

SFC Discards Plans for Legislative Amendments on IPO Sponsor Prospectus Liability

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In a surprising change of direction, the SFC has discarded plans to amend Hong Kong's companies legislation to make it clear that sponsors of IPOs have statutory prospectus liability.

Supplemental Consultation Conclusions

On 22 August 2014 the SFC issued consultation conclusions (supplemental to the December 2012 consultation conclusions ("First Conclusions") on IPO sponsors' regulation) regarding sponsor's civil and criminal liability for misstatements in a prospectus.

The SFC's original position

In the paper, the SFC restates its own original position, held at the time of the First Conclusions, as follows: "[T]he SFC's position when the Consultation Paper was issued was that, although there was a strong argument that sponsors were already covered by the relevant legislation (which was also the SFC's view), given the fact that sponsors and others had expressed contrary views and given that there had been no Hong Kong case law on the subject, it may be helpful to specify sponsors in the relevant legislation (now the Companies (Winding Up and Miscellaneous Provisions) Ordinance ("CWUMPO")) as a category of persons who authorise the issue of prospectuses."

In the original words of the First Consultation, "Although some respondents argued that the proposal was not a clarification but an extension of prospectus liability to sponsors because in their view it is clear that existing provisions do not apply, there were also respondents who were of the view that the existing [Companies Ordinance] provisions apply to sponsors. These diverging views and the lack of case law on the issue demonstrate the need to clarify whether sponsors are subject to existing civil and criminal prospectus liability provisions."

The First Consultation went on to say: "The existence of conflicting comments from respondents and the lack of Hong Kong case law on whether or not sponsors are subject to [the prospectus] provisions demonstrate that there is considerable merit in removing any ambiguity. [...] [I]t would not be credible to propose that an amendment is made to clarify that sponsors do not have legal liability. Accordingly, we will recommend that the current statutory liability provisions be amended so that a person who has authorised the issue of a prospectus includes a sponsor."

The SFC's current position

The SFC now states that, after discussions with industry participants and other parties, it considers that no legislative amendments are necessary to specify sponsors as a separate category because, putting it simply, sponsors are certainly one of the potentially liable classes of persons. The SFC does not mention what judicial authority it is relying on, nor whether counsel's opinion has been sought. Nor, so far, has the Hong Kong Government (either the Financial Services and Treasury Bureau or the Department of Justice) indicated their position. One would hope there would be consistency between the positions of the SFC and the Government, not least because one would expect the Department of Justice to exercise prosecutorial control in any serious case, but the position is not clear.

The SFC's basis

As a basis for its view, the SFC cites the wording of the sponsor's declaration in the Listing Rules, which require sponsors to confirm in writing that they believe the prospectus "contains all information requirement by relevant legislation and rules", and is "true, accurate and complete in all material respects". The SFC also notes the sponsor's general duties and functions which must be discharged before the prospectus is "authorised for registration" under the CWUMPO.

Decision not to amend the Companies Ordinance is on the one hand welcome, but on the other hand the SFC's stance leaves an unsatisfactory state of affairs

It is our view that sponsors should not be subject to statutory prospectus liability for a number of reasons, not least because they are already subject to robust regulation and are not primarily responsible for the contents of a prospectus: the directors of the issuer must have primary responsibility.

However, the SFC's latest position is that sponsors are already covered under existing law and there is no need to make legislative amendments. It will be noted that under the existing prospectus provisions, persons who "authorised the issue of a prospectus" could be exposed to the same measure of liability for misstatements as directors and promoters of the company. This is an unsatisfactory state of affairs. It is self-evident from their history that the existing statutory provisions were formulated prior to the introduction of the role of sponsors in Hong Kong and not drafted with sponsors in mind. They contain real ambiguity as to their application to sponsors, which in our view means they should be construed in favour of sponsors on the basis of the principle against doubtful penalization. They reverse the burden of proof inappropriately by seeking to put the onus on sponsors, if applicable to them, to demonstrate reasonableness of conduct. They are unclear as to the standard of liability and the test for mens rea. As the SFC put it originally, if sponsors are to have statutory prospectus liability, there was a "need to clarify" and the issue should not be dealt with, as the SFC now appears to be contemplating, by way of a test case to the courts on the basis of the existing provisions.

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