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RMB Follow-On Offerings in Hong Kong

Renminbi (**RMB**) bonds issuances have reached a record high this year in Hong Kong. A natural development from this market momentum would be offerings of equity securities in RMB (**RMB follow-on offerings**), which are expected to provide additional and popular means for Hong Kong listed companies to obtain funding in RMB. The challenges are whether and how the market and practices will develop to cope with the technical requirements in allowing trading of equity securities in a non-fully convertible currency, i.e. RMB.

The Larger Question - RMB Liquidity

In its "Update on HKEx RMB Product Developments" published on 5 September 2011 (**5-Sept Update**), The Stock Exchange of Hong Kong Limited (**Stock Exchange**) made clear that RMB follow-on offerings can be implemented by listed companies in Hong Kong. The regulatory regime should basically be no different for those follow-on offerings, e.g. placing (including top-up placing), rights issue, open offer, scrip dividend scheme, convertible bonds etc. which were carried out in Hong Kong dollars (**HKD**).

In short, the Stock Exchange is supportive of the development of a market in Hong Kong for RMB follow-on offerings. Yet, RMB is currently not a fully convertible currency. The larger question is: where does the RMB for these offerings come from?

RMB has been accumulating off-shore, in financial centres like Hong Kong where a market for trading of the currency (called CNH) exists. By the end of June 2011, RMB deposits in Hong Kong amounted to around RMB 553 billion. To ensure liquidity of RMB for the equity market, one of the solutions offered is the introduction of a RMB Equity Trading Support Facility (**TSF**) by the Stock Exchange. In short, TSF aims to serve as a back-up facility to enable investors to buy RMB-traded shares in the secondary market operated by the Stock Exchange with HKD if they do not have sufficient RMB or have difficulty in obtaining RMB from other sources. TSF is expected to be rolled out in October 2011. We have written two legal updates entitled "The New RMB Equity Trading Support Facility" and "The New RMB Equity Trading Support Facility - Update No. 1" about TSF. Certain features of TSF are still evolving and may be subject to regulatory approvals.

Sufficient RMB and a liquid pool of the currency will be a pre-requisite for the RMB follow-on offerings market to develop.

Practical Points to Note

A few major points to bear in mind when planning for RMB follow-on offerings:

- **Remitting RMB back to Mainland China**

  RMB is convertible only on current account and certain pre-approved capital account transactions. Accordingly, remittance of RMB from Hong Kong to Mainland China is not automatic and requires specific governmental approvals (in particular The People's Bank of China and State Administration of Foreign Exchange). The situation is similar to companies issuing RMB-denominated, or Dim Sum, bonds.

During his visit to Hong Kong in August 2011, Vice-Premier Li Keqiang announced a series of measures to support Hong Kong's position as an international financial centre. Seven of these measures are beneficial to the development of offshore RMB business, which include revising measures for the management of foreign investment projects to support and encourage Hong Kong enterprises to use RMB for direct investments in Mainland China, and allowing investments in Mainland China equity market by means of the RMB Qualified Foreign Institutional Investor scheme (i.e. RMB QFII).

The Ministry of Commerce of the People's Republic of China (**MOFCOM**) has solicited public comments (**MOFCOM Consultation**) on issues concerning cross-border direct investments using off-shore RMB (**RMB FDI**). One pre-requisite for these measures is that they will not pose any major impact on Mainland China's overall foreign exchange reserve or cause a drastic rise or drop in its volume. MOFOCM's proposal has mapped out the approval process for RMB FDI and projects where RMB FDI may be allowed. These projects include those with capital contribution amounting to RMB300 million or above, in sectors such as financing guarantee, leasing, small-amount loan and auction, in foreign-funded investment companies, foreign-funded venture capital investment or equity investment enterprises, and in industries subject to the government's macro control policy including cement, iron and steel, electrolytic aluminium and shipbuilding.

These measures, if implemented, are expected to provide alternative routes to remit RMB back to Mainland China.

Listed companies interested in RMB follow-on offerings are responsible for liaising with the relevant authorities in Mainland China to obtain relevant remittance approvals .

- **Creating a new trading counter for the shares involved**

  There is no requirement to create a new trading counter (i.e. issuing RMB-traded shares and obtaining a separate stock code) in order to raise RMB but it seems it would be preferable to do so. A new trading counter (and accordingly a new stock code) is needed only if the shares are to be traded in RMB in future. If only HKD-traded shares are issued, according to the 5-Sept Update, there is no need to have a new trading counter. However, listed companies planning on raising RMB on the back of HKD-traded shares will have at least the following two points to bear in mind. Firstly, added disclosure will be expected especially where investors will be putting up RMB for return in HKD-traded shares.

Secondly and more importantly, TSF, which serves as a back-up facility for purchase of RMB-traded shares as explained above, may not be available for RMB follow-on offerings if no RMB-traded shares will be issued.

- **RMB-traded shares are not a new class of shares**

  The 5-Sept Update contemplates that listed companies may offer different currency options for shareholders when paying dividends. The key is to ensure equal treatment of the different tranches of shares. HKD-traded shares and RMB-traded shares are meant to be the same class of shares and should be entitled to identical shareholders rights. The main difference should only be their respective trading arrangements. The idea is that so long as there is sufficient authorised capital and authority to issue new shares, RMB follow-on offerings should be able to be implemented in the same way as in HKD.

  Dividends: Care must be taken to effect payment of dividends in RMB and it will depend on the specific circumstances of the listed company concerned. The following factors may be relevant:

whether and how RMB is to be set as the default currency, the denomination of the share capital, any existing restriction in effecting a foreign currency dividend, and the place of incorporation etc.

Fungibility/Transferability: HKD-traded shares and RMB-traded shares should be fungible/ transferable. However, the 5-Sept Update contemplates that there may be a need to have a short period of non-transferability for the first few RMB follow-on offerings, given that market practices are still evolving. The intention, we believe, should be to avoid creating two different classes of shares. However, whether and how such non-transferability will necessitate shareholders' approval and/or amendments to constitutional documents will remain to be seen.

Currency options for dividend payment and fungibility/transferability of shares are not issues unique to the dual-counter arrangements proposed for RMB-traded shares. Indeed, listed companies with dual or multiple listings have had mechanisms in place to implement currency options for dividend payment, and transfer of shares from one market to another.

If any trading restrictions and/or arrangements are imposed on RMB-traded shares or RMB follow-on offerings, listed companies should be minded that no new class of RMB-traded shares should be created as a result.

You can download copies of the 5-Sept Update via the following link:

http://www.hkex.com.hk/eng/newsconsul/hkexnews/2011/Documents/110905news.pdf

You can download copies of the MOFCOM Consultation (in Chinese) via the following link:

http://wzs.mofcom.gov.cn/aarticle/n/201108/20110807709720.html?3400603016=680129489

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