

Submission to Bills Committee on Companies (Amendment) Bill 2004

Professor Raymond W. So

Department of Finance, Chinese University of Hong Kong

Further to my earlier submission and personal presentation of views on the definition of “Subsidiaries,” this serves as further clarifications on the subject. In particular, my submission is in line with the two points raised in the letter sent to me on March 3, 2005 by Ms Connie Szeto (CB1/BC/3/04).

1. When a SPE is set up for securitization purpose, the transferor (or originator) typically exercises minimal control over the SPE. Though from the percentage of voting right, the transferor in theory can vote and control the SPE, it is rarely the case. Thus, the concept of effective control applies. Nevertheless, it is difficult to judge whether a transferor is dormant on the control of SPE. In many jurisdictions, for example Japan, a threshold of 50% of the voting rights, both directly and indirectly, will be considered as a subsidiary and no attempt is made on the effective control.
2. My view on this issue is simple: we should not adopt an accounting standard for the sake of accepting it or for sake of keeping things simple. Why SPEs exist at the very first place? They are created to circumvent unfavorable restrictions which are harmful to the development of the securitization market. They are not created to hind things under the carpet. The Korean and Japanese experience show some insights to Hong Kong on how to have SPE not consolidated in the group accounts. Korean SPEs are established so that the originator typically holds less than 2% of the ownership stake, with a third person being appointed as the sole director of the SPE. For the Japanese case, SPEs are usually held either by another SPE and not consolidated. We need not have a carve-out of the definition of “subsidiary,” but rather some alternative definition of “control” so that SPE established for securitization purpose can fall into, so that the SPEs need not be consolidated with the group accounts.

17 March 2005