



CONSULTATION PAPER

REVIEW OF CHAPTER 37 – DEBT ISSUES TO PROFESSIONAL INVESTORS ONLY

The Law Society's Submissions

The Stock Exchange of Hong Kong Limited (the "Exchange") has issued a consultation paper on "Review of Chapter 37 - Debt Issues to Professional Investors Only" on 6 December 2019 (the "Consultation Paper"). The Law Society makes the following submissions on the consultation questions posed.

The abbreviations in this submission follow those adopted in the Consultation Paper. The "Definitions" section of the Consultation Paper is appended to this submission for easy reference.

Question 1: Do you agree with the proposed increase of the NAV Requirement from HK\$100 million to HK\$1 billion? Please give reasons for your views.

Law Society's response:

Given the HK\$100 million threshold has remained unchanged for over 15 years, it is sensible to re-visit this threshold and adjust it at least for inflation. However, the basis for determining the magnitude of this adjustment is rather unclear – it is advisable for the Exchange to explain how the new HK\$1 billion threshold is determined.

However, consideration should be given to whether the proposed HK\$1 billion NAV Requirement might act to exclude asset-light companies, such as tech and other innovative companies, from Hong Kong's listed debt market. The Exchange could risk losing these listings to the SGX which has no NAV Requirement for debt offered only to professional investors: under Rule 303(2)(b) of the SGX Main Board Rules, an issue of debt securities by an issuer whose equity securities are not listed on SGX is eligible for listing if it has a principal amount of at

least S\$750,000 (or its equivalent in foreign currencies) and at least 80% of the issue is subscribed by “specified investors”.

The Exchange might also consider adding an alternative eligibility criteria for Chapter 37 listing:

- (a) issuers who can meet the requirements for equity listing under Main Board Listing Rule 8.05 (this is in order to cater for unlisted companies which can meet the criteria for equity listing); and
- (b) debt issues with a credit rating of investment grade and above.

Question 2: (a) *Do you agree that the Exchange should maintain the current Eligibility Exemption available for State corporations? Please give reasons for your views.*

(b) *If not, which type of State corporations should comply with Issuer Eligibility Requirements? Please give reasons for your views.*

Law Society’s response:

- (a) No. The rationale for maintaining the current Eligibility Exemption available for State corporations is unclear from the Consultation Paper, particularly when the current Eligibility Exemption (i) does not seem to address the comments received by the Exchange (as described in paragraph 64 of the Consultation Paper), and (ii) is not in line with the practice of SGX, LUXSE, ISE and LSE.

The Eligibility Exemption available for State corporations rests on, among others, the assumptions that (i) the State will step in to back the payment obligations of the relevant State corporation in case of default by the State corporation, and (ii) the relevant issuers are likely to be of significant size and they should, by default, be able to meet the eligibility requirements. However, given (i) the recent defaults in domestic bonds backed by the government in the PRC, and (ii) the broad definition of the “State” under Rule 37.58 (which includes a wide range of persons under a state or any regional or local authority thereof), we must not assume that any “State” (especially those at the municipal level) has sufficient financial resources to demonstrate financial strength, automatically warranting the Eligibility Exemption.

- (b) We propose to explore the feasibility of requiring State corporations to be subject to the same Issuer Eligibility Requirements applicable to non-State corporations.

Question 3: (a) Do you agree with the proposed introduction of a minimum issuance size of HK\$100 million (or equivalent in other currencies) for Chapter 37 Debts?

(b) Do you agree that such minimum issuance size shall not apply to tap issuances?

Please give reasons for your views.

Law Society's response:

(a) Yes, in respect of the introduction of a minimum threshold. However, there are three issues to note:

- **Basis for determination of threshold**

The basis for determining this threshold is rather unclear. It is advisable for the Exchange to clarify how the HK\$100 million threshold is determined.

- **Balancing against the competitiveness of our Professional Debt Regime**

SGX is a direct competitor of the Exchange for the listing of debt securities in Asia. We note that there is no general minimum issuance size requirement for standalone issuances, but the SGX requires a minimum size of S\$750,000 (HK\$4.36 million) for certain types of standalone issuances, e.g., debt securities issued by domestic corporations and local bodies (as pointed out in footnote 60 to 72 of the Consultation Paper). The same minimum issuance size requirement applies to domestic corporations whose equity securities are not listed on SGX if: (1) the issuer satisfies the qualifying criteria for equity listing; or (2) 80% of the debt securities are subscribed by "specified investors" (broadly equivalent to "professional investors" in Hong Kong). The minimum issuance size requirement does not however apply to debt security issues which have a credit rating of investment grade or above (SGX Main Board Rule 303(2)(d)).

However, there is no minimum issuance size requirement for listing foreign debt securities on SGX where 80% of the debt securities will be subscribed by specified investors. Issuers must however meet one of the following requirements: (1) the issuer's equity securities are listed on SGX; (2) the issuer is able to meet the SGX's requirements for the listing of equity securities or meets an alternative profit requirement; or (3) the debt securities have a credit rating of investment grade or above (SGX Main Board Rule 304). Further, the minimum issuance size requirement for SGX is HK\$29.05 million for each series issued under a medium-term notes programme but not for standalone issuances or tap issuances (as pointed out in paragraph 72 of the Consultation Paper).

Given that SGX has no minimum issuance size requirement for foreign debt securities issues subscribed by professional investors (as to 80%), it is advisable for the Exchange to assess how many cases of Chapter 37 Debts are currently issued for less than HK\$100 million, and therefore how setting the proposed HK\$100 million minimum threshold would, on the one hand, help achieve the objective of enhancing the Professional Debt Regime "by ensuring that only issuers with financial capacity and a proven track-record of supporting debt issuances of a significant amount would be eligible" (as stipulated in paragraph 69 of the Consultation Paper), and balancing the possibility of losing potential issuers to SGX, on the other. Failure to properly assess this would put the Exchange at a competitive disadvantage.

- **Lower threshold for GEM Chapter 30 professional debt issues**

While Consultation question 3(a) is framed in relation to Chapter 37 Debts, the draft amendments to the GEM Listing Rules (Appendix II to the Consultation Paper) propose the same minimum issuance size of HK\$100 million for GEM-listed debt issues offered only to professionals (proposed new GEM Rule 30.05A). This has the potential of excluding small and medium-sized enterprises from the listed debt market.

- (b) Yes, as tap issuances are "top-ups" from the original issuances which should have satisfied the minimum issuance size requirement.

Question 4: Do you agree with the proposal to require issuers 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, in addition to the existing legend required under Rule 37.31? Please give reasons for your views.

Law Society's response:

Yes, as the warning statements would hopefully be more conspicuous to investors. We suggest amending the proposed statement as follows (with proposed amendments bolded and underlined):

*“**Notice to Hong Kong investors:** The Issuer confirms that the [Bonds] are intended for purchase by professional investors only (as defined in the Securities and Futures Ordinance (Cap 571) and Rules made thereunder) and have been listed on The Hong Kong Stock Exchange Limited on that basis. Accordingly, the Issuer confirms that the [Bonds] are not appropriate as an investment for, **and are not directed at,** retail investors in Hong Kong. Investors should carefully consider the risks involved.”*

We further propose to combine the Rules 37.31 and 37.31A for simplicity.

The Exchange may also consider implementing steps to improve the secondary market for listed debts directed at professional investors only, and to widen the scope of investments available to retail investors, by assessing the suitability for the Hong Kong market of rules similar to Singapore's “bond seasoning framework”. This allows plain vanilla bonds which were originally offered only to professional investors, to be offered to retail investors in the secondary market after they have been listed on SGX for six months. These “seasoned” bonds can also be re-denominated into smaller lot sizes. Eligible issuers can also offer additional bonds to retail investors on the same terms as the “seasoned” bonds without a prospectus.

Question 5: *Do you agree with the proposal to require publication of listing documents for Chapter 37 Debts on the Exchange's website on the listing date? Please give reasons for your views.*

Law Society's response:

Yes, we agree that the proposal may achieve the intended purpose set out in paragraph 89 of the Consultation Paper. Mandatory publication of listing documents would also encourage issuers to ensure the statements contained in the listing documents are accurate and not misleading.

Question 6: *(a) Do you agree that the Exchange's current disclosure and vetting approach in relation to listing documents for Chapter 37 should remain unchanged, notwithstanding that the intended investors would include HNW Investors? Please give reasons for your views.*

- (b) *For the purpose of Rule 37.29, should there be a different standard with specific disclosure requirements in respect of Chapter 37 Debts that are offered to HNW Investors, compared to those that are offered to Institutional Investors, for example, the manner of presenting information such as the terms and conditions and financial information of issuer and any credit support provider (even though the current Hong Kong legal framework does not differentiate disclosure standards between Institutional Investors and HNW Investors)? If so, what should those specific disclosure requirements be? Please give reasons for your views.*

Law Society's response:

- (a) Yes. A reversal of the current “light-touch” approach to the previous prescriptive vetting approach is one step backward, and would undermine the competitiveness of the Hong Kong bond market in Asia.
- (b) No. The proposed differentiation in disclosure standards for HNW Investors and Institutional Investors is an artificial one – in reality, there is a significant overlap in instances where Chapter 37 Debts are issued to (i) Institutional Investors only, and (ii) both Institutional Investors and HNW Investors (particularly taking into account the secondary market activities discussed in the Consultation Paper).

We acknowledge the different levels of sophistication between Institutional Investors and HNW Investors. To afford more protection to HNW Investors, while the current “light-touch” approach remains to be adopted, we agree with the Exchange’s proposal to issue market guidance on disclosures of specified Special Features and other disclosure-related matters, as set out in paragraphs 102 to 104 of the Consultation Paper. The market guidance on disclosures would encourage better disclosure of bespoke features in Chapter 37 Debts and thus facilitate HNW Investors’ understanding of their proposed investments.

Question 7: (a) *Do you agree that the Exchange should publish disclosure guidance to the market on specified Special Features found in certain Chapter 37 Debts and other disclosure-related matters? Please give reasons for your views.*

- (b) *Do you have other suggestions on any additional or alternative proposals that the Exchange may implement to promote disclosure quality and consistency for Chapter 37 Debts? Please give reasons for your views.*

Law Society's response:

- (a) Yes. This would give more clarity to market participants in terms of the disclosures expected of Special Features while not reverting to the prescriptive disclosure approach.
- (b) We believe the publication of disclosure guidance to the market should be adequate to promote disclosure quality and consistency for Chapter 37 Debts while adhering to the spirit of the current "light-touch" approach. However, in order to encourage licensed intermediaries to consider the risks related to Special Features disclosed in listing documents when assessing the suitability of bonds for clients (i.e. when they are required to assess suitability under paragraph 5.2 of the Code of Conduct), the SFC may also consider issuing a circular to Licensed Intermediaries on the need to consider such risks in appropriate cases.

Question 8: Do you agree with the proposal to codify the PI Waiver by revising the definition of "professional investors" under Chapter 37 to include HNW Investors?

Law Society's response:

Yes. It has become confusing to market participants due to the different definitions of "professional investors" under Chapter 37 and the SFO. Over the years, the PI Waiver has evolved to become a "procedural" waiver and it has increased the administrative burden on issuers.

Question 9: (a) Do you agree with the proposal to allow eligibility of a REIT Issuer (or a REIT Guarantor) to be assessed by reference to the REIT Assets and REIT Financials respectively, provided that it has recourse to the REIT Assets to satisfy the obligations under the relevant Chapter 37 Debts? Please give reasons for your views.

(b) Do you agree that if the relevant REIT is listed on the Exchange, a REIT Issuer (or a REIT Guarantor) should be qualified as a HK Listco and therefore, be exempted from the Issuer Eligibility Requirements? Please give reasons for your views.

Law Society's response:

- (a) Yes. It is sensible to take into account REIT Assets when assessing the eligibility of a REIT Issuer, if the REIT Issuer has recourse to the REIT Assets to satisfy its obligations under the relevant Chapter 37 Debts.
- (b) Yes. This is a logical step to align the requirements for REIT Issuers and HK Listcos to issue Chapter 37 Debts.

Question 10: Do you have any comments on the proposed enhancements relating to the continuing obligations of the issuer and guarantor under Chapter 37?

Law Society's response:

We are generally supportive of the proposed enhancements.

Question 11: Do you agree with the proposal to replace the existing requirements to submit copies of constitutional documents and resolutions as part of the listing application documents with a requirement to provide written confirmation by the issuer (or guarantor, as the case may be) in relation to its due incorporation, capacity and authorisation? Please give reasons for your views.

Law Society's response:

Yes.

The proposed change achieves the same purpose of ensuring due incorporation, capacity and authorisation of an issuer, but reduces the list of documents required for submission - a right step towards the direction of moving to a paperless regime.

By the same reason, the requirement to provide copies of approvals authorizing the issue and listing of shares in respect of convertible securities (under Rule 37.35(j)) should also be replaced by an issuer's written confirmation.

Question 12: (a) Do you agree with the proposal to replace the existing requirement to submit last published financial statements with a new requirement for an issuer (or the guarantor that an issuer relies in fulfilling the Issuer Eligibility Requirements) to submit its audited financial statements to evidence its

fulfilment of the Issuer Eligibility Requirements? Please give reasons for your views.

- (b) *Where the issuer (or the guarantor) is exempted from the Issuer Eligibility Requirements or where the required audited financial statements are disclosed in the listing document, do you agree that such issuer (or guarantor) should not be required to separately submit financial statements to the Exchange? Please give reasons for your views.*

Law Society's response:

- (a) Yes. This is an important clarification to achieve the objective of assessing the Issuer Eligibility Requirements.
- (b) Yes. It is, to a large extent, redundant to require a separate submission of financial statements, if an issuer is exempt from the Eligibility Requirements or if the relevant information is already disclosed in the listing document.

Question 13: *Do you agree with the proposal to amend Rule 37.26 to clarify that supplementary listing document includes a pricing supplement? Please give reasons for your views.*

Law Society's response:

Yes. This does not change the current Rules in substance but clarifies the scope of a supplementary listing document.

Question 14: *The Exchange invites your comments regarding whether the drafting of the proposed housekeeping Rule amendments will give rise to any ambiguities or unintended consequences.*

Law Society's response:

No comment.

Question 15: *Do you have any other comments in respect of the matters discussed in the Consultation Paper? If so, please set out your additional comments.*

Law Society's response:

While we generally support the review of the current Chapter 37 regime to safeguard investors' interests in light of the market developments since the 2011 Consultation Conclusions, we must balance the need to maintain Hong Kong as an attractive listing platform for the continuous development of its bond market, especially when Hong Kong is undergoing a difficult time. As a general remark, we must ensure that we are not imposing additional entry barriers that competing markets do not have, as this would undermine the competitiveness of Hong Kong's bond market.

**The Law Society of Hong Kong
6 February 2020**

DEFINITIONS

TERM	DEFINITION
“2010 Consultation”	Consultation Paper on Proposed Changes to Requirements for the Listing of Debt Issues to Professional Investors Only on 17 December 2010 (here)
“2011 Consultation Conclusions”	Consultation Conclusions on Proposed Changes to Requirements for the Listing of Debt Issues to Professional Investors Only on 21 October 2011 (here)
“CCASS”	Central Clearing and Settlement System
“Chapter 37 Debts”	Debt securities listed on the Exchange under Chapter 37
“CMU”	Central Moneymarkets Unit
“CWUMPO”	Companies (Winding Up and Miscellaneous Provisions) Ordinance (Cap.32 of the Laws of Hong Kong)
“Eligibility Exemption”	The exemption available to supranationals, State corporations, HK Listcos and special purpose vehicles formed for listing asset-backed securities from the Issuer Eligibility Requirements
“EU”	European Union
“Exchange”	The Stock Exchange of Hong Kong Limited
“Exchange Participant”	As defined in the Trading Rules
“GEM”	GEM of the Exchange
“GEM Rules”	The Rules Governing the Listing of Securities on GEM of the Exchange
“HK Listco(s)”	Companies whose equity securities are listed on the Exchange
“HKEX”	Hong Kong Exchanges and Clearing Limited
“HKMA”	Hong Kong Monetary Authority
“HNW Investors”	High net worth corporates, high net worth individuals and others as prescribed by rules made under section 397 of the SFO ¹

¹ Please refer to the Securities and Futures (Professional Investor) Rules (Cap. 571D of the Laws of Hong Kong).

TERM	DEFINITION
“Institutional Investors”	Professional investors as defined under section 1 of Part 1 of Schedule 1 to the SFO, excluding the HNW Investors
“ISE”	Irish Stock Exchange
“Issuer Eligibility Requirements”	NAV Requirement and the requirement to provide audited accounts for the past two years pursuant to Rules 37.05 and 37.06 respectively
“Licensed Intermediary(ies)”	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 activities under the SFO
“LSE”	London Stock Exchange
“LUXSE”	Luxembourg Stock Exchange
“Main Board”	Main Board of the Exchange
“MiFID II”	The revised Markets In Financial Instruments Directive of the EU, applicable from 3 January 2018
“MOF”	Ministry of Finance of the PRC
“NAV Exemption”	The exemption available to supranationals, State corporations, HK Listcos, corporations listed on another stock exchange that is a member of the World Federation of Exchanges and special purpose vehicles formed for listing asset-backed securities from the NAV Requirement pursuant to Rule 37.05
“NAV Requirement”	The requirement under Rule 37.05 that an issuer must have minimum net assets of HK\$100 million in order to be eligible for listing its debt securities under Chapter 37
“NDRC”	National Development and Reform Commission of the PRC
“PI Waiver”	In light of Rule 37.58 which provides that a professional investor includes a professional investor as defined in Part 1 of Schedule 1 to the SFO (excluding those prescribed by rules made under section 397 of the SFO), waivers would be granted by the Exchange, if applied by listing applicants, to modify the definition of professional investors under Rule 37.58 such that Chapter 37 Debts may also be marketed to professional investors prescribed by rules made under section 397 of the SFO, i.e. HNW Investors

TERM	DEFINITION
“PRC” or “Mainland”	The People’s Republic of China
“Professional Debt Regime” or “Chapter 37”	Chapter 37 of the Main Board Rules - “Debt Issues to Professional Investors Only”
“Prospectus Regime”	The regime under the CWUMPO where the offering document of any offer of shares or debentures of a company to the public for subscription has to be registered under section 38D(1) of the CWUMPO and to comply with the content requirement in accordance with section 38(1) of the CWUMPO
“REIT”	A real estate investment trust
“REIT Assets”	The assets of a REIT
“REIT Financials”	The audited financials of a REIT
“REIT Guarantor”	A guarantor of Chapter 37 Debts which has recourse against the assets of a REIT for satisfying its guarantee obligations under the relevant Chapter 37 Debts
“REIT Issuer”	An issuer that has recourse against the assets of a REIT for satisfying its obligations under its Chapter 37 Debts
“Relevant Information”	Information relating to the default of one’s obligations under the debt securities that are listed on the Exchange or matters leading to or involving one’s winding up and/or liquidation
“Rules” or “Main Board Rules”	The Rules Governing the Listing of Securities on the Exchange
“SFC”	The Securities and Futures Commission
“SFC Authorisation Regime”	The regime under section 103 of the SFO where no person may issue an advertisement, invitation or document containing an invitation to the public to enter into an agreement to subscribe for securities unless the issue is authorised by the SFC or otherwise exempted
“SFC Code of Conduct”	Code of Conduct for Persons Licensed by or Registered with the SFC, as published by the SFC and updated from time to time
“SFO”	The Securities and Futures Ordinance (Cap. 571 of the Laws of Hong Kong)

TERM	DEFINITION
“SGX”	Singapore Exchange Limited
“Special Features”	The non-exhaustive list of special features of certain bonds that render such bonds complex as posted on the SFC’s website ² , 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
“State”	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
“State corporation(s)”	Any company or other legal person which is directly or indirectly controlled or more than 50 per cent. of whose issued equity share capital (or equivalent) is beneficially owned by, and/or by any one or more agencies of, a State or all of whose liabilities are guaranteed by a State or which is specified as such from time to time by the Exchange
“Suitability Obligation”	The obligation of Licensed Intermediaries to ensure the suitability of a recommendation or solicitation for a client is reasonable in all the circumstances under the SFC Code of Conduct
“Trading Rules”	The Rules of the Exchange relating to the trading of securities on the Exchange

Exchange rates used in this paper for calculating the Hong Kong dollar equivalent amounts are based on the weighted average month-end rates for 2018 sourced from the HKMA’s website.

² <https://www.sfc.hk/web/EN/rules-and-standards/suitability-requirement/non-exhaustive-list-of-examples-of-non-complex-and-complex-products/>