Update on HKEx RMB Product Developments

5 September 2011

The introduction of renminbi (RMB) products is a key aspect of the Strategic Plan 2010-2012 of Hong Kong Exchanges and Clearing Limited (HKEx). The following questions and answers provide an update on HKEx's efforts to develop sustainable markets for RMB products.

HKEx & Market Participant Readiness

Q: Are HKEx and market participants ready to support RMB securities trading?

A: Both HKEx and the market are ready for the listing, trading and clearing of pure RMB products. Seven RMB-traded debt securities and one RMB-traded REIT have successfully listed and are trading on HKEx.

HKEx held a RMB Readiness Test from 17 to 20 March to allow Exchange Participants (EPs), participating banks and others to verify their operational readiness for dealing in listed RMB-traded securities. The end-to-end Test included a payment run to ensure a smooth flow of CCASS (Central Clearing and Settlement System for securities) money settlement in RMB, as well as electronic IPO subscriptions, trading, clearing and settlement of listed RMB-traded securities.

As of 29 July 2011, 206 Exchange Participants (EPs), out of total 313 EPs on the RMB readiness list had traded at least once in the Hui Xian REIT. These 206 EPs contributed about 80 per cent of the total market turnover for July 2011.

RMB Products

Q: What RMB products does HKEx plan to introduce besides bonds? Are there any plans for structured products, stocks, futures, other products?

A: HKEx's objective is to develop a comprehensive range of sustainable RMB-traded products for its markets. The development of products for listing and trading on an exchange depends on many factors, including technical and operational readiness (which HKEx has achieved in its securities market and expects to achieve in its derivatives market by year end, insofar as its systems and operations are concerned), market demand and in the case of RMB-traded products, RMB liquidity in Hong Kong.

RMB-traded bonds and a RMB-traded REIT are already listed and trading at HKEx and HKEx looks forward to the listing of other RMB-traded products such as shares, structured products, ETFs and derivatives on its markets at an appropriate time. HKEx will continue to assess all the relevant factors and work closely with market participants on the introduction of different RMB-traded products on its markets.

RMB-traded shares

RMB IPO: A potential issuer can raise funds through a RMB IPO via a "Single Tranche, Single Counter" Model or a "Dual Tranche, Dual Counter" Model.

RMB follow-on offering: A listed issuer can raise funds through a RMB follow-on offering by launching a new counter of RMB-traded shares alongside the HKD counter.

I. General Questions

Q: Will the issuer automatically be able to remit the RMB proceeds raised from a RMB IPO or a RMB follow-on offering to the Mainland?

A: Regardless of the currency involved, if an issuer wishes to remit RMB proceeds to the Mainland, it will have to obtain all necessary approvals from the relevant Mainland authorities. The procedure should be similar to the existing arrangement for remitting funds raised in Hong Kong back to the Mainland.

Q: *If an issuer decides to raise funds through a RMB IPO or a RMB follow-on offering, will it result in additional delays in the review process by the Listing Division?*

A: There should not be any delays in the listing review process as all IPOs and follow-on offering will be subject to the same process regardless of the currency of the funds that they are raising. However, since we are in the early stage of the development of RMB products on the HKEx platform, there may be additional disclosure requirements and mechanics in relation to a RMB IPO or a RMB follow-on offering. We will dedicate necessary resources to work closely with all prospective and existing issuers seeking a RMB IPO or a RMB follow-on offering to prevent unnecessary delays in the process.

Q: Will issuers who raise funds through RMB IPOs or RMB follow-on offerings be subject to additional HKEx compliance rules?

A: At the moment, we do not see the need for any additional compliance rules for issuers of RMB IPOs other than what are currently in the Listing Rules. We will review such need from time to time and as the situation may require as the RMB equity market in Hong Kong develops.

Q: Does an issuer need approval to remit the RMB proceeds to the Mainland at the time of A1 filing, Listing Committee Hearing or listing?

A: There is no HKEx Listing Rule requirement to obtain prior approval, but any remittance of funds into the Mainland will require the necessary approvals (see relevant question above).

Q: Will there be a minimum market capitalization requirement for a RMB IPO or a RMB follow-on offering?

A: For RMB IPO, given transferability, the HKD and RMB tranches need to meet the minimum market capitalisation requirement under the Listing Rules on an aggregate basis at the time of listing.

For RMB follow-on offering, given transferability, there is no specific requirement, but we expect a meaningful offer size and an adequate spread of shareholders for the RMB counter to support secondary market liquidity.

Q: Can issuers list HDRs (Hong Kong Depositary Receipts) in RMB?

A: HKEx Listing Rules do not restrict RMB denomination under the HDR regime.

II. RMB IPO Models

"Single Tranche, Single Counter" Model

Q: Can investors use HKD in addition to RMB to subscribe for RMB IPOs?

A: We are in principle positive to enabling HKD subscription as an option for RMB IPOs. Any model that enables HKD subscription should recognise that RMB is the principal fund-raising currency in a RMB IPO, and therefore there has to be a minimum level of subscription in RMB. If an issuer is to provide a HKD subscription option to investors, the prospectus should clearly disclose the detailed subscription mechanism, including in particular the HKD/RMB conversion mechanism and associated costs and risks to the investors as well as the application of the claw-back and re-allocation mechanism between subscriptions in RMB and subscriptions in HKD. We will continue to explore with relevant stakeholders, including the share registrars, to achieve a proper balance between the key drivers and operational complexity of such a model.

"Dual Tranche, Dual Counter" Model

Q: What is a Dual Tranche, Dual Counter RMB IPO?

A: A Dual Tranche, Dual Counter RMB IPO is the simultaneous offering and initial listing of a tranche of RMB-traded shares and a tranche of HKD-traded shares by the same issuer. All shares from the two tranches are of the same class and all shareholders are treated equally. Upon listing, shares of the two tranches will be traded under two separate counters on the HKEx in their respective currencies (ie one in RMB and one in HKD). The trades of the respective counters will be cleared and settled separately under CCASS, HKEx's Central Clearing and Settlement System for securities. The Dual Tranche, Dual Counter model may entail a mechanism whereby a shareholder may transfer his/her shares from one tranche to the other through the share registrar. The concept is similar to dually-listed companies whose shares may be traded in different currencies in different markets, except that the Dual Tranche, Dual Counter model being studied by HKEx will work in the same market. The above describes how a possible Dual Tranche, Dual Counter model would work. HKEx retains flexibility for other possible IPO models.

Q: Under the Dual Tranche, Dual Counter model, what is the allocation mechanism between the RMB and HKD tranches before pricing?

A: We expect the two tranches will work in largely the same way as two parallel IPOs except that the upfront allocation of shares between the two tranches will have to be clearly disclosed in the prospectus; and the offer price of the two tranches should be the same (subject only to HKD/RMB conversion), etc. The prospectus will also need to fully disclose the claw-back and re-allocation mechanisms and that they function independently within the tranche. Having satisfied the intra-tranche claw-back/re-allocation requirements, the issuer may re-allocate shares between the two tranches in the light of market demand.

Q: Should RMB and HKD tranches be priced at the same level?

A: See answer to the question above. The offer price of the two tranches should be the same after foreign exchange conversion. The FX rate or the mechanism for the determination of the FX rate to be used for the purpose of calculating the final offer price should be clearly disclosed in the prospectus.

Q: How will underwriters' stabilisation work after a Dual Tranche, Dual Counter IPO?

A: The existing "Greenshoe" mechanism (ie the over-allotment option) will apply to each of the two tranches on the basis of their respective pre-determined offer size. We will review the requirement based on the circumstances and merits of individual cases.

Q: Will a RMB tranche of shares require an additional intermediary like an HDR does?

A: In general, we do not see the need for any additional intermediaries for a RMB IPO other than what is required under the Listing Rules for the issuance of shares. Any new requirements will be considered in more detail on the circumstances and merits of individual cases.

III. RMB follow-on offerings

Q: Can an existing listed issuer raise funds in RMB? If so, what are the methods of such RMB follow-on offering?

A: Yes, an existing listed issuer can raise funds in RMB. A listed issuer can choose to raise funds in RMB via placement, rights issue/open offer, public offer, or a combination of the above, which is similar to existing fund raising methods allowed under the Listing Rules. The RMB follow-on offering will lead to a new counter of RMB-traded shares of the same issuer on the Stock Exchange alongside the HKD counter. While the new shares subscribed in RMB will be traded in the RMB counter, the existing HKD-traded shares will continue to be traded in the existing HKD counter.

Q: Will the RMB follow-on offering process be more complex than the existing mechanism?

A: The process for a RMB follow-on offering should be similar to the existing follow-on offering process in other currency. Existing disclosure requirements per Listing Rules and Company Ordinance shall continue to apply. There should be additional disclosure on the establishment of dual trading counters and related arrangements for corporate actions such as dividend payments and currency options.

Q: Can a listed issuer launch a new RMB counter without making a RMB follow-on offering?

A: We retain flexibility for other possible means to issue RMB-traded shares, but there should be a reasonable supply of RMB-traded shares to support the secondary market liquidity.

Q: Can a listed issuer raise funds in RMB without launching a new RMB counter?

A: Yes, the existing Listing Rules permits secondary fund raising in currency other than HKD, including RMB. Shares resulting from such secondary fund raising may be traded in the HKD counter, provided there is sufficient disclosure to the market.

IV. Dual counters-related questions
(Applicable to Dual Tranche, Dual Counter IPO and follow-on offering)

Q: Will HKD-traded shares and RMB-traded shares be transferable?

A: Transferability between the two tranches of shares post-listing will help to ensure the efficiency of arbitrage and thereby maintain the prices of the two counters in the secondary market within a reasonable gap. Therefore, in principle we favour allowing transferability between the two tranches of shares. Since we are still at the early stage of development of RMB equities in Hong Kong, there may be a need to have a short period of non-transferability for the first few RMB IPOs or RMB follow-on offerings. We will retain flexibility on this issue and work with prospective issuers who are interested in a dual counters fund raising to find an optimal solution on transferability during the IPO process.

Q: Will holders of the RMB-traded shares and the HKD-traded shares be treated differently?

A: Where the shares of the two counters are the same class of shares, shareholders shall be entitled to identical shareholders rights.

Q: Will the ownership disclosure requirement apply on a combined basis?

A: Where there is transferability, the ownership continuity and control requirement will be based on the combined tranches. We will review the requirement based on the circumstances and merits of individual cases.

Q: Will the public float be calculated on a combined basis?

A: Yes, given transferability, the public float will be determined on a combined basis.

Q: Under the Dual Tranche, Dual Counter Model and where the issuer has issued shares overseas, if a shareholder transfers his shares from an overseas share register to the Hong Kong share register, will the shares be denoted as RMB-traded shares or HKD-traded shares?

A: It will be the shareholder’s option to decide.

Q: If a listed issuer issues new shares under a general mandate after the launch of a RMB counter, how will the mandate limit and benchmark price be determined?

A: The Listing Rules allow an issuer to seek a general mandate of 20 per cent of its total issued share capital. Where there is transferability, the limit would be calculated on a combined basis. It would be the issuer’s option to decide the currency for the new issue. Guidance will be provided later on the calculation of benchmark price.

Q: Will dividends be paid in HKD or RMB?

A: Any dividend policy (and for that matter other corporate actions) will have to be consistent with the fact that the shares of the two tranches are the same class of shares. Subject to the above and insofar as dividend payment is concerned, the issuer may offer an option to all the shareholders to elect to take a dividend in the currency in which the dividend is declared or in an alternative currency or currencies, and set a different default currency for the respective tranches in the absence of an election by the shareholder. In the cases in which the issuer offers to pay a dividend in RMB (as an option), it will have to consider its access to RMB for dividend payment and its obligation in that respect in relation to the availability of RMB. There should be adequate disclosure in relation to dividend payment and currency options (if any) in the prospectus.

Q: Will bonus or scrip shares be issued in the form of RMB-traded shares or HKD-traded shares?

A: It will be the issuer's option to decide. Similar to dividend payment, the issuer may offer an option to all shareholders to elect to receive RMB-traded shares or HKD-traded shares, and set a different default currency for the respective tranches in the absence of an election by the shareholders.

Q: Will the size limits on options granted under share option schemes apply to each tranche or combined tranches?

A: Where there is transferability, the size limits will be determined on a combined basis.

Q: Can a listed issuer issue RMB-traded shares or HKD-traded shares as the consideration for an acquisition?

A: It will be the issuer's option to decide.

Q: How will a listed issuer's market capitalisation be determined when calculating the consideration ratio for a transaction?

A: Guidance will be provided later on the calculation of the market capitalisation. For example, it could be based on the total number of shares and the closing price of the dominant counter. Alternatively, it could be calculated based on the number of shares of each tranche and their respective closing prices.

Q: Can a listed issuer repurchase RMB-traded shares or HKD-traded shares or both under a repurchase mandate?

A: It will be the issuer's option to decide. Where there is transferability, the 10 per cent limit on the repurchase mandate will be determined on a combined basis. Guidance will be provided later on the calculation of the benchmark price.

Q: Can a listed issuer remove one of the counters?

A: It will be the issuer's option to decide. We may introduce criteria for the de-counter option.

Fees and Other Transaction Costs Associated with RMB IPOs and Trades

Q: What currency/currencies will investors/brokers use to pay for RMB IPOs and trades?

A: For RMB IPOs, investors and brokers will be able to pay the levies and other costs (such as commission) in RMB. For secondary market trading in RMB-traded securities, brokers will have to pay the SFC levy as well as other exchange and clearing fees in HKD. For stamp duty, HKEx's understanding is that the current legislation requires the stamp duty for securities transactions, including transactions in RMB-traded shares, to be paid in HKD. HKEx is currently exploring with the relevant government agency and brokers as to how it may facilitate stamp duty collection for trading of RMB-traded shares in the secondary market and make it as efficient as possible.

RMB Equity Trading Support Facility*Note* (TSF)

What is the TSF and how will it work?

The RMB Equity TSF, or Trading Support Facility, is aimed to serve as a back-up facility to enable investors to buy RMB-traded shares in the secondary market with HKD if they have difficulty in obtaining RMB.

Key features of the TSF:
- It will be a back-up facility;
- RMB available through the TSF will be recyclable;
- It will be open and optional to all Stock Exchange Participants; and
- The TSF RMB will be a committed source of funding and priced at commercial rate.

The TSF will source RMB from one or more banks in Hong Kong and provide the RMB through its participating brokers to investors who wish to buy RMB-traded shares in the secondary market. RMB from the TSF will be used to settle trades in RMB-traded shares through HKEx's securities clearing house, the Hong Kong Securities Clearing Company (HKSCC) – the operator of CCASS. The forex rate used by the TSF will be set on a commercial basis by the TSF partner banks.

The users of the TSF will pay HKD for RMB. When they sell the RMB-traded shares they bought with RMB from the TSF, they will have to return the RMB to the TSF for the equivalent amount of HKD. This so-called Hong Kong Dollar In, Hong Kong Dollar Out (or "HKD In, HKD Out") mechanism, which will all take place inside CCASS, will ensure that the TSF is sustainable without access to an unlimited supply of RMB.

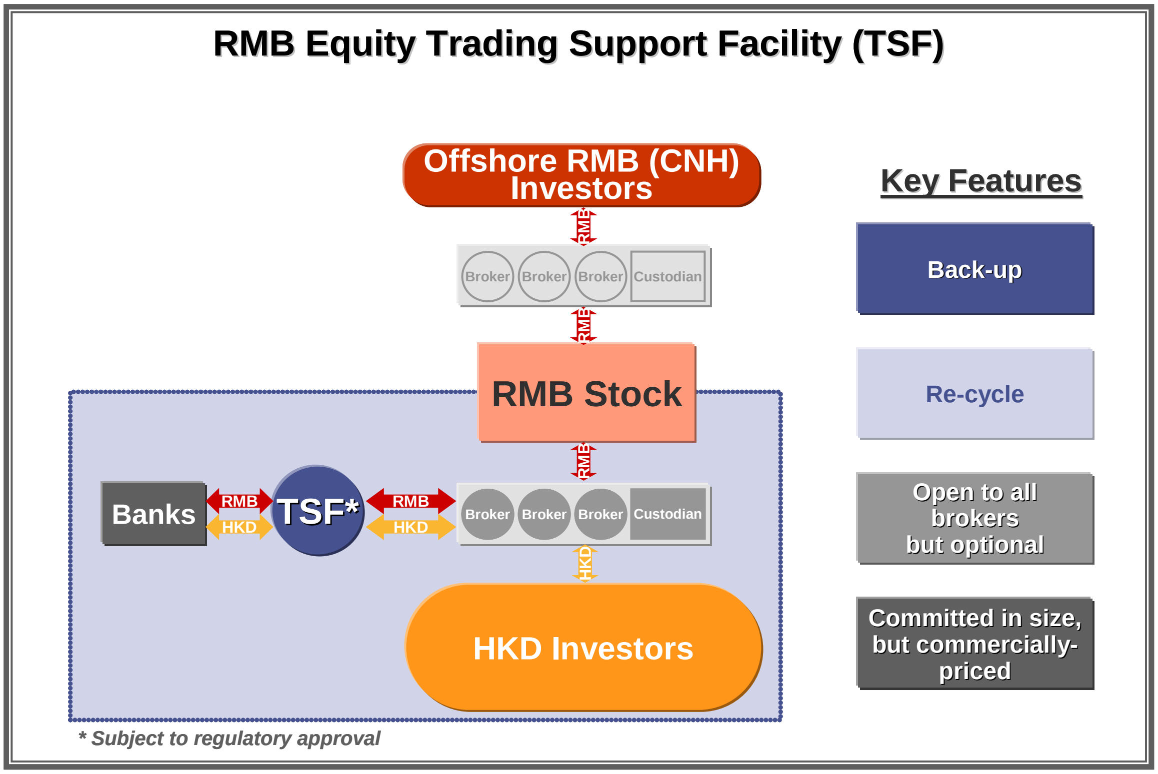
The design of the TSF will ensure the price discovery process for RMB-traded shares in the secondary market and their liquidity will not be constrained by the prevailing level of RMB in the market at any given time. It also does not require any modification to the current trade settlement process in CCASS.

The TSF will be optional for investors as well as brokers. Investors' interest in using the TSF is likely to depend on his/her access to other sources of RMB. Brokers' interest is likely to depend on how they operate their business and their customers' needs.

Why is the TSF needed?

RMB-traded shares are important to the further development of the offshore RMB market in Hong Kong, but the long-term growth and stability of the RMB equity market is subject to the challenge of whether there is sufficient and reliable RMB liquidity in Hong Kong. The TSF is designed to help overcome this possible hindrance and allow RMB-traded shares to develop without constraints arising from limited RMB availability at any given time. The TSF will also help support the normal trading of RMB-traded shares in exceptional situations if RMB supply becomes constrained.

Illustration of the TSF



TSF Details

Q: When will the TSF be rolled out?

A: The current plan is to roll out the TSF in October in 2011. HKEx will inform the market of the timetable as soon as it is ready.

Q: How many Exchange Participants have signed up for the TSF so far?

A: Up to end August 2011, 81 EPs and 10 Custodian Participants have signed up for the TSF.

Q: What will be the size of the TSF?

A: The TSF will be based on the amount of RMB available in Hong Kong (ie CNH) and therefore will be maintained at a size which is healthy and appropriate with respect to the total RMB deposit base in Hong Kong. HKEx expects the initial size of the TSF will be modest and correlated with the size of the RMB offerings that the TSF will support. Over time it may grow in tandem with RMB equity market demand and the overall RMB deposit base in Hong Kong. The TSF will be there to help support and ensure the sustainable development of the RMB equity market in Hong Kong, and it will be there as long as it is needed.

Q: Will the TSF create additional risks for HKEx?

A: The major risk of the TSF is at its RMB fund flow. Since the TSF will manage the RMB/HKD fund flow on a back-to-back basis between its partner banks and the brokers, the risk would be manageable. HKEx will make sure that adequate risk management measures are established to mitigate the risks associated with and arising from the TSF operation.

Q: Will the TSF be competing with the banks and brokers in the RMB forex business?

A: No. The TSF will source RMB from the banks and therefore will not be competing with them. The TSF is meant to be complementary to the services of the brokers to help them better serve their customers interested in RMB share trading in the secondary market.

Q: Will the TSF be mandatory for Exchange Participants (EPs)?

A: No. It will be optional for EPs, and EPs and other market intermediaries will be free to offer other RMB-related services to their customers within the regulatory framework of the securities and money markets.

Q: Will the TSF be a heavy burden on EPs' operations and systems?

A: EPs wishing to use the TSF will probably have to modify their operations and possibly their systems, particularly their back-office systems. The efforts required will depend on the current operations and system set-ups of individual EPs.

Q: What would happen if no EPs were willing to work with the TSF?

A: HKEx believes the TSF presents interesting new business opportunities and there will be sufficient EP interest.

Q: *Will the TSF be made available during subscription in an IPO?*

A: No. The TSF will be used to support secondary trading only.

Q: *Will the TSF be made available during the stabilisation period?*

A: Yes. The TSF will be available for secondary market trading, including the stabilisation period.

Note: Certain features of the TSF described above are subject to change as HKEx finalises the detailed funding and operational model and receives more market feedback. The introduction of the TSF and some of its features are subject to the required approvals from the relevant regulatory agencies.