

Subcommittee on Companies Ordinance (Exemption of Companies and Prospectuses from Compliance with Provisions) (Amendment) Notice 2011

This paper provides information in respect of items (a) – (d) below as requested by Members at the meeting on 23 November 2011.

(a) To provide information on: (i) when the thresholds of 10% and HK\$3 million in relation to property interests of companies as specified in paragraph 34(2) of the Third Schedule to the Companies Ordinance were put in place, (ii) the background and rationale for setting these thresholds, and (iii) whether any review on the thresholds has been conducted since then

2. The property valuation requirement (with the threshold of 10% or HK\$3 million) under paragraph 34 of the Third Schedule to the CO was enacted on 1 March 1973 pursuant to the Companies (Amendment) Ordinance 1972.

3. Based on the First Report of The Companies Law Revision Committee published on 24 June 1971, the Committee considered that as land in Hong Kong were of extremely high value resulting in land being one of the major items in the balance sheets of most large companies, valuation should be made statutory. The Committee recommended that a valuation should be required in every case where the value of land and buildings owned by a company as stated in the prospectus exceeds 10% of its assets or HK\$1 million, whichever is the less. However, the Report did not explain the rationale for setting such threshold. The threshold of 10% or HK\$3 million was then introduced in the Bill but there was no public record of the rationale for increasing the threshold from HK\$1 million to HK\$3 million.

4. The property valuation requirement and its threshold have remained the same since the enactment.

5. The reason for the recommendation – that land is one of the major items in the balance sheet of most large companies – is no longer true for most listing applicants coming to the Hong Kong market.

- (b) To explain the benefits of the proposed exemptions under the Amendment Notice on: (i) the operation of companies and their compliance cost, in particular for international corporations seeking listings in Hong Kong, (ii) investors, and (iii) Hong Kong's competitiveness as an international financial centre vis-à-vis similar requirements in other major financial centres***
- (c) To provide a comparison of the current and proposed property valuation and disclosure requirements on companies using examples of companies with different core businesses, property activities, non-property activities, or mixture of both, to illustrate how the proposed exemptions would help reduce the compliance cost on companies, reduce the bulk of prospectuses thus be more environmental in the production of prospectuses without compromising investors' interest to have sufficient and comprehensive information about the companies***

6. The valuation requirements in the Companies Ordinance apply once the total value of a listing applicants' property interests exceed the thresholds of \$3m or 10% of assets. Once triggered the valuation requirements apply to each and every property interest regardless of its value, its materiality to the business or the relevance of the valuation report to investors' understanding and assessment of the business. Except for valuation reports for operating leases where the value has been determined to be zero the valuation report must be included in the prospectus.

7. Below is a table showing the number of property interests of some companies that have listed in Hong Kong in the last 3 years. Absent relief¹ from the valuation provisions in the Companies Ordinance the cost of obtaining independent valuations would be a significant burden to these companies and a major disincentive to list in Hong Kong. In one case the listing applicant had over 46,000 properties that in total represented less than 2% of its assets.

¹ Exemptions may be given by the SFC where together with HKEx's recommendation it is considered that the exemption will not prejudice the interests of the investing public and compliance with any or all of these requirements would be irrelevant or unduly burdensome or is otherwise unnecessary or inappropriate.

	Total property interests / total assets	Number of individual property interest	Number of jurisdictions	Proposed Exemption		
				Full valuation report	Summary of full valuation report	Overview
Companies with non-property activities						
Company 1	11.7%	413	30	-	-	413
Company 2	7.5%	527	34	-	-	527
Company 3	1.3%	2,500	30	-	-	2,500
Company 4	1.4%	333	13	-	-	333
Company 5	0.3%	680	14	-	-	680
Company 6	1.3%	46,067	9	-	-	46,067
Company 7	7.8%	877	27	-	-	877
Company 8	14.5%	19,907	12	-	-	19,907
Company 9	1.8%	4,735	2	-	-	4,735
Company 10	33.4%	75	2	-	-	75
Company 11	34.4%	113	2	-	-	113
Company 12	36.9%	92	1	-	-	92
Companies with property activities						
Company 13	75.3%	95	5	1	49	45
Company 14	50.6%	43	2	6	13	24
Company 15	77.5%	37	1	6	12	19
Company 16	87.9%	12	1	7	3	2
Company 17	75.4%	98	2	3	43	52
Companies with property and non-property activities						
Company 18	34.6%	134	1	6	14	114

Key assumptions

1. "Total property interests" is estimated base on different information disclosed in the financial statements of each listing applicant. The estimated figures may include items that are not related to property interests.
2. The analysis is based on valuation amount of individual property as carrying amount is not disclosed in the prospectus. Given that valuation amount is usually higher than carrying amount, individual property interests that require valuation may be less.

8. As can be seen the number of property interests for many large international companies without property activities is in the hundreds often spread over many jurisdictions. The cost of obtaining independent valuations is likely to very significant not only in terms of the financial cost but also in terms of time required.

9. Costs of valuations are not disclosed in prospectuses and are not public information. Based on our information from market practitioners:

- (a) one international listed company engaging in mining activities with approximately 2,500 property interests in 30 jurisdictions estimated that valuations of all its property interests would cost about US\$3 million and the prospectus would have needed to include some 2,000 pages of valuation reports.
- (b) one international retailer with over 300 property interests in 29 jurisdictions estimated that valuations would cost about US\$250,000 to US\$300,000. The prospectus would have needed to include some 100 pages of valuation reports.

10. Individual valuations reports on large numbers of properties will be voluminous making prospectuses lengthy. Excessive information does not serve the needs of investors as it results in key information being obscured by the less relevant information. For information to be useful to investors it should focus on what is relevant to investors' decisions.

11. The length of prospectuses of the companies in the above table varies between 1,732 and 453. Even excluding the extreme examples the average is over 600 pages. We have been advised by market practitioners that Hong Kong prospectuses are significantly longer than is the norm in other leading financial markets by a factor of 100 to 200 pages. We are concerned that unnecessary length does not serve the interests of investors. This proposal is important for investors by seeking to provide them with information that is focused and presented in a more meaningful manner.

12. In the above table there are three companies with non-property activities whose property interests are more than 30% of their total assets. The property interests are mainly plants and structures built for companies to generate their products for sale. In relative terms the value of the largest two

individual property interests represented only 2.7% or 1.2% of the company's total assets. These were purpose built plants and the values of the property interests are based purely on their use as can be seen by the fact that the valuer used depreciated replacement cost method for his valuation. No other individual property interest exceeded 1% of total assets.

13. We understand from market practitioners that an applicant will print around 30,000 copies of a prospectus (10,000 in English and 20,000 in Chinese) and this can be ten times larger for the largest IPOs. Thus for every 100 pages required for valuation reports, at least 3,000,000 pages will be printed.

14. We have compared the prospectus requirements in Hong Kong, Australia, US, PRC, UK and Singapore. Hong Kong is the only jurisdiction that requires valuations for all property interests of listing applicants. In the PRC, valuation is only required where funds raised are used to acquire assets. In Singapore and the UK, valuations are only required for principal (for Singapore) or material properties (for UK) relating to property activities.

(d) To explore the suggestion from members for companies to provide the full details of a valuation report on property interests by electronic means, or to set out the details in appendices to the prospectus, which would help reduce the compliance cost on companies and ensure protection for investors at the same time

15. Under the proposals, a listing applicant's non-property activities would not generally have valuation reports for a significant number of its property interests. For property interests of a listing applicant's property activities, whilst some properties are required by accounting standards to be stated at valuation, there is no specific obligation for a listing applicant to obtain independent valuation reports for each property. For less material property interests, independent valuations may not have been obtained as suggested. Thus the use of electronic means to disclose part of the prospectus, which as discussed below is not provided for in the law, would still represent a considerable cost by requiring valuation reports to be prepared purely for the purpose of disclosure.

16. Section 39B of the CO permits a prospectus to consist of more than one document in accordance with the provisions of Part 1 of the Twenty-first

Schedule. The provision is for facilitating the conduct of programme offers (i.e. offers made on a repeat or continuous basis or through successive tranches). The provision is not applicable to a prospectus and a separate electronic part containing a valuation report as they are not programme and issue prospectuses. The separate electronic part will not be regarded as part of the prospectus as it is not contained in the prospectus as one document.

The Securities and Futures Commission

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