



Hong Kong

January 2020

## HKEX CONSULTS ON AMENDMENTS TO THE CHAPTER 37 PROFESSIONAL DEBT REGIME

On 6 December 2019, the Stock Exchange of Hong Kong Limited (**HKEx**) announced<sup>1</sup> the publication of a Consultation Paper<sup>2</sup> on proposals to review the listing regime for debt issues to professional investors only set out in Chapter 37 of the Main Board Listing Rules and Chapter 30 of the GEM Listing Rules. The consultation is open until 7 February 2020.

The current regime came into effect in November 2011 implementing proposals put forward in HKEx's December 2010 Consultation Paper<sup>3</sup>, as amended in its October 2011 consultation conclusions<sup>4</sup>. Please see Charltons' January 2011 newsletter<sup>5</sup> for details of the December 2010 Consultation Paper.

### I. Current Chapter 37 Professional Debt Regime

The current Chapter 37 regime takes a light-touch approach to the listing of professional debt issues, as proposed by the 2010 consultation. While the regime succeeded in streamlining the listing process, a number of problems have been identified

with Chapter 37, which together with market developments since the last consultation, are the impetus for the current review. Please see Charltons' note<sup>6</sup> for a summary of the current regime.

A significant issue identified by HKEx is that retail investors have purchased Chapter 37-listed debt issues in the secondary market, notwithstanding that the intended market for these issues is restricted to professional investors – that is institutional professional investors (i.e. professional investors as defined in paragraphs (a) to (i) of the definition in Schedule 1 to the Securities and Futures Ordinance (the **SFO**) and high net worth (**HNW**) investors (i.e. professional investors defined in the Securities and Futures (Professional Investor) Rules. Indeed, on 31 March 2016, the Securities and Futures Commission (**SFC**) published a Circular to Licensed Corporations<sup>7</sup> (**LCs**) highlighting instances of Chapter 37-listed debt being sold to retail investors, and emphasising that these are targeted to professional investors only. This is one factor behind the proposed amendments to Chapter 37.

1 [https://www.hkex.com.hk/News/News-Release/2019/191206news?sc\\_lang=en](https://www.hkex.com.hk/News/News-Release/2019/191206news?sc_lang=en)  
2 <https://www.hkex.com.hk/-/media/HKEX-Market/News/Market-Consultations/2016-Present/December-2019-Chapter-37-Debt-Issues/Consultation-Paper/cp201912.pdf?la=en>  
3 <https://www.hkex.com.hk/-/media/HKEX-Market/News/Market-Consultations/2006-to-2010/December-2010-Consultation-Paper-on-Proposed-Changes/Consultation-paper/cp2010122.pdf>  
4 <https://www.hkex.com.hk/-/media/HKEX-Market/News/Market-Consultations/2006-to-2010/December-2010-Consultation-Paper-on-Proposed-Changes/Conclusions/cp2010122cc.pdf>  
5 <https://www.charltonslaw.com/hkex-publishes-consultation-paper-on-proposed-changes-to-requirements-for-the-listing-of-debt-issues-to-professional-investors-only/>

In terms of market developments, Chapter 37 debt issues have grown both in the number of issuances and the amount raised since adoption of the current regime in 2011. According to the Consultation Paper, the number of Chapter 37-listed debt issues rose from 36 in 2011 to 297 in 2018, while the total funds raised by those issues increased from approximately HK\$126

6 <https://www.charltonslaw.com/hong-kong-law/listing-of-debt-securities-for-professional-investors-on-the-stock-exchange-of-hong-kong-limited/>  
7 <https://www.sfc.hk/edistributionWeb/gateway/EN/circular/suitability/doc?refNo=16EC18>

billion in 2011 to HK\$1,043 billion in 2018. The development of Hong Kong's debt market remains a key initiative of the Hong Kong Government, and in 2018, the Government included debt securities in the categories of "qualifying debt instruments" eligible for a concessionary profits tax rate on interest income and profits. A further major development was the launch of China-Hong Kong Bond Connect in July 2017 which allows offshore investors to buy and sell in China's interbank bond market and hold these securities in their Hong Kong custodians' accounts. Bond Connect's Southbound trading link, which has yet to be developed and will provide Mainland Chinese investors with access to Hong Kong's bond market, is expected to further enhance Hong Kong as an international debt trading hub.

## II. Proposed Amendments to HKEx's Chapter 37 Professional Debt Regime

The key proposed changes to Chapter 37 would:

- Raise the minimum net assets requirement from HK\$100 million to HK\$1 billion;
- Impose a minimum issuance size of HK\$100 million;
- Require an explicit statement in issuers' listing documents that the intended investor market in Hong Kong are professional investors only;
- Require publication of listing documents on the HKEx's website on the listing date;
- Provide guidance on the disclosure of certain special features in Chapter 37 debt securities and on other disclosure-related matters; and
- Introduce other Listing Rule amendments to improve HKEx's regulatory oversight of issuers' and guarantors' continuing obligations.

The proposals are aimed at balancing the need to safeguard investors and maintaining an effective and appropriate platform for developing Hong Kong's bond market.

References are to the proposed amendments to the Main Board Listing Rules. Comparable amendments are proposed to the equivalent GEM Listing Rules.

## 1. Eligibility for Listing Professionals Only Debt on HKEx

HKEx is proposing a number of amendments to the eligibility requirements for professionals only debt issues currently set out in HKEx Listing Rules 37.09 to 37.12.

### (a) Increase in Chapter 37 issuers' minimum net assets requirement

HKEx is proposing to raise the current minimum net assets requirement for Chapter 37 issuers from HK\$100 million to HK\$1 billion so that only issuers with larger asset pools will be able to list debt on HKEx under Chapter 37.

HKEx considered using other financial thresholds to determine eligibility, but found that setting a threshold applicable to all issuers would be too difficult, and thus it is not currently proposing to use other financial eligibility thresholds.

State corporations will continue to be exempt from complying with issuer eligibility requirements under Listing Rules 37.05b and 37.06b. The HKEx Listing Rules define a "State" to include 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. A "State corporation" is any company or other legal person: (i) which is directly or indirectly controlled, or beneficially owned as to more than 50% of its issued equity share capital (or equivalent) by a State and/or by any one or more State agencies; (ii) all of whose liabilities are guaranteed by a State; or (iii) is specified as such by the HKEx.

### (b) New minimum issuance size of HK\$100 million for Chapter 37 debt

There is no minimum issuance size requirement under the current regime; the minimum HK\$50 million proposed in the 2010 consultation was not adopted.

HKEx is now proposing to introduce a minimum issuance size of HK\$100 million for Chapter 37-listed debt issues to ensure that only issuers with financial capacity and a proven track record of supporting debt issuances of significant amounts will be eligible for listing. Further, a higher minimum issuance size may exclude small issuances under medium term notes programmes.

The minimum issuance size requirement will not apply to tap issuances where the issuer has already fulfilled the minimum issuance size requirement for the original issuance.

## 2. Issuer Statement on Intended Professional Investor Market

Under the current regime, HKEx Listing Rule 37.31 requires listing documents for Chapter 37 debt issues to contain a statement limiting the distribution to professional investors only. In recent years, to further reinforce the message that Chapter 37 debt issues are intended to be offered to professional investors only, HKEx has required the inclusion of the following statement on the front cover of listing documents:

*“Investors should not purchase the bonds in the primary or secondary markets unless they are Professional Investors and understand the risks involved. The bonds are only suitable to Professional Investors”.*

Listing documents for Chapter 37 issues are not however published on HKEx’s website and thus potential investors and licensed intermediaries may not be made aware that debt instruments are intended only for professional investors. HKEx disseminates a “Professionals Only” data field to information vendors for screen display to alert investors and intermediaries that Chapter 37 debt issues are intended to be offered to professional investors only. In practice, however, secondary market purchasers may not be made aware of the intended market for a debt issue because the vast majority of Chapter 37 debt is traded off-exchange and deposited with and cleared through overseas clearing systems (or CMU) rather than CCASS.

HKEx’s ability to police secondary market sales of Chapter 37 debt issues is limited because overseas clearing systems and CMU will not allow the imposition of any transfer restrictions, such as contractual undertakings by purchasers of Chapter 37-listed debts to limit on-sale to professional investors only. Moreover, HKEx’s Listing Rules only regulate issuers of Chapter 37 debt, and do not apply to Licensed Intermediaries involved in secondary market sales of Chapter 37 debt. Once primary distribution of a Chapter 37 debt issue is complete, neither the issuer nor HKEx have any control over who the debt is sold to in the secondary market.

In an attempt to discourage secondary market sales of Chapter 37 debt issues, HKEx is proposing to require a clearer statement to be included on the front cover of listing documents, and gives the following example statement in the Consultation Paper:

*“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 retail investors in Hong Kong. Investors should carefully consider the risks involved.”*

The aim is to ensure that retail investors and Licensed Intermediaries are informed that Chapter 37 debt issues are intended only for professional investors. This will also assist Licensed Intermediaries who are required to ensure the suitability of investment products for particular investors which they solicit or recommend the product to, and when clients purchase a complex product<sup>8</sup> on an unsolicited basis.<sup>9</sup>

## 3. Publication of Listing Documents

Under the current regime, there is no requirement for issuers of Chapter 37 debt to publish their listing documents.

HKEx considers that the problem with this approach is that investors may not see the caution statement in the listing document.

It therefore proposes to require listing documents for Chapter 37 issues to be published on the HKEx website on the date the debt is listed, so that potential investors and Licensed Intermediaries will be notified of the fact that the market for the issue is restricted to professional investors and of other relevant information.

## 4. Disclosure and Vetting

The Listing Rules do not prescribe detailed content requirements for listing documents issued in relation to professionals only debt issues listed under Chapter 37, although HKEx Listing Rules 37.27, 37.28 and 37.31 require the inclusion of standard disclaimers, a responsibility statement and a statement limiting distribution to professional investors in listing document. Instead, HKEx Listing Rule 37.29 imposes a general requirement that listing documents must contain the information that the investors an issuer is offering securities to would customarily expect.

<sup>8</sup> For the definition of “complex products”, please refer to the SFC’s website at <https://www.sfc.hk/web/EN/rules-and-standards/suitability-requirement/non-complex-and-complex-products/>.

<sup>9</sup> SFC Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission. Paragraph 5.2.

HKEx therefore vets applications for listing of Chapter 37 debt issues only to ensure that the eligibility criteria are fulfilled and its review of listing documents is limited to checking that the required disclaimers and statements are included.

Concerns have been raised regarding the light touch approach taken by HKEx with respect to listing document disclosure and vetting, particularly in relation to Chapter 37 debt issues which are complex products – i.e. bonds with the “special features” that render bonds complex posted on the SFC website<sup>10</sup>, including perpetual or subordinated bonds, bonds with variable or deferred interest payment terms, extendable maturity dates, convertible or exchangeable bonds, bonds with contingent write down or loss absorption features, and bonds with multiple credit support providers and structures. Another argument in favour of reviewing the current disclosure requirements and vetting process is that Chapter 37 debt issues are typically targeted at high net worth investors as well as institutional investors. There have thus been suggestions that HKEx should adopt a prescriptive disclosure framework as adopted by similar listing platforms in the EU (e.g. LUXSE, ISE and LSE) which require listing documents to include a description of the issuer’s/guarantor’s business, financial information and the terms of the debt issuance. The relevant stock exchanges also comment on listing documents as part of the listing process. However, the Singapore Stock Exchange has a regulatory regime for professional debt issues which is very similar to that in Hong Kong.

HKEx is proposing to maintain its current approach which it considers to be appropriate for a professional-investors-only market and as striking a good balance between investor protection and fostering development of the bond market in Hong Kong. However, it proposes to supplement its approach with market guidance on disclosure of specified special features and other disclosure-related matters.

Accordingly, the proposed market guidance will:

- a) discuss the listing document disclosures which professional investors customarily expect for Chapter 37 debt issues that have special features and provide suggestions on how to bring these Special Features and the associated risks to investors’ attention (e.g. by a warning statement on the front page of the offering document);

- b) remind issuers generally that listing document disclosures should be commensurate with the customary expectation of the intended investors; and

- c) remind issuers to generally highlight in the summary of terms and conditions section of the listing structure and features of the debts as well as any key terms affecting the rights of the investors.

The market guidance will be updated from time to time to reflect changing market conditions.

### 5. Definition of Professional Investors

HKEx Listing Rule 37.58 defines professional investors as investors defined as professionals under Schedule 1 Part 1 of the Securities and Futures Ordinance. This therefore limits the definition to institutional investors (i.e. authorised financial institutions, banks, insurers, collective investment scheme, intermediaries providing investment services and government bodies), and excludes high net worth investors which are “professional investors” under the Securities and Futures (Professional Investor) Rules.

In response to market feedback critical of the exclusion of high net worth investors from the professionals definition following the implementation of the current regime in November 2011, the HKEx clarified that it would grant waivers on a case-by-case basis to allow Chapter 37 debt issues to be marketed to high net worth investors in its March 2012 guidance letter<sup>11</sup>. Since the waiver had general effect under HKEx Listing Rule 2.04, HKEx has granted the waiver as a general waiver since May 2013.

Virtually all Chapter 37 issuers apply for the professional investor waiver to give themselves greater flexibility in marketing the securities. However, since the waiver has not been codified in the Listing Rules, potential issuers may not be aware of the possibility of obtaining a waiver. The need to apply for the grant of the waiver also creates an administrative burden on issuers which is inconsistent with the light touch regulatory approach of the professional debt regime.

HKEx thus proposes to codify the waiver by revising the definition of professional investors to include HNW investors.

<sup>10</sup> <https://www.sfc.hk/web/EN/rules-and-standards/suitability-requirement/non-exhaustive-list-of-examples-of-non-complex-and-complex-products/>

<sup>11</sup> <https://www.hkex.com.hk/-/media/hkex-market/listing/rules-and-guidance/other-resources/debt-securities/20120330>

## 6. Other HKEx Listing Rule Amendments

HKEx is proposing the following Listing Rule amendments to improve the operation of Chapter 37, further streamline the listing application process and to enhance its regulatory oversight over issuers and guarantors' in terms of their continuing obligations.

### (a) Allow issuer's or guarantor's eligibility assessment to reference Real Estate Investment Trust (REIT) assets and financials

Under the current regime, the eligibility assessment (under Listing Rules 37.05 and 37.06) for a REIT issuer or guarantor is based on their own assets and audited financials. HKEx proposes to amend the Listing Rules to allow the eligibility of a REIT issuer or guarantor to be assessed by reference to the REIT assets and financials, on the condition that the REIT issuer or guarantor has recourse to the REIT assets to satisfy obligations under the Chapter 37 debt issue.

Further, if the relevant REIT is listed on the HKEx, a REIT Issuer (or a REIT Guarantor) should qualify as a company whose equity securities are listed on the HKEx and thus be exempt from:

- i) the requirement of Listing 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; and
- ii) the requirement to provide audited accounts for the past two years pursuant to Listing Rule 37.06.

### (b) Enhancing issuers' and guarantors' continuing obligations

- i) Introduce an obligation for issuers/guarantors to promptly respond to HKEx enquiries

There is currently no requirement under Chapter 37 for issuers to respond promptly to HKEx enquiries, although Listing Rule 13.10 imposes such a requirement on issuers of listed equity securities. Accordingly, HKEx proposes to introduce a requirement on issuers and guarantors of Chapter 37 debt issues to respond promptly to HKEx enquiries.

- ii) To require announcement of default or matters leading to or involving winding up and/or liquidation

Currently, there is no specific requirement under Chapter 37 for issuers or guarantors to announce information relating to the default of their obligations under the debt securities that are listed on the HKEx or matters leading to or involving their winding up and/or liquidation.

Listing Rule 37.47B(a) imposes an obligation to simultaneously announce inside information that must be disclosed under Part XIVA of the SFO, while Listing Rule 37.47A requires a guarantor to announce information which may have a material effect on its ability to meet its obligations under Chapter 37 debt securities.

In contrast, issuers of listed equity securities are subject to a specific requirement under Listing Rule 13.19 to publish breach of loan agreements for loans significant to their operations, and Listing Rule 13.25 requires them to inform HKEx of their winding up or liquidation.

HKEx therefore proposes to introduce a new specific requirement in Chapter 37 obliging issuers and/or guarantors to announce information relating to the default of their obligations under the debt securities and matters leading to or involving their winding up and/or liquidation, as soon as reasonably practicable, on the occurrence of a default on their HKEx-listed debt securities. This will include cross-default of its Chapter 37 debt which is triggered by a default on other debt obligations of the issuer or guarantor or matters leading to or involving its winding up and/or liquidation.

- iii) To require announcement on developments after trading suspension of Chapter 37 Debts

There is currently no requirement for issuers and/or guarantors of Chapter 37-listed debt to periodically publish market update announcements following suspension in trading of their Chapter 37 debt securities. Issuers of listed equity securities are however required to publish quarterly announcements following suspension of trading of their equity securities under Listing Rule 13.24A.

HKEx accordingly proposes to introduce a requirement in Chapter 37 requiring issuers and/or guarantors to publish quarterly announcements on developments after suspension in trading of their Chapter 37 debt securities.

- iv) To clarify the timing of making an announcement of information to avoid a false market or information having material effect on a guarantor's ability to meet its obligations under debt securities



Under the current regime, issuers are, following consultation with HKEx, required to immediately announce any information necessary to avoid a false market in their listed debt securities (HKEx Listing Rule 37.47(b)), which is comparable to the requirement on issuers of equity securities to announce such information as soon as reasonably practicable.

- v) To require issuers to announce information having a material effect on their ability to meet their obligations under listed debt securities

Guarantors are required by Listing Rule 37.47A to immediately announce information which may have a material effect on their ability to meet obligations under the debt securities, but there is no equivalent requirement imposed on issuers.

HKEx therefore proposes to amend the requirements of HKEx Listing Rule 37.47(b) and 37.47A from “immediately” to “as soon as reasonably practicable”. Moreover, HKEx proposes to amend Listing Rule 37.47A to extend the requirement to issuers.

- vi) To clarify which entities need to comply with the continuing obligations

Listing Rules 37.44 to 37.53 set out issuers’ continuing obligations. In the case of guaranteed issues, HKEx also expects guarantors to comply with the continuing obligations.

HKEx therefore proposes to amend Listing Rule 37.44 to clearly state which continuing obligations apply to guarantors.

- vii) To clarify the scope of debt securities with respect to the continuing obligations

It is also proposing to amend Listing Rules 37.47A, 37.48(b), 37.49(c), 37.50(c) and 37.51 to refer to “listed debt securities” rather than to “debt securities” (as currently) to clarify that the continuing obligations only apply in respect of debt securities listed on the HKEx. HKEx further proposes to define “listed debt securities” in the list of defined terms “debt securities that are listed on the exchange”.

### (c) Streamlining the listing application process

- i) Constitutional documents and resolutions submitted to Exchange

Under the current regime, issuers or guarantors are required to submit the following constitutional documents and resolutions to HKEx:

- A) Memorandum and articles of association, certificate of incorporation or equivalent (Listing Rules 37.35(e)1 and 37.35(f)1);
- B) Copies of resolutions by its governing body authorising the issue and allotment of the debt securities, the application for listing and issuing listing document (Listing Rules 37.35(h) and 37.35(i)); and
- C) A copy of the shareholders’ resolution if the debt securities are authorised by shareholders (Listing Rule 37.35(g)).

HKEx proposes to remove and the above-mentioned requirements and replace them with a requirement for the issuer or guarantor to provide written confirmation in relation to its due incorporation, capacity and authorisation. This is because HKEx considers that it is not its role to review these documents and due incorporation, capacity and authorisation are generally confirmed by legal counsel in standard bond issuances.

- ii) Last published financials submitted to Exchange

Currently, issuers or guarantors not listed on the HKEx must submit their last published financial statements to HKEx as part of the listing application process to demonstrate fulfil the eligibility requirements (Listing Rules 37.35(e)2 and 37.35(f)2).

HKEx proposes to replace these rules with a new requirement for issuers (or guarantors) to submit their audited financial statements in fulfilment of the issuer eligibility requirements, where the issuer or guarantor is not exempted from the eligibility requirements or where the audited financial statements are not disclosed in the listing document.

### (d) Clarify the scope of supplementary listing document

Under the current regime, Listing Rules 37.26 to 37.33 set out the requirements relating to the information an issuer must disclose in its listing document and other listing document requirements. The requirements apply to the base listing document and the supplementary listing document for each issue under debt issuance programmes.

Listing Rule 37.26 does not state that the supplementary listing document includes the pricing supplement, however HKEx states that they have, in practice, been applying Listing Rules 37.26 to 37.33 to the pricing supplement. Accordingly, HKEx proposes to amend Listing Rule 37.26 to make clear that the supplementary listing document includes the pricing supplement.

### III Responding to the Consultation Paper

Responses to HKEx's proposals should be submitted on or before **Friday 7 February 2020**. Responses can be made using the questionnaire available at: <https://www.hkex.com.hk/-/media/HKEX-Market/News/Market-Consultations/2016-Present/December-2019-Chapter-37-Debt-Issues/Questionnaire/cp201912q.docx>.<sup>12</sup>

Written comments may be sent by email to [response@hkex.com.hk](mailto:response@hkex.com.hk), with the subject line: "**Re: Review of Chapter 37 – Debt Issues to Professional Investors Only**".

Alternatively, responses can be sent by mail or hand delivery to:

Corporate and Investor Communications Department

Hong Kong Exchanges and Clearing Limited

8 Connaught Place, Central

Hong Kong

**Re: Review of Chapter 37 – Debt Issues to Professional Investors Only**

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<sup>12</sup> <https://www.hkex.com.hk/-/media/HKEX-Market/News/Market-Consultations/2016-Present/December-2019-Chapter-37-Debt-Issues/Questionnaire/cp201912q.docx>

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