

11/08/23

If you have any questions regarding the matters discussed in this memorandum, please contact the attorneys listed on the last page or call your regular Skadden contact.

This memorandum is provided by Skadden, Arps, Slate, Meagher & Flom LLP and its affiliates for educational and informational purposes only and is not intended and should not be construed as legal advice. This memorandum is considered advertising under applicable state laws.

One Manhattan West
New York, NY 10001
212.735.3000

42/F, Edinburgh Tower, The Landmark
15 Queen's Road Central, Hong Kong
Hong Kong
852.3740.4700

The Stock Exchange of Hong Kong Limited (**HKEx**) is proposing to permit companies listed on the exchange to hold their own shares as treasury shares and to introduce rules on companies' resale of treasury shares. The proposals, set out in a new consultation paper, will:

- Give companies listed in Hong Kong additional flexibility in managing their capital structure.
- Address liquidity issues to a certain extent.
- Align Hong Kong with global market practice.

The proposals are subject to market consultation, with the consultation period ending on 27 December 2023.

Background

The Rules Governing the Listing of Securities on the Stock Exchange of Hong Kong Limited (**Listing Rules**) do not currently permit listed companies to retain treasury shares, and they require any repurchased shares to be cancelled. This reflects a similar restriction on Hong Kong-incorporated companies under Hong Kong's Companies Ordinance and, according to HKEx, is intended to prevent market manipulation and insider dealing in connection with share repurchases and resales of treasury shares.

However, in recent years HKEx has successfully attracted "homecoming" listings of Greater China companies, in particular new economy companies, with dual listings in the U.S., where treasury shares are a common feature of the market. At the same time, HKEx acknowledges that Hong Kong's Securities and Futures Ordinance (**SFO**) contains extensive provisions guarding against market manipulation and insider dealing, which are actively enforced by the Securities and Futures Commission (**SFC**).

Treasury Shares To Be Permitted

HKEx is proposing to abolish the requirement to cancel repurchased shares. As a result, listed companies will be permitted to hold repurchased shares in treasury for future resale, if permitted under the laws of their place of incorporation. Many of the most popular jurisdictions of incorporation for HKEx-listed companies, such as the Cayman Islands and Bermuda, permit treasury shares.

Share repurchases will continue to be conducted under existing rules pursuant to a share repurchase mandate obtained from shareholders, which permits a company to repurchase up to 10% of its shares on-market in any 12-month period. Companies will be required to disclose in the related explanatory statement to shareholders (sent at the time of convening the shareholder meeting to obtain the mandate) whether they intend to cancel repurchased shares or retain them as treasury shares. It is unclear whether this will bind the companies or merely constitute an expression of their present intention.

Resales of Treasury Shares

The nature of treasury shares will enable companies to resell the shares into the market in small lots, which will facilitate such sales being made at market prices. By contrast, placings of new shares are generally conducted in larger quantities and at a discount to the market price.

HKEx To Permit Treasury Shares

HKEx proposes that resales of treasury shares will be governed by the same rules applicable to the issuance and sales of new shares. As such:

- Resales of treasury shares will be subject to preemptive rights (*i.e.*, offered to all shareholders on a pro rata basis) or conducted under a shareholders' mandate, which may be either a general mandate or specific mandate. Most listed companies in Hong Kong obtain a general mandate from shareholders to issue new shares representing up to 20% of their issued share capital in any 12-month period. In addition, this general mandate is increased by the number of shares repurchased in a year (up to the 10% share repurchase mandate limit). Resales of treasury shares will therefore count against these mandate limits.
- Resales of treasury shares will be subject to a maximum price discount of 20%, similar to placings of new shares under a general mandate.

On-market resales of treasury shares will be required to be disclosed by way of next-day returns, however no announcement will be required.

New listing applicants will be permitted to retain their treasury shares upon listing. Details of treasury shares must be disclosed in the prospectus. The existing six-month moratorium on issuances of new shares after listing will also apply to resales of treasury shares.

Companies may also use treasury shares to satisfy award grants under share schemes, in which case such grants will be treated as share awards funded by new shares and subject to the overall share scheme limits.

Restrictions on Treasury Shares and Resales

While the total number of treasury shares available for resale or grant will be subject to the above limits, there will be no restrictions on the actual number of treasury shares that may be held by a company.

Treasury shares may not be voted and will be disregarded in calculations of total outstanding shares for the purposes of the Listing Rules (*e.g.*, in calculating public float, market capitalization and mandate limits, as well as for size tests for notifiable transactions).

HKEx explicitly wishes to discourage companies from repeatedly repurchasing and reselling their own shares on the market with the intention of manipulating the share price or making a trading profit. To guard against market manipulation, the following limitations will apply:

- The existing moratorium on issuance of new shares within 30 days after any share repurchase will also apply to resales of treasury shares, such that companies may not resell any treasury shares within 30 days after any share repurchase.
- Conversely, companies also may not undertake an on-market share repurchase within 30 days after any resale of treasury shares.
- The existing restriction on undertaking share repurchases while there is undisclosed inside information or during the one-month period preceding any results announcement shall also apply to resales of treasury shares.
- Companies may not knowingly sell treasury shares on-market to a core connected person, while sales of treasury shares off-market to connected persons will be subject to the usual connected transaction rules. On-market sales of treasury shares to a connected person without knowledge will be fully exempt from the connected transaction rules.

Implications Under the Takeovers Code and SFO

Because their voting rights are suspended, treasury shares will be excluded from the calculation of voting rights under the Takeovers Code. As a result, shares repurchased and held in treasury will be treated in the same way as if the shares had been cancelled, and may result in an increase in existing shareholders' respective shareholding percentages for the purposes of the Takeovers Code. Care will therefore need to be taken to ensure that a mandatory general offer obligation is not inadvertently triggered by companies' dealings in treasury shares.

By contrast, treasury shares will remain part of a company's issued shares for the purposes of the disclosure of interests regime under Part XV of the SFO, and thus shareholding interest percentages will need to be calculated accordingly. Notably, a listed company itself will have a disclosure obligation if it holds 5% or more of its own shares as treasury shares.

The SFC is expected to issue further guidance on treasury shares in due course.

Waivers

HKEx has in recent years granted waivers from the share cancellation requirement to a number of overseas companies listing in Hong Kong, permitting them to hold treasury shares. Those companies will be required to comply with the new Listing Rules requirements after the rule amendments become effective. However, HKEx has indicated that it will consider waivers from the new rule requirements on a case-by-case basis.

HKEx To Permit Treasury Shares

Contacts

Paloma Wang

Partner / Hong Kong
852.3740.6888
paloma.wang@skadden.com

Kai Sun

Partner / Beijing
86.10.6535.5533
kai.sun@skadden.com

Anthony Pang

Counsel / Hong Kong
852.3740.4831
anthony.pang@skadden.com

Lillian Lian

Counsel / Hong Kong
852.3740.4750
lillian.lian@skadden.com

Martina To

Counsel / Hong Kong
852.3740.4776
martina.to@skadden.com