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# Hong Kong Depositary Receipt Framework To Be Implemented On 1 July 2008

## Introduction

On 9 May 2008, the Stock Exchange of Hong Kong (the **Exchange**) published a new Chapter 19B to the Main Board Listing Rules which will allow issuers to list on the Main Board (but not the Growth Enterprise Market) through Hong Kong Depositary Receipts (**HDRs**) from 1 July 2008.

The new HDR framework will mean that Hong Kong will have the only Asian depositary receipt (**DR**) regime that allows issuers to target retail investors: in contrast, the Singapore DR regime is available only to institutional and accredited investors. Another distinguishing feature of the Hong Kong DR regime, is that there is no requirement for the issuer to be already listed on another stock exchange, which is a feature of Singapore's DR regime.

The new Chapter 19B, other amendments to the Main Board Listing Rules and a set of Frequently Asked Questions are available on the Exchange's website at [www.hkex.com.hk](http://www.hkex.com.hk/). The purpose of this note is to summarise the key features of the HDR regime.

## Background

The principal objective of the new HDR framework is to attract more overseas issuers to list in Hong Kong, a key objective under the Exchange's 2007-2009 Strategic Plan. The current Listing Rules require companies to list in the form of ordinary shares and to maintain a share register or a branch of their share register in Hong Kong. These requirements effectively bar the listing of companies from jurisdictions which prohibit the issue of shares overseas or the maintenance of an overseas share register. Companies which are expected to benefit from the new framework include those from Russia, India, Taiwan and South Korea.

HDRs also present a number of advantages to Hong Kong investors. On an HDR issue, a global bank will act as a depositary and take delivery of the shares (via a custodian in the issuer's jurisdiction), and issue HDRs in a given ratio to the shares in Hong Kong. The depositary will hold the shares on behalf of the HDR holders, collect and convert dividends into either Hong Kong or US dollars (as elected by the issuer), account for any tax withholding or reclaim, and handle voting and entitlements on the HDR holders' behalf.

## Key Features Of The HDR Framework

### 1. No Change To Main Listing Regime

There will be no change to the basic listing regime: the same admission requirements, continuing obligations and disclosure requirements, and the need to demonstrate equivalent standards of shareholder protection in the issuer's home jurisdiction, will apply whether a company lists in the form of ordinary shares or HDRs.

The amendments to the Listing Rules are therefore not extensive and focus on the two-tier legal structure of HDRs and ensuring that holders of HDRs enjoy equivalent rights and protections to holders of underlying shares. This is achieved mainly by imposing requirements in relation to the depositary agreement and the depositary itself.

### 2. Who Can Issue HDRs?

The Exchange will accept applications from issuers from any jurisdiction which can meet the requirements of the Listing Rules as amplified by the Joint Policy Statement Regarding the Listing of Overseas Companies (the **Joint Policy Statement**) published in March 2007. Essentially, an overseas issuer is required to demonstrate to the Exchange that its jurisdiction of incorporation offers standards of shareholder protection that are equivalent to those provided in Hong Kong. The Joint Policy Statement sets out the key areas in which equivalence must be established. If the Exchange considers that the home jurisdiction fails to provide comparable standards of shareholder protection, it may still allow the issuer to list in Hong Kong if the issuer amends its constitutional documents (articles of association or equivalent) to provide the required level of shareholder protection.

Hong Kong and Mainland issuers will be allowed to list HDRs. However, an issuer cannot have both shares and HDRs listed on the Exchange at the same time. An existing listed issuer must apply to delist as a share issuer before re-applying to list as a HDR issuer. That process will require the share issuer to comply with its own constitutional requirements and relevant rules and regulations, including obtaining shareholders' approval where appropriate.

## Chapter 19B Of The Main Board Listing Rules

New chapter 19B provides that an issuer can choose to list in the form of HDRs and that the Listing Rules apply in the same manner as to the listing of equity securities. The issuer of the shares which are represented by HDRs is "the issuer" for the purposes of the Listing Rules (Rule 19B.04). Some of the key features of the chapter are set out below.

1. **HDR Qualities**: The HDRs must be freely transferable and the securities which the HDRs represent must be fully paid and free from all liens and restriction on the right of transfer to the depositary. HDRs may be issued in respect of newly issued shares and/or in respect of shares placed with a depositary by existing shareholders provided that the issuer applies to be the issuer of such depositary receipts and assumes the obligations and duties imposed on an issuer by the Listing Rules.
2. **Register of HDRs**: An approved share registrar is required to maintain in Hong Kong a register of HDR holders and the transfers of the HDRs. Only HDRs registered in Hong Kong will be permitted to be traded on the Exchange.
3. **Requirements for Depositary**: The depositary is required to: (a) be duly incorporated and operate in conformity with its constitutional documents; (b) be a suitably authorised and regulated financial institution acceptable to the Exchange; and (c) have adequate experience in issuing and managing DR programmes in Hong Kong or overseas. Depositaries will not require a depositary licence.
4. **Public Float Calculation**: Listing Rule 8.08(1)(a) applies to HDR issuers as it does to share issuers and requires that at least 25% of the issuer's total issued share capital is held by the public at all times. In the case of companies with an expected market capitalisation at the time of listing of HK$10 billion or more, the Exchange has a discretion to accept a lower public float of between 15% and 25%.

* Where the HDRs listed in Hong Kong are fungible with the underlying shares, the total shares and shares represented by HDRs of the issuer held by the public on both the Exchange and any relevant overseas market(s) will count towards the 25% (Rule 19B.08).

1. **Deposit Agreement**: Issuers are required to enter into a Deposit Agreement with the depositary, which acts as the agent of the issuer for the benefit of the HDR holders. The Deposit Agreement is required to stipulate the rights, duties and obligations of the depositary, issuer, HDR holders, and custodian and to set out the fee structure of the depositary. The Deposit Agreement must also define the procedures for the replacement or removal of the depositary and/or the custodian and should specify the procedures for amending the agreement. The governing law of the Deposit Agreement is required to be Hong Kong law or any other law that is generally used in accordance with international practice.
2. **Number of Authorised HDRs**: HDRs seeking to list on the Main Board will be able to represent any number of shares. In addition, the issuer can apply to list any number of HDRs provided that it meets all other listing requirements (e.g. the public float requirement). To allow for future conversions of the underlying shares into HDRs, the issuer may apply to list a greater number of HDRs than will be issued for capital raising (i.e. it may apply for "headroom"). Any combination of HDRs issued for capital raising or issued as a result of conversion of underlying shares will be permitted and listing approvals will be given for specific purposes and amounts.

* No further application for listing HDRs will be required for the creation of listed HDRs resulting from the conversion of shares into HDRs. Likewise, no further listing of HDRs will be needed for any further issue of shares, provided that the original amount of listed HDRs is not exceeded. The depositary will monitor the level of outstanding HDRs on a day-to-day basis and will not permit shares to be converted into HDRs if this would cause the number of authorised HDRs to be exceeded. Listing must be sought for all further issues of HDRs in excess of the amount of HDRs already listed.

1. **Methods of Listing HDRs**: The methods of listing are the same as for issuers of shares: Chapter 7 of the Listing Rules applies to HDR issuers in the same way as it applies to share issuers. Accordingly, HDR issuers may list by way of introduction if the requirements of Rules 7.13 to 7.17 are met and a placing of HDRs will not normally be permitted if there is expected to be significant public interest in an issue (Rule 7.10).
2. **Trading, Clearing and Settlement**

* 8.1 Currency: HDRs will be traded and settled in Hong Kong dollars or US dollars: the choice of currency will be that of the HDR issuer.
* 8.2 Trading and Settlement Procedures: The trading, clearing and settlement arrangements for HDRs will be the same as for shares. All Stock Exchange Participants will be eligible to trade HDRs and investors will be able to trade HDRs through their usual stock accounts. The trading platform for stock trading, the Automatic Order Matching and Execution System, will be used for HDRs. Trades executed in the Exchange's trading system will be settled through CCASS operated by HKSCC on the second settlement day after trading (T+2). On settlement, investors' HDR holdings will be credited to or debited from their accounts with the Central Clearing and Settlement System (**CCASS**), or the CCASS accounts of their designated custodians or Stock Exchange Participants. Minor amendments have been made to the rules and procedures of CCASS to accommodate the trading of HDRs.
* 8.3 Stamp Duty: Stamp duty will apply to trades in HDRs at the rate of 0.1% on the value traded per side, as is the case for trades in shares.
* 8.4 HDR Scrip: To trade on the Exchange, HDRs will have to be deposited in CCASS and will be traded and settled on a book-entry electronic basis. As is the case for shares, however, HDR holders will have the option of withdrawing HDR scrip from, or depositing HDR scrip into, CCASS.

1. **Dividend Payment**: The depositary will convert dividends received from the issuer into either Hong Kong or US dollars and will remit the proceeds, net of any applicable taxes and the depositary's own fee, to the HDR holder. Where the investor holds the HDRs in CCASS, the dividend will be credited to his CCASS account (in the case of an Investor Participant) or the CCASS account of his broker or custodian, net of CCASS's dividend collection fee in accordance with the existing CCASS tariff.
2. **Rights of HDR Holders**: The rights of HDR holders will be broadly equivalent, but not identical, to those of the underlying shareholders. The rights of HDR holders will be contractual and will arise from the deposit agreement, whereas the rights of shareholders are reinforced by statute in the issuer's jurisdiction of incorporation. The local laws may prohibit foreign investors from holding shares directly: no such restriction will however apply to the HDRs. Subject to compliance with local laws and regulations, HDR holders who want to enforce their rights as shareholders may choose to convert their HDRs into shares of the issuer.

* As regards voting rights, the depositary will send information on resolutions and voting procedures to the HDR holders and will pass the HDR holders' voting instructions back to the issuer.

1. **Short Selling**: HDRs will be subject to the existing rules on short selling. Where the HDR issuer satisfies the Exchange's criteria and is placed on the list of eligible stocks, short selling in the normal manner will be allowed.
2. **Issues of Warrants on HDRs**: It will be possible for warrants to be issued on HDRs provided that the issuer meets the Exchange's criteria for the underlying stock for warrant issuance.

## Listing Document Requirements

Two new parts E and F have been added to Appendix 1 of the Listing Rules setting out the requirements for listing documents in respect of HDRs. These are modeled closely on certain existing parts of Appendix 1.

## Possible Future Developments

The Exchange has raised the possibility that following a period of monitoring the application of the new HDR Listing Rules, it may give consideration to the future introduction of the following relaxations:

1. Requirements for the following may be dispensed with: Chinese translations, physical scrip, the appointment of an approved share registrar, paper-based communications with HDR holders, and distribution of financial reports to HDR holders;
2. Exemptions from the requirements for the following: (a) management presence in Hong Kong; (b) secretary's ordinary residence in Hong Kong; (c) application of Chapter 14A on connected transactions; and (d) exemption from the requirements for a company's Articles of Association (Appendix 3); and
3. The establishment of a simplified regime accessible only to professional investors.

This note is intended as a summary only of the Main Board Hong Kong Depositary Receipt framework. Specific advice should be sought in relation to any particular situation.

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