



PUBLIC RESPONSE PAPER

NO. 2/2011

**PROPOSED UPDATES TO
GUIDELINES ON CONTENTS OF APPLICATIONS RELATING
TO TAKE-OVERS AND MERGERS**

The Securities Commission Malaysia (SC) issues this Public Response Paper pursuant to feedback received on the Consultation Paper dated 19 March 2010 on the Proposed Updates To Guidelines On Offer Documentation Of The Malaysian Code On Take-Overs And Mergers 1998.

This Public Response Paper is dated 28 January 2011

PART (1): INTRODUCTION

- 1.1 On 19 March 2010, the SC published a Consultation Paper on the Proposed Updates to Guidelines on Offer Documentation of the Malaysian Code on Take-Overs and Mergers 1998 (**Consultation Paper**) with the view to enhance protection accorded to offeree shareholders. The consultation paper invited feedback on the proposal for SC to provide guidance on the interpretation of the term 'fair and reasonable' as well as on matters that should be analysed and synthesised in reaching such a conclusion.
- 1.2 To ensure that offeree shareholders are provided with sufficient information and advice within a reasonable time to help them decide whether to accept or reject an offer, the Malaysian Code on Take-Overs and Mergers 2010 (**2010 Code**)¹ requires that the offeree appoints an independent adviser (**IA**) in relation to the take-over offer. The IA is required to disclose in the independent advice circular (**IAC**) all information needed by offeree shareholders to make an informed assessment as to the merits of accepting or rejecting the take-over offer and the extent of the risks involved in doing so².
- 1.3 Currently, the 2010 Code requires the IA to comment and advise the offeree shareholders on the reasonableness of the offer³. In Malaysia, the term 'fair and reasonable' is presently taken as a composite term by the market. There is no precise definition on what is 'fair and reasonable' under the 2010 Code nor has the market developed a definition.
- 1.4 Since the standard of 'fair and reasonable' is used to determine whether an offer should be accepted or rejected, SC is of the view that it is important for the standard to be clearly defined and interpreted in a consistent manner.

¹ The 2010 Code came into effect on 15 December 2010 with enhanced investor protection. The 2010 Code supersedes the 1998 Code.

² Subsection 15(9) of the 2010 Code. The same requirement is found in Subsection 15(9) of the 1998 Code.

³ Paragraph 4, Second Schedule of the 2010 Code. The same requirement is found in Paragraph 1, Schedule 2 of the 1998 Code.

- 1.5 As part of the consultation process, the SC held several dialogue sessions with industry participants, including investment banks, public listed companies, fund managers, securities houses, institutional investors, special interest groups and other relevant professionals. The SC would like to thank all respondents for their feedback and comments.
- 1.6 The SC has thoroughly reviewed all feedback received before issuing this response. A large majority of the respondents supported the proposal that the SC provide clear guidance on how 'fair and reasonable' is to be interpreted and matters that need to be addressed in making a recommendation.

PART (2): SUMMARY OF SC'S PROPOSALS AND RESPONSES RECEIVED

2.1 The term 'fair and reasonable' should be interpreted as two distinct and discrete terms, namely, 'fair' and 'reasonable', as opposed to a composite term.

2.1.1 The SC proposes that 'fair and reasonable' be interpreted as two distinct terms, namely, 'fair' and 'reasonable', as opposed to an interpretation as a composite term. This is to ensure that the IA examines both quantitative (or valuation) aspects as well as other matters in providing its advice. The decoupling of the terms will ensure that the IAC can be easily understood, is transparent and provides a clear basis to justify the recommendation.

Feedback from respondents

- 2.1.2 A large majority of the respondents were in support of defining 'fair' and 'reasonable' as two distinct terms and were of the view that the SC's proposal has sufficiently provided guidance on how the terms should be interpreted.
- 2.1.3 The majority of respondents agreed that the proposal to decouple 'fair and reasonable' into two distinct terms will better assist offeree shareholders in making informed

decisions regarding an offer. The respondents also agreed that the SC's proposal would help develop a common understanding and interpretation of the terms as well as to ensure shareholders receive clear and useful advice.

- 2.1.4 Some respondents had commented that the current practice has resulted in analysis that was disjointed and at times insufficient. There were also concerns that an IA's advice may be biased towards certain conclusions given the lack of an objective framework.
- 2.1.5 A majority of the respondents agreed that the assessment of 'fair' and 'reasonable' as two distinct terms will ensure that quantitative and qualitative factors are addressed separately and will further improve the quality of an IAC. This will assist offeree shareholders to better understand how the IA arrives at its opinion and recommendation.
- 2.1.6 There was a suggestion that in order to improve the usefulness and clarity of the advice, the standard of 'fair and reasonable' should be removed altogether and that the IA should only be required to give an opinion on whether an offer or proposal should be accepted.

Our response

- 2.1.7 The standard of 'fair and reasonable' is very fundamental in the independent advice process and its interpretation will affect the manner in which users of the IAC make their decisions.
- 2.1.8 After taking into consideration the current approach taken by the market on the 'fair and reasonable' standard, the SC is of the view that decoupling the term 'fair' and 'reasonable' will lead to more clarity and depth of analysis.
- 2.1.9 The SC does not believe that the standard of 'fair and reasonable' should be removed as it is important for offeree shareholders to know by what standard an opinion is given. Moreover, a structured analysis is important to enable offeree shareholders to fully appreciate the advice given and to make an informed decision.

2.1.10 The SC also believes that it is important to provide guidance on the interpretation of what is 'fair' and 'reasonable' as these concepts can be nebulous. This can potentially give rise to a wide variance in interpretation and allow IAs to be selective in the way they carry out their analysis.

2.2 Independent adviser's approach in analysing an offer

2.2.1 The Consultation Paper also addressed the matters that an IA should consider in analysing a particular offer. The Consultation Paper also discussed how an IA should approach situations where independent advice is required, including in cases of exemptions from mandatory offer obligations, schemes of arrangement and selective capital reductions. The SC gave its views on matters that should be looked into when an IA is assessing such proposals.

Feedback from respondents

2.2.2 A large majority of respondents supported the proposals but stressed the need for consistency in the application of the requirement. Many respondents also felt that it is important for IAs to value the subject securities and clearly disclose key aspects of the valuation and explain how they have arrived at their conclusions.

2.2.3 Several respondents expressed views that the current practice of comparing valuation metrics of the offer price (e.g. price earnings ratio, price book ratio) against comparables did not provide sufficient depth and quality in analysis. In many cases, the analysis was 'illustrative' only and did not provide a sufficient basis for an opinion to be formed.

2.2.4 A majority of the respondents held the view that valuation is the key factor as to whether an offer is fair. As such, they agreed with the proposal set forth in the Consultation Paper for the IA to provide greater clarity on the valuation methodology used in reaching a view. The IA should explain and justify why it has applied a particular valuation methodology.

- 2.2.5 Many respondents agreed that the IA should apply at least 2 alternative valuation methods when forming an opinion on the fairness of an offer and the key aspects of such valuations to be disclosed along with the results. When the IA had used the work of another expert in preparing his advice, the credentials of that expert must be disclosed.
- 2.2.6 While some respondents were concerned about the time constraint and the IA's access to information, others felt that timing issues can be overcome with a modification of regulatory timelines to allow early appointment of IA so that it has more time and avenues to access the required information. Some respondents felt that the concerns expressed can be largely overcome if a competent IA is appointed. The respondents also suggested that there should be a stronger collaboration between the board of directors of the offeree and the IA to ensure that all required information is made accessible to the IA.

Our response

- 2.2.7 After taking into account the responses and feedback received, the SC is of the view that IAs should carry out a valuation of the subject securities in determining 'fairness'. The IA should also examine other relevant factors in arriving at its recommendation.
- 2.2.8 It is not the intention of the SC to prescribe an exhaustive criteria or methodology for providing independent advice. The IA must exercise discretion in ascertaining the most appropriate approach to be taken and on a case-by-case basis.
- 2.2.9 The SC is mindful of the time constraint faced by IAs in preparing IACs especially where valuations need to be carried out. Under the 2010 Code, approval from the SC will not be required for the appointment of IAs⁴ thereby enabling the IA to commence work earlier and have sufficient time to prepare its advice. Under the current framework, the appointment of an IA by the board of offeree can be made at the point when the notice

⁴ Subsection 15(11) of the 2010 Code, requires an IA appointed by the board of directors of the offeree to declare its independence from any conflict of interest or potential conflict of interest to the SC within 3 days of its appointment.

of a take-over offer is served on the board of the offeree. This gives the IA approximately thirty-one (31) days to undertake the necessary valuation and to prepare the IAC.

2.2.10 Currently, the 2010 Code⁵ requires the board of an offeree to disclose all information that the offeree shareholders and the advisers would reasonably require in the IAC for the purposes of making an informed decision as to the merits of accepting or rejecting the offer. The 2010 Code also requires the IA to disclose such information after making enquiries as are reasonable in the circumstances⁶. As such, the IA will be able to access the information it reasonably requires to form an opinion in the manner recommended by the Consultation Paper.

2.3 Other feedback received

2.3.1 A majority of the respondents expressed the view that there is a need for the quality of independent advice to be improved and agreed that the proposal set forth by the SC is timely. Respondents were of the opinion that current practice in preparing the IAC does not adequately meet the needs of offeree shareholders who are faced with the decision of whether to accept an offer or proposal and to determine whether they were being compensated appropriately for such an exit or proposal.

2.3.2 Many respondents suggested that the SC needs to ensure that investors and directors have access to a wider pool of resources with appropriate expertise to provide independent advice.

Our response

2.3.3 The SC recognises the need to promote quality in the capital market through innovation and healthy competition, which is essential for lifting professional standards across the financial services industry and to strengthen public confidence in the capital market. The

⁵ Subsection 14(2) of the 2010 Code. This same requirement is found under Subsection 14(2) of 1998 Code.

⁶ Subsection 15(10) of the 2010 Code. This same requirement is found under Subsection 15(9) of 1998 Code.

SC recognises that the present pool of IAs is limited and that it would be beneficial to widen the pool of skills and resources available to offerees and their shareholders. As such, the SC will revise Paragraph 1.1, Practice Note 7 of the 2010 Code and the Guidelines on Principal Advisers for Corporate Proposals to widen the pool of advisers eligible to act as an IA for take-over matters.

PART (3): CONCLUSION

- 3.1 Moving forward, SC will provide guidance on matters that should be analysed and synthesised in reaching a recommendation. Guidance on the requirements will be incorporated via amendments to Chapter 12, Part IV of the Guidelines and Contents of Applications Relating to Take-Overs and Mergers with the proposals outlined in the Consultation Paper.
- 3.2 The update and revision of Chapter 12, Part IV of the New Guidelines will be made available on the SC's website in due course.