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# Ex-Entitlement Trading Only After Shareholder Approval Effective 20 June 2011

## Introduction

On 20 May 2011, the Hong Kong Exchanges and Clearing Limited (**HKEx**) published [consultation conclusions](http://www.hkex.com.hk/eng/newsconsul/mktconsul/Documents/cp2010123cc.pdf) (**Conclusions**) ([see archive](cp2010123cc.pdf)) on its December 2010 proposal that shares should only be permitted to trade ex-entitlement after the entitlement has been approved by shareholders (**Proposal**). The Proposal received majority support from the 45 respondents to HKEx's consultation paper of December 2010 (**Consultation Paper**).

Entitlements are benefits, such as cash or securities, distributed by a company to its shareholders. Some entitlements are announced and then distributed to registered shareholders directly (such as interim dividends), while others are conditional entitlements, in that they are "proposed" by the board and still require shareholder approval at a general meeting in accordance with statutory or Listing Rules requirements. Under the regulatory regime presently operating in Hong Kong, there is no restriction on the timing of the record date for a conditional entitlement. The company can set the record date before or after the date of shareholder approval.

A key concern of HKEx, highlighted in the Consultation Paper[[1]](#footnote-26), was that permitting a company to set the record date (and thus the ex-date) before a general meeting exposes those engaged in share trading to a risk of uncertainty as regards the entitlement. HKEx stated in the Conclusions that the new regime removes this uncertainty and ensures that shares are traded in a more informed manner, leading to a fairer and more orderly market. Additionally, the amended Listing Rules bring the regulatory framework in Hong Kong in this area into line with practices employed in the Mainland, and in leading financial centres such as New York, Singapore and Australia.

The key amendments to the Listing Rules arising from the Conclusions are to be found in Chapter 13 of the Main Board Listing Rules and Chapter 17 of the GEM Listing Rules and are as follows:

* Shares may no longer be traded ex entitlement prior to shareholder approval (Rule 13.66 (2) Main Board, Rule 17.78 (2) GEM)
* The Rules now impose a requirement that the record date be set at least 3 business days after the date of shareholder approval (Note 3 to Rule 13.66 (2) Main Board and Note 2 to Rule 17.78 (2) GEM)
* The Rules now impose a requirement for a minimum of one cum-trading day after the general meeting (Note 3 to Rule 13.66 (2) Main Board and Note 2 to Rule 17.78 (2) GEM)
* These amendments to the regulatory regime will be applied to all conditional entitlements which are subject to general meeting approval.

The necessary amendments to the Main Board and GEM Listing Rules will come into force on 20 June 2011. A transitional period has been provided for such that entitlements with timetables announced before 20 June 2011 will not be affected.

## Shares To Be Traded Ex-Entitlement Only After Shareholder Approval (Rule 13.66 (2) Main Board, Rule 17.78 (2) GEM)

As noted in the introduction, under the current regulatory regime in Hong Kong there is no restriction on the timing of the record date for a conditional entitlement. An issuer can set the record date before or after the date of shareholder approval. Sellers are exposed to a risk of uncertainty when the record date (and thus the ex-date) is set before the date of the general meeting; i.e. they may not receive the entitlement as expected and the shares would turn out to have been sold at a discount to the buyers if the distribution is blocked by shareholders at the general meeting.

The majority of the respondents were in support of the proposal of trading ex-entitlement only after shareholder approval. HKEx stated that the proposal can remove the unnecessary risk of uncertainty faced by sellers and the trading of stocks would be conducted in a fairer and more orderly manner to both buyers and sellers. That such reform is required is evidenced by a recent example of a listed company cancelling its rights issue after the ex-entitlement date, causing losses to many small investors.

One of the respondents to the Conclusions noted that the proposal of trading ex-entitlement only after shareholder approval would also benefit the derivative products market. Under the current system, the making of capital adjustments on the ex-date applies also to all equity derivative products. Prohibiting ex-entitlement trading of shares without prior shareholder approval eliminates the risk of uncertainty not only in relation to the Exchange’s related derivatives products, but for equity derivatives across the market. This also permits a consistent approach to entitlements for the cash and derivatives markets.

In response to concerns that trading ex-entitlement after shareholder approval will prolong the timetable of the distribution process, HKEx stated that the benefits of a fair and orderly market and the enhancement of investor protection outweigh such concerns. In addition, issuers can minimize timing delays by closing the register just for a single day or by taking a snapshot of its register books at the end of the record date. Another alternative noted by HKEx to achieve a shorter overall timetable is for issuers to decide on a record date without a book closure.

## Record Date To Be Set At Least 3 Business Days After The Date Of Shareholder Approval (Note 3 To Rule 13.66 (2) Main Board, Note 2 To Rule 17.78 (2) GEM

Setting the record date at least three business days after the date of shareholder approval, given that Hong Kong presently adopts a T+2 settlement period, means that there will be at least one cum-trading day after the shareholders’ meeting. An investor who wishes to receive the entitlement, but does not want the uncertainty of purchasing the shares before the general meeting, will thus be given sufficient time to purchase the shares after the shareholders’ approval and become a registered shareholder on the record date. Existing shareholders will also have sufficient time to sell their cum-entitlement shares after the approval of shareholders, if they do not wish to receive the entitlement.

Respondents to the Consultation were largely in support of the requirement of setting the record date at least three business days after the date of shareholder approval and the Rules have been amended accordingly. As noted in the introduction, incorporating this change will bring HKEx's requirements on the ex-date of conditional entitlements closer to the practices of the Mainland and leading overseas securities markets, such as New York, Australia and Singapore.

## A Minimum Of One Last Cum-Trading Day After The General Meeting (Note 3 To Rule 13.66(2) Main Board, Note 2 To Rule 17.78 (2) GEM

In the Consultation Paper, HKEx proposed that if an issuer fails to publish the voting results of its general meeting through HKEx news website by 11pm on the date of the general meeting, the last cum-trading day should be extended to at least the second business day after the general meeting.

While most of the respondents agreed with HKEx that the proposal would allow sufficient time for investors to digest the results of the general meeting and act accordingly, some considered that no extension would be necessary if it proved possible to publish the voting results no later than 30 minutes prior to the earlier of:

* the commencement of the morning trading session; or
* any pre-opening session,

on the business day following the general meeting (under Listing Rule 13.39(5)).

HKEx noted that the aim of the proposal to have at minimum one cum-trading day subsequent to the general meeting is to give enough time to the market to process the results of that meeting. In light of this policy goal, and the feedback received from market participants, HKEx agreed to amend the Listing Rules to the effect that an issuer who fails to publish the result of the poll conducted in the general meeting in the manner prescribed under rule 13.93(5), must ensure there is at least one trading day for trading in the securities with entitlements once the results of that poll are published.

## The Ex-Entitlement Arrangement Be Applicable To All Conditional Entitlements

Another key question raised by HKEx in the Consultation Paper was whether the requirement of obtaining shareholder approval prior to engaging in ex-entitlement trading should be applied to all conditional entitlements or only to some of them.

While a few respondents took the view that the final dividend should be exempted from the requirement, as it is seldom disapproved in the general meeting and may be substituted by an interim dividend declared by the board of directors (resulting in shareholders losing the opportunity to comment on dividend policy at the general meeting), the majority of the respondents supported the proposal that the requirement be applied to all conditional entitlements. This is because a uniform application of the rules avoids confusion for investors and market practitioners alike. HKEx noted in the Conclusions that such consistency will also benefit both the cash and derivatives markets, as discussed above. Accordingly, the Listing Rules will be amended so that the requirement applies to all conditional entitlements.

HKEx acknowledged in the Conclusions that even if the record date is set after the general meeting, some entitlements, such as distribution in specie of existing shares in a spin-off company, will still be exposed to the risk of uncertainty. This is due to the fact that such entitlements are conditional upon factors additional to shareholder approval. HKEx stated in the Conclusions that it plans to conduct a separate review of these conditions (except for the approval of the listing application), with the aim of reducing the level of uncertainty which currently surrounds them.

## Conclusion

HKEx ended the Conclusions by noting that the obligations set out in the Listing Rules are prescribed minimums only, and that issuers and directors should be aware of their responsibility to create, in each specific circumstance, distribution plans which are fair and orderly. HKEx stated their intention to scrutinize the development of the new regime and to engage in further dialogue with any interested market participants.

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1. See Charlton's [newsletter](/newsletters/hklaw/en/2011/107/nl-hklaw-20110114-107.html) on this Consultation Paper. [↑](#footnote-ref-26)