SLAUGHTER AND MAY/

CLIENT BRIEFING

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ENHANCED LISTING REGIME FOR PROFESSIONAL DEBT IN HONG KONG

Summary

On 21 August 2020, the Stock Exchange of Hong Kong Limited (**SEHK**) updated Chapter 37 of the Main Board Listing Rules (**Chapter 37**) and Chapter 30 of the GEM Listing Rules to enhance the listing regime for debt issues to professional investors only (**Professional Debt Regime**).[1] The SEHK has also published guidance on Chapter 37 (**Guidance**), which provides guidance on the disclosure standards in connection with the Professional Debt Regime, in particular debt securities with special features (**DSSFs**).

The amendments to the Listing Rules and the Guidance will take effect on 1 November 2020.

Background

The current Professional Debt Regime is expedient and streamlined. It does not contain prescribed disclosure requirements and vetting is limited to the fulfilment of eligibility requirements and the inclusion of certain prescribed statements (including a prescribed disclaimer) in the listing documents. In the light of an increasing number of retail investors in debt securities listed under Chapter 37 (**Chapter 37 Debt**) in the secondary market and the SEHK's very limited regulatory oversight in the off-exchange secondary market trading, the SEHK published a consultation paper in 2019 with a view to enhancing the Professional Debt Regime.

Responses to the consultation paper indicated there was general support for the SEHK's proposals.

Key updates to the Listing Rules

Increasing the existing issuer's minimum net assets requirement from HK$100 million to HK$1 billion

In determining an issuer's listing eligibility, NAV is a clear and objective criterion. A study conducted by the SEHK indicated that 98.1% of issuers of Chapter 37 Debt listed between 2016 and 2018 had net assets of at least HK$1 billion.

An issuer, or the guarantor that wholly owns the issuer, is required to satisfy the NAV requirement.

Introducing a minimum issuance size of HK$100 million

This is to ensure that only issuers with financial capacity and a proven track-record of supporting debt issuances of a significant amount would be eligible for issuing Chapter 37 Debt. The size of 99.2% of Chapter 37 Debt issued from 2016 to 2018 was at least HK$100 million.

The new minimum issuance size does not apply to tap issuances or to unlisted issuances under medium term note programmes listed under Chapter 37.

Requiring listing documents to state explicitly that the intended Hong Kong investor market is for professional investors only

While Chapter 37 Debt is intended for professional investors only, Chapter 37 Debt is sold to retail investors in the secondary market and traded off-exchange and deposited and cleared through overseas clearing systems. Since Chapter 37 does not regulate off-exchange secondary trading and does not apply to licensed corporations or registered institutions

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[1] This client briefing focuses on the amendments to Chapter 37 of the Main Board Listing Rules. Equivalent amendments have been made to Chapter 30 of the GEM Listing Rules (to the extent equivalent provisions exist in the GEM Listing Rules).

in the secondary market, the SEHK has limited oversight and cannot ensure that Chapter 37 Debt traded on the secondary market is to professional investors only.

This new explicit disclosure requirement seeks to protect retail investors in the Hong Kong secondary market.

Requiring publication of listing documents on the SEHK's website on the listing date

In the case of a medium term note programme, this new requirement applies to the base listing document and the supplementary listing document (including the pricing supplement) for each issue (except unlisted issuances).

Eligibility exemption for State corporations not applying to regional or local authorities

The SEHK has received complaints about default on Chapter 37 Debt issued by corporations controlled or majority owned by regional or local authorities of a State (as defined in Rule 37.58). As such corporations may not be supported financially by their State, they will not automatically be exempt from the issuer eligibility requirements in Chapter 37 (**Issuer Eligibility Requirements**).[2]

The exemptions to the Issuer Eligibility Requirements will continue to apply to corporations controlled or majority owned by a central government.

Expanding the definition of "professional investors" to include professional investors prescribed by rules made under section 397 of the SFO (such as high net worth investors)

The definition of "professional investors" in Rule 37.58 has historically excluded professional investors as defined by the rules made under section 397 of the Securities and Futures Ordinance (Cap. 571 of the Laws of Hong Kong) (**SFO**). Currently listing applicants have to apply for a professional investor waiver such that the definition of professional investors under Chapter 37 aligns with that in such SFO rules in order to include high net worth investors. This amendment will streamline the listing application process.

Enhancing continuing obligations

Certain amendments have been made to improve the operation of the continuing obligations under Chapter 37, mainly the disclosure obligations of issuers (and guarantors in the case of guaranteed issues) concerning:

- unusual movements in the price or trading volume of listed debt securities
- any possible false market
- any default (including cross-default) or insolvency or liquidation matters
- during any suspension of trading, a quarterly update.

Amendments to the listing application process

The listing application will require a written confirmation in relation to the due incorporation, capacity and authorisation of the issuer and any guarantor instead of their constitutional documents and resolutions.

The SEHK will also require an issuer/guarantor to submit a copy of its audited financial statements (rather than its last published financial statements). This new requirement will not apply where an issuer/guarantor is exempted from the Issuer Eligibility Requirements or where the audited financial statements are already contained in the listing document.

Exemptions for REIT issuers from Issuer Eligibility Requirements

Currently under Chapter 37, for the purpose of the Issuer Eligibility Requirements, an issuer/guarantor with recourse against the assets of a real estate investment trust (**REIT**) is assessed based on its own assets and audited financials even though its obligations will in practice be satisfied by the assets of the REIT.

Under the revised Chapter 37, the assets and financials of the relevant REIT will be assessed for such purpose and a REIT issuer/guarantor will be exempt from the Issuer Eligibility Requirements if the REIT is listed on the SEHK.

[2] Issuer Eligibility Requirements refer to the minimum net assets requirement of HK$1 billion (Rule 37.05) and the requirement for audited accounts for two years (Rule 37.06).

Guidance

Chapter 37 does not contain any prescribed disclosure requirements. The Guidance provides further information on the disclosure standards for Chapter 37 Debt listing documents.

General disclosures

Customary expected disclosures for Chapter 37 Debt listing documents include the following:

- a summary of the key terms and conditions
- financial information on the obligors
- risk factors relating to the obligors, their business and the Chapter 37 Debts, including:
    - any structural or other risks associated with Chapter 37 Debts, such as subordination, security and credit support
    - if issued by State corporations, disclosure on the relationship with the government and the level of financial support from the State (or, if no such financial support, disclosure that the repayment obligations remain the sole obligation of the issuer and that the relationship with the State does not necessarily correlate or provide assurance as to the issuer's financial condition)
    - the risks that modifications, waivers and other decisions by the trustee or a prescribed percentage of the holders may be considered to be adverse to the interests of individual or minority holders and that their recourse may be limited
- the full terms and conditions
- description of the use of proceeds from the issuance
- business disclosure on the obligors
- a summary of the key taxation consequences associated with dealings in the Chapter 37 Debts
- any restrictions on the subscription and sale of the Chapter 37 Debts
- any other material information that may be necessary to facilitate investors in making an informed investment decision.

Issuers should deliberate whether their Chapter 37 Debts contain any unique features that may affect the rights of investors. For example, it may be suitable to include a disclaimer on the front cover of listing documents highlighting the characteristics of DSSFs. In any event, listing documents should indicate that the Chapter 37 Debts are for professional investors only. If only a specific type of professional investors is targeted, that should be made clear in the listing documents.

Specific guidance on DSSFs

The SEHK has provided specific guidance on the disclosures regarding DSSFs, which is summarised in the Annex.

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Annex

Specific Disclosure Guidance on DSSFs

TYPE OF DSSF	PRODUCT FEATURES	EXPECTED DISCLOSURES
Perpetual debt securities	A debt security with no fixed maturity date or with variable or deferred payment terms	• the issuer's ability to defer or cancel distribution payments (on an optional or mandatory basis); whether such deferral or cancellation can be for an unlimited number of times; whether any deferred or cancelled distributions are cumulative or forfeited • the impact of any "pushers" or "stoppers" in relation to distributions and the consequential impact on investors • the perpetual nature of the securities and the nature of any redemption rights of the issuer; where investors have no right to require redemption, a more robust risk factor highlighting such risk • the status of subordinated perpetual debt securities and their ranking relative to other indebtedness • the circumstances in which the rate of distribution could be reset or adjusted and the consequential impact on investors; where there is no such reset or adjustment, a more robust risk factor emphasising the perpetual nature of the debt securities • the limited remedies for default or non-payment • any legal and/or commercial drivers behind the issuance
Debt securities with extendable maturity dates	A debt security where the maturity date can, at the option of the issuer, be extended	• the possibility of a delay in the final redemption payment, including such delay not resulting in holders' right to accelerate payments or to take action against the issuer • a description of any different interest rate or method for determining the interest rate during the extension of the maturity period • any restrictions imposed on the issuer where it has elected to extend the maturity date
Convertible bonds and exchangeable	(1) Debt securities convertible into or exchangeable for equity securities or other	• the nature of the underlying shares and dividends payable on those shares • a description of the exchange property together with any risks associated with the exchange property • the conversion price or exchange ratio • a description of the conversion or exchange right; the process for the exercise of such right

TYPE OF DSSF	PRODUCT FEATURES	EXPECTED DISCLOSURES
bonds (**EQL Securities**)	property; and (2) debt securities with non-detachable warrants or similar rights to subscribe or purchase equity securities or other property attached	• the nature of any adjustments to the conversion price or the exchange property and other anti-dilutive protection for investors • any ability of the issuer to elect to pay cash in lieu of delivering the underlying shares or exchange property • the nature of any redemption rights • the nature of any lock-up on the issuer or major shareholders regarding dealings in the EQL Securities or the underlying shares • any key risks relating to the underlying shares (e.g. fluctuations in their price and limited anti-dilution protection) • the nature of any related party transactions • information on substantial shareholders of the issuer of the underlying shares
Debt securities with contingent write down or loss absorption features (**CWD Securities**)	A debt security issued by a financial institution which requires a principal amount of the instrument to be written down, or converted into ordinary shares, upon the occurrence of a particular trigger event	• the ability of the issuer to cancel distributions (on an optional or mandatory basis); whether such cancellation can be for an unlimited number of times; whether any cancelled distributions are cumulative or forfeited • the impact of any "stoppers" in relation to distributions and the consequential impact on investors • if no maturity date, the perpetual nature of the CWD Securities and the nature of any redemption rights of the issuer; where investors have no right to require redemption, a more robust risk factor highlighting such a risk • the ability of the issuer to require a principal amount to be written down, or converted into ordinary shares, upon the occurrence of a trigger event • the consequences of such write down or conversion; a description of the relevant trigger event; the impact on investors • the status of subordinated CWD Securities and their ranking relative to other indebtedness • the circumstances in which the rate of distribution could be reset or adjusted and the impact on investors • the limited remedies for default • disclosure of the regulatory capital treatment (if any), key regulatory capital requirements, current regulatory capital ratios and any applicable resolution regime

TYPE OF DSSF	PRODUCT FEATURES	EXPECTED DISCLOSURES
Debt securities with multiple credit support providers and structures (**MCS Securities**)	A debt security which has the benefit of security or other types of credit support and/or contains more than one obligor (that may include an issuer, guarantor or provider of other similar credit support)	• a summary of the key terms of the credit support (including the ranking and status of the credit support and, if appropriate, the form of the document evidencing the credit support) • the identity of each credit support provider • issuer should consider the level of business and risk disclosure on the credit support provider and the credit support structure that would be appropriate. It should bear in mind the identity and nature of the credit support provider, its relationship with the credit support provider, the regulatory regime governing the performance of the credit support and the nature (including the complexity) of the credit support, including the level of “protection” afforded by the credit support • in the case of a standby letter of credit, any complex arrangements about pre-funding, notifications and drawings involved in the payment cash flows on each scheduled payment date and the consequences of, and risks associated with, any failure in the operation of such arrangements