

Updating Your Study Manual

Instructions for Inserting Version 1.2, 2003

The followings serve as the instructions for updating **Topic 4: Miscellaneous** of Study Manual 5 for the Licensing Examination for Securities and Futures Intermediaries. Please be reminded that only the updated sections are provided for downloading. You may replace the relevant sections with this updated version for the study manual you possess.

Instructions:

1. Download and print out the following pages.
 2. **Remove** pages 4-3 to 4-4 and **Insert** new pages 4-3 to 4-4.
 3. **Remove** pages 4-13 to 4-14 and **Insert** new pages 4-13 to 4-14.
 4. **Remove** pages 4-17 to 4-18 and **Insert** new pages 4-17 to 4-18.
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have the necessary information available to form an opinion concerning the value of the other property to which such convertible debt securities relate — for example, property development. This rule does not apply to an issue of convertible debt securities by a state or a supranational.

- 2.6 Paragraphs 19 to 31 of Part C of Appendix 1 set out additional requirements for the contents of listing documents relating to the issue of convertible debt securities.
- 2.7 The requirements for convertible equity securities on the Growth Enterprise Market ('GEM') are set out in Chapter 22 of the GEM Listing Rules. Convertible equity securities may be listed on GEM only if the underlying securities are listed (or will become) a class of equity securities listed on GEM.
- 2.8 Convertible bonds will, if converted into ordinary shares, dilute the holding of existing shareholders of a listed issuer. Pursuant to rule 13.51(3), an issuer shall inform the Exchange immediately any decision is made in regard to any change in the rights attaching to any class of listed securities and any change in the rights attaching to any shares into which any listed debt securities are convertible or exchangeable.
- 2.9 Where listing is sought for convertible equity securities, a listed issuer must specifically include the following:
- information concerning the nature of the equity securities to which the convertible equity securities relate and the rights attaching thereto; and
 - the conditions of and procedures for conversion, exchange, subscription or purchase, and details of the circumstances in which they may be amended.
- 2.10 The issue of convertible bonds constitutes price-sensitive information because of the potential dilution of shareholders' interests. An issuer must make an announcement as soon as the potential issue has been agreed by its Board of directors.
- 2.11 Certain institutional investors — for example, pension funds — are restricted, by their own constitutions, to buying certain kinds of instruments. Convertible bonds are normally listed on an exchange to obtain a listing status which permits these investors to purchase them. This is often called a 'listing of convenience'. Readers should note that the most popular place to list convertible bonds is on the Luxembourg Stock Exchange, which has become very attractive because of its recognized branding for such issues. Luxembourg-listed issues by companies listed on the Exchange are usually only offered in Hong Kong to professional investors. Accordingly, very few such issues have been listed on the Exchange, despite the fact that its

listing requirements and fees are fairly similar. As the issue of convertible bonds involves the issue of new shares to persons other than the company's existing shareholders, it is important to ensure that the directors of the company are authorized by the company's shareholders to allot such shares.

3 Rights issues

3.1 A rights issue is an offer by way of rights to existing holders of securities which enables those holders to subscribe for securities in proportion to their existing holdings. In the past, rights issues have caused the Exchange and the SFC concern because certain listed companies have had excessive numbers of issues in the space of one year. This has resulted in the minority shareholders being diluted at the expense of the controlling shareholder because they have not always had the available funds to take up their rights.

3.2 In normal circumstances, all rights issues must be fully underwritten. Underwriting provides a degree of certainty to an issuer through the commitment of sound financial institutions. It also enables an issuer to plan on the basis of assured funds. Where an independent professional underwriter is used, it also means that the issue is managed and reviewed by an independent professional party. However, there may be circumstances in which it is appropriate for an issuer to proceed without underwriting where:

- underwriting can only be obtained subject to a *force majeure* clause (or other similar terms and conditions) which is unacceptable to the directors; or
- the issuer has specific intended uses for the proceeds and can show that the additional costs of underwriting the issue are not justified in the particular circumstances; or
- an underwriting commitment has been terminated by the underwriter upon the occurrence of an event of *force majeure* (other than an event which also constitutes a breach of warrant by the issuer), after the offer has opened. In such circumstances, the issuer must have ensured that the conditions of the issue are structured in a manner which permits the issue to proceed on a non-underwritten basis, with the consent of the Exchange.

3.3 In appropriate circumstances, the Exchange will be prepared to permit an issue which is not fully underwritten to proceed, subject to the additional disclosure requirements set out in rule 7.19(3) of the Listing Rules. In all such cases, the issuer should contact the Exchange to seek informal and confidential guidance as to the requirements that will apply to an issue at the earliest opportunity.

- particulars of outstanding options at the beginning and at the end of the financial year/period, including number of options, date of grant, vesting period, exercise period and exercise price;
- particulars of options granted during the financial year/period, including number of options, date of grant, vesting period, exercise period, exercise price and (for options over listed securities) the closing price of the securities immediately before the date on which the options were granted;
- the number of options exercised during the financial year/period with the exercise price and (for options over listed securities) the weighted average closing price of the securities immediately before the dates on which the options were exercised;
- the number of options cancelled during the financial year/period together with the exercise price of the cancelled options; and
- the number of options which lapsed in accordance with the terms of the scheme during the financial year/period.

4.14 An issue of securities by a listed issuer or its subsidiary to a connected person is not normally subject ([Listing Rule 14A.31\(3\)\(b\)](#)) to any disclosure or shareholders' approval requirements as connected transactions if the securities are issued to the connected person under an employee or executive share scheme which complies with Chapter 17.

Topic summary

In this topic we have reviewed the three forms of securities which are issued quite often by listed issuers, being mainly listed companies.

The topic commenced with a review of convertible bonds, and we noted particularly that that they must be approved by the Exchange prior to its issue and that where they are convertible into new equity securities they may only be listed if the equity securities are or will become listed at the same time.

We then considered the area of rights issues, where we noted that many of the requirements for rights issues have been in response to perceived abuses by listed companies.

Finally, we looked at share options. In particular, we looked at the need for approval of the schemes by shareholders and by independent non-executive directors.

Checklist

Below is a checklist of the main points covered by this topic. Use this checklist to test your learning.

- Convertible bonds are debt securities, which must, prior to their issue, be approved by the Exchange.
- Convertible debt securities which are convertible into equity securities may be listed only if such equity securities are a class of listed equity securities or a class of equity securities listed or dealt in on another exchange.
- Convertible bonds will, if converted into ordinary shares, dilute the holding of existing shareholders of a listed issuer.
- A rights issue is an offer by way of rights to existing holders of securities which enables those holders to subscribe for securities in proportion to their existing holdings.
- In normal circumstances, all rights issues must be fully underwritten.
- There may be circumstances in which it will be appropriate for an issue to proceed without an underwriting.
- If the proposed rights issue would increase either the issued share capital or the market capitalization of the issuer by more than 50%, the rights issue must be approved by the independent shareholders.
- The total number of securities which may be issued upon exercise of all options to be granted under the scheme and any other schemes must not exceed in aggregate 10% of the relevant class of securities of the listed issuer in issue.

Answers to revision questions

- Answer 1: Convertible debt securities which are convertible into equity securities may be listed only if such equity securities are (or will become at the same time) a class of listed equity securities; or a class of equity securities listed or dealt in on another regulated, regularly operating, open stock market recognized by the Exchange.
- Answer 2: In normal circumstances, all rights issues must be fully underwritten on the Main Board. On **GEM**, a rights issue does not have to be underwritten (GEM Rule 10.23). Underwriting provides a degree of certainty to an issuer through the commitment of sound financial institutions. It also enables an issuer to plan on the basis of assured funds. Where an independent professional underwriter is used, it also means that the issue is managed and reviewed by an independent professional party.
- Answer 3: In order to facilitate fundraising by very substantial companies the Exchange will normally allow such companies to proceed with a rights issue on a non-underwritten basis, subject to prior notification of the Exchange. However, even with very substantial companies the Exchange may still insist that a rights issue is fully underwritten in exceptional circumstances (for example, if the issue is to raise funds for 'general corporate purposes').
- Answer 4: A listing document (other than one supporting a capitalization issue) must not contain reference (general or particular) to future profits or contain dividend forecasts based on an assumed future level of profits unless supported by a formal **profit forecast**.
- Answer 5: In addition to the shareholders' approval, each grant of options to a director, Chief Executive or substantial shareholder of a listed issuer, or any of their respective associates, under a scheme of the listed issuer or any of its subsidiaries, must be **approved by independent non-executive directors** of the listed issuer (excluding an independent non-executive director who is the grantee of the options).
- Answer 6: Where any grant of options to a substantial shareholder or an independent non-executive director of the listed issuer, or any of their respective associates, would result in the securities issued and to be issued upon exercise of all options already granted and to be granted (including options exercised, cancelled and outstanding) to such person in the 12-month period up to and including the date of such grant: (a) representing in aggregate over 0.1% of the relevant class of securities in issue; and (b) (where the securities are listed on the Exchange), having an aggregate value, based on the closing

price of the securities at the date of each grant, in excess of HK\$5 million, such further grant of options must be approved by shareholders of the listed issuer.

Answer 7: A grant of options may not be made after a **price-sensitive** event has occurred or a price-sensitive matter has been the subject of a decision until such price-sensitive information has been published in the newspapers.

Answer 8: An issue of securities to a connected person is not normally subject ([Listing Rule 14A.31\(3\)\(b\)](#)) to any disclosure or shareholders' approval requirements as connected transactions if the securities are issued to the connected person under an employee or executive share scheme which complies with Chapter 17.