

HKEx LISTING DECISION

HKEx-LD33-2012 (published in July 2012) (updated in September 2013)

[\[Streamlined and incorporated into the Guide for New Listing Applicants in January 2024\]](#)

Parties	Two GEM Board listing applicants
Issue	Disclosure requirements for two applicants engaged in the pawn loan business in the People's Republic of China ("PRC")
Listing Rules and Regulations	GEM Rules 14.08(7) and 17.56(2) (Equivalent to Main Board Rules 11.07 and 2.13(2))
Decision	The applicants should ensure disclosures specific to their PRC pawn loan business were made in the listing documents

FACTS

1. The Applicants were short-term financing service providers which engaged in the pawn loan business in the PRC.
2. The pawn loan industry was strictly regulated in the PRC. Due to certain licensing restrictions, the applicants' interests in their business were operated under various contract-based arrangements, commonly referred to as Structured Contracts. There were also a number of regulatory requirements and thresholds which the Applicants had to observe and comply with on daily basis.
3. The Applicants' customer profiles were mainly individuals and small and medium enterprises who had difficulty in obtaining normal bank loans.

APPLICABLE RULES, REGULATIONS AND PRINCIPLES

4. GEM Rule 17.56(2) (Main Board Rule 2.13(2)) provides that the information contained in an issuer's document must be accurate and complete in all material respects and not be misleading or deceptive. In complying with this requirement, the issuer must not, among other things:
 - (a) omit material facts of an unfavourable nature or fail to accord them appropriate significance; and
 - (b) present favourable possibilities as certain or as more probable than is likely to be the case.
5. GEM Rule 14.08(7) (Main Board Rule 11.07) states that as an overriding principle, all listing documents must contain such particulars and information as, according to the particular nature of the issuer and the securities for which listing is sought, is necessary to enable an investor to make an informed assessment of the activities, assets and liabilities, financial position, management and prospects of the issuer and of its profits and losses and of the rights attaching to such securities.

ANALYSIS

6. The Exchange considered that the pawn loan industry in the PRC had the following characteristics :
- (a) due to existing legal restrictions concerning the industry, applicants normally used various contract-based arrangements, or Structured Contracts, to give them contractual rights to receive all economic benefits derived from and control all voting rights of the underlying PRC operating companies, without a direct or indirect equity shareholding in the underlying companies;
 - (b) the pawn loan industry was strictly regulated in the PRC;
 - (c) pawn loan providers were subject to higher credit risk and default risk than normal financial institutions because of their customer profiles, namely borrowers who could not otherwise secure normal bank loans;
 - (d) as a result of the higher credit risk and default risk, a sound internal control and risk assessment system was important to ensure proper operation of a pawn loan business and to monitor the applicant's regulatory compliance;
 - (e) an applicant's ability to recover loans and/or take possession of the collateral would have a material effect on its financial condition and operation results;
 - (f) the pawn loan business was usually financed by a combination of paid-in capital, bank loans and internally generated funds; and
 - (g) although a pawn loan operator provided loans (i.e. financial assistance) to customers in its ordinary course of business, these loans did not fall under the definition of "ordinary and usual course of business" under GEM Rule 19.04(8) (Main Board Rule 14.04(8)) (which only applies to banking companies and/or securities houses). Accordingly, the pawn loan provider had to comply with the relevant GEM Rules Chapter 19 (Main Board Rules Chapter 14) requirements after listing if the amount of a loan granted to any customer exceeded the notifiable transaction threshold. Similarly, it would also be required to observe the disclosure obligations under GEM Rules 17.15 to 17.17A (Main Board Rules 13.13 to 13.15A).

CONCLUSION

7. The Applicants should ensure that the following disclosures specific to their PRC pawn loan business were made in the listing documents so that investors would have sufficient information to arrive at an informed investment judgement :

Use of Structured Contracts

8. The Exchange had set out the standard of review on the use of Structured Contracts by listing applicants in a separate Listing Decision LD43-3. The Applicants should ensure their business arrangements and listing documents disclosures properly follow such guidance.

Compliance with laws applicable to pawn loan industry

9. The listing documents should disclose in detail:
- (a) the minimum registered capital requirements, which might vary depending on the type of collateral the Applicants accepted;
 - (b) the minimum working capital requirements, for each branch office and for the operating entity as a whole;
 - (c) how the value of pawned property was appraised;
 - (d) the maximum loan amount that might be provided on individual loans, to a single customer, and in aggregate;
 - (e) the maximum interest rate and administration fee that could be charged;
 - (f) the Applicant's sources of funding and any restriction on the type of person a pawn loan provider could borrow money from;
 - (g) any restrictions on the business activities of the pawn loan providers, e.g. whether they could accept cash deposits in any form and whether they could provide loans to borrowers without any collateral; and
 - (h) any requirement for the establishment and implementation of procedures for the safe operation of the pawn loan business, e.g. proper maintenance of written records, reporting of suspicious persons, installation of various security systems and measures.
10. The Applicants should disclose their compliance with legal requirements. For any non-compliance, the listing documents should disclose:-
- (a) details of non-compliances (such as the extent of non-compliance, frequency of breaches, the illegal income or cost saving derived);
 - (b) reasons for the non-compliance;
 - (c) actions taken to rectify the non-compliances and enhanced internal control measures to prevent re-occurrence;
 - (d) the potential impact to the Applicants as a result of the non-compliances (e.g. the maximum penalty that may be imposed, risk of uplifting or non-renewal of various licences); and
 - (e) the sponsors' view on whether the non-compliances may affect their assessment of the directors' suitability under GEM Rules 5.01 and 5.02 (Main Board Rules 3.08 and 3.09), and where material, suitability of listing of the Applicants under GEM Rule 11.06 (Main Board Rule 8.04).

Loan and customer profiles and major income streams

11. Having a clear overview of the Applicants' loan and customer profile and their major income streams was crucial for an investor to understand and assess the Applicants' business risks and profitability. Accordingly, the listing documents should disclose:
 - (a) a discussion of the number and type of customers for each category of loan, how customers were introduced to the Applicants (e.g. referral by third party, walk-in or repeat customers) and number of repeat customers;
 - (b) an analysis of loans by category (e.g. equity right pawn loans, personal property pawn loans and real estate pawn loans), and their proportion to the total loan amount;
 - (c) detailed profiles for each category of loan, such as the number and total amount of new loans, average size of loans, average loan-to-value ratios, average surety ratios, average loan repayment periods (in days), number of loans renewed and loan renewal ratios, loan impairment ratios and impairment policies etc;
 - (d) an analysis of major revenue streams (such as interest income, administrative fee income and other service or consultation income), with appropriate commentary on their fluctuation;
 - (e) the revenue model and pricing policy for each type of product and service provided, including the range of interest rates and fees charged on each type of loan and service;
 - (f) ageing analysis of loan receivables and the value of assets pledged for each ageing category, how renewed loans were recorded in the ageing analysis and their amounts, details of impairment and provisioning policies, and factors to be considered as an indication of impairment.

Risk management and internal controls

12. The Applicants should demonstrate that they had adopted sufficient measures in monitoring their risks, and disclose details in the listing documents. While the measures adopted might differ from company to company, they would normally cover areas such as:
 - (a) loan approval procedures;
 - (b) risk assessment (including both credit risk and market risk);
 - (c) legal and compliance procedures;
 - (d) anti-money laundering policies and the standards / regulations adhered to;
 - (e) collateral valuation; and
 - (f) how physical collateral was stored and the risks involved.

13. Relevant experience of responsible management and working teams should be discussed, and regular training should be provided to keep management and employees abreast of the latest market and regulatory developments. For measures relying on external professionals, the listing documents should also disclose the relevant experience of the experts and the specific work performed by them¹ (*Updated in September 2013*).

Collateral valuation

14. Listing documents should disclose how values of different types of collaterals are determined, the target loan-to-value ratio for each category of loan, the frequency of review of the collateral value and how subsequent changes in collateral value are accounted for. The Applicants should also disclose the procedures adopted to ensure the borrowers had the legal right to offer the collateral.
15. Where a third party appraiser was used, details of the engagement (such as engagement period, frequency of review, qualifications of the appraiser etc.) should also be disclosed.

Loan collection

16. The listing documents should disclose:
 - (a) loan default rates;
 - (b) details of loan collection procedures and methods, when they would be triggered and whether any part of the loan collection procedures was sub-contracted;
 - (c) where collection agents were engaged, the laws / regulations these agents were required to comply with, their terms of engagement and measures to monitor their conduct in the loan collection process should be discussed; and
 - (d) procedures for seizing the underlying collateral in the event of loan defaults, and where this had happened during the Track Record Period, details of the procedures used.

Source of funding

17. The listing documents should provide a breakdown of the sources of funds available to the Applicants during the Track Record Period, and discuss the availability of each source (with reference to the latest market developments and government policy, where appropriate). The unutilized banking facilities available for drawdown as at the latest practicable date and any non-standard loan covenants should also be discussed.

¹ In the event the external professionals are 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.

Advance to entities and notifiable transactions

18. The Applicants should disclose in their listing documents (a) a confirmation that there were procedures in place to ensure their compliance with GEM Rules Chapter 19 (Main Board Rules Chapter 14) and GEM Rules 17.15 to 17.17A (Main Board Rules 13.13 to 13.15A) after listing; and (b) if their existing loan profile had already exceeded the thresholds under those rules, the relevant details.