



HKEX Consults on Listing Rules Relating to Treasury Shares

On 27 October 2023, the Hong Kong Stock Exchange (**HKEX**) published a [Consultation Paper](#)¹ outlining proposed Listing Rule amendments to establish a new treasury share regime. The HKEX is proposing to remove the current requirement to cancel repurchased shares, thereby enabling listed issuers to repurchase shares and retain them in treasury for subsequent resale, if this is allowed by the laws of their respective places of incorporation and their constitutional documents. Additionally, the HKEX has put forward a framework to govern the resale of treasury shares, which would be incorporated in the Listing Rules.

The HKEX is seeking market feedback on its proposals and the deadline for responding to the Consultation Paper is 27 December 2023. Interested parties can respond to the Consultation Paper by completing and submitting the questionnaire available on the HKEX website at https://surveys.hkex.com.hk/jfe/form/SV_81XiEIN0YD7LvUO.

Background

Under the current Listing Rules of the Hong Kong Stock Exchange (**HKEX Listing Rules**), a listed issuer's repurchase of its own shares results in the automatic cancellation of the listing of those repurchased shares. Although approximately 92% of listed issuers on the Stock Exchange of Hong Kong Limited (**Exchange**) are incorporated in jurisdictions that permit the holding of treasury shares (which include Mainland China, Bermuda, the BVI and the Cayman Islands²), these issuers are bound by the HKEX Listing Rules to promptly cancel the listing status of any shares they repurchase. The HKEX is of the view that the proposed HKEX Listing Rule amendments will allow issuers more flexibility in adjusting their share capital, potentially reducing their cost of capital.

The proposed treasury share regime will not, however, apply to the 8% of listed issuers that are incorporated in Hong Kong. This is because the Hong Kong Companies Ordinance (Cap. 622) mandates the immediate cancellation of any repurchased shares, thereby preventing repurchased shares from being held in treasury for subsequent resale. Depending on the outcome of the consultation, the HKEX will coordinate with the relevant parties to consider amending the Hong Kong Companies Ordinance to allow Hong Kong-incorporated issuers to benefit from the proposed treasury share regime.

HKEX's Proposed Treasury Shares Regime

The Consultation Paper outlines the following amendments to the HKEX Listing Rules regarding the proposed treasury share regime.

Removing the requirement to cancel repurchased shares

Currently, when a listed issuer repurchases its shares, the shares are automatically cancelled and the documents of title of the repurchased shares must be cancelled and destroyed immediately after settlement of the repurchase.³ This requirement was introduced to protect against market manipulation by listed issuers engaging in repetitive repurchasing and resale of their own shares and to prevent insiders from trading in the shares with the benefit of non-public information about share repurchases and the resale of treasury shares.

The HKEX proposes to amend the HKEX Listing Rules by removing the requirement to cancel repurchased shares and their listing on the Exchange. This amendment will allow listed issuers to hold these shares in treasury, subject to the laws of their respective places of incorporation and constitutional documents.

Repurchases of shares will continue to be made under the existing HKEX Listing Rules which require issuers to obtain either shareholders' approval for a specific repurchase or a repurchase mandate to repurchase shares on the Exchange.⁴ The repurchase mandate is restricted to a maximum of 10% of an issuer's total issued share capital on the date of the resolution granting the repurchase mandate.

Treating resales of treasury shares as new share issues

The HKEX proposes to treat the resale of treasury shares in the same way as an issuance of new shares, as both actions have a similar impact on issuers' existing shareholders.

Resale of treasury shares to be conducted on a pre-emptive basis or with a shareholders' mandate

The HKEX proposes to revise HKEX Listing Rule 13.36 so that, in alignment with the issuance of new shares, the resale of treasury shares will be subject to pre-emption, necessitating an offer to all shareholders on a pro-rata basis, or alternatively, will need to be approved by shareholders under a specific mandate or a general mandate approved in advance by shareholders.

Under the HKEX Listing Rules, listed issuers can obtain a general mandate from shareholders allowing them to issue new shares up to a maximum of 20% of their issued share capital within a 12-month period, which can be increased by the number of shares repurchased during the year, up to the limit of the 10% share repurchase mandate. The general mandate and repurchase mandate limits will be calculated based on the number of issued shares excluding treasury shares held by the listed issuer at the relevant time. On-market resales of treasury shares under the general mandate will be subject to a maximum price discount of 20% of the higher of: (i) the shares' closing price on the trading day before the resale; or (ii) the shares' average closing price in the five trading days before the resale. The price discount limit for off-market resales of treasury shares under the general mandate will be the same as for an issue of new shares.

Share schemes

A share scheme using treasury shares to satisfy share grants will be treated as a share scheme funded by new shares under Chapter 17 of the HKEX Listing Rules. Consequently, grants of treasury shares under the scheme will be subject to the scheme mandate limit approved by shareholders.

Connected transaction requirements

A resale of treasury shares to a connected person will be subject to the same connected transaction requirements under Chapter 14A of the HKEX Listing Rules as an issue of new shares to a connected person. Accordingly, independent shareholders' approval will be required for a resale of treasury shares to a connected person, unless exempt.

Disclosure obligations

The HKEX is proposing to apply the following HKEX Listing Rule requirements applicable to new share issues to resales of treasury shares and changes in the number of treasury shares: the announcement requirement under HKEX Listing Rule 13.28 (except that no announcement will be required for an on-market resale of treasury shares);

the next day disclosure return requirement under HKEX Listing Rule 13.25A; the monthly return requirement under HKEX Listing Rule 13.25B; and the annual report disclosure requirements under Paragraphs 11 and 11A of Appendix 16.

Mitigation of risk of market manipulation and insider dealing

While the civil and criminal regimes under Parts XIII and XIV of the Securities and Futures Ordinance (**SFO**), respectively, provide primary protection against stock market manipulation and insider dealing, the HKEX is proposing to introduce additional provisions to mitigate the risks of these activities.

Moratorium period for resales of treasury shares and share repurchases

A listed issuer is prohibited from issuing new shares for a period of 30-days (referred to as the “moratorium period”) following any share repurchase.⁵ The HKEX proposes extending the moratorium period to resales of treasury shares, whether they occur on or off-market, so that issuers will be prohibited from reselling treasury shares within 30 days after a share repurchase. The rationale behind the proposal is to prevent the price of a resale of treasury shares being affected by the issuer’s earlier share repurchase.

The HKEX is also proposing to impose a moratorium period to prevent issuers from making an on-Exchange share repurchase within 30 days of an on-Exchange resale of treasury shares. This proposal aims to prevent issuers from repeatedly repurchasing and reselling their own shares on market to make a trading profit or to manipulate their share price.

Dealing restrictions for resale of treasury shares on the Exchange

The HKEX proposes extending the following dealing restrictions to on-Exchange resales of treasury shares:

- *HKEX Listing Rule 10.06(2)(e)*: A listed issuer is prohibited from repurchasing its shares on the Exchange during the month prior to any results announcement⁶ or when there is undisclosed inside information (the **Restricted Period**). The HKEX proposes extending this restriction to the resale of treasury shares, thereby prohibiting issuers from reselling treasury shares on the Exchange during the Restricted Period.
- *HKEX Listing Rule 10.06(2)(c)*: A listed issuer is prohibited from knowingly purchasing its shares from a core connected person and a core connected person is prohibited from knowingly selling shares to the issuer on the Exchange. This HKEX Listing Rule will be extended to an issuer’s resale of treasury shares on the Exchange to prevent a listed issuer from knowingly reselling treasury shares to a core connected person on the Exchange. However, the HKEX is proposing that a resale of treasury shares on Exchange to a connected person without knowledge will be fully exempt from the connected transaction requirements, which mirrors the exemption for on-market share repurchases under HKEX Listing Rule 14A.94(1).
- *HKEX Listing Rule 10.06(2)(d)*: Where a listed issuer appoints a broker to repurchase its shares, it is required to procure the broker to disclose information about the purchases to the Exchange if that information is requested. The HKEX proposes extending this provision to on-Exchange resales of treasury shares so that a listed issuer will be required to procure its broker to disclose information about on-Exchange resales of treasury shares to the Exchange.

Treasury shares in relation to new listing applicants

Under the proposed amendments, new listing applicants will be able to retain their treasury shares on listing and will need to disclose details of their treasury shares in their prospectus.

Furthermore, HKEX Listing Rule 10.08, which restricts the issuance of new shares by a listed issuer within six months of its new listing, will also apply to the resale of treasury shares. Hence, a new listing applicant will be prohibited from issuing any new shares, reselling any treasury shares, or entering into any agreement for a new share issue or treasury share resale, within six months after listing.

Other HKEX Listing Rule amendments affecting treasury shares

The HKEX has also proposed the following amendments affecting treasury shares:

- *Voting rights of treasury shares*: Issuers (as the holders of their treasury shares) will be required to abstain

from voting on matters that require shareholders' approval under the HKEX Listing Rules. The HKEX also notes in the Consultation Paper that laws typically suspend the shareholders' rights associated with treasury shares, such as dividend, distribution, and voting rights. These rights are put on hold until the treasury shares are sold or transferred out of the treasury, at which point they are resumed. Listed issuers will therefore need to provide instructions to relevant parties, such as their share registrars, brokers, and agents, to ensure proper identification and segregation of treasury shares.

- *Exclusion of treasury shares in the calculation of issued shares:* Given that the rights attached to treasury shares are typically suspended by law, the HKEX proposes that treasury shares will be disregarded when calculating an issuer's issued shares or voting shares for the purposes of calculating:
 - o the public float;
 - o the market capitalisation;
 - o the equity capital ratio for size test calculation;
 - o the size limit for issuing or purchasing securities as a percentage of the issued shares (for example, the general mandate limit, repurchase mandate limit, scheme mandate limit and the size of a rights issue needing minority shareholders' approval);
 - o a person's percentage of rights to vote at a general meeting (for example, the definitions of controlling shareholder and substantial shareholder); and
 - o a person's percentage interest in the issuer (for example, in determining the independence of independent non-executive directors).
- *Disclosure requirement:* A listed issuer will be required to disclose in the explanatory statement for share repurchase mandate (sent to shareholders with the notice convening the general meeting to obtain the mandate) whether it intends to cancel the repurchased shares or keep them as treasury shares.⁷
- *Resale of treasury shares through agents or nominees:* The requirements and restrictions under the proposed HKEX Listing Rule amendments will also apply to resales of treasury shares by an agent or a nominee on behalf of an issuer or its subsidiaries.

Implications under the Takeovers Code

Under the Codes on Takeovers and Mergers and Share Buy-backs (the **Takeovers Code**), treasury shares are not considered to possess any voting rights. However, when a listed issuer repurchases shares and holds them as treasury shares, the voting rights percentage of shareholders in the listed issuer will increase in the same way as when repurchased shares are cancelled. In the event that a shareholder's voting rights exceed the trigger or creeper thresholds under Rule 26 of the Takeovers Code due to the holding of repurchased shares as treasury shares, the shareholder will typically trigger a mandatory general offer obligation, except where the shareholder is neither a director of the listed issuer nor acting, or presumed to be acting, in concert with any of the directors of the listed issuer. This is the same practice as applies when repurchased shares are cancelled.

The Takeovers Code implications of a resale of treasury shares will be similar to those of new share issues. For example, if an offeree resells treasury shares during an offer period, it may trigger frustrating action implications under Rule 4 of the Takeovers Code.

If the treasury share regime is implemented, the SFC will release a practice note outlining the treatment and implications of treasury shares specifically in the context of a Takeovers Code-related transaction.

Disclosure of interests under Part XV of the SFO

Conversely, for the purposes of Part XV of the SFO, treasury shares are considered part of an issuer's issued voting shares despite the temporary suspension of the voting rights attached to them.⁸ As a result, any repurchase of shares that are held as treasury shares and reselling of treasury shares by an issuer will not alter the total amount of issued voting shares for the purpose of calculating the percentage figures of shareholders' interests.

Listed issuers' disclosure obligation

If an issuer repurchases and holds its own shares in treasury, resulting in the acquisition of a 5% or more interest in those shares, the issuer would effectively become a substantial shareholder of itself and would be required to disclose that interest under Part XV of the SFO.

[1] HKEX. (October 2023). Consultation Paper on Proposed Amendments to Listing Rules Relating to Treasury Shares.

[2] Other jurisdictions include Canada (BC), Italy, Japan, Jersey, Luxembourg, Singapore, the UK and the US.

[3] *HKEX Listing Rules 10.06(5)*.

[4] *HKEX Listing Rule 10.06(1)*.

[5] *HKEX Listing Rule 10.06(3)*.

[6] *HKEX Listing Rule 10.06(2)(e)* prohibits listed issuers from repurchasing their own shares during the period commencing one month before the earlier of: (i) the date of the board meeting for the approval of their financial results for any period; and (ii) the deadline for the announcement of such financial results, and ending on the date of the announcement.

[7] Proposed amendments to current *HKEX Listing Rule 10.06(1)(b)*.

[8] *Under section 308(2) of the SFO*, the temporary suspension of voting rights for shares within a specific class of issued shares in a listed corporation does not impact the application of Part XV of the SFO regarding interests in those shares or any other shares within the same class..

This newsletter is for information purposes only

Its contents do not constitute legal advice and it should not be regarded as a substitute for detailed advice in individual cases. Transmission of this information is not intended to create and receipt does not constitute a lawyer-client relationship between Charltons and the user or browser. Charltons is not responsible for any third party content which can be accessed through the website.

If you do not wish to receive this newsletter please let us know by emailing us at unsubscribe@charltonslaw.com

CHARLTONS
易周律師行

Hong Kong Office

Dominion Centre 12th Floor
43-59 Queen's Road East Hong Kong

enquiries@charltonslaw.com

www.charltonslaw.com
Tel: + (852) 2905 7888
Fax: + (852) 2854 9596