

Press Release

LCQ7: Share consolidation and rights issue conducted by listed companies

Wednesday, June 17, 2015

Following is a question by the Hon Starry Lee and a written reply by the Secretary for Financial Services and the Treasury, Professor K C Chan, in the Legislative Council today (June 17):

Question:

Some members of the securities industry have relayed to me that, in recent years, quite a number of listed companies first consolidated shares by a high ratio and then conducted rights issue at a significantly discounted price to raise funds from shareholders. As a result, the share prices of the companies concerned kept dropping, giving rise to the scenario of "downward price manipulation". The major shareholders of such companies acquired a large number of shares when the share prices were at a low level, thus diluting the shareholding of those minor shareholders who had not subscribed for new shares. Those members of the securities industry have also pointed out that since the management and the major shareholders of the companies have very close relationship, such financial activities might involve insider dealings. In this connection, will the Government inform this Council if it knows:

(1) the respective numbers of cases in which listed companies consolidated shares and conducted rights issue in each of the past five years and, among such cases, (i) the number of those in which consolidation of shares was followed by rights issue, and (ii) the respective highest ratios of consolidation of shares and rights issue involved; how such figures compare to the relevant figures of other major financial centres during the same period and to those of Hong Kong in the preceding five years; whether the Securities and Futures Commission (SFC) and the Stock Exchange of Hong Kong (SEHK) have analysed those figures; if they have, of the outcome; if not, the reasons for that;

(2) whether SFC and SEHK have examined if there have been cases of listed companies abusing the arrangements for consolidation of shares and rights issue; if they have, of the details; if not, the reasons for that;

(3) whether listed companies are required to obtain the approval of SFC and

SEHK before conducting rights issue; if so, of the procedures and the general reasons for rejecting such applications; whether there is any prevailing restriction on the highest ratios of consolidation of shares or rights issues for listed companies;

(4) whether SFC investigated, in the past five years, into the substantial fluctuations of the share prices of listed companies during the relevant period in which consolidation of shares was followed by rights issue; if it did, of the outcome and the number of such cases in each year; if not, the reasons for that;

(5) whether SFC has looked into the situation in which minor shareholders suffered losses because listed companies raised funds from shareholders by first consolidating shares and then conducting rights issue; if it has, of the details and the measures adopted by SFC for protecting the rights and interests of minor shareholders; if not, the reasons for that; and

(6) whether SFC and SEHK have reviewed the relevant requirements governing listed companies in consolidating shares and conducting rights issue; if they have, of the outcome; if not, the reasons for that?

Reply:

President,

Our response to the six parts of the question is as follows:

(1) The number of rights issues and share consolidations announced by Hong Kong-listed issuers in the past five years, and the highest ratios in each year are set out at Annex.

The Securities and Futures Commission (SFC) and the Stock Exchange of Hong Kong (SEHK) do not have the corresponding statistics for overseas markets.

(2) The SEHK administers and enforces the Listing Rules. In cases where abuse in rights issues and/or share consolidations are noted, the SEHK would deal with such cases individually, including making referrals to appropriate law enforcement agencies when securities laws might have been violated.

For dilutive rights issues (i.e. any issue which increases issued shares by more than 50 per cent on its own or aggregated with other pre-emptive issues in the last 12 months), the Listing Rules provide additional safeguards by requiring shareholder approval. The controlling shareholders or directors (where there is no controlling shareholder) must abstain from voting. This is to afford extra protection to minority shareholders against materially dilutive rights issues.

(3) Corporate actions such as rights issues and share consolidations are commercial decisions of the individual boards of listed issuers. The Listing Rules set out specific disclosure and shareholder approval requirements where circumstances warrant. Where an issuer's board proposes a rights issue, it must publish an announcement, a shareholders' circular (if shareholder approval is required) and a listing document. The issuer must obtain the SEHK's approval for the listing of the nil paid rights and the rights shares.

The Listing Rules set out specific disclosure requirements for the documents, including details of the rights issue (including offer price, issue size and underwriting arrangements) and the proposed use of proceeds, such that shareholders may make an informed investment decision.

Where a shareholder approval is required, the shareholders' circular must include a letter from an independent financial adviser with an appropriate licence under the Securities and Futures Ordinance (Cap. 571), containing its recommendation to the issuer's independent board committee and shareholders as to whether the terms of the rights issue are fair and reasonable and whether they are in the interests of the issuer and its shareholders as a whole, and to advise shareholders on how they should vote. Shareholders may make an informed voting decision having considered all the relevant information from the shareholders' circular.

Should the shareholders decide to proceed with the rights issue, they have the options of: (i) subscribing for the shares offered on a pro rata basis and if so desired, apply for excess shares; and/or (ii) selling their nil paid rights on the market to compensate for the dilution.

The SEHK, being the frontline regulator of listed companies, would

normally approve a rights issue transaction after being satisfied that all relevant Listing Rules requirements have been complied with.

(4) In the last few years, the SFC has on average made about 25 to 30 inquiries involving stock price volatility around the time of rights issues or open offers carried out by listed companies. Many of these cases concern suspected insider dealing activities or short selling ahead of a large deep discounted rights issue. Most investigations do not lead to enforcement action being taken because the evidence is insufficient to prove that an offence has been committed to the standard required by Hong Kong's court or tribunals; key witnesses are not available; other evidence is missing; or the suspected manipulator cannot be identified.

(5) The downward price change upon a large deep discounted rights issue may reflect market forces. If there is any insider dealing or manipulation, the SFC may take criminal, civil and/or Market Misconduct Tribunal proceedings.

(6) The SEHK reviews its rules and practices from time to time based on factors such as market development, investor protection and the policies and practices of other leading international financial centres. It has conducted a number of reviews of the rules and practice on rights issues in each year since 2012. It believes that the current regime in this area is appropriate, and strikes a correct balance between shareholders' protection and issuers' access to capital markets.

The SFC at staff level asked the SEHK to review the rights issue policy in 2012 and 2013 amid concerns about possible abusive use of rights issues and share consolidations by certain listed companies. In particular, to assist shareholders that chose not to participate in a rights issue, the SFC suggested that consideration be given to (i) requiring that listed companies sell the rights that are not taken up with the proceeds paid to non-participating shareholders pro-rata to their shareholdings and to (ii) prohibiting open offers.

At the policy meetings of November 2012 and July 2013, the Listing Committee reviewed the matter and did not support any changes to the rights issue regime, having considered that the abuses appeared to be individual cases of possible market manipulation and tightening the Listing Rules for all listed companies would create a bias against this more equitable form of fund raising

and would not be in shareholders' or listed companies' interests.

The reply above has incorporated inputs from the SFC and the SEHK.

Ends