

SFC Issues New Guidance for H Share Issuers

On 17 March 2023, the SFC issued new guidance for H share issuers following the announcement of New PRC Regulations¹ for overseas listings and the repeal of the Special Regulations² and the Mandatory Provisions³ (together, the **PRC Rule Changes**) which took effect on 31 March 2023. H share issuers are companies incorporated in the PRC whose shares are listed on the Hong Kong Stock Exchange (**HKEX**).

The issue addressed by the SFC's latest guidance is that from 31 March 2023, as a matter of PRC law, an H share issuer's domestic shares (including listed A shares) and its H shares are no longer classified as different classes of shares, removing the requirement to hold separate class meetings where an H share issuer proposes to vary the rights attaching to either the domestic or H shares.

The SFC's position is that despite H shares and domestic shares constituting a single class of shares under the New PRC Regulations, the fact that they are not directly fungible with each other requires them to be treated as separate classes of shares for the purposes of:

- certain provisions of the SFC Codes on Takeovers and Mergers and Share Buy-backs (the **SFC Codes**); and
- disclosure of interests in H share issuers under Part XV of the Securities and Futures Ordinance (the **SFO**).

The SFC's guidance on the application of the SFC Codes and Part XV of the SFO to H share issuers commencing 31 March 2023 is set out in new [Practice Note 25](#) and a new SFC [Frequently Asked Question \(FAQ\)](#) on "Disclosure of interests in PRC issuers".

The HKEX will also amend the HKEX Listing Rules to reflect the New PRC Regulations and has included these and certain other proposed amendments in its [February 2023 Consultation Paper](#).⁴ For further details, please refer to Charltons' newsletter "[HKEX Consults on Listing Rule Amendments for PRC Issuers](#)".

Practice Note 25: Application of the Code on Takeovers and Mergers (Takeovers Code) to H Share Issuers

Definition of "Associate" and Rule 22 – Disclosure of dealings during an offer period

Under the Takeovers Code, class (6) associates include any person who owns or controls 5% or more of any class of relevant securities⁵ issued by an offeror, potential offeror, or the offeree company, including a person who owns or controls 5% or more as a result of any transaction.

Under Practice Note 25, the determination of whether a holder of H shares is a class (6) associate should be based on the total issued H shares only, rather than the entire issued share capital of the H Share issuer. This is intended to ensure that dealings by holders of a substantial stake in H shares are disclosed under Rule 22 of the Takeovers Code.

A shares and unlisted domestic shares of H share issuers will be treated as the same class for the purpose of determining any such class (6) associates.

Delistings and privatisations – Rules 2.2 and 2.10

A proposal to delist H shares from the HKEX or privatise an H share issuer using a scheme of arrangement or capital reorganisation must be approved by 75% of the votes of the offeree's disinterested shareholders and must not be voted against by 10% or more of the votes of the disinterested shareholders (Rules 2.2 and 2.10 of the Takeovers Code, respectively).

Note 6 to Rule 2 requires that where an offeree company has more than one class of shares, the requirements of Rules 2.2 and 2.10 apply to each class separately. This means that a separate class approval from holders of H shares is required.

The SFC observes that any proposal to delist or privatise the H shares of an H share issuer will have a greater impact on the interests of the holders of its H shares compared to its other shareholders. To adequately protect their interests, Practice Note 25 provides that holders of H shares will continue to receive the same level of protection as they received before the PRC Rule Changes, and any approvals under Rules 2.2 and 2.10 must be decided by holders of H shares only.

Offers for more than one class of equity shares – Rule 14

Rule 14 requires that when a company has more than one class of equity shares, a comparable offer must be made for each class, irrespective of whether they carry voting rights.

In the case of an H Share issuer, a Rule 14 comparable offer for A shares is typically required when an offer is made for H shares, unless waived by PRC regulatory authorities or if all holders of the issuer's other securities agree to a waiver. Similarly, when an offer is made for the A shares of an H Share issuer, the Takeovers Code requires a comparable H share offer to be made.

Given the inherent differences in the trading prices, currencies and markets for A and H shares, and the fact that they are not directly fungible, the SFC will continue to treat the A shares, H shares and other equity securities of H share issuers separately and will retain the Rule 14 comparable offer requirement after the PRC Rule Changes.

The SFC has provided a three-step approach to calculate the H share offer price for an H Share issuer.

1. Convert the offer price per A share into HK\$:
 - Use the RMB to HK\$ exchange rate quoted by The People's Bank of China (PBOC) on the date of the Rule 3.5 announcement (or if none, the most recent date quoted by the PBOC prior to the date of announcement).
2. Determine the ratio (R) of average daily volume-weighted average trading prices (VWAP) per H share for the preceding 6-months ending on the last trading day before the publication of the Rule 3.5 announcement to the average daily VWAP per A share for the same period:

$$R = \frac{\text{average daily VWAP per H share for the preceding 6-months ending on the last trading day before the publication of the Rule 3.5 announcement}}{\text{average daily VWAP per A share for the preceding 6-months ending on the last trading day before the publication of the Rule 3.5 announcement, which has already been converted from RMB to HK\$}}$$

- o Convert daily VWAP per A share from RMB to HK\$ using the RMB to HK\$ exchange rate quoted by the PBOC on each applicable date.
- o If the number of trading days for A shares and H shares differs significantly during the applicable six-month period, practitioners should consult the SFC for alternative trading periods to calculate the ratio.

3. Calculate the H share offer price:

- Multiply the converted offer price per A share (Step 1) by the ratio (Step 2).

The same approach is also applied to determine the applicable fee for a whitewash document relating to H Share issuers and the applicable highest price for an H share offer resulting from A share purchases (e.g. Rules 24 and 26.3).

When determining the H share offer price by reference to domestic share purchases, the principles established in the Panel's Sanmenxia Decision apply. The RMB purchase price for the domestic shares is converted into HK\$ using the applicable PBOC exchange rate.

Nature of consideration to be offered – Rule 23

Rule 23.1 of the Takeovers Code outlines when a cash offer is required during a takeover. A cash offer is mandatory under the following circumstances:

- (a) If an offeror and any person acting in concert with it purchase for cash 10% or more of the voting rights of a class of shares in the offeree company during the offer period and the six months prior to its commencement, the offer for that class must be in cash or accompanied by a cash alternative at not less than the highest price paid for that class of shares during the above period.⁶
- (b) If an offeror or any person acting in concert with it purchases shares of a class for cash during the offer period, the offer should be in cash or with a cash alternative at not less than the highest price paid for that class during the offer period.
- (c) The SFC may determine that a cash offer is necessary to give effect to General Principle 1 if it considers the circumstances warrant such a requirement.

Additionally, Rule 23.2 stipulates that if an offeror and any person acting in concert with it purchases any class of the offeree company's shares carrying 10% or more of the voting rights in exchange for securities in the three months before the commencement of or during the offer period, these securities will normally be required to be offered to all other shareholders of that class.

The primary purpose of these rules is to ensure fair treatment for shareholders affected by takeovers, mergers and share buy-backs, which is in line with General Principle 1.

The SFC will continue to treat domestic shares and H shares as separate classes when applying Rule 23 after the PRC Rule Changes. The SFC also provides the following examples for illustration.

- Assume a PRC H Share issuer has a share capital consisting of 75% A shares and 25% H shares, and an offer is made for both A shares and H shares.
- If an offeror and its concert parties acquire 10% of the H shares (i.e. 2.5% of the total share capital) within the relevant period, Rule 23.1(a) will be triggered for the H share offer. However, the rule will not be triggered if the total H shares acquired are less than 10% of the total H shares, even if an aggregate of 10% of the total share capital is acquired.
- Any acquisition of H shares by an offeror and its concert parties during an offer period will trigger Rule 23.1(b) for the H share offer. However, an acquisition of any A shares during the offer period will not trigger the rule for the H share offer.
- The SFC emphasises that Rule 23.1(c) allows it to require a cash offer in certain circumstances to ensure that shareholders receive fair treatment. This means that although an offeror's acquisition of 10% of an issuer's A shares during the relevant period would not normally trigger the requirement for a cash offer for the H share offer, if the relevant PRC regulations would require a cash offer for the A share offer, then the SFC will also require a cash offer for the H share offer. In simple terms, if a cash offer is made or required to be made for A shares, a cash offer should also be made for the H share offer to ensure that all shareholders receive fair and equal treatment. The same principles apply to Rules 23.1(b) and 23.2.

Special deals and whitewash waivers

The SFC confirms that the existing practices for special deals under Rule 25 and Practice Note 17, and whitewash waivers under Note 1 on dispensations from Rule 26 and Schedule VI, remain unchanged after the PRC Rule Changes. Consequently, shareholder approval for special deals and whitewash waivers will not require separate class approval of holders of H shares.

Practice Note 25: Application of the Share Buy-backs Code to H Share Issuers

Off-market share buy-backs – Rule 2

Rule 2 of the Share Buy-backs Code requires that an off-market share buy-back must be approved by the SFC before a company repurchases any shares. This approval typically comes with the condition that at least three-fourths of the votes cast by disinterested shareholders approve the proposed off-market share buy-back at a general meeting. The SFC typically considers “disinterested shareholders” to be those shareholders whose relevant securities will not be bought back under the off-market share buy-back proposal, irrespective of the type of shares they hold. No distinction is made for different classes of relevant securities and there is no requirement for separate class meetings to approve an off-market share buy-back by an H share issuer.

The SFC confirms its approach to off-market share buy-backs remains unchanged after the PRC Rule Changes.

Shareholder Approval – Rule 3

Rule 3.1 – General meeting to approve a share buy-back by general offer

Under Rule 3.1 of the Share Buy-backs Code, a share buy-back by general offer must be approved by a majority of votes cast by shareholders who are present in person or by proxy at a general meeting. All shareholders, regardless of the type of shares they hold, have the right to attend and vote at this meeting. This approach remains unchanged after the PRC Rule Changes.

Rule 3.3 – Approval of delistings and privatisations by independent shareholders

Rule 3.3 requires that if, after a proposed share buy-back, the shares of an offeror are to be delisted from the Hong Kong Stock Exchange or the company is to be privatised, the share buy-back by general offer must be approved by:

- at least 75% of the votes attaching to the shares owned by independent shareholders cast in person or by proxy at a duly convened general meeting;⁷ and
- the number of votes cast against the resolution not exceeding 10% of the votes attaching to the shares owned by independent shareholders.

If an offeror has more than one class of equity share capital, Rule 3.4 indicates that the SFC may require the share buy-back to be approved by a majority of votes cast by holders of each class of shares present in person or by proxy at separate class meetings convened to consider the proposed share buy-back.

The SFC notes that for H share issuers proposing to buy-back all H shares by way of a general offer resulting in a delisting of H shares, the rights of holders of H shares will be significantly impacted, and their interests are considered to be materially different from the holders of domestic shares. In these circumstances, the SFC requirements under Rule 3.3 should be approved at a general meeting by holders of H shares only. This approach remains unchanged following the PRC Rule Changes.

Disclosure of interests in H share issuers under Part XV of the SFO

The SFC’s latest [Frequently Asked Question \(FAQ\)](#) on “Disclosure of interests in PRC issuers” confirms that there is no change to the current practice of reporting H shares and domestic shares separately under Part XV of the SFO. This means that interests in H shares should continue to be calculated as a proportion of the number of issued H shares separately from the number of issued domestic shares. For more information, please refer to paragraph 2.6.9 of the [Outline of Part XV of the Securities and Futures Ordinance \(CAP. 571\) - Disclosure of Interests](#).

The FAQ also contains a reminder that all notifications and reports under Part XV should be submitted electronically through the DION System to the Stock Exchange for publication on the HKEX website.

[1] The “Decision of the State Council to Repeal Certain Administrative Regulations and Documents” issued by the State Council of the PRC on 17 February 2023 and the “Trial Administrative Measures of Overseas Securities Offering and Listing by Domestic Companies” and related guidelines issued by the CSRC on 17 February 2023 (together, the **New PRC Regulations**)

[2] The Special Regulations on the Overseas Offering and Listing of Shares by Joint Stock Limited Companies (the **Special Regulations**)

[3] The Mandatory Provisions for Companies Listing Overseas set out in Zheng Wei Fa (1994) No. 21 issued on 27 August 1994 by the State Council Securities Policy Committee and the State Commission for Restructuring the Economic System (the **Mandatory Provisions**)

[4] HKEX. Consultation Paper: Rule Amendments Following Mainland China Regulation Updates and Other Proposed Rule Amendments Relating to PRC Issuers

[5] For the definition of relevant securities, please refer to paragraphs (a) to (d) in Note 4 to Rule 22 of the Takeovers Code

[6] Shares acquired by an offeror and any person acting in concert with it in exchange for securities, either during or in the 6 months preceding the commencement of the offer period, will normally be deemed to be purchases for cash on the basis of the value of the securities at the time of the purchase

[7] Independent shareholders are those who do not have a material interest in the share buy-back proposal which is different from the interests of all other shareholders

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