HKEX 香港交易所

LISTED ISSUER REGULATION NEWSLETTER

Issue 1 | November 2019

Welcome to the first issue of our new Listed Issuer Regulation Newsletter.

As Hong Kong's frontline regulator of listed companies, the Exchange has a statutory duty to ensure, so far as reasonably practicable, an orderly, informed and fair market for the trading of securities. The Listed Issuer Regulation team supervises listed companies and performs this function through the administration of the Listing Rules.

As a team we are now pleased to bring you this new semi-annual Newsletter, which will provide updates to our listed companies on the work we are doing at the Exchange. In particular, it will improve transparency on how we administer the Listing Rules. It will also update on news and provide insights and observations on listed companies' compliance, as well as highlighting matters that may assist listed companies in compliance.

In the last few years the Exchange has taken a number of significant steps to address specific patterns of behaviour identified in some listed companies. As part of this, we have conducted a holistic review of our regulation relating to listed companies, culminating in 4 separate consultations on: (1) the frameworks for cancellation of listings; (2) capital raisings; (3) adverse/ disclaimed audit opinions on financial reports; and (4) backdoor listings and continuing listing criteria. We have also reviewed the Rules to improve disclosures in corporate communication.

The changes that were introduced as a result of these consultations and Rule changes have updated and improved the listed company regulatory framework. However, we are cognizant that the corporate behaviours that have undermined market confidence in recent years were carried out by a small group of listed companies and accordingly, we have taken a targeted approach when amending the Rules. For example, in the areas of backdoor listings and continuing listing criteria, the amended Rules give the Exchange more discretion to take a purposive approach where the concerns relate to fundamental principles. And, in the areas of delisting, adverse/ disclaimed audit opinion and highly dilutive capital raisings, the amended Rules are more prescriptive and now restrict extreme actions that are clearly not in the interests of shareholders. Additionally, requirements for greater transparency on the activities of listed companies has led to better disclosures.

In our first newsletter, we report on our observations on the delisting regime and highly dilutive capital raisings one year after implementation of the amended Rules, and our efforts in targeting shell activities. This issue also highlights some new disclosure requirements applicable to all listed companies.

We hope you find this newsletter informative and insightful. We would warmly welcome any feedback on its content. Please send your thoughts and comments to listingnewsletter@hkex.com.hk.

The Exchange has commenced delisting of long suspended companies under the new delisting regime

Last year, the Exchange implemented new Rules that allow the Listing Committee to delist long suspended companies that fail to remedy regulatory issues within a time period. Under the transitional arrangement, a number of companies were given a deadline of 31 July 2019.

We are pleased to note that, since last August, eight companies successfully resolved all their regulatory issues and resumed trading. These issues involved delays in releasing audited financial results and shareholder disputes (resulting in non-functioning boards), and included one company that was suspended for more than six years. With a clear delisting deadline, the new Rules incentivize these companies to rectify issues and minimize trading suspension.

The Listing Committee has decided to delist 15[1] long suspended companies with 31 July deadlines. Some were suspended for many years and known to have serious regulatory issues including suspected fraudulent activities, accounting irregularities and management integrity. With the new delisting Rules the Exchange can delist these companies upon expiry of the deadline, rather than allowing them to remain suspended indefinitely on the Exchange.

Under the new Rules, companies must resolve all regulatory issues and comply with the Rules before the expiry of the remedial period.

The Department's role is to give guidance by post-vetting companies' announcements and responding to enquiries promptly, and confirming when companies can resume trading. Below are some helpful observations:

- Many long suspended companies did not timely publish announcements (or provided very limited information in their announcements) about their business operations and progress towards resolving regulatory issues. This is not only unhelpful for shareholders, but may also delay companies' efforts in resolving regulatory issues. For example, some companies published their financial statements (being one of the resumption guidance items) shortly before the expiry of the remedial periods and were found to operate very limited business operations. This triggered issues about compliance with Rule 13.24[2], which the companies did not address before the end of the remedial periods.

  Although suspended, companies are still required to comply with the requirements under the Listing Rules and the Securities and Future Ordinance (e.g. disclosure of inside information under Part XIVA).

[1] Ten out of these 15 cases are currently undergoing the review procedures under the Listing Rules. In two cases the decisions to delist were upheld by the Listing Review Committee and the companies were delisted in November, four months after the initial cancellation decisions were made (please see box: The new Listing Review Committee).

[2] Main Board Rule 13.24/ GEM Rule 17.26 requires a listed company to carry on a sufficient level of operations and to have sufficient assets to maintain its operations to warrant the listing of the company.

Updates should be informative to the market, and would allow the Department to review the company's resumption progress, or raise new resumption guidance on new developments (e.g. issues with insufficient operations under Rule 13.24[3]).

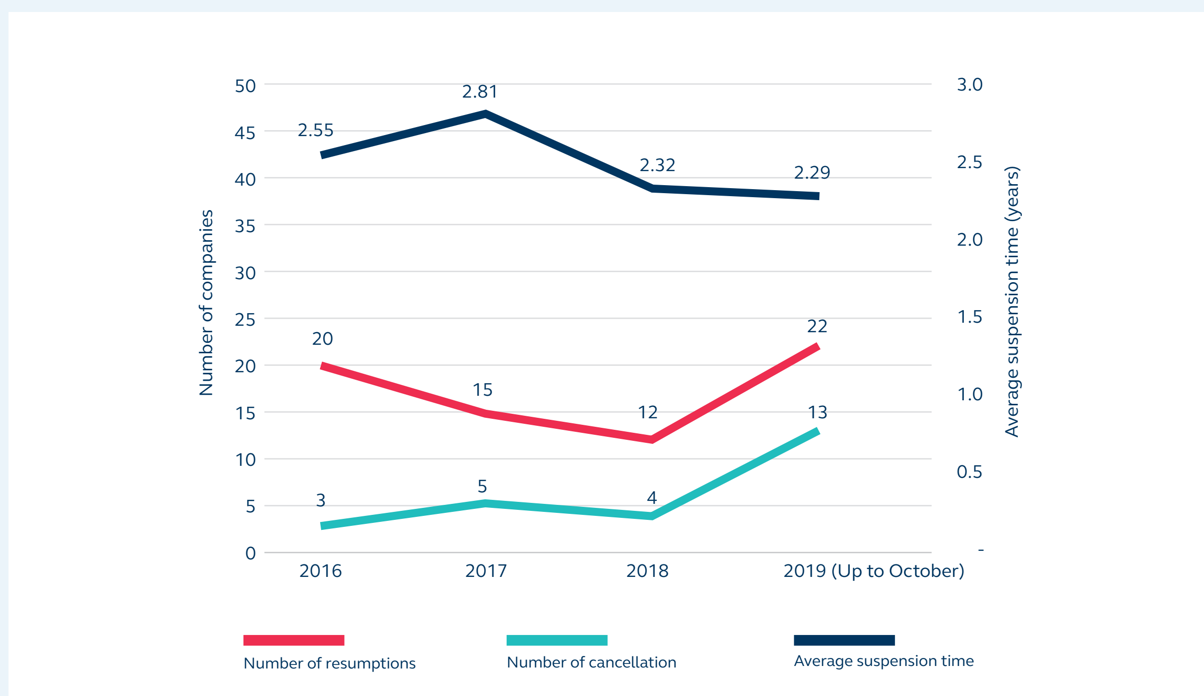
- Where a company submits a resumption request before the expiry of the remedial period, the Department will, as soon as practicable, confirm in writing to the company whether trading can resume. **The company should provide all supporting materials, for example, investigation reports and the views of the independent board committees to the Department.**

- Where a company fails to remedy issues at the end of its remedial period, the Department will recommend the Listing Committee to delist the company. If the company has made a submission in support of its resumption application, this information will be taken into account and included in the Department's report to the Listing Committee. **While the Department normally advises the company of the meeting date as a matter of courtesy, this is not a hearing and does not require attendance by the company.**

[3] GEM Rule 17.26.

We received a number of requests shortly before 31 July for extension of the deadline for companies to identify white knights, to propose or to implement resumption plans. Our Guidance Letter GL95-18 explained that extensions would only be granted in exceptional circumstances where the delays were due to factors outside the control of the company. Those requests were not granted by the Listing Committee.

The chart below illustrates the positive effects of the new regime: there were increases in the number of resumptions and delisting of companies in 2019, and a shorter average suspension period of companies currently suspended.



The new Listing Review Committee

The Exchange has amended its Rules on the listing review process. Listing cancellations decided by the Listing Committee on or after 6 July 2019 are now subject to only one level of review by a newly formed Listing Review Committee, separate and distinct from the Listing Committee.

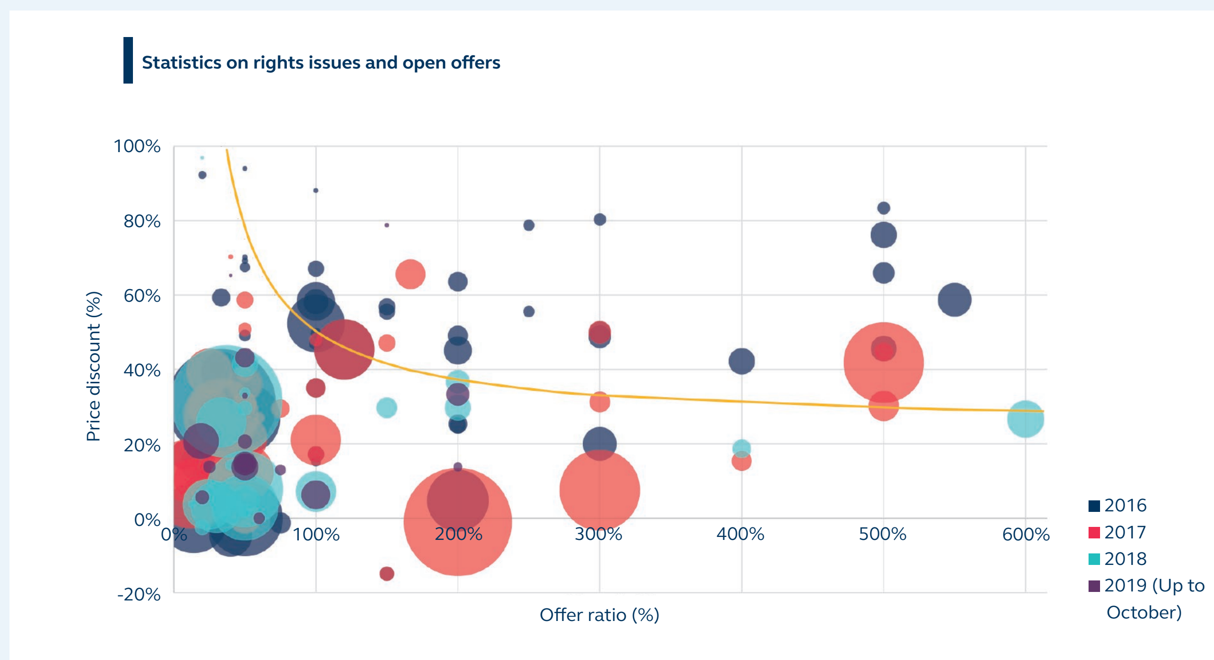
At a review hearing before the Listing Review Committee, the company has the right to make written submissions, to attend the hearing and to be accompanied by its professional advisers. At the hearing the Committee may ask questions and seek clarifications on specific matters.

A review hearing takes the form of a hearing de novo.

The Exchange has curtailed highly dilutive capital raisings

In July 2018, we amended the Rules on capital raisings to restrict large scale deeply discounted fundraisings, having noted issues with high shareholders' dilution and abusive market practices such as "downward price manipulations". Under the amended Rules we would approve highly dilutive share issuances only in exceptional circumstances, with independent shareholders' approval.

Since then, "highly dilutive" fundraisings have been curtailed as illustrated below. High dilution is defined as 25% or more value dilution, as represented by bubbles (i.e. fundraisings) above the yellow line.



Note: The above chart excludes one highly dilutive issue conducted in 2018 before the Rule amendments with offer ratio outside the boundaries of this chart.

The Exchange addresses "shell" activities with amended backdoor listing and continuing listing rules

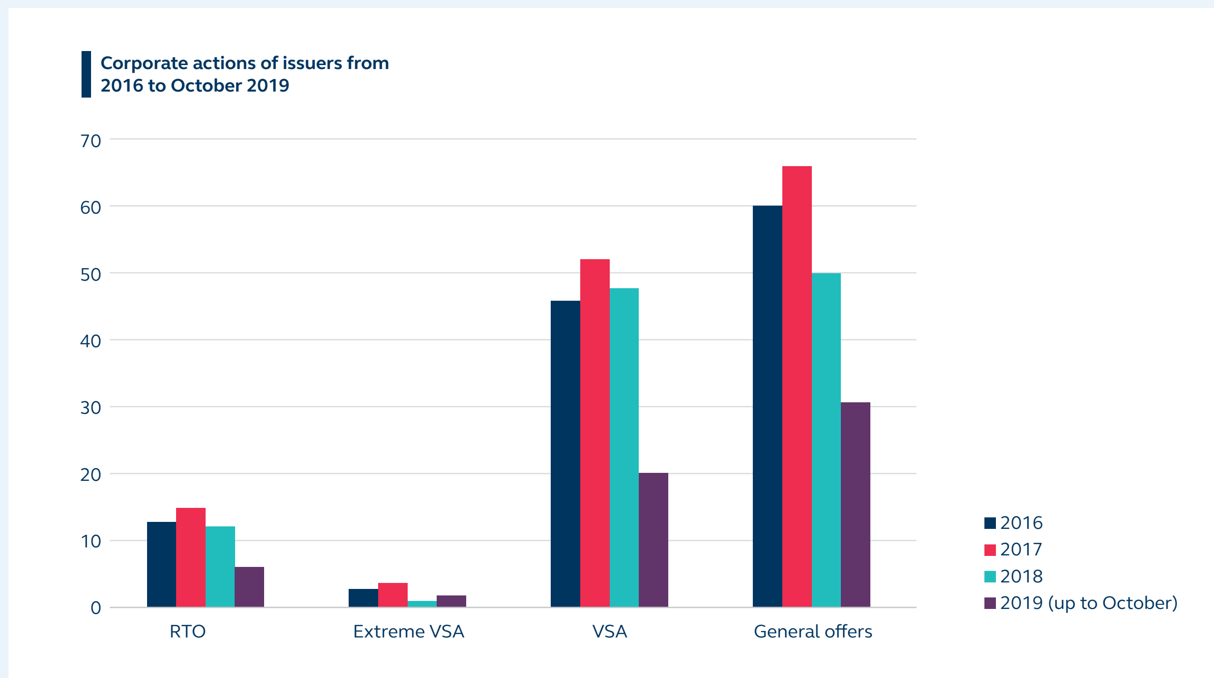
On 1 October 2019, the amended Rules on reverse takeovers (RTO) and continuing listing criteria (Rule 13.24[4]) took effect. This was the latest in our series of consultations intended to address patterns of problematic corporate behaviours of some listed companies.

We are glad to see a reduction in the number of proposed extreme VSAs, RTOs[5] and very substantial acquisitions since taking a robust approach in recent years. We also show below the number of general offers (some of which may involve trading of shell companies).

[4] References to Main Board Rule 13.24 also refer to GEM Rule 17.26.
[5] These include transactions which the Exchange ruled as RTO transactions and did not proceed.

In addition to the amendments to RTO Rules, we have also amended the continuing listing criteria to require listed companies to maintain sufficient operations and assets to support the operations to warrant their continuing listing (Rule 13.24). A small number of listed companies are found not to comply with the new Rule. These companies generally hold significant securities investments, or hold investment properties that do not generate much income.

We have written to inform these companies of our assessment. They have a transitional period up to 1 October 2020 to comply with the new Rule 13.24. For the avoidance of doubt, this transitional provision is available only to companies that have significant assets but insufficient operations.



New disclosure Rules and guidance

The Exchange has also made some recent changes to disclosure Rules **applicable to all listed companies.**

Treasury activities, securities investments and wealth management products

Under the amended Rule 14.04(1)(g)[6], listed companies buying and selling securities as part of their ordinary and usual course of business can no longer claim revenue exemption. We also withdrew listing decision LD53-2, which described a very narrow set of circumstances where securities transactions for treasury purposes were exempt from notifiable transactions requirements under the revenue exemption.

Consequently, listed companies must announce (and/or seek shareholders' approval) for securities transactions under the notifiable transaction rules in Chapter 14[7]. We continue to exempt securities transactions conducted by a member of the issuer group that is a banking company, insurance company or securities house mainly engaged in regulated activities under the SFO.

In our daily review of listed companies' transactions, we note two common pitfalls: firstly, some companies purchased wealth management products with fixed or guaranteed returns issued by financial institutions and failed to announce these transactions, having mistakenly considered these products to be similar to traditional deposits placed with banks and not constitute a "transaction". Secondly, some companies acquired similar securities and did not aggregate these acquisitions, thus failing to make the required announcements. Our FAQ 057-2019 provides guidance on aggregation of securities transactions.

Disclosure of counterparties in transactions and securities subscriptions including the beneficial owners

Under the amended Rule 14.58[8], listed companies must disclose the identity of the counterparties to a notifiable transaction in the announcement. This is in addition to pre-existing requirements to disclose their principal business activities and provide confirmation that they are not connected persons.

Where listed companies issue shares to subscribers, current Rule 13.28 requires disclosure of the identity of the subscribers (unless the number are six or more).

While the Rules set out the prescribed disclosure requirements only, **we highly encourage companies to also disclose the identity of the beneficial owners, particularly where the counterparties are investment holding vehicles.** This is because information in companies' documents must be meaningful, accurate and complete in all material respects[9]. Below are some examples where the disclosure of beneficial owners would likely be material information for investors:

[6] GEM Rule 19.04(1)(g).
[7] GEM Chapter 19.
[8] GEM Rule 19.58.
[9] See Rule 2.13/GEM Rule 17.56.

- Where there are continuing relationships with the counterparty, for example, it may continue to hold an equity interest in the acquisition target or are joint venture partners;
- Where as part of the disposal, the listed company may take back a promissory note from the counterparty;
- Where the counterparty was the founder or key management, and played a meaningful role in the historical financial performance of the acquisition targets; or
- Where the subscriber of securities (including convertible securities) would hold a material interest in the listed company, for example, where the subscription triggers disclosure of interests requirements under Part XV of the Securities and Futures Ordinance, or where the subscriber would play a strategic role in the listed company.

Overboarding of independent non-executive directors (INEDs)

From 1 January 2019, the new CG Code Provision A.5.5(2) requires that where an individual nominated to be an INED will be holding their seventh (or more) listed company directorship, the shareholders' circular for the general meeting must contain an explanation of why the board believes the individual would still be able to devote sufficient time to the board.

Up to June 2019, over 40 individuals are holding seven or more directorships in over 350 listed companies, of which over 20% proposed to re-elect those INEDs at their annual general meetings. We identified a number of companies that failed to make this disclosure in their circulars for the annual general meetings. Upon our follow up, some companies published clarification announcements to explain the boards' view. This is helpful for shareholders to understand considerations of the board in making the nominations.

However, companies that did not make the disclosure in the shareholders circulars are technically not in compliance with the CG Code Provisions. Under the "comply or explain" requirement, these companies must explain why they deviated from this disclosure requirement in subsequent interim and annual reports. This is regardless of whether they published subsequent announcements to explain their boards' view. For the avoidance of doubt, the "deviation" that should be explained is why the disclosure was not made in the shareholders' circular.

New disclosures required in annual reports

There are new disclosure requirements for companies' annual reports published on or after 1 October 2019. They include disclosure of the following:

- Details of each **securities investment that represents 5% or more of a company's total assets**, calculated based on the value of each investment as at the year end date. There should also be a discussion on the performance of each investment during the year, and a discussion of the company's investment strategy; and

- the **outcome of a guarantee on the financial performance of an acquisition target** that was subject to notifiable or connected transaction requirements previously. If there is any subsequent change to the terms of the guarantee or if the actual financial performance of the target acquired fails to meet the guarantee, the company should make such disclosure in an announcement and annual report.