

## HKEX GUIDANCE LETTER

HKEX-GL63-13 (July 2013) (Updated in September 2013, May 2014 ~~and~~, May 2016) ~~effective for applications submitted on or after 1 October 2013 and March 2019)~~

~~(Updated due to withdrawal of include relevant guidance letter superseded by from HKEX-GL86-16) LD97-1 and HKEX-LD19-2011 which have been withdrawn)~~

Subject	Guidance on disclosure of <del>material</del> non-compliance incidents in listing documents
Listing Rules <del>and Regulations</del>	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)
Related Publications	<del>Listing Decisions HKEX-LD96-1, HKEX-LD97-1, HKEX-LD19-2011, HKEX-LD33-2012 and HKEX-LD73-2013</del> <del>Section C of Appendix 1 in Guidance Letter HKEX-GL68-13 – Guidance on suitability for listing for new applicants (“GL68-13”)</del> Guidance Letter HKEX-GL86-16 <del>(Updated in May 2016)</del> <u>Guide on Producing Simplified Listing Documents Relating to Equity Securities for New Applications (“GL86-16”)</u>
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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 Department on a confidential basis for an interpretation of the Listing Rules or this letter.*

### 1. Purpose

- 1.1 This letter provides guidance on the categorisation and disclosure of ~~material~~ non-compliance incidents in listing documents. ~~-(Updated in March 2019)~~
- 1.2 The Exchange expects new applicants to follow this letter when preparing their listing applications. ~~documents~~. 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, among other things, potential investors are given sufficient information to enable them to make a properly informed assessment of an applicant. ~~issuer~~.

- 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 issuer~~ 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, among other things, 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 issuer~~ and its business, in the opinion of the Exchange, to be suitable for listing.

### 3. Guidance

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

- 3.1 This Guidance Letter ~~divides~~addresses three types of non-compliance incidents ~~into three categories:~~
- (a) Material Impact Non-compliances: Non-compliance incidents which, individually or in ~~the~~ aggregate, have had or ~~may~~are reasonably likely to have in the future, a material financial or operational impact on the ~~listing~~new 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~~their recurring nature may reflect negatively on the ~~listing~~new 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>†</sup>.~~
- ~~(c)~~ Immaterial Non-compliances: Non-compliance incidents which are neither Material ~~Impact~~ Non-compliances nor Systemic Non-compliances.

#### ~~(d)~~(c) Suitability (Updated in May 2014) March 2019)

<sup>†</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.~~

3.2 New applicants should refer to GL68-13 for relevant guidance regarding (i) a Material Non-compliance that raises concern regarding a director's competency leading to issues of his/ her suitability as a director which cannot be addressed by disclosure; and (ii) certain non-compliances that may affect a new applicant's suitability for listing under Main Board Rule 8.04 (GEM Rule 11.06). (Updated in March 2019)

#### Disclosure and rectification

3.3 New applicant should refer to paragraphs 3.4 to 3.10 below regarding the disclosure and rectification of each type of non-compliance incidents. (Updated in March 2019)

#### Material Non-compliances

~~1.1 The Exchange expects the~~ 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.

new applicant to have implemented enhanced internal control measures to prevent the recurrence of Material Non-compliances, and the

~~Disclosure and rectification (Updated in May 2014)~~

~~1.2 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

~~3.23.4 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~~non-compliance incidents, corresponding risk factors, and the identity and position of the director(s)/ senior management involved in the non-compliance incidents; (if any);
- (b) whether the new applicant has been ~~or will be charged or~~ penalised for the non-compliance incidents during the ~~track~~trading record period and up to the latest practicable date or is likely to be penalised in the future, with confirmation from the competent authorities (and a legal ~~opinions~~opinion confirming the competence of the relevant authorities). If ~~se~~applicable, disclose the actual or maximum penalty (including the amounts), ~~whether the~~

~~applicant has any provisions made any provision (if not, reasons for not making provision therefor), and the potential operational and financial impact on the new applicant; (if material);~~

- (c) ~~details of the enhanced internal controls control measures implemented to prevent their recurrence (, including when they were implemented and the identity, position, qualification and experience of the personnel who are responsible for ensuring the compliances). In the event compliance, the directors' and the sponsor(s)' view on the adequacy and effectiveness of the enhanced internal control measures and basis thereof. If an independent internal control expert has been separately engaged to review the internal controls<sup>2</sup>, included disclose the identity of and the salient terms scope of review of engagement of an the internal control expert and, its major findings and recommendations, and the new applicant's timing of implementation of any of the internal control expert's such 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 5.02), and the applicant's suitability for listing under Main Board Rule 8.04 (GEM Rule 11.06).~~

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~~1.3 Material Impact Non-compliances should also be highlighted in the "Summary and Highlights" section of the applicant's listing document.~~

- ~~(f)(d) The Exchange normally expects the rectification of all Material Impact Non-compliances to be completed fully rectified before a listing listing unless the rectification is not applicable or possible. Where the Exchange accepts that certain nonapplicable, the new applicant should disclose (1) detailed explanations on why rectification is not applicable or possible; (2) where the new applicant is able to demonstrate that Material Non-compliance incidents can only be rectified within a short period shortly after listing, the listing document should disclose a legal adviser's view, with basis, whether confirmation that there is anyno impediment to rectify the nonrectification of the Material Non-compliances, and a statement that the new applicant will disclose the progress of the rectification in the interim/ annual reports and detailed explanation for any delay in the rectification-; or (3) what and when~~

<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 new 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 new 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.

the rectification actions were taken/ will be taken;  
Systemic Non-compliances

why

~~1.4 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):~~

~~(g)(e) the views of the directors and the sponsor(s), with basis, on whether they believe the directors are suitable to act as the new 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/director under Main Board Rules 3.08 and 3.09 (GEM Rules 5.01 and 5.02), and why the new applicant's suitability is suitable for listing under Main Board Rule 8.04 (GEM Rule 11.06); and~~

~~(a) the disclosure 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 brief summary 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).~~

~~(h)(f) Systemic Non-compliances should also be highlighted in the "Summary and Highlights" section of the new applicant's listing document. with appropriate cross reference. (Updated in March 2019)~~

### 3.5 (Deleted in March 2019)

### 3.6 (Deleted in March 2019)

3.7 Material Non-compliances that involve bill financing from banks<sup>3</sup> and interest rate/loan arbitrage<sup>4</sup> that are not criminal in nature may be addressable by disclosure. The new applicant will be required to:

- (a) cease all non-compliant bill financing and for a period of at least 12 months demonstrate that its business is sustainable when it is in compliance; and
- (b) disclose in its listing document (i) the information required in paragraph 3.4 above; (ii) the amount of gains from the non-compliant bill financing; (iii) an unqualified audited financial results covering at least one complete 12-month period after the cessation of the non-compliant bill financing; and (iv) the independent internal control expert's review and conclusions at the end of a 12-month audited period on the new applicant's enhanced internal control measures indicating that there

<sup>3</sup> If the interest rate for trade financing is lower than the market interest for commercial loans, a borrower may obtain trade financing even if it is not supported by actual underlying transactions.

<sup>4</sup> For example, if the interest rate in Hong Kong is lower than that in the PRC, a borrower with an RMB deposit in a PRC bank may obtain an RMB-denominated letter of credit guaranteed by its deposit, and then use such letter of credit to pay its subsidiary in Hong Kong for fictitious purchases. The Hong Kong subsidiary then obtains this letter of credit and uses it as collateral to obtain a foreign currency loan from a Hong Kong bank.

are no major negative findings on the new applicant's internal control system during such 12-month audited period.

**(Updated in March 2019)**

### Systemic Non-compliances

3.8 The Exchange expects the new applicant to disclose information set out in paragraph 3.4 above, except that no rectification (i.e. paragraph 3.4(d)) is required. (Updated in March 2019)

**3.9 (Deleted in March 2019)**

### Immaterial Non-compliances

3.10 The Exchange does not require the disclosure or rectification of any Systemic/Immaterial Non-compliances. The (Updated in March 2019)

3.10A To be clear, the decision to rectify any Systemic or Immaterial Non-compliances compliance rests with the new applicant's directors and its sponsor(s). (Added in March 2019)

### Immaterial Non-compliances

~~4.5 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 2016) and disclosure requirements~~

~~3.33.11 In addition to the guidance on general disclosure of material non-compliance incidents in this Guidance Letter and GL86-16, please also refer to Listing Decisions HKEX-LD96-1 (directors with past SFC disciplinary records), HKEX-LD97-1 (regulatory non-compliance record), HKEX-LD19-2011 (non-compliant bill financing), HKEX-LD33-2012 (compliance with laws applicable to pawn loan industry in the PRC) and HKEX-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 (disclosure in the "Industry Overview" section) which relates to suitability for listing, GL68-13 for further guidance on suitability. (Updated in March 2019)~~

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