Charltons - Hong Kong Law Newsletter - 09 August 2010

[online version](http://www.charltonslaw.com/sfc-dual-filing-update-identifies-shortcomings-in-prospectus-disclosure/)

# SFC Dual Filing Update Identifies Shortcomings In Prospectus Disclosure

The Securities and Futures Commission (**SFC**) published its latest Dual Filing Update in July 2010 highlighting deficiencies in listing applications received during the six months ending March 2010. Out of 68 listing applications, the SFC raised comments on 60 applications and deferred commenting on two others due to serious deficiencies found in the submissions. The SFC reviews disclosures by listing applicants under the dual filing regime, which refers to the requirement of the Securities and Futures (Stock Market Listing) Rules under which listing applicants and listed companies have to file applications and disclosure materials with the SFC.

The SFC points out that it is the responsibility of the sponsors and other professional parties to ensure that proper due diligence is conducted in respect of listing applicants and that any attempt to avoid full disclosure until requisitions or enquiries by the regulator, creates unnecessary delays in the listing process and may call into question the credibility of the application.

## Relationship with significant stakeholders

One of the main issues highlighted by the SFC was the lack or insufficiency of disclosure of relationships between the applicant and significant stakeholders, such as distributors and suppliers.

In one case, the initial draft prospectus failed to address that some of the applicant's employees were the shareholders of a majority of the listing applicant's distributors. In another case, the draft prospectus omitted to disclose that one of the listing applicant's largest suppliers in one year during the track record period was controlled by two of the applicant's directors.

## Explanations of financial performance

Inadequate and sometimes potentially materially inaccurate explanations of listing applicants' financial performance were another issue raised by the SFC. In one case, the enquiries by the SFC concerning the disclosure revealed vital deficiencies in the draft prospectus and associated submissions and led to the withdrawal of the application following the resignation of the reporting accountants and sponsors.

## Identification and assessment of non-compliance with rules and regulations

Another shortcoming identified by the SFC was the lack of disclosure of non-compliance with applicable rules and regulations. In one case, the applicant was engaged in a highly regulated business. It was revealed by the SFC that the fees charged to the applicant's customers were in breach of the limits imposed by the relevant regulations. The applicant's legal adviser failed to identify the breach and the potential risk to the applicant's business.

The SFC noted that sponsors lacking the necessary expertise to assess an applicant's compliance with applicable regulatory requirements should consult independent advisers and seek clarification from relevant authorities as appropriate.

## Mining Companies

In relation to listing applicants that are still at the exploration and development stage, the SFC points out that the importance of providing sufficient disclosure for investors to assess the feasibility of the applicant's projects. In particular, applicants should disclose their mining or exploration rights and other regulatory approvals required for their mining activities, their construction and financing plan and the timeframe to commencement of commercial production.

The SFC notes that in a number of cases reviewed, the applicants provided only limited information as to how they proposed to develop the transport infrastructure necessary for their production activities and delivery of products to customers. In one case, a mining company failed to disclose how it would be able to sustain its operations independently of its controlling shareholders after listing. A further criticism made by SFC is that in a number of cases reviewed, the applicants' financial condition depended on the success of their projects but the necessary permits from relevant authorities had yet to be obtained.

## Disclosure of investors' obligations when investing in foreign incorporated companies

Another issue highlighted by the SFC is that in various cases where applicant's place of incorporation was recognized as an acceptable jurisdiction only recently, the disclosure lacked sufficient information concerning obligations to which potential investors may become subject. The SFC stresses the importance of highlighting the relevant risks and obligations of shareholders and how investors may be able to fulfil the obligations.

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