

## **HKEX~~x~~ GUIDANCE LETTER**

**HKEX~~x~~-GL63-13 (July 2013) (Updated in September 2013, ~~and~~ May 2014 and May 2016) – effective for applications submitted on or after 1 October 2013**

**(Updated due to withdrawal of guidance letter superseded by HKEX-GL86-16)**

<b>Subject</b>	<b>Guidance on disclosure of material non-compliance incidents in listing documents</b>
<b>Listing Rules and Regulations</b>	<b>Main Board Rules 2.03(2), 2.13(2), 3.08, 3.09 and 8.04 GEM Rules 2.06(2), 5.01, 5.02, 11.06 and 17.56(2)</b>
<b>Related Publications</b>	<b>Listing Decisions HKEX<del>x</del>-LD96-1, HKEX<del>x</del>-LD97-1, HKEX<del>x</del>-LD19-2011, HKEX<del>x</del>-LD33-2012 and HKEX<del>x</del>-LD73-2013 <b><u>Section C of Appendix 1 in Guidance Letter <u>HKEX-GL86-16</u>HKEx-GL48-13 (Updated in May 2016)</u></b></b>
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**Important note:** *This letter does not override the Listing Rules and is not a substitute for advice from qualified professional advisers. If there is any conflict or inconsistency between this letter and the Listing Rules, the Listing Rules prevail. You may consult the Listing DepartmentDivision on a confidential basis for an interpretation of the Listing Rules or this letter.*

### **1. Purpose**

- 1.1 This letter provides guidance on the disclosure of material non-compliance incidents in listing documents.
- 1.2 The Exchange expects applicants to follow this letter when preparing their listing applications. A listing document that does not follow this guidance may be considered not substantially complete as required under the Listing Rules.

### **2. Relevant Listing Rules**

- 2.1 Main Board Rule 2.03(2) (GEM Rule 2.06(2)) requires that potential investors are given sufficient information to enable them to make a properly informed assessment of an applicant.
- 2.2 Main Board Rule 2.13(2) (GEM Rule 17.56(2)) requires the information contained in a listing document to be accurate and complete in all material respects and not be misleading or deceptive. In complying with this requirement, an applicant must not, among other things, omit material facts of an unfavourable nature or fail to accord them with appropriate significance.
- 2.3 Main Board Rule 3.08 (GEM Rule 5.01) states that the Exchange expects the

directors to fulfil fiduciary duties and to have duties of skill, care and diligence to a standard at least commensurate with the standard under Hong Kong law.

- 2.4 Main Board Rule 3.09 (GEM Rule 5.02) provides that every director of a listed issuer must satisfy the Exchange that he has the character, experience and integrity and is able to demonstrate a standard of competence commensurate with his position as a director of a listed issuer.
- 2.5 Main Board Rule 8.04 (GEM Rule 11.06) requires both the applicant and its business, in the opinion of the Exchange, to be suitable for listing.

### 3. Guidance

#### *Categorisation of non-compliances (~~added~~ **Added in May 2014**)*

- 3.1 This Guidance Letter divides non-compliance incidents into three categories:
- (a) Material Impact Non-compliances: Non-compliance incidents which, individually or in the aggregate, have had or may have in the future, a material financial or operational impact on the listing applicant. For example, non-compliances giving rise to significant financial penalties or which may result in the closure of material operating facilities.
  - (b) Systemic Non-compliances: Non-compliance incidents which are not Material Impact Non-compliances, but which reflect negatively on the listing applicant's or its directors'/ senior management's ability or tendency to operate in a compliant manner. For example, repeated and/ or continuous breaches of laws<sup>1</sup>.
  - (c) Immaterial Non-compliances: Non-compliance incidents which are neither Material Impact Non-compliances nor Systemic Non-compliances.

#### *Suitability (Updated in May 2014)*

- 3.2 If non-compliance incidents are of a serious nature (for example, involving fraud or deceit by directors or senior management, systematic failure of an applicant's internal controls and/ or matters with significant financial impact on an applicant), this can translate into an issue of suitability of the directors and/ or suitability for listing of an applicant. This may result in an application being rejected or the Exchange requesting a demonstration period of compliance from the cessation of the non-compliance incident(s) to demonstrate that the rectification measures and enhanced internal control measures adopted are effective, and there is no financial impact on the applicant. The demonstration period would generally be required to be an audited period.

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<sup>1</sup> For the avoidance of doubt, non-compliance incidents which satisfy the test for being Material Impact Non-compliances and which also reflect negatively on the listing applicant's or its directors'/ senior management's ability or tendency to operate in a compliant manner, should be categorised as Material Impact Non-compliances.

*Disclosure and rectification (Updated in May 2014)*

- 3.3 Where it is determined that the non-compliance incidents do not give rise to a suitability issue, the expected level of disclosure in the listing document on the non-compliance incidents and the need for their rectification is based on their category.

Material Impact Non-compliances

- 3.4 The Exchange expects the following to be disclosed in the listing document, either in the form of a table or plain text (whichever presents the issue in a more comprehensible manner):

- (a) reasons for the non-compliance incidents, nature and extent of the breaches, corresponding risk factors, and the identity and position of the director(s)/ senior management involved in the non-compliance incidents;
- (b) whether the applicant has been or will be charged or penalised for the non-compliance incidents during the track record period and up to the latest practicable date with confirmation from the competent authorities (and legal opinions confirming the competence of the relevant authorities). If so, disclose actual or maximum penalty (including the amounts), whether the applicant has made any provision (if not, reasons for not making provision), and the potential operational and financial impact on the applicant;
- (c) enhanced internal controls to prevent their recurrence (including the identity, position, qualification and experience of the personnel who are responsible for ensuring the compliances). In the event an independent internal control expert has been separately engaged to review the internal controls<sup>2</sup>, include the identity of and the salient terms of engagement of an internal control expert and its findings and recommendations, and the applicant's timing of implementation of any of the internal control expert's recommendations (and the internal control expert's follow-up review, if any); **(Updated in September 2013)**
- (d) how and when the rectification actions were taken/ will be taken; and
- (e) the views of the directors and the sponsor(s), with basis, on whether the applicant's enhanced internal control measures are adequate and effective under Main Board Rule 3A.15(5) (GEM Rule 6A.15(5)), the suitability of the directors under Main Board Rules 3.08 and 3.09 (GEM Rules 5.01 and

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<sup>2</sup> If the internal control expert is the reporting accountants or another accounting firm, the relevant guidelines and practices of the accounting profession position an internal controls review as private advice to the directors of the applicant (and if they are party to the engagement, the sponsors). Accordingly, in such circumstances the name of the reporting accountants or other accounting firm and details of their work and findings may be prevented from being quoted or referenced in the listing document. One circumstance in which internal controls work may be referenced in the listing document is where it is practicable for the applicant and the sponsor to additionally and separately engage the reporting accountants or other accounting firm to also perform an assurance engagement in relation to internal controls.

5.02), and the applicant's suitability for listing under Main Board Rule 8.04 (GEM Rule 11.06).

- 3.5 Material Impact Non-compliances should also be highlighted in the "Summary and Highlights" section of the applicant's listing document.
- 3.6 The Exchange normally expects the rectification of all Material Impact Non-compliances to be completed before a listing. Where the Exchange accepts that certain non-compliance incidents can only be rectified within a short period after listing, the listing document should disclose a legal adviser's view, with basis, whether there is any impediment to rectify the non-compliances, and a statement that the applicant will disclose the progress of the rectification in the interim/annual reports and detailed explanation for any delay in the rectification.

#### Systemic Non-compliances

- 3.7 The Exchange expects the following to be disclosed in the listing document, either in the form of a table or plain text (whichever presents the issue in a more comprehensible manner):
- (a) the views of the directors and the sponsor(s), with basis, on whether the applicant's internal control measures are adequate and effective under Main Board Rule 3A.15(5) (GEM Rule 6A.15(5)), the suitability of the directors under Main Board Rules 3.08 and 3.09 (GEM Rules 5.01 and 5.02), and the applicant's suitability for listing under Main Board Rule 8.04 (GEM Rule 11.06); and
  - (b) the disclosures set out in paragraphs 3.4(a) to (c) above, to the extent necessary to enable investors to make an informed assessment of the applicant (i.e. where, based on the nature and circumstances of the non-compliance incidents, a disclosure set out in paragraphs 3.4(a) to (c) above would not be material to such an assessment, it does not need to be included).

- 3.8 Systemic Non-compliances should also be highlighted in the "Summary and Highlights" section of the applicant's listing document.
- 3.9 The Exchange does not require the rectification of any Systemic Non-compliances. The decision to rectify Systemic Non-compliances rests with an applicant's directors and its sponsor(s).

#### Immaterial Non-compliances

- 3.10 The Exchange does not require the disclosure of Immaterial Non-compliances nor does it require the rectification of any of such non-compliances. The decision to rectify an Immaterial Non-compliance, whether or not disclosed in the listing document, rests with an applicant's directors and its sponsor(s).

*Listing Decisions relating to specific material non-compliance incidents and Guidance Letter on suitability (Updated in May 20142016)*

- 3.11 In addition to the guidance on general disclosure of material non-compliance

incidents in this Guidance Letter, please also refer to Listing Decisions HKE~~X~~-LD96-1 (directors with past SFC disciplinary records), HKE~~X~~-LD97-1 (regulatory non-compliance record), HKE~~X~~-LD19-2011 (non-compliant bill financing), HKE~~X~~-LD33-2012 (compliance with laws applicable to pawn loan industry in the PRC) and HKE~~X~~-LD73-2013 (non-compliance with building laws) which relate to specific cases of non-compliance incidents, and [Section C of Appendix 1 in Guidance Letter ~~HKEX-GL86-16~~ ~~HKEx-GL48-13~~](#) (disclosure in the “Industry Overview” section) which relates to suitability for listing, for further guidance.

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