



The Hong Kong Capital Markets Association

Promoting the Hong Kong Bond Market -

The Quick Fixes for Hong Kong Securities Law Take Effect

The Companies (Amendment) Ordinance 2004 took effect from 3 December 2004. This reform marks the completion of phase two in a three-phase securities law reform programme. Billed as a “quick fix” for some of the most obvious deficiencies of Hong Kong’s legal framework for securities offerings, the amendments are intended to keep the system going pending the radical overhaul promised for phase three of the reforms.

The quick fixes fall into two major areas. First, a number of new safeharbours are introduced which will serve to exclude certain types of offering from the prospectus regime. The prospectus regime requires a compliant prospectus to be prepared, in English and Chinese, and registered for a public offering of shares or bonds. It is expected that the availability of the new safeharbours will have the biggest impact in practice on the way offerings are structured for distribution in Hong Kong. These fixes will promote Hong Kong as a centre for international and institutional offerings.

Second, a number of adjustments are made to the way in which the prospectus regime operates for public offerings. In this area, the quick fixes largely translate into law the progress which had been made on the basis of guidelines issued by the Securities and Futures Commission in early 2003, but a number of other reforms are introduced for the first time. These fixes will help Hong Kong’s domestic bond market develop further.

Twelve New Safeharbours

In all, a dozen new safeharbours from the prospectus regime are introduced. Three of the new safeharbours are likely to have the biggest impact in practice.

Offers to “Professional Investors”

This is one of the most welcome features of the legislation. It tackles two of the most frequent grumbles about the old regime. Adoption of the definition of “professional investor” from the Securities and Futures Ordinance means that there is now a unified “professionals” exemption from both the prospectus and advertising regimes. Under the unamended Companies Ordinance, “professionals” were limited to market professionals – persons whose ordinary business is to buy or sell shares or debentures – while “professional investors” under the Securities and Futures Ordinance and the amended Companies Ordinance include not only a list of market professionals, such as intermediaries, banks and insurance companies, but also a category of high net worth individuals (those with portfolios of cash and securities of at least HK\$8 million, or a little more than US\$1 million). The new professional investor safeharbour is also now made available to companies incorporated in Hong Kong, whereas the existing professionals exemption was available only to companies incorporated outside Hong Kong.

Statutory Private Placement Safeharbour

There has been an informal understanding amongst lawyers in Hong Kong that offerings which are restricted to an absolute maximum of 50 offerees do not, depending on the circumstances, usually constitute an offering to the “public” so as to require registration of a prospectus. The Amendment Ordinance gives statutory force to a private placement exemption for the first time. Up to 50 offerees may be approached without the document by which the offer is made constituting a prospectus. In counting the 50 offerees, offers of securities of the same class during any period of 12 months are counted together.

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High Denomination Offerings

Another innovation provides that offerings of securities in denominations, or minimum purchase amounts, of at least HK\$500,000 are excluded from the prospectus regime. This is another useful advance. Although low denominations – US\$1,000 or HK\$10,000 is the norm – are common even in the professionals market, the high denomination safeharbour is expected to be useful, particularly in the context of distribution to relatively wealthy individuals through private bank networks. This type of distribution – very common in Hong Kong for securities issued overseas – has long existed on (and often, one suspects beyond) the fringes of legality. The new safeharbour should help remove the doubt from the area.

Direct issues by Hong Kong companies

The new law makes clear that the new safe harbours are available to Hong Kong as well as foreign issuers of bonds. The Ordinance also help clarify that offers to the overseas public do not need to be taken into account. The net result is that it is no longer necessary for prospectus law reasons for Hong Kong companies to issue their bonds through a Caymans or BVI finance vehicle – they can issue direct.

Agreed Selling Restriction

On the basis of the new legislation, five law firms active in advising on bond issues have settled an agreed wording for the selling restriction clause which is common on international institutional bond issues. The firms – Slaughter and May, Linklaters, Freshfields Bruckhaus Deringer, Clifford Chance and Allen & Overy – expect their agreed approach to help make documentation for these issues clearer and less subject to negotiation on this point.

Changes to the Prospectus Regime

The Amendment Ordinance also makes a number of adjustments to the way the prospectus regime operates for offers to the public. Many of these amendments are designed simply to reflect in the law positions which have now been established as a matter of interpretation and practice following publication of the SFC's guidelines in 2003 (part of phase one of the reform programme). These areas include:

- Replication of EMTN-type programmes through the “dual prospectus” structure in which frequent offerings of bonds or structured notes can be accommodated using a programme prospectus and an issue prospectus.
- Provision for offer awareness advertising is now also built into the Ordinance. Although ground-breaking when first introduced in the SFC's 2003 guidelines, these provisions have in fact been little used in practice because of their very restricted nature and have been side-lined by the development of promotional advertising for securities issues.
- A number of informal relaxations relating to procedural requirements for registering prospectuses, are also now embedded into the Ordinance.

Generally speaking, these amendments are uncontroversial in that they reproduce positions which had been reached, without legislative change, on the basis of interpretation and practice. It is perhaps regrettable that in one or two areas translation of these positions into black letter law will result in a loss of flexibility – as for example the provisions relating to the “amendment” of prospectuses and the requirement for offers to cease on the earlier of the publication of the next annual report and accounts of an issuer or the date 12 months after publication of a programme prospectus.

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The Amendment Ordinance also introduces some new features in miscellaneous areas. Three points are perhaps particularly worthy of note:

- A requirement to file a supplemental prospectus is introduced if it is necessary to correct or supplement material information contained in the original prospectus. Although supplementals have been generally accepted as a fact in Hong Kong there was, until now, no statutory requirement to publish a supplemental prospectus.
- Liability for omission of material information from a prospectus is introduced. Until now, prospectus liability has been limited to untrue or misleading statements. Extension of liability to include omission plugs a gap – but does beg a question: by what standard is the omission judged?
- Persons who can sue on a prospectus are extended to include subscribers or purchasers through an intermediary.

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“Professional Investors”

The Securities and Futures Ordinance introduced the concept of a “professional investor”, which is defined to include nine specific categories of professional, such as investment intermediaries, authorised financial institutions, regulated insurance companies, regulated collective investment schemes, governments and multilateral agencies, and a tenth category of persons of a class prescribed by rules made under the SFO by the SFC. The SFC has in its “Professional Investor Rules” provided that the following will be included in the definition of “professional investor”: individuals with a portfolio of securities and cash of not less than HK\$8,000,000 or equivalent, as shown by an accountant’s certificate or custodian statement; an investment holding company owned by such a individual; a company with a portfolio of securities and cash of not less than HK\$8,000,000 or with total assets of not less than HK\$40,000,000 as shown by its most recent audited financial statements or a custodian statement; and a trust corporation with total trust assets of not less than HK\$40,000,000 as similarly demonstrated. So Hong Kong now has its version of an exempt class of “high net worth” offerees – there remains no exempt class of “sophisticated investor” offerees as such. Offers to these “professional investors” are now also exempted from the Companies Ordinance prospectus regime.

The twelve new safeharbours

Offers excluded from the prospectus regime, in brief summary:

- to “professional investors”
- to not more than 50 persons
- for total consideration of HK\$5 million or less
- in minimum denominations of HK\$500,000
- to underwrite securities
- in connection with takeovers, mergers or share repurchases
- to shareholders of bonus shares or scrip dividends
- to employees and similar
- by charities for charitable purposes
- to club members for club purposes
- exchange offers
- of authorised collective investment schemes.

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Buyer beware!

This statement (or a statement to like effect) must be contained, in a prominent position, in offers relying on the new safeharbours (except for offers to professional investors or underwriters or relating to mergers and authorised collective investment schemes)

“WARNING

The contents of this document have not been reviewed by any regulatory authority in Hong Kong. You are advised to exercise caution in relation to the offer. If you are in any doubt about any of the contents of this document, you should obtain independent professional advice.”

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New Hong Kong Selling Restrictions from 3 December 2004

Standard Form

Agreed between Allen & Overy, Clifford Chance, Freshfields Bruckhaus Deringer, Linklaters and Slaughter and May

The changed form of restrictions (as they would apply to an international institutional offering of shares or bonds, whether the issuer is incorporated in Hong Kong or outside Hong Kong) is as follows:

Each Manager has represented and agreed that:	
1	it has not offered or sold and will not offer or sell in Hong Kong, by means of any document, any [Securities] other than (a) to “professional investors” as defined in the Securities and Futures Ordinance (Cap. 571) of Hong Kong and any rules made under that Ordinance; or (b) in other circumstances which do not result in the document being a “prospectus” as defined in the Companies Ordinance (Cap. 32) of Hong Kong or which do not constitute an offer to the public within the meaning of that Ordinance; and
2	it has not issued or had in its possession for the purposes of issue, and will not issue or have in its possession for the purposes of issue, whether in Hong Kong or elsewhere, any advertisement, invitation or document relating to the [Securities], which is directed at, or the contents of which are likely to be accessed or read by, the public of Hong Kong (except if permitted to do so under the securities laws of Hong Kong) other than with respect to [Securities] which are or are intended to be disposed of only to persons outside Hong Kong or only to “professional investors” as defined in the Securities and Futures Ordinance and any rules made under that Ordinance.

Notes:

1. It is intended that this form will normally be used for standard offerings of shares or debentures in the international institutional market. Other types of transactions may require adjustments to the language to suit circumstances.
2. In offerings by a non-Hong Kong incorporated company only, it is not wrong to include as an additional carve out in paragraph 1 a reference to “persons whose ordinary business is to buy or sell shares or debentures, whether as principal or agent”. If a manager or issuer client prefers to see this language, it may be included.
3. Other stylistic variations may also be necessary – and are unobjectionable – to conform to the style or conventions used in a document or to the house style of a law firm (for example the way Ordinances are referred to). Generally in these cases “draftsman’s privilege” applies and the style preferred by the law firm with drafting responsibility for the document should be accepted.

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