

## 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.

The impact of the proposed increase in the NAV requirement would be fairly limited given that it does not apply to listed company debt (i.e., debt issued by companies listed on the Exchange or other stock exchanges that are members of the World Federation of Exchanges), or debt issued by State corporations or SPVs formed for asset-backed security listings. Its effect would thus be to bar debt listings by unlisted companies with net assets of below HK\$1 billion.

A key aim of the Consultation's proposals is to protect retail investors who acquire Chapter 37 debt securities, particularly those acquiring complex products, in the secondary market, despite the intended market for these products being restricted to professionals. The solution would thus appear to lie in putting a stop to acquisitions of Chapter 37 debt by retail investors, rather than in preventing unlisted companies from issuing debt to professional investors who are able to assess and take the associated risks.

As noted in the Consultation Paper, better compliance by SFC-licensed and registered intermediaries with the suitability obligation under paragraph 5.2 of the SFC Code of Conduct would assist in stopping retail investors acquiring professionals only debt. This is however outside the Exchange's control and depends upon the SFC's continued monitoring of licensed intermediaries' compliance with the suitability obligation, particularly in relation to complex products and debt issues by unlisted companies, and enforcement in appropriate cases. Moreover, the suitability obligation under paragraph 5.2 applies only to licensed intermediaries' solicitations and recommendations of investment products, although the suitability obligation under paragraph 5.5(a)(ii) relating to complex products applies to any service provided to the client in a complex product.

If the primary objective is to prevent Hong Kong retail investors acquiring securities intended for the professionals market, the best way of achieving this would be to prohibit sales of Chapter 37-listed debt securities to retail investors, with the possible exception of securities that are of investment grade or above. Sales of unlisted debt securities to retail investors might also be prohibited to counter the problem of licensed intermediaries selling unlisted debt with complex features and/or other inherent risks to retail investors, debt which is typically offered via private placement (as noted in the SFC's 31 March 2016 "Circular to Licensed Corporations: Distribution of bonds listed under Chapter 37 of the Main Board Listing Rules and local unlisted private placement bonds"). These are changes which would need to be implemented to Hong Kong's securities law framework. The Securities and Futures Ordinance (Cap. 571) allows debt securities, including complex and high yield debt securities, to be offered in Hong Kong either to professional investors, including HNW professionals, or in circumstances not constituting an offer to the Hong Kong public (i.e., via private placement). Beyond intermediaries' obligation to ensure the suitability of products for particular clients, there is nothing to prevent secondary sales of these products to retail investors. The Group thus opposes the proposed increase in the NAV requirement for debt issues by unlisted companies primarily because this would not address the problem of retail investors acquiring debt which is not suitable for them.

Further, even if an increase in issuers' NAV were to correlate with their financial health or quality of their debt securities, which is doubtful, the Group considers that as a professionals only market, Chapter 37 should not attempt to prescribe issuer quality. While issuer quality is a legitimate concern for the protection of retail investors, as indicated above, the Group considers this to be best achieved by prohibiting the sale of Chapter 37 debt securities to retail investors in the secondary market. That issuer eligibility criteria are unnecessary in the context of a professionals only market is evident from their absence on the LSE, LUXSE and ISE. The SGX additionally has no eligibility requirements for issuers of debt subscribed as to 80% by professional investors, although a minimum issue size of S\$750,000 (HK\$4.36 million) is required for Singaporean (but not foreign) issuers. The proposed increase would thus put the Exchange's requirements out of alignment with those considered appropriate by other international professional debt markets. Furthermore, an increase in required NAV risks pushing asset-light tech and other new economy companies to list on SGX or other competitor exchanges rather than the Exchange. Applying the same NAV requirement to debt listings on GEM could also prevent SMEs from accessing the Hong Kong listed debt market.

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.

There is obviously some logic in removing the exemption for issuers whose debt obligations will not be met by the State. The Group notes however that tightening the definition of State corporation would have implications for example for connected transactions, and that there may be difficulties in having different definitions for different chapters. It would be useful to have data on State corporation defaults on Chapter 37 listed debt in order to be able to assess the need for any change to the current position.

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

n/a

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

For the same reasons highlighted in the response to Question 1 above, the Group does not consider that the proposed increase in minimum issuance size will address the concerns raised by the Consultation Paper, namely protecting retail investors who acquire Chapter 37 debt in the secondary market.

In 2010, the HK\$50 million proposed requirement for Chapter 37 debt securities was considered unnecessary for professionals only issues and removed. Moreover, the SGX has no minimum issue size requirement for: (i) debt securities of foreign issuers of debt that are subscribed as to 80% by professional investors; (ii) Singaporean government or government agency debt; and (iii) investment grade debt of Singaporean issuers that are not listed on the SGX. As noted in the Consultation Paper (paragraph 72), the minimum issue size requirement on other markets is significantly lower than the HK\$100 million minimum proposed for the Exchange: the equivalent of

HK\$1.85 million on LUXSE and ISE, and HK\$2.09 million in the case of the LSE. It should also be noted that the Exchange's existing HK\$500,000 minimum denomination requirement, aimed at deterring acquisition of Chapter 37 debt by retail investors, has no equivalent requirement on the SGX or the LSE's Professionals Securities Market. In the case of LUXSE and ISE, there is no minimum denomination requirement, although bonds with a denomination of EUR100,000 (HK\$925,000) or above benefit from less onerous disclosure requirements under the EU's wholesale debt regime.

The Group particularly opposes the proposed application of the HK\$100 million minimum issuance size to GEM, given the potential to discourage SMEs from listing debt on GEM, thereby cutting off GEM as a source of funding for these companies.

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

Yes

No

Please give reasons for your views.

There is no need for the minimum issuance size requirement to apply to tap issuances, given that it will be met by the original issuance.

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 proposed requirement as it may assist licensed intermediaries in complying with the suitability obligation and in alerting retail investors that they are not the intended market for Chapter 37 debt securities.

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 which complements the proposal to require a statement of intended investor market (above proposal 4) and is in line with the requirements for listing debt securities on LUXSE and Euronext Dublin, which obligate prospectus publication on their respective websites.

Consideration might also be given to extending this requirement to include publication on the websites of intermediaries involved in placing or selling the securities and fiscal or paying agents. The LUXSE and Euronext Dublin both require that where the prospectus is made available on the issuer's website, it should also be available on the websites of financial intermediaries placing or selling the securities, including the paying agents.

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.

The Group agrees that there should be no change to the current disclosure and vetting approach, and that no changes should be made to take account of potential purchasers who are HNW Investors.

Key factors for companies choosing a listing venue are the ease, speed and efficiency of the listing process. Chapter 37's current light-touch regime was introduced primarily because the pre-2011 regime's prescriptive disclosure approach resulted in longer vetting periods. This was thought to be the main reason why the SGX had managed to establish itself as Asia's primary listing venue for debt securities (paragraph 37 of the Consultation Paper). To revert to requiring more prescriptive listing document disclosure which would lengthen the Exchange's vetting process would likely reduce the attractiveness of the Exchange as a venue for professionals only debt listings, particularly given that this is not required to list on SGX.

Moreover, if Chapter 37 debt is intended only for professional investors, the level of disclosure should be appropriate for sophisticated investors, not retail investors.

As already noted, a ban on sales to retail investors of Chapter 37-listed debt and other investment products considered suitable only for professional

investors, is considered the best way of preventing retail investors from acquiring products intended for sophisticated investors. If there is concern that individual investors who qualify as "professional investors" lack sufficient knowledge and/ or expertise, there is the possibility of raising the qualifying threshold above HK\$8 million. However, it is the Group's view that plain vanilla debt should not be inherently riskier, and will often pose less risk, than equity securities. In the case of complex products, investors should be protected by the additional 'Know your client' provisions which apply to intermediaries offering complex products to clients under paragraph 5.5 of the SFC Code of Conduct which, if complied with, should prevent such products being sold to investors for whom they are not suitable. High yield bonds have also been the focus of SFC reminders to licensed intermediaries regarding fulfilment of their Code of Conduct obligations (see the SFC's March 2014 "Circular to Licensed Corporations: Selling of complex bonds and high-yield bonds"). However, high yield bonds are not covered by the additional 'Know your client' obligations that apply to complex products under paragraph 5.5, and this is something which the SFC might consider addressing in the context of protecting retail investors. Protection at this level lies within the scope of SFC regulation and cannot be provided by the Listing Rules.

- (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.

For the reasons given in response to part (a) above, the Group does not consider it necessary to have different standards with specific listing document disclosure requirements in respect of Chapter 37 Debts that are offered to HNW investors.

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.

Yes, we agree that disclosure guidance on specified Special Features would be useful, provided that it does not result in unnecessary or burdensome disclosure in the context of the professionals only debt market. This could be particularly helpful to licensed intermediaries in fulfilling their Code of Conduct obligations. This disclosure guidance should also cover high yield debt securities despite these not being included in the SFC's list of examples of complex products.

- (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.

n/a

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.

The Group agrees with the proposed codification of the PI Waiver as it will alert new issuers to the fact that this waiver is routinely available and remove the administrative burden of waiver applications.

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 the proposal given that REIT Assets should be applied in satisfying the debt obligations of Chapter 37 REIT Issuers.

- (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 that Exchange-listed REIT Issuers (or Guarantors) should be regarded as equivalent to HK Listcos and thus exempted from the Issuer Eligibility Requirements.

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.

The Group agrees with the proposed new requirements and clarifications as regards continuing obligations of issuers and guarantors under Chapter 37.

It notes in particular the proposed specific requirements for issuers and/or guarantors to announce default on their listed debt securities, winding-up or liquidation. It suggests however that the drafting of proposed Listing Rule 37.47E(a) should make clear that the announcement obligation extends to cross-default of a Chapter 37 issuer's debt which is triggered by a default on its other debt obligations (as proposed by paragraph 119 of the Consultation Paper).

The Group also suggests that Chapter 37 debt issuers should be required to publish their financial information on their company website, or if none, on the HKEx website. Issuers whose equity securities are listed on the Exchange are already required to publish their financial information under Chapters 13 and 18 of the Main Board and GEM Listing Rules, respectively. A specific requirement for issuers whose equity securities are not listed on the Exchange to publish the same financial information as is required by Chapters 13 and 18 should be included to ensure investors have access to issuers' latest financial information.

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.

The Group welcomes the proposal which is beneficial from a "green" perspective.

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.

The Group agrees with the proposed requirement for unlisted companies to provide audited financial statements since these will provide greater certainty that the eligibility requirements of Chapter 37 are met.

- (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.

Since audited financial statements are required in order to ascertain whether issuers satisfy the eligibility requirements (the NAV requirement and requirement for 2 years audited accounts), there is no reason to require entities exempt from those eligibility requirements to submit financial statements. Likewise, if the audited financial statements are included in the listing document, it would be reasonable to remove the separate need for the issuer to submit them to the Exchange.

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.

The Group agrees with the proposal which is essentially a codification of the Exchange's current practice.

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.

n/a

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.

Chapter 37 essentially caters for two very different bond markets: (i) the Eurobond market in which Chapter 37-listed debt is sold to institutional investors and cleared primarily through Euroclear and Clearstream; and (ii) the local Hong Kong debt market in which bonds are sold to both HNW and institutional investors. Investors in the Eurobond market are institutional investors who arguably do not require the Consultation's proposed protections.

As already noted, the main concern noted by the Consultation Paper is that retail investors are able to acquire Chapter 37-listed debt securities in the secondary market as a result of licensed intermediaries' failure to fulfil their obligations under the SFC Code of Conduct to ensure that investment products are suitable for the investors given their financial circumstances and understanding of the product. Similar problems have apparently arisen with licensed intermediaries selling unlisted debt and other investment products to retail investors.

The answer to these failings by licensed intermediaries should not be to raise the eligibility requirements for unlisted issuers (i.e. companies not listed on the Exchange or an overseas exchange) to a point that would prevent them from listing debt issues to professional investors. If it is assumed that Chapter 37 professional investors are able to assess the risks attached to this type of debt, what is needed is a watertight method of preventing retail investors from acquiring it, which arguably is achievable only via a ban on secondary sales of such securities to retail investors.

Further, if Chapter 37 is to provide a market for offering debt securities only to professional investors, the Exchange should avoid reintroducing prescriptive disclosure requirements which could negatively impact the ease, speed, efficiency and cost of listing on the Exchange, particularly vis à vis SGX's listing process. That said, the Exchange's suggestion of providing guidance on disclosure suitable for complex products is welcomed, and should also cover high yield debt securities, provided that it does not result in unnecessary or burdensome disclosure in the context of Hong Kong's professionals only debt market.

A further measure which the Exchange could consider to assist in ring-fencing secondary market sales of Chapter 37 debt securities to professional investors only, would be to introduce an electronic OTC bond trading platform similar to Singapore's SGX Bond Pro, which is open only to professional investors and aims to provide a liquid secondary market for Asian bonds.

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