

# Hong Kong Capital Markets Update

ISSUE 2019-08 | December 2019



## **HKEX's consultation on proposed changes to Chapter 37 of the Main Board Listing Rules – Debt Issues to Professional Investors Only**

On 6 December 2019, the Stock Exchange of Hong Kong Limited (the Exchange) published a [consultation paper](#) (Consultation) seeking market views on its proposed changes to Chapter 37 of the Main Board Listing Rules – Debt Issues to Professional Investors Only (Chapter 37 or Professional Debt Regime). The deadline for submissions is 7 February 2020.

### **Highlights**

- The Exchange proposed amendments to Chapter 37 seeking to balance the need to safeguard investor protection while maintaining an effective and appropriate listing platform for the continued development of the bond market in Hong Kong in light of market developments.
- The deadline for submitting responses to the Consultation is 7 February 2020.

### **Background**

The current Professional Debt Regime with its streamlined approach was introduced in 2011. Debt securities listed under Chapter 37 (Chapter 37 Debts) have grown significantly both in terms of the number of issuances and issuance amount since the adoption of the current light-touch Professional Debt Regime in 2011. At the same time, the Exchange notes that certain views have been expressed that enhancements could be made to Chapter 37 eligibility requirements, that Chapter 37 Debts have increased in complexity, and questioning the adequacy of their disclosures in the listing document. The Exchange also understands that notwithstanding that Chapter 37 Debts are intended for professional investors only; Licensed Intermediaries<sup>1</sup> have been selling Chapter 37 Debts to retail investors in the secondary market.

Taking into account market developments since 2011 as well as the preliminary feedback of a number of stakeholders, the Exchange is putting forward a proposal for market consultation which seeks to balance the need to safeguard investor protection while maintaining an effective and appropriate listing platform for the continued development of the bond market in Hong Kong.

### **Key proposals**

#### ***Eligibility requirements***

The Exchange proposes to increase the NAV Requirement<sup>2</sup> for issuers from HKD 100 million to HKD 1 billion with the intention to ensure that only issuers with larger asset pools could list debts under Chapter 37.

<sup>1</sup> Corporations that are either licensed by the SFC as a licensed corporation, or registered with the SFC as a registered institution, to carry out regulated activity under the SFO

<sup>2</sup> The requirement under Rule 37.05 that an issuer must have minimum net assets of HKD 100 million in order to be eligible for listing its debt issues under Chapter 37

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The Exchange proposes to maintain the current Eligibility Exemption<sup>3</sup> available for State<sup>4</sup> corporations given that the Eligibility Exemption is based on whether corporations are majority owned by, and/or agencies of, a State, rather than the financial support or backing provided by a State in case of default of its payment obligations.

The Exchange also proposes to introduce a minimum issue size requirement of HKD 100 million (or equivalent in other currencies) for Chapter 37 Debts (excluding tap issuances) to ensure that only issuers with financial capacity and a proven track record to support debt issuances of significant amounts would be eligible. The proposed approach is in line with other key professional debt listing markets.

### ***Issuer statement on intended investor market***

Recognising the Exchange's very limited ability to ring-fence the sale of Chapter 37 Debts in the off-exchange secondary market, the Exchange proposes to require an issuer to state explicitly on the front cover of the listing document the intended investor market in Hong Kong (i.e. professional investors only) for its Chapter 37 Debts to better alert retail investors in Hong Kong that they are not the intended class of investors for Chapter 37 Debts. Together with the Exchange's proposal to make listing documents for Chapter 37 Debts publicly available on the Exchange's website on the listing date (see below), the Exchange believes that the statement will also help to facilitate suitability assessment by Licensed Intermediaries and complement the SFC's actions in tackling the mis-selling of Chapter 37 Debts in the secondary market.

### ***Publication of listing documents***

The Exchange proposes to require the publication of listing documents for Chapter 37 Debts on the debt's listing date. The Exchange considers that the publication would benefit Licensed Intermediaries and potential investors as they will have access to complete information on the relevant Chapter 37 Debts and be alerted to the caution statements included in the listing documents highlighting the nature of the securities which target professional investors only.

### ***Disclosure and vetting***

To address concerns on the adequacy of disclosure for Chapter 37 Debts with Special Features<sup>5</sup>, the Exchange considers that it is appropriate to issue market guidance. The proposed guidance will discuss disclosures relating to Special Features which are customarily expected by professional investors to be included in the offering document and include suggestions on how to draw investors' attention to these Special Features and the associated risks. Further, it will remind issuers generally that disclosures in the listing document should be commensurate with the customary expectation of the intended investors, and highlight in the summary of terms and conditions section of the offering documents the structure and features of the debts as well as any key terms affecting the rights of the investors.

### ***Definition of professional investors***

The Exchange proposes to codify the PI Waiver<sup>6</sup> to streamline the Listing Rules and alleviate the unnecessary administrative burden on issuers.

### ***Other Rules amendments***

The Exchange also proposes to make a number of other amendments to Chapter 37 to improve the operation of the Rules. These proposals relate to the following:

- a) Amendment to allow eligibility assessment referencing the assets of a real estate investment trust (REIT) and the audited financials of a REIT if the assets of REIT will be applied for satisfying obligations under the debt securities issued by REIT Issuer (or guaranteed by REIT guarantor). Further, if the REIT is listed on the Exchange, the REIT Issuer (or REIT guarantor) will enjoy the Eligibility Exemption (as accorded to Hong Kong-listed companies);

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<sup>3</sup> The exemption available to supranational, State corporations, Hong Kong-listed companies and special purpose vehicles formed for listing asset-based securities from the Issuer Eligibility Requirements (i.e. NAV Requirement and the requirement to provide audited accounts for the past two years)

<sup>4</sup> Includes any agency, authority, central bank, department, government, legislature, minister, ministry, official or public or statutory person of, or of the government of, a state or any regional or local authority thereof

<sup>5</sup> The non-exhaustive list of special features of certain bonds that render such bonds complex as posted on the SFC's website, which include perpetual or subordinated bonds, or those with variable or deferred interest payment terms, extendable maturity dates, or those which are convertible or exchangeable or have contingent write-down or loss absorption features, or those with multiple credit support providers and structures

<sup>6</sup> A general waiver to modify the definition of professional investors under Chapter 37 such that Chapter 37 Debts may be marketed to high-net-worth corporates, high-net-worth individuals and others as prescribed by rules made under section 397 of the SFO

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- b) The inclusion of a specific obligation for issuers and guarantors of Chapter 37 Debts to respond promptly to the Exchange's enquiries;
- c) The inclusion of a specific obligation for issuers and guarantors to announce relevant information (i.e. default, winding-up and liquidation);
- d) The inclusion of a requirement for issuers and/or guarantors to publish quarterly announcement of its developments after trading suspension of Chapter 37 Debts to improve transparency;
- e) Amendment to allow announcement of information to avoid a false market or information that may materially affect guarantor's obligations under Chapter 37 Debts it guarantees to be made "as soon as reasonably practicable" rather than "immediately";
- f) Amendment to require issuers to announce information which may have material effect on its ability to meet obligations under its Chapter 37 Debts;
- g) Amendment to clarify guarantors' continuing obligations;
- h) Amendment to clarify the scope of debt securities with respect to the continuing obligations;
- i) The replacement of the obligation for issuers (and the guarantors) to submit copies of constitutional documents and resolutions authorising, among other things, the issuance of debt securities with a written confirmation of due incorporation, capacity and authorisation;
- j) The clarification of the requirements for issuers and guarantors to submit audited financial statements (instead of last-published financial statements) to establish the fulfilment of the Issuer Eligibility Requirements (so that submission of audited financial statements is only necessary for issuer or the guarantor that an issuer relies on in fulfilling Issuer Eligibility Requirements, and no such submission is necessary where the issuer (or the guarantor) is exempted from the Issuer Eligibility Requirements, or if the financial information is already included in the listing document);
- k) Amendment to clarify that reference to supplementary listing document includes a pricing supplement; and
- l) The making of housekeeping changes to improve Listing Rules' clarity and to correct any typographical errors.

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If you have any questions about the matters discussed in this publication, please feel free to contact the following capital markets partners and directors.

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