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# HKEx Publishes Consultation Paper On Proposed Changes To Requirements For The Listing Of Debt Issues To Professional Investors Only

## Introduction

On 17 December 2010, Hong Kong Exchanges and Clearing Limited ("**HKEx**") published a consultation paper on proposed changes to the requirements for the listing of debt securities targeted exclusively at professional investors ("**the Consultation Paper**"), currently referred to in the Rules as listing by selective marketing. The proposals relate only to issues to professional investors and aim to bring the Stock Exchange of Hong Kong ("**the Exchange**") into line with the approach adopted by other leading stock exchanges, with the substantial reduction of processing times being a key goal. In routine cases, the Exchange will aim to issue a letter confirming eligibility for listing 5 business days after its receipt of the listing application. The proposals include:

* Presenting the Rules in more accessible language;
* Unifying the definition of professional investor in the Rules with the definition in the Securities and Futures Ordinance;
* Removing provisions relevant only to retail investors from the eligibility requirements for applicants;
* Replacing the current detailed disclosure requirements in listing documents with an obligation to include information that is customary for offers of debt securities to professionals. Existing requirements to include responsibility and disclaimer statements in prescribed forms and a statement limiting distribution of the offering circular to professionals will be retained;
* Streamlining the application procedures for applicants and the vetting and approval procedures within the Listing Division; and
* Removing provisions relevant only to retail investors from continuing obligations imposed on listing applicants.

## Background To The Proposals

Chapter 37 of the Listing Rules deals with listing debt securities that are offered only to professional investors and not to public investors in Hong Kong. As noted above, these debt listings are referred to in the Rules as listings by selective marketing. In the case of such debt listings, most trading occurs off-exchange, with trading on-Exchange being relatively rare. Listing is sought so that institutional investors with investment mandates that are limited to listed debt can subscribe for these issues. As a result, this type of debt listing has traditionally been subject to light touch regulation at the Exchange and stock exchanges worldwide.

The Rules for debt listing were introduced in 1994 and have remained unaltered since then. In 2008 HKEx engaged a consultant to review the existing listing regime and make recommendations for improving the competitiveness of the Exchange as an international venue for listing without compromising the quality of the market. The consultant's verdict was that Hong Kong had missed an opportunity to become the number one location for debt listing in Asia, losing out principally to Singapore. The difficulty of listing on the Exchange was highlighted, especially the document intensive nature of the process. These conclusions were supported by market practitioners subsequently consulted by the Exchange. The Consultation Paper under discussion represents an effort to address the issues raised by the 2008 review.

Hong Kong tax was also raised by some practitioners as an obstacle to the development of Hong Kong's professional debt market. For corporations, interest on bonds issued by non-government (or government related) entities is taxable if it has a Hong Kong source. Hence interest on a corporate bond listed in Hong Kong is generally taxable, although there are certain exemptions. For example, Section 26A of the Inland Revenue Ordinance grants a full exemption from profits tax for interest income in respect of certain debt instruments, including, among others, long term debt instruments with an original maturity of at least 7 years. HKEx acknowledges that the tax position may restrict the effectiveness of its proposals.

The deadline for responses to the Consultation is 18 February 2011. The Consultation Paper and questionnaire is available at [*here*](http://www.hkex.com.hk/eng/newsconsul/mktconsul/Documents/cp2010122.pdf).

## The Proposals

### Accessibility of language used in the Rules

In recognition of the fact that the Rules are drafted in a complex and not particularly accessible style, HKEx proposes adopting plainer language to make the meaning and intent of the Rules clearer for applicants and other users. Appendices I and II to the Consultation Paper set out alternative drafts of the proposed Rules in simpler language and the Exchange is seeking feedback on the form preferred by market practitioners.

The drafting in Appendix I is a considerable move away from the current style; in particular using the pronouns "we" and "you" in place of the "Exchange" and "Applicant". Appendix II, adopts a plainer style than that currently employed, but retains the references to the "Exchange" and "Applicant". There are no substantive differences in Appendices I and II, with the changes relating only to style. The expression "selectively marketed securities" is currently used in the Rules to refer to debt that is offered only to professional investors. However, this is only clear if the definitions section of the Rules is referred to. HKEx proposes to replace the expression "selectively marketed securities" with "debt issues to professional investors only", to more clearly indicate the intended scope of the Rules.

### Eligibility Requirements

#### Investors: Issues and Proposals

According to HKEx, there is a needless ambiguity in the regulatory framework in this area, in that the definition of professional investors in the Rules differs from the definition in Schedule 1 of the Securities and Futures Ordinance (the "**SFO**"). Consequently, HKEx proposes to replace the current definition with one that refers to the definition in the SFO. The proposed Rule 37.58 defines "professional investor" as a professional investor as defined in Schedule 1 to the SFO.

#### Listing Applicants: Issues and Proposals

The current Rules contain relatively basic eligibility requirements for securities which could be removed without prejudicing retail investors, as the securities in question would not normally be offered to them. However, HKEx proposes to retain these standards, as they provide a clear indication of the type of entity that will be eligible for listing. Other exchanges retain eligibility standards and they are not a matter of concern for market practitioners. The eligibility standards are set out in proposed Rules 37.03 to 37.25 and are mostly based on existing eligibility criteria with some deletions and modifications discussed below.

#### Deletions

The following provisions which aim to protect retail investors will be deleted:

* Current Rule 37.09 requires that a Hong Kong incorporated issuer must not be a private company. Private companies are prohibited by law from issuing a prospectus offering debt securities to the public. Debt issues to professionals will not however be offered to the public.
* Current Rules 37.12 and 37.16(ii) require, with some exceptions, that the nominal value of securities listed must be at least HK$50,000,000 to ensure marketability.
* Rule 37.15 provides that an issuer must maintain a paying agent in Hong Kong and a register of holders in Hong Kong.

As professional investors do not need the protections contained in these Rules, HKEx proposes to remove them.

#### Modifications

Rule 37.12 requires an issuer to have net assets of HK$100 million unless it is listed on the Exchange. It is proposed via the amended Rule 37.05 to widen this exemption to include companies listed on an exchange that is a member of the World Federation of Exchanges (the "**WFE**").

Currently Rule 28.03 indicates that debt securities convertible into equity may only be listed if that equity is (or will be) listed on the Exchange or on another regulated, regularly operating open stock market recognised for this purpose (a "**recognised exchange**".) Rule 27.03 provides that warrants convertible into debt securities may only be listed if the debt securities are or will be listed on a recognised exchange. HKEx proposes to replace the requirement for an exchange to be recognised with a requirement for the exchange to be a member of the WFE. See Proposed Rules 37.18(b) and 37.23(b) for details of how this is to be achieved.

Rule 28.05 provides that HKEx must approve any alteration to the terms of convertible debt securities after they have been listed, unless the alteration takes effect automatically under the terms of the issue. A similar requirement relating to warrants is detailed in current Rule 27.04. HKEx states in the Consultation Paper that it considers the rules requiring its consent to changes in terms and conditions to be appropriate to protect the interests of retail investors, but to be redundant in the case of professional investors.

Instead HKEx, following the example set by Singapore, plans to require the terms of a convertible debt issue to provide for appropriate adjustments to conversion rights if there is a change in capital. A specific requirement has also been proposed for issuers to alert HKEx if they propose to change the terms of a debt security, except through provisions that take automatic effect. See proposed Rules 37.20, 37.25 and 37.49(c) for the specifics of the proposals. Additionally HKEx has expanded some of the references to equity securities under the new regime to include depositary receipts (proposed Rules 37.14 and 37.18(b).)

#### Other Issues Raised by HKEx

The majority of debt issues to professionals listed on the Exchange are deposited into overseas settlement systems and any trades that do occur on the Exchange require the buyer and seller to agree on how to make settlement. This makes it extremely difficult for a retail investor to trade these securities on the Exchange. HKEx notes that it would be possible to alter the Rules to require debt issues to professionals to be deposited into overseas settlement systems, as a further measure to ensure that they are not acquired by retail investors in the secondary market. However HKEx does not favour this approach and invites comments on this position and on the suggestion that it could amend the Rules to introduce a higher value minimum board lot, another method by which retail investors' access to such products could be limited.

## Listing Approval

### Issues

Under the current regulatory regime, Rule 2A.05A states that the Executive Director - Listing (the name for the Head of Listing in the Rules) may approve debt listings by States, Supranationals, State Corporations, Banks and corporations having an investment grade credit rating, and also issuers whose equity securities are listed on the Exchange and have a market capitalisation of at least HK$5 billion. All other applications must go to the Listing Committee for approval. The Listing Committee adopts a light touch approach in cases of listing debt securities for professionals. Nevertheless, HKEx considers that the obligation to present applications to the Listing Committee creates uncertainty for applicants, lengthens listing timetables and precludes the offering of a uniform review standard for applications.

As set out in the Memorandum of Understanding between the Exchange and the Securities and Futures Commission ("**SFC**"), the SFC's policy is to follow the assessment and recommendation of the Exchange in confirming its non-objection to the listing of debt securities. The practical effect of this policy position is that the SFC will not review, as a matter of routine, applications to list debt for professionals.

### Proposal

The Consultation Paper details a procedure whereby HKEx will only vet listing applications for compliance with eligibility criteria and to ensure they include appropriate disclaimers and responsibility statements. This level of review is unlikely to raise issues requiring the Committee’s attention. As a result, HKEx proposes to amend the Rules so that all applications to list debt for professionals may be approved by the Head of Listing. This newly flexible approach will be augmented by proposals to allow the Head to delegate his responsibilities within the Listing Division. These changes will be effected by way of amendments to Rule 37.02. and Rule 2A.05A. These amendments are detailed in Annex III to the Consultation Paper.

## Listing Documents

### Issues

The Consultation Paper notes that under the current regime the Rules impose extensive disclosure obligations on listing documents for debt issues to professionals. HKEx notes that this has been contrasted by market practitioners with the situation in Singapore, where disclosure obligations are much less demanding.

HKEx highlights the fact that retail investors are almost wholly reliant on the listing document for information about an issuer but that this is not the case with professional investors. Many potential issuers are well known corporations that are reviewed regularly by analysts. The institutions in the professional debt market will already have established credit lines for the better known corporates. For these investors there is little need to include financial and other background information about an issuer in the listing document. Information on how to apply for the securities will not be required as it is most likely that the investors have been approached to purchase the debt securities by an intermediary.

The different purposes that the Listing Documents serve for different kinds of investors are an important issue for HKEx. Retail investors need the documentation so that they can assess the terms and conditions of the offer and decide whether or not to subscribe. However professionals view the listing document as a record of the terms and conditions agreed through negotiation. As the listing document for debt securities for professionals serves a very different purpose from that of a listing document targeting retail investors, it is possible to leave the contents to be determined by the issuer and the professional investors without prescribing any requirements. This is broadly the approach proposed by HKEx.

However, HKEx highlights that in the aftermath of the recent economic crisis a number of jurisdictions are imposing disclosure and other requirements on offers of asset backed securities, requirements that apply to offers to professionals as well as to retail investors. As a consensus emerges as to the appropriate requirements, HKEx believes that they should apply to asset backed debt securities for professionals listed on the Exchange.

### Proposals

HKEx's proposals in relation to Listing Documents are detailed in proposed Rules 37.26 to 37.33. Their effect is to considerably simplify the existing requirements, as they propose to replace detailed disclosure requirements with an obligation to provide the information that the investors to whom securities are being offered would normally expect. This is set out in proposed Rule 37.29. However HKEx proposes to retain the existing requirements for:

* A prescribed disclaimer that HKEx and the Exchange are not responsible for the contents of the listing document. See proposed Rule 37.27.
* A prescribed responsibility statement for the contents of the document. HKEx will continue to allow this statement to be made on a corporate basis. See proposed Rule 37.28.
* A statement limiting the distribution of the listing document to professional investors. See proposed Rule 37.31.
* The inclusion of additional information which may be specified by HKEx, to ensure the flexibility which may occasionally be necessary to require additional information to be included in a listing document (e.g. details of any waivers granted). See proposed Rule 37.30.

Additional flexibility for Listing Documents is proposed as follows:

* At present they must be in English. It is proposed to accept them in either English or Chinese. See proposed Rule 37.32.
* At present they must be in printed form although additional copies may be made available electronically. It is proposed to permit them to be in printed or electronic form. See proposed Rule 37.33.

## Application Vetting

### Issues and Proposals

HKEx considers in the Consultation Paper whether or not to continue with the current practice of vetting listing applications for debt securities for professionals in order to ensure all of their eligibility criteria have been met. In light of the fact that it is not a particularly costly process, in terms of time or financial expenditure, HKEx proposes to retain the practice.

It is proposed that the present review methods of HKEx with regard to whether the prescribed disclaimer and responsibility statements and statement limiting distribution to professionals are included in the listing document be retained. Additionally if HKEx has required additional information to be included in the listing documentation it will be straightforward to review whether it has been included.

However HKEx dismisses the idea of reviewing whether a Listing Document contains the other more detailed information which professional investors are accustomed to, as such documents are often tailor made by the specific investors to whom they are directed. As a result the issuer is better placed to assess the needs of professional investors in such circumstances than HKEx would be.

## Application Procedures

### Issues and Proposals

The proposals set out by HKEx in the Consultation Paper regarding Application Procedures are similar to those currently in place, with some deletions, modifications and an addition to introduce listing eligibility letters. They are detailed in proposed Rules 37.34 to 37.39.

#### Deletions

In order to ensure conformity with the proposals to end the practice of reviewing the detailed contents of disclosure documents, the following Rules will be deleted:

* Rules 37.21 and 37.24 requiring drafts to be annotated to indicate compliance with the detailed disclosure requirements.
* Rule 37.24(3) requiring draft trust deeds to be annotated to indicate compliance with Appendix 4 of the Rules.
* Rule 37.24(4) requiring a disclosure checklist. Rule 37.26 requiring certified copies of every report, financial statement, letter or opinion that is included in the listing document, a deletion which will bring Hong Kong into line with regulatory norms in Singapore. HKEx also proposes to remove current Rule 37.23, which obliges it to review publicity material, as it is only appropriate for the regulation of offers to retail investors.

#### Modifications

HKEx highlights the fact that, at present, the Rules specify a number of different deadlines for submitting documents for a listing application. However, in practice, it is normal for all documents to be received with the listing application and HKEx aims to formalise this market standard. The requirement for all copies of documents to be certified copies will also be relaxed (see proposed Rule 37.35). The obligation to present documents either in English or translated into English will be amended in order to allow documents to be in English or Chinese or translated into one of these languages (see proposed Rule 37.34). It is also proposed to amend the rule that an Applicant must publish a formal notice of listing two clear business days before listing so that the notice may be published on listing (proposed Rule 37.39).

#### Listing Eligibility Letter

HKEx states that once the routine process of assessing the eligibility of an application for listing is complete a listing eligibility letter will be issued to the Applicant. This will also indicate whether additional information in the listing document is required. The letter will be valid for three months and will be very similar to the approval letter for a debt programme. For routine applications, HKEx expects to issue the eligibility letter 5 business days after receipt of the application. Once an Applicant has a listing eligibility letter it may proceed to list. However, the Applicant cannot issue the listing document in final form until confirmation has been received from the HKEx that it may be issued (as provided in proposed Rule 37.37). If the listing document is to be finalised immediately after review by HKEx, the eligibility letter may confirm that the listing document can be published. HKEx also states that the current practice of issuing listing approval letters one day before the listing date will be continued.

## Continuing Obligations

### Issues and Proposals

The continuing obligations for debt issuers are currently detailed in the Listing Agreement found in Appendix 7 to the Rules ("**The Listing Agreement**"). HKEx proposes to include them in Chapter 37 of the Rules, bringing them into line with the continuing obligations for equity issuers, which are detailed in Chapters 13, 14 and 14A. Many of the current provisions in the Listing Agreement are intended to protect retail investors and as a result are not appropriate for debt issues targeted exclusively at professionals. HKEx proposes to remove such provisions, and also those which are encompassed by the general disclosure obligation, from the Listing Agreement. The proposals are set out in new Rules 37.44 to 37.57.

The following continuing obligations will be imposed under the new regulatory framework:

* To comply with the Listing Rules.
* To comply with a general disclosure obligation to ensure that there is sufficient information for any trading in the securities to take place on a fair and orderly basis.
* To announce information that has been released on other markets to prevent information asymmetry. To announce redemptions or cancellations of debt securities.
* To notify the Exchange of any proposal to amend the trust deed, change the trustee or amend the terms of convertible securities.
* To notify the Exchange if a debt issue is listed on another exchange.
* To notify the Exchange if all of a debt issue has been redeemed or an issue has been fully converted.
* To provide the Exchange with copies of accounts and circulars for information.

As with much of the new regulatory framework, these requirements are similar to those currently in place in Singapore. The Listing Rules in Singapore require debt issuers to comply with a general disclosure obligation; to announce redemptions or cancellations of debt securities, amendments to the trust deed and proposals to replace a trustee; and to provide copies of annual accounts.

The general disclosure obligation, the requirement to announce information released on other markets, and to notify the Exchange if debt securities are listed on another exchange are continuations of existing requirements.

HKEx's proposed Rule 37.45 notes that the method for disclosing information required under the Rules is an announcement on the HKEx website, which must include an appropriate disclaimer. The current obligation to submit announcements to HKEx for pre-vetting will be removed under the proposals, bringing the rules for issues of debt securities into line with practices for equity issuers.

HKEx has elected to retain an express statement, contained in Proposed Rule 37.46, obliging the issuer to comply with the Rules in force from time to time. This duplicates the undertaking in the formal listing application to comply with the Rules, but HKEx believes that the retention of an express statement in the Rules emphasises the importance of this requirement.

Proposed Rule 37.48(a) mimics the requirements imposed by the Singapore Exchange, demanding the disclosure, as soon as possible, of any redemption or cancellation of debt securities. This represents a simplification of the requirements currently enshrined in the Listing Agreement, which oblige the issuer to notify the Exchange of purchases, redemptions, cancellations, drawings or proposed drawings to effect partial redemptions of debt securities, as soon as possible after they are made. The aim of this amendment is to ensure that the information about the size of a debt issue that is outstanding remains current.

Proposed Rule 37.49 requires notification of proposals to replace a trustee for bondholders, amend the trust deed for a debt issue, or amend the terms of convertible securities (except for amendments that take place automatically under the terms and conditions). HKEx has made this proposal in order to ensure that that it can assess whether to impose additional conditions on the change.

Proposed Rule 37.50 requires an issuer to notify the Exchange if an issue has been fully redeemed or converted so that it may be delisted. This is a new requirement which codifies existing practice.

Proposed Rule 37.52 requires an issuer to provide the Exchange with a copy of any circular sent to bondholders or the trustee. This replaces an existing requirement to submit these to the Exchange for pre-vetting. Proposed Rule 37.53 requires the issuer to provide the Exchange with copies of its annual report and accounts and interim report. For guaranteed issues only the guarantor's accounts are required. This reflects an existing requirement in paragraph 12(1) of the Listing Agreement, modified to allow electronic copies to be sent to the Exchange. Proposed Rule 37.57 allows the Exchange to impose additional conditions on an issuer. This reflects an existing requirement in paragraph 17(1) of the Listing Agreement.

## Miscellaneous Issues Raised By HKEx

HKEx proposes in the Consultation Paper to bring the GEM Rules on listing debt for professionals into line with the Main Board Rules discussed in this newsletter and invite responses on whether they should limit eligibility under those Rules to companies already listed on GEM.

In its proposals HKEx has included provisions from Chapters 27 to 30 that apply to debt for professionals in Chapter 37. Provisions have also been included from the listing agreement into Chapter 37. HKEx invites comments on whether other provisions in the Rules should also be included in Chapter 37.

*This note contains a summary only of the proposals included in HKEx's Consultation Paper on Proposed Changes to the Requirements for Listing Debt Issues to Professional Investors only. Specific advice should be sought in relation to any particular situation.*

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