NON-PREEMPTIVE SHARE ISSUES IN ASIA

Role of Regulation in Investor Protection

CFA Institute

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CFA Institute is the global association of investment professionals that sets the standards for professional excellence. We are a champion for ethical behavior in investment markets and a respected source of knowledge in the global financial community.

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Executive Summary

A primary concern of investors in Asia is equitable treatment upon issuance of new shares. When a company issues additional shares, it reduces existing shareowners' proportional ownership in that company if they do not have (or opt out of) the opportunity to participate in the new issue through their preemptive rights. The objective of these rights is to prevent insiders and management from diluting shareowners' proportion of the voting and economic rights of the company (Technical Committee of the International Organization of Securities Commissions 2009).

It is a common practice in some Asian markets (e.g., Hong Kong, Singapore, Thailand, and Malaysia), however, for companies at annual general meetings (AGMs) to seek mandates from shareowners to issue shares without preemptive rights. Such mandates not only temporarily suspend the right of existing shareowners to subscribe to the sale of new shares but also give company directors the right to issue shares to parties at their discretion, depending on information disclosed when they seek the mandate from shareowners. Worse, these shares usually are issued at a discount to current share price that ranges from 5% to 20%.

The reasons for such mandates vary. One reason is to convert bondholder debt to equity, thus improving the capital structure of the company. Other reasons include introducing a new strategic investor or a "friendly investor." These mandates expire annually, but fresh mandates can be sought at the next AGM. The main concern for minority shareowners is that the cumulative effect of such multiple placements can significantly dilute their interests.

The objective of this report is to create awareness among investors, regulators, and company management and to draw a broad consensus on the principle of preemption. This report is part of our continued effort to raise the bar on corporate governance principles in Asia and to build trust and transparency among the various stakeholders within Asia's capital markets.

Scope, Objectives, and Methodology

In this report, we review the rules and regulations governing non-preemptive share issuance based on general mandates across major jurisdictions in Asia (Hong Kong, Singapore, Thailand, and Malaysia). We then compare them with the UK regulations of preemption and highlight the differences between jurisdictions. In addition to analysing the regulatory differences, we examine actual placings data from the Hong Kong market and analyse practical issues relating to the interpretation of general mandate regulations in Hong Kong that affect the rights of minority shareowners. Toward this end, we collected two sets of publicly available data from the Hong Kong Exchange (HKEx) website covering a four-year period (January 2009–December 2012): placings data as well as poll results for the general mandates authorising these placings. We examine these data against the Hong Kong listing rules to determine whether the spirit of the law was being adhered to. Poll results from AGMs help to clarify the approval process—for example, whether the purpose of such mandates was articulated with adequate details and what the percentage of support was for resolutions passed given the concentrated ownership structures of Hong Kong companies. We then extrapolate whether the situations would have been any different had the minimum requirement been a special resolution (requiring three-fourths majority) and had the substantial shareowners not been permitted to vote.

Review of Findings

We find that although some markets require a simple majority to pass the general mandate resolution, others require a 75% majority. Some markets are conservative about the percentage of discount allowed for non-preemptive shares, whereas others permit a discount of up to 20%. No market in Asia has a cumulative cap on the amount of shares that can be issued without preemptive rights as a percentage of the total existing share capital issued.

Moreover, these non-preemptive offerings were occurring concurrently with a significant reduction in total equity funds raised in Hong Kong in 2011 and 2012. We believe this was likely the result of the spillover effect of the European crisis and the financial market meltdown. Nevertheless, total equity placings[1] in Hong Kong increased by 114% from 2011 to 2012 (Hong Kong Stock Exchange 2012). Data from the placing documents yielded a number of other key findings—namely, the inadequacy of information disclosed to shareowners regarding the number and names of placees (i.e., the persons/entities receiving the placement), the utilisation of funds raised, the incidence of multiple placings, and continuous placings over the four-year period.

It is not uncommon for multiple placements and continuous placements, which lead to dilution of minority shareowners' interests, to occur in Hong Kong. The reason is that in Asia, unlike in the United Kingdom, there is no cumulative cap over a three-year period for placings without preemptive rights. We find that most reasons given for issuing shares under a general mandate are vague or generic. Actual utilisation of the proceeds raised is not disclosed to shareowners. Details of prior share issuance, including placees' information, are not readily available to shareowners. We conclude that better disclosure and greater transparency, with the intention of protecting investors, is needed. Almost 44% of the general mandate requests in 2012 and 37% in 2011 would have been rejected under the current rules if the substantial shareowners had not been permitted to vote in the resolution. This situation raises an important question of whether the current simple majority requirement is sufficient to protect minority shareowner interest.

Policy Recommendations: Improving Investor Protection

To further enhance investor protection, CFA Institute recommends these measures:

1. *Cumulative caps over a three-year rolling period.* In the United Kingdom, the Pre-Emption Group Statement of Principles restricts the maximum number of non-preemptive shares allowed over a three-year rolling period to be capped at 7.5% of total issued share capital. Currently, there are no such caps in the markets we reviewed in Asia. CFA Institute recommends that there should be a maximum limit over a three-year rolling period, implemented through regulations (i.e., stock exchange listing rules or the Companies Act should mandate a total cap over a three-year rolling period).

[1]Total equity placings include placings made through general and special mandates and include shares, convertibles, and warrants.

2. *Transparency and disclosure.*

    a. *Adequate disclosure of placees and discount details of prior share issuance.* Where companies have placed shares based on general mandates in the immediately preceding three years, we recommend that the management clearly disclose the number and percentage of shares issued in those earlier placings and the discount at which the shares were issued, as well as details of the actual placees (including criteria for selecting these placees), in the proxy materials at the next AGM for shareowner information.

    b. *Adequate disclosure of utilisation of share issuance proceeds.* When the new share mandate request is made, investors are often given very vague descriptions of how the share issuance proceeds will be utilised. CFA Institute recommends that companies avoid giving generic reasons, such as future working capital or future investment opportunities. As a best practice, they should articulate clearly the intended uses for the funds to be raised through the general mandates. For companies that have raised capital in the immediately preceding three years through earlier mandates, we further recommend that the actual utilisation of proceeds raised earlier be included in the proxy materials at the next AGM for shareowner information.

3. *Shareowner approval.* Hong Kong and Singapore require simple majorities for share mandate approval, China requires two-thirds, and the United Kingdom requires three-fourths. CFA Institute recommends that share mandates require more than a simple majority approval. A three-fourths majority requirement would provide more equitable protection for minority shareowners in most Asian markets. Our study of Hong Kong showed that at a 75% approval level, 15% of the general mandate requests would have been rejected in 2012; 17% in 2011; 10% in 2010; and 14% in 2009.

Structure of This Report

Section 1 of this report[2] defines preemption. Section 2 draws a comparison between regulations in different jurisdictions in Asia (i.e., Hong Kong, Malaysia, Singapore, and Thailand) and the United Kingdom. Section 3 analyses Hong Kong placings data over four years (January 2009–December 2012) and highlights the trend and implications of multiple and continuous private placements completed through general mandates in Hong Kong. Section 4 summarises the rights, roles, and responsibilities of various stakeholders—management; boards; controlling shareowners; and minority, or noncontrolling, shareowners—within organisations and the role of regulators in the corporate governance ecosystem. This final section also recommends policy changes to improve minority shareowner rights in any organisation.

[2]Disclaimer: Data in our report focus only on private placings through a general mandate of publicly listed companies in Hong Kong over the last four years (publicly available data collected from HKEx). We have intentionally made some conspicuous omissions from the dataset—such as new issues to corporate insiders or parent firms, rights issues, and issues of warrants and convertible securities—because they are governed by separate listing rules and company law guidelines in Hong Kong. This report is not about the rights issues or seasoned equity offerings because they are equity issued to the public at large. Placings made through special mandates have not been included in the data because they have a separate approval process in Hong Kong.

1. What Is a Preemptive Right?

Preemption right[3]—also known as "preemptive right"—is a subscription privilege for existing shareowners of a company. It gives them the first right to refuse or purchase additional shares offered by the company. This right protects existing shareowners by giving them the option to retain their percentage of ownership in a company and to ensure that their proportion of voting and other economic interests/rights in the company is not diluted (Technical Committee of the International Organization of Securities Commissions 2009).

In the United Kingdom, preemptive rights are embedded in UK company law.[4] Some markets in Asia (i.e., Hong Kong, Singapore, and Malaysia) derive their regulatory frameworks from the UK system and have acquired the force of a fixed rule of law that gives shareowners the preemptive right by statute, by articles, or by listing rules.

Need for Balance: The Company's Financial Flexibility vs. Investors' Financial Ability

Although it is generally believed that preemption rights safeguard shareowners' positions and avoid agency conflicts, Paul Myners, a former UK financial services secretary, challenged the fundamentals of preemption itself (Myners 2005). He suggested that many companies and their advisers believe that the ability to select the most appropriate capital-raising method for their needs is being unnecessarily constrained by the way that shareowners' rights are currently applied. In other words, does the application of preemption rights hinder the ability of companies to raise funds flexibly for innovation and growth?

The value of preemption is a real one for shareowners, and the value will differ considerably from company to company depending on whether there is a risk of dilution of monetary value or of control. Companies argue that shareowners' preemption rights adversely affect their ability to raise cash through the issuance of new shares. Minority shareowners argue that they have no legal protection against the dilutive effect of fresh non-preemptive shares being issued at deep discounts to market price to friends and associates of controlling shareowners. A common fear is that non-preemptive shares permit the transfer of value to new investors at the expense of existing shareowners.

The effectiveness of preemptive rights as a shareowner protection mechanism ultimately depends on the financial ability of the shareowner who owns the right to pay the subscription price for the new shares (Technical Committee of the International Organization of Securities Commissions 2009). Whether companies can make pragmatic financial decisions while safeguarding minority shareowners' interests is often a matter of perception and is highly debated.

[3]According to Merriam-Webster, the right of preemption is "the right of purchasing before others. . . a prior seizure or appropriation: a taking possession before others" and the origin of preemption is the medieval Latin word for "previous purchase."
[4]See www.legislation.gov.uk/ukpga/2006/46/section/571.

Waiver of Preemption Rights

In most Asian markets, shareowners have preemptive rights that they may waive by granting a mandate as per statutory provisions (Organisation of Economic Co-Operation, OECD 2007). For example, listing rules in Hong Kong permit management to seek general or special[5] mandates from shareowners to issue shares without preemptive rights. These mandates give company directors the legal right to offer private placement of shares to hand picked investors, either directly or through placing agents, at a discount to the market price. Management is aware that issuing shares privately at a steep discount to fund capital needs or growth opportunities could possibly precipitate share dilution of existing shareowners. The expropriated shareowner not only loses economic benefits but also, and more importantly, suffers a further reduction in other ownership rights, such as voting.

[5]Shareowners' approval may either be by specific mandate (i.e., approval by ordinary resolution in general meeting of a specific transaction) or by general mandate. A special mandate is required when a company proposes a placing with a specific purpose—for example, to finance an acquisition and the target's business development—and has yet to enter into any placing agreement. It has to take reasonable steps to ensure that sufficient information about the placing, including the framework for setting the terms of the placing and the specific use of proceeds, is provided to shareowners. Placings under a special mandate are outside the scope of this project.

2. Comparison of Non-Preemptive Share Issuance Regulations

We provide a comparative analysis of the regulatory environment relating to non-preemptive share issuance based on general mandates across a few jurisdictions in Asia—namely, Hong Kong, Singapore, Malaysia, and Thailand. Because most of these markets derive their regulatory frameworks from the UK system, we compare these regulations with the UK preemptive rights structure, where such rights are embedded in UK company law. **Table 1** compares key elements in the approval process for private placements across the respective markets in Asia. The elements include the percentage of shareowner approval required, the maximum percentage of new share capital that can be issued, the maximum discount at which these shares can be issued, and the cumulative limit over a three-year period.

Table 1. **Comparative Analysis of Non-Preemptive Share Issuance Rules**

Rules	United Kingdom	Hong Kong	Singapore	Malaysia	Thailand
Can a listed company issue new shares without preemptive rights?	Yes	Yes	Yes	Yes	Yes
What percentage of shareowner approval is required at the shareowners' meeting?	75%	50%	50%	50%	75%
What is the maximum percentage of new shares that can be issued without preemptive rights in one year?	5% (as per preemption group)	20%	20%	10%	10%
What is the cumulative limit over a three-year rolling period?	7.5%[a]	—	—	—	—
What is the maximum discount at which the new shares can be issued without preemptive rights?	5%[a]	20%	10%	10%	No discount for general mandates
What is the term of the general mandate?	15 months or until the next AGM (as per preemption group)	One year or until the next AGM	Until the next AGM	Until the next AGM	Until the next AGM

[a]UK Pre-Emption Group (2008).

United Kingdom

Preemption rights are a cornerstone of UK company law and are enshrined in law by the Second Company Law Directive and the Companies Act 1985, which provide that these rights may be lifted only by a special resolution (75% majority) of shareowners at a general meeting.[6]

[6]See www.legislation.gov.uk/ukpga/2006/46/section/571.

LR (listing rule) 9.3.11 requires that a listed company proposing to issue equity shares for cash first offer those securities to existing shareowners in proportion to their holdings. This rule does not apply where shareowners have authorised a general waiver of statutory preemption rights in accordance with the Companies Act.

Although the law and the listing rules seem permissive, standards have become more stringent because of pressure from institutional investors that support the best practice guidelines published by the Pre-Emption Group.[7] The initial preemption guidelines were published in 1987 by the original Pre-Emption Group. This served as a guidance to assess disapplication of preemption rights. The current Pre-Emption Group was set up in 2005 to produce a statement to provide clarity on the circumstances in which flexibility might be appropriate and to make use of an agreed-on authority for a non-preemptive share issue. Its members represent listed companies, investors, and intermediaries. The Statement of Principles was initially published in May 2006 to replace the Pre-Emption Guidelines. It is not a set of rules; rather, it is intended to provide a basis for discussion of the business case between companies and their investors.

Key points of the Statement of Principles are as follows:

- Requests to waive preemption rights are more likely to be routine when the company seeks authority to issue no more than 5% of ordinary share capital in any one year.
- Companies should not issue more than 7.5% of the company's ordinary share capital for cash except to existing shareowners in any rolling three-year period in the absence of suitable advance consultation and explanation or the matter having been specifically highlighted at the time of request at shareowner meetings for disapplication of preemption rights.
- Companies should note that a discount of greater than 5% is not likely to be regarded as routine.
- Authority to disapply preemption rights following a routine request would normally be granted by shareholders' approval of an appropriate resolution at an AGM.
- Shareholders will not generally agree to a nonroutine disapplication request without a sufficiently strong business case for this course of action. Thus, nonroutine requests would be made at an AGM only when the company is in a position to justify this approach by providing information regarding the business case. Otherwise, a specially convened extra ordinary general meeting would be needed.

An updated version of the Statement of Principles (UK Pre-Emption Group 2008) was published in July 2008. It contains a limited number of changes, which

- Clarify that convertible instruments are covered by the Statement of Principles;

[7]See www.pre-emptiongroup.org.uk/About-Us.aspx.

- Recognise that shareholders would not normally have concerns if there is no dilution of value as a result of the proposed issue; and
- Recommend that companies not seek an authorisation for more than a maximum of 15 months, in line with current practice.

Hong Kong

The listing rules of Hong Kong[8] attempt to strike a balance between commercial practicality and investor protection (HKEx 2013). The listing rules currently permit two types of mandates—a general as well as a special mandate.

- The general mandate gives management the right to allot, issue, or grant shares, securities convertible into shares, options, warrants, or other rights to subscribe for shares or such convertible securities.
- Management can seek shareowners' approval via ordinary resolutions (for non-H-share issuers) or special resolutions (for H-share issuers[9]) to issue up to a maximum of 20% of the company's existing issued share capital as non-preemptive shares.
- In addition, the listing rules allow companies to privately place any securities that have been repurchased as long as they do not exceed 10% of the company's existing issued share capital. This action, however, must first be approved by existing shareowners through a separate ordinary resolution at a general meeting to allow for the repurchased securities to be added to the 20% general mandate.
- Mandates for non-preemptive share issuance lapse automatically at the next general meeting.
- If a listed issuer has obtained a general mandate and issued securities pursuant to it, it may "refresh" the mandate by convening a special general meeting of the shareowners (before the next AGM) by seeking independent shareowner approval for up to another 20% of its existing issued share capital. There are no restrictions on the number of times the general mandate can be "refreshed," although the controlling shareowner[10] is not permitted to vote on these subsequent refreshments.

[8]The Stock Exchange of Hong Kong Limited (Exchange) is a wholly owned subsidiary of HKEx. It makes the listing rules of Hong Kong and reviews the rules from time to time to ensure that they address developments in the market and international best practices and also represent acceptable standards that help to ensure that investors have and can maintain confidence in the market.

[9]H-shares are shares issued by companies incorporated in mainland China and listed on the Hong Kong Stock Exchange. See www.hkex.com.hk/eng/prod/secprod/eqty/Documents/equities.pdf.

[10]A controlling shareowner is any person who is entitled to exercise or control the exercise of 30% or more of the voting power at general meetings of the issuer or who is in a position to control the composition of a majority of the board of directors of the issuer. A "substantial shareowner" is a person who is entitled to exercise, or control the exercise of, 10% or more of the voting power at any general meeting of the company.

- The issuer may not issue any securities pursuant to a general mandate if the relevant price represents a discount of 20% or more to the benchmarked price[11] of the securities unless the issuer can satisfy the exchange that it is in a serious financial position and that the only way it can be saved is by an urgent rescue operation that involves the issue of new securities at a price representing a discount of 20% or more to the benchmarked price of the securities or that there are other exceptional circumstances.

- For all Hong Kong–listed companies, after an issuer agrees to issue securities under a general mandate, it must publish an announcement before the next business day that includes names of the placees if they are fewer than six in number or a brief generic description of the placees if there are more. All issuance to connected persons has to be approved by independent shareowners.

General Mandate Approval for Hong Kong–Listed Companies Incorporated in Mainland China

General mandates can also be granted in the case of Hong Kong–listed companies incorporated in the People's Republic of China (PRC). These PRC companies must obtain the approval of A-shareowners[12] and H-shareowners at separate class meetings through special resolutions (requiring two-thirds majority) at AGMs. PRC company law does not permit a PRC company to have authorised but unissued share capital. Hence, any proposed issuance of shares pursuant to a general mandate can be achieved only after the articles of association of the company have been amended to increase the registered share capital. To avoid holding another shareowners' meeting to approve this extra step, it is common practice, when the general mandate is approved, for the directors to also be authorised to amend the articles of association to increase the registered share capital and reflect the new capital structure. Any such amendments to the articles of association of the company have to be submitted to the relevant PRC authorities for approval.[13]

Singapore

The Companies Act of Singapore (Section 161) requires approval at a general meeting of members, and the shares are placed through a placing agent, which is usually a stockbroking firm or an investment bank (Singapore Stock Exchange 2013). Private placements in Singapore are governed by the Singapore Stock Exchange (SGX) listing rules (LR 806–813); key features are summarised as follows:

[11]Benchmarked price is the higher of (a) the closing price on the date of the relevant placing agreement or other agreement involving the proposed issue of securities under the general mandate and (b) the average closing price in the five trading days immediately prior to the earlier of (i) the date of announcement of the placing or the proposed transaction or arrangement involving the proposed issue of securities under the general mandate, (ii) the date of the placing agreement or other agreement involving the proposed issue of securities under the general mandate, and (iii) the date on which the placing or subscription price is fixed.

[12]A-shares are shares issued by companies incorporated in mainland China. They are listed and traded on the mainland A-share markets (Shanghai and Shenzhen) and quoted in renminbi. They are not listed on the Hong Kong Stock Exchange.

[13]The impact of general mandates on H-share issuers is beyond the scope of this project.

- LR 806 allows shareowners to give the board of directors a general mandate to issue shares through placements. The number of shares issued in a private placement must not exceed 20% of the previously issued shares of the firm.
- LR 811 stipulates that the issuer is permitted to issue shares at a discount of up to 10% on the last price of the shares on the exchange transacted either at the time of or immediately preceding the signing of the placement agreement.
- LR 812(1) places further restrictions on a company's ability to place shares with an issuer's directors and substantial shareowners, their family members, or related companies or where their aggregate interest is at least 10%. SGX leaves some flexibility for issuers by stating that it may approve placements to restricted entities if independent shareowner approval is received or if SGX is satisfied that the person is independent and not under the control or influence of any of the issuer's directors or substantial shareowners.
- Singapore listing rules do not restrict the resale of the placement shares by the purchasers.
- LR 810(1) requires that where a placing agent is used, issuers disclose the identity of the placing agent, the amount of proceeds to be raised, and the use of such proceeds. Significant faith is placed in the role of the placing agents, their independence, and their management of conflicts when placing shares. When a placing agent is used, no placees have to be named.
- LR 810(2) requires that all placees be named where a placing agent is not used. Complete disclosure to each placee on the number of shares and the price at which they are placed is mandatory. The process for identifying the placees and the rationale for choosing those placees have to be disclosed.
- An issuer cannot rely on the general mandate for an issue of convertible securities if the maximum number of shares to be issued upon conversion cannot be determined at the time of issue of the convertible securities.

Malaysia

Chapter 6, Part C, of Malaysia's listing rules sets out the general requirements for new issue of securities (Bursa Malaysia Securities Berhad 2013). Section 6.03 relates to the general mandate for the issue of securities.

- A listed issuer in Malaysia must not issue any shares or convertible securities if the nominal value of those securities exceeds 10% of the nominal value of the issued and paid-up capital of the listed issuer except with prior shareowner approval in a general meeting. Section 132D of the Companies Act of Malaysia (Part V, Division 2) empowers the directors of an issuer to seek approval from the shareowners through an ordinary resolution before issuing shares based on general mandates for purposes that they may deem fit and expedient and in the best interest of the company.

- Where a general mandate is sought, the listed issuer must indicate clearly whether it is a new mandate or renewal of an existing mandate as well as the purpose and utilisation of the proceeds. If it is a renewal, it is mandatory to disclose the proceeds raised from the previous mandate as well as the details and status of the utilisation of those proceeds.

- Shares issued based on a general mandate cannot be priced at more than a 10% discount to the weighted average market price of the shares for the five market days immediately before the price-fixing date.

- Shares issued cannot be placed to an interested director, interested major shareowner, interested chief executive, or interested person connected to any of these and any nominee corporations unless the names of the ultimate beneficiaries are disclosed. Where the issue of shares departs from any of these applicable prohibitions, the listed issuer must obtain the prior approval of shareowners in a general meeting that makes clear the precise terms and conditions of the issue, including the price, purpose, and utilisation of proceeds. Allotment of shares based on general mandates to related parties requires specific approval of independent shareowners.

- In Part D, Sections 6.11–6.16 stipulate the duties of the principal adviser, who must act as a placement agent for the placement of securities. The listed issuer must issue and allot securities as soon as possible after the price-fixing date. The principal adviser must submit to the exchange the following details: the final list of placees, including names, addresses, and passport/company registration numbers; the ultimate beneficial owners of the securities; and the amount and price of securities placed to each entity.

Thailand

In the listing regulations issued by Stock Exchange of Thailand,[14] the "general mandate capital increase" refers to the expansion of a listed company's share capital by shareowner approval being sought in advance via a resolution in a meeting (Stock Exchange of Thailand 2009). At the same time, the company's board of directors will be authorised to determine the objectives and terms of the issuance, as well as the allocation of these shares for capital increase; this allows the board to determine the price, date, and time of the offer or the conditions of each offer of the shares as appropriate.

- The listed company may allocate capital-increase shares by way of private placement for no more than 10% of the paid-up capital as of the date its board of directors resolved to approve the general mandate capital increase.

- The offering price for such private placements cannot be made at a discount to market price.

- Such general mandates to allocate capital-increase shares remain valid until the next AGM. A minimum majority of three-fourths is necessary at the shareowner meeting to pass a proposal for a capital increase under a general mandate.

[14]See www.set.or.th/en/products/financial/files/GM_Brochure.pdf and www.set.or.th/set/notification.do?idLv1=1&idLv2=10&language=en&country=US.

- In accordance with Sections 136 and 137 of the Public Limited Company Act, the resolution must state the number of shares allotted.
- After the resolution has been passed by the board of directors, a capital-increase report form must be filed with the exchange by the following business day, at least one hour before the first trading session commences. The form must include complete details of the capital increase, including the number of shares, percentage of paid-up capital, the objectives of capital increase, plans for utilising the proceeds, benefits that the company will receive, and benefits that the shareowners will receive from the capital increase.
- Within five working days of allotment, the listed company must also send to the exchange all details related to the issuance and allotment of private placement of shares, including the names of placees, their relationship with the company, and the remaining shares that need to be allocated under the general mandate.

3. Analysis of Hong Kong Market Placings Data

The definition of placing as per Chapter 7 of the Hong Kong listing rules is "the obtaining of subscriptions for or the sale of securities by an issuer or intermediary primarily from or to persons selected or approved by the issuer or intermediary." In this section, we examine data over four years (2009–2012) from the Hong Kong Stock Exchange and analyse share placements based on general mandates. We look at how placement regulations are implemented in Hong Kong and the practical issues faced by investors as a result of the way these regulations are interpreted.

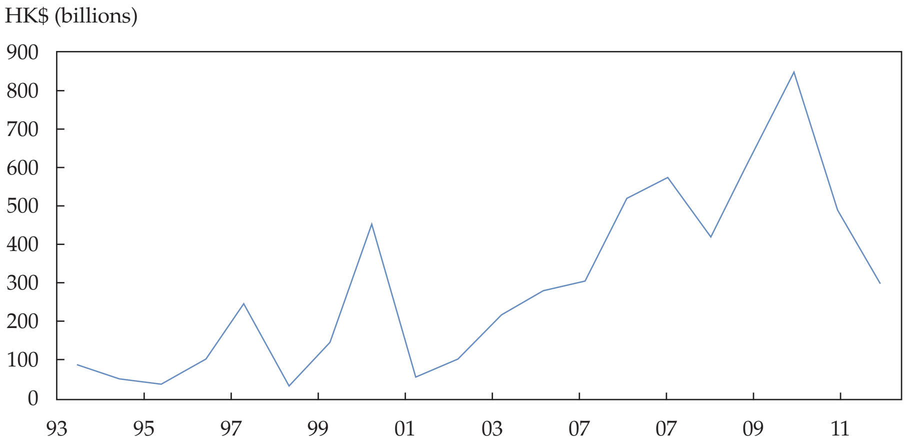
The Big Picture: Equity Funds Raised vs. Placings in Hong Kong–Listed Companies

When considering the placings data from the *HKEx Fact Book 2012*, the most striking data relate to the volatility in the amount of equity funds raised and total placings completed by Hong Kong–listed companies in the last four years.

Figure 1 shows that there was a significant reduction in equity funds raised in 2011 and 2012 compared with in previous years; from HK$845 billion in 2010 to HK$483 billion in 2011 (a 43% decline) and HK$300 billion in 2012 (a further 38% decline). This shift is generally attributed to the growing uncertainty in global financial markets and a dry IPO market in Asia Pacific during that period.

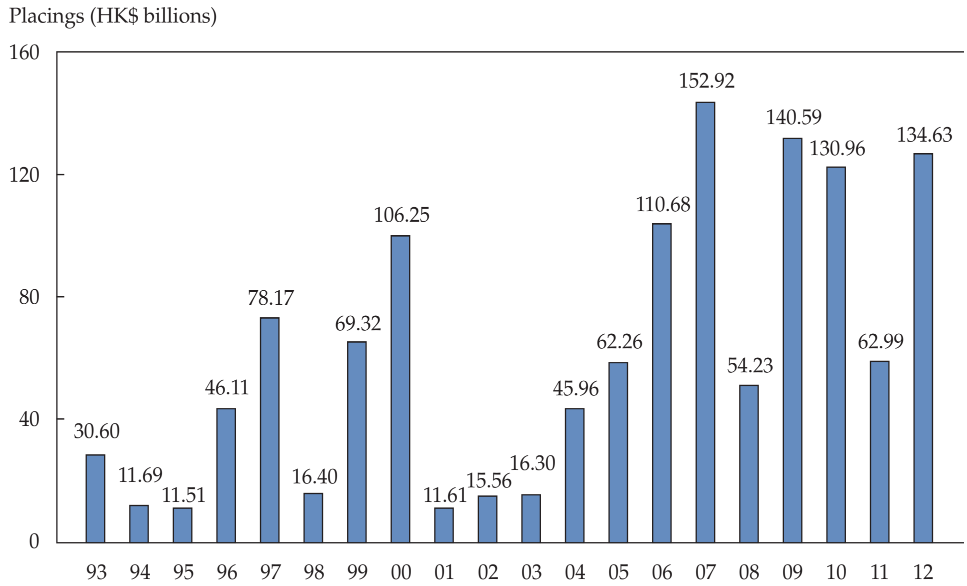
Although there was a declining trend in equity funds raised as a whole, total share placings by Hong Kong–listed companies actually increased substantially in 2012 compared with in 2011 and even in 2010. **Figure 2** shows that although there was a 52% drop in the dollar value of placings in 2011 compared with in 2010, that value rebounded 114% the following year in 2012, surpassing even 2010 levels (by almost 3%). In 2012, HK$135 billion of funds were raised through placings (including shares through general and special mandates as well as convertible bonds), representing 45% of total equity funds raised (HK$300 billion). The comparison between total equity funds raised and total share placings underscores the recent importance of placings as a source of capital for Hong Kong–listed companies.

Figure 1. Equity Funds Raised by Listed Companies in Hong Kong, 1993–2012



Source: HKEx (2012).

Figure 2. Total Placings by Hong Kong-Listed Companies, 1993–2012



Source: HKEx (2012).

Scope of This Study

In order to understand the implementation of the listing rules related to private placements through general mandates, we collected placings data[15] for a four-year period (January 2009–December 2012) that are available publicly on the HKEx website. We focused on companies that were component stocks of the benchmark, the Hang Seng Composite Index (HSCI).[16] Data of all the AGMs related to the share placings were also compiled.

Data Analysis

Of the total placings in Hong Kong for the four-year period (2009–2012), we isolated data related only to share issuance based on general mandates.[17]

Table 2 shows the number of companies that made share placements based on general mandates each year between 2009 and 2012 as well as details of these placements:

- In 2012, 26 companies made share placements. In all, there were 28 share placements based on general mandates approved in 27 AGMs.
- In 2011, 21 companies made a total of 23 placements through 23 AGMs.
- In 2010, 44 companies made 56 placements through 49 AGMs.
- In 2009, 45 companies made 54 placements through 48 AGMs.

Table 2 shows that the total number of companies making share placements through general mandates declined from 2009 to 2011. This drop could be attributed to the financial crisis that began in late 2008.

Table 2. **Share Placings Based on General Mandates, 2009–2012**

Placement Information	2012	2011	2010	2009
Companies making share placements	26	21	44	45
Total number of share placements	28	23	56	54
Total number of AGMs where share placings were approved	27	23	49	48

[15]The greatest challenge was identifying errors, exceptions, and outliers and isolating them to get valid data. Data not included for the purpose of this report are specific mandates, long positions of substantial shareowners, share award schemes for employees, unreliable voting results, and H-shares (shares issued by companies incorporated in mainland China and listed on the HKEx).
[16]The HSCI offers a comprehensive Hong Kong market benchmark that covers about 95% of the total market capitalisation of stocks listed on the Main Board of the Stock Exchange of Hong Kong (SEHK). The HSCI is also subdivided into three size indices, including the Hang Seng Composite LargeCap Index (HSLI), the Hang Seng Composite MidCap Index (HSMI), and the Hang Seng Composite Small Cap Index (HSSI), which covers the top 80%, the next 15%, and the remaining 5%, respectively, of the total market capitalisation of the HSCI.
[17]In Hong Kong, a special mandate is required when a company proposes to seek a mandate for a placing with a specific purpose or for any proposal to issue new shares that exceeds the limits of listing rule 13.36(2) as it must be considered by shareowners on a case by by-case basis under LR 13.36(1). Apart from the purpose, the key difference between general and special mandates is that controlling shareowners abstain from voting in favour of any refreshments of the general mandates, whereas they can vote on special mandates.

We then broke down the placings data further into large-cap, mid-cap, and small-cap categories as per HSCI classification. We looked for trends with regard to private placements, such as the purpose of asking for general mandates, the percentage of discount for placings, and the incidence of multiple placings and continuous placings over the four-year period. We also analysed the adequacy of disclosure with regard to the identity and number of placees. Our analysis of all AGMs reveals the type of resolutions passed and the percentage of support received for passing these resolutions. We then extrapolated whether the resolutions would have been passed if the minimum requirement had been a special resolution (three-fourths majority) and if the substantial shareowners had not been permitted to vote. We summarise the findings in this section of the report.

Analysis of Data from Placings

Table 3 highlights a couple of important statistics. Firstly, the total number of companies in the HSCI[18] making private share placements through general mandates dropped drastically from 45 in 2009 to 26 in 2012. Secondly, based on the sample data, in total, 26 companies on the HSCI raised HK$63.1 billion gross proceeds through placements in 2012 versus 21 companies that raised gross proceeds of HK$17.7 billion in 2011. This represents an increase of more than 2.5 times, with large-cap companies representing 35% of the total in 2012.

Table 3. **Classification Based on Company Size in HSCI Index, 2009–2012**

Classification	2012	2011	2010	2009
Large cap	35%	10%	9%	24%
Mid cap	38%	33%	36%	42%
Small cap	27%	57%	55%	34%
Companies making share placements under a general mandate	26	21	44	45
Gross proceeds raised	HK$63.1 billion	HK$17. 7 billion	HK$63.6 billion	HK$68 billion

Analysis of Prices on Private Placement of Shares

The average discount at which private placements were made in Asia varies between 10% and 20%. The maximum discount permitted by Hong Kong listing rules on private placings is 20% of the benchmarked price of the shares. This value is comparatively higher than in Singapore and Malaysia, where such discounts are capped at 10%, and in Thailand, where no discount is permitted for shares issued based on general mandates. The implication of higher discount rates is, of course, a higher dilution impact of existing shareowners' interests.

Academic Research on Private Placement Discounts

Several academic researchers have studied why private placements are issued at relatively large discounts to market price. One particular question examined is whether discounts are an indication of how investors and markets value the future prospects of the company.

[18]As of September 2013, there are 357 companies in HSCI, out of which 72 are large-cap, 159 are mid-cap, and 126 are small-cap companies. See www.hsi.com.hk/HSI-Net/static/revamp/contents/en/dl_centre/factsheets/FS_HSCIe.pdf and www.hsi.com.hk/HSI-Net/static/revamp/contents/en/dl_centre/brochures/hsci_E.pdf.

The earlier literature has focused mainly on the impact of information asymmetry, monitoring, illiquidity, and management entrenchment. More recent studies have also considered changes in large shareowners' control over such firms, especially in Asia, where family-controlled ownership is common.

Earlier Academic Arguments

Myers and Majluf (1984) evaluated equity capital as a new financing choice on the assumption that the capital structure choice was already made. They argued that dilution problems arise because of the information asymmetry between insiders and outsiders; that is, issuers not only know what the funds raised will be used for (financing new investments, repurchasing debt, resolving a liquidity crisis) but also are in a position to know more than outside investors about the true value of the company's assets and its future investment opportunities. To the extent that such firm-specific information is hidden from the market, it can contribute to market valuation errors. Temporary pricing errors affect the corporate issuance decisions in the following way: Undervalued companies tend to avoid issuing stock, preferring to postpone planned investments if no other source of financing materialises in the short term. Myers and Majluf concluded that when managers have superior information and stock is issued to finance investments, the stock market responds to the announcement of new equity offerings by dropping the issuer's stock price. In other words, investors are hedging to compensate for their own informational disadvantage.

On the other hand, Wruck (1989) argued that private placees tend to be block purchasers and thus are more sophisticated and better-informed about the issuers. According to Wruck's monitoring hypothesis, the new investors can help monitor the management and private placement discounts can be viewed as compensation for their contributions.

Hertzel and Smith (1993) proposed a very different perspective. They argued that private placements can actually mitigate the information asymmetry problem because management usually adopts one-on-one negotiations to credibly convince investors in private placements about their firms' prospects. Their certification hypothesis suggests that discounts offered in private placements are strongly correlated with information revelation costs. In other words, the discount is to compensate the placees for their effort, time, and resources spent on due diligence to assess firm value and to certify the issue.

Contradictory Empirical Evidence

In Asia, private placements are typically firm commitment offerings made through investment banks or brokerage firms to new investors who typically have no previous connection with the issuer, as required by the local listing rules. As argued in earlier academic studies, *ex post* monitoring is not anticipated in the firm commitment for underwriting private placements.

The recent academic literature has revived the debate on private placements by questioning the validity of the earlier hypotheses based on monitoring, information asymmetry, and certification. Barclay, Holderness, and Sheehan (2007) offered an entrenchment hypothesis to explain that incumbent management uses the private placement route to put in place a set of "friendly" (passive) owners to thwart takeover attempts. Wu (2004) also identified support for the entrenchment hypothesis, indicating that discounts in private placements to owner/managers are significantly larger than those offered to outside parties, especially when the largest existing shareowners maintain lead control status (dominant control).

Yeh and Ma (2012) found evidence of private placements being used as self-dealing vehicles (i.e., insiders enjoy a significantly large discount) in Taiwan, particularly when existing insiders retain dominant control, but not if there is a change in control power after the placement. Wu, Wang, and Yao (2005) also found a direct correlation between controlling ownership concentration and the discounts offered on private placements in Hong Kong.

In Asia, there are a plethora of other factors that influence the decision to offer private placements at discounts, such as the type of investor, ownership concentrations, and motivation for private placement (i.e., financial distress, aggressive growth, or just financial need). The reasons for issuing private placements at discounts and the price at which they are issued are multifaceted issues in Asia. It is difficult to positively identify any one particular reason.

Data Analysis of Prices

We analysed the prices at which share placements were completed in Hong Kong during the four years (2009–2012).

In 2012 and 2011, 4% of the total share placements were made at a premium to market prices, and in 2009 and 2010, 9%. Of these, 68% of the companies that issued shares at a premium were small-cap companies. In terms of reasons to issue shares at a premium, the data reveal that 75% of the cases are related to acquisition because of possible synergies and better valuation of the future prospects of the company by the management and placees.

Key findings related to discounts as shown in **Table 4**, include the following:

- In 2012, one in four total placements was made at a discount of less than 5%, which is almost double the figure for 2011 (13%).
- In 2012, almost two in three of the placings were performed at a discount of 5%–10%; note that the maximum discount allowed in most major Asian financial markets (with the exception of Hong Kong) is 10%.
- No issues were made at a discount of greater than 15% in 2012 and 2011, which indicates an improvement in market trends.
- The Hong Kong listing rules permit a discount of greater than 20% under exceptional circumstances, such as serious financial trouble. No issues were made at a discount greater than 20%.

In summary, almost 89% of the placements in 2012 were made at discounts of less than 10%. Although the maximum permissible limit is 20%, no placements in 2011 and 2012 were made with a discount greater than 15%. This analysis raises an important question:

Should Hong Kong regulatory authorities revisit the issue and reduce the permissible limit to safeguard minority shareowner interests and to harmonise the regulations with other Asian markets?

Table 4. **Analysis of Share Placement Discounts**

Discount Range	2012 (%)	2011 (%)	2010 (%)	2009 (%)
Share placements at a premium	4	4	9	9
Share placements at market price	0	22	5	4
Discount less than 5%	25	13	7	4
Discount of 5%–10%	64	43	46	44
Discount of 10%–15%	4	9	20	22
Discount of 15%–20%	0	0	13	15
Information not available	4	9	0	2

Cumulative Effect of Multiple Placements and Continuous Placements

The cumulative effect of multiple placements in one year and continuous placements in consecutive years can significantly dilute minority shareowners' interest. We analysed our sample data to see how many companies used the general mandate for share issuance more than once in the four-year period studied and in consecutive years.

Analysis of discounts issued in our sample data of HSCI companies highlight the following statistics:

- 19% made placements in two out of four years, and another 5% made placements in three out of four years.
- Altogether, 24% of the companies utilised their mandates in more than one year.
- In addition, 15% of the companies utilised the mandate in consecutive years, and 29% of the companies had multiple placements in one year.
- Two companies in particular conducted eight placings—each between 2009 and 2012. They achieved this through refreshments of mandates in the same year. Because the placings exceeded the 20% limit (of issued share capital) imposed by Hong Kong listing rules, the companies were required to obtain independent shareowner approval in order to renew mandates.

In the United Kingdom, there is a maximum limit of 7.5% over a three-year rolling period established by the Pre-Emption Group. Currently, there are no such caps in the markets we reviewed in Asia. If guidelines similar to those in the United Kingdom were established in Hong Kong, 61% of the companies making placements would have exceeded this cap of 7.5%. If the cap were raised to 10%, then more than 43% of the companies would still have exceeded the cap.

CFA Institute recommends setting a maximum limit on placings over a three-year rolling period in the listing rules of stock exchanges to provide a measure of check and balance on the dilution of existing shareowners' interest. Even so, before voting on the issuance of new capital stock, shareowners should review the factors or reasons for the issuance of new capital stock.

Disclosure: Placees

In Hong Kong, the listing rules require a listed company to disclose the names of placees if they are fewer than six in number or provide a brief generic description of them in the case of six or more placees. Placements made to connected persons are subject to shareowner approval even if they are issued under a preexisting general mandate. All issuances to connected persons have to be approved by independent shareowners.

As shown in **Table 5**, 67% of placings in 2009 and 71% in 2010 were issued to more than six placees. Although the figure fell to 48% in 2011, it bounced back to 71% by 2012. Therefore, for a majority of these placements, only a generic description of the placees was provided to existing shareowners. For more details on placees, investors had to comb through stock exchange announcements or share registers.

Table 5. A Breakdown of Placements according to Number of Placees, 2009–2012

	2012 (%)	2011 (%)	2010 (%)	2009 (%)
More than six placees (generic description of placees)	71	48	71	67
Fewer than six placees (names of placees published)	29	52	29	33

Shareowners have a right to know the identity of the placees. Apart from dilution concerns, a central concern for minority shareowners is the degree of discretion that management has in placing these shares and the degree of interconnectedness between management and the placees.

CFA Institute recommends better disclosure regarding the process of selecting placees and the complete identification of placees to help shareowners to make informed assessments before voting on future share mandate requests.

Disclosure: Utilisation of Placement Proceeds

We also examined the placings data for reasons provided on the need for such placings. A range of reasons—some specific but most vague—were given by companies seeking such placings.

As shown in **Table 6**, in 2012, 21% of placings were undertaken for the vague reason of raising working capital, whereas another 40% indicated funding for working capital together with a number of other expenses, such as capital expenditures, expansion/growth, or debt repayment.

In total, 61% of placings in 2012 involved working capital funding. This number was 47% in 2011, 55% in 2010, and 67% in 2009. This result indicates that a relatively high percentage of mandates was requested for working capital–related needs.

Table 6. Reasons for Requesting General Mandate to Issue Non-Preemptive Shares, 2009–2012

Reason	2012 (%)	2011 (%)	2010 (%)	2009 (%)
Working capital	21	17	16	19
Working capital and capital expenditure	11	13	—	—
Working capital and expansion/growth	18	17	32	41
Working capital and repayment of debt	11	—	7	7
Future acquisition opportunities	—	—	18	11
Expansion (development projects)	11	5	16	6
Specific acquisition	11	43	11	15
Specific investment	17	5	—	1

All PRC companies, regardless of whether they are listed in Hong Kong or mainland China, are required by China Securities Regulatory Commission (CSRC) to provide a specific usage plan for the raised proceeds, including a detailed breakdown of the projects to be funded by the placement.

Need for Better Disclosure for Shareowners to Make an Informed Judgment

Based on the data from placings and the analysis of regulatory requirements, it is evident that the disclosure regime can be further enhanced to safeguard the interests of minority shareowners.

An important consideration before approving a general mandate is the issuer's cost of capital and alternative sources of capital. Without undermining the importance of non-preemptive share issuance in cases where it could be the last resort for emergency capital for companies under financial distress, we raise the dilutive concern of minority shareowners when fresh non-preemptive shares are issued at deep discounts to market price to friends and associates of controlling shareowners. A common fear is that non-preemptive shares permit the transfer of value to new investors at the expense of existing shareowners.

To mitigate this fear and concern of minority shareowners, a detailed (not generic) explanation for the intended use of the proceeds can help shareowners scrutinise and evaluate whether the purpose justifies the placing and thus make an informed judgment, keeping in mind the long-term benefits for the company.

There is a balance to be struck between allowing significant shareowners the ability to vote their interests like anyone else and using their outsized positions to effectively disenfranchise minority shareowners.

Further to the CFA Institute recommendation for better disclosure regarding the process of selecting placees and the complete identification of placees, CFA Institute recommends that companies avoid giving a generic reason, such as future working capital or future investment opportunities. As a best practice, they should instead articulate clearly the reasons why funds are to be raised while requesting a general mandate and also to disclose the actual utilisation of proceeds raised through earlier mandates in the proxy materials at the next AGM. This action will help shareowners make informed judgments as to whether the actual utilisation matched the original purpose.

Data from AGMs: Poll Results

In addition to analysing the placings data, we looked at the corresponding AGM agendas and poll results. Poll voting became mandatory in Hong Kong on 1 January 2009. The results of these votes give a good indication of how investors cast their votes for or against general mandates.

Out of the 348 companies in the HSCI, only 33 companies did not seek a general mandate at their respective AGMs in 2012. This result seems to indicate that a request for a general mandate has become a routine item on the AGM agendas of Hong Kong–listed companies.

Hong Kong listing rules also require only an ordinary resolution (50% majority) to approve a general mandate. There are two exceptions to this rule.

- PRC companies listed in Hong Kong are also governed by mainland China regulations, which require a two-thirds, or 66.67%, majority to approve a general mandate issuance without a rights issue.
- Some companies that have primary listings in the United Kingdom have voluntarily applied the higher standards of UK law to their Hong Kong listings. In particular, they comply with the stipulation for a special resolution (a three-fourths majority), along with the 5% preemption guidelines—maximum 5% discount and 5% of issued shares—from the United Kingdom.

Table 7 shows the breakdown of voting results of all AGMs where share mandates were approved and placings of non-H-shares have been conducted. We categorised the results by percentage quartiles to determine whether the resolution to waive preemptive rights would have been passed if the mandatory requirement had been a special resolution.

Table 7. **Analysis of AGM Poll Results, 2009–2012**

Percentage of Votes Approving the General Mandate Issuance	2012 (%)	2011 (%)	2010 (%)	2009 (%)
Less than 50%	—	—	—	—
>50% but <75%	15	17	10	14
>75% but <100%	85	83	84	83
100%	0	0	6	3

What If a Special Resolution Were Required to Pass a General Mandate Request?

A special resolution[19] requires that 75% of votes be in favour of the resolution. As shown in Table 7, 15% of the general mandate requests approved in 2012 would not have passed a special resolution requirement in 2012 because these mandates received less than 75% of votes. Similarly, 17% of the approved mandates would have been rejected in 2011, 10% in 2010, and 14% in 2009 if the requirement had been the more stringent special resolution. This result suggests that the voice of the minority shareowners would have been captured more accurately had a special resolution been mandated.

What If the Substantial Shareowners Were Not Permitted to Vote?

Where the information was available, we excluded the substantial shareowner votes from the polling results to try to better discern minority shareowners' decision/interest in issuing shares without preemptive rights. The results, shown in **Table 8** below, show a stark contrast to the results for all shareowners (in Table 7).

Table 8. **Adjusted Poll Results after Excluding the Substantial Shareowner from Total Votes in Favour of the Resolution, 2009–2012**

Breakdown of Adjusted Poll Results[a]	2012	2011	2010	2009
Adjusted Votes	% of AGM	% of AGM	% of AGM	% of AGM
Less than 50%	44	37	30	42
>50% but <75%	20	32	21	16
>75% but <100%	36	32	42	39
100%	—	0	7	3

[a]Adjusted votes = total votes in favour of the resolution less the substantial shareowner (assuming that the substantial shareowner would have voted for the resolution) divided by the total number of votes casted both for and against the resolution.

Table 8 shows that almost 44% of the general mandate requests granted in 2012 would have been rejected if the substantial shareowner in those cases had not been permitted to vote in the resolution. This figure was 37% in 2011, 30% in 2010, and 42% in 2009 because the requests would have received less than 50% of the votes and the resolution would have been rejected for lack of a simple majority.

What If the Substantial Shareowners Had Not Been Permitted to Vote and a Special Resolution Had Been Required?

Taking into consideration the concentration of ownership typical in Hong Kong companies, it is interesting to note that the adjusted votes indicate that if a special resolution had been required and if the substantial shareowners had not voted, almost 64%—nearly two-thirds—of the approved mandates in 2012 would have been rejected, compared with 69% in 2011, 51% in 2010, and 58% in 2009.

[19]According to the Hong Kong Companies Ordinance, Chapter 32, Section 116, a resolution will be a special resolution when it has been passed by not less than three-fourths of the members at a general meeting. See www.legislation.gov.hk/blis_ind.nsf/CURALLENGDOC/1838F370FCF11632C825648000432657?OpenDocument.

This analysis raises important questions as to whether minority shareowners in Hong Kong enjoy preemptive rights in practice and whether they are adequately protected against dilution through private placements performed via a general mandate.

CFA Institute recommends that share mandates require more than a simple majority approval; a three-fourths majority requirement would provide more equitable protection for minority shareowners in most Asian markets.

Latest Trend toward Disapproval of Some General Mandate Requests

Awareness is rising with regard to general mandate issuance in Hong Kong. Overseas institutional investors, who control more than 40% of the Hong Kong stock market, have increased their participation and engagement in the decision-making process.

These investors have analysed the time and cost taken to issue shares through rights issues versus through placing agents. The time taken for placings in Hong Kong is substantial, especially when it involves more than six placees. A majority of private placements in Hong Kong are performed through placing agents (investment banks and brokers) who are equally expensive when compared with underwriters of rights issues. Companies have to realise that documentation and extra time are minor costs relative to the value shareowners receive by preserving their fundamental rights of protection.

Investors realise that although Hong Kong LR 14 mandates that placements to connected persons need independent shareowner approval, it is often impossible for investors to know if the placees are related or connected to the substantial shareowners when placees are shell companies with nominee directors and shareowners. Existing shareowners typically learn about the placements and the identity of the placees (if fewer than six) through formal, mandatory public announcements that are posted on the HKEx website after the placement has been made. When there are more than six placees, only a generic description is provided in the announcement, and hence, shareowners would have to comb through HKEx announcements or share registers to determine whether their companies have new substantial shareowners.

The AGM data show a gradual shift in shareowner perception about such placements because a small percentage of general issuance mandate requests made in recent years were rejected by shareowners at AGMs.

4. Conclusion and Recommendations

This research is a part of the continued efforts of CFA Institute to raise the bar on corporate governance practices of significance to investors in Asia. Our goal in this specific case is to create awareness among investors regarding preemptive rights. This report provides a review of share issuance under a general mandate in Asia, with particular reference to data from Hong Kong–listed companies. The primary aim of our review and data analysis is to help create a stronger corporate governance framework that better defines the rights, roles, and responsibilities of various stakeholders—the management; board; controlling shareowners; and minority, or noncontrolling, shareowners—within an organisation and the role of regulators in the corporate governance ecosystem.

Management: Good Governance and Effective Communication

To this end, we believe that management should keep shareowners well-informed and seek to engage them in advance of key strategic decisions (within the limits of ensuring confidentiality of price-sensitive information). This behaviour is particularly important when companies are considering the issuance of new shares and when their boards may seek approval from shareowners to waive preemption rights on an as-needed basis. The general purpose behind requesting these mandates has to be clearly described at the AGMs.

Clear communication regarding strategies and decisions taken to generate long-term value for shareowners is of paramount importance in the development of a good corporate governance framework. Management has a responsibility to present the pros and cons of the individual proposals so that shareowners can review the cases made by each company on their merits and make informed assessments, using the investment criteria most appropriate for their markets.

Shareowners: Criteria for Waiving Preemptive Rights

In "The Corporate Governance of Listed Companies: A Manual for Investors",[20] CFA Institute has noted that shareowners should determine whether they have the right to approve changes to corporate structures and policies that may alter their relationships with their companies. Shareowner input on corporate changes to certain corporate structures is vital because it has

[20]Kurt Schacht, James C. Allen, and Matthew Orsagh, "The Corporate Governance of Listed Companies: A Manual for Investors, Second Edition," CFA Institute Codes, Standards and Position Papers, vol. 2009, no. 12 (September 2009): www.cfainstitute.org/learning/products/publications/ccb/Pages/ccb.v2009.n12.1.aspx. See p. 35.

the ability to affect the value, ownership percentage, and rights associated with the company's securities. Investors should determine whether shareowners must approve such proposals with supermajority votes.

Before voting on the issuance of new capital stock, therefore, shareowners should review the issues behind the proposed placings. The critical considerations are likely to include the strength of the business case, financing options available to management, the level of dilution of value and control for existing shareowners, the level of transparency in the process, and alternate options or contingency plans to obtain funds to achieve the intended purpose.

Shareowners have the responsibility to engage with company management to understand and to recognise that thresholds for non-preemptive issues are different for different companies under different circumstances. For example, the size of a company, its business sector, and the nature of its business all have relevance, as does the life-cycle stage of the company and its current capital structure.

Shareowners have to exercise their rights to determine the reasons behind requests to issue shares under a general mandate, refreshments of such mandates, and the impact of consecutive utilisation of general mandates. Regardless of the percentage of share issuance, the discount at which shares are issued is equally critical to the consideration of shareowner dilution. Shareowners, as a best practice, also have to question whether there is a need for a cumulative percentage of share issuance without preemptive rights. These reasons should be analysed and alternative forms of capital be considered at the AGM before the general mandate is approved.

Shareowners have a right to know the identities of the persons/entities receiving the placement (placees). Apart from dilution concerns, a central concern for minority shareowners is the degree of discretion that management has in placing these shares and the increased degree of discretion they will have after the shares are placed. Management, in turn, places significant faith and trust in the placing agents' role and their independence in identifying placees who are not connected with or related to the substantial shareowners. Ensuring the independence of placees (from substantial shareowners) and the transparency of the selection process helps restore confidence among minority shareowners. CFA Institute believes that the first step toward creating this atmosphere is for management to declare the placees. It is also the responsibility of management to ensure that information on placees is easily accessible to existing shareowners without their having to comb through stock exchange announcements or share registers.

Shareowners should consider the effects that a substantial shareowner(s) may have on such an election. More shareowners have to be engaged at such meetings if the voices of shareowners—particularly minority shareowners—are to be heard.

Improving Investor Protection: Policy Recommendations

To further enhance investor protection, CFA Institute recommends the following measures.

1. *Cumulative caps over a three-year rolling period.* In the United Kingdom, the Pre-Emption Group Statement of Principles restricts the maximum number of non-preemptive shares allowed over a three-year rolling period with a cap at 7.5% of total issued share capital. Currently, there are no such caps in the markets we reviewed in Asia. CFA Institute recommends there be a maximum limit over a three-year rolling period, implemented through regulations (i.e., stock exchange listing rules or the Companies Act mandating a total cap over a three-year rolling period).

2. *Transparency and disclosure.*

    a. *Adequate disclosure of placees and discount details of prior share issuance*. Where companies have placed shares based on general mandates in the immediately preceding three years, we recommend that management clearly disclose the number and percentage of shares issued in those earlier placings, the discount at which the shares were issued, and details of the actual placees (including criteria for selecting these placees) in the proxy materials at the next AGM for shareowner information.

    b. *Adequate disclosure of utilisation of share issuance proceeds*. When the new share mandate request is made, investors are often given very vague descriptions of how the share issuance proceeds will be utilised. CFA Institute recommends that companies avoid generic reasoning, such as future working capital or future investment opportunities. As a best practice, they should articulate clearly the intended uses for the funds to be raised through the general mandates. For companies that have raised capital in the immediately preceding three years through earlier mandates, we further recommend that the actual utilisation of proceeds raised earlier be included in the proxy materials at the next AGM for shareowner information.

3. *Shareowner approval*. Hong Kong and Singapore require a simple majority for share mandate approval, China requires two-thirds, and the United Kingdom requires three-fourths. CFA Institute recommends that share mandates require more than a simple majority approval; a three-fourths majority requirement would provide more equitable protection of minority shareowners in most Asian markets. Our study of Hong Kong showed that at a 75% approval level, 15% of the general mandate requests would have been rejected in 2012; 17% in 2011; 10% in 2010; and 14% in 2009.

In conclusion, given that requests for waivers of preemption rights by issuers may have a significant and negative effect on shareowners, it is important that they be better informed so that they can better understand the implications of their decisions and participate with greater awareness. The management teams of companies seeking such waivers have a duty to shareowners to act in the best interests of the companies while choosing the most appropriate method of financing. The practical way forward for companies is to ensure more clarity in disclosures when seeking approval to waive preemption rights. Nevertheless, the current regulatory framework can also be further enhanced through regulatory reforms and changes as suggested in this report.

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CFA Institute

AUTHOR

Padma Venkat, CFA
Director
Capital Markets Policy

CONTRIBUTORS

Kurt N. Schacht, JD, CFA
Managing Director
Standards and Financial
Market Integrity

Robert W. Dannhauser, CFA
Head
Capital Markets Policy

Tony Tan, DBA, CFA
Head
Standards and Financial
Market Integrity Division
Asia-Pacific Region

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THE AMERICAS
(800) 247 8132 PHONE (USA and Canada)
+1 (434) 951 5499 PHONE
+1 (434) 951 5262 FAX

915 East High Street
Charlottesville, VA 22902
USA

477 Madison Avenue
21st Floor
New York, NY 10022-5802
USA

ASIA PACIFIC
+852 2868 2700 PHONE
+852 8228 8820 INFO HOTLINE
+852 2868 9912 FAX

23/F, Man Yee Building
68 Des Voeux Road
Central, Hong Kong SAR

EMEA
+44 (0) 20 7330 9500 PHONE
+44 (0) 20 7330 9501 FAX

131 Finsbury Pavement
7th Floor
London EC2A 1NT
United Kingdom

Square de Meeûs 38/40
1000 Brussels, Belgium

9 780938 367871 90000 >

CFA Institute

www.cfainstitute.org
info@cfainstitute.org