

Corporate Finance

Changes brought by implementation of H-share full circulation

Introduction

As discussed in our previous newsletter article entitled "[Listing of a PRC Business – Red Chip or H-share?](#)" issued in July 2015, businesses in People's Republic of China ("PRC") can be listed on The Stock Exchange of Hong Kong Limited ("HKEx") as "H-shares companies" or as "red-chip companies". For "H-shares companies", the shares are divided into (i) foreign shares approved by the China Securities Regulatory Commission ("CSRC") to freely circulate in Hong Kong market; and (ii) domestic shares held by mainland investors or qualified foreign investors and which can only be transferred through to PRC entities except with approval from the CSRC.

The domestic shares, which are not freely tradeable to investors outside the PRC, create restrictions on overall liquidity of the company. For enhancing corporate governance and promoting the interaction between the financial markets of PRC and Hong Kong, CSRC has effected a significant reform in the H-shares market, turning the non-tradable domestic shares into foreign shares available for public trading on HKEx (the "**Full Circulation Scheme**").

Full Circulation Scheme

Full circulation of H-shares means that the domestic shares could be converted to H-shares and traded in the Hong Kong stock market.

On 29 December 2017, the "CSRC Pilot Programme for the Deepening Reforms on the Overseas Listing Regime with the "Full Circulation" of H Shares (中國證監會深化境外上市制度改革開展 H 股“全流通”試點)" was issued to mark the commencement of the implementation of full circulation of H-Shares. In the pilot of full circulation of H-shares launched in 2018, about 7.1 billion stock shares held by 27 shareholders of three companies, namely AviChina Industry & Technology Company Limited (Stock Code: 2357), Legend Holdings Corporation (Stock Code: 3396) and Shangdong Weigao Group Medical Polymer Company Limited (Stock Code: 1066), were approved by CSRC to be converted into H-shares and successfully listed on HKEx for trading.

In view of the successful operation of the pilot programme, CSRC promulgated the *Guidelines on Applying for "Full Circulation" of Unlisted Domestic Shares of H-shares Listed Companies* (H 股公司境內未上市股份申請“全流通”業務指引) (the "**Guidelines**") on 14

November 2019 to fully implement the Full Circulation Scheme. Further, on 31 December 2019, China Securities Depository and Clearing Corporation Limited (“**ChinaClear**”) and Shenzhen Stock Exchange jointly issued the *Implementation Rules for H-shares “Full Circulation” Business* to set out details of administrative processes, such as registration of shares and clearing settlements.

Challenges and opportunities

The long-awaited Full Circulation Scheme is expected to bring challenges and opportunities to the stock market of Hong Kong.

The full circulation of H-shares increases the incentive for PRC companies applying for IPO in Hong Kong by using the “H-share structure” as the shares held by the controlling shareholders in the PRC can be freely transferable in the HKEx after the listing of the company. According to Article 4 of the Guidelines, an unlisted enterprise which applies for an IPO on the H-shares market may submit an application for full circulation together with its IPO application.

The full circulation of H-shares can relieve the pressure and financial difficulties of controlling shareholders as the controlling shareholders can sell their shares directly or charge them as collateral in the Hong Kong stock market.

Interest of the controlling shareholders can be more aligned with foreign shareholders after the full circulation as the share price quoted in the HKEx will have a direct impact on the value of the shares held by the controlling shareholders whose domestic shares were previously not being able to trade in the HKEx.

The downside of owning onshore assets is that rules in relation to non-trade transfers apply and share pledges are subject to PRC law and regulations. There is a general prohibition of non-trade off-exchange transfers of shares unless in certain specified circumstances (i.e. transfers in the event of a succession, divorce, company dissolution or charitable donations). While a pledge over onshore H-shares is possible, the exact procedures for the creation and enforcement of such pledge will only be stipulated in further regulations to be issued by ChinaClear. Pending such further regulations, ChinaClear is only able to consider the pledge of onshore H-shares on a case-by-case basis.

Looking forward

With the implementation of the Full Circulation Scheme, the HKEx may be more attractive as an IPO location for PRC companies. Although figures show that full conversion itself might not significantly increase trading volume without the controlling shareholder selling or disposing of the domestic shares, more and more H-shares companies, such as Zhejiang

Cangnan Instrument Group Company Limited (Stock Code: 1743) and Zhongan Online P&C Insurance Co., Ltd. (Stock Code: 6060), have announced their proposed participation in the Full Circulation Scheme. It is expected that full circulation of H-shares will become a market norm in the long run.

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Important: The law and procedure on this subject are very specialised and complicated. This article is just a very general outline for reference and cannot be relied upon as legal advice in any individual case. If any advice or assistance is needed, please contact our solicitors.

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