THE LAW SOCIETY OF HONG KONG 香港律師會

Submissions by the Law Society of Hong Kong on the Combined Consultation Paper on "*Proposed Changes to the Listing Rules*"

	Proposed Reform	Response
1.	**Use of issuers' websites for communications with shareholders** – proposed Rule amendments to facilitate the greater use of issuers' websites and to make available electronic rather than physical copy of corporate communications to shareholders.	**Agreed.**
2.	**Express information gathering powers** – proposed Rule amendments to give HKEx express powers to gather information from issuers and directors/supervisors.	**Disagree.** The current powers available to SEHK and SFC are sufficient and the exercise of extensive powers by junior members of SEHK staff will not be conducive for efficiency and investors' protection. Otherwise, appropriate checks and balances would need to be introduced.
3.	**Qualified accountants** – proposal to remove the requirement for a qualified accountant for all issuers.	**Strongly agree.** The practical difficulties involved in this requirement tend to outweigh the benefits, especially with the greater convergence of PRC accounting principles and IFRS.
4.	**Review of sponsor's independence** – proposed minor Rule amendments to require sponsors to demonstrate independence from the listing applicant throughout the	**Agree with suggestions to alternative formulation.** There is a good rationale for this proposal. However, in respect of the (a) start-date and (b) end-date for the relevant period, an alternative suggestion is that (a) be the date of submission of

listing process.

5. **Public float** – proposed Rule amendments to the minimum level of public float and the constituents of "the public". Under the proposal, the minimum public float requirements are as follows:

Market capitalisation at the time of listing	**Minimum public float requirement**
Below HK$10 billion	25%
Over HK$10 billion but below HK$40 billion	The higher of (i) 15%; and (ii) the percentage that would result in the market value of the securities held in public hands to be equal to HK$2.5 billion (determined at the time of listing)
Over HK$40 billion	The higher of (i) 10%; and (ii) the percentage that would result in the market value of the securities held in public hands to be equal to HK$6 billion (determined at the time of listing)

HKEx proposes that:

(a) the market value of the securities held in public

the A1 (being, for SEHK's purpose, commencement of the listing process) and (b) be the date of the prospectus (being the date on which information about the company is officially released). This is consistent with the requirement in the UK where the sponsor is required to remain independent only up to the date when the prospectus is approved.

Agree in principle re revising the public float regime Agreed that Rule 8.08(1)(d) should be brought up to date. Agree that the minimum public float should be reduced from 15% to 10%. However, the relevant market capitalisation thresholds are too high. Fixing the thresholds based on the boom market figures prevailing in the last couple of years will distort the picture, rendering illusory the intended benefits of reform.

The following formula is suggested instead:

Not exceeding HK$8 billion	25%
Over HK$8 billion but below HK$20 billion	The higher of (i) the percentage that would result in the market value of the securities held in public hands to be equal to HK$2.0 billion (determined at the time of listing) and (ii) 15%
Over HK$20 billion	The higher of (i) the percentage that would result in the market value of the securities held in public hands to be equal to HK$3 billion (determined at the time of listing) and (ii) 10%

Suggest that the SEHK has discretion to allow for a public float of less than 10% in appropriate circumstances.

Disagree with proposed 5% shareholding threshold in definition of "the public". It is submitted that the 5% threshold is not appropriate for Hong Kong (although it may be appropriate for the UK where listed companies tend to be much more widely held). This makes it too easy for third parties to accumulate 5% and may entail the shareholding structure to change in a way to necessitate the company taking steps

	hands will be determined on the basis of the expected issue price; (b) this proposal, if adopted, will not take retrospective effect; and (c) any shareholder holding 5% or more of the voting power of an issuer should not be recognised as a member of "the public". HKEx also proposes to set a minimum level of "market float" and issuers are expected to meet this minimum requirement at the time of listing. HKEx has not formulated detailed rules in this regard and welcomes suggestions from the market.	to dilute shareholding, perhaps repeatedly during the year, as a response to events over which the company has no control (although the company may have knowledge of such events because of rules for disclosure of interest). In particular, PRC-incorporated companies require a number of additional approvals prior to issuance of shares and requiring them to issue shares for the purposes of maintaining the public float is not feasible. **Agree with market float only in limited circumstances.** Where the company is qualifies to go below 10%, it is reasonable for SEHK to ensure a suitable level of liquidity by examining the amount of shares subject to lock-up arrangements. However, market float should <u>not</u> be made an additional requirement in other cases (i.e. cases where the company has to comply with a public float requirement of 10% or more).
6.	**Bonus issues of a class of securities new to listing** – proposed Rule amendments to disapply the requirement for a minimum spread of securities holders in the event of a bonus issue of a new class of securities involving options, warrants, or similar rights to subscribe or purchase shares.	**Agreed.**
7.	**Pre-vetting vs. post-vetting of public documents** – proposed Rule amendments to move progressively away from pre-vetting announcements, to reduce pre-vetting of circulars and to deal with other issues relating to issuers' public documents.	**Agree with qualifications.** We welcome the proposal to move away from pre-vetting of announcement for the reasons stated in the consultation paper. However, provisions of the Listing Rules are written in non-technical language and at times their intended application is not entirely clear from their wording (see for example the supplementary guidance issued by the Exchange on the note to rule 17.03(13)). As rule 1.06 provides that the Listing Rules are to be interpreted by the Exchange, the vetting process provides certainty that the way the rules are applied by the issuer is consistent with the interpretation of the Exchange. We therefore

		support the Exchange's proposal to retain pre-vetting for listing document and most of the circulars. For announcements which will not be subject to pre-vetting and which are not followed by circulars, we suggest the Exchange should ensure post-vetting is undertaken promptly so that any deficiencies would be ratified and the market is promptly notified of Exchange's interpretation of specific rules which is not clear from the express wording of the relevant provisions. In relation to paragraph 7.48 of the consultation paper which deals with amendment to memorandum and articles of association of a listing issuer, we do not agree that the issuer's legal adviser should be required to confirm there is "nothing unusual" about the proposed amendment for a company listed in Hong Kong. Such confirmation should be given by the issuer, although the listed issuer is expected to consult its legal adviser before arriving at its own conclusion. In regard to paragraph 7.58 , for the reasons given by SEHK in paragraph 7.56, we support the proposal to amend the circular requirements relating to discloseable transactions. In situations where the Rules currently require the inclusion of an expert report, as such report is rarely available when the transaction is announced, it should be the subject of a further announcement, to be issued within 21 days of the original announcement.
8.	**Disclosure of changes in issued share capital** – proposed Rule amendments to require speedy and greater disclosure to enhance transparency on changes in the issued share capital and other movements in issuers' securities.	**Agreed.** However, some members consider the 5% de minimis threshold to be too low, and suggest that a change of 2.5% (or more) is material enough for next day disclosure.
9.	**Disclosure requirements for announcements regarding issues of securities for cash and allocation basis for excess shares in rights issue** – proposed Rule amendments to codify disclosure practices in respect of announcements for issues of securities for cash, irrespective of whether general mandates are involved, and require disclosure of the allocation basis for excess	**Agreed.**

shares in rights issues / open offers.

10. **Alignment of requirements for material dilution in major subsidiary and deemed disposal** – proposed Rule amendments to align the respective requirements for shareholders' approval in respect of material dilution and deemed disposal of an interest in a subsidiary.

Agreed. There is clear overlap between Main Board Rule 13.36(1)(a)(ii) (GEM Rule 17.39(2)) and Main Board Rule 14.29 (GEM 19.29). Although the former (proposed to be removed) is slightly more stringent than the latter, better coherence and consistency can be achieved by removing the material dilution requirements and opting for the deemed disposal requirement which is already part of the general notifiable transactions regime.

11. **General mandates** – public comment is being sought on various issues relating to the issue of securities under a general mandate, including:

(a) the permissible size of issue of securities for cash and other purposes – whether the size should be increased or reduced and whether there should be separate pools in a general mandate for the issue of securities for (i) cash and (ii) other purposes;

(b) the calculation of the size limit – whether in calculating the size limit issuers should exclude securities repurchased since the granting of the general mandate so that the issued share capital as at the date of the granting of the general mandate will remain the reference point for such calculation; and

(c) where issues of securities are at a discount: (i) whether the maximum discount of 20% to the "benchmarked price" should apply only to placings of shares for cash or to placings of all securities; (ii) whether issuers should obtain a specific mandate for issues of shares to satisfy the exercise of warrants, options and convertible securities; and (iii) whether issuers should issue a circular for the purpose of seeking such a specific

Propose retention of existing requirements. As SEHK stated, the key is to find a balance between protection of minority against dilution and ease to the issuer of raising funds in the secondary market. It is submitted that the current 20% restriction on number of shares and 20% cap on pricing discount work well and there is no immediate need to revise the rules. In particular, the 20% cap on the number of shares that could be issued for a PRC-incorporated company limits the number to 20% of the outstanding H shares, which is a significantly smaller number than 20% of the entire issued share capital of a company. Any further reduction in this percentage would be very detrimental to the operation of the H share companies in the HK market. The existing 20% maximum discount to be benchmarked price should also be retained to ensure consistency in applications of this restriction.

One particular concern raised by SEHK (at paragraphs 11.36 and 11.39) is that since the 2004 Rule amendments, an increasing number of issuers have sought specific rather than general mandates, enabling them to avoid the requirement to obtain independent shareholders' approval for refreshments of general mandates as required under the 2004 Rule amendments. Rather than impose restrictions on the existing general mandate requirements, we suggest that where a specific mandate is sought for a non-preemptive issue of shares which would otherwise require the refreshment of an existing general mandate, the specific mandate should be subject to independent shareholders' approval.

	mandate.	
12.	**Voting at general meetings** – public comment is being sought on whether: (a) voting by poll should be made mandatory at all general meetings (the Rules currently only require voting by poll at general meetings held to consider connected transactions and transactions that require controlling shareholders to abstain from voting); and (b) the minimum notice period required for convening shareholders' meetings should be extended to 28 days for annual general meetings, and a period of between 14 and 28 days for extraordinary general meetings.	**Mixed views.** Some members believe voting by poll for all general meetings and extension of the notice period will be detrimental to market efficiency, as company law already gives sufficient protection and there is no need to impose additional requirements in these areas. Some members however support the proposal for voting by poll at all general meetings, noting the additional administrative burdens are not significant and it is a better representation of shareholders' preferences.
13.	**Disclosure of information about and by directors/supervisors** – proposed Rule amendments which would facilitate investors and the market obtaining enhanced and more up-to-date information on directors and supervisors. HKEx proposes an extension to the period when directors and supervisors are required to disclose prescribed information to the public. Under the proposal, the prescribed information should be disclosed continuously from the date of appointment up to and including the date of resignation of the director/supervisor.	**Agree with qualifications.** It is too onerous to impose on listed issuers and their directors a continuous obligation to disclose any change to information previously disclosed. This means that public announcement would have to be made, for example, when an executive director takes up a new position in a subsidiary of the listed issuer (rule 13.51(2)(b)), which could well be a routine matter. An announcement would also need to be made when there is a change in the director's interest in shares of the listed issuer which is already subject to disclosure obligations under Part XV of the SFO (rule 13.52(2)(f)). We believe that periodic disclosure of biographical details under the current provisions is adequate. In any event, the listed issuer is already under a continuous obligation under rule 13.09 to disclosure all matters material to its listing status.
14.	**Codification of waiver to property companies** – proposed Rule amendments to codify an exemption for issuers engaged in property development as a principal	**Agreed.** **On question 14.5, some members take the view that the definition of Qualified Connected Person should not be limited a person that is only**

	business activity from shareholders' approval, where it involves the acquisition of land or property development projects in Hong Kong from the Government or Government-controlled entities through public auctions or tenders.	**connected by virtue of being a joint venture partner with the listed issuer in existing single purpose property projects and should include all connected persons that are defined under Rule 14A.11 of the Listing Rules.**
15.	**Self-constructed fixed assets** – proposed Rule amendments to exclude from the Rules on notifiable transactions any construction of a fixed asset by an issuer for its own use in the ordinary and usual course of its business.	**Agreed.**
16.	**Disclosure of information in takeovers** – proposed introduction of a new Rule to codify HKEx's current practice of granting waivers from the Rules on the publication of prescribed information on target companies in certain situations such as hostile takeovers.	**Agreed, and some members take the view that the waiver should be extended to non-hostile takeovers where there is insufficient non-public information.** Codification will substantially reduce uncertainty in a takeover. As the granting of such waiver should be based on the legal and practical feasibility of obtaining information relating to the target, some members take the view that the matter should not turn on whether the offer is hostile or not. Indeed, a takeover that starts off being hostile may subsequently become recommended and there is no benefit in "branding" a takeover as hostile or otherwise for this purpose.
17.	**Review of director's and supervisor's declaration and undertaking**	**Agree with (a) and (c).**
	(a) Streamlining disclosure of director's and supervisor's information through an issuer's "appointment announcement" – proposed Rule amendments to streamline the disclosure of directors' and supervisors' biographical information in various prescribed forms of declaration and undertaking;	
	(b) Information gathering powers of HKEx – given the proposed introduction to the Rules of an express power of HKEx to gather information from issuers (see Issue 2) – proposed introduction of a similar	**Disagree with (b).** The current information gathering powers of SEHK are sufficient.

provision in the director's undertaking; and

(c) Service of disciplinary proceedings on directors – proposed amendments to the Main Board Rules to include detailed provisions for a service similar to those already included in the GEM Rules and to make express HKEx's ability to change the terms of the director's undertaking without the need for each director to re-execute his undertaking.

18. **Review of the Model Code for Securities Transactions by Directors** – proposed Rule amendments to four areas of the Model Code, namely:

(a) expanding the list of "permitted dealings" by directors to include: (i) dealings where beneficial interests in the securities do not change; (ii) dealings where the director shareholder places his shares in a top-up placing; and (iii) bona fide gifts to a director by a third party;

(b) clarifying the meaning of "price sensitive information" to refer to the provisions of general disclosure of price sensitive information in Rule 13.09(1) and related notes;

(c) extending the current "black out" period to commence from the issuer's year or period end, and end on the date the issuer publishes the relevant results announcement. If the proposals contained in the periodic financial reporting consultation paper published by HKEx in August 2007 are adopted, and an issuer makes full use of the period permitted to publish its results, the maximum "black out" period in one year could be as long as eight months; and

Agree with (a), (b) and (d), with additional suggested exception. There should be an express exception for dealings by directors purely in the capacity of an agent or nominee – i.e. where there is a change in underlying beneficial interest but no director's personal interest is involved at all. As "dealing" is not limited under the Listing Rules exclusively to proprietary dealings, and is expressly defined under the SFO to include agency dealings, there is a need to set out this exception.

Strongly Disagree with (c). A potential black out of seven to eight months out of a year is too long. SEHK stated in para 18.20 the regulatory rationale, being that "directors … should be long term investors in the company". Whilst there are benefits to be gained from the long-term commitment of management, this goes against the commercial rationale behind executive share grants, in that such grants are financial incentives which, in many cases, are considered by both the director and the issuer as a part of the director's remuneration package.

In the case of companies that issue quarterly financial reports, the black out period will be unacceptably long.

A rationale put forward by SEHK is to reduce the risk of insider trading. It is submitted that extending the black out period is not an appropriate way to address the risk. Instead, more effort should be made on investigation and enforcement of the insider dealing rules.

Propose to clarify the meaning of "dealing". In a recent case SEHK gave the view that the issuance of an offer announcement of a takeover by way of scheme of arrangement in a management buy-out could amount to "dealing" by directors

(d) restricting the time for an issuer to respond to a request for clearance to deal and the time for dealing once clearance has been received from the issuer. HKEx proposes 5 business days in both cases.

for the purposes of the black out rule, even though the scheme document would be posted, and the scheme meeting would be held, after the end of the black-out period.

It is submitted that this is not a correct reading of general contractual principles (the offer to acquire shares is not made until the scheme document is issued and no acquisition of shares takes place until there is an acceptance either through the shareholders voting to pass the scheme and the scheme taking effect in accordance with the rules, or in the case of a general offer, a shareholder tenders his acceptance to an offer).

It is proposed that, to ensure equality of information in takeover cases, SEHK should make it clear that announcement of a takeover offer or scheme of arrangement does not of itself amount to dealing in securities. Provided that the financial information disclosed in the offer/scheme document is the same financial results which gave rise to the black out in the first place, there will be no disparity in information and investors' protection will not be compromised.

The Law Society of Hong Kong

Securities Law Committee

7 April 2008

114124