Bills Committee on Companies (Amendment) Bill 2003

Schedule 1 – Amendments to the Companies Ordinance relating to prospectus

Response to 2nd Submission dated 4 November 2003 from Ms Alice Y L Chan Department of Professional Legal Education, Faculty of Law, University of Hong Kong

BACKGROUND

The Administration and the Securities and Futures Commission (SFC) had a meeting with the respondent on 25 November 2003 on the latter's second submission. The meeting enabled us to have a better understanding of the respondent's concerns and to make clarifications where appropriate. We have taken into account the discussion on that day in preparing our response to her second submission as set out below.[1]

RESPONSE

I. Offers not subject to the prospectus regime (Section 2(1) and the 17th Schedule)

2. When we conducted the consultation on proposed amendments to the Companies Ordinance (CO) to facilitate offers of shares and debentures in March 2003, we invited views from market practitioners, as well as bodies representing investors' interest. In preparing the Companies (Amendment) Bill 2003, we have given all submissions due consideration and believe that the legislative proposals would be conducive to market development without compromising investor protection.

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[1] We believe that it would be more constructive to have a face-to-face dialogue with the respondent in view of the nature of some of her suggestions and observations. We have therefore met with the respondent on 25 November 2003 and through the meeting obtained a better understanding of her concerns. We are grateful to the respondent for sparing her time to go through her submissions with us in detail.

Section 3 of the proposed 17th Schedule – small-scale offers

3. We agree that if an offer is not subject to the prospectus regime, its costs will be lower. This is a key reason for the amendment – small-scale offers might not otherwise occur because the cost of producing a prospectus would be too high. In proposing the $5 million threshold in the Bill, we have taken into account market views and the costs associated with preparing a prospectus in compliance with prospectus requirements under CO. We believe that the proposed $5 million threshold, together with the 12-month restriction[2] in Part 4 of the proposed 17th Schedule, sufficiently defines a very limited section of the public to which a small-scale offer may be made.

4. We note the observation that the small-scale offer exemption applies only to "personal offers"[3] in Australia. We however consider that whether the offer is a "personal" one is irrelevant from the angle of investor protection since the offerees under a "personal" offer do not necessarily have sufficient knowledge to understand the risks involved.

Section 7 of the proposed 17th Schedule – offers for no consideration

5. Following our discussion with the respondent, we have identified ways to refine the drafting of section 7(a) to enhance clarity, as below -

"An offer of shares in a company -

(a) made for no consideration to any or all holders of shares in the company; or

(b) made, as an alternative to a dividend or other distribution, to all holders of issued shares in the company of any class, provided the shares offered are fully paid-up shares of the same class; and

(c) containing a statement specified in Part 3 of the Eighteenth Schedule to this Ordinance."

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[2] Under section 3 of Part 4 of the 17th Schedule, for the purpose of the proposed small-scale offer, an offer is to be taken together with any other offer of the same class of shares or debentures which was open at anytime within the period of 12 months ending with the date on which the first-mentioned offer is first made.

[3] Under the Australian Corporations Act 2001, a personal offer is defined to mean an offer that may only be accepted by the person to whom it is made and an offer made to a person who is likely to be interested in the offer.

Section 8 of the proposed 17th Schedule – offers to "qualifying persons"

6. We do not consider that the proposed exempt offer to consultants is open to abuse because it is sufficiently limited by the restriction that the services rendered by a consultant must be those "commonly rendered by an employee ……". Taking into account companies' existing practice, we believe that the extension to consultants is appropriate and necessary, enabling those who in effect operate as employees to be treated on an equal basis when companies wish to offer shares to their workforce.

7. In addition, under the existing section 48A(2) of CO, any offer which can be properly regarded in all the circumstances as being a domestic concern of the persons making and receiving it shall not be taken as an offer to the public and thus would not fall under the prospectus regulatory regime. Such offers include one where there is a pre-existing relationship between the offeror and the members of the group (e.g. employees of the offeror) to whom the offer is made. According to SFC's existing practice and understanding of market professionals (and in particular legal advisers working in the field of corporate finance), consultants rendering services commonly rendered by employees would also fall under this category. In other words, the existing regime in practice already allows the exclusion of such offers from the prospectus requirements under CO. This exemption would provide legal certainty to the existing practice, which is in line with a specific request of the market and should lower costs. This exemption would not alter the existing practice and the current level of protection for investors who are consultants providing services commonly rendered by employees.

II. SFC's powers of exemption and amendment (Sections 38A and 360)

8. We consider that the two existing grounds of exemption, namely "irrelevant" and "unduly burdensome", are no longer sufficient in a market which demonstrates and supports ongoing innovation in the form of new offering structures, offering methods and financial products. In keeping with the international trend towards a facilitative regulatory model, we propose an additional ground for exemption, i.e. ***the exemption will not prejudice the interest of the investing public.***

9. We are satisfied that the additional ground for and expanded scope of exemption will facilitate offers of shares and debentures without undermining investor protection; indeed this is explicit in the language used.

10. In exercising its exemption powers, including those provided for under the Bill, SFC must take into consideration its statutory regulatory objectives and functions under sections 4 – 6 of the Securities and Futures Ordinance. To ensure transparency of SFC's operations, we propose in the Bill that SFC shall publish on-line such particulars of exemptions granted under the new sections 38A(1) and 342A(1) as it considers appropriate. SFC's plan is to set up a designated webpage on the SFC website setting out all the relevant prospectus-related provisions in the CO in respect of which an exemption has been granted to an applicant, the statutory grounds on which it is granted and the reasons therefor. This will be formatted to ensure maximum transparency and utility. The information set out in SFC's website mentioned above will also be published in the relevant prospectus. Hence, the exemptions granted to individual issuers are made public.

III. Construction of offerings to the public (Section 48A)

11. We agree that an offer under the 17th Schedule may constitute an offer to the public under section 48A(1). In other words, section 48A(1) and the new 17thSchedule are not mutually exclusive. Our policy intent is to carve out from the prospectus regime the exempt offers specified under the 17th Schedule. After re-examination of the proposed new sections 2(1) regarding the definition of "prospectus" and 48A, and the proposed new 17th Schedule, we consider that our policy intent would have already been achieved without any amendment to section 48A. Subject to Members' views, the proposed new section 48A(3) could be dropped.

IV. Overall standard of disclosure in prospectus (Paragraph 3 of the 3rd Schedule)

12. The amendment would not enable an issuer to argue successfully for a lower standard of disclosure. The purpose of the amendment is to encourage **appropriate** disclosure for different types of issues, which should enable the Court to decide that, in practice, a **higher** standard of disclosure is appropriate in some

areas, depending on the type of issue. This would enhance investor protection whilst encouraging issuers to target disclosure more specifically and eliminate unnecessary disclosure from prospectuses. The language reflects the approach now being adopted by the SFC in practice. SFC's regulatory experience shows that this approach operates well and has not given rise to any regulatory concern.

V. Definition of "prospectus" (Section 2(1))

13. The Companies Ordinance deals with issues by companies, and is not about bond issues generally. It is not our policy intent under this Bill to extend the reach of CO to foreign sovereign bond issues or other non-corporate issues.

Financial Services and the Treasury Bureau
Securities and Futures Commission
27 November 2003