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# HKEx Publishes Listing Decisions In Relation To Convertible Note/Bond Issues

The Stock Exchange of Hong Kong (the **Exchange**) published three listing decisions in March 2013 in relation to convertible note/bond issues. The first, [HKEx-LD55-2013](http://www.hkex.com.hk/eng/rulesreg/listrules/listdec/Documents/ld55-2013.pdf) ([see archive](ld55-2013.pdf)), dealt with the classification of a subscription of convertible notes by a listed issuer under Chapter 14 of the Listing Rules and whether the issuer was required to classify it as if the notes were fully converted. The second, [HKEx-LD56-2013](http://www.hkex.com.hk/eng/rulesreg/listrules/listdec/Documents/ld56-2013.pdf) ([see archive](ld56-2013.pdf)) concerned the changes which the Exchange required to be made to the terms of convertible notes to ensure that the public float requirement would not be breached on the issue of shares on conversion of notes. In the third, [HKEx-LD54-2013](http://www.hkex.com.hk/eng/rulesreg/listrules/listdec/Documents/ld54-2013.pdf) ([see archive](ld54-2013.pdf)), the Exchange insisted that an issuer obtain shareholders’ approval for material changes to the terms of convertible bonds which had been issued under a general mandate, as a condition of approving the changes to the terms of the bonds. The following is a summary of the issues involved and the reasons for the Exchange’s decisions.

## 1. HKEx-LD55-2013: Classification of a listed issuer’s subscription for convertible notes where conversion is at the discretion of the listed issuer

Company A was a Main Board listed issuer which proposed to subscribe for convertible notes to be issued by Company B, another Main Board listed issuer which was independent of Company A. Under the terms of the notes, Company A had the right to convert the notes into new shares of Company B at any time during the conversion period. As the transaction involved provision of financial assistance to Company B, it was a transaction under Chapter 14 of the Listing Rules. The issue under consideration was whether the subscription had to be classified as if the notes were fully converted.

Listing Rules 14.04(1), 14.12, 14.26, 14.74 and 14.75 were applied in considering the issue. Among them, Rules 14.74 and 14.75 state that:

14.74

The following apply to an option involving a listed issuer, the exercise of which is not at the listed issuer’s discretion: (1) on the grant of the option, the transaction will be classified as if the option had been exercised. For the purpose of the percentage ratios, the consideration includes the premium and the exercise price of the option; and (2) ...

14.75

The following apply to an option involving a listed issuer, the exercise of which is at the listed issuer’s discretion:   
(1) on the acquisition by, or grant of the option to, the listed issuer, only the premium will be taken into consideration for the purpose of classification of notifiable transactions. Where the premium represents 10% or more of the sum of the premium and the exercise price, the value of the underlying assets, the profits and revenue attributable to such assets, and the sum of the premium and the exercise price will be used for the purpose of the percentage rations; (2) on the exercise of such option by the listed issuer, the exercise price, the value of the underlying assets and the profits and revenue attributable to such assets, will be used for the purpose of the percentage rations...

The Exchange decided that the subscription would be a transaction for Company A that involved provision of financial assistance to Company B and accepting an option to convert the notes into Company’s B shares. When Company A entered into the subscription agreement,

1. it should classify the subscription by calculating the percentage ratios for the provision of financial assistance to Company B;
2. **it was not necessary to classify the subscription as if the notes were fully converted given that the conversion was at Company A’s discretion**;
3. if Company A subsequently proposed to exercise the conversion rights, it would be required to classify the conversion as a transaction at that time taking into account the conversion price and Company B’s total assets, revenue and profits. This was in line with the approach applicable to transactions involving options under Chapter 14.

## 2. HKEx-LD56-2013: Exchange not prepared to give listing approval for new shares to be issued upon conversion of convertible notes that could result in a company's public float falling below the Listing Rule requirement

Company A was a Main Board listed issuer which proposed to issue certain new shares (the **Subscription Shares**) and convertible notes that would be convertible into new shares of Company A (the **Conversion Shares**) to Company B under the terms of a subscription agreement. The issue was conditional on approval of Company A’s shareholders and the Exchange’s listing approval for the Subscription Shares and Conversion Shares.

After the issue of the Subscription Shares, Company B would become a substantial shareholder of Company A while the public float requirement would be maintained. However, based on the shareholding structure of Company A at that time, if Company B exercised its conversion rights under the notes, the public float would fall below the 25% requirement.

Listing Rules 8.08(1)(a) and 13.32(1) require at least 25% of an issuer’s total issued share capital to be held by the public.

The issue considered by the listing committee was whether the Exchange would give listing approval for new shares to be issued upon conversion of the convertible notes.

To address the public float issue, Company A proposed to undertake to the Exchange that it would take appropriate measures to ensure compliance with the public float requirement at all times. For example, it would place new shares to independent third parties to maintain a 25% public float as a result of any conversion of the convertible notes, or it would redeem some of the convertible notes. Alternatively, Company A proposed to limit the maximum number of Conversion Shares that it might issue to Company B to be 25% of Company A’s issued share capital at the time of entering into the subscription agreement.

The Exchange did not consider the arrangements proposed by Company A adequate to meet the public float concern and would not give listing approval for the Conversion Shares until the issue was addressed. To address the Exchange’s concern, Company A and Company B agreed to revise the terms of the convertible notes such that a conversion of the notes could not take place if it would result in Company A failing to meet the public float requirement.

## 3. HKEx-LD54-2013: Whether the Exchange would approve proposed changes to the terms of convertible bonds issued by a company under a general mandate

Company A issued certain convertible bonds to an independent third party (the **Investor**) under a general mandate (the **Original Mandate**). The Original Mandate allowed Company A to issue new shares of not more than 20% of its issued shares until the conclusion of the next annual general meeting.

Subsequently, Company A and the Investor proposed to revise the terms of the bonds:

1. to reduce the initial conversion price of the bonds although based on the revised conversion price, the maximum number of conversion shares issuable would not exceed that issuable under the Original Mandate; OR
2. to extend the conversion period and the maturity date of the bonds for one year, but without changing the conversion price of the bonds such that there would be no change to the number of conversion shares issuable.

Company A submitted that the Original Mandate would be sufficient to cover the conversion shares issuable under the revised terms of the bonds. It sought the Exchange’s approval for the proposed changes to the terms of the bonds.

### Applicable Listing Rules

Listing Rule 13.36 require an issuer to obtain the consent of shareholders in general meeting or a general mandate given by ordinary resolution in general meeting prior to allotting, issuing or granting shares, convertible securities or other options and warrants. Listing Rule 28.05 provides that any alterations in the terms of convertible debt securities after issue must be approved by the Exchange.

The issue was whether the Exchange would approve the proposed changes to the terms of convertible bonds issued under the Original Mandate.

The Exchange considered that the proposed revision to the terms would constitute a material change to the terms of the convertible bonds and should be regarded as new arrangements for Company A to issue convertible securities to the investor. The Original Mandate could not therefore be relied on for the new arrangements.

Instead, Company A was required to comply with Listing Rule 13.36 for the new arrangements by obtaining a specific mandate for issuing the conversion shares under the revised terms of the bonds. Otherwise, the Exchange would not approve the proposed changes to the terms of the bonds.

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