

# Legal Commentary

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## Unveiling of the H-share “Full Circulation” Reform

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The China Securities Regulatory Commission (“**CSRC**”) has recently unveiled the H-share “full circulation” reform with the promulgation of the *Guidelines on Applying for “Full Circulation” of Unlisted Domestic Shares of H-share Listed Companies* (CSRC Circular [2019] No. 22, issued on November 14, 2019, the “**Guidelines**”) and publication on the CSRC website of official answers to questions related to the reform, the *CSRC Spokesperson’s Press Conference Q&A Regarding the Comprehensive Launch of the “Full Circulation” Reform for H-share Listed Companies* (the “**CSRC Q&A**”).

### H-share “full circulation” – a Primer

The “full circulation” of H-share listed companies has been a long-discussed topic. Prior to the pilot implementation of the reform, domestic companies listed on the H-share market could not publicly trade their domestic unlisted shares on the Hong Kong Stock Exchange, thereby restricting the overall liquidity of the companies’ shares and also, to a certain extent, causing the Hong Kong Stock Exchange to become less attractive as an IPO location for domestic companies.

Previously, during the “full circulation” pilot reform in 2017, several documents were promulgated with respect to the pilot implementation of the reform, beginning with CSRC issuing opinions on the H-share “full circulation” pilot reform, followed by China Securities Depository and Clearing Corporation Limited (“**CSDC**”) and the Shenzhen Stock Exchange promulgating the *Implementing Rules for the Pilot Reform of “Full Circulation” of Shares of H-share Listed Companies (for Trial Implementation)* and the *Guidelines for Handling Business under the Pilot Reform of “Full Circulation” of Shares of H-share Listed Companies (for Trial Implementation)*. During the pilot period, three companies were approved for “full circulation” of their shares on the H-share market, including Legend Holdings (03396.HK), China Aerospace Science and Industry Corporation (02357.HK), and Weigao Group (01066.HK).

This time, CSRC has promulgated the Guidelines to specify rules for H-share “full circulation”, marking the formal launch of the “full circulation” reform<sup>1</sup>.

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<sup>1</sup> The reform involves H-share companies that are solely listed on the Hong Kong Stock Exchange. Unlisted domestic shares of H-share companies after being converted into H-shares can be listed and traded on the Hong Kong Stock Exchange. The “full circulation” program does not apply to A+H-share listed companies.

## **Key points of H-share “full circulation”**

### **I. Shares eligible to apply for “full circulation”**

According to the Guidelines, the following types of shares of H-share listed companies or companies applying for IPO on the H-share market are eligible to apply for H-share “full circulation”: unlisted domestic shares held by domestic shareholders before an overseas public offering; unlisted domestic shares issued after an overseas public offering; unlisted shares held by foreign shareholders.

It is worth noting that after an H-share listed enterprise is approved for “full circulation”, additional shares that it issues to domestic shareholders are still regarded as domestic shares, and it is thus necessary again to apply for “full circulation” for those shares to be traded on the H-share market.

### **II. Application conditions and requirements**

According to the Guidelines, domestic shareholders of H-share listed companies may decide on the number and proportion of shares to apply for “full circulation” and entrust the enterprise to submit a “full circulation” application, provided that doing so complies with relevant laws, regulations, and state-owned asset management, foreign investment, industry supervision, and other policy requirements.

According to the CSRC Q&A, CSRC will actively and orderly advance “full circulation” reform work in accordance with laws and regulations based upon the principle of “one mature, one put forward”. Compared with the previous CSRC requirements which consisted of four basic conditions for pilot enterprises, the Guidelines greatly reduce the thresholds for applicant enterprises by no longer placing conditions on the applicant’s industry and scale, or setting enterprise approval quotas and completion deadlines. (For the trial period requirements, please refer to CSRC Spokesman Chang Depeng’s Answer to Reporter’s Questions on Issues Related to the Pilot Implementation of “Full Circulation” Reform for H-share Listed Companies; of these basic conditions, two restricted pilot enterprises as follows: the enterprise applicant must be in an industry that upholds the development concepts of innovation, coordination, green, openness, and sharing, is in line with the direction of national industrial policy development, is suitable for the national strategy of serving the real economy and supporting construction of the “Belt and Road”, must represent an excellent enterprise, the equity structure of the enterprise’s shares is relatively simple, and the market value of its existing shares is not less than HKD 1 billion).

According to the Guidelines, the H-share “full circulation” must still abide by existing restrictions on foreign investment. That is, an enterprise may apply but must comply with foreign investment ratio restrictions when determining the number and proportion of shares to apply for “full circulation” if the enterprise is in an industry subject to special administrative measures for foreign investment (negative list) in which foreign investment is restricted but not prohibited. The specific implementation of these restrictions remains to be observed.

### **III. Application timing and decision-making, examination, and approval procedures**

In terms of application timing, according to the Guidelines, an unlisted enterprise that applies for an IPO on the H-share market may submit an application for “full circulation” together with its IPO

application. This means that it is possible for an H-share listed enterprise have restrictions removed on overall liquidity of its shares at the IPO through administrative approval procedures. Enterprises that have been listed on the H-share market may separately submit an application for “full circulation” to CSRC at any time, or they may choose to submit an application together with an application for overseas refinancing based on their own circumstances.

The relevant decision-making, examination, and approval procedures for the “full circulation” program mainly include the enterprise’s internal decision-making, approval by the competent authority (if applicable), and examination and approval by CSRC:

- 1. Internal enterprise decision-making:** H-share listed enterprises or enterprises applying for an IPO on the H-share market should undertake necessary internal decision-making procedures to fully protect shareholders’ right to know and right of participation. During the pilot period, three pilot enterprises clearly specified in their articles of association the relevant procedures for “full circulation” matters, and specified that they are not subject to voting procedures for shareholders’ meetings, class meetings, and other matters.
- 2. Competent authority approval:** The H-share “full circulation” program must be carried out “in compliance with relevant laws, regulations, and state-owned asset management, foreign investment, industry supervision, and other policy requirements.” In the CSRC Q&A, the spokesperson also emphasized the procedures for obtaining advance approval from the competent authorities: financial, quasi-financial, and other companies which have requirements for the admission of shareholders should obtain the approval of the competent supervisory authorities in advance; “full circulation” applications for state-controlled enterprises and state-held shares are required to comply with the relevant regulations on supervision and management of state-owned equity.

Relevant enterprises applying for “full circulation” should, based on actual circumstances, submit supervisory opinions issued by the competent supervisory department (if applicable), and the government approval to the state-owned equity conditions and the conversion of state-owned shares into overseas listed shares (if applicable), according to the administrative licensing guidelines published on the official CSRC website for the *“Examination and Approval of Overseas Public Offerings and Listings of Limited Companies (Including Additional Issuances)”* (the latest version was published in July 2019).

- 3. CSRC examination and approval:** Applications for “full circulation” will be handled through CSRC administrative licensing procedures for *“Examination and Approval of Overseas Public Offerings and Listings of Limited Companies (Including Additional Issuances)”*.

#### IV. Procedures for registering “full circulation” shares

Subject to the needs of cross-border securities market supervision, “full circulation” shares will be registered through special cross-border share conversion registration and share registration procedures:

- 1. Cross-border share conversion registration:** After CSRC approval, CSDC will undertake the

relevant procedures to convert the fully circulated shares from unlisted domestic shares to shares eligible to be listed and traded on the Hong Kong Stock Exchange.

It is worth noting that H-share “full circulation” applications for domestic unlisted shares are irreversible. This means “full circulation” shares which have undergone cross-border share conversion registration procedures to register as overseas-listed shares cannot be converted back into unlisted domestic shares. This issue requires the special attention of H-share listed companies and their shareholders who also plan to apply for IPOs on the A-share market.

- 2. Share registration:** Shares which have completed cross-border share conversion registration will be deposited with CSDC Hong Kong Co., Ltd. (“**CSDC Hong Kong**”), which will serve as the nominee holder. The shares will then be deposited in the name of CSDC Hong Kong with Hong Kong Securities Clearing Enterprise Limited, and Hong Kong Securities Clearing Company Nominees Limited will be registered as the ultimate nominee holder of the shares in the register of shareholders of the H-share listed enterprise.

## **V. Procedures for trading shares after “full circulation”**

According to the Guidelines, domestic shareholders of an H-share listed enterprise will be able to sell the “full circulation” shares of the enterprise and purchase the Hong Kong-listed shares of the enterprise (the purchase function has not been enabled for technical reasons and will be fixed after the completion of technical system and other conditions).

Domestic shareholders of an H-share listed enterprise must authorize the enterprise to choose a domestic securities company to participate in the trading of “full circulation” shares. Specifically, the domestic shareholders will entrust a domestic securities company to submit a transaction instruction through Shenzhen Securities Communications Co., Ltd. to a Hong Kong securities company designated by the domestic securities company. The Hong Kong securities company will then trade the shares on the Hong Kong Stock Exchange in accordance with the exchange’s rules.

In addition, according to the CSRC Q&A, domestic shareholders are allowed to participate in H-share “full circulation” services through existing RMB ordinary share accounts (i.e. A-share securities accounts) without having to open new securities accounts, which differs from the pilot period where shareholders of pilot enterprises were required to open special “full circulation” accounts with CSDC for share trading.

## **Looking forward**

The unveiling of the H-share “full circulation” reform provides flexibility for improving the liquidity of company shares, and may also attract more domestic companies to consider conducting IPOs on the Hong Kong Stock Exchange without establishing an overseas structure, especially those enterprises that are unsuitable for setting up overseas structures and have difficulty in completing public offerings on the A+H share markets, and will help domestic enterprises to make better use of both domestic and overseas markets and resources for development. It remains to be observed whether offshore structure-based IPOs, a prevailing IPO model for PRC enterprises to list on the Hong Kong exchange, will be affected after

the “full circulation” reform. In the future, CSDC will join with the Shenzhen Stock Exchange to formulate implementing rules related to the “full circulation” program to stipulate the specific business mechanisms and arrangements of the reform. We will also continue watching the progress, effects, and issues regarding the “full circulation” reform.

## ***Important Announcement***

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