



Hong Kong Institute of
Certified Public Accountants
香港會計師公會

By email (response@hkex.com.hk) and by post

10 February 2020

Our Ref.: C/CFAP, M124896

Hong Kong Exchanges and Clearing Limited
Eighth Floor, Two Exchange Square
8 Connaught Place, Central
Hong Kong

Dear Sirs,

Re: Consultation Paper on Review of Chapter 37 – Debt Issues to Professional Investors Only

— The Hong Kong Institute of CPAs' Corporate Finance Advisory Panel has reviewed the Consultation Paper ("CP") on "Review of Chapter 37 – Debt Issues to Professional Investors Only" and is pleased to provide its comments on the proposals.

While the Institute supports the underlying principle of Hong Kong Exchanges and Clearing Limited ("HKEX")'s initiative to protect the interests of investors and, at the same time, maintain an effective listing platform for bond market development in Hong Kong, we have some concerns about the proposed approach to addressing these aims. The proposals seem to focus primarily on ensuring the financial strength and capacity of issuers, rather than addressing the apparent problem areas more directly, i.e., how to ensure that certain types of investors, who are not, or may not, in practice, be, professional investors, are discouraged from investing in debt issues under Chapter 37 of the Listing Rules ("Ch37 DIs"), and/or are given adequate warning about the risks if they choose to do.

Proposed increased of the net asset value ("NAV") requirement

While we understand the intention behind the proposal to increase the minimum NAV Requirement of issuers of Ch37 DIs to give better protection to investors and improve the quality of listings, we believe that this may make Hong Kong uncompetitive relative to alternative markets for listing debt securities. In particular, we note that for listing of foreign debt securities on Singapore Exchange ("SGX"), an asset requirement is one of the alternative eligibility criteria only, whereas the Luxembourg Stock Exchange ("LUXSE"), Irish Stock Exchange ("ISE") and London Stock Exchange ("LSE") do not prescribe any asset requirement for determining an issuer's eligibility for debt listings.

If the proposed NAV threshold requirement of HK\$1 billion is seen as being too high, this will just encourage issuers to list their bonds on other exchanges with lower requirements, including SGX.

Maintaining the current eligibility exemption available for state corporations

We note that LUXSE, ISE and LSE do not provide a waiver for state corporations. We consider that it may be time to review the blanket waiver for state corporations, or as a minimum, require state corporations that list Ch37 DIs, which have no government



guarantee, to make it more explicit that investors cannot expect any debts of the corporation to be underwritten by the government in the event of the default or bankruptcy of the corporation.

Introduction of a minimum issuance size for Chapter 37 Debts

Whilst, once again, we appreciate that HKEX's objective is to improve the quality of listings by allowing only issuers with financial capacity and a proven track-record of supporting debt issuances of a significant amount to be eligible to list Ch37 DIs, we are concerned about Hong Kong's competitive position. In this regard, we note that the minimum issuance size for listing on SGX is S\$5 million (around HK\$30 million), and is even lower for listing on LUXSE, ISE and LSE. The proposed minimum issuance size of HK\$100 million, therefore, is likely to lead more bond issuers to list debt securities on other markets, which could have an adverse impact on the development of the bond market in Hong Kong.

Publishing disclosure guidance to the market on specified special features

Publishing disclosure guidance to the market on specified special features found in certain Ch37 DIs and other disclosure-related matters may be worthwhile from an investor protection perspective. At the same time, HKEX should clarify the status of any such guidance. As, in general, bonds are listed and sold in multiple jurisdictions, there could be an issue if the disclosure expectations in Hong Kong deviate substantially from the requirements in other markets and are seen as being much more onerous.

Other comments

While generally, we agree with other proposals in the CP, further clarification may be needed in relation to certain matters, such as the meaning of "unusual movements" in the price or trading volume of the Ch37 DIs, and how HKEX could monitor this, especially when the debts are not traded through the HKEX clearing system; and the meaning and practical implications of a suspension, given that most trading in Ch37 DIs is conducted on an OTC basis.

In order to improve Hong Kong's competitiveness, in principle, the direction of travel should be to streamline the application process for debt listings and to reduce timeframes for listing of debt/ securitisation transactions. Listing applications for wholesale bonds on SGX, for example, can be processed within one business day.

Under the circumstances, HKEX may need to consider further whether the proposals in the CP could over-regulate the market for genuine professional investors and hinder efforts to develop Hong Kong as a regional hub for bond issuance/ listing, and as a securitisation financing hub for infrastructure and small and medium enterprises.

It would appear that there are underlying issues regarding how to alert retail investors in the secondary market of the risks attached to Ch37 DIs and whether the definition of "professional investor", for whom fewer protections are deemed necessary, needs to be reviewed.

As regards the latter point, we see this as a concern given that the size of an investment portfolio that qualifies an individual to be called a "professional investor"



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has not been increased for 17 years, and is now equivalent to no more than the value of a small flat in Hong Kong. Moreover, a "portfolio" could be merely a time deposit at a bank. It is questionable, therefore, whether all those currently falling within the definition of "professional investor" should be so regarded, and additional protections for some of them may be warranted. For this reason, while the CP identifies certain important issues with the existing regime that merit further consideration, we have reservations about the way in which it tries to address these issues.

The completed questionnaire, which explains the Institute's views in more detail, are attached.

Should you have any questions on the Institute's submission, please feel free to contact me at the Institute.

Yours faithfully,



Peter Tisman
Director, Advocacy and Practice Development

PMT/NCL/pk

Encl.

Part B Consultation Questions

Please indicate your preference by checking the appropriate boxes. Please reply to the questions below on the proposed change discussed in the Consultation Paper downloadable from the HKEX website at:

<https://www.hkex.com.hk/-/media/HKEX-Market/News/Market-Consultations/2016-Present/December-2019-Chapter-37-Debt-Issues/Consultation-Paper/cp201912.pdf>

Where there is insufficient space provided for your comments, please attach additional pages.

Capitalised terms have the same meaning as defined in the Consultation Paper unless otherwise stated.

1. Do you agree with the proposed increase of the NAV Requirement from HK\$100 million to HK\$1 billion?

Yes

No

Please give reasons for your views.

While, we understand the Exchange's aim to improve the quality and financial security of debt listings, and strengthen investor protection, raising the minimum Net Asset Value ("NAV") Requirement for issuers of debt under Chapter 37 of the Listing Rules ("Ch37 DIs"), from HK\$100 million to HK\$1 billion, would represent a substantial increase in the minimum requirements. We have serious concerns about the impact that such a major change would have on the competitiveness of Hong Kong's listed debt market.

We note that, for listing of foreign debt securities on the Singapore Exchange ("SGX"), an asset requirement (i.e., that the issuer should have consolidated net tangible assets of at least S\$50 million (around HK\$300 million)) is one of the alternative eligibility criteria only. We also note that other competing markets, including the Luxembourg Stock Exchange ("LUXSE"), Irish Stock Exchange ("ISE") and the London Stock Exchange ("LSE") do not have any asset requirement for determining the issuer's eligibility for debt listings.

Furthermore, as the Exchange point out in the consultation paper ("CP"), a majority of Ch37 DIs are currently traded over-the-counter ("OTC") and bonds are listed normally to enable investors (such as funds), which are permitted to invest only in listed bonds and/ or equities, to invest in such bonds. The listing location of the bonds is not crucial to the issuers and, therefore, by raising the threshold of the NAV requirement tenfold, as proposed, issuers may be encouraged to list their bonds on other exchanges with lower requirements, such as SGX.

We believe that concerns about retail investors purchasing bonds on the secondary market, as well as certain categories of persons, who should probably not be regarded as being professional investors, being sold Ch37 DIs without sufficient safeguards, need to be addressed by other, more targeted means.

As regards the latter point, we believe that there is a potential concern because the size of an investment portfolio which qualifies an individual to be called a "professional investor", has not been increased for 17 years and is now equivalent only to the value of a small flat in Hong Kong. Furthermore, a "portfolio" could be merely a time deposit at a bank. It could also be an account shared with an "associate." In practice, therefore, the value of the portfolio at the disposal of someone deemed to be "professional investor" could be even less than HK\$8 million. This being the case, it is questionable whether all those currently falling within the definition of "professional investor" can legitimately be regarded as such. Additional protections for some of them may be warranted.

2. (a) Do you agree that the Exchange should maintain the current Eligibility Exemption available for State corporations?

Yes

No

Please give reasons for your views.

We note the observation (at paragraph 64 of CP), that the Exchange has received comments on whether financial support or backing will be provided by a state to its state corporations in case of default by these corporations of their payment obligations. These comments were driven by the risk disclosures in recent listing documents of Ch37 DIs issued by state corporations, indicating that the repayment obligations under their Ch37 DIs remain with the issuer, i.e., no financial support will be provided to the issuer by the state in case of default of its payment obligations. Questions have been raised, therefore, about the appropriateness of the current exemption available to state corporations from the Issuer Eligibility Requirements ("Eligibility Exemption").

The CP indicates that LUXSE, ISE and LSE do not provide an equivalent exemption for state corporations. As regards Mainland state corporations, it is quite widely reported these days that the debt burden in the Mainland is substantial and that the Central People's Government or provincial governments will not generally underwrite the debts of state-owned enterprises. We would suggest, therefore, that unless and until the issues raised in the response to Q1, about alerting retail investors in the secondary market of the risks attached to Ch37 DIs and revisiting the definition of "professional investor" are adequately addressed, it may be appropriate to review the blanket Eligibility Exemption accorded to state corporations. As a minimum, it would seem that state corporations listing Ch37 DIs, which have no state guarantee, should be required to make it more explicit to investors that they cannot expect any debts of the corporation to be guaranteed by the state in the event of the default or bankruptcy of the corporation.

- (b) If not, which type of State corporations should comply with Issuer Eligibility Requirements? Please give reasons for your views.

3. (a) Do you agree with the proposed introduction of a minimum issuance size of HK\$100 million (or equivalent in other currencies) for Chapter 37 Debts?

Yes

No

Please give reasons for your views.

Again, we understand the intention to provide better protection for investors by ensuring that only issuers with financial capacity and a proven track-record of supporting debt issuances of a significant amount will be eligible for listing. However, for similar reasons as in the case of the proposal to increase the minimum NAV of issuers, we have concerns that setting this relatively high hurdle will result in business migrating to other markets, given the much lower minimum issuance size elsewhere, including LUXSE, ISE, LSE, and SGX. As pointed out in the CP, the previous minimum issuance size of HK\$50 million was removed following a consultation in 2010, "on the basis that it was a requirement to protect retail investors and not applicable to a regime for professional investors" (see paragraph 66, footnote 59). In principle, the same argument continues to apply. To the extent that there is problem about the types of investors that are, in fact, able to access Ch37 DIs, or to whom they may be marketed, these issues should be dealt with by more targeted measures, as suggested in our reply to Q1.

- (b) Do you agree that such minimum issuance size shall not apply to tap issuances?

Yes

No

Please give reasons for your views.

We have no specific comment on this.

4. Do you agree with the proposal to require issuers to state explicitly on the front cover of the listing document the intended investor market in Hong Kong (i.e. professional investors only) for its Chapter 37 Debts, in addition to the existing legend required under Rule 37.31?

Yes

No

Please give reasons for your views.

We agree with this proposal from an investor protection perspective. In particular, it could help to alert retail investors in Hong Kong that Ch37 DIs are not intended for them and that they purchase such debt at their own risk .

5. Do you agree with the proposal to require publication of listing documents for Chapter 37 Debts on the Exchange's website on the listing date?

Yes

No

Please give reasons for your views.

We agree with this proposal as an enhancement of transparency from an investor protection perspective. However, if the listing documents for Ch37 DIs are required to be published on the Exchange website (rather than platforms, such as Bloomberg, which are more usually accessed by professional investors) there is always a risk that this may attract greater attention from retail investors, which would defeat the purpose. Therefore, it will be important for investors who are not professional investors to be directed via the website to the warning that these investments are intended for professional investors only.

6. (a) Do you agree that the Exchange's current disclosure and vetting approach in relation to listing documents for Chapter 37 should remain unchanged, notwithstanding that the intended investors would include HNW Investors?

Yes

No

Please give reasons for your views.

We note that the legal framework in Hong Kong imposes no mandatory requirements for contents on offerings to professional investors, and does not differentiate disclosure standards between institutional investors and "high net worth (HNW)" investors." We note also that in a 2010 consultation the market favoured moving away from the previous, more prescriptive, approach. Furthermore, adopting a prescriptive disclosure approach under Chapter 37 could result in regulatory inconsistency and different disclosure requirements for Hong Kong listed securities compared with other securities, such as overseas listed or unlisted debt securities, where the same class of professional investors may be targeted for securities with potentially the same structure and features (paragraph 99(a) of the CP).

While, in principle, we agree with the Exchange's proposal, the fact that the issue is being raised is evidence that concerns have arisen under the current "light-touch" approach. As we have indicated above, in our view, there is a clear need to revisit the definition of "professional investor", particularly as this relates to HNW individuals and corporations.

- (b) For the purpose of Rule 37.29, should there be a different standard with specific disclosure requirements in respect of Chapter 37 Debts that are

offered to HNW Investors, compared to those that are offered to Institutional Investors, for example, the manner of presenting information such as the terms and conditions and financial information of issuer and any credit support provider (even though the current Hong Kong legal framework does not differentiate disclosure standards between Institutional Investors and HNW Investors)? If so, what should those specific disclosure requirements be?

Yes

No

Please give reasons for your views.

We consider that it may not be necessary to impose a different standard with specific disclosure requirements in respect of Ch37 DIs offered to HNW investors, as this could make the regulatory regime cumbersome and complicated, and less attractive to issuers. As indicated above, the current Hong Kong legal framework does not differentiate disclosure standards between institutional investors and HNW Investors.

That said, as also explained above, we consider that a more fundamental issue is the need to look again at the definition of "professional investor."

7. (a) Do you agree that the Exchange should publish disclosure guidance to the market on specified Special Features found in certain Chapter 37 Debts and other disclosure-related matters?

Yes

No

Please give reasons for your views.

In principle, publishing some disclosure guidance to the market on specified Special Features found in certain Ch37 DIs and other disclosure-related matters should aid transparency. However, the status of such guidance would need to be clarified. Bonds in general are listed and sold in multiple jurisdictions and there are general market standards on disclosure. Therefore, the Exchange would need to keep any such guidance under review to ensure that it remains current and broadly in line with standards elsewhere.

- (b) Do you have other suggestions on any additional or alternative proposals that the Exchange may implement to promote disclosure quality and consistency for Chapter 37 Debts?

Yes

No

Please give reasons for your views.

We have no specific comment on this.

8. Do you agree with the proposal to codify the PI Waiver by revising the definition of "professional investors" under Chapter 37 to include HNW Investors?

Yes

No

You may provide reasons for your views.

Codifying the PI Waiver can be considered after the definition of "professional investor", as this relates to HNW investors, has been reviewed, otherwise it would risk codifying a potential problem area.

9. (a) Do you agree with the proposal to allow eligibility of a REIT Issuer (or a REIT Guarantor) to be assessed by reference to the REIT Assets and REIT Financials respectively, provided that it has recourse to the REIT Assets to satisfy the obligations under the relevant Chapter 37 Debts?

Yes

No

Please give reasons for your views.

We agree with this proposal. It would establish consistency, on the basis that there should be no difference from an investor's perspective between the debt issuance of a listed company and a listed REIT

- (b) Do you agree that if the relevant REIT is listed on the Exchange, a REIT Issuer (or a REIT Guarantor) should be qualified as a HK Listco and therefore, be exempted from the Issuer Eligibility Requirements?

Yes

No

Please give reasons for your views.

We agree with this proposal. See the response to Q9 above.

10. Do you have any comments on the proposed enhancements relating to the continuing obligations of the issuer and guarantor under Chapter 37?

Yes

No

Please give reasons for your views.

In principle, we agree with the proposals.

We support the proposal to clarify that the timing of making an announcement of information to avoid a false market, or information having a material affect on a guarantor's ability to meet its obligations under debt securities, should be "as soon as reasonably practicable" rather than "immediately." While we understand that this is intended to be a less rigorous requirement, it should be made clear how "as soon as reasonably practicable" has been interpreted in actual cases.

11. Do you agree with the proposal to replace the existing requirements to submit copies of constitutional documents and resolutions as part of the listing application documents with a requirement to provide written confirmation by the issuer (or guarantor, as the case may be) in relation to its due incorporation, capacity and authorisation?

Yes

No

Please give reasons for your views.

We agree with this proposal, which would help to streamline the application process and so increase the competitiveness of Hong Kong's bond issuing/ listing market.

12. (a) Do you agree with the proposal to replace the existing requirement to submit last published financial statements with a new requirement for an issuer (or the guarantor that an issuer relies in fulfilling the Issuer Eligibility Requirements) to submit its audited financial statements to evidence its fulfilment of the Issuer Eligibility Requirements?

Yes

No

Please give reasons for your views.

We agree with this proposal, which would help to streamline the application process and increase the competitiveness of Hong Kong's bond issuing/ listing market.

- (b) Where the issuer (or the guarantor) is exempted from the Issuer Eligibility Requirements or where the required audited financial statements are disclosed in the listing document, do you agree that such issuer (or guarantor) should not be required to separately submit financial statements to the Exchange?

Yes

No

Please give reasons for your views.

We agree with this proposal, as it would help to streamline the application process and increase the competitiveness of Hong Kong's bond issuing/ listing market.

13. Do you agree with the proposal to amend Rule 37.26 to clarify that supplementary listing document includes a pricing supplement?

Yes

No

Please give reasons for your views.

We agree with this proposal.

14. The Exchange invites your comments regarding whether the drafting of the proposed housekeeping Rule amendments will give rise to any ambiguities or unintended consequences.

Regarding the draft LR 37.46A, we would request the that Exchange clarify (i) the meaning of "unusual movements" in the price or trading volume of Ch37 DIs; and (ii) how the Exchange could monitor the price and trading volume, especially when the debts are not traded on the Exchange's clearing system.

As a separate matter, as regards the reference in the CP to the possible suspension from trading of Ch37 DIs, the implications and effect of a suspension should be clarified, given that most trading of Ch37 DIs is conducted on an OTC basis.

15. Do you have any other comments in respect of the matters discussed in the Consultation Paper? If so, please set out your additional comments.

We understand the aim of the proposals in the CP to improve the quality of debt listings and provide better safeguards for investors. However, it may be necessary to consider further whether the proposals would achieve that end without over-regulating the market for genuine professional investors and hindering efforts to develop Hong Kong as a regional hub for bond issuance/ listing, and a securitisation financing hub for infrastructure and small and medium enterprises.

As we note above, underlying issues seem to be how to ensure (i) that retail investors in the secondary market are fully aware of the risks attached to Ch37 DIs and, as far as possible, discouraged from investing in them, and (ii) that the definition of “professional investor,” is restricted to those investors who can reasonably be considered to be experienced and relatively sophisticated. However, the proposals in the CP focus mainly on regulation of, and minimum requirements for, issuers rather than trying to address these concerns more directly.

Separately, if the issues outlined above can be resolved, we consider that measures to streamline the application process and timeframe for listing of debt/ securitisation transactions would help to increase the competitiveness of the Hong Kong market. We understand that listing applications for wholesale bonds in SGX, for example, can be processed within 1 business day.

End -

