



Hong Kong

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TIGHTENED HONG KONG LISTING RULES ON CAPITAL RAISINGS BY LISTED ISSUERS EFFECTIVE 3 JULY 2018

Changes to the Listing Rules of the Hong Kong Stock Exchange (**HKEx**) will take effect on 3 July 2018. These implement the proposals suggested by HKEx in its September 2017 Consultation Paper on capital raisings by listed issuers¹ aimed at restricting practices by listed issuers which result in unfair treatment of minority shareholders that HKEx considers to negatively affect an orderly market for securities trading. For more details of the consultation paper, please see Charltons' November 2017 newsletter.² HKEx published its Consultation Conclusions³ on the proposals, and further amendments to the HKEx Listing Rules, on 4 May 2018.

The HKEx Listing Rule changes target potentially abusive practices by listed issuers including deeply discounted fund raisings, share consolidations and subdivisions, and a number of cases where capital raisings lacked commercial rationale. The key changes to the Listing Rules (as described in more detail below) are as follows:

1) Highly dilutive capital raisings

- a) The amended Listing Rules disallow rights issues, open offers and specific mandate placings, individually or when aggregated within a rolling

12-month period, that would result in a cumulative material value dilution (25 per cent or more), unless there are exceptional circumstances, e.g. the issuer is in financial difficulties;

2) Rights issues and open offers – the amended Listing Rules:

- a) require minority shareholders' approval for all open offers, unless the new shares will be issued under an existing general mandate;
- b) remove the underwriting requirements for all rights issues and open offers;
- c) require underwriters (if any) for rights issues and open offers to be persons licensed under the Securities and Futures Ordinance (the **SFO**) and independent of issuers and their connected persons, except that controlling shareholders or substantial shareholders may act as underwriters if compensatory arrangements are available for unsubscribed offer shares and the connected transaction Listing Rules are complied with;
- d) remove the connected transaction exemption currently available to connected persons acting as underwriters of rights issues or open offers;

1 <http://www.hkex.com.hk/-/media/hkex-market/news/market-consultations/2016-present/september-2017-consultation-paper-on-capital-raisings-by-listed-issuers/consultation-paper/cp2017092>

2 <https://www.charltonslaw.com/consultation-paper-on-capital-raisings-by-listed-issuers/>

3 [http://www.hkex.com.hk/-/media/HKEX-Market/News/Market-Consultations/2016-Present/September-2017-Consultation-Paper-on-Capital-Raisings-by-Listed-Issuers/Conclusions-\(May-2018\)/cp2017092cc.pdf](http://www.hkex.com.hk/-/media/HKEX-Market/News/Market-Consultations/2016-Present/September-2017-Consultation-Paper-on-Capital-Raisings-by-Listed-Issuers/Conclusions-(May-2018)/cp2017092cc.pdf)

- e) require issuers to adopt either excess application arrangements or compensatory arrangements for the disposal of unsubscribed shares in rights issues or open offers (these arrangements are currently optional);
- f) require issuers to disregard any excess applications made by controlling shareholders and their associates in excess of the offer size minus their pro-rata entitlements;

3) Placing of warrants or convertible securities under general mandate – the Listing Rule amendments:

- a) disallow the use of a general mandate for a placing of warrants; and
- b) restrict the use of the general mandate for the placing of convertible securities with an initial conversion price that is not less than the market price of the shares at the time of placing.

The following is a summary of the changes that will be made to the Main Board Listing Rules. Comparable changes will be made to the equivalent GEM Listing Rules.

Highly dilutive capital raisings

Current Listing Rules and Practices

New issues of equity securities by a listed issuer must first be offered to existing shareholders pro rata to their shareholdings, unless the listed issuer obtains shareholders' approval to issue new shares. Two types of mandate can be sought from shareholders:

- a) A mandate specific to a proposed share issue (**specific mandate**); or
- b) A prior mandate for issuing securities, subject to the HKEx Listing Rule restrictions under LR 13.36(2) on:
 - i) **issue size**: the aggregate number of shares to be allotted must not exceed the aggregate of (a) 20% of the number of the issued shares at the date of the resolution granting the mandate; and (b) the number of shares repurchased by the issuer since the grant of the mandate (up to a maximum of 10% of the

issued shares at the date of the resolution approving the repurchase mandate), provided that the issuer was granted a mandate to add repurchased shares to the general mandate by a separate shareholders' resolution; and

- ii) **price discount** where the shares are issued for cash: the shares must not be issued at a discount of more than 20% to the benchmarked price of the shares (**general mandate**).

Generally, placings to and subscriptions by individuals that are selected by issuers or an intermediary (**placings**) require shareholders' approval. Since existing shareholders do not normally have an opportunity to subscribe for the offered shares, their ownership will be diluted by the share issue.

Listing Rule Changes

Rights issues, open offers and specific mandate placings that result in a material value dilution either individually or when accumulated over a rolling 12-months period, will be prohibited, other than in exceptional circumstances.

Value dilution is defined as a theoretical value dilution based on the offer ratio and the discount of the offer price to the market price before the offer announcement, i.e.:

$$\frac{\text{Number of new shares to be issued} \times \text{Percentage price discount}}{\text{Number of issued shares as enlarged by the offer}}$$

Material value dilution is defined as dilution of **25% or more** on a cumulative basis. In calculating cumulative value dilution, HKEx will refer to the aggregate number of shares issued over 12 months, as compared to the number of shares issued immediately prior to the first offer or placing and to the weighted average of the price discounts.

Where the offer ratio or price discount for the fundraising appears to oppress shareholders, HKEx will retain the right to not grant approval or impose additional requirements on the fundraising.

Rights issues and open offers

Current Listing Rules and Practices

In a rights issue, new shares must be offered to shareholders in proportion to their existing shareholdings. Shareholders who do not subscribe for the new shares can sell their nil-paid rights on HKEx. In open offers, shares may be offered not in proportion to existing shareholdings, if the open offer has been approved by shareholders or offered under the general mandate. An open offer is non-renounceable and shareholders who do not subscribe for new shares will have their investments diluted.

Currently, the Listing Rules require rights issues and open offers to be approved by the issuer's minority shareholders (the issuer's controlling shareholders and their associates must abstain from voting in favour of the resolution) if they increase the number of issued shares or market capitalisation by more than 50% (alone or when aggregated with other rights issues and open offers in the previous 12 months).

New shares that are not taken up by shareholders during the subscription period of a rights issue or open offer can be disposed of by:

- a) allowing shareholders to apply for the unsubscribed shares in excess of their pro rata entitlement (**excess application arrangement**) – with a requirement to allocate the unsubscribed shares to applicants on a fair basis. Existing shareholders are able to apply for unsubscribed shares in excess of their assured entitlements; or
- b) selling the unsubscribed shares in the market and paying any premium to the non-subscribing shareholders (**compensatory arrangement**), where shareholders may be compensated through distribution of funds raised from the sale of unsubscribed shares exceeding the offer price.

Main Board Rule 7.19(1) requires that under normal circumstances, all right issues must be fully underwritten, and Main Board Rule 7.24(1) requires that in normal circumstances, all open offers must be fully underwritten.

Listing Rule Changes

Under the amended Listing Rules, all open offers will require shareholders' approval, unless shares are issued under an existing general mandate. This practice is closer to international practice, for example in the UK, Singapore and Australia.

If unsubscribed shares in rights issues or open offers are to be disposed of, issuers will need to adopt excess application arrangements or compensatory arrangements. It will be up to issuers to decide whether to adopt excess application or compensatory arrangements.

The currently available exemption⁴ for connected transactions to connected persons acting as underwriters for rights issues or open offers will be removed. If a controlling or a substantial shareholder proposes to act as an underwriter, independent shareholders' approval will be required.

HKEx Listing Rules 7.19(1) and 7.24(1) will be removed, removing the underwriting requirement for pre-emptive offers for all Main Board listed issuers. However, if an underwriter is to be engaged on a rights issue or an open offer by the issuer, the underwriter will need to be:

- a) licensed under the SFO; and
- b) independent of the issuer and its connected persons, unless a controlling shareholder or substantial shareholder assumes the role of underwriter and the unsubscribed offer shares are subject to a compensatory arrangement and fully compliant with the connected transaction rules.

Issuers must disregard applications from controlling shareholders and their associates that exceed the offer size less the pro-rata entitlement. It will be issuers' responsibility to identify excess applications by controlling shareholders and their associates.

Placing of warrants or convertible securities under general mandate

Current Listing Rules and Practices

HKEx Listing Rule 13.36 allows a general mandate to be sought for the issue of new securities of up to 20% of the number of

⁴ Currently, Main Board Listing Rule 14A.92 (2)(b)

the issuer's shares as at the date of the shareholders' approval of the mandate. For placing securities for cash consideration, a 20% discount limit on the issue price is imposed, benchmarked against the higher of: (i) the closing price on the date of the agreement and (ii) the average closing price in the 5 previous trading days (**benchmark price**).

Listing Rule Changes

General mandates will no longer be allowed for placings of warrants and options for cash. Instead, specific mandates will need to be obtained by the issuers. This is in fact a codification of an existing practice adopted in May 2015 as per HKEx listing decision LD90-2015.⁵

New Rule 13.36(7) has been added as a result of responses to the consultation. This states that "the issuer may not issue warrants, options or similar rights to subscribe for (i) any new shares of the issuer or (ii) any securities convertible into new shares of the issuer, for cash consideration pursuant to a general mandate given under rule 13.36(2)(b)".

In future, specific mandates will only be allowed for placings of convertible equity and debt securities with an initial conversion price that is equal or greater than the market price of shares at the time of the placing.

Disclosure of the use of proceeds from equity fundraisings

Current Listing Rules and Practices

Disclosure of the use of proceeds of equity issues made under a general mandate is required to be made in the issuer's annual reports.⁶ HKEx proposed that announcements of proposed equity fundraisings should also disclose the intended use of proceeds.

Pursuant to Main Board Rule 13.28, a decision of the directors to issue securities for cash needs to be followed by an announcement published no later than "30 minutes before the earlier of the commencement of the morning trading session or any pre-opening session on the next business day".

⁵ <http://www.hkex.com.hk/-/media/hkex-market/listing/rules-and-guidance/interpretation-and-guidance-contingency/listing-decisions/2015/ld90-2015>

⁶ Main Board Listing Rules Appendix 16.11

Listing Rule Changes

Issuers will be required to disclose and periodically update "reasonably detailed" information on the use of proceeds in their interim and annual reports, such as any material change or delay in their intended use.

Annual reports will also need to contain discussions of future plans for material investments or capital assets, and expected source of funding in the year to follow.

Paragraph 11(8) to Appendix 16, which details information to be included in annual reports in case of issue of equity securities for cash, has been amended to replace "the use of proceeds" with

- (8) the total funds raised from the issue and details of the use of proceeds including:
 - a) a detailed breakdown and description of the proceeds for each issue and the purposes for which they are used during the financial year;
 - b) if there is any amount not yet utilized, a detailed breakdown and description of the intended use of the proceeds for each issue and the purposes for which they are used and the expected timeline; and
 - c) whether the proceeds were used, or are proposed to be used, according to the intentions previously disclosed by the issuer, and the reasons for any material change or delay in the use of proceeds.

Subdivision or bonus issue of shares

Current Listing Rules and Practices

Currently, if the market price of securities approaches HK\$0.01 or HK\$9,995, Rule 13.64 entitles HKEx to require the issuer to change its trading method, or to proceed with a consolidation, or to split its securities.

Listing Rule Changes

Following the consultation, a minimum adjusted price of HK\$1 will be introduced for subdivision or bonus issues of shares, below which a subdivision or bonus issue of shares will not be allowed to proceed. This value will initially be in force for

a six-month demonstration period. The theoretical adjusted price will be calculated on the basis of the lowest daily closing price of the shares.

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