



Hong Kong

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HONG KONG STOCK EXCHANGE PUBLISHES GUIDANCE LETTER ON BONUS ISSUES OF SHARES

Background

The Stock Exchange of Hong Kong Limited (the **Exchange**) has published a new guidance letter HKEx-GL88-16 on the Exchange's approach to bonus issues of shares (**bonus issues**) by listed issuers.

The move follows an upsurge in the number of bonus issues with a large distribution ratio by listed companies. In a number of these cases, the Exchange witnessed significant price and volume fluctuations in the trading of their shares during the ex-entitlement period. The guidance letter reminds listed issuers to properly plan their bonus issues to avoid the development of disorderly trading. Under the Listing Rules, where there is reasonable likelihood of disorderly trading for large-scale bonus issues, the Exchange may not grant listing approval.

Guidance

A bonus issue of shares is as an allotment of new shares by a listed issuer to its existing shareholders, credited as fully paid out of its reserves or profits, in proportion to their shareholdings. When a company issues bonus shares under the "no-par" regime, the shares will have no nominal value and the company is no longer required to transfer an amount to share capital if it issues shares for no consideration, unless it elects to do so (e.g. by capitalising profits). As a result, a company may allot and issue bonus shares either with or without increasing its share capital.

Bonus issues are one of the options that listed issuers may use to bring equity securities to listing. Listed issuers must comply both with the specific Rule requirements for bonus issues and the general principle of the Rules that issuers must ensure that their issues of shares are conducted in a fair and orderly manner.

Size of bonus issues

Under the current trading arrangements, a time interval occurs between the ex-entitlement date for a bonus issue (the **ex-date**)¹ and the date of allotment of bonus shares (the **allotment date**). Consequently, the previous closing share price is adjusted downward on the ex-date but the bonus shares would not be available for trading until the allotment date, causing a squeeze in the availability of shares and significant price fluctuations during the ex-entitlement period. The Exchange observed that unexpected price fluctuations in a number of cases occur when listed issuers conduct bonus issues of shares with a large distribution ratio.

¹ Under the T+2 settlement cycle, shares will be traded ex-entitlements to the bonus issue on the trading day immediately before the record date (or the last registration date where there is a book closure). Share price will be adjusted downward on the ex-date in accordance with the distribution ratio. A portion of the shareholders' holdings in the company will not be tradeable until the bonus shares are issued.

The Exchange found that listed issuers' reason for conducting bonus issues of shares² is to increase the liquidity of their shares in the market. However, the Exchange believes this purpose could also be accomplished by effecting a share subdivision as both have the effect of increasing the number of shares outstanding and reducing the share price.

The Exchange reminded all listed issuers that it is their responsibility to ensure their bonus issues of shares are conducted in a fair and orderly manner. Further, the Exchange may not grant listing approval for large scale bonus issues of shares where there is reasonable likelihood of disorderly trading during the ex-entitlement period. Thus, the Exchange expects listed issuers to adopt share subdivisions in these circumstances to avoid disorderly trading during the ex-entitlement period. A bonus issue of 200% or more of its existing issued shares is likely to cause concern; however, the Exchange reserves the right to raise the same concern for a smaller bonus issue in the light of particular facts and circumstances.

There are limited exceptional circumstances in which the Exchange will grant listing approval for large scale bonus issues of shares. For instance, if the issuer is prevented from carrying out a share subdivision by the laws of the issuer's jurisdiction of incorporation or the requirements of another stock exchange where it is dually listed. In these circumstances, the company must demonstrate that the proposed issue is not likely to give rise to disorderly trading during the ex-entitlement period.

Timetable for bonus issues

The Exchange reminds listed issuers to follow its guidance on "Guide on distribution of dividend and other entitlements" when planning bonus issues. In particular, the ex-entitlement period should be as short as practicable. Where a bonus issue is subject to condition(s), the company must clearly disclose the condition(s) in the bonus issue announcement.

Trading limits

Listed issuers should not propose any bonus issue of shares (or share subdivision) that infringes the principle of Rule 13.64. This gives the Exchange the right to require a listed issuer to change the trading method or to proceed with a consolidation of

its securities when the market price of its securities approaches the limit of HK\$0.01, which the Exchange considers to be any trading price less than HK\$0.1.³

² As highlighted in the Securities and Futures Commission's Corporate Regulation Newsletter of March 2016, it could be misleading or inaccurate if a company discloses its bonus issue of shares as "a reward" to shareholders or a means to widen its capital base.

³ See also the "Guide on trading arrangements for selected types of corporate actions".

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