or scheme of arrangement will be exempted from the CO prospectus regime provided that the offer complies with the laws and regulatory requirements of the company's home jurisdiction and any principal stock exchange on which it is listed.

### 7. Adjustment of anti-avoidance mechanism

The SFC has revised its proposals to focus on the safe harbours most prone to abuse, namely the "50 persons private placement" and "HK$5 million small-scale offering" exemptions. New provisions will be introduced whereby (i) closely related offers made within a period of 12 months (whether or not made by the same entity) will be aggregated when determining the offeree/offer size limits and (ii) the SFC will be empowered to aggregate "closely related" offers within such period when determining whether the relevant safe harbour has been abused. The criteria for determining whether offers are "closely related" will be set out in SFC guidelines

### 8. Persons liable for a prospectus

The scope of the CO prospectus liability regime will be amended to include (i) the issuer and/or offeror of the shares or debentures and (ii) each person who accepts, and is stated in the prospectus as accepting responsibility for the prospectus. The liability of (i) "promoters" and (ii) persons who "authorise the issue of a prospectus" will be removed. In view of the market response and the new Guidelines for Sponsors and Compliance Advisors which will come into effect on 1 January 2007, the SFC will not impose prospectus liability on sponsors for the time being. Criminal liability will only be imposed if there is intent to deceive or recklessness.

### 9. Disclosure for rights issues

Prospectuses for rights issues and issues of shares or debentures that are uniform with listed shares or debentures will be required to comply with reduced (rather than negligible) content requirements which will be prescribed in subsidiary legislation.

### 10. Supplemental prospectus and right of withdrawal

The issuer of a prospectus will be required to publish a supplemental prospectus if it becomes aware of a new circumstance that (i) has arisen since the prospectus date **but prior** to the announcement of the results of allocation; (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 will also be required to notify investors of the availability of the supplemental prospectus and grant investors the right to withdraw their allocations and be repaid in full (including related brokerage fees). The latest time for publication of the supplemental prospectus will be the date of commencement of the withdrawal period. The original proposal that the issuer should also be required to extend the offer period will not be taken forward. It is proposed that the right to withdraw will be exercisable by successful applicants for a specified period of not less than seven business days. If an investor decides to exercise the right to withdraw, he must do so in respect of all the shares allotted to him.

### 11. Pre-deal research

The SFC will not at this stage proceed with its original proposal which was to prohibit the issue of written pre-deal research reports by connected analysts (ie. analysts employed by a sponsor, manager or underwriter to an offering (or by a related company) and require the publication of leaked verbal pre-deal research and commentary by the issuer of the IPO prospectus. The new proposals are that:

1. subject to compliance with internal control and compliance procedures, an advanced draft prospectus may be made available to selected analysts (including connected analysts) for the purposes of preparing the research report;
2. the red-herring prospectus will be required to be made available to the public after the relevant listing application has been heard and the in-principle approval has been granted;
3. the scope of Paragraph 16 of the Code of Conduct for Persons Licensed by or Registered with the SFC will be extended to prohibit analysts from obtaining (a) any forward looking information (including both qualitative and quantitative forecasts) about the prospective issuer and (b) any material information not already contained in the draft prospectus or in the public domain.

The SFC is also considering amendments to the Corporate Finance Adviser Code of Conduct 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 or material information not contained in the draft prospectus, has been disclosed or provided to analysts during such meetings.

## Proposals That Will Not Be Taken Forward

The proposals dropped by the SFC include the following:

### 1. Misstatements: secondary market purchasers eligible for compensation

The proposed extension of the classes of persons who may claim compensation for a misstatement in a prospectus to subsequent purchasers who buy in the secondary market will not be pursued at this stage.

### 2. Misstatements: removal of requirement for proof of reliance on prospectus

The SFC will drop the proposed removal of the requirement for claimants to prove that they have actually read and relied on the prospectus when making a claim for compensation.

### 3. The 3-day rule

The SFC will not proceed with the proposed extension of 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.

This note is intended as a summary only of the principal findings of the SFC's Consultation Conclusions on the Consultation Paper on Possible Reforms to the Prospectus Regime in the Companies Ordinance. Specific advice should be sought in relation to any particular situation.

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