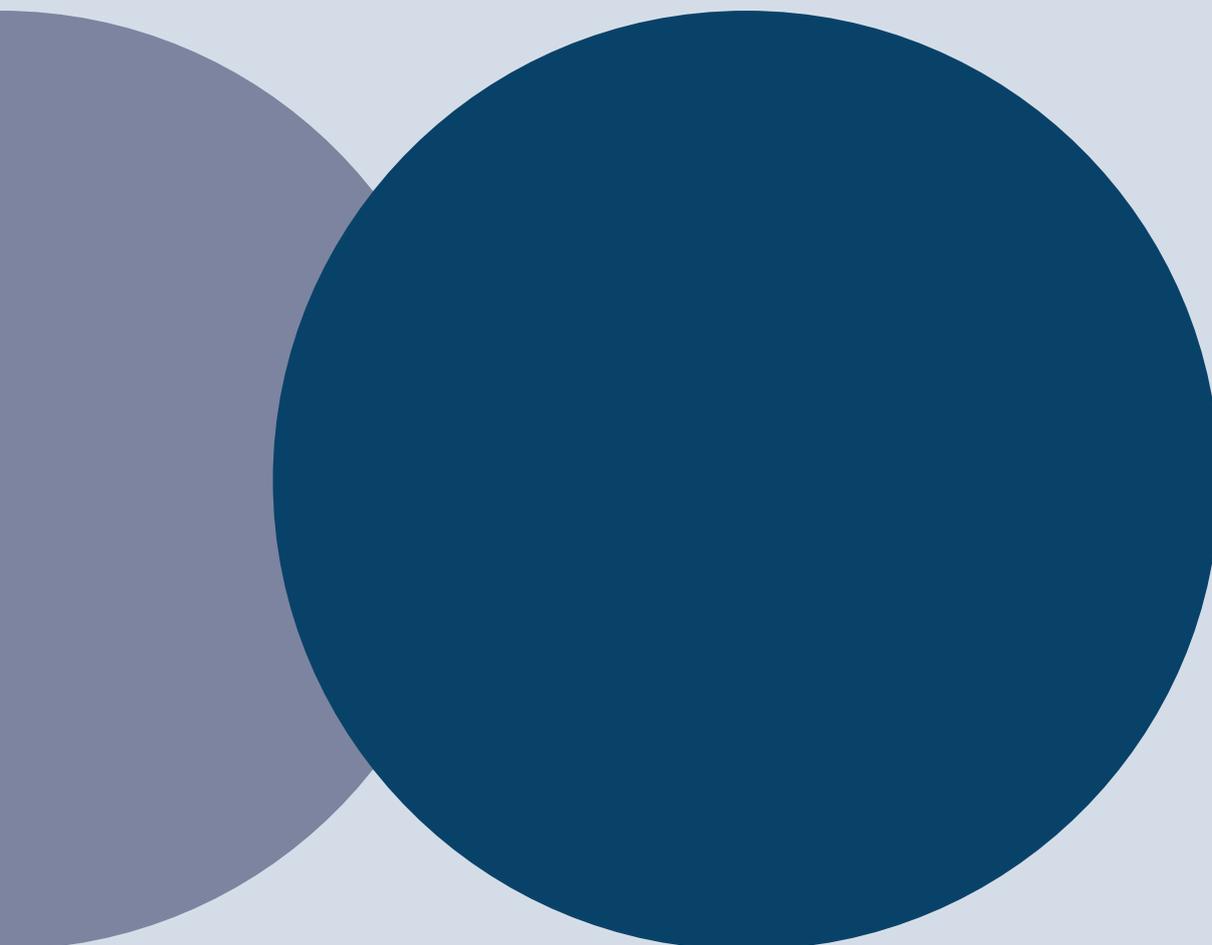


July 2019

## CONSULTATION CONCLUSIONS

### BACKDOOR LISTING, CONTINUING LISTING CRITERIA AND OTHER RULE AMENDMENTS



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## EXECUTIVE SUMMARY

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1. This paper presents the results of the Consultation Paper on Backdoor Listing, Continuing Listing Criteria and other Rule Amendments (the **Consultation Paper**) published by the Stock Exchange of Hong Kong Limited (the **Exchange**), a wholly owned subsidiary of Hong Kong Exchanges and Clearing Limited (**HKEX**), on its proposed amendments to the Rules on backdoor listing and continuing listing criteria and other Rule amendments.

### **Background**

2. The purpose of the Consultation Paper was to consider whether the Rules on backdoor listing (the **RTO Rules**) and continuing listing criteria should be amended. In recent years, the prevalence of backdoor listing has resulted in a substantial increase in the value of a listing status, leading to extensive activities related to investors acquiring control of listed issuers for their listing status (rather than the underlying business) with a view to backdoor listings, and listed issuers undertaking corporate actions, such as disposals of businesses, to facilitate the sale of the listed shells. These shell activities can invite speculative trading and lead to opportunities for market manipulation, insider trading, and undermine investors' confidence in our market. The proposals to amend the RTO Rules and continuing listing criteria were intended to improve the regulation of shell activities in light of these concerns.
3. We received a total of 121 responses from a broad range of stakeholders. Respondents were supportive of our initiatives to address backdoor listing and shell activities, however, some respondents provided substantial comments and raised concerns on specific RTO proposals. These concerns were mainly focused on the possible interpretation of the RTO proposals to apply to normal business activities. Some considered that smaller issuers would be particularly affected, as the proposals would present more hurdles when they undertake M&A activities. For issuers whose businesses were underperforming or in sunset industries, they considered the proposals would make it difficult for these issuers to conduct acquisitions to turnaround their businesses. Some respondents were also concerned that certain proposals would give the Exchange too much discretion, leading to regulatory uncertainty.

## Comments raised on specific proposals

4. Under the RTO proposals, the Exchange would make a RTO assessment with reference to factors including whether a listed issuer had undergone a fundamental change of its business, for example, through making acquisitions in a new line of business, disposing of or terminating its original business, and/or introducing new significant shareholders and equity fund raisings. Some respondents considered that the assessment factors could cover a wide range of corporate actions and where companies undertook these actions as part of their business development, they could be ruled as a RTO. They considered business diversification to be a common strategy to achieve business growth in today's business environment. They were also of the view that the current economic climate presents significant political and economic uncertainties, and coupled with technological changes that are transforming many industries, issuers must maintain flexibility and be ready to respond to changes in their industries and the environment.
5. Some respondents were concerned that smaller issuers would be particularly restricted in their M&A activities, and for issuers whose businesses were underperforming or in sunset industries, they might be restricted from conducting acquisitions to turnaround their businesses. The respondents considered that corporate actions to divest the loss making businesses or to diversify into new businesses would fall under, and be restricted by, the "series of transactions and/or arrangements" factor in the RTO Rules. Furthermore, the proposed 36-month assessment period was too long and would further restrict issuers' flexibilities. Where issuers entered into RTO transactions, the proposals would also: (i) exclude smaller issuers from the less rigorous extreme transaction category; and (ii) subject Rule 13.24 issuers<sup>1</sup> to more stringent RTO requirements, increasing the compliance burdens and costs for these issuers.
6. Some respondents were also concerned about regulatory uncertainty as they considered the assessment factors (particularly, the "series of transactions and/or arrangements" factor) in the principle based test to be too wide and discretionary. Further, some respondents considered the proposed "pre-ordained strategy"<sup>2</sup> approach to be unfair as it suggested a presumption that all aborted transactions would amount to a pre-ordained strategy to circumvent the new listing requirement.

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<sup>1</sup> Rule 13.24 is a continuing listing criterion and requires an issuer to have sufficient operations and/or assets of sufficient value to warrant its continued listing. Rule 13.24 issuer generally describes an issuer that does not meet the Rule 13.24 requirements. See proposal B(1) for details.

<sup>2</sup> Under the proposal, where the issuer aborts a transaction (the last in a series) after the Exchange's RTO ruling, the Exchange may impose additional requirements on the completed transactions if it considers them to form a pre-ordained strategy to circumvent the new listing requirements.

## Our Responses

7. The current RTO Rules define a RTO transaction to be an acquisition (or series of acquisitions) of assets which constitutes an attempt to achieve a listing of the assets *and* a means to circumvent the new listing requirements. This is a purposive rather than prescriptive test, and in assessing whether a transaction falls into the RTO Rules, the Exchange would consider the six assessment factors set out in the current RTO Guidance Letter [GL78-14](#).
8. In the Consultation Paper, the Exchange proposed to codify the six assessment factors, and to modify two factors (the “series of transactions and/or arrangements” and the “change in control or de facto control”) in light of the rationale for the proposed RTO Rule changes, which was to address *circumstances involving shell activities where there is a concern about circumvention of the new listing requirements*. The Consultation Paper also cited extensive examples where the Exchange considered certain transactions to be part of issuers’ shell activities, based on our experience reviewing these transactions in recent years.
9. We note that the respondents’ concerns may be heightened by the discussions in the Consultation Paper and certain proposals to deal with egregious cases which may give the impression that the proposed RTO Rules may be applied extensively. We acknowledge these concerns and reiterate that the RTO Rules are anti-avoidance provisions and as such, some flexibility must be provided to the Exchange. At the same time, we are minded to exercise the Rules purposively to address shell activities in the context of *acquisitions to achieve a circumvention of new listing requirements*. We will modify the RTO Rules and guidance materials and where applicable, provide examples to reflect this.
10. We also reiterate that the RTO Rules are not intended to restrict legitimate business activities of listed issuers, including business expansion or diversification that is part of the issuer’s business strategies related to its existing business, or is consistent with the issuer’s size and resources.
11. Major modifications to the RTO proposals and clarifications are highlighted below:
  - (a) *Clarify the objective of the RTO Rules: We seek to apply the RTO Rules to address shell activities involving recent backdoor structures. The six assessment factors described in the principle based test of the RTO Rules provide guidance to the market on the factors that the Exchange normally considers in assessing whether the acquisitions involve an attempt to achieve a listing of the acquisition targets and a circumvention of the new listing requirements.*

In our experience, shell activities often involve a new investor acquiring a listed issuer as its listing platform and using that issuer to operate a new business. Accordingly, in addressing shell activities, the Exchange will give particular regard to the assessment factors: (i) change in control or de facto control of the issuer; and (ii) fundamental change in the issuer's principal business (see proposal A(2)).

- (b) *Amend the “series of transactions and/or arrangements” factor under the RTO Rules:* To address concerns about regulatory uncertainties and the possible application of the RTO Rules to transactions in an issuer's normal course of business, we will remove references to greenfield operations, equity fundraisings and termination of businesses from the “series of transactions and/or arrangements” factor.

As explained in the Consultation Paper, the Exchange noted “shell activities” whereby an investor acquires control of an issuer and achieves a new listing of new businesses through the above mentioned activities, thereby circumventing the new listing requirements. Where these activities do not involve acquisitions the RTO Rules (proposed Rule 14.06B) would not apply. In those circumstances the Exchange may apply Rule 2.04 to impose additional requirements, or Rule 13.24 (requiring sufficient operations) or Rule 6.01(4) (suitability for continued listing) to address shell activities (see proposal A(3)).

We have considered, and decided not to amend the proposed 36-month period given that, in recent years, some issuers attempted to circumvent the RTO Rules through a series of activities that took place over a period of more than 24 months (being the period recommended by respondents). We also consider that the amendments above would alleviate respondents' concerns about the extent of the application of the RTO Rules.

- (c) *Revise the additional requirements for RTOs undertaken by Rule 13.24 issuers:* In the Consultation Paper, we proposed additional requirements on RTOs by Rule 13.24 issuers and required both (i) the acquisition targets and (ii) the enlarged group to meet all new listing requirements under Chapter 8. We will remove the proposed requirement for the enlarged group to meet Rule 8.05 to address respondents' concerns that Rule 13.24 issuers with substantial historical losses cannot conduct RTO transactions, unless the acquisition targets have significant profit track record to cover those losses (see proposal A(6)(a)).
- (d) *Remove the “pre-ordained” strategy on aborted transactions:* As explained in the Consultation Paper, this referred to cases where the Exchange would consider the series of transactions to be a circumvention of the new listing requirements. In light of market concerns, we will not adopt this approach (see proposal A(3)).

- (e) *Modify the eligibility requirements for extreme transactions:* To address concerns that the proposed eligibility requirements<sup>3</sup> would be prejudicial against smaller issuers, we will modify the requirements such that an issuer may use the extreme transaction category if it has been under the control or de facto control of the same person for a long period (normally not less than three years) prior to the proposed transaction, where the proposed transaction would not result in a change in control or de facto control (see proposal A(5)).

### **Proposals on continued listing criteria**

12. We also consulted on proposals to amend the current Rule 13.24 (requiring issuers to maintain sufficient operations and/or assets of sufficient value) and Rules 14.82 and 14.83 (restrictions on cash companies) to address shell activities. The proposals would restrict issuers that have disposed of or otherwise wound down their principal businesses to maintain their listing status through, among others, holding securities investments, or maintaining a portfolio of assets.
13. Respondents supported our proposals. Some respondents raised specific comments which are discussed in Chapter 3. In response to their comments, we have modified the proposals to provide exemptions for members of an issuer's group that are banking companies, insurance companies and/or securities houses that are subject to supervision by other regulatory authorities (see proposals B(2) and C(2)).
14. Appendix I sets out a summary of the conclusions on the proposals. Appendix II sets out a summary result of our quantitative analysis of responses. The amended Main Board Rules and GEM Rules are set out in Appendix III. We provide clarifications and guidance on the application of the amended Rules through new Guidance Letters set out in Appendix IV. Appendix V contains the list of respondents.
15. The Rule amendments will take effect from 1 October 2019.
16. A transitional period of 12 months from the effective date of the Rule amendments (i.e. 1 October 2019) will apply to listed issuers that do not comply with the new Rule 13.24 or Rule 14.82 (see Chapter 3 of this paper) strictly as a result of the Rule amendments. This transitional arrangement will minimize the impact of the Rule amendments on those issuers by allowing them a 12-month period to comply with the Rules as amended. For the avoidance of doubt, the transitional arrangement will not apply to issuers that do not comply with the current requirements under Rule 13.24 or 14.82, or become non-compliant with the new Rule 13.24 or 14.82 after the effective date of the Rule amendments.

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<sup>3</sup> See paragraph 109 for the original proposal.

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## CHAPTER 1 : INTRODUCTION

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### Background

17. On 29 June 2018, the Exchange published the Consultation Paper.
18. The purpose of the consultation was to consider whether the Rules on backdoor listing and continuing listing criteria should be amended. The proposals were intended to address specific concerns about patterns of problematic corporate behavior of some listed companies, with a view towards maintaining the reputation of our market and quality of listed companies. There were also proposals to enhance the Rule requirements in various areas, including securities transactions, significant distribution in specie of unlisted assets and notifiable or connected transactions.
19. The consultation period ended on 31 August 2018.

### Number of responses and nature of respondents

20. We received 121 responses from a broad range of respondents. Of them, 68 responses were entirely identical, in content, to other responses and were not counted. A list of respondents (other than those who requested anonymity) is set out in Appendix V. Except for three respondents who requested the Exchange not to publish their submissions, the full texts of all the [submissions](#) are available on the HKEX website.

Table 1: Number and percentage of responses by category

| Respondent Category                                | No. of responses | Percentage of responses |
|--|------------------|-------------------------|
| <b>INSTITUTIONS</b>                                |                  |                         |
| <b>Listed issuers</b>                              | <b>9</b>         | <b>17%</b>              |
| <b>Professional bodies / industry associations</b> | <b>7</b>         | <b>13%</b>              |
| <b>Market practitioners</b>                        | <b>21</b>        | <b>39%</b>              |
| Accounting firm                                    | 1                | 2%                      |
| Law firms  | 7                | 13%                     |
| Corporate finance firms                            | 10               | 19%                     |
| Investment management firms                        | 3                | 5%                      |
| <b>Other entities</b>                              | <b>2</b>         | <b>4%</b>               |
| <b>INDIVIDUALS</b>                                 |                  |                         |
| <b>Listed company staff</b>                        | <b>1</b>         | <b>2%</b>               |
| <b>Corporate finance staff</b>                     | <b>3</b>         | <b>6%</b>               |
| <b>Investment management staff</b>                 | <b>2</b>         | <b>4%</b>               |
| <b>Lawyers</b>                                     | <b>2</b>         | <b>4%</b>               |
| <b>Individual investors</b>                        | <b>2</b>         | <b>4%</b>               |
| <b>HKEX participant staff</b>                      | <b>1</b>         | <b>2%</b>               |
| <b>None of the above</b>                           | <b>3</b>         | <b>5%</b>               |
| <b>Total</b>                                       | <b>53</b>        | <b>100%</b>             |

21. Chapters 2 to 4 summarises the major comments, our responses and conclusions.

### **Summary of Proposals and Modifications to the Proposals**

22. Our proposals as set out in the Consultation Paper are described below. We also set out modifications to the proposed Rule amendments, where applicable, in italics below. Please also refer to Chapters 2 to 4 for details.

#### ***Proposals relating to Backdoor Listing***

##### **A. Amend the RTO Rules:**

- A(1) Retain the principle based test in the RTO Rules (proposed Rule 14.06B) and codify the six assessment factors currently set out in Guidance Letter [GL78-14](#) (with modifications set out in **Proposals A(2) and A(3)** below);

- A(2) extend the current factor “issue of restricted convertible securities” in the principle based test to include any change in control or de facto control of the issuer;

*We will modify the indicative factors for assessing any change in control or de facto control as follows: (i) a change in controlling shareholder of the issuer; or (ii) a change in the single largest substantial shareholder who is able to exercise effective control over the issuer as indicated by factors such as a substantial change to its board of directors and/or senior management.*

- A(3) clarify in the “series of transactions and/or arrangements” factor:

- (a) transactions and/or arrangements (completed or proposed) may be considered to form a series if they are in reasonable proximity or are otherwise related. The Exchange will not normally consider a transaction or arrangement outside a 36-month period as part of the series; and

*We will remove references to greenfield operations, equity fundraisings and termination of businesses from the “series of transactions and/or arrangements” factor, and modify the size test which compares the size of the new business with the original business in assessing whether the series of transactions would give rise to a fundamental change in business in the new RTO Guidance Letter.*

- (b) for the purpose of the RTO Rules, the series of transactions and/or arrangements (completed or proposed) would be treated as if it were one transaction; consequently, it is no longer required for the proposed (last) transaction to be an acquisition to trigger the RTO Rules;

A(4) retain and modify the bright line tests under current Rule 14.06(6) and current Rules 14.92 and 14.93:

- (a) retain the bright line tests under current Rules 14.06(6)(a) and (b) in a Note to the new Rule 14.06B; and extend the aggregation period from 24 months to 36 months;
- (b) modify current Rules 14.92 and 14.93 (proposed Rule 14.06E) to restrict any material disposal (or a disposal by way of distribution in specie that amounts to a material disposal) of an issuer's existing business at the time of or within 36 months after a change in control, unless (i) its remaining business or (ii) the asset(s) acquired from the new controlling shareholder (and his/her/its associates) and any other person(s), would meet the requirements under Rule 8.05 (or Rule 8.05A or 8.05B); and

*We will modify the Rule to apply to a series of disposals (and not just a single disposal) and also make other drafting changes.*

- (c) provide the Exchange with a discretion to apply proposed Rule 14.06E to a material disposal (or a disposal by way of distribution in specie that amounts to a material disposal) of an issuer's existing business at the time of or within 36 months after a change in the single largest substantial shareholder of the issuer;

*We will modify the Rule to clarify that the Exchange will make reference to the "change in control or de facto control" factor when applying its discretion, and also make other drafting changes.*

A(5) codify the current "extreme VSA" requirements (proposed Rule 14.06C):

- (a) codify the current "extreme VSA" requirements in Guidance Letter [GL78-14](#) into the Rules, and rename this category of transaction as "extreme transaction"; and

- (b) impose additional requirements on issuers that may use the extreme transaction category: (i) the issuer has been operating a principal business with substantial size which will continue after the transaction; or (ii) the issuer has been under the control of a large business enterprise for a long period (normally not less than three years) and the transaction forms part of a business restructuring of the group and would not result in a change in control;

*We will modify requirement (ii) such that an issuer may use the extreme transaction category if it has been under the control or de facto control of the same person (or group of persons) for a long period (normally not less than 36 months) prior to the proposed transaction, and that the proposed transaction would not result in a change in control or de facto control.*

- A(6) impose additional requirements applicable to transactions classified as RTOs and extreme transactions:

- (a) impose an additional requirement that both the acquisition target(s) and the enlarged group must be suitable for listing (Rule 8.04), and the acquisition target(s) must meet Rule 8.05 (or Rule 8.05A or 8.05B). For an issuer that has failed to comply with Rule 13.24, each of the acquisition target(s) and the enlarged group must meet all the new listing requirements in Chapter 8;

*For an issuer that has failed to comply with Rule 13.24, we will remove the requirement for the enlarged group to meet Rule 8.05, and will require the acquisition targets to meet Rule 8.04 (suitability for listing), Rule 8.05 (or Rule 8.05A or 8.05B) (track record requirements) and Rule 8.07 (sufficient public interest).*

- (b) introduce a new Rule 14.57A to clarify the applicable track record period and the requirements for pro forma income statement of the acquisition targets in an extreme transaction or a RTO that involves a series of transactions and/or arrangements; and

*We will modify the requirement to require issuers to submit financial information of the acquisition targets based on accountants' reports or audited financial information to the Exchange to demonstrate compliance with Rule 8.05.*

- A(7) add a new Rule 14.06D to codify, with modification, the practice set out in Guidance Letter [GL84-15](#) to regulate backdoor listings through large scale issue of securities.

*We will modify proposed Rule 14.06D to clarify that it applies to equity fundraisings that involve a change in control or de facto control of the issuer to align with the intention of Guidance Letter [GL84-15](#), and also make other drafting changes.*

### **Proposals relating to Continuing Listing Criteria**

#### **B. Amend Rule 13.24:**

- B(1) Amend Rule 13.24 to make it clear that a listed issuer must carry out a business with a sufficient level of operations and have assets of sufficient value to support its operations to warrant its continued listing; and amend the Note to Rule 13.24 to provide guidance on the operation of the Rule; and

*We will modify the Note to Rule 13.24 to clarify that the onus is upon the issuer to provide information for the Exchange's assessment on its compliance with Rule 13.24 (rather than to demonstrate that it is in compliance with the Rule as set out in the proposal).*

- B(2) exclude an issuer's trading and/or investment in securities (other than an investment company listed under Chapter 21) when considering the sufficiency of the issuer's operations and assets under Rule 13.24.

*We will amend the Rule to also exempt trading and/or investment in securities by a member of an issuer's group that is a banking company; an insurance company; or a securities house that is mainly engaged in regulated activities under the SFO. We will also amend the Rule to clarify that the Rule would apply to an issuer's "proprietary" trading and/or investment in securities.*

#### **C. Amend the cash company Rules (Rules 14.82 to 14.84):**

- C(1) Extend the definition of short-dated securities in the cash company Rules (Rule 14.82) to cover investments that are easily convertible into cash and rename it as "short-term investments"; and

*We will amend the proposed Note to Rule 14.82 to clarify the purpose of the Rule and that the scope of short-term investments includes securities that are held by the issuer for investment or trading purposes and are readily realisable or convertible into cash. Reference to the issuer's intention is removed.*

- C(2) amend Rule 14.83 to confine the exemption to clients' assets relating to the issuer's securities brokerage business.

*We will amend the Rule to also exempt cash and short-term investments held by a member of an issuer's group that is a banking company, an insurance company or a securities house that is subject to supervision by other regulatory authorities. The exemption will not apply to an issuer that operates a securities house where the Exchange has concerns that the issuer is holding cash and short-term investments through the member to circumvent Rule 14.82. Consequential changes to Rule 8.05C will also be made.*

### **Other proposed Rule amendments**

#### **D. Proposals relating to securities transactions:**

- D(1) Confine the revenue exemption from the notifiable transaction requirements for purchases and sales of securities to cases where they are conducted by banking companies, insurance companies and securities houses within the listed issuers' group;

*We will modify the Rule to clarify that in the case of a member which is a securities house, the exemption will be available only if such member is mainly engaged in regulated activities under the SFO.*

- D(2) add a specific requirement for issuers to disclose in their annual reports details of each securities investment that represents 5% or more of their total assets.

*We will modify the proposed Rule to clarify that the proposed Rule is an additional disclosure requirement and the 5% threshold is based on the issuer's investments in each investee company as at the end of the reporting period.*

- E. Codify Listing Decision [LD75-4](#) to impose additional requirements where an issuer proposes a significant distribution in specie of unlisted assets comparable to requirements for a withdrawal of listing.

#### **F. Proposals relating to notifiable or connected transactions:**

- F(1) Require (i) disclosure on the outcome of any guarantee on the financial performance of an acquisition target that is subject to the notifiable or connected transaction requirements (irrespective of whether the guaranteed financial performance is met) in the next annual report; and (ii) disclosure by way of an announcement if (a) there is any subsequent change to the terms of the guarantee; or (b) the actual financial performance of the target acquired fails to meet the guarantee (currently required for a connected transaction only);

- F(2) require (i) disclosure on the identities of the parties to a transaction in the announcements and circulars of notifiable transactions; and (ii) disclosure on the identities and activities of the parties to the transaction and of their ultimate beneficial owners in the announcements of connected transactions; and
- F(3) amend the Rules to make it clear that where any calculation of the percentage ratios produces an anomalous result or is inappropriate to the sphere of activity of the listed issuer, the Exchange (or the issuer) may apply an alternative size test that it considers appropriate to assess the materiality of a transaction under Chapter 14 or 14A.
23. The amended Listing Rules are set out in Appendix III. The [amended Rules](#) are also available on the HKEX website. They have been approved by the Board of the Exchange and the Board of the Securities and Futures Commission. They will become effective on 1 October 2019.
24. We would like to express gratitude to all the respondents for their time and effort in reviewing the Consultation Paper and sharing with us their views.
25. This paper should be read in conjunction with the [Consultation Paper](#), which is posted on the HKEX website. All Rule references are to the Main Board Rules unless otherwise stated. The proposals apply equally to the GEM Rules.

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## CHAPTER 2 : MARKET FEEDBACK AND CONCLUSIONS ON PROPOSALS RELATING TO BACKDOOR LISTING

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26. In this chapter, we set out the comments received on our proposals relating to backdoor listing. We also set out our responses and conclusions.

### Market Feedback and Our Responses on Proposals

#### A. Amend the RTO Rules

- (1) **Retain the principle based test in the RTO Rules and codify the six assessment factors currently set out in Guidance Letter [GL78-14](#) (with modifications)**

#### The proposal

27. When applying the principle based test in the RTO Rules, the Exchange will consider whether an acquisition or a series of acquisitions of assets (the **acquisition targets**) constitutes an attempt to achieve the listing of the acquisition targets and a means to circumvent the new listing requirements. We currently make this assessment with reference to the six assessment factors set out in the Guidance Letter [GL78-14](#).
28. We proposed to codify the six assessment factors in a Note to the proposed Rule 14.06B (subject to modifications set out in Proposals A(2) and A(3) below). **(Question 1)**
29. These assessment factors (as modified by Proposals A(2) and A(3)) include: (i) the size of the acquisition targets relative to that of the issuer; (ii) the nature and scale of the issuer's business before the acquisition(s); (iii) any fundamental change in the issuer's principal business(es); (iv) any change in control (as defined in the Takeovers Code) or de facto control of the listed issuer; (v) the quality of the acquisition targets; and (vi) other transactions or arrangements (historical, proposed or intended) which, together with the acquisition(s), form a series of transactions and/or arrangements to list the acquisition targets.

#### Comments received

30. 57% of the respondents supported the proposal and 28% opposed. The remaining 15% did not indicate a view.
31. Those who supported the proposal generally considered that the proposal would provide more clarity and certainty to the market on the Exchange's application of the RTO Rules.

32. However, some respondents were concerned that the assessment factors were generic and subjective and it was unclear as to the principles behind the assessment factors and how they would be applied. The Exchange has wide discretion in deciding whether a proposed acquisition would be considered a RTO. This would create significant regulatory uncertainty and might hinder issuers from conducting legitimate business transactions:
- (a) Some respondents commented that the assessment factors could cover a wide range of corporate actions and any acquisition of a target business different from the issuer's principal business, even if it were for vertical or horizontal expansion, might be deemed as RTOs. The application of the assessment factors would not distinguish transactions for legitimate business expansions or diversifications from those that were intended to circumvent the new listing requirements.
  - (b) Some respondents commented that it was not clear whether the six assessment factors were to be applied conjunctively or disjunctively. For example, it appeared that the Exchange might deem an acquisition as a RTO even absent any change in control, if some other factors applied.
  - (c) Some respondents noted that the current Guidance Letter [GL78-14](#) limits the application of the principle based test to "extreme cases" only and suggested retaining this approach in guidance form or otherwise specifying situations that would normally fall outside the RTO regime. This would avoid the RTO Rules from unduly restricting legitimate business transactions.
33. Some respondents considered that codifying the assessment factors into the Rules would reduce the Exchange's flexibility to deal with abusive transactions and market developments. It would be more appropriate to retain the assessment factors in guidance form.
34. A few respondents provided other suggestions on the proposal. One respondent suggested that the Exchange should take an overall approach in applying the assessment factors, instead of focusing on any single assessment factor and another respondent suggested the Exchange to place more emphasis on certain assessment factors (such as the nature and scale of the issuer's business before the acquisition) to better reflect the objective of deterring shell activities. Another respondent suggested that in lieu of applying the RTO Rules, the Exchange should require issuers to seek minority shareholders' approval for acquisitions that deviated from their original principal business to enhance shareholders' protection.

### **Our response and conclusion**

35. As explained in the Consultation Paper, the principle based test and the assessment factors provide a framework for assessing backdoor listing. Codification of the assessment factors into the RTO Rules would provide more clarity and certainty on the application of the principle based test in deciding whether a transaction is a RTO.

36. We note the respondents' concerns that the assessment factors were generic and subjective and would give the Exchange wide discretion to deem any transactions as RTOs. This is not the intention or the purpose of the RTO Rules. As explained in our current RTO Guidance Letter [GL78-14](#), the RTO Rules are principle based, anti-avoidance provisions designed to prevent the circumvention of the new listing requirements. Our consultation aims to amend these Rules to reflect the evolving market practices, particularly in relation to the use of shell companies for backdoor listing activities. We consider that the RTO Rules remain a purposive test, and the assessment factors would provide clear guidance to the market on the factors the Exchange would normally consider in making the RTO assessment. As set out in the current RTO Guidance Letter, in applying the principle based test, the Exchange would consider the factors and whether, taken together, an acquisition (or series of acquisitions) would be considered an attempt to achieve a listing of the acquisition targets and circumvent the new listing requirements. We will clarify these points in the new RTO Guidance Letter (see Appendix IV).
37. Having considered the market responses, we will adopt the proposal to codify the assessment factors (with the modifications discussed in sections (2) and (3)) into Note 1 to the proposed Rule 14.06B.
38. We will not adopt the suggestion set out in paragraph 34 above to require minority shareholders' approval for acquisitions that deviate from the issuers' principal businesses. It does not address issues concerning backdoor listing and shell activities and is outside the scope of this consultation.
- (2) Extend the current factor "issue of restricted convertible securities" to include any change in control or de facto control of the issuer**

#### **The proposal**

39. We proposed to extend the current factor "issue of restricted convertible securities"<sup>4</sup> in the principle based test to include any change in control or de facto control of the issuer. **(Question 2)**
40. In assessing whether there is a change in de facto control of the issuer, the Exchange proposed to take into account the following indicative factors: (i) any substantial change in the issuer's board of directors and key management; (ii) any change in its single largest substantial shareholder; and (iii) any issue of restricted convertible securities<sup>5</sup> to a vendor as consideration for an acquisition.

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<sup>4</sup> As set out in the current Guidance Letter [GL78-14](#), the Exchange would take into account six assessment factors including, among others, any issue of restricted convertible securities to the vendor which would provide it with de facto control of the issuer.

<sup>5</sup> Convertible securities with a conversion restriction mechanism to avoid triggering a change in control under the Takeovers Code.

## Comments received

41. 55% of the respondents supported the proposal and 28% opposed. The remaining 17% did not indicate a view or had only provided comments.
42. Some respondents considered that the bright line tests already covered backdoor listings that involve “change in control”. It would not be necessary to include the element of “change in control or de facto control” under the principle based test.
43. Some respondents considered the proposed indicative factors to be extensive, arbitrary and highly subjective:
  - (a) *Any substantial change in the issuer’s board of directors and key management* – some considered that an issuer’s board and key management might change for a number of reasons, for example, due to change in business strategies or for business improvement, or appointment of appropriate personnel for newly acquired business. Such changes would not necessarily relate to shell activities. Furthermore, the meaning of “substantial change” is not clear, and the scope of “key management” could potentially be very extensive. This proposed factor would undermine the issuers’ ability to identify the right persons in conducting their business affairs.
  - (b) *Any change in its single largest substantial shareholder* – some considered that a change in the single largest substantial shareholder would not necessarily be indicative of a change in control. For example, a new substantial shareholder holding 10% interest might only be a passive investor. This proposed factor would restrict issuers from issuing new shares for funding or as consideration for acquisitions.
  - (c) *Restricted convertible securities* – some respondents commented that it was premature for the Exchange to conclude that there would be a change in de facto control when restricted convertible securities were issued but not yet exercised. It also contradicts the Takeovers Code, where a subscription of convertible securities is not considered to have voting powers unless the conversion right is exercised.
44. Some respondents did not agree to include “change in de facto control” under the assessment factor as the definition was unclear and inconsistent with the concept of “control” under the Takeovers Code and this would create market confusion.

45. One respondent suggested that the Exchange may instead rely on the “concert party” concept<sup>6</sup> under the Takeovers Code. Another respondent commented that a “change in the single largest substantial shareholder” could be easily circumvented or manipulated, for example, by appointing a number of nominees to hold interests (i.e. below 10%) in issuers.

### **Our response and conclusion**

46. In our experience, shell activities generally involve the acquisition by investors of a listed issuer and subsequent injection of new businesses into the issuer. Accordingly, a change in control or de facto control is a relevant factor in differentiating shell activities from legitimate transactions carried out as part of an issuer’s normal course of business, including its expansion strategies. It would also capture RTO transactions that are designed to circumvent the bright line tests.
47. We acknowledge respondents’ concerns that the indicative factor “any substantial change in the issuer’s board of directors and key management” would be too extensive, as it could cover circumstances that do not involve a change in de facto control of the listed issuer. We also note respondents’ request to clarify the meaning of “substantial change” to the board and/or key management. We consider that it would normally include a change in all or a majority of the issuer’s executive directors and/or senior management carrying executive functions. We also acknowledge that an introduction of a single largest substantial shareholder may not necessarily represent a change in control of the issuer, particularly where that shareholder is a passive investor.
48. Accordingly, we will amend the proposed indicative factors to: (i) a change in controlling shareholder of the issuer; or (ii) a change in the single largest substantial shareholder who is able to exercise effective control over the issuer as indicated by factors such as a substantial change to its board of directors and/or senior management. The reference to “key management” will be replaced with “senior management” which is consistent with other similar references in the Rules<sup>7</sup>.

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<sup>6</sup> Under the definitions of the Takeovers Code, persons acting in concert comprise persons who, pursuant to an agreement or understanding (whether formal or informal), actively cooperate to obtain or consolidate “control” (as defined in the Takeovers Code) of a company through the acquisition by any of them of voting rights of the company. Without prejudice to the general application of this definition, persons falling within each of the classes specified in the Takeovers Code will be presumed to be acting in concert with others in the same class unless the contrary is established. “Control” shall be deemed to mean a holding, or aggregate holdings, of 30% or more of the voting rights of a company, irrespective of whether that holding or holdings gives de facto control.

<sup>7</sup> Under paragraph 12 of Appendix 16 and paragraph 34 of Appendix 1B, listed issuers are required to disclose information relating to their senior management in their interim reports, annual report and listing documents.

49. We will not normally apply the “change in control or de facto control” factor if (a) the new substantial (and not controlling) shareholder is a passive investor in the issuer; or (b) there are changes in the issuer’s board of directors and/or senior management but not its controlling or single largest substantial shareholder. However, where the issuer does not have a controlling or single largest substantial shareholder, a substantial change in its board of directors and/or senior management may raise questions about whether there is a change in de facto control of the issuer.
50. We note some respondents commented that the “issue of restricted convertible securities” factor was not indicative of a change in de facto control. We clarify that this is an existing assessment criterion, and is intended to address circumvention of “control” under the Takeovers Code in the bright line tests of the RTO Rules.
51. We also note some respondents’ comments that the “change in de facto control” factor might confuse the market as it would introduce a different concept of control, compared to that under the Takeovers Code. We clarify that this assessment factor is applied only in the RTO context to identify the circumstances where there may be a backdoor listing concern. It is not a determinant of whether an issuer has “changed control” under the Takeovers Code or for other Rules purposes.
52. In response to the comment in paragraph 45 above, where there is a concern about any issuer and other parties engaging in market misconduct activities to circumvent the RTO Rules, this would be subject to regulatory investigations and law enforcement. We may also take this into consideration when applying the RTO Rules.
53. Having considered the market responses, we will adopt the proposal with modifications set out in paragraph 48 above.

- (3) Clarify the “series of transactions and/or arrangements” factor to refer to transactions and/or arrangements that are in reasonable proximity or are otherwise related and normally within a 36-month period, and that the RTO Rules may apply to transactions that were previously completed

*The “series of transactions and/or arrangements” factor (Question 3(a))*

**The proposal**

54. We proposed that, when considering whether an acquisition and other transactions or arrangements (completed or proposed) form a series, we would take into account transactions and arrangements that take place in reasonable proximity or are otherwise related. The factor is not intended to unduly restrict business expansion or diversifications by issuers that take place over a reasonable period (usually three or more years) where there would be more disclosure for shareholders and the public to assess the issuer’s business operations and developments. These transactions and arrangements may include changes in control/de facto control, acquisitions, disposals or termination of the issuers’ original businesses, and in limited circumstances (described in paragraphs 44 to 46 in the Consultation Paper)<sup>8</sup>, greenfield operations or equity fundraisings related to, or for the development of, newly acquired lines of businesses. **(Question 3(a))**
55. In this connection, the Consultation Paper provided guidance on size test calculations for a series of acquisitions:
- (a) when calculating the percentage ratios for acquisitions in a series of acquisitions, we proposed to compare: (i) the aggregate financial figures of the targets acquired or to be acquired at their respective times of acquisitions against (ii) the lower of the issuer’s relevant financial figures or market capitalization before the first transaction in the series and those at the time of the latest proposed transaction; and
  - (b) when assessing whether there is a fundamental change in principal business (in the context of a series of transactions and/or arrangements), the Exchange would compare the size of the issuer’s new businesses in aggregate with that of its original business (i.e. the business it operated before the first transaction/event in the series) at the time of the latest proposed transaction in the series, making reference to the financial figures in the most recently published accounts of the issuer and the targets.

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<sup>8</sup> In the Consultation Paper, we explained that the Exchange would consider greenfield operations, equity fundraising or multiple new businesses as part of a series of transactions or arrangements in limited circumstances, where these arrangements are related to shell activities, including the use of the listed issuer as a listing platform for new businesses or as part of shell maintenance activities.

## Comments received

56. 40% of the respondents supported the proposal and 38% opposed. The remaining 22% did not indicate a view or had only provided comments.
57. Respondents who supported the proposal generally considered that specifying a period provided more certainty and the proposed three-year period was reasonable.

*A series of transactions and/or arrangements within the 36 months period or are otherwise related*

58. A number of respondents were concerned that the proposed scope of “transactions and/or arrangements” that might fall under a “series” is too extensive and coupled with the proposed 36-month assessment period, would restrict meaningful growth or diversification of an issuer’s business:
- (a) Some respondents considered that the proposed 36-month period to be too long, as businesses today are subject to shorter business cycle in the fast-changing market environment. This is especially true for new economy companies, which may take less than three years from start-up to successful listing.
  - (b) Some respondents considered that transactions including acquisitions, disposals, greenfield operations or equity fundraisings are not necessarily shell activities, but part of an issuer’s normal business strategies. For example, where an issuer makes its first successful acquisition and intends to conduct additional acquisitions to build this business, these transactions within a three-year period may, where material, be aggregated and deemed as RTOs. Some respondents also took the view that greenfield operations and equity fundraising should be excluded from a “series” as issuers should not be unduly restricted from starting, or raising funds for, new businesses for diversification or organic growth.
  - (c) Some respondents were of the view that the performance of the original businesses of the issuers might decline and even become loss-making for various reasons. Such issuers might need to undertake corporate actions involving equity fundraisings, restructuring, terminating and/or disposing of its original businesses, acquiring new businesses, and/or starting greenfield operations which would change the principal businesses. However, under the proposal, these corporate actions might be treated as a “series” and trigger RTOs. Without undergoing these actions, issuers whose businesses are underperforming or in sunset industries might not be able to improve their business performance and financial position and hence result in more shell companies and possible delisting, which was not in the interest of minority shareholders.

59. Some respondents suggested the Exchange to adopt a 24-month period to align with the current RTO bright line tests. A few respondents suggested a 12-month period to align with the aggregation Rules for notifiable transactions<sup>9</sup>, or a 24-month period for GEM issuers to align with the IPO track record period under GEM Rules.
60. A respondent commented that the “series of transactions and/or arrangements” factor should not operate in isolation, and backdoor listing concerns could only arise where the transactions constituted circumvention of the new listing requirements. For example, where an issuer had valid grounds for a disposal (e.g. disposing of a loss-making business), such disposal should not be considered as part of a “series of transactions and/or arrangements” unless it was pre-ordained.
61. Some respondents sought clarification on the following matters:
- (a) the relevant factors for aggregating a series of transactions and/or acquisitions. For example, whether transactions with different independent third parties would be considered as a “series”; and
  - (b) what transactions and arrangements would be considered “otherwise related” and hence fall under the “series of transactions and/or arrangements” factor even where they were outside the 36-month period. A respondent considered that there should be a hard cut-off for the assessment period.

#### *Size test calculations*

62. Some respondents disagreed with the proposal to assess whether a series of transactions and/or arrangements would give rise to a fundamental change in business by comparing the size of the new business with the original business based on their latest financial figures. They considered the proposal to be contrary to how companies operated; if an issuer achieved success after diversifying into a new business, it might continue to acquire similar businesses. However, if the new business performed well and had grown in size, the proposal would restrict further acquisitions as the new business would be substantial in size compared to the original business, resulting in “a fundamental change in business” assessment under the proposal. This view would contradict normal business strategies and further, disregard the fact that post-acquisition growth in the new business should be attributed to the issuer’s current management team.

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<sup>9</sup> Rule 14.22 requires issuers to aggregate a series of transactions and treat them as if they were one transaction if they are all completed within a 12 month period *or* are otherwise related.

63. Some respondents disagreed with the size test calculations for a series of transactions and/or arrangements using the lower of the issuer's relevant financial figures or market capitalization (i) before the first transaction in the series and (ii) at the time of the latest proposed transaction. They considered it inappropriate to use the issuer's financial figures and market capitalization 36 months ago as it would disregard the improvements in the issuer's original business and financial positions over time. This was particularly the case for market capitalization as they might be affected by market conditions and other external factors outside the issuer's control.

### **Our response and conclusion**

64. As explained in the Consultation Paper, the Exchange has in recent years applied the "series of transactions and/or arrangements" factor to (i) address circumvention of the RTO requirements where issuers break up its acquisition of a new business into a series of smaller acquisitions, or acquire a new business and then dispose of its original business (resequencing transactions); and (ii) to address shell activities where investors acquire control of listed issuers and use these issuers as a listing platform to acquire new businesses that bear no relationship with their original business. In both circumstances these transactions would have the effect of fundamentally changing the nature of the issuer's principal business and circumventing the new listing requirements.
65. In the Consultation Paper, we explained that assessing those transactions and/or arrangements in totality would provide an important safeguard against circumvention of the RTO Rules. We considered that the RTO Rules should be principle based, and should provide a framework for addressing backdoor listing. At the same time, the Rules should not restrict legitimate business activities of listed issuers, including business expansion or diversification that is part of the issuer's business strategies related to its existing business, or is consistent with the issuer's size and resources.

### *A series of transactions and/or arrangements*

66. We note respondents' concerns that the proposed scope of transactions and arrangements under the "series of transactions and/or arrangements" factor is too wide and may unduly restrict legitimate business expansion or diversification or corporate rescues by issuers. To address concerns about regulatory uncertainties and the possible application of the RTO Rules to transactions in an issuer's normal course of business, we will remove references to greenfield operations, equity fundraisings and termination of businesses from the "series of transactions and/or arrangements" factor. This is consistent with the scope of the RTO Rules which applies to acquisition(s) that attempt to circumvent the new listing requirements. The discussion in the Consultation Paper was meant to refer to those arrangements in the context of shell activities designed to circumvent the new listing requirements, and not in a more general context involving normal business activities.

67. Where an issuer conducts shell activities through a series of transactions and/or arrangements involving greenfield operations, equity fundraisings, and/or termination of all or some of its original businesses and such activities are not within the scope of the RTO Rules, the Exchange may exercise its rights under Rule 2.04 to impose additional conditions, for example, requiring the issuer to comply with the RTO requirements<sup>10</sup>. The Exchange may also address shell maintenance concerns (e.g. an issuer operates multiple lines of new businesses or terminates its businesses) by applying Rule 6.01(4) (suitability for listing)<sup>11</sup> or Rule 13.24 (sufficiency of operations)<sup>12</sup>.
68. Under the “nature and scale of the issuer’s business before the acquisition” factor, the Exchange will consider the nature of the issuer’s existing business and its financial position in making a RTO assessment, for example, whether it is a “shell” company. An issuer that has wound down/disposed of its original business and moved into new businesses that can be easily discontinued (e.g. trading business or money lending business<sup>13</sup>) may suggest that the issuer is engaged in shell activities to facilitate backdoor listing. A newly listed issuer that conducted a series of arrangements (such as change in controlling shareholder, acquisitions and/or disposals) shortly after the lock-up period may also suggest shell activities.

*36-month period or are otherwise related*

69. We note respondents’ concern that the proposed 36-month period is too long and would affect legitimate business expansion or diversification. Some respondents suggested using the 24-month period as currently set out in the RTO bright line test.
70. As explained in the Consultation Paper, the current Rules and guidance materials do not provide guidance on the duration of the period applicable in assessing a series of transactions and/or arrangements. We proposed an assessment period of 36 months as guidance, having considered that business expansions or diversifications over a period longer than three years would provide shareholders more disclosures to assess the issuer’s business operations and developments.
71. We will retain this proposed assessment period of 36 months. In recent years, we have observed cases involving issuers attempting to circumvent the RTO Rules through activities that took place over a period of more than 24 months after the change in control or de facto control of the issuers concerned. A shorter period would not address these circumvention cases.

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<sup>10</sup> See Listing Decisions [LD122-2019](#) and [LD123-2019](#).

<sup>11</sup> See Guidance Letter [GL96-18](#).

<sup>12</sup> See Listing Decision [LD105-2017](#).

<sup>13</sup> See paragraph 10 of Guidance Letter [GL96-18](#) on suitability.

72. To address other comments raised by the respondents, we will clarify the following:
- (a) Aggregation will normally apply to acquisitions that are related, for example: (i) acquisitions that are part of a similar line of business, or (ii) acquisitions of interests in the same company or group of companies in stages; or (iii) acquisitions of businesses from the same or related party. Absent indication of an attempt to achieve a listing of assets and a means to circumvent the new listing requirements, acquisitions of multiple lines of businesses from different parties would not normally be aggregated in a RTO assessment.
  - (b) We will not normally consider a transaction or arrangement outside the 36-month period as part of the series, unless there is clear nexus between the transactions and/or arrangements, or where there are specific concerns about circumvention of the RTO Rules. For example:
    - (i) A transaction proposed shortly outside the 36-month period and which is likely to be under contemplation during the 36-month period.
    - (ii) Where an issuer terminated a proposed acquisition of a target business (or downsized the acquisition) in response to the Exchange's RTO ruling, the Exchange may treat further acquisition(s) of the same target business outside the 36-month period as part of a series.
    - (iii) Where an issuer acquired a new business together with an option to acquire another target business and this option is exercised more than 3 years from the original acquisition, the Exchange may consider these acquisitions as a series.
  - (c) However, we believe that it is inappropriate to set a hard cutoff for the assessment period, as this is a purposive test and the Exchange should have flexibility to address extreme cases where issuers deliberately delay a contemplated transaction until immediately after the 36-month period.

The above guidance will be included in the new RTO Guidance Letter.

### *Size test calculations*

73. We acknowledge respondents' concerns that the proposal to compare the size of the new business with the original business in assessing whether there is a fundamental change in business (set out in paragraph 55(b)) may discourage development or expansion of the new business acquired and restrict further acquisitions. We will not adopt a pure quantitative size test. However, in considering whether there is a fundamental change in business over the 36-month period, we will have regard to the size of the acquisition targets (at the time of their respective acquisitions), compared to the size of the original business (at the time of the last transaction in the series).
74. On balance, we will adopt the proposed size tests (set out in paragraph 55(a)) which measure the size of a series of transactions and/or acquisitions relative to that of the issuer as if they all took place at the time of the first transaction<sup>14</sup>. We have noted cases where issuers deliberately split a significant transaction into smaller transactions over time, and consider it appropriate to use the lower of (i) the issuer's financial figures and market capitalization before the first transaction in the series and (ii) its financial figures and market capitalization at the time of the last transaction in the series, to better reflect the effect of the transactions on the issuers. As this is a guidance only, we will consider any anomalous results case-by-case.
75. Having considered the market responses, we will adopt the proposal with modifications set out paragraphs 66 and 73 above.

### ***Applying the RTO Rules to transactions that were previously completed (Question 3(b))***

#### **The proposal**

76. We proposed to amend the current Rule 14.06(6) (or proposed Rule 14.06B) to clarify that a series of acquisitions may include proposed and/or completed acquisitions. **(Question 3(b))**
77. In the Consultation Paper, we also stated that where an issuer has aborted the latest proposed transaction in a series, and the Exchange considers that the proposed transaction, together with the series of transactions and/or arrangements previously conducted, forms a pre-ordained strategy of the issuer to circumvent the new listing requirements, it may impose additional requirements on the issuer by requiring it to engage a financial adviser to conduct due diligence and make enhanced disclosures on its completed acquisitions in the series.

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<sup>14</sup> This approach is in line with the size tests adopted for bright line tests under the current RTO Rules (Note 2 to proposed Rule 14.06B).

## **Comments received**

78. 47% of the respondents supported the proposed change to Rule 14.06(6) (or the proposed Rule 14.06B) and 34% opposed. The remaining 19% did not indicate a view or had only provided comments.
79. Some respondents considered that it would be unduly onerous or impractical to perform due diligence on completed acquisitions, particularly for the pre-acquisition periods. Some also commented that the proposed requirements would not add much benefit to shareholders as the acquired businesses were already part of the issuer's group and subject to the general disclosure and financial reporting requirements. A respondent sought clarification on how the proposed Rules would operate on completed acquisitions.
80. Some respondents disagreed to include "proposed or intended" acquisitions in a "series" as they were yet to be made. They considered that the requirement should not apply to potential acquisitions in the future.
81. A number of the respondents disagreed with imposing additional requirements in circumstances where an issuer aborted the latest proposed transaction in the series following a RTO ruling. They considered that it would be unfair to presume the aborted transaction to be part of a "pre-ordained strategy" to circumvent new listing requirements, or to require issuers to "disprove" such presumption. If this practice was to be adopted, an issuer might refrain from conducting any other acquisition in the fear that it, together with any previous acquisitions, would be deemed as a RTO. This would introduce a great degree of regulatory risk. One respondent sought to clarify that this proposal should not affect issuers that had consulted the Exchange prior to entering into a proposed transaction.

## **Our response and conclusion**

82. As a RTO is deemed to be a new listing, the disclosure and due diligence requirements would be the same as those applicable to new listings. Where a series of acquisitions amount to a RTO, the same requirements should accordingly be applied to all the acquisitions in the series that form part of the RTO transaction (including the completed acquisitions).
83. We clarify that under the proposed Rule 14.06B, "proposed or intended" acquisition refers to the current acquisition that is the subject of the announcement and not a potential acquisition that is yet to be entered into. To avoid confusion, we will remove the references to "proposed, intended and/or completed" acquisitions from the proposed Rule 14.06B. Instead we will make clear in Rule 14.04(2A) that a RTO may involve a series of acquisitions some or all of which may have been completed.

84. Respondents were concerned that our proposed approach to a terminated transaction, as set out in paragraph 81 above, would result in significant regulatory uncertainty as they considered any transaction could taint a series of completed acquisitions and deem them to be RTO, creating significant compliance burden that might be unwarranted. We note respondents' concern, and while this approach was intended for egregious cases only, in view of market concerns on the possible regulatory ambiguities we will not adopt this approach. Nonetheless, where there is a concern that the terminated transaction is part of a series of transactions or arrangements which constitute an attempt to achieve a listing of the acquisition targets and a means to circumvent new listing requirements, the Exchange may require an issuer to include a negative statement in the announcement regarding the plans and intention of the issuer and its connected persons involved in relation to possible future transactions/arrangements, where appropriate. The disclosure would provide transparency to investors, and where appropriate, the SFC may take regulatory action under the SFO and/or the Securities and Futures (Stock Market Listing) Rules.
85. Having considered the market responses, we will adopt the proposal with the modifications set out in paragraphs 83 and 84 above.

**(4) Retain and modify the bright line tests under current Rule 14.06(6) and current Rules 14.92 and 14.93**

***Retain and modify bright line tests under current Rule 14.06(6) (Questions 4(a) and 4(b))***

**The proposal**

86. We proposed to:
- (a) retain the bright line tests under Rules 14.06(6)(a) and (b) as a Note to the proposed Rule 14.06B; (**Question 4(a)**) and
  - (b) extend the aggregation period under Rule 14.06(6)(b) from 24 months to 36 months. (**Question 4(b)**)

**Comments received**

87. (Question 4(a)) 75% of the respondents supported the proposal and 8% opposed. The remaining 17% did not indicate a view.
88. (Question 4(b)) 36% of the respondents supported the proposal and 45% opposed. The remaining 19% did not indicate a view or only provided comments.

89. A large majority of the respondents agreed with the proposal to retain the bright line tests.
90. A majority of the respondents did not agree with the proposal to extend the aggregation period for very substantial acquisitions from the incoming controlling shareholders from 24 months to 36 month. The reasons they provided were similar to those discussed under paragraph 58 above.

### **Our response and conclusion**

91. In light of market support, we will retain the bright line tests in Note 2 to proposed Rule 14.06B. For the reasons discussed under paragraphs 70 and 71 above, we will adopt the proposal to extend the aggregation period for the bright line tests to 36 months to align with that under the principle based test.

### ***Retain and modify disposal restrictions under current Rules 14.92 and 14.93 (Questions 5(a) and 5(b))***

#### **The proposal**

92. We proposed to retain the bright line test to restrict disposals of existing business after a change in control under the Takeovers Code in current Rules 14.92 and 14.93, and modify the Rules to restrict any material disposal (or a disposal by way of distribution in specie that amounts to a material disposal) of an issuer's existing business at the time of or within 36 months after a change in control, unless (i) its remaining business or (ii) the asset(s) acquired from the new controlling shareholder (and its associates) and any other person(s) would meet the requirements under Rule 8.05 (or Rule 8.05A or 8.05B) (proposed Rule 14.06E). (**Question 5(a)**)
93. We also proposed to add a Note to proposed Rule 14.06E to provide the Exchange the discretion to apply proposed Rule 14.06E to a material disposal (or a disposal by way of distribution in specie that amounts to a material disposal) of an issuer's existing business within 36 months after a change in the single largest substantial shareholder of the issuer. This Note would provide similar disposal restrictions in circumstances involving a de facto change of control under the principle based test. (**Question 5(b)**)

#### **Comments received**

94. (Question 5(a)) 45% of the respondents supported the proposal and 34% opposed. The remaining 21% did not indicate a view or only provided comments.

95. (Question 5(b)) 45% of the respondents supported the proposal and 34% opposed. The remaining 21% did not indicate a view or only provided comments.
96. Some respondents considered that the restriction period should remain at 24 months, as it would be unfair to restrict disposals for a prolonged period and there might be genuine commercial reasons for material disposals, for example, disposing of non-performing asset/business to cut losses. Some also commented that the proposed restriction might conflict with the directors' fiduciary duties to act in the best interest of the issuer and its shareholders. Some respondents supporting the proposal also suggested retaining the 24-month period for similar reasons.
97. Some respondents made further comments on the proposed Rule 14.06E:
- (a) It was not necessary to extend Rule 14.92 (proposed Rule 14.06E) to *disposals at the time of the change in control*, because the Rule was to deter circumvention by deferring a disposal after an acquisition shortly following a change in control.
  - (b) A respondent commented that disposals of businesses back to the original shareholders should be allowed, as the original shareholders might often be the logical buyers of such businesses. Another respondent considered that there was no need to impose any disposal restrictions at all as issuers would be caught under Rule 13.24 if they failed to maintain sufficient level of operations upon disposal.
98. Some respondents made comments on the proposed Note to Rule 14.06E:
- (a) Some respondents opposed the Note which extended (at the Exchange's discretion) the disposal restriction to cases involving a change in the single largest substantial shareholder. They commented that a shareholder holding less than 30% interest might not exert any control over the issuer. The proposal might unduly restrict disposals that might be beneficial to the issuers.
  - (b) Some respondents commented that the Note was not necessary as, under the proposed Rule 14.06B, a change in de facto control was already proposed to be one of the assessment factors of the principle based test, as such, the disposal may be part of a series of transactions and/or transactions subject to the RTO Rules.

#### *Other comments*

99. One respondent suggested that the proposed Rule 14.06E should apply to a series of disposals (instead of a single material disposal only) to prevent circumvention of the Rule requirement.

100. A few respondents sought clarification on the proposed Rule, including the materiality threshold for a “material disposal”; the meaning of “intended change in control” and how it differed from a “proposed change in control”; and whether the general waiver<sup>15</sup> from Rule 14.92 would remain in force upon the new Rule 14.06E becoming effective.

### **Our response and conclusion**

#### *Proposed Rule 14.06E*

101. As explained in the Consultation Paper, the current Rules 14.92 and 14.93 (proposed Rule 14.06E) complement the RTO bright line tests, and discourage an issuer from disposing of its original business after the acquisition of the target asset with a view to circumventing the RTO requirements by resequencing the transaction. We consider it appropriate to retain the disposal restriction as it operates to deter resequencing of transactions to circumvent the RTO requirements, and is separate from Rule 13.24 which requires issuers to maintain sufficient operations as a continued listing requirement.
102. As regards the proposed restriction period, we will adopt a 36-month period to align with that of the RTO Rules for the reasons discussed in paragraphs 70 and 71 above.
103. The proposed Rule is not intended to restrict issuers from disposing part of their businesses or assets for commercial reasons, as the proposed modification would restrict the proposed Rule to disposal(s) of *all or a material* part of the issuer’s existing business, as opposed to any existing business of the issuer (which may operate multiple businesses) under the current Rule 14.92. In other words, the proposed Rule would not restrict an investor from acquiring the controlling interest in an issuer and subsequently conduct a business reorganization to dispose of the issuer’s non-performing business segments, provided that is not all or a material part of the issuer’s business.
104. We will adopt the proposal to extend the restriction under Rule 14.92 (proposed Rule 14.06E) to a disposal *at the time of the change in control* (and not only disposal(s) after the change in control). As explained in the Consultation Paper, it would capture shell creation structures where a controlling shareholder would dispose of his shareholding interest to a new investor, and at the same time buy back a material part of the issuer’s principal business.

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<sup>15</sup> As endorsed by the SFC under Rule 2.04, the Exchange may grant a waiver from Rule 14.92 to issuers if their disposals do not fall under the following circumstances:

- (a) there has been an injection of assets from the new controlling shareholder; and
- (b) taking into account the disposal(s), the asset injection (or a series of injections) from the new controlling shareholder during the period leading to and after the change in control would have resulted in a very substantial acquisition.

*Note to proposed Rule 14.06E*

105. We note some respondents' comments that the proposed RTO Rules would already address disposals in circumstances involving a de facto control and as such, the Note is unnecessary. As explained in the Consultation Paper, the Note to proposed Rule 14.06E would apply where a new shareholder acquires de facto control of an issuer and it develops a new business through greenfield operation, and subsequently, disposes of its original business and circumvents the new listing requirements. This is a form of shell activity whereby the new shareholder acquires the issuer for its listing platform, but would not be caught by the proposed RTO Rules which only apply to arrangements involving acquisitions.
106. Some respondents opposed the proposal on the basis that a substantial shareholder might not exert any control over the issuer. We will modify the Note to proposed Rule 14.06E to clarify that the Exchange will make reference to the "change in control or de facto control" factor under the principle based test of Rule 14.06B when considering whether to exercise the discretion to impose restriction on an issuer's disposal.

*Other comments*

107. In response to the respondents' comments in paragraph 99, we will revise the proposed Rule 14.06E to cover "a series of disposals" and not just a single material disposal. We will also make a drafting change to the proposed Rule to refer to a "proposed" change in control of the issuer (instead of a "proposed or intended" change in control), and to clarify that the "material disposal" refers to disposal of all or a material part of the issuer's business.
108. The general waiver from Rule 14.92 will be withdrawn upon the new Rule 14.06E becoming effective, as the waiver contradicts the proposed modification to require the issuer to meet the requirements under Rule 8.05 as condition for disapplication of the Rule.
109. Having considered the market responses, we will adopt the proposed Rule 14.06E and the Note, with modifications set out in paragraphs 106 and 107 above.

**(5) Codify the current “extreme VSA” requirements (proposed Rule 14.06C)**

***Codify the extreme VSA requirements with additional requirements on the issuers (Question 6(a))***

**The proposal**

110. We proposed to codify the extreme VSA requirements under Guidance Letter [GL78-14](#) into a new Rule 14.06C and rename this category of transaction as “extreme transaction”, with the following additional requirements:

- (a) the issuer has been operating a principal business with substantial size which will continue after the transaction. As general guidance, “a principal business with substantial size” may include a principal business with annual revenue or total asset value of HK\$1 billion or more, excluding any revenue or assets not attributable to the issuer’s original principal business; or
- (b) the issuer has been under the control of a large business enterprise for a long period (normally not less than three years) and the transaction forms part of a business restructuring of the group and would not result in a change in control.

**(Question 6(a))**

**Comments received**

- 111. 45% of the respondents supported the proposal and 32% opposed. The remaining 23% did not indicate a view or only provided comments.
- 112. A majority of the respondents agreed with the proposal to codify the current “extreme VSA” requirements and rename the category as “extreme transaction”.
- 113. However, some respondents expressed concerns on the proposed additional requirement for the issuer to have a principal business of substantial size or controlled by a large business enterprise for a long period. They considered the proposal to be unfair to mid and smaller issuers. If the concern is backdoor listing, the focus should be on the quality of the acquisition target and not the issuer.

114. Some respondents considered that the threshold of HK\$1 billion for revenue or assets was unduly restrictive and more stringent than the new listing eligibility requirements. About one-third of the issuers would not meet the threshold based on their annual revenue and total assets as of August 2018. The proposal was unfair and prejudicial to a large number of issuers, particularly the mid and small sized issuers. A respondent suggested an alternative threshold of HK\$100 million for Main Board issuers (HK\$50 million for GEM issuers) in terms of annual revenue or total asset value.
115. Some respondents also commented that the proposal did not take into account the characteristics of different businesses, the scale of which might not be determined by reference to asset value or amount of revenue (e.g. new economy companies).

### **Our response and conclusion**

116. As explained in the Consultation Paper, we consider that the extreme transaction category should not be made available to issuers with “shell” like characteristics. This is to align with our policy intent to discourage investors from acquiring issuers as “listed shells” for backdoor listings. As such, we proposed to introduce the eligibility criteria for issuers that may use this transaction category.
117. Having considered the respondents’ comments and the rationale of the proposal, we will modify the second proposed eligibility criterion (set out in paragraph 110(b)) such that an issuer may use the extreme transaction category if it has been under the control or de facto control of the same person (or group of persons) for a long period (normally not less than 36 months) prior to the proposed transaction, and that the proposed transaction would not result in a change in control or de facto control.
118. We believe that the proposed criterion, as modified, would serve the purpose of discouraging shell activities involving investors acquiring “listed shells” for backdoor listing while addressing market concerns about unfair treatment toward mid to small sized issuers.
119. Further, we will retain the first proposed eligibility criterion (set out in paragraph 110(a)) that requires issuers to operate businesses of substantial size. This may apply in circumstances where investors acquired control of issuers with a view to operating the underlying businesses and subsequently the issuers expand or diversify their businesses through very significant acquisitions.

120. In assessing whether an issuer's business is of substantial size, the Exchange will consider the nature and operating model of the issuer's business, its financial position and its future plans. This is not a bright line test, but as general guidance, the issuer should have annual revenue or total asset value of HK\$1 billion or more<sup>16</sup>. We believe that a high threshold is necessary to provide a strong deterrent against acquisitions of issuers for their listing platforms for backdoor listings. We will however modify this requirement by removing the reference to "excluding any revenue or assets which are not attributable to the issuer's original principal business".
121. Having considered the market responses, we will adopt the proposed Rule 14.06C with modifications set out under paragraphs 117 and 120 above.

***Proposed disclosure and due diligence requirements for extreme transactions (Questions 6(b) and 6(c))***

**The proposal**

122. We proposed that issuers proposing an extreme transaction must comply with the disclosure requirements applicable to a new applicant. These requirements are set out under proposed Rules 14.53A and 14.69. **(Question 6(b))**
123. We also proposed that issuers must appoint a financial adviser to perform due diligence on the assets subject to the acquisitions (and any assets and business subject to a series of transactions and/or arrangements, if any). These requirements are set out under proposed Rule 14.53A(2). **(Question 6(c))**

**Comments received**

124. (Question 6(b)) 70% of the respondents supported the proposed enhanced disclosure requirements for extreme transactions and 11% opposed. The remaining 19% did not indicate a view.
125. (Question 6(c)) 70% of the respondents supported the proposed due diligence requirements for extreme transactions and 11% opposed. The remaining 19% did not indicate a view.
126. Some respondents considered that it might not be of much value to require enhanced disclosure on completed acquisitions, as their updates should have been disclosed in issuers' announcements and financial reports. The proposed requirement would create disproportionate compliance burden on issuers.

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<sup>16</sup> This quantitative threshold is for guidance only and is set out in the RTO Guidance Letter and not the Rules.

127. Some respondents considered the proposed due diligence requirement to be unduly burdensome. The due diligence requirements with reference to Practice Note 21 to the Listing Rules standards would significantly increase transaction costs and prolong the transaction timetable. In practice, vendors, especially independent third parties, might refuse the issuer's request to perform Practice Note 21 due diligence on the targets intended to be acquired and cancel the proposed transaction. Some respondents considered that, as extreme transactions were not new listing applications, the Exchange should allow financial advisers (apart from those qualified to conduct sponsors' work) to conduct the due diligence work.

### **Our response and conclusion**

128. The proposed requirements for enhanced disclosure and due diligence on extreme transactions reflect the current practice set out in Guidance Letter [GL78-14](#). As an extreme transaction has the effect of achieving a listing of the acquisition targets, we consider it necessary for the issuer to provide more information and assurance on the quality of the acquisition targets to a standard comparable to new listing applications.

129. In light of market support, we will adopt the proposed Rules 14.53A and 14.69.

### **(6) Impose additional requirements applicable to transactions classified as RTOs and extreme transactions**

#### **(a) Impose additional requirements applicable to RTOs under Rule 14.54 and extreme transaction under Rule 14.06C**

#### ***Proposed requirements for non-Rule 13.24 issuers (Question 7(a))***

#### **The proposal**

130. We proposed to amend Rule 14.54 (applicable to RTOs) and add Rule 14.06C(2) (applicable to extreme transactions) to require that:

- (a) both the acquisition targets and the enlarged group must meet Rule 8.04 (i.e. be suitable for listing); and
- (b) the acquisition targets must meet Rule 8.05 (or Rule 8.05A or 8.05B) (i.e. the track record requirements) and the enlarged group must meet all the new listing requirements set out in Chapter 8 of the Rules (except Rule 8.05).

The proposed Note to Rule 14.54(1) also states that if the Exchange is aware of information suggesting that the reverse takeover is to avoid any new listing requirement, the listed issuer must demonstrate that each of the acquisition targets meet all the new listing requirements set out in Chapter 8 of the Listing Rules.

### **(Question 7(a))**

#### **Comments received**

131. 49% of the respondents supported the proposal and 30% opposed. The remaining 21% did not indicate a view or had only provided comments.
132. Some respondents, while agreeing in principle, considered that an acquisition target might not be able to meet the stringent requirements under Rule 8.04 and Rule 8.05 (or Rule 8.05A or Rule 8.05B). This proposal might restrict issuers whose businesses were underperforming or in sunset industries from diversifying into new businesses through undertaking acquisitions and as such, it might lead to more shell companies and delisting. One respondent considered that in these cases, the Exchange should allow issuers to acquire new businesses, even if the acquisition targets did not meet the new listing requirements and instead subject them to more stringent shareholders' approval requirement.
133. An respondent suggested that the new Rule 14.54 should provide an exemption for issuers that did not undergo a change in control such that they might pursue business or asset acquisitions that were commercially sound even though falling short of Rule 8.05 requirements, for example, the proposed acquisition of a target with profitable track records of two years, where the enlarged group (with the issuer being under the same control for three years) could meet all the other basic listing conditions under Chapter 8.
134. One respondent commented that the proposal appeared to be more stringent than the new listing requirements, as the current Rules allow listing of companies that did not meet the Chapter 8 requirements, for example, biotech companies.
135. Some respondents considered that it was not necessary or appropriate to require the enlarged group to re-comply with all the new listing requirements under Chapter 8 (except Rule 8.05), as the enlarged group, as an existing listed issuer, should have been subject to continuing listing obligations and therefore met the Chapter 8 requirements.

#### **Our response and conclusion**

136. As explained in the Consultation Paper, the proposal requires the acquisition targets to meet Rules 8.04 and 8.05 to prevent circumvention of new listing requirements through significant acquisitions.

137. We do not consider it appropriate to provide an exemption for transactions proposed by issuers with non-performing businesses or issuers that do not undergo a change in control. Where a transaction proposed by such an issuer is extreme by reference to the assessment factors under the principle based test and classified as a RTO transaction, it should comply with the same requirements as other RTOs.
138. As regards the respondents' comments that the current Rules allow new listings of biotech companies that did not meet Rule 8.05, it should be noted that this type of companies are subject to different listing requirements under Chapter 18A. They are different from other new applicants seeking a listing under Chapter 8 and where such circumstances arise, must be assessed case-by-case.
139. We will retain the existing requirement for the enlarged group to meet all the listing requirements under Chapter 8 (except Rule 8.05) as a RTO or extreme transaction would involve a significant change to the nature and scale of the issuer's business.
140. Having considered the market responses, we will adopt the proposed Rules 14.54(1) and 14.06C(2) with an amendment to the Note of the proposed Rule 14.54 to correct a drafting error that the acquisition targets (and not each of the targets in the case of a series of acquisitions) must meet the new listing requirements.

#### ***Requirements for Rule 13.24 issuers (Question 7(b))***

##### **The proposal**

141. We also proposed to amend Rule 14.54 to require that where an issuer that has failed to comply with Rule 13.24 (**Rule 13.24 issuer**) proposes a RTO, each of (a) the acquisition targets and (b) the enlarged group must meet all the new listing requirements set out in Chapter 8 of the Rules. (**Question 7(b)**)

##### **Comments received**

142. 41% of the respondents supported the proposal and 38% opposed. The remaining 21% did not indicate a view or only provided comments.

143. Some respondents considered that the additional RTO requirements for Rule 13.24 issuers were unfair and might discourage corporate rescues. Their main arguments were as follows:
- (a) The proposal was unduly onerous as the acquisition target would need to have sufficient profits to meet Rule 8.05 requirements and also make up for historical losses of a Rule 13.24 issuer. It was difficult for Rule 13.24 issuers to identify acquisition targets of a substantial size to undergo RTOs and re-comply with Rule 13.24. The proposal would unduly hinder corporate rescue plans for Rule 13.24 issuers and eventually result in delisting.
  - (b) A respondent noted that in assessing whether the enlarged group could meet Rule 8.05, the Exchange would disregard historical losses arising from discontinued operations of the issuer. However, this might only apply to RTOs proposed by long suspended companies that had ceased to operate their original businesses. Rule 13.24 issuers that intended to continue their existing businesses while at the same time acquiring new businesses through RTOs would still encounter difficulties stated in paragraph 143(a) above.
  - (c) Making the RTO requirements more restrictive for Rule 13.24 issuers was not in line with the long standing practice of Hong Kong and other major markets that allowed companies to undergo corporate rescues. In the past, some long suspended companies were able to resume trading through RTOs and their share price generally performed well after resumption. It would be in the interest of minority shareholders to facilitate Rule 13.24 issuers to conduct RTOs. The current Rule 14.54 has worked well as it ensures that the acquisition target is qualified for new listing.
144. Some respondents suggested that if the proposal was adopted, the Exchange should provide more flexibility in applying the new requirements to issuers undergoing restructuring or in provisional liquidation. For example, where the enlarged group failed to meet Rule 8.05 requirements, the Exchange should, in some exceptional cases, look beyond the three-year track record period, or only partially offset the issuer's historical losses with the acquisition target's profits.

### **Our Response and conclusion**

145. As explained in the Consultation Paper, the proposal is intended to discourage the use of shell companies for backdoor listing. We, however, acknowledge the respondents' concerns that the proposed requirement for the enlarged group to meet Rule 8.05 might unduly hinder Rule 13.24 issuers' resumption plans involving RTOs. We will modify the proposal to require the enlarged group to meet all the new listing requirements under Chapter 8 except Rule 8.05.

146. As explained in the Consultation Paper, there were concerns that investors would acquire the controlling interest in a Rule 13.24 issuer for its public shareholder base and then conduct a RTO transaction (instead of an initial public offer) to circumvent Rule 8.07 which requires sufficient public interest in the business of the acquisition target. Under the proposed Rule, the issuer and its sponsor must demonstrate that there is sufficient public interest in the business of the acquisition target and the enlarged group. This may be demonstrated by, for example, conducting a public offer or other analysis with evidence to demonstrate a sufficient level of public interest in the acquisition targets. For this purpose, it would not be sufficient to simply rely on the issuer's existing shareholder base to satisfy the requirements.
147. Having considered the responses, we will adopt the proposed Rule 14.54(2) with the following modifications:
- (a) the acquisition targets must meet Rule 8.04 (suitable for listing), Rule 8.05 (or Rule 8.05A or 8.05B) (track record requirements) and Rule 8.07 (sufficient public interest)<sup>17</sup>; and
  - (b) the enlarged group must meet all the new listing requirements set out in Chapter 8 of the Rules (except Rule 8.05).

We will also modify proposed Note to Rule 14.54(1) so that it will apply to both Rules 14.54(1) and (2).

- (b) **Introduce new Rule 14.57A to clarify the applicable track record period and the requirements for pro forma income statement in an extreme transaction or a RTO that involves a series of transactions and/or arrangements**

#### **The proposal**

148. We proposed to add Rule 14.57A to clarify that, for extreme transactions and RTOs that involve a series of transactions and/or arrangements, the track record period for the completed acquisition(s) and the latest proposed transaction in the series would be referenced to the latest proposed transaction and covers the three financial years immediately prior to the issue of the circular for that transaction. **(Question 8(a))**

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<sup>17</sup> There is no equivalent provision under the GEM Rules. However, under the public offer requirement of GEM Rule 10.11A, GEM listing applicants would satisfy the Exchange that there would be sufficient public interest in the business of a GEM issuer and in the securities for which listing is sought. We will specify under proposed GEM Rule 19.54(2) that both the acquisition targets and the enlarged group must meet the sufficient public interest requirement.

149. We also proposed that issuers conducting extreme transactions and RTOs that involve a series of transactions and/or arrangements would be required to include in the circular the pro forma income statement (or for a GEM issuer, the pro forma cash flow statement) of all the acquisition targets in the series of acquisitions (and where applicable, new businesses developed by the issuer that form part of the series) for the track record period as set out in the proposed Rule 4.30. **(Question 8(b))**

### **Comments received**

150. (Question 8(a)) 60% of the respondents supported the proposal and 21% opposed. The remaining 19% did not indicate a view.

151. (Question 8(b)) 60% of the respondents supported the proposal and 21% opposed. The remaining 19% did not indicate a view or had only provided comments.

152. Some respondents, including accounting professionals, considered that there may be practical difficulties in producing the pro forma information under the proposed Rule 4.30. They commented that it would be difficult to delineate the results of “new business” acquired or developed by the issuer from its other businesses to produce the pro forma statement. Also, the proposal to publish pro forma income statement for each of the three financial years of the track record period, or combining targets with different lengths of financial periods might contradict certain applicable accounting standards. Such statement might also be confusing to shareholders given its highly hypothetical nature. Some accounting professionals suggested that the pro forma statement should be submitted as a private submission to the Exchange (instead of disclosing in the circular or listing document).

### **Our response and conclusion**

153. The purpose of the proposed pro forma income statement (for Main Board issuers)/cash flow statement (for GEM issuers) is for the issuer to demonstrate that the acquisition targets as a whole can comply with Rule 8.05 for the track record period. Having considered the respondents’ concerns about the preparation and disclosure of such pro forma information, we have decided not to adopt the proposed Rule 4.30 and the related disclosure requirements for the pro forma information. We will instead require issuers to submit to the Exchange the financial information of the acquisition targets based on accountants’ reports or audited financial information to demonstrate compliance with Rule 8.05<sup>18</sup>.

154. Having considered the responses, we will adopt the proposed Rule 14.57A with the modifications set out in paragraph 153.

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<sup>18</sup> Such approach is in line with our practice in requiring an issuer to provide to the Exchange financial results of its remaining group to demonstrate that the remaining group can meet Rule 8.05 in a spin-off under Practice Note 15.

- (7) **Add a new Rule to codify, with modification, the practice set out in Guidance Letter [GL84-15](#) to regulate backdoor listings through large scale issue of securities**

### **The proposal**

155. We proposed to add a new Rule 14.06D to codify the practice (as set out in Guidance Letter [GL84-15](#)) to disallow large scale issue of securities where the fund raised would be used to start a greenfield operation, which, in the opinion of the Exchange, is a means to circumvent the new listing requirements and to achieve a listing of that greenfield operation. We also proposed to modify the practice to apply the proposed Rule where the funds raised are to be used to develop a new business through future acquisitions (in addition to greenfield operations under current practice). **(Question 9)**

### **Comments received**

156. 51% of the respondents supported the proposal and 28% opposed. The remaining 21% did not indicate a view or had only provided comments.
157. A majority of the respondents agreed with the proposal. A respondent commented that the Exchange should focus on whether the cash was raised for genuine and legitimate committed purpose instead of the level of cash.
158. Some respondents, however, considered that it is a legitimate business practice for issuers and in the shareholders' interest to conduct fundraisings or hold onto cash for business expansions or diversification. The proposal would restrict fundraisings for business expansion or diversification, e.g. new economy companies that are asset-light.
159. Some respondents commented that the proposal was not necessary given other Rule changes, including the restrictions on highly dilutive capital raising activities and the proposed cash company Rules (Rules 14.82 and 14.83).
160. One respondent suggested that the proposal seemed to also cover large scale equity fundraisings not involving a change in control of the issuers, which was not in line with the guidance under Guidance Letter [GL84-15](#).

### **Our response and conclusion**

161. The proposal is to codify the current practice (with a minor modification) in Guidance Letter [GL84-15](#), which has been in place since December 2015. As explained in the Consultation Paper, this is intended to apply to a large scale equity fundraisings proposed by an issuer with the intention of developing and/or acquiring a new business that is expected to be substantially larger than the issuer's existing principal business. The effect of the transaction is to achieve a listing of the new business that would not have otherwise met the new listing requirements. The proposal is not intended to restrict issuers from raising funds for legitimate business development or diversification.

162. In applying the proposed Rule 14.06D, the Exchange would not simply rely on the cash to asset ratio of the issuer as a result of its equity fundraising. It will also consider other factors, including the issuer's existing business, operation and financial position, its business plans and the intended use of proceeds, and whether there is, or will be, any change in control or de facto control of the issuer. For example, for issuers engaging in asset-light businesses that may have a relatively high cash to asset ratio after fundraising activities, Rule 14.06D will not apply where the proceeds are to be used for business expansion or diversification that is part of the issuer's business strategies related to its existing business, or is consistent with the issuer's size and resources. We will clarify this in the revised guidance letter on Rule 14.06D. We will retain the quantitative threshold of the cash to asset ratio<sup>19</sup> as general guidance in the revised guidance letter and remove the proposed Note 2 to Rule 14.06D.
163. We clarify that the purpose of proposed Rule 14.06D is to deter backdoor listing through large scale equity fundraisings, while the cash company Rules (Rules 14.82 and 14.83) will continue to address problems concerning issuers that become cash shells for any reasons. The recent Rule changes on highly dilutive fundraisings also serve a different purpose, as they seek to prevent abusive fundraisings that may not afford fair treatment to minority shareholders.
164. We acknowledge the respondent's comment that Guidance Letter [GL84-15](#) was intended to apply to large scale equity fundraisings that would involve a change in control or de facto control of the issuers. We will modify the proposed Rule 14.06D to clarify this point.
165. Having considered the market responses, we will adopt proposed Rule 14.06D with the modifications set out in paragraphs 162 and 164.

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<sup>19</sup> Guidance Letter [GL84-15](#) provides that the Exchange would not normally apply the cash company Rule to an issuer's equity fundraising if less than half of its assets would consist of cash as a result of the fundraising.

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## CHAPTER 3 : MARKET FEEDBACK AND CONCLUSIONS ON PROPOSALS RELATING TO CONTINUING LISTING CRITERIA

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166. This chapter sets out the comments received on our proposals relating to continuing listing criteria and our responses and conclusions.

### B. Amend Rule 13.24

#### (1) Proposal to require an issuer to have sufficient operations and assets of sufficient value to support its operations to warrant its continued listing and to amend the Note to Rule 13.24 to provide guidance on the operation of the Rule

##### The proposal

167. We proposed to amend Rule 13.24 (proposed Rule 13.24(1)) to require issuers to have a business with a sufficient level of operations and assets of sufficient value to support its operations to warrant the continued listing of the issuer's securities. **(Question 10)**

168. We also proposed to add a Note to the proposed Rule 13.24(1) to make it clear that the Rule is a qualitative test, and the Exchange may consider an issuer to have failed to comply with the Rule in situations where, for example, the Exchange considers that the issuer does not operate a business that has substance and/or that is viable and sustainable. The assessment is made by the Exchange based on the specific facts and circumstances of individual issuers. The onus is upon the issuer to demonstrate to the Exchange's satisfaction that it is in compliance with the Rule. The proposed Note also cited money lending as an example and set out certain factors that the Exchange may take into account when assessing whether the money lending business of a particular issuer is a business of substance. **(Question 11(a))**

169. We proposed to remove the existing Note to Rule 13.24 which sets out the characteristics<sup>20</sup> of issuers which are unable to comply with Rule 13.24, as these characteristics do not adequately describe all situations where an issuer is considered to have failed to comply with Rule 13.24 and may mislead readers. **(Question 11(b))**

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<sup>20</sup> Such characteristics include: (i) financial difficulties to an extent which seriously impairs an issuer's ability to continue its business or which has led to the suspension of some or all of its operations; and/or (ii) issuers which have net liabilities as at their balance sheet date i.e. issuers whose liabilities exceed their assets.

## Comments received

### *Proposed Rule 13.24(1)*

170. (Question 10) 47% of the respondents supported the proposal and 30% opposed. The remaining 23% did not indicate a view or only provided comments.
171. Some respondents considered that an asset test was unnecessary or inappropriate as businesses might be asset-light, particularly those operating in the new economy. Some respondents also pointed out that asset size is not a requirement for new listing applicants, and hence it should not be a post-listing obligation. A supporting respondent also commented that in applying Rule 13.24, the Exchange should take into account the characteristics of “new economy” companies as qualities such as innovation and intellectual vitality might be more important than the asset size for the industry.
172. A respondent suggested retaining the existing Rule 13.24 to allow issuers with significant assets but limited operations to maintain a listing. For example, issuers holding significant assets (e.g. large commercial buildings or a fleet of vessels) might outsource their operations to external management companies. It would not be in the interests of shareholders to suspend and eventually delist the issuers. Some respondents commented that the Exchange should not be concerned with the size of an issuer’s operation, and should allow an issuer to maintain its listing as long as it had an operation and was capable of discharging its disclosure obligations.

### *Proposed Note to Rule 13.24(1)*

173. (Question 11(a)) 58% of the respondents supported the proposal and 15% opposed. The remaining 27% did not indicate a view or had only provided comments.
174. (Question 11(b)) 60% of the respondents supported the proposal and 17% opposed. The remaining 23% did not indicate a view or had only provided comments.
175. Some respondents were concerned that the proposed Note to Rule 13.24(1) was unclear as to how the qualitative test would be applied and gave the Exchange too much discretion. They commented that there was no clear guideline or benchmark for determining whether a business has substance or was viable and sustainable. Some respondents questioned whether the regulator was in a position to determine whether an issuer’s business had substance or was viable and sustainable. It was also unfair to place the onus on an issuer to demonstrate compliance with the Rule, particularly as the issuer would need to prove the Exchange’s initial assessment wrong.

176. Some respondents considered that the existing Note to Rule 13.24 should be retained as it would provide specific and objective guidance in interpreting Rule 13.24.

### **Our response and conclusion**

#### *Proposed Rule 13.24(1)*

177. As explained in the Consultation Paper, the proposal clarifies that an issuer must carry out a business with a sufficient level of operations to warrant its continued listing. It must also have assets of sufficient value to support its operations. The proposed Rule does not require issuers to have assets of substantial size to justify a listing as the sufficiency of asset test is assessed by reference to the nature and size of the issuer's operation. It would not restrict issuers from engaging in asset-light businesses.
178. The Consultation Paper also clarified that issuers that hold significant assets but do not carry on a business of sufficient size would not meet the continuing listing criteria. Whether an issuer holding significant assets and outsourcing their operations to external management companies would be considered to operate a business would have to be assessed case-by-case, having regard to, among others, the circumstances of the issuer and the practices of the industry in which it operates.

#### *Proposed Note to Rule 13.24(1)*

179. We note that respondents questioned how the qualitative test would be applied, and whether the Exchange is in a position to determine the substance and viability of a business. The assessment of sufficiency of operations is within the context of whether the issuer remains suitable for listing and therefore, is a determination made by the Exchange. Further, the application of the qualitative test has been explained in our guidance materials, including a number of Listing Decisions published in recent years. The proposed Note to Rule 13.24(1) reflects the Exchange's current practice in applying Rule 13.24. Further guidance is set out in a new Guidance Letter on Rule 13.24 (see Appendix IV).
180. We will amend the proposed Note to Rule 13.24(1) to clarify that the onus is upon the issuer to provide relevant information for the Exchange's assessment about the issuer's compliance with proposed Rule 13.24 (rather than to demonstrate that it is in compliance with the Rule as set out in the proposal).
181. The existing Note to Rule 13.24 will be removed as the guidance therein is not exhaustive and guidance will be set out in the Guidance Letter on Rule 13.24.
182. Having considered the market responses, we will adopt the proposals with the modifications set out in paragraph 180 above.

**(2) Proposal to exclude an issuer’s trading and/or investment in securities when considering the sufficiency of an issuer’s operations and assets under Rule 13.24**

**The proposal**

183. We proposed that when considering the sufficiency of an issuer’s operations and assets under Rule 13.24 (proposed Rule 13.24(1)), its securities trading and/or investment activities would be excluded (except for an investment company listed under Chapter 21). **(Question 12)**

**Comments received**

184. 45% of the respondents supported the proposal and 32% opposed. The remaining 23% did not indicate a view or had only provided comments.

185. Some respondents considered that securities trading and investment activities should not be excluded from Rule 13.24 assessment if they were legitimate or genuine business transactions. Many issuers carried out securities trading and investment activities as part of their ordinary course of business or for treasury management purposes. Instead, the Exchange might exercise its discretion to disregard an issuer’s securities trading and investment activities based on the facts and circumstances of the issuer.

186. Some respondents considered that the Exchange should provide an exemption to issuers that were subject to prudential regulations (e.g. securities brokerage firms or asset management companies), as securities trading and investment activities were carried out by these issuers as part of, or ancillary to, their principal businesses. For example, an issuer engaging in underwriting business for IPOs would normally generate underwriting commissions, investment gains from taking proprietary position in the offering (or in other investment activities) and trading income derived from stabilization activities in an IPO. These incomes were generated from an integrated business activity; however, under the proposal, the incomes generated from proprietary securities trading and investments would have been excluded for the Rule 13.24 assessment.

187. A respondent suggested that the Exchange should define “securities” and “investment” and clarify, for example, whether investment in properties was excluded from the definition under the proposed Rule 13.24(2)<sup>21</sup>. Another respondent suggested that the Exchange should clarify that the proposed Rule would apply to proprietary securities trading and/or investments, and not non-proprietary securities trading and/or investment activities made by securities brokerage houses or financial institutions for their customers.

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<sup>21</sup> Under the proposed Rule 13.24(2), trading and/or investment in securities by an issuer (other than an issuer which is an investment company listed under Chapter 21) are excluded when considering whether the issuer can meet Rule 13.24(1).

## Our response and conclusion

188. As explained in the Consultation Paper, the proposal addresses concern about issuers engaging in proprietary securities trading and/or investments for shell maintenance purposes. This proposal is part of the assessment of sufficiency of operations and would not restrict an issuer from carrying out proprietary securities trading and investment activities as ancillary activities or for treasury management.
189. In the Consultation Paper, we have also clarified that the proposal is not intended to target issuers in the financial services industry such as banks, insurance companies or securities houses that carry out securities trading and/or investment activities as part of, or ancillary to, their principal businesses. We will modify the proposed Rule 13.24(2) to exempt several types of issuers that are subject to supervision by other regulatory authorities. For the avoidance of doubt, the exemption is confined to activities undertaken by the licensed entity within a listed group, and in the case of a securities house, it must be mainly engaged in regulated activities under the SFO as part of its ordinary and usual course of business. It should be noted that proprietary securities trading and/or investment is not a regulated activity under the SFO and accordingly, this exemption is not available where proprietary securities trading and/or investment constitutes a significant part of the business of the securities house.
190. In response to the respondents' comments in paragraph 187, we will modify the proposed Rule 13.24(2) to clarify that it is applicable to *proprietary trading and/or investment in securities*. Issuers may refer to the Securities and Futures Ordinance for the definition of "securities".
191. Having considered the market responses, we will adopt the proposed Rule 13.24(2) with the modifications set out in paragraphs 189 and 190 above.

**C. Amend the cash company Rules (Rule 14.82 to 14.84)**

**(1) Extend the definition of short-dated securities in Rule 14.82 to cover investments that are easily convertible into cash**

**The proposal**

192. We proposed to extend the definition of “short-dated securities” in the cash company Rules (Rules 14.82 to 14.84) to cover investments that are easily convertible into cash (**short-term investments**). (**Question 13**)
193. As set out in the proposed Note to Rule 14.82, in determining whether an issuer’s assets are short-term investments, the Exchange will apply a principle based approach and consider the issuer’s intention in holding the assets and the marketability or liquidity of the assets. Examples of short-term investments include: bonds, bills or notes which have less than 1 year to maturity, or those which have maturity of over 1 year and are intended to be held for less than 1 year; securities listed on the Exchange or other stock exchanges that are available for sale; investments that are easily realisable or convertible to cash; and advances to third parties which are repayable within 1 year (excluding trade receivables arising from the issuer’s ordinary and usual course of business).

**Comments received**

194. 58% of the respondents supported the proposal and 21% opposed. The remaining 21% did not indicate a view.
195. A supporting respondent suggested that the Exchange should take into account the business nature of the issuers when applying the cash company Rules, for example, biotech companies were usually asset-light and subject to enhanced working capital requirements.
196. Some respondents raised concerns about the definition of “short-term investments”:
- (a) Some respondents considered that the definition of “short-term investments” was unclear and might cover a wide variety of assets. For example, most stocks could be considered as long-term or short-term investments and easily be converted into cash, and properties held for investment were also easily realisable or convertible to cash. A respondent also commented that the scope of “advances to third parties” was too wide.
  - (b) In deciding what constitutes “short-term investments”, the Exchange would consider the intention of the issuer in holding the assets. This would involve a subjective judgement, and it was unclear how the Exchange can assess “intent”.

197. Another respondent asked whether there would be exemption for treasury activities of issuers that had a clearly stated and established treasury policy.
198. A few respondents considered that this proposal was not necessary as the proposed requirements under Rule 13.24 would address shell activities involving securities trading/investments and money lending business.

### **Our response and conclusion**

199. As explained in the Consultation Paper, the proposal aims to prevent issuer's circumvention of the cash company Rules by converting a substantial amount of cash (e.g. the proceeds from significant disposals) into highly liquid assets. Rule 13.24 serves a different purpose from the cash company Rules as it requires an issuer to have sufficient operations to justify a continued listing status.
200. We acknowledge the respondents' concerns that the definition of short-term investments was unclear and too extensive. We will amend the proposed Note to Rule 14.82 to clarify the scope of short-term investments and remove the reference about the issuer's intention in holding its assets. We will also remove "advances to third parties" as an example of short-term investments as they would be caught only in exceptional cases where there is a concern about circumvention of the cash company Rules. The proposed Note, as modified, is as follows:
- (a) Rule 14.82 is intended to apply to issuers that hold a very high level of cash and short-term investments. *In assessing whether an issuer is a cash company, the Exchange will apply a principle based approach and normally take into account the value of the issuer's cash and short-term investments relative to its total assets, its level of operations and financial position, and the nature of the issuer's business and its cash needs in the ordinary and usual course of business.*
  - (b) *Short-term investments include securities that are held by the issuer for investment or trading purposes and are readily realisable or convertible into cash. Examples of short-term investments include (i) bonds, bills or notes which have less than one year to maturity; (ii) listed securities (whether on the Exchange or otherwise) that are held for investment or trading purposes; and (iii) investments in other financial instruments that are readily realisable or convertible into cash.*
201. We do not consider it necessary to provide a general exemption for treasury activities given that a cash company refers to an extreme circumstance where the assets of an issuer consist wholly or substantially of cash.
202. Having considered the market responses, we will adopt the proposed Rule 14.82 with the modifications set out in paragraph 200 above.

**(2) Amend Rule 14.83 to confine the exemption to clients' assets relating to the issuer's securities brokerage business**

**The proposal**

203. Under current Rule 14.83, a listed issuer that is solely or mainly engaged in the securities brokerage business will not be subject to Rule 14.82. In the Consultation Paper, we proposed to amend Rule 14.83 to confine the exemption to clients' assets relating to the issuer's securities brokerage business. **(Question 14)**

**Comments received**

204. 62% of the respondents supported the proposal and 19% opposed. The remaining 19% did not indicate a view or had only provided comments.

205. Some respondents disagreed with the proposal as securities brokerage companies generally kept a high level of cash for business needs and to satisfy the prescribed level of liquid capital for maintaining their licenses. For example, some securities brokerage companies often maintained substantial cash for underwriting opportunities. The proposal would essentially reduce their liquid capital and undermine their competitiveness and opportunities to undertake large-scale underwriting transactions.

206. Some respondents commented that shell maintenance activities involved a limited number of issuers only, and there was little controversy over the application of the existing exemption under Rule 14.83.

207. A respondent suggested the Exchange to define "securities brokerage business" under proposed Rule 14.83 and indicate clearly under what circumstances an issuer engaging in securities brokerage business might be regarded as a cash company.

208. Some respondents considered that the exemption under Rule 14.83 should be extended to other businesses that maintain a high level of cash and liquid assets in their ordinary course of business, such as asset management businesses. A respondent proposed to exempt SFC-registered financial group whose ordinary business included securities trading and investment.

209. A respondent noted that the proposal was not consistent with the exemption under Rule 8.05C<sup>22</sup> that was available to new applicants solely or mainly engaged in the securities brokerage business.

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<sup>22</sup> Under Rule 8.05C, an issuer or group (other than an investment company in which case the conditions set out in Chapter 21 apply) whose assets consist of wholly or substantially of cash or short-dated securities will not normally be regarded as suitable for listing, except where the issuer or group is solely or mainly engaged in the securities brokerage business. "Short-dated securities" means securities such as bonds, bills or notes which have less than one year to maturity.

## **Our response and conclusion**

210. As stated in the Consultation Paper, the proposed change to Rule 14.83 is not intended to impose undue restriction on the operations of securities brokerage companies. The proposal seeks to enhance investor protection and address shell activities through cash companies. However, we acknowledge the respondents' concerns as the proposals (including proposed amendments to Rule 14.82) might increase regulatory uncertainty for securities brokerage companies in capital management and impose additional compliance burden in monitoring their cash level to avoid triggering Rule 14.82.
211. Accordingly, we will modify the proposal to exempt members of an issuer's group that are securities houses and/or certain other types of licensed entities that are also subject to supervision by other regulatory authorities (including banking companies and insurance companies). The modified exemption under Rule 14.83 is confined to the activities undertaken by the licensed entity within a listed group, in line with our proposed modification to Rule 13.24(2) (see paragraph 189). We will also clarify in the note to the Rule that the exemption will not apply to an issuer that operates a securities house where the Exchange has concerns that the issuer is holding cash and short-term investments through a member to circumvent Rule 14.82. For example, an issuer holding excessive cash and/or securities investments cannot circumvent the Rule by holding such assets through a member that is a licensed broker with minimal brokerage operations. The Exchange will apply a principle based approach and consider, among others, the cash and/or short-term investments in light of the member's operating model and its cash needs for the purpose of its regulated activities, which should be substantiated by its historical track record.
212. The definitions of securities house, banking company and insurance company are set out in Rules 14.04 and 14A.88.
213. Having considered the market responses, we will adopt the proposal with the modifications set out in paragraph 211 above. We will make consequential changes to Rule 8.05C to ensure consistency.

## **Transitional arrangements for proposals relating to continuing listing criteria**

214. As stated in the Consultation Paper, we propose a transitional period of 12 months from the effective date of the Rule amendments (i.e. 1 October 2019) in relation to the amended Rules 13.24, 14.82 and 14.83 as discussed in sections B and C above.

215. The transitional period will apply to listed issues that do not comply with the new Rule 13.24 or 14.82 strictly as a result of the Rule amendments. This transitional arrangement will minimize the impact of the Rule amendments on those issuers by allowing them a 12-month period to comply with the Rules as amended. The Exchange is minded to allow the issuers to bring themselves into compliance with the new Rules. Where the issuers' proposals involve corporate actions that may be subject to the RTO assessment, the Exchange will evaluate each case individually and take into account the underlying purpose of the proposals in its RTO assessment, with the objective of facilitating these issuers to comply with the new Rules. For the avoidance of doubt, the transitional arrangement will not apply to issuers that do not comply with the current requirements under Rule 13.24 or 14.82, or become non-compliant with the new Rule 13.24 or 14.82 after the effective date of the Rule amendments.

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## CHAPTER 4 : MARKET FEEDBACK AND CONCLUSIONS ON OTHER PROPOSED RULE AMENDMENTS

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216. This chapter sets out the comments received on other proposed Rule amendments and our responses and conclusions.

### D. Proposals relating to securities transactions

#### (1) Confine the revenue exemption for securities transactions

##### The proposal

217. We proposed to confine the revenue exemption under Rule 14.04(1)(g) for purchases and sales of securities to cases where they are conducted by banking companies, insurance companies and securities houses within the listed issuers' group. Securities transactions by other issuers would not be exempted and the issuers have to comply with the notifiable transaction requirements under Chapter 14 when conducting these transactions. **(Question 15)**

##### Comments received

218. 55% of the respondents supported the proposal and 26% opposed. The remaining 19% did not indicate a view or had only provided comments.

219. Some respondents disagreed with the proposal for the following reasons:

(a) The proposal aimed to address shell activities that involved a limited number of issuers only. It would, however, have the effect of restricting most other issuers from conducting legitimate securities transactions. The respondents considered that the revenue exemption should be made available as long as the securities transactions were genuine and regularly carried out by issuers.

(b) The proposal contradicts with the Exchange's position set out in the Listing Decision ([LD53-2](#)) that treasury activities were not intended to fall within the ambit of Chapter 14.

220. Some respondents suggested extending the revenue exemption to securities trading and investment activities by asset management companies that were regulated by prudential regulators.

221. A few respondents sought clarification on how the aggregation Rules would apply to securities transactions, for example, whether investments in securities of different entities, or investments made through different banks or institutions would be aggregated.

## **Our response and conclusion**

222. As explained in the Consultation Paper, the proposal seeks to enhance investor protection and address shell activities. Securities transactions are not disallowed; instead, the proposal provides better transparency and investors' protection by requiring issuers to disclose and/or obtain shareholders' approval for their material securities transactions, depending on the size of the transactions.
223. Under the proposal, the revenue exemption is confined to securities transactions conducted by a member of an issuer's group that is a banking company, an insurance company or a securities house subject to supervision by other regulatory authorities as part of its ordinary and usual course of business. For a member that is a securities house, the exemption will only be available if such member is mainly engaged in regulated activities under the SFO. It should be noted that proprietary securities trading and/or investment is not a regulated activity under the SFO and accordingly, this exemption is not available where proprietary securities trading and/or investment constitutes a significant part of the business of the securities house. We will clarify this in the proposed Rule.
224. In response to the respondents' query, under the aggregation Rules in Chapter 14, an issuer is required to aggregate investments to the extent that they were made in the same company or group of companies, but not securities in different companies. FAQ Number [057-2019](#) published today provides guidance on these requirements.
225. We will remove Listing Decision ([LD53-2](#)), which is superseded by the proposal.
226. In light of market support, we will adopt the proposal with the modifications set out in paragraph 223 above.

## **(2) Require disclosure of significant investments in annual reports**

### **The proposal**

227. We proposed to require issuers to disclose in their annual reports details of each securities investment that represents 5% or more of the total assets, including:
- (a) the name and principal business of the underlying company, the number or percentage of shares held and the investment costs;
  - (b) the fair value of each investment as at the year end date and its size relative to the issuer's total assets;
  - (c) the performance of each investment during the year, including any realized and unrealized gain or loss and any dividend received; and

(d) a discussion of the issuer's strategy for the significant investments.

**(Question 16)**

**Comments received**

228. 70% of the respondents supported the proposal and 9% opposed. The remaining 21% did not indicate a view or had only provided comments.
229. Some respondents considered that the disclosure requirement was unduly burdensome as issuers' investments for treasury management purposes were often short-term. Some considered that the proposal was redundant in light of issuers' existing disclosure obligations, for example, the notifiable transaction requirements on significant investments, or the requirements to disclose substantial shareholdings in other listed issuers under the SFO. For investments in companies listed in other markets, disclosure of the investee companies' performance might already be required under other exchanges' rules.
230. A respondent considered that a qualitative discussion in the "Management Discussion and Analysis" section about asset/investment performance would provide more useful information than a snap shot of the investment balance at the end of the year based on total assets.
231. Some respondents sought clarifications on the proposed Rule, including whether "securities investments" covered treasury activities and short-term investments under proposed cash company Rules, whether the 5% threshold was based on the value at the time of the investment or as at the end of the reporting period, and whether the disclosure requirements applied to securities investments on a standalone or aggregated basis.

**Our response and conclusion**

232. The purpose of the proposal is to promote transparency of investment activities by requiring issuers to disclose detailed information and periodic updates on their significant investments.
233. Under the current Paragraph 32(4) of Appendix 16, issuers are required to comment on their significant investments held, their performance during the financial year and future prospect in their annual reports. The proposal will impose an additional requirement for issuers to disclose specific information of their significant investments as at the issuer's financial year end. For the sake of clarity, we will set out the proposed requirement in a separate Rule.
234. The proposal will allow investors to assess the performance of significant investments after they are acquired by the issuers. The proposal should not impose undue burden on issuers as it will apply to significant investments only and the disclosure items are in line with the Exchange's recommended disclosures as part of its review of issuers' annual reports in recent years.

235. The proposed Rule requires an issuer to disclose details of each securities investment that represents 5% or more of its total assets. In light of the respondents' comments, we will modify the proposed Rule to make clear that the 5% threshold is calculated based on the value of the issuer's investments in *each investee company as at the year end date*.
236. Under the proposed Rule, securities investments cover an issuer's interests in securities of investee companies that are accounted for by the issuer as investments. There is no exemption for treasury activities or short-term investments.
237. In light of market support, we will adopt the proposal with the modifications as set out in paragraphs 233 and 235 above and an amendment to the proposed Rule to require disclosure of both the number and percentage of shares held by the issuer in the underlying company.

## **E. Proposal relating to distribution in specie of unlisted assets**

### **The proposal**

238. We proposed to codify the requirements for significant distribution in specie of unlisted assets currently set out in Listing Decision [LD75-4](#) into the Rules:
- (a) the distribution in specie must be approved by independent shareholders with at least 75% of the votes attaching to any class of listed securities held by holders voting either in person or by proxy at the meeting, and the number of votes cast against the resolution is not more than 10% of the votes attaching to any class of listed securities held by holders permitted to vote in person or by proxy at the meeting. Controlling shareholders (or directors (other than independent non-executive directors) and the chief executive, where there is no controlling shareholder) and their respective associates must abstain from voting for the resolution; and
  - (b) the shareholders (other than the directors (excluding independent non-executive directors), chief executive and controlling shareholders) should be offered a reasonable cash alternative or other reasonable alternative.

### **(Question 17)**

### **Comments received**

239. 72% of the respondents supported the proposal and 7% opposed. The remaining 21% did not indicate a view.
240. A respondent considered that a distribution in specie should only be viewed as a disposal under Chapter 14 and not be subject to more stringent requirements of delisting. Another respondent considered that only shareholders with a material interest in the distribution should be required to abstain from voting. A controlling shareholder should be allowed to vote if its interest in the distribution is same as that of other shareholders, which was in line with the requirement of a very substantial disposal under Chapter 14.

241. A respondent agreed with the proposal in principle but considered that the more stringent requirements should only apply in cases where, following the distribution, the remaining group would be unable to comply with Rule 13.24, but not to other “very substantial disposal” cases.

### **Our response and conclusion**

242. As explained in the Consultation Paper, a significant distribution in specie of unlisted assets is tantamount to a delisting of the business by the issuer and as such, it should be subject to similar level of protection offered to minority shareholders as in the case of delisting (including the voting requirements). The proposal is a codification of the existing practice set out in Listing Decision [LD75-4](#), which has been adopted since 2015.

243. In light of market support, we will adopt the proposal.

## **F. Proposals relating to notifiable or connected transactions**

### **(1) Disclosure on the outcome of a financial performance guarantee of a target acquired by the issuer in a notifiable or connected transaction**

#### **The proposal**

244. Under Rule 14A.63, an issuer is required to disclose in an announcement and the next annual report information about any financial performance guarantee given by a connected person in relation to an acquisition of a company or business by the issuer. We proposed to amend Chapters 14 and 14A to require:

- (a) disclosure on the outcome of a guarantee on the financial performance of an acquisition target that is subject to the notifiable or connected transaction requirements (irrespective of whether the guaranteed financial performance is met) in the next annual report; and
- (b) disclosure by way of an announcement if (i) there is any subsequent change to the terms of the guarantee; or (ii) the actual financial performance of the target acquired fails to meet the guarantee (or the guarantee as amended).

#### **(Question 18)**

### **Comments received**

245. 73% of the respondents supported the proposal and 6% opposed. The remaining 21% did not indicate a view or had only provided comments.
246. A few respondents considered that the proposal would not provide much additional value to investors. For example, if the outcome of a financial performance guarantee was material, the issuer was already required to disclose the information pursuant to the general disclosure obligations under the SFO. Another respondent commented that it was not appropriate or possible for the Rules to particularize all potential subsequent events after completion of the transactions for disclosure purposes.

### **Our response and conclusion**

247. As explained in the Consultation Paper, as a matter of accountability and transparency, issuers should provide updates on any financial performance guarantees given by the vendors in notifiable or connected transactions. In practice, these guarantees are often used to justify the basis for determining the consideration for acquisitions, particularly where the target companies were newly established or loss-making before the acquisitions. The proposal is in line with the Exchange's recommended disclosures on financial performance guarantees as part of its review of issuers' annual reports in recent years.
248. In view of market support, we will adopt the proposal.

## **(2) Disclosure on the identities of the parties to a transaction**

### **The proposals**

249. We proposed to require disclosures on the identities of the parties to transactions in the announcements and circulars of notifiable transactions. **(Question 19(a))**
250. We proposed to require disclosure on the identities and activities of the parties to transactions and of their ultimate beneficial owners in the announcements of connected transactions (in addition to the existing disclosure requirements in circulars). **(Question 19(b))**

### **Comments received**

251. (Question 19(a)) 68% of the respondents supported the proposal and 9% opposed. The remaining 23% did not indicate a view or had only provided comments.
252. (Question 19(b)) 68% of the respondents supported the proposal and 9% opposed. The remaining 23% did not indicate a view or had only provided comments.

### *Notifiable transaction disclosure requirement*

253. A few respondents opposed the proposal as counterparties might have legitimate grounds for not publicly disclosing their identities. The proposal would adversely affect issuers from conducting commercial transactions. As an alternative, the respondents suggested disclosing the information to the Exchange only, or granting waivers, where appropriate.

### *Connected transaction disclosure requirement*

254. A respondent opposed the proposal as the counterparty might not agree to disclose its ultimate beneficial owner, and suggested submitting the information to the Exchange only. Another respondent suggested that the disclosure requirement should be restricted to the connected persons involved in the transaction only and exclude other shareholders of the counterparty (for example, passive minority co-investors).
255. A few respondents sought clarification on the disclosure requirement in respect of the ultimate beneficial owners of a counterparty that was owned by a discretionary managed fund, as the fund manager might be obliged to keep the information confidential, or might not be able to ascertain the identities of the beneficial owners.

### **Our response and conclusion**

256. As stated in the Consultation Paper, the purpose of the proposed disclosure requirements is to enhance transparency of material transactions. Issuers are expected to provide meaningful information about the background and identities of the parties to the transaction to the market<sup>23</sup>. In respect of connected transactions, the existing Rules already require disclosure of the identities and activities of the counterparties and their ultimate beneficial owners in transaction circulars. This proposal extends the requirement to announcements.
257. Where a counterparty is owned by a discretionary managed fund, the ultimate beneficial owners would normally be the fund and its beneficiaries or discretionary objects under the connected transaction Rules. If there are any exceptional circumstances that may render compliance with the requirement unduly burdensome or difficult in a notifiable or connected transaction, this will need to be considered by the Exchange on a case-by-case basis.
258. In view of market support, we will adopt the proposals.

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<sup>23</sup> Under current Rule 14.58(2), issuers are required to disclose a general description of the principal business activities of the counterparties.

### **(3) Alternative size tests requirements**

#### **The proposal**

259. We proposed to amend the Rules to make it clear that if any calculation of the percentage ratios for a transaction produces an anomalous result or is inappropriate to the sphere of activities of the issuer, the Exchange (or the issuer) may apply an alternative size test that it considers appropriate to assess the materiality of a transaction under Chapter 14 or 14A. **(Question 20)**

#### **Comments received**

260. 70% of the respondents supported the proposal and 9% opposed. The remaining 21% did not indicate a view.

261. Some respondents considered that the proposal would give the Exchange the discretion to adopt alternative size tests for any transactions and create regulatory uncertainty to issuers and their advisers. One respondent suggested that the Exchange should provide guidance setting out factors and circumstances that it normally considered appropriate to apply alternative size tests; or the Exchange should notify the issuer in advance of its intention to apply alternative size tests. This would allow issuers with sufficient time to collate relevant information for computing alternative size tests and avoid reclassification of a transaction after the announcement.

#### **Our response and conclusion**

262. As regards the respondents' comments, a typical scenario where the Exchange may exercise its discretion to apply alternative size tests on a proposed transaction is that the issuer has undertaken or agreed to undertake corporate actions (e.g. disposals of assets or businesses) that would result in a significant reduction in the scale of its business operation and/or total assets<sup>24</sup>.

263. In light of market support, we will adopt the proposal.

### **G. Other comments and suggestions**

264. A respondent suggested that the Exchange should provide an alternative trading platform for trading of securities of issuers that "were pending to be delisted" or "had been delisted", or arrangements similar to "ST" adopted in the PRC, such that those securities could continue to be traded in the market until they were formally delisted, thereby help minimizing the potential loss of shareholders.

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<sup>24</sup> See Question 11 of FAQ series 7 for an example where the Exchange may require an issuer to submit alternative revenue and profits ratios for future transactions.

265. A respondent provided other suggestions to deter issuers from becoming cash shells: (a) to require issuers that had been suspended for six months after being ruled as cash company to convene a mandatory shareholder meeting to vote on distribution of cash by either capital return or dividend in order to reduce the cash level. Controlling shareholders and their affiliates should abstain. If the proposed distribution was supported by minority shareholders, the issuer could reduce cash and re-comply with the Rules. If not, the Exchange might continue to suspend the issuers and/or proceed with delisting them; and (b) to require a supermajority (75%) approval for a transaction where a cash company would be created through disposing a substantial part of its assets, or the issuer intended to use the disposal proceeds to substantially change its principal business.
266. Another respondent generally supported the proposals and provided additional suggestions that were unrelated to the proposals, namely, on (i) improving disclosure by issuers on how transactions were monitored over the approval period and subsequent developments (such as breach of pre-set conditions), and (ii) other alternatives to the “comply or explain” approach in the corporate governance reports to increase the accountability and transparency of listed issuers. It also proposed full disclosure of cross-shareholdings between issuers (including the unwinding of such cross-shareholdings), because the practice of cross-shareholdings went against market principles of fairness as issuers were expected to do business with those they had shareholding relationships, instead of those that best met requirements.
267. We welcome the comments and suggestions. As they are not within the scope of this consultation, we will give further consideration in the future, where appropriate.

## APPENDIX I : SUMMARY OF CONCLUSIONS ON PROPOSALS

| Proposals in the Consultation Paper |  | Recommendations in Consultation Conclusion  | Proposed Rules reference       |                                |
|-------------------------------------|--|---|--------------------------------|--------------------------------|
|                                     |  |   | MB                             | GEM                            |
| 1                                   | Codify the six assessment factors under the principle based test in a Note to the proposed Rule 14.06B.  | Adopted (with modifications set out in proposals 2 and 3 below).  | Note 1 to 14.06B               | Note 1 to 19.06B               |
| 2                                   | Extend the current factor “issue of restricted convertible securities” in the principle based test to include any change in control or de facto control of issuers.  | Adopted with modifications to the indicative factors for assessing any change in control or de facto control as follows: (i) a change in controlling shareholder of the issuer; or (ii) a change in the single largest substantial shareholder who is able to exercise effective control over the issuer as indicated by factors such as a substantial change to its board of directors and/or senior management. | Note 1(e) to 14.06B            | Note 1(e) to 19.06B            |
| 3(a)                                | As regards the “series of transactions and/or arrangements” factor, include transactions and/or arrangements that take place in reasonable proximity (normally within a 36-month period) or are otherwise related.   | Adopted with modifications to the scope of transactions and/or arrangements that may fall under a series by removing the references to “greenfield operations”, “equity fundraisings” and “termination of businesses”.  | Note 1(f) to 14.06B, 14.22     | Note 1(f) to 19.06B, 19.22     |
| 3(b)                                | Amend Rule 14.06B to clarify that a series of acquisitions may include proposed and/or completed acquisitions.   | Adopted by making clear in Rule 14.04(2A) that a series of transactions and/or arrangements may include completed acquisition(s). Removed the reference to “proposed, intended and/or completed” acquisitions from Rule 14.06B.   | 14.04(2A), Note 1(f) to 14.06B | 19.04(2A), Note 1(f) to 19.06B |
| 4(a)                                | Retain the bright line tests under Rules 14.06(6)(a) and (b) in a Note to the proposed Rule 14.06B.  | Adopted.  | Note 2 to 14.06B               | Note 2 to 19.06B               |
| 4(b)                                | Extend the aggregation period from 24 months to 36 months under the bright line test currently set out in Rule 14.06(6)(b).  | Adopted.  | Note 2 to 14.06B               | Note 2 to 19.06B               |
| 5(a)                                | Proposed changes to Rule 14.92 (proposed Rule 14.06E) to restrict any material disposal of an issuer’s existing business at the time of or within 36 months after a change in control, unless its remaining business or the asset(s) acquired would meet Rule 8.05 requirements. | Adopted with modifications to the proposed Rule to cover a series of disposal (and not just a single disposal), and to refer to a “proposed” change in control of the issuer (and not a “proposed or intended” change in control) and “a disposal of all or a material part of the issuer’s business” (and not a “material disposal”).  | 14.06E(1)                      | 19.06E(1)                      |

| Proposals in the Consultation Paper |  | Recommendations in Consultation Conclusion   | Proposed Rules reference   |  |
|-------------------------------------|--|--|--|--|
|                                     |  |  | MB   | GEM  |
| 5(b)                                | Add a Note to proposed Rule 14.06E to provide the Exchange with a discretion to apply the disposal restriction at the time of or within 36 months after a change in the issuer's single largest substantial shareholder.   | Adopted with modification to clarify that when the Exchange applies its discretion, it will make reference to the "change in control or de facto control" factor under Rule 14.06B (and not "a change in the issuer's single largest substantial shareholder").  | Note to 14.06E   | Note to 19.06E   |
| 6(a)                                | Add a new Rule 14.06C for "extreme transactions" such that issuers may use the extreme transaction category if the issuer can demonstrate that the transaction is not an attempt to circumvent the new listing requirements and it has been (i) operating a principal business with substantial size which will continue after the transaction, or (ii) under the control of a large business enterprise for a long period (normally not less than 36 months) and the transaction forms part of a business restructuring of the group and would not result in a change in control. | Adopted with modifications to the second proposed eligibility criterion such that issuer may use extreme transaction category if the issuer can demonstrate that the transaction is not an attempt to circumvent the new listing requirements and it has been under the control or de facto control of the same person (or group of persons) for a long period (normally not less than 36 months), and the proposed transaction would not result in a change in control or de facto control. | 14.04(7),<br>14.06C,<br>14.34,<br>14.35,<br>14.53A,<br>14.58           | 19.04(7),<br>19.06C,<br>19.34,<br>19.35,<br>19.53A,<br>19.58           |
| 6(b)                                | Impose disclosure requirements for circulars of extreme transactions set out in proposed Rules 14.53A(1) and 14.69.  | Adopted.   | 4.01(3),<br>4.26,<br>14.53A(1),<br>14.63,<br>14.69(1)(d),<br>14.71     | 7.01(3),<br>7.28,<br>19.53A(1),<br>19.63,<br>19.69(1)(d),<br>19.71     |
| 6(c)                                | Impose due diligence requirements for extreme transactions under proposed Rule 14.53A(2).  | Adopted.   | 13.87A,<br>13.87B,<br>13.87C,<br>14.53A(2),<br>Appendices<br>29 and 30 | 17.99A,<br>17.99B,<br>17.99C,<br>19.53A(2),<br>Appendices<br>21 and 22 |
| 7(a)                                | Amend Rule 14.54 and add Rule 14.06C(2) as described in paragraph 69(i) of the Consultation Paper.   | Adopted with an amendment to correct a drafting error in note 1 to Rule 14.54 such that the acquisition targets (and not <u>each</u> of the targets in a series of acquisitions) must meet the new listing requirements.   | 14.06C(2),<br>14.54(1)   | 19.06C(2),<br>19.54(1)   |
| 7(b)                                | Amend Rule 14.54 to impose additional requirements on RTOs proposed by Rule 13.24 issuers (as described in paragraph 69(ii) of the Consultation Paper).  | Adopted with modifications to require (i) the acquisition targets to meet Rules 8.04, 8.05 and 8.07 (and not all the new listing requirements) and (ii) the enlarged group to meet all the new listing requirements under Chapter 8 except Rule 8.05.  | 14.54(2)   | 19.54(2)   |
| 8(a)                                | Clarify the track record requirements for extreme transactions and RTOs that involve a series of transactions and/or arrangements (proposed Rule 14.57A).  | Adopted.   | 14.57A(1)  | 19.57A(1)  |

| Proposals in the Consultation Paper |  | Recommendations in Consultation Conclusion  | Proposed Rules reference |                  |
|-------------------------------------|--|---|--------------------------|------------------|
|                                     |  |   | MB                       | GEM              |
| 8(b)                                | Require issuers to prepare pro forma income statement of all the acquisition targets in the entire series of acquisitions (where applicable, would include any new business developed by the issuer that forms part of the series) for the track record period (proposed Rule 4.30). | Adopted with modification to require the issuer to submit financial information to the Exchange to demonstrate compliance with Rule 8.05 by the acquisition targets as a whole (instead of preparing and publishing pro forma information for the series of acquisitions).  | 14.57A(2)                | 19.57A(2)        |
| 9                                   | Add a new Rule 14.06D to codify, with modification, the practice under Guidance Letter GL84-15 (as described in paragraph 81 of the Consultation Paper).   | Adopted with a modification to clarify that Rule 14.06D applies to equity fundraisings that involve a change in control or de facto control of the issuer.  | 14.06D                   | 19.06D           |
| 10                                  | Require issuers to have a business with a sufficient level of operations and assets of sufficient value to support its operations to warrant the continued listing of the issuers' securities.   | Adopted.  | 13.24(1)                 | 17.26(1)         |
| 11(a)                               | Add a Note to the proposed Rule 13.24(1) as described in paragraphs 107 to 109 of the Consultation Paper, including specifying that the onus is on the issuer to demonstrate to the Exchange's satisfaction that it is in compliance with the Rule.                                  | Adopted with modification to clarify that the onus is on the issuer to provide information for the Exchange's assessment about its compliance with Rule 13.24.  | Note to 13.24(1)         | Note to 17.26(1) |
| 11(b)                               | Remove the Note to Rule 13.24 (as described in paragraph 112 of the Consultation Paper).   | Adopted.  | Note to 13.24(1)         | Note to 17.26(1) |
| 12                                  | Exclude an issuer's securities trading and/or investment activities (other than a Chapter 21 company) when considering the sufficiency of the issuer's operations and assets under Rule 13.24.   | Adopted with modifications to clarify that the Rule would apply to an issuer's proprietary trading and/or investment in securities, and to exempt proprietary trading and/or investment in securities carried out in the ordinary and usual course of business by a member of the issuer's group that is a banking company; an insurance company; or a securities house that is mainly engaged in regulated activities under the SFO. | 13.24(2)                 | 17.26(2)         |
| 13                                  | Extend the definition of short-dated securities in the cash company Rules to cover investments that are easily convertible into cash ("short-term investments").   | Adopted with modifications to the proposed Rule to clarify the purpose of the Rule and the scope of short-term investments (i.e. securities that are held for investment or trading purposes and are readily realisable or convertible into cash). Removed the references to "the issuer's intention" and "advances to third parties".  | 14.82                    | 19.82            |

| Proposals in the Consultation Paper |   | Recommendations in Consultation Conclusion   | Proposed Rules reference                                    |  |
|-------------------------------------|---|--|---|--|
|                                     |   |  | MB  | GEM  |
| 14                                  | Confine the exemption under Rule 14.83 to clients' assets relating to the issuer's securities brokerage business only.  | Adopted with modifications to exempt cash and short-term investments held by a member of an issuer's group that is a banking company, an insurance company or a securities house, but this exemption will not apply to an issuer that operates a securities house where the Exchange has concerns that the issuer is holding cash and short-term investments through the member to circumvent Rule 14.82. Also made consequential changes to Rule 8.05C. | 8.05C,<br>14.04(5A),<br>14.83                               | 11.06,<br>19.04(5A),<br>19.83              |
| 15                                  | Confine the revenue exemption for purchases and sales of securities to cases where they are conducted by banking companies, insurance companies and securities houses within the listed issuer's group.                                 | Adopted with a modification to clarify that where the member of an issuer's group is a securities house, that member should be mainly engaged in regulated activities under the SFO.   | Note 2 to<br>14.04(1)(g),<br>14.04(5A)                      | Note 2 to<br>19.04(1)(g),<br>19.04(5A)     |
| 16                                  | Require issuers to disclose in their annual reports details of each securities investment that represents 5% or more of their total assets (as described in paragraph 134 of the Consultation Paper).                                   | Adopted with modifications to clarify that the 5% threshold is based on the issuer's investments in each investee company as at the end of the reporting period and to require disclosure of both the number and percentage of shares held by the issuer in the underlying company.  | Paragraph<br>32(4A) of<br>Appendix 16                       | 18.41(4A)                                  |
| 17                                  | Codify the requirements set out in Listing Decision LD75-4 for significant distribution in specie of unlisted assets into the Rules (as described in paragraph 137 of the Consultation Paper).  | Adopted.   | 14.94   | 19.93                                      |
| 18                                  | Require disclosure on any subsequent change and the outcome of any financial performance guarantee of a target acquired by the issuer in a notifiable or connected transaction (as set out in paragraph 140 of the Consultation Paper). | Adopted.   | 14.36B,<br>14A.63,<br>Paragraph<br>6.3(i) of<br>Appendix 16 | 19.36B,<br>20.61,<br>Note 4(h) to<br>18.07 |
| 19(a)                               | Require disclosure on the identity of the parties to a transaction in the announcements and circulars of notifiable transactions.   | Adopted.   | 14.58(2)  | 19.58(2)                                   |
| 19(b)                               | Require disclosure on the identities and activities of the parties to the transaction and of their ultimate beneficial owners in the announcements of connected transactions.   | Adopted.   | 14A.68(1A),<br>14A.70(3)                                    | 20.66(1A),<br>20.68(3)                     |

| Proposals in the Consultation Paper |   | Recommendations in Consultation Conclusion | Proposed Rules reference |              |
|-------------------------------------|---|--|--------------------------|--------------|
|                                     |   |  | MB                       | GEM          |
| 20                                  | Make clear that if any calculation of the percentage ratios produces an anomalous result or is inappropriate to the sphere of activities of the issuer, the Exchange (or the issuer) may apply an alternative size test that it considers appropriate to assess the materiality of a transaction under Chapter 14 or 14A. | Adopted.                                   | 14.20,<br>14A.80         | 19.20, 20.78 |

## APPENDIX II : SUMMARY RESULT OF QUANTITATIVE ANALYSIS

| Proposals in the Consultation Paper |  | Feedback    |             |   |            |
|-------------------------------------|--|-------------|-------------|---|------------|
|                                     |  | Support     | Against     | Partly agree/<br>disagree,<br>or comments<br>only | No view    |
| 1                                   | Codify the six assessment factors under the principle based test in a Note to the proposed Rule 14.06B.  | 30<br>(57%) | 15<br>(28%) | -<br>(-)  | 8<br>(15%) |
| 2                                   | Extend the current factor “issue of restricted convertible securities” in the principle based test to include any change in control or de facto control of issuers.  | 29<br>(55%) | 15<br>(28%) | 2<br>(4%)   | 7<br>(13%) |
| 3(a)                                | As regards the “series of transactions and/or arrangements” factor, include transactions and/or arrangements that take place in reasonable proximity (normally within a 36-month period) or are otherwise related.   | 21<br>(40%) | 20<br>(38%) | 5<br>(9%)   | 7<br>(13%) |
| 3(b)                                | Amend Rule 14.06B to clarify that a series of acquisitions may include proposed and/or completed acquisitions.   | 25<br>(47%) | 18<br>(34%) | 2<br>(4%)   | 8<br>(15%) |
| 4(a)                                | Retain the bright line tests under Rules 14.06(6)(a) and (b) in a Note to the proposed Rule 14.06B.  | 40<br>(75%) | 4<br>(8%)   | -<br>(-)  | 9<br>(17%) |
| 4(b)                                | Extend the aggregation period from 24 months to 36 months under the bright line test currently set out in Rule 14.06(6)(b).  | 19<br>(36%) | 24<br>(45%) | 2<br>(4%)   | 8<br>(15%) |
| 5(a)                                | Proposed changes to Rule 14.92 (proposed Rule 14.06E) to restrict any material disposal of an issuer’s existing business at the time of or within 36 months after a change in control, unless its remaining business or the asset(s) acquired would meet Rule 8.05 requirements. | 24<br>(45%) | 18<br>(34%) | 4<br>(8%)   | 7<br>(13%) |
| 5(b)                                | Add a Note to proposed Rule 14.06E to provide the Exchange with a discretion to apply the disposal restriction at the time of or within 36 months after a change in the issuer’s single largest substantial shareholder.   | 24<br>(45%) | 18<br>(34%) | 2<br>(4%)   | 9<br>(17%) |

| Proposals in the Consultation Paper |  | Feedback    |             |   |             |
|-------------------------------------|--|-------------|-------------|---|-------------|
|                                     |  | Support     | Against     | Partly agree/<br>disagree,<br>or comments<br>only | No view     |
| 6(a)                                | Add a new Rule 14.06C for “extreme transactions” such that issuers may use the extreme transaction category if the issuer can demonstrate that the transaction is not an attempt to circumvent the new listing requirements and it has been (i) operating a principal business with substantial size which will continue after the transaction, or (ii) under the control of a large business enterprise for a long period (normally not less than 36 months) and the transaction forms part of a business restructuring of the group and would not result in a change in control. | 24<br>(45%) | 17<br>(32%) | 4<br>(8%)   | 8<br>(15%)  |
| 6(b)                                | Impose disclosure requirements for circulars of extreme transactions set out in proposed Rules 14.53A(1) and 14.69.  | 37<br>(70%) | 6<br>(11%)  | -<br>(-)  | 10<br>(19%) |
| 6(c)                                | Impose due diligence requirements for extreme transactions under proposed Rule 14.53A(2).  | 37<br>(70%) | 6<br>(11%)  | -<br>(-)  | 10<br>(19%) |
| 7(a)                                | Amend Rule 14.54 and add Rule 14.06C(2) as described in paragraph 69(i) of the Consultation Paper.   | 26<br>(49%) | 16<br>(30%) | 1<br>(2%)   | 10<br>(19%) |
| 7(b)                                | Amend Rule 14.54 to impose additional requirements on RTOs proposed by Rule 13.24 issuers (as described in paragraph 69(ii) of the Consultation Paper).  | 22<br>(41%) | 20<br>(38%) | 3<br>(6%)   | 8<br>(15%)  |
| 8(a)                                | Clarify the track record requirements for extreme transactions and RTOs that involve a series of transactions and/or arrangements (proposed Rule 14.57A).  | 32<br>(60%) | 11<br>(21%) | -<br>(-)  | 10<br>(19%) |
| 8(b)                                | Require issuers to prepare pro forma income statement of all the acquisition targets in the entire series of acquisitions (where applicable, would include any new business developed by the issuer that forms part of the series) for the track record period (proposed Rule 4.30).   | 32<br>(60%) | 11<br>(21%) | 1<br>(2%)   | 9<br>(17%)  |
| 9                                   | Add a new Rule 14.06D to codify, with modification, the practice under Guidance Letter GL84-15 (as described in paragraph 81 of the Consultation Paper).   | 27<br>(51%) | 15<br>(28%) | 1<br>(2%)   | 10<br>(19%) |

| Proposals in the Consultation Paper |   | Feedback    |             |   |             |
|-------------------------------------|---|-------------|-------------|---|-------------|
|                                     |   | Support     | Against     | Partly agree/<br>disagree,<br>or comments<br>only | No view     |
| 10                                  | Require issuers to have a business with a sufficient level of operations and assets of sufficient value to support its operations to warrant the continued listing of the issuers' securities.  | 25<br>(47%) | 16<br>(30%) | 1<br>(2%)   | 11<br>(21%) |
| 11(a)                               | Add a Note to the proposed Rule 13.24(1) as described in paragraphs 107 to 109 of the Consultation Paper, including specifying that the onus is upon the issuer to demonstrate to the Exchange's satisfaction that it is in compliance with the Rule. | 31<br>(58%) | 8<br>(15%)  | 4<br>(8%)   | 10<br>(19%) |
| 11(b)                               | Remove the Note to Rule 13.24 (as described in paragraph 112 of the Consultation Paper).  | 32<br>(60%) | 9<br>(17%)  | 1<br>(2%)   | 11<br>(21%) |
| 12                                  | Exclude an issuer's securities trading and/or investment activities (other than a Chapter 21 company) when considering the sufficiency of the issuer's operations and assets under Rule 13.24.  | 24<br>(45%) | 17<br>(32%) | 1<br>(2%)   | 11<br>(21%) |
| 13                                  | Extend the definition of short-dated securities in the cash company Rules to cover investments that are easily convertible into cash ("short-term investments").  | 31<br>(58%) | 11<br>(21%) | -<br>(-)  | 11<br>(21%) |
| 14                                  | Confine the exemption under Rule 14.83 to clients' assets relating to the issuer's securities brokerage business only.  | 33<br>(62%) | 10<br>(19%) | 1<br>(2%)   | 9<br>(17%)  |
| 15                                  | Confine the revenue exemption for purchases and sales of securities to cases where they are conducted by banking companies, insurance companies and securities houses within the listed issuer's group.   | 29<br>(55%) | 14<br>(26%) | 1<br>(2%)   | 9<br>(17%)  |
| 16                                  | Require issuers to disclose in their annual reports details of each securities investment that represents 5% or more of their total assets (as described in paragraph 134 of the Consultation Paper).   | 37<br>(70%) | 5<br>(9%)   | 2<br>(4%)   | 9<br>(17%)  |
| 17                                  | Codify the requirements set out in Listing Decision LD75-4 for significant distribution in specie of unlisted assets into the Rules (as described in paragraph 137 of the Consultation Paper).  | 38<br>(72%) | 4<br>(7%)   | -<br>(-)  | 11<br>(21%) |

| Proposals in the Consultation Paper |   | Feedback    |           |   |             |
|-------------------------------------|---|-------------|-----------|---|-------------|
|                                     |   | Support     | Against   | Partly agree/<br>disagree,<br>or comments<br>only | No view     |
| 18                                  | Require disclosure on any subsequent change and the outcome of any financial performance guarantee of a target acquired by the issuer in a notifiable or connected transaction (as set out in paragraph 140 of the Consultation Paper).   | 39<br>(73%) | 3<br>(6%) | 1<br>(2%)   | 10<br>(19%) |
| 19(a)                               | Require disclosure on the identity of the parties to a transaction in the announcements and circulars of notifiable transactions.   | 36<br>(68%) | 5<br>(9%) | 3<br>(6%)   | 9<br>(17%)  |
| 19(b)                               | Require disclosure on the identities and activities of the parties to the transaction and of their ultimate beneficial owners in the announcements of connected transactions.   | 38<br>(68%) | 3<br>(9%) | 3<br>(6%)   | 9<br>(17%)  |
| 20                                  | Make clear that if any calculation of the percentage ratios produces an anomalous result or is inappropriate to the sphere of activities of the issuer, the Exchange (or the issuer) may apply an alternative size test that it considers appropriate to assess the materiality of a transaction under Chapter 14 or 14A. | 37<br>(70%) | 5<br>(9%) | -<br>(-)  | 11<br>(21%) |

Note:

1. If the entire body of the response is identical, word-for-word, with the entire body of another response, it will be recorded as a "duplicate response" and it will not be counted for the purpose of a quantitative and qualitative analysis of the responses. As 68 responses, out of a total of 121 responses received, were entirely identical in content to other responses, we received a total of 53 original responses.

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## APPENDIX III : AMENDMENTS TO THE LISTING RULES

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### Amendments to Main Board Listing Rules

#### Chapter 4

#### GENERAL

#### ACCOUNTANTS' REPORTS AND PRO FORMA FINANCIAL INFORMATION

##### When Required

4.01 This Chapter sets out the detailed requirements for ... . Accountants' reports are required to be included in the following listing documents and circulars: -

...

- (3) a circular issued in connection with a reverse takeover (see rule 14.69), an extreme transaction (see rule 14.69), a very substantial acquisition (see rule 14.69) or a major transaction (see rule 14.67) (unless the company being acquired is itself a listed company on the Main Board or GEM).

...

4.26 In the cases referred to in rule 4.01(3) concerning a circular in connection with a reverse takeover, an extreme transaction or a very substantial acquisition, the pro forma financial information required under rules 14.69(4)(a)(ii) or 14.69(4)(b)(ii) on the enlarged group (i.e. the issuer, its subsidiaries and any business or subsidiary or, where applicable, assets acquired or proposed to be acquired since the date to which the latest audited financial statements of the issuer have been made up (including but not limited to any business, company or companies being acquired)) must include all the information referred to in rule 4.29 in respect of such enlarged group.

...

## Chapter 6

### GENERAL

#### TRADING HALT, SUSPENSION, CANCELLATION AND WITHDRAWAL OF LISTING

6.01 Listing is always granted subject to the condition that where the Exchange considers it necessary for the protection of the investor or the maintenance of an orderly market, it may at any time direct a trading halt or suspend dealings in any securities or cancel the listing of any securities in such circumstances and subject to such conditions as it thinks fit, whether requested by the issuer or not. The Exchange may also do so where:-

...

- (3) the Exchange considers that the issuer does not carry on a business as required under ~~have a sufficient level of operations or sufficient assets to warrant the continued listing of the issuer's securities (see rule 13.24);~~ or

...

## Chapter 8

### EQUITY SECURITIES

#### QUALIFICATIONS FOR LISTING

...

8.05C (1) ~~An issuer or group (other than an investment company in which case the conditions set out in Chapter 21 apply) will not be regarded as suitable for listing if its group's whose assets consist wholly or substantially of cash and/or short-term investments (as defined in the notes to rule 14.82) or short-dated securities will not normally be regarded as suitable for listing, except where the issuer or group is solely or mainly engaged in the securities brokerage business. "Short-dated securities" means securities such as bonds, bills or notes which have less than one year to maturity.~~

- (2) Cash and/or short-term investments held by a member of an issuer's group that is a banking company (as defined in rule 14A.88), an insurance company (as defined in rule 14.04) or a securities house (as defined in rule 14.04) will normally not be taken into account when applying rule 8.05C(1).

Note: This exemption will not apply to an issuer that operates a securities house where the Exchange has concerns that the issuer is holding cash and short-term investments through a member to circumvent rule 8.05C(1). For example, an issuer holding excessive cash and/or securities investments cannot circumvent the rule by holding such assets through a member that is a licensed broker with minimal brokerage operations. The Exchange will apply a principle based approach and consider, among others, the cash and/or short-term investments in light of the member's operating model and its cash needs for the purpose of its regulated activities, which should be substantiated by its historical track record.

Note: See Practice Note 3

...

## Chapter 13

### EQUITY SECURITIES

#### CONTINUING OBLIGATIONS

...

#### Sufficient operations

- 13.24 (1) An issuer shall carry out, directly or indirectly, a business with a sufficient level of operations and assets of sufficient value to support its operations ~~or have tangible assets of sufficient value and/or intangible assets for which a sufficient potential value can be demonstrated to the Exchange to warrant the continued listing of the issuer's securities.~~

~~Note: Characteristics of issuers which are unable to comply with rule 13.24 include:~~

- ~~(i) financial difficulties to an extent which seriously impairs an issuer's ability to continue its business or which has led to the suspension of some or all of its operations; and/or~~
- ~~(ii) issuers which have net liabilities as at their balance sheet date i.e. issuers whose liabilities exceed their assets.~~

Rule 13.24(1) is a qualitative test. The Exchange may consider an issuer to have failed to comply with the rule in situations where, for example, the Exchange considers that the issuer does not have a business that has substance and/or that is viable and sustainable.

The Exchange will make an assessment based on specific facts and circumstances of individual issuers. For example, when assessing whether a money lending business of a particular issuer is a business of substance, the Exchange may consider, among other factors, the business model, operating scale and history, source of funding, size and diversity of customer base and loan portfolio and internal control systems of the money lending business of that particular issuer, taking into account the norms and standards of the relevant industry.

Where the Exchange raises concerns with an issuer about its compliance with the rule, the onus is on the issuer to provide information to address the Exchange's concerns and demonstrate to the satisfaction of the Exchange its compliance with the rule.

- (2) Proprietary trading and/or investment in securities by an issuer and its subsidiaries (other than an issuer which is an investment company listed under Chapter 21) are normally excluded when considering whether the issuer can meet rule 13.24(1).

Note: This rule would not normally apply to proprietary securities trading and/or investment activities carried out in the ordinary and usual course of business by a member of an issuer's group that is:

- (a) a banking company (as defined in rule 14A.88);
- (b) an insurance company (as defined in rule 14.04); or
- (c) a securities house (as defined in rule 14.04) that is mainly engaged in regulated activities under the SFO. It should be noted that proprietary securities trading and/or investment is not a regulated activity under the SFO and accordingly, this exemption is not available where proprietary securities trading and/or investment constitutes a significant part of the business of the securities house.

...

### **Financial advisers appointed in relation to extreme transactions**

13.87A A financial adviser appointed by a listed issuer under rule 14.53A(2) in relation to an extreme transaction must conduct reasonable due diligence on the assets acquired and/or to be acquired under the extreme transaction to put itself in a position to be able to make the declaration in Appendix 29. The extent of its work and scope of due diligence shall be referenced to Practice Note 21 to the Listing Rules.

13.87B The financial adviser must be a person licensed or registered under the SFO for Type 6 regulated activity and permitted under its license or certificate of registration to undertake the work of a sponsor. The financial adviser must submit to the Exchange an undertaking in the prescribed form set out in Appendix 30 to:

- (a) comply with the Listing Rules; and

- (b) co-operate in any investigation conducted by the Listing Division and/or the Listing Committee of the Exchange, including answering promptly and openly any questions addressed to the financial adviser, promptly producing the originals or copies of any relevant documents and attending before any meeting or hearing at which the financial adviser is requested to appear.

13.87C The issuer must assist the financial adviser to perform its duties. The requirements under rule 13.81 shall apply mutatis mutandis as if all references to “independent financial adviser” were references to “financial adviser”.

...

## Chapter 14

### EQUITY SECURITIES

#### NOTIFIABLE TRANSACTIONS

##### Preliminary

14.01 This Chapter deals with certain transactions, principally acquisitions and disposals, by a listed issuer. It describes how they are classified, the details that are required to be disclosed in respect of them and whether a circular and shareholders' approval are required. It also sets out provisions to deter circumvention of new listing requirements and considers additional requirements in respect of takeovers and mergers.

...

##### Definitions

14.04 For the purposes of this Chapter:-

- (1) any reference to a “transaction” by a listed issuer:

...

- (g) to the extent not expressly provided in rules 14.04(1)(a) to (f), excludes any transaction of a revenue nature in the ordinary and usual course of business (as referred to in rule 14.04(8)) of the listed issuer;

*Notes: 1 To the extent not expressly provided in rules 14.04(1)(a) to (f), any transaction of a revenue nature in the ordinary and usual course of business of a listed issuer will be exempt from the requirements of this Chapter.*

- 2 (a) *Any transaction involving the acquisition ~~and~~ or disposal of properties will generally not be considered to be of a revenue nature unless such transactions ~~are~~ is carried out as one of the principal activities and in the ordinary and usual course of business of the listed issuer.*

(b) Any transaction involving the acquisition or disposal of securities will generally not be considered to be of a revenue nature unless it is carried out in the ordinary and usual course of business by a member of the listed issuer's group that is:

(i) a banking company (as defined in rule 14A.88);

(ii) an insurance company; or

(iii) a securities house that is mainly engaged in regulated activities under the SFO. It should be noted that proprietary securities trading and/or investment is not a regulated activity under the SFO and accordingly, this exemption is not available where proprietary securities trading and/or investment constitutes a significant part of the business of the securities house.

3 ...

4 ...

...

(2A) “acquisition targets” in rules 14.06B, 14.06C, 14.53A, 14.54 and 14.57A mean the assets to be acquired, or in the context of a series of transactions and/or arrangements, the assets acquired and/or to be acquired. In other words, a series of transactions and/or arrangements may include completed acquisition(s);

...

(5A) an “insurance company” means a company which is authorized to carry out insurance business under the Insurance Ordinance or appropriate overseas legislation or authority. For the avoidance of doubt, an “insurance company” does not include an insurance broker or insurance agent;

(6) a “listed issuer” means a company or other legal person whose securities are already listed on the Main Board–, including a company whose shares are represented by listed depositary receipts, and unless the context otherwise requires, includes its subsidiaries;

(7) a “notifiable transaction” means a transaction classified as a share transaction, discloseable transaction, major transaction, very substantial disposal, or very substantial acquisition or reverse takeover under rule 14.06 or a transaction classified as a reverse takeover or extreme transaction under rule 14.06B or 14.06C;

...

- (11) a “securities house” means a corporation which is licensed or registered under the Securities and Futures Ordinance for Type 1 (dealing in securities) or Type 8 (securities margin financing) regulated activity;

...

### **Classification and explanation of terms**

14.05 A listed issuer considering a transaction must, at an early stage, consider whether the transaction falls into one of the classifications set out in rule 14.06, 14.06B or 14.06C. In this regard, the listed issuer must determine whether or not to consult its financial, legal or other professional advisers. Listed issuers or advisers which are in any doubt as to the application of the requirements in this Chapter should consult the Exchange at an early stage.

14.06 The transaction classification is made by using the percentage ratios set out in rule 14.07. The classifications are:—

...

- (5) very substantial acquisition — an acquisition or a series of acquisitions (aggregated under rules 14.22 and 14.23) of assets by a listed issuer where any percentage ratio is 100% or more; ~~and~~

### **Provisions to deter circumvention of new listing requirements**

14.06A The Exchange may impose additional requirements where it considers the arrangements of a listed issuer represent an attempt to circumvent the new listing requirements under the Listing Rules. These arrangements include circumstances set out below:

#### Reverse takeovers

14.06B ~~(6) reverse takeover—~~ A reverse takeover is an acquisition or a series of acquisitions of assets by a listed issuer which, in the opinion of the Exchange, constitutes, or is part of a transaction and/or arrangement or series of transactions and/or arrangements which constitute, an attempt to achieve a listing of the acquisition targets (as defined in rule 14.04(2A)) assets to be acquired and a means to circumvent the requirements for new applicants set out in Chapter 8 of the Exchange Listing Rules. A “reverse takeover” normally refers to:

#### Notes:

1. Rule 14.06B is aimed at preventing acquisitions that represent an attempt to circumvent the new listing requirements. In applying this principle based test, the Exchange will normally take into account the following factors:

- (a) the size of the acquisition or series of acquisitions relative to the size of the issuer;
- (b) a fundamental change in the issuer's principal business;
- (c) the nature and scale of the issuer's business before the acquisition or series of acquisitions;
- (d) the quality of the acquisition targets;
- (e) a change in control (as defined in the Takeovers Code) or de facto control of the listed issuer (other than at the level of its subsidiaries);

In assessing whether there has been a change in control or de facto control of the issuer, the Exchange will consider (i) any change in the controlling shareholder of the issuer; or (ii) any change in the single largest substantial shareholder who is able to exercise effective control over the issuer, as indicated by factors such as a substantial change to its board of directors and/or senior management.

In circumstances involving an issue of convertible securities with a conversion restriction mechanism to avoid triggering a change in control under the Takeovers Code (i.e. restricted convertible securities) to a vendor as the consideration for an acquisition, the Exchange will consider whether the issuance is a means to allow the vendor to effectively control the issuer;

- (f) other transactions or arrangements which, together with the acquisition or series of acquisitions, form a series of transactions or arrangements to list the acquisition targets.

These transactions or arrangements may include changes in control/de facto control, acquisitions and/or disposals. The Exchange may regard acquisitions and other transactions or arrangements as a series if they take place in a reasonable proximity to each other (which normally refers to a period of 36 months or less) or are otherwise related.

The Exchange will consider whether, taking the factors together, an issuer's acquisition or series of acquisitions constitute an attempt to list the acquisition targets and circumvent the new listing requirements.

- 2. Without limiting the generality of rule 14.06B, the following transactions are normally reverse takeovers (the bright line tests):

- (a) an acquisition or a series of acquisitions (aggregated under rules 14.22 and 14.23) of assets constituting a very substantial acquisition where there is or which will result in a change in control (as defined in the Takeovers Code) of the listed issuer (other than at the level of its subsidiaries); or

(b) acquisition(s) of assets from a person or a group of persons or any of his/their associates pursuant to an agreement, arrangement or understanding entered into by the listed issuer within 36 24-months of such person or group of persons gaining control (as defined in the Takeovers Code) of the listed issuer (other than at the level of its subsidiaries), where such gaining of control had not been regarded as a reverse takeover, which individually or together constitute(s) a very substantial acquisition. For the purpose of determining whether the acquisition(s) constitute(s) a very substantial acquisition, the lower of:

(A) the latest published figures of the asset value, revenue and profits as shown in the listed issuer's accounts and the market value of the listed issuer at the time of the change in control, which must be adjusted in the manner set out in rules 14.16, 14.17, 14.18 and 14.19, as applicable, up to the time of the change in control; and

(B) the latest published figures of the asset value, revenue and profits as shown in the listed issuer's accounts and the market value of the listed issuer at the time of the acquisition(s), which must be adjusted in the manner set out in rules 14.16, 14.17, 14.18 and 14.19, as applicable,

is to be used as the denominator of the percentage ratios.

*Note:*—Rule 14.06B 14.06(6) will apply irrespective of whether any general offer obligations under the Takeovers Code have been waived.

#### Extreme transactions

14.06C An “extreme transaction” is an acquisition or a series of acquisitions of assets by a listed issuer, which individually or together with other transactions or arrangements, may, by reference to the factors set out in Note 1 to rule 14.06B, have the effect of achieving a listing of the acquisition targets, but where the issuer can demonstrate to the satisfaction of the Exchange that it is not an attempt to circumvent the requirements for new applicants set out in Chapter 8 of the Listing Rules and that:

- (1) (a) the issuer (other than at the level of its subsidiaries) has been under the control or de facto control (by reference to the factors set out in Note 1(e) to rule 14.06B) of a person or group of persons for a long period (normally not less than 36 months), and the transaction would not result in a change in control or de facto control of the issuer; or
- (b) the issuer has been operating a principal business of a substantial size, which will continue after the transaction; and
- (2) the acquisition targets meet the requirements of rule 8.04 and rule 8.05 (or rule 8.05A or 8.05B) and the enlarged group meets all the new listing requirements set out in Chapter 8 of the Listing Rules (except rule 8.05).

Note: Where the extreme transaction involves a series of transactions and/or arrangements and the acquisition targets cannot meet rules 8.05(1)(b) and/or (c) due to a change in their ownership and management solely as a result of the acquisition by the issuer, the Exchange may grant a waiver from strict compliance with these rules based on the facts and circumstances of the case. In considering a waiver of rule 8.05(1)(b), the Exchange will consider, among others, whether the issuer has the expertise and experience in the relevant business/industry of the acquisition targets to ensure the effective management and operation of the acquisition targets.

#### Large scale issue of securities

14.06D Where a listed issuer proposes a large scale issue of new securities (including any shares, warrants, options or convertible securities) for cash to acquire and/or develop a new business, which, in the opinion of the Exchange, is a means to circumvent the new listing requirements and to achieve a listing of that new business, the Exchange may refuse to grant listing approval for the shares to be issued.

Note: This rule is an anti-avoidance provision to prevent circumvention of the new listing requirements. It is intended to apply to a large scale issue of securities for cash proposed by a listed issuer where there is, or which will result in, a change in control or de facto control of the issuer (by reference to the factors set out in Note 1(e) to rule 14.06B), and the proceeds are to be used to acquire and/or develop a new business that is expected to be substantially larger than the issuer's existing principal business. The effect of the proposal is to achieve a listing of the new business that would not have otherwise met the new listing requirements.

#### Restriction on disposals

14.06E (1) A listed issuer may not carry out a disposal or distribution in specie (or a series of disposals and/or distributions in specie) of all or a material part of its existing business: -

(a) where there is a proposed change in control (as defined in the Takeovers Code) of the listed issuer (other than at the level of its subsidiaries); or

(b) for a period of 36 months from a change in control (as defined in the Takeovers Code),

unless the remaining group, or the assets acquired from the person or group of persons gaining such control or his/their associates and any other assets acquired by the listed issuer after such change in control, can meet the requirements of rule 8.05 (or rule 8.05A or 8.05B).

(2) A disposal or distribution in specie (or a series of disposals and/or distributions in specie) by a listed issuer which does not meet the above requirement will result in the listed issuer being treated as a new listing applicant.

Note: The Exchange may apply this rule to a disposal or distribution in specie (or a series of disposals and/or distributions in specie) by a listed issuer of all or a material part of its existing business where (a) there is a proposed change in de facto control of the issuer (by reference to the factors set out in Note 1(e) to rule 14.06B); or (b) for a period of 36 months from such change, if the Exchange considers that the disposal(s) and/or distribution(s) in specie may form part of a series of arrangements to circumvent the new listing requirements.

...

#### *Exceptions to the classification rules*

- 14.20 Where any calculation of the percentage ratio produces an anomalous result or is inappropriate to the sphere of activity of the listed issuer, the listed issuer may apply to the Exchange to may, where any of the calculations of the percentage ratios produces an anomalous result or is inappropriate to the sphere of activity of the listed issuer, disregard the calculation and/or apply substitute other relevant indicators of size, including industry specific tests. The listed issuer must seek prior consent of the Exchange if it wishes to apply this rule and must provide alternative test(s) which it considers appropriate to the Exchange for consideration. The Exchange may also require the listed issuer to apply other size test(s) that the Exchange considers appropriate.

...

#### *Aggregation of transactions*

- 14.22 In addition to the aggregation of transactions under rules 14.06B, 14.06C and 14.06E of acquisitions under rule 14.06(6)(b), the Exchange may require listed issuers to aggregate a series of transactions and ...

...

### **Requirements for all transactions**

#### *Notification and announcement*

- 14.34 As soon as possible after the terms of a share transaction, discloseable transaction, major transaction, very substantial disposal, very substantial acquisition, extreme transaction or reverse takeover have been finalised, the listed issuer must in each case:-

...

- 14.35 For a share transaction, the announcement must contain the information set out in rules 14.58 and 14.59. For a discloseable transaction, major transaction, very substantial disposal, very substantial acquisition, extreme transaction or reverse takeover, the announcement must contain ...

...

Guaranteed profits or net assets

14.36B This rule applies to any notifiable transaction where the listed issuer acquires a company or business from a person and that person guarantees the profits or net assets or other matters regarding the financial performance of the company or business.

- (1) The listed issuer must disclose by way of an announcement any subsequent change to the terms of the guarantee and the reason therefor, and whether the issuer's board of directors considers that such change is fair and reasonable and in the interests of the shareholders as a whole.
- (2) If the actual performance fails to meet the guarantee (or where applicable, the guarantee as amended), the listed issuer must disclose the following by way of an announcement:
  - (a) the shortfall, and any adjustment in the consideration for the transaction or other consequence under the guarantee;
  - (b) whether the person has fulfilled its obligations under the guarantee;
  - (c) whether the listed issuer has exercised any option to sell the company or business back to the person or other rights it held under the terms of the guarantee, and the reasons for its decision; and
  - (d) the board of directors' opinion on:
    - (i) whether the person has fulfilled its obligations; and
    - (ii) whether the decision of the listed issuer to exercise or not to exercise any options or rights set out in rule 14.36B(2)(c) is fair and reasonable and in the interests of the shareholders as a whole.
- (3) The listed issuer must disclose whether the actual performance of the company or business acquired meets the guarantee in its next annual report.

...

**Additional requirements for extreme transactions**

14.53A In the case of an extreme transaction, the listed issuer must:

- (1) comply with the requirements for very substantial acquisitions set out in rules 14.48 to 14.53. The circular must contain the information required under rules 14.63 and 14.69; and

Note: See also rule 14.57A if the extreme transaction involves a series of transactions and/or arrangements.

- (2) appoint a financial adviser to perform due diligence on the acquisition targets to put itself in a position to be able to make a declaration in the prescribed form set out in Appendix 29. The financial adviser must submit to the Exchange the declaration before the bulk-printing of the circular for the transaction.

Note: See also rules 13.87A to 13.87C for the requirements relating to financial advisers.

#### **Additional requirements for reverse takeovers**

14.54 The Exchange will treat a listed issuer proposing a reverse takeover as if it were a new listing applicant.

- (1) ~~The enlarged group or the assets to be acquired~~ acquisition targets must be able to meet the requirements of rule 8.04 and rule 8.05 (or rule 8.05A or 8.05B), ~~and in addition,~~ the enlarged group must ~~be able to meet all the other basic conditions~~ new listing requirements set out in Chapter 8 of the Exchange-Listing Rules (except rule 8.05).
- (2) Where the reverse takeover is proposed by a listed issuer that has failed to comply with rule 13.24, the acquisition targets must also meet the requirement of rule 8.07 (in addition to the requirements for the acquisition targets and the enlarged group set out in rule 14.54(1)).
- (3) The listed issuer must comply with the requirements for all transactions set out in rules 14.34 to 14.37.

#### Notes:

1. For the purposes of (1) and (2) above, if the Exchange is aware of information suggesting that the reverse takeover is to avoid any new listing requirement, the listed issuer must demonstrate that the acquisition targets meet all the new listing requirements set out in Chapter 8 of the Listing Rules.
2. See also rule 14.57A if the reverse takeover involves a series of transactions and/or arrangements.
3. Where the reverse takeover involves a series of transactions and/or arrangements and the acquisition targets cannot meet rules 8.05(1)(b) and/or (c) due to a change in their ownership and management solely as a result of the acquisition by the issuer, the Exchange may grant a waiver from strict compliance with these rules based on the facts and circumstances of the case. In considering a waiver of rule 8.05(1)(b), the Exchange will consider, among others, whether the issuer has the expertise and experience in the relevant business/industry of the acquisition targets to ensure the effective management and operation of the acquisition targets.

...

## **Additional requirements for extreme transactions and reverse takeovers**

14.57A Where an extreme transaction or reverse takeover involves a series of transactions and/or arrangements: -

- (1) the track record period of the acquisition targets normally covers the three financial years immediately prior to the issue of the circular or listing document for the latest proposed transaction of the series; and
- (2) the listed issuer must provide sufficient information to the Exchange to demonstrate that the acquisition targets can meet the requirements under rule 8.05 (or rule 8.05A or 8.05B) (see rule 14.06C(2) or 14.54).

### **Contents of announcements**

#### *All transactions*

14.58 The announcement ~~of for~~ a share transaction, discloseable transaction, major transaction, very substantial disposal, very substantial acquisition, extreme transaction or reverse takeover must contain at least the following information:-

...

- (2) a description of the principal business activities carried on by the listed issuer and the identity and a general description of the principal business activities of the counterparty, ~~if the counterparty is a company or entity;~~

...

*Discloseable transaction, major transaction, very substantial disposal, very substantial acquisition, extreme transaction and reverse takeover announcements*

14.60 In addition to the information set out in rule 14.58, the announcement ~~of for~~ a discloseable transaction, ... very substantial acquisition, extreme transaction or reverse takeover must contain at least brief details of the following:-

...

### **Contents of circulars**

#### *General principles*

14.63 A circular ~~of for~~ a major transaction, very substantial disposal, ~~or~~ very substantial acquisition or extreme transaction and a listing document for a reverse takeover sent by a listed issuer to holders of its listed securities must:-

...

*Very substantial acquisition circulars, extreme transaction circulars  
and reverse takeover listing documents*

14.69 A circular issued for a very substantial acquisition or an extreme transaction or a listing document issued for a reverse takeover must contain:-

- (1) for a reverse takeover, or an extreme transaction:
  - (a) the information required under rule 14.66 (except for the information required under rules 14.66(2), 14.66(3), 14.66(10), 14.66(11)) and rules 14.67(3) and 14.67(7);
  - (b) the information required under Appendix 1, Part A, if it applies, except ... ; and
  - (c) [Repealed 1 January 2009]
  - (d)
    - (i) for a reverse takeover, information on the enlarged group's property interests (as defined in rule 5.01(3)) under rules 5.01A and 5.01B; and
    - (ii) for an extreme transaction, the information required under Chapter 5 on the property interests acquired and/or to be acquired by the issuer;

...

*Circulars for specific types of companies*

14.71 Where a major transaction, very substantial acquisition, very substantial disposal, extreme transaction or reverse takeover involves acquiring or disposing of an interest in an infrastructure project or ...

...

**Cash companies**

14.82 Where for any reason (including immediately after completion of a notifiable transaction or connected transaction) the assets of a listed issuer (other than an "investment company" as defined in Chapter 21 of the Exchange Listing Rules) consist wholly or substantially of cash ~~or short dated securities~~ and/or short-term investments, it will not be regarded as suitable for listing and trading in its securities will be suspended. ~~"Short dated securities" means securities such as bonds, bills or notes which have less than 1 year to maturity.~~

Notes:

1. Rule 14.82 is intended to apply to issuers that hold a very high level of cash and short-term investments. In assessing whether an issuer is a cash company, the Exchange will apply a principle based approach and normally take into account the value of the issuer's cash and short-term investments relative to its total assets, its level of operations and financial position, and the nature of the issuer's business and its cash needs in the ordinary and usual course of business.

2. Short-term investments include securities that are held by the issuer for investment or trading purposes and are readily realisable or convertible into cash. Examples of short-term investments include (a) bonds, bills or notes which have less than one year to maturity; (b) listed securities (whether on the Exchange or otherwise) that are held for investment or trading purposes; and (c) investments in other financial instruments that are readily realisable or convertible into cash.

14.83 Cash and short-term investments held by a member of an issuer's group that is a banking company (as defined in rule 14A.88), an insurance company or a securities house A listed issuer which is solely or mainly engaged in the securities brokerage business will normally not be taken into account when applying subject to rule 14.82.

Note: This exemption will not apply to an issuer that operates a securities house where the Exchange has concerns that the issuer is holding cash and short-term investments through a member to circumvent rule 14.82. For example, an issuer holding excessive cash and/or securities investments cannot circumvent the rule by holding such assets through a member that is a licensed broker with minimal brokerage operations. The Exchange will apply a principle based approach and consider, among others, the cash and/or short-term investments in light of the member's operating model and its cash needs for the purpose of its regulated activities, which should be substantiated by its historical track record.

14.84 The listed issuer may apply to the Exchange to lift the suspension once it has a business suitable for listing. The Exchange will treat its application for lifting of the suspension as if it were an application for listing from a new applicant. The listed issuer will be required, among other things, to issue a listing document containing the specific information required by Appendix I Part A, and pay the non-refundable initial listing fee. The Exchange reserves the right to cancel the listing if such suspension continues for more than 12 months or in any other case where it considers it necessary. It is therefore advisable to consult the Exchange at the earliest possible opportunity in each case.

...

#### **Restriction on Disposal**

14.92 ~~[Repealed [●]]A listed issuer may not dispose of its existing business for a period of 24 months after a change in control (as defined in the Takeovers Code) unless the assets acquired from the person or group of persons gaining such control or his/their associates and any other assets acquired by the listed issuer after such change in control can meet the trading record requirement of rule 8.05.~~

14.93 ~~[Repealed [●]]A disposal by a listed issuer which does not meet the requirement under rule 14.92 will result in the listed issuer being treated as a new listing applicant.~~

#### **Distribution in specie to shareholders**

14.94 Where a listed issuer proposes a distribution in specie (other than securities listed on the Main Board or GEM) and the size of the assets to be distributed would amount to a very substantial disposal based on the percentage ratio calculations:

- (1) The issuer must obtain prior approval of the distribution by independent shareholders in a general meeting. The issuer's controlling shareholders (or if there is no controlling shareholder, the directors (other than independent non-executive directors) and chief executive of the issuer) and their respective associates must abstain from voting in favour of the resolution. Further, the shareholders' approval for the distribution must be given by at least 75% of the votes attaching to any class of listed securities held by holders voting either in person or by proxy at the meeting, and the number of votes cast against the resolution is not more than 10% of the votes attaching to any class of listed securities held by holders permitted to vote in person or by proxy at the meeting.
- (2) The issuer's shareholders (other than the directors (excluding independent non-executive directors), chief executive and controlling shareholders) should be offered a reasonable cash alternative or other reasonable alternative for the distributed assets.

Note: Where the assets proposed to be distributed are securities listed in other jurisdictions, the Exchange may waive the requirements in rule 14.94(2) if the issuer can demonstrate that there is a liquid market for the securities, the shareholders may readily dispose of those securities, and where appropriate, the issuer will make arrangements to facilitate the shareholders to hold or dispose of those securities.

## Chapter 14A

### EQUITY SECURITIES

#### CONNECTED TRANSACTIONS

...

#### *Guaranteed profits or net ~~tangible~~-assets*

- 14A.62 The following apply if the listed issuer's group acquires a company or business from a connected person, and the connected person guarantees the profits or net ~~tangible~~-assets or other matters regarding the financial performance of the company or business.
- 14A.63 (1) The listed issuer must disclose by way of an announcement any subsequent change to the terms of the guarantee and the reason therefor, and whether the issuer's independent non-executive directors consider that such change is fair and reasonable and in the interests of the shareholders as a whole.
- (2) If the actual performance fails to meet the guarantee (or where applicable, the guarantee as amended), the listed issuer must disclose the following ~~in~~ by way of an announcement ~~and in its next annual report~~:
- (4a) the shortfall, and any adjustment in the consideration for the transaction or other consequence under the guarantee;
- (2b) whether the connected person has fulfilled its obligations under the guarantee;

(3c) whether the listed issuer's group has exercised any option to sell the company or business back to the connected person or other rights it held under the terms of the guarantee, and the reasons for its decision; and

(4d) the independent non-executive directors' opinion on:

(ai) whether the connected person has fulfilled its obligations; and

(bii) whether the decision of the listed issuer's group to exercise or not to exercise any options or rights set out in rule 14A.63(3)(2)(c) is fair and reasonable and in the interests of the shareholders as a whole.

(3) The listed issuer must disclose whether the actual performance of the company or business acquired meets the guarantee in its next annual report.

...

### **Announcements**

14A.68 An announcement ~~for~~of a connected transaction must contain at least:

(1) the information set out in rules 14.58 to 14.60 (contents of announcements for notifiable transactions);

(1A) the identities and a description of the principal business activities of the parties to the transaction and of their ultimate beneficial owner(s);

(2) the connected relationship between the parties to the transaction, and the connected person's interests in the transaction;

...

14A.70 The circular must contain at least:

...

(3) ~~the identity and activities~~identities and a description of the principal business activities of the parties to the transaction and of their ultimate beneficial owner(s);

...

### *Exception to percentage ratio calculations*

14A.80 If any calculation of the percentage ratio produces an anomalous result or is inappropriate to the sphere of activity of the listed issuer, the listed issuer may apply to the Exchange to may disregard the ratio calculation and/or apply other relevant indicators of size, including industry specific tests. consider alternative test(s) provided by the listed issuer. The listed issuer must seek prior consent of the Exchange if it wishes to apply this rule and must provide alternative test(s) which it considers appropriate to the Exchange for consideration. The Exchange may also require the listed issuer to apply other size test(s) that the Exchange considers appropriate.

...

## Appendix 16

### DISCLOSURE OF FINANCIAL INFORMATION

...

#### Information in annual reports

6. A listed issuer shall include the information as set out in paragraphs 8 to 34A in its annual report. ...

...

- 6.3 *An annual report shall contain the following information required under other parts of the Listing Rules:*

...

- (i) *information required under rule 14.36B and/or rule 14A.63 about any of profit-guarantee provided by a connected person regarding the financial performance of the a company or business acquired from the connected person under rule 14A.63;*

...

32. A listed issuer shall include in its annual report ... . As a minimum the directors of the listed issuer should comment on the following:-

...

- (4) significant investments held, their performance during the financial year and their future prospects;

- (4A) a breakdown of its significant investments (including any investment in an investee company with a value of 5 per cent. or more of the issuer's total assets as at the year end date):

- (a) details of each investment, including the name and principal businesses of the underlying company, the number and percentage of shares held and the investment costs;

- (b) the fair value of each investment as at the year end date and its size relative to the issuer's total assets;

- (c) the performance of each investment during the year, including any realised and unrealised gain or loss and any dividends received; and

- (d) a discussion of the issuer's investment strategy for these significant investments;

...

## Appendix 29

### FINANCIAL ADVISER'S DECLARATION (FOR EXTREME TRANSACTION)

To: The Listing Division  
The Stock Exchange of Hong Kong Limited

...../...../.....

We, ....., are the financial adviser appointed by .....  
(the "Company") on [Date] to perform due diligence on [a description of the proposed  
transaction] (the "Transaction") as required under rules 13.87A and 14.53A(2) of the Rules  
Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited (the  
"Rules") and have offices located at .....

Under Rules 13.87A and 14.53A(2), we declare to The Stock Exchange of Hong Kong  
Limited (the "Exchange") that:

- (a) having made reasonable due diligence inquiries, we have reasonable grounds to  
believe and do believe that:
- (i) the acquisition targets (as defined in Rule 14.04(2A)) are able to meet the  
requirements under Rule 8.04 and Rule 8.05 (or Rule 8.05A or 8.05B). In  
addition, the enlarged group is able to meet all the new listing requirements in  
Chapter 8 of the Rules (except for Rule 8.05 and those rules agreed with the  
Exchange);
  - (ii) the Company's circular contains sufficient particulars and information to enable a  
reasonable person to form as a result thereof a valid and justifiable opinion of the  
Transaction and the financial condition and profitability of the acquisition targets  
at the time of the issue of the circular;
  - (iii) the information in the non-expert sections of the circular:
    - (A) contains all information required by relevant legislation and rules;
    - (B) is true, accurate and complete in all material respects and not misleading  
or deceptive in any material respect, or, to the extent it consists of opinions  
or forward looking statements by the Company's directors or any other  
person, such opinions or forward looking statements have been made  
after due and careful consideration and on bases and assumptions that are  
fair and reasonable; and
    - (C) does not omit any matters or facts the omission of which would make any  
information in the non-expert sections of a circular or any other part of the  
circular misleading in a material respect; and
  - (iv) there are no other material issues relating to the Transaction which, in our  
opinion, should be disclosed to the Exchange;

(b) in relation to each expert section in the circular, having made reasonable due diligence inquiries, we have reasonable grounds to believe and do believe (to the standard reasonably expected of a financial adviser which is not itself expert in the matters dealt with in the relevant expert section) that:

(i) where the expert does not conduct its own verification of any material factual information on which the expert is relying for the purposes of any part of the expert section, such factual information is true in all material respects and does not omit any material information. Factual information includes:

(A) factual information that the expert states it is relying on;

(B) factual information we believe the expert is relying on; and

(C) any supporting or supplementary information given by the expert or the Company to the Exchange relating to an expert section;

(ii) all material bases and assumptions on which the expert sections of the circular are founded are fair, reasonable and complete;

(iii) the expert is appropriately qualified, experienced and sufficiently resourced to give the relevant opinion;

(iv) the expert's scope of work is appropriate to the opinion given and the opinion required to be given in the circumstances (where the scope of work is not set by a relevant professional body);

(v) the expert is independent from (1) the Company and its directors and controlling shareholder(s); (2) the counterparty to the Transaction and the acquisition targets; and (3) the directors and controlling shareholder(s) of the counterparty to the Transaction; and

(vi) the circular fairly represents the views of the expert and contains a fair copy of or extract from the expert's report; and

(c) in relation to the information in the expert reports, we, as a non-expert, after performing reasonable due diligence inquiries, have no reasonable grounds to believe and do not believe that the information in the expert reports is untrue, misleading or contains any material omissions.

Signed: .....

Name: .....

For and on behalf of: ..... *[insert the name of financial adviser]*

Dated: .....

**Note:** Each and every director of the financial adviser, and any officer or representative of the financial adviser supplying information sought in this form, should note that this form constitutes a record or document which is to be provided to the Exchange in connection with the performance of its functions under “relevant provisions” (as defined in Part 1 of Schedule 1 to the Securities and Futures Ordinance (Cap 571) as amended from time to time) and is likely to be relied upon by the Exchange. Therefore, you should be aware that giving to the Exchange any record or document which is false or misleading in a material particular will render relevant persons liable for prosecution for an offence under subsection 384(3) of the Securities and Futures Ordinance (Cap 571) as amended from time to time. If you have any queries you should consult the Exchange or your professional adviser immediately.

### **Appendix 30**

#### **FINANCIAL ADVISER’S UNDERTAKING (FOR EXTREME TRANSACTION)**

To: The Listing Division  
The Stock Exchange of Hong Kong Limited

...../...../.....

We, ....., are the financial adviser (the “Firm”) appointed by ..... (the “Company”) on [Date] to perform due diligence on [a description of the proposed transaction] (the “Transaction”) as required under rules 13.87A and 14.53A(2) of the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited (the “Rules”) and have offices located at .....

Pursuant to Rule 13.87B, we undertake to The Stock Exchange of Hong Kong Limited (the “Exchange”) that we shall:

- (a) comply with the Rules from time to time in force; and
- (b) cooperate in any investigation conducted by the Listing Division and/or the Listing Committee of the Exchange, including answering promptly and openly any questions addressed to us, promptly producing the originals or copies of any relevant documents and attending before any meeting or hearing at which we are requested to appear.

Signed: .....

Name: .....

For and on behalf of: ..... *[insert the name of financial adviser]*

Dated: .....

## Amendments to GEM Listing Rules

### Chapter 7

#### GENERAL

#### ACCOUNTANTS' REPORTS AND PRO FORMA FINANCIAL INFORMATION

##### When required

7.01 This Chapter sets out the detailed requirements for ... . Accountants' reports are required to be included in the following listing documents and circulars: -

...

- (3) a circular issued in connection with a major transaction, a very substantial acquisition, an extreme transaction or a reverse takeover (see rules 19.67 and 19.69) unless the company being acquired is itself a company listed on GEM or the Main Board.

...

7.28 In the cases referred to in rule 7.01(3) concerning a circular in connection with a reverse takeover, an extreme transaction or a very substantial acquisition, the pro forma financial information required under rules 19.69(4)(a)(ii) or 19.69(4)(b)(ii) on the enlarged group (i.e. the issuer, its subsidiaries and any business or subsidiary or, where applicable, assets acquired or proposed to be acquired since the date to which the latest audited financial statements of the issuer have been made up (including but not limited to any business, company or companies being acquired)) must include all the information referred to in rule 7.31 in respect of such enlarged group.

...

### Chapter 9

#### GENERAL

#### TRADING HALT, SUSPENSION AND RESUMPTION OF DEALINGS, CANCELLATION AND WITHDRAWAL OF LISTING

...

9.04 Under rule 9.01, the Exchange may direct a trading halt or suspend dealings in an issuer's securities regardless of whether or not the issuer has requested the same and may do so in any circumstances, including:-

...

- (3) where the Exchange considers that the issuer does not carry on a business as required under ~~have a sufficient level of operations or sufficient assets to warrant the continued listing of the issuer's securities (see rule 17.26);~~ or

...

## Chapter 11

### EQUITY SECURITIES

#### QUALIFICATIONS FOR LISTING

...

- 11.06 (1) Both the issuer and its business must, in the opinion of the Exchange, be suitable for listing. Without limiting the generality of this rule, an issuer will not be regarded as suitable for listing if its group's whose assets consist wholly or substantially of cash and/or short-term investments (as defined in the notes to rule 19.82) or short-dated securities will not normally be regarded as suitable for listing, except where the issuer or group is solely or mainly engaged in the securities brokerage business. "Short-dated securities" means securities such as bonds, bills or notes which have less than 1 year to maturity.
- (2) Cash and/or short-term investments held by a member of an issuer's group that is a banking company (as defined in rule 20.86), an insurance company (as defined in rule 19.04) or a securities house (as defined in rule 19.04) will normally not be taken into account when applying rule 11.06(1).

Note: This exemption will not apply to an issuer that operates a securities house where the Exchange has concerns that the issuer is holding cash and short-term investments through a member to circumvent rule 11.06(1). For example, an issuer holding excessive cash and/or securities investments cannot circumvent the rule by holding such assets through a member that is a licensed broker with minimal brokerage operations. The Exchange will apply a principle based approach and consider, among others, the cash and/or short-term investments in light of the member's operating model and its cash needs for the purpose of its regulated activities, which should be substantiated by its historical track record.

...

## Chapter 17

### EQUITY SECURITIES

#### CONTINUING OBLIGATIONS

...

#### *Sufficient operations*

- 17.26 (1) An issuer shall carry out, directly or indirectly, a business with a sufficient level of operations and assets of sufficient value to support its operations or have tangible assets of sufficient value and/or intangible assets for which a sufficient potential value can be demonstrated to the Exchange to warrant the continued listing of the issuer's securities.

~~Note: Characteristics of issuers which are unable to comply with rule 17.26 include:~~

- ~~(i) financial difficulties to an extent which seriously impairs an issuer's ability to continue its business or which has led to the suspension of some or all of its operations; and/or~~
- ~~(ii) issuers which have net liabilities as at their balance sheet date i.e. issuers whose liabilities exceed their assets.~~

Rule 17.26(1) is a qualitative test. The Exchange may consider an issuer to have failed to comply with the rule in situations where, for example, the Exchange considers that the issuer does not have a business that has substance and/or that is viable and sustainable.

The Exchange will make an assessment based on specific facts and circumstances of individual issuers. For example, when assessing whether a money lending business of a particular issuer is a business of substance, the Exchange may consider, among other factors, the business model, operating scale and history, source of funding, size and diversity of customer base and loan portfolio and internal control systems of the money lending business of that particular issuer, taking into account the norms and standards of the relevant industry.

Where the Exchange raises concerns with an issuer about its compliance with the rule, the onus is on the issuer to provide information to address the Exchange's concerns and demonstrate to the satisfaction of the Exchange its compliance with the rule.

- (2) Proprietary trading and/or investment in securities by an issuer and its subsidiaries are normally excluded when considering whether the issuer can meet rule 17.26(1).

Note: This rule would not normally apply to proprietary securities trading and/or investment activities carried out in the ordinary and usual course of business by a member of an issuer's group that is:

- (a) a banking company (as defined in rule 20.86);
- (b) an insurance company (as defined in rule 19.04); or
- (c) a securities house (as defined in rule 19.04) that is mainly engaged in regulated activities under the SFO. It should be noted that proprietary securities trading and/or investment is not a regulated activity under the SFO and accordingly, this exemption is not available where proprietary securities trading and/or investment constitutes a significant part of the business of the securities house.

...

### **Financial advisers appointed in relation to extreme transactions**

17.99A A financial adviser appointed by a listed issuer under rule 19.53A(2) in relation to an extreme transaction must conduct reasonable due diligence on the assets acquired and/or to be acquired under the extreme transaction to put itself in a position to be able to make the declaration in Appendix 21. The extent of its work and scope of due diligence shall be referenced to Practice Note 2 to the GEM Listing Rules.

17.99B The financial adviser must be a person licensed or registered under the SFO for Type 6 regulated activity and permitted under its license or certificate of registration to undertake the work of a sponsor. The financial adviser must submit to the Exchange an undertaking in the prescribed form set out in Appendix 22 to:

(a) comply with the GEM Listing Rules; and

(b) co-operate in any investigation conducted by the Listing Division and/or the GEM Listing Committee of the Exchange, including answering promptly and openly any questions addressed to the financial adviser, promptly producing the originals or copies of any relevant documents and attending before any meeting or hearing at which the financial adviser is requested to appear.

17.99C The issuer must assist the financial adviser to perform its duties. The requirements under rule 17.93 shall apply mutatis mutandis as if all references to “independent financial adviser” were references to “financial adviser”.

...

## **Chapter 18**

### **EQUITY SECURITIES**

#### **FINANCIAL INFORMATION**

...

*Information to accompany directors' report and annual financial statements*

18.07 The listed issuer shall include the disclosures required under the relevant accounting standards adopted and the information set out in rules 18.07A to 18.47 in its directors' report and annual financial statements. ...

...

4 An annual report shall contain the following information required under other parts of the GEM Listing Rules:

...

(h) information required under rule 19.36B and/or rule 20.61 about any of profit guarantee provided by a connected person regarding the financial performance of the a company or business acquired from the connected person under rule 20.61;

...

18.41 A discussion and analysis of the group's performance during the year and the material factors underlying its results and financial position. ... As a minimum the directors of the listed issuer should comment on the following:-

...

(4) significant investments held, their performance during the year and their future prospects;

(4A) a breakdown of its significant investments (including any investment in an investee company with a value of 5 per cent. or more of the issuer's total assets as at the year end date):

(a) details of each investment, including the name and principal businesses of the underlying company, the number and percentage of shares held and the investment costs;

(b) the fair value of each investment as at the year end date and its size relative to the issuer's total assets;

(c) the performance of each investment during the year, including any realised and unrealised gain or loss and any dividends received; and

(d) a discussion of the issuer's investment strategy for these significant investments;

...

## Chapter 19

### EQUITY SECURITIES

#### NOTIFIABLE TRANSACTIONS

##### Preliminary

19.01 This Chapter deals with certain transactions, principally acquisitions and disposals, by a listed issuer. It describes how they are classified, the details that are required to be disclosed in respect of them and whether a circular and shareholders' approval are required. It also sets out provisions to deter circumvention of new listing requirements and ~~considers~~ additional requirements in respect of takeovers and mergers.

...

##### Definitions

19.04 For the purposes of this Chapter:-

(1) any reference to a "transaction" by a listed issuer:

...

- (g) to the extent not expressly provided in rules 19.04(1)(a) to (f), excludes any transaction of a revenue nature in the ordinary and usual course of business (as referred to in rule 19.04(8)) of the listed issuer;

Notes: 1 *To the extent not expressly provided in rules 19.04(1)(a) to (f), any transaction of a revenue nature in the ordinary and usual course of business of a listed issuer will be exempt from the requirements of this Chapter.*

2 (a) *Any transaction involving the acquisition ~~and~~ or disposal of properties will generally not be considered to be of a revenue nature unless such transactions ~~are~~ carried out as one of the principal activities and in the ordinary and usual course of business of the listed issuer.*

(b) *Any transaction involving the acquisition or disposal of securities will generally not be considered to be of a revenue nature unless it is carried out in the ordinary and usual course of business by a member of the listed issuer's group that is:*

(i) *a banking company (as defined in rule 20.86);*

(ii) *an insurance company; or*

(iii) *a securities house that is mainly engaged in regulated activities under the SFO. It should be noted that proprietary securities trading and/or investment is not a regulated activity under the SFO and accordingly, this exemption is not available where proprietary securities trading and/or investment constitutes a significant part of the business of the securities house.*

3 ...

4 ...

...

(2A) *“acquisition targets” in rules 19.06B, 19.06C, 19.53A, 19.54 and 19.57A mean the assets to be acquired, or in the context of a series of transactions and/or arrangements, the assets acquired and/or to be acquired. In other words, a series of transactions and/or arrangements may include completed acquisition(s);*

...

(5A) an “insurance company” means a company which is authorized to carry out insurance business under the Insurance Ordinance or appropriate overseas legislation or authority. For the avoidance of doubt, an “insurance company” does not include an insurance broker or insurance agent;

(6) a “listed issuer” means a company or other legal person whose securities are already listed on GEM and, unless the context otherwise requires, includes its subsidiaries;

(7) a “notifiable transaction” means a transaction classified as a share transaction, discloseable transaction, major transaction, very substantial disposal, or very substantial acquisition or reverse takeover under rule 19.06 or a transaction classified as a reverse takeover or extreme transaction under rule 19.06B or 19.06C;

...

(11) a “securities house” means a corporation which is licensed or registered under the Securities and Futures Ordinance for Type 1 (dealing in securities) or Type 8 (securities margin financing) regulated activity;

...

#### **~~Classification and explanation of terms~~**

19.05 A listed issuer considering a transaction must, at an early stage, consider whether the transaction falls into one of the classifications set out in rule 19.06, 19.06B or 19.06C. In this regard, the listed issuer must determine whether or not to consult with its Compliance Adviser and/or its financial, legal or other professional advisers. Listed issuers, Compliance Advisers or other advisers which are in any doubt as to the application of the requirements in this Chapter should consult the Exchange at an early stage.

...

19.06 The transaction classification is made by using the percentage ratios set out in rule 19.07. The classifications are:—

...

(5) very substantial acquisition — an acquisition or a series of acquisitions (aggregated under rules 19.22 and 19.23) of assets by a listed issuer where any percentage ratio is 100% or more; ~~and~~

## Provisions to deter circumvention of new listing requirements

19.06A The Exchange may impose additional requirements where it considers the arrangements of a listed issuer represent an attempt to circumvent the new listing requirements under the GEM Listing Rules. These arrangements include circumstances set out below:

### Reverse takeovers

19.06B ~~(6) reverse takeover~~—A reverse takeover is an acquisition or a series of acquisitions of assets by a listed issuer which, in the opinion of the Exchange, constitutes, or is part of a transaction and/or arrangement or series of transactions and/or arrangements which constitute, an attempt to achieve a listing of the acquisition targets (as defined in rule 19.04(2A)) assets to be acquired and a means to circumvent the requirements for new applicants as set out in Chapter 11. –A “reverse takeover” normally refers to:-

#### Notes:

1. Rule 19.06B is aimed at preventing acquisitions that represent an attempt to circumvent the new listing requirements. In applying this principle based test, the Exchange will normally take into account the following factors:

- (a) the size of the acquisition or series of acquisitions relative to the size of the issuer;
- (b) a fundamental change in the issuer's principal business;
- (c) the nature and scale of the issuer's business before the acquisition or series of acquisitions;
- (d) the quality of the acquisition targets;
- (e) a change in control (as defined in the Takeovers Code) or de facto control of the listed issuer (other than at the level of its subsidiaries);

In assessing whether there has been a change in control or de facto control of the issuer, the Exchange will consider (i) any change in the controlling shareholder of the issuer; or (ii) any change in the single largest substantial shareholder who is able to exercise effective control over the issuer, as indicated by factors such as a substantial change to its board of directors and/or senior management.

In circumstances involving an issue of convertible securities with a conversion restriction mechanism to avoid triggering a change in control under the Takeovers Code (i.e. restricted convertible securities) to a vendor as the consideration for an acquisition, the Exchange will consider whether the issuance is a means to allow the vendor to effectively control the issuer;

- (f) other transactions or arrangements which, together with the acquisition or series of acquisitions, form a series of transactions or arrangements to list the acquisition targets.

These transactions or arrangements may include changes in control/de facto control, acquisitions and/or disposals. The Exchange may regard acquisitions and other transactions or arrangements as a series if they take place in a reasonable proximity to each other (which normally refers to a period of 36 months or less) or are otherwise related.

The Exchange will consider whether, taking the factors together, an issuer's acquisition or series of acquisitions constitute an attempt to list the acquisition targets and circumvent the new listing requirements.

2. Without limiting the generality of rule 19.06B, the following transactions are normally reverse takeovers (the bright line tests):

- (a) an acquisition or a series of acquisitions (aggregated under rules 19.22 and 19.23) of assets constituting a very substantial acquisition where there is or which will result in a change in control (as defined in the Takeovers Code) of the listed issuer (other than at the level of its subsidiaries); or
- (b) acquisition(s) of assets from a person or a group of persons or any of his/their associates pursuant to an agreement, arrangement or understanding entered into by the listed issuer within ~~36~~ 24-months of such person or group of persons gaining control (as defined in the Takeovers Code) of the listed issuer (other than at the level of its subsidiaries), where such gaining of control had not been regarded as a reverse takeover, which individually or together constitute(s) a very substantial acquisition. For the purpose of determining whether the acquisition(s) constitute(s) a very substantial acquisition, the lower of:
  - (A) the latest published figures of the asset value, revenue and profits as shown in the listed issuer's accounts and the market value of the listed issuer at the time of the change in control, which must be adjusted in the manner set out in rules 19.16, 19.17, 19.18 and 19.19, as applicable, up to the time of the change in control; and
  - (B) the latest published figures of the asset value, revenue and profits as shown in the listed issuer's accounts and the market value of the listed issuer at the time of the acquisition(s), which must be adjusted in the manner set out in rules 19.16, 19.17, 19.18 and 19.19, as applicable,

is to be used as the denominator of the percentage ratios.

~~Note:—Rule 19.06B 19.06(6)~~ will apply irrespective of whether any general offer obligations under the Takeovers Code have been waived.

### Extreme transactions

19.06C An “extreme transaction” is an acquisition or a series of acquisitions of assets by a listed issuer, which individually or together with other transactions or arrangements, may, by reference to the factors set out in Note 1 to rule 19.06B, have the effect of achieving a listing of the acquisition targets, but where the issuer can demonstrate to the satisfaction of the Exchange that it is not an attempt to circumvent the requirements for new applicants set out in Chapter 11 of the GEM Listing Rules and that:

- (1) (a) the issuer (other than at the level of its subsidiaries) has been under the control or de facto control (by reference to the factors set out in Note 1(e) to rule 19.06B) of a person or group of persons for a long period (normally not less than 36 months), and the transaction would not result in a change in control or de facto control of the issuer; or
- (b) the issuer has been operating a principal business of a substantial size, which will continue after the transaction; and
- (2) the acquisition targets meet the requirements of rule 11.06 and rule 11.12A (or rule 11.14) and the enlarged group meets all the new listing requirements in Chapter 11 of the GEM Listing Rules (except rule 11.12A).

Note: Where the extreme transaction involves a series of transactions and/or arrangements and the acquisition targets cannot meet rules 11.12A(2) and/or (3) due to a change in their ownership and management solely as a result of the acquisition by the issuer, the Exchange may grant a waiver from strict compliance with these rules based on the facts and circumstances of the case. In considering a waiver of rule 11.12A(3), the Exchange will consider, among others, whether the issuer has the expertise and experience in the relevant business/industry of the acquisition targets to ensure the effective management and operation of the acquisition targets.

### Large scale issue of securities

19.06D Where a listed issuer proposes a large scale issue of new securities (including any shares, warrants, options or convertible securities) for cash to acquire and/or develop a new business, which, in the opinion of the Exchange, is a means to circumvent the new listing requirements and to achieve a listing of that new business, the Exchange may refuse to grant listing approval for the shares to be issued.

Note: This rule is an anti-avoidance provision to prevent circumvention of the new listing requirements. It is intended to apply to a large scale issue of securities for cash proposed by a listed issuer where there is, or which will result in, a change in control or de facto control of the issuer (by reference to the factors set out in Note 1(e) to rule 19.06B), and the proceeds are to be used to acquire and/or develop a new business that is expected to be substantially larger than the issuer’s existing principal business. The effect of the proposal is to achieve a listing of the new business that would not have otherwise met the new listing requirements.

### Restriction on disposals

19.06E (1) A listed issuer may not carry out a disposal or distribution in specie (or a series of disposals and/or distributions in specie) of all or a material part of its existing business:-

(a) where there is a proposed change in control (as defined in the Takeovers Code) of the listed issuer (other than at the level of its subsidiaries); or

(b) for a period of 36 months from a change in control (as defined in the Takeovers Code).

unless the remaining group, or the assets acquired from the person or group of persons gaining such control or his/their associates and any other assets acquired by the listed issuer after such change in control, can meet the requirements of rule 11.12A (or rule 11.14).

(2) A disposal or distribution in specie (or a series of disposals and/or distributions in specie) by a listed issuer which does not meet the above requirement will result in the listed issuer being treated as a new listing applicant.

Note: The Exchange may apply this rule to a disposal or distribution in specie (or a series of disposals and/or distributions in specie) by a listed issuer of all or a material part of its existing business where (a) there is a proposed change in de facto control of the issuer (by reference to the factors set out in Note 1(e) to rule 19.06B); or (b) for a period of 36 months from such change, if the Exchange considers that the disposal(s) and/or distribution(s) in specie may form part of a series of arrangements to circumvent the new listing requirements.

...

### *Exceptions to the classification rules*

19.20 Where any calculation of the percentage ratio produces an anomalous result or is inappropriate to the sphere of activity of the listed issuer, the listed issuer may apply to the Exchange to disregard the calculation and/or apply substitute other relevant indicators of size, including industry specific tests. The listed issuer must seek prior consent of the Exchange if it wishes to apply this rule and must provide alternative test(s) which it considers appropriate to the Exchange for consideration. The Exchange may also require the listed issuer to apply other size test(s) that the Exchange considers appropriate.

...

### *Aggregation of transactions*

19.22 In addition to the aggregation of transactions under rules 19.06B, 19.06C and 19.06E of acquisitions under rule 19.06(6)(b), the Exchange may require listed issuers to aggregate a series of transactions and ...

...

## Requirements for all transactions

### *Notification and announcement*

19.34 As soon as possible after the terms of a share transaction, discloseable transaction, major transaction, very substantial disposal, very substantial acquisition, extreme transaction or reverse takeover have been finalised, the listed issuer must in each case:-

...

19.35 For a share transaction, the announcement must contain the information set out in rules 19.58 and 19.59. For a discloseable transaction, major transaction, very substantial disposal, very substantial acquisition, extreme transaction or reverse takeover, the announcement must contain ...

...

### Guaranteed profits or net assets

19.36B This rule applies to any notifiable transaction where the listed issuer acquires a company or business from a person and that person guarantees the profits or net assets or other matters regarding the financial performance of the company or business.

(1) The listed issuer must disclose by way of an announcement any subsequent change to the terms of the guarantee and the reason therefor, and whether the issuer's board of directors considers that such change is fair and reasonable and in the interests of the shareholders as a whole.

(2) If the actual performance fails to meet the guarantee (or where applicable, the guarantee as amended), the listed issuer must disclose the following by way of an announcement:

(a) the shortfall, and any adjustment in the consideration for the transaction or other consequence under the guarantee;

(b) whether the person has fulfilled its obligations under the guarantee;

(c) whether the listed issuer has exercised any option to sell the company or business back to the person or other rights it held under the terms of the guarantee, and the reasons for its decision; and

(d) the board of directors' opinion on:

(i) whether the person has fulfilled its obligations; and

(ii) whether the decision of the listed issuer to exercise or not to exercise any options or rights set out in rule 19.36B(2)(c) is fair and reasonable and in the interests of the shareholders as a whole.

(3) The listed issuer must disclose whether the actual performance of the company or business acquired meets the guarantee in its next annual report.

...

### **Additional requirements for extreme transactions**

19.53A In the case of an extreme transaction, the listed issuer must:

- (1) comply with the requirements for very substantial acquisitions set out in rules 19.48 to 19.53. The circular must contain the information required under rules 19.63 and 19.69; and

*Note: See also rule 19.57A if the extreme transaction involves a series of transactions and/or arrangements.*

- (2) appoint a financial adviser to perform due diligence on the acquisition targets to put itself in a position to be able to make a declaration in the prescribed form set out in Appendix 21. The financial adviser must submit to the Exchange the declaration before the bulk-printing of the circular for the transaction.

*Note: See also rules 17.99A to 17.99C for the requirements relating to financial advisers.*

### **Additional requirements for reverse takeovers**

19.54 The Exchange will treat a listed issuer proposing a reverse takeover as if it were a new listing applicant.

- (1) The enlarged group or the assets to be acquired acquisition targets must be able to meet the requirements of rule 11.06 and rule 11.12A (or rule 11.14), and In addition, the enlarged group must be able to meet all the other basic conditions new listing requirements set out in Chapter 11 of the GEM Listing Rules (except rule 11.12A).
- (2) Where the reverse takeover is proposed by a listed issuer that has failed to comply with rule 17.26, the Exchange must be satisfied that there will be sufficient public interest in the business of the acquisition targets and the enlarged group and in the securities for which listing is sought (in addition to the requirements for the acquisition targets and the enlarged group set out in rule 19.54(1)).
- (3) The listed issuer must comply with the requirements for all transactions set out in rules 19.34 to 19.37.

Notes:

1. *For the purposes of (1) and (2) above, if the Exchange is aware of information suggesting that the reverse takeover is to avoid any new listing requirement, the listed issuer must demonstrate that the acquisition targets meet all the new listing requirements set out in Chapter 11 of the GEM Listing Rules.*
2. *See also rule 19.57A if the reverse takeover involves a series of transactions and/or arrangements.*

3. Where the reverse takeover involves a series of transactions and/or arrangements and the acquisition targets cannot meet rule 11.12A(2) and/or (3) due to a change in their ownership and management solely as a result of the acquisition by the issuer, the Exchange may grant a waiver from strict compliance with these rules based on the facts and circumstances of the case. In considering a waiver of rule 11.12A(3), the Exchange will consider, among others, whether the issuer has the expertise and experience in the relevant business/industry of the acquisition targets to ensure the effective management and operation of the acquisition targets.

...

### **Additional requirements for extreme transactions and reverse takeovers**

19.57A Where an extreme transaction or reverse takeover involves a series of transactions and/or arrangements: -

- (1) the track record period of the acquisition targets normally covers the two financial years immediately prior to the issue of the circular or listing document for the latest proposed transaction of the series; and
- (2) the listed issuer must provide sufficient information to the Exchange to demonstrate that the acquisition targets can meet the requirements under rule 11.12A (or rule 11.14) (see rule 19.06C(2) or 19.54).

### **Contents of announcements**

#### *All transactions*

19.58 The announcement ~~of for~~ a share transaction, discloseable transaction, major transaction, very substantial disposal, very substantial acquisition, extreme transaction or reverse takeover must contain at least the following information: -

...

- (3) a description of the principal business activities carried on by the listed issuer and the identity and a general description of the principal business activities of the counterparty, ~~if the counterparty is a company or entity;~~

...

*Discloseable transaction, major transaction, very substantial disposal, very substantial acquisition, extreme transaction and reserve takeover announcements*

19.60 In addition to the information set out in rule 19.58, the announcement of for a discloseable transaction, major transaction, very substantial disposal, very substantial acquisition, extreme transaction or reverse takeover must contain at least brief details of the following:-

...

**Contents of circulars**

*General principles*

19.63 A circular of for a major transaction, very substantial disposal, ~~or~~ very substantial acquisition or extreme transaction and a listing document for a reverse takeover sent by a listed issuer to holders of its listed securities must: -

...

*Very substantial acquisition circulars, extreme transaction circulars and reverse takeover listing documents*

19.69 A circular issued for a very substantial acquisition or an extreme transaction or a listing document issued for a reverse takeover must contain:-

(1) for a reverse takeover, or an extreme transaction:

- (a) the information required under rule 19.66 (except for the information required under rules 19.66(3), 19.66(4), 19.66(11) and 19.66(12)) and rule 19.67(3);
- (b) the information required under Appendix 1, Part A, if it applies, except ... ; and
- (c) [Repealed 1 January 2009]
- (d) (i) for a reverse takeover, information on the enlarged group's property interests under rules 8.01A and 8.01B; and  
(ii) for an extreme transaction, the information required under Chapter 8 on the property interests acquired and/or to be acquired by the issuer;

...

*Circulars for specific types of companies*

- 19.71 Where a major transaction, very substantial acquisition, very substantial disposal, extreme transaction or reverse takeover involves acquiring or disposing of an interest in an infrastructure project or ...

...

*Cash companies*

- 19.82 Where for any reason (including immediately after completion of a notifiable transaction or connected transaction) the assets of a listed issuer consist wholly or substantially of cash ~~or short dated securities~~ and/or short-term investments, it will not be regarded as suitable for listing and trading in its securities will be suspended. ~~“Short dated securities” means securities such as bonds, bills or notes which have less than 1 year to maturity.~~

Notes:

1. Rule 19.82 is intended to apply to issuers that hold a very high level of cash and short-term investments. In assessing whether an issuer is a cash company, the Exchange will apply a principle based approach and normally take into account the value of the issuer’s cash and short-term investments relative to its total assets, its level of operations and financial position, and the nature of the issuer’s business and its cash needs in the ordinary and usual course of business.
  2. Short-term investments include securities that are held by the issuer for investment or trading purposes and are readily realisable or convertible into cash. Examples of short-term investments include (a) bonds, bills or notes which have less than one year to maturity; (b) listed securities (whether on the Exchange or otherwise) that are held for investment or trading purposes; and (c) investments in other financial instruments that are readily realisable or convertible into cash.
- 19.83 Cash and short-term investments held by a member of an issuer’s group that is a banking company (as defined in rule 20.86), an insurance company or a securities house A listed issuer which is solely or mainly engaged in the securities brokerage business will normally not be taken into account when applying subject to rule 19.82.

Note: This exemption will not apply to an issuer that operates a securities house where the Exchange has concerns that the issuer is holding cash and short-term investments through a member to circumvent rule 19.82. For example, an issuer holding excessive cash and/or securities investments cannot circumvent the rule by holding such assets through a member that is a licensed broker with minimal brokerage operations. The Exchange will apply a principle based approach and consider, among others, the cash and/or short-term investments in light of the member’s operating model and its cash needs for the purpose of its regulated activities, which should be substantiated by its historical track record.

- 19.84 The listed issuer may apply to the Exchange to lift the suspension once it has a business suitable for listing. The Exchange will treat its application for lifting of the suspension as if it were an application for listing from a new applicant. The listed issuer will be required, among other things, to appoint a Sponsor and issue a listing document containing the specific information required by Appendix I Part A and pay the non-refundable initial listing fee. The Exchange reserves the right to cancel the listing if such suspension continues for more than 6 months or in any other case where it considers it necessary. It is therefore advisable to consult the Exchange at the earliest possible opportunity in each case.

...

#### **Restriction on disposal**

- 19.91 ~~[Repealed [●]]~~A listed issuer may not dispose of its existing business for a period of 24 months after a change in control (as defined in the Takeovers Code) unless the assets acquired from the person or group of persons gaining such control or his/their associates and any other assets acquired by the listed issuer after such change in control can meet the requirement of rule 11.12A.
- 19.92 ~~[Repealed [●]]~~A disposal by a listed issuer which does not meet the requirement under rule 19.91 will result in the listed issuer being treated as a new listing applicant.

#### **Distribution in specie to shareholders**

- 19.93 Where a listed issuer proposes a distribution in specie (other than securities listed on the Main Board or GEM) and the size of the assets to be distributed would amount to a very substantial disposal based on the percentage ratio calculations:

- (1) The issuer must obtain prior approval of the distribution by independent shareholders in a general meeting. The issuer's controlling shareholders (or if there is no controlling shareholder, the directors (other than independent non-executive directors) and chief executive of the issuer) and their respective associates must abstain from voting in favour of the resolution. Further, the shareholders' approval for the distribution must be given by at least 75% of the votes attaching to any class of listed securities held by holders voting either in person or by proxy at the meeting, and the number of votes cast against the resolution is not more than 10% of the votes attaching to any class of listed securities held by holders permitted to vote in person or by proxy at the meeting.
- (2) The issuer's shareholders (other than the directors (excluding independent non-executive directors), chief executive and controlling shareholders) should be offered a reasonable cash alternative or other reasonable alternative for the distributed assets.

Note: Where the assets proposed to be distributed are securities listed in other jurisdictions, the Exchange may waive the requirements in rule 19.93(2) if the issuer can demonstrate that there is a liquid market for the securities, the shareholders may readily dispose of those securities, and where appropriate, the issuer will make arrangements to facilitate the shareholders to hold or dispose of those securities.

## Chapter 20

### EQUITY SECURITIES

#### CONNECTED TRANSACTIONS

...

##### *Guaranteed profits or net ~~tangible~~-assets*

- 20.60 The following apply if the listed issuer's group acquires a company or business from a connected person, and the connected person guarantees the profits or net ~~tangible~~-assets or other matters regarding the financial performance of the company or business.
- 20.61 (1) The listed issuer must disclose by way of an announcement any subsequent change to the terms of the guarantee and the reason therefor, and whether the issuer's independent non-executive directors consider that such change is fair and reasonable and in the interests of the shareholders as a whole.
- (2) If the actual performance fails to meet the guarantee (or where applicable, the guarantee as amended), the listed issuer must disclose the following by way of ~~in~~ an announcement and in its next annual report:
- (~~1~~a) the shortfall, and any adjustment in the consideration for the transaction or other consequence under the guarantee;
  - (~~2~~b) whether the connected person has fulfilled its obligations under the guarantee;
  - (~~3~~c) whether the listed issuer's group has exercised any option to sell the company or business back to the connected person or other rights it held under the terms of the guarantee, and the reasons for its decision; and
  - (~~4~~d) the independent non-executive directors' opinion on:
    - (~~a~~i) whether the connected person has fulfilled its obligations; and
    - (~~b~~ii) whether the decision of the listed issuer's group to exercise or not to exercise any options or rights set out in rule 20.61(~~3~~)(~~2~~)(c) is fair and reasonable and in the interests of the shareholders as a whole.
- (3) The listed issuer must disclose whether the actual performance of the company or business acquired meets the guarantee in its next annual report.

...

## Announcements

20.66 An announcement ~~of for~~ a connected transaction must contain at least:

- (1) the information set out in rules 19.58 to 19.60 (contents of announcements for notifiable transactions);
- (1A) the identities and a description of the principal business activities of the parties to the transaction and of their ultimate beneficial owner(s);
- (2) the connected relationship between the parties to the transaction, and the connected person's interests in the transaction;

...

20.68 The circular must contain at least:

- (3) ~~the identity and activities~~ identities and a description of the principal business activities of the parties to the transaction and of their ultimate beneficial owner(s);

...

### *Exception to percentage ratio calculations*

20.78 If any calculation of the percentage ratio produces an anomalous result or is inappropriate to the sphere of activity of the listed issuer, the listed issuer may apply to the Exchange to may disregard the calculation ratio and consider alternative test(s) provided by the listed issuer, and/or apply other relevant indicators of size, including industry specific tests. The listed issuer must seek prior consent of the Exchange if it wishes to apply this rule and must provide alternative test(s) which it considers appropriate to the Exchange for consideration. The Exchange may also require the listed issuer to apply other size test(s) that the Exchange considers appropriate.

...

## Appendix 21

### FINANCIAL ADVISER'S DECLARATION (FOR EXTREME TRANSACTION)

To: The Listing Division  
The Stock Exchange of Hong Kong Limited

...../...../.....

We, ....., are the financial adviser appointed by .....  
(the "Company") on [Date] to perform due diligence on [a description of the proposed  
transaction] (the "Transaction") as required under rules 17.99A and 19.53A(2) of the Rules  
Governing the Listing of Securities on GEM of The Stock Exchange of Hong Kong Limited  
(the "GEM Listing Rules") and have offices located at .....

Under GEM Listing Rules 17.99A and 19.53A(2), we declare to The Stock Exchange of Hong Kong Limited (the "Exchange") that:

- (a) having made reasonable due diligence inquiries, we have reasonable grounds to believe and do believe that:
  - (i) the acquisition targets (as defined in GEM Listing Rule 19.04(2A)) are able to meet the requirements under GEM Listing Rule 11.06 and GEM Listing Rule 11.12A (or GEM Listing Rule 11.14). In addition, the enlarged group is able to meet all the new listing requirements in Chapter 11 of the GEM Listing Rules (except for GEM Listing Rule 11.12A and those rules agreed with the Exchange);
  - (ii) the Company's circular contains sufficient particulars and information to enable a reasonable person to form as a result thereof a valid and justifiable opinion of the Transaction and the financial condition and profitability of the acquisition targets at the time of the issue of the circular;
  - (iii) the information in the non-expert sections of the circular:
    - (A) contains all information required by relevant legislation and rules;
    - (B) is true, accurate and complete in all material respects and not misleading or deceptive in any material respect, or, to the extent it consists of opinions or forward looking statements by the Company's directors or any other person, such opinions or forward looking statements have been made after due and careful consideration and on bases and assumptions that are fair and reasonable; and
    - (C) does not omit any matters or facts the omission of which would make any information in the non-expert sections of a circular or any other part of the circular misleading in a material respect; and
  - (iv) there are no other material issues relating to the Transaction which, in our opinion, should be disclosed to the Exchange;
- (b) in relation to each expert section in the circular, having made reasonable due diligence inquiries, we have reasonable grounds to believe and do believe (to the standard reasonably expected of a financial adviser which is not itself expert in the matters dealt with in the relevant expert section) that:
  - (i) where the expert does not conduct its own verification of any material factual information on which the expert is relying for the purposes of any part of the expert section, such factual information is true in all material respects and does not omit any material information. Factual information includes:
    - (A) factual information that the expert states it is relying on;
    - (B) factual information we believe the expert is relying on; and
    - (C) any supporting or supplementary information given by the expert or the Company to the Exchange relating to an expert section;
  - (ii) all material bases and assumptions on which the expert sections of the circular are founded are fair, reasonable and complete;

- (iii) the expert is appropriately qualified, experienced and sufficiently resourced to give the relevant opinion;
  - (iv) the expert's scope of work is appropriate to the opinion given and the opinion required to be given in the circumstances (where the scope of work is not set by a relevant professional body);
  - (v) the expert is independent from (1) the Company and its directors and controlling shareholder(s); (2) the counterparty to the Transaction and the acquisition targets; and (3) the directors and controlling shareholder(s) of the counterparty to the Transaction; and
  - (vi) the circular fairly represents the views of the expert and contains a fair copy of or extract from the expert's report; and
- (c) in relation to the information in the expert reports, we, as a non-expert, after performing reasonable due diligence inquiries, have no reasonable grounds to believe and do not believe that the information in the expert reports is untrue, misleading or contains any material omissions.

Signed: .....

Name: .....

For and on behalf of: ..... *[insert the name of financial adviser]*

Dated: .....

**Note:** Each and every director of the financial adviser, and any officer or representative of the financial adviser supplying information sought in this form, should note that this form constitutes a record or document which is to be provided to the Exchange in connection with the performance of its functions under "relevant provisions" (as defined in Part 1 of Schedule 1 to the Securities and Futures Ordinance (Cap 571) as amended from time to time) and is likely to be relied upon by the Exchange. Therefore, you should be aware that giving to the Exchange any record or document which is false or misleading in a material particular will render relevant persons liable for prosecution for an offence under subsection 384(3) of the Securities and Futures Ordinance (Cap 571) as amended from time to time. If you have any queries you should consult the Exchange or your professional adviser immediately.

## Appendix 22

### FINANCIAL ADVISER'S UNDERTAKING (FOR EXTREME TRANSACTION)

To: The Listing Division  
The Stock Exchange of Hong Kong Limited

...../...../.....

We, ....., are the financial adviser (the "Firm") appointed by ..... (the "Company") on [Date] to perform due diligence on [a description of the proposed transaction] (the "Transaction") as required under rules 17.99A and 19.53A(2) of the Rules Governing the Listing of Securities on GEM of The Stock Exchange of Hong Kong Limited (the "GEM Listing Rules") and have offices located at .....

Pursuant to GEM Listing Rule 17.99B, we undertake to The Stock Exchange of Hong Kong Limited (the "Exchange") that we shall:

- (a) comply with the GEM Listing Rules from time to time in force; and
- (b) cooperate in any investigation conducted by the Listing Division and/or the GEM Listing Committee of the Exchange, including answering promptly and openly any questions addressed to us, promptly producing the originals or copies of any relevant documents and attending before any meeting or hearing at which we are requested to appear.

Signed: .....

Name: .....

For and on behalf of: ..... *[insert the name of financial adviser]*

Dated: .....

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## APPENDIX IV : GUIDANCE LETTERS

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### Part I

#### HKEX GUIDANCE LETTER

HKEX-GL[ ]-[ ] ([date])

|                      |   |
|----------------------|---|
| <b>Subject</b>       | <b>Guidance on application of the reverse takeover Rules</b>                                    |
| <b>Listing Rules</b> | <b>Main Board Rules 14.06B, 14.06C and 14.06E</b><br><b>GEM Rules 19.06B, 19.06C and 19.06E</b> |

**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.*

#### I. BACKGROUND AND PURPOSE

1. This guidance letter provides guidance on the application of the reverse takeover (**RTO**) Rules and related requirements. It supersedes the previous Guidance Letter GL78-14 published in May 2014.
2. Under the Rules (**RTO Rules**), a reverse takeover is defined as an acquisition or series of acquisitions which, in the opinion of the Exchange, constitutes an attempt to achieve a listing of the assets acquired and a means to circumvent the new listing requirements (**principle based test**)<sup>25</sup>. In May 2014, the Exchange published Guidance Letter GL78-14 to provide guidance on the RTO Rules, particularly, the six assessment factors the Exchange would apply in deciding whether an acquisition (or series of acquisitions) would be a RTO under the principle based test.
3. The RTO Rules also contain two specific forms of RTOs involving a change in control of the listed issuer (as defined under the Takeovers Code) and an acquisition or a series of acquisitions of assets from the new controlling shareholder and/or its associates at the time of, or within 36 months of the change in control (**bright line tests**)<sup>26</sup>.

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<sup>25</sup> See Rule 14.06B.

<sup>26</sup> See Note 2 to Rule 14.06B.

4. In recent years, the prevalence of backdoor listings has resulted in a substantial increase in the value of a listing status, leading to extensive activities related to investors acquiring controls of listed issuers for their listing platforms (rather than the underlying business) with a view to eventual backdoor listings, and listed issuers undertaking corporate actions (such as disposals of businesses) to facilitate the sale of their listing platforms. Such activities also led to opportunities for market manipulation and undermine investors' confidence in our market. Where these "shell" companies subsequently enter into significant acquisitions, the Exchange would apply the RTO Rules to discourage "shell" activities.
5. In July 2019, the Exchange published its consultation conclusions on *Backdoor Listing, Continuing Listing Criteria and Other Rule Amendments*. The Rule amendments are intended to apply the RTO Rules to:
  - arrangements that circumvented the then RTO Rules, for example, structuring a RTO transaction as a series of smaller acquisitions, or re-sequencing transactions to acquire a new business before disposing of the original business, or through a series of acquisitions and disposals; and
  - arrangements involving an investor acquiring control of a listed issuer and using the listed issuer as a listing platform to achieve a listing of new businesses that may have no connection with the issuer's original business. These new businesses may be acquired by the listed issuer, or developed as greenfield operations and, following the disposal, cessation and/or curtailment of the original business operation, become the major operation of the listed issuer<sup>27</sup>.
6. In applying the RTO Rules, the Exchange has regard to the following:
  - The RTO Rules are principle based, anti-avoidance provisions designed to prevent the circumvention of new listing requirements for the assets acquired and/or to be acquired. As such, the Exchange would apply the RTO Rules purposively and the six assessment factors described in the Rules provide guidance to the market on factors that the Exchange would normally consider in a RTO assessment. The applications of these assessment factors would vary from case to case, depending on the specific circumstances of the issuer.
  - As the RTO Rules are principle based, they should provide a framework for addressing backdoor listings and sufficient flexibility to address changing RTO structures, without imposing undue restrictions on legitimate business activities of issuers.

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<sup>27</sup> Acquisition of new business(es) may be subject to the RTO Rules. Rule 14.06D (see paragraph 38) may apply to greenfield operations and large scale issue of securities, and Rule 14.06E (see paragraphs 39 to 42) may impose restrictions on disposals.

- The RTO Rules are not intended to restrict legitimate business activities of listed issuers, including business expansion or diversification that is part of the issuer's business strategies related to its existing business, or is consistent with the issuer's size and resources.
  - When applying the RTO Rules, the Exchange's approach is targeted towards transactions that represent an attempt to circumvent the new listing requirements, particularly those involving companies engaging in "shell" activities, as indicated by the factors (a) change in control or de facto control of the listed issuer and (b) fundamental change in the issuer's principal business.
7. All Rule references in this letter are to the Main Board Listing Rules. As GEM RTO Rules are the same as Main Board RTO Rules, the guidance in this letter also applies to GEM issuers.

## **II. FURTHER GUIDANCE ON THE ASSESSMENT FACTORS UNDER THE PRINCIPLE BASED TEST**

### ***A. Rule 14.06B (principle based test)***

8. Rule 14.06B defines a RTO to be *an acquisition or a series of acquisitions of assets by a listed issuer which, in the opinion of the Exchange, constitutes, or is part of a transaction and/or arrangement or series of transactions and/or arrangements which constitute, an attempt to achieve a listing of the acquisition targets and a means to circumvent the requirements for new applicants set out in Chapter 8 of the Listing Rules*. Note 1 to this Rule sets out factors the Exchange will normally consider in assessing whether the acquisition or series of acquisitions is a RTO transaction:
- i) the size of the acquisition or series of acquisitions relative to the size of the issuer;
  - ii) a fundamental change in the issuer's principal business;
  - iii) the nature and scale of the issuer's business before the acquisition or series of acquisitions;
  - iv) the quality of the acquisition targets;
  - v) a change in control (as defined in the Takeovers Code) or de facto control of the listed issuer (other than at the level of its subsidiaries); and/or
  - vi) other transactions or arrangements which, together with the acquisition or series of acquisitions, form a series of transactions or arrangements to list the acquisition targets.

9. Rule 14.04(2A) defines acquisition targets to be the assets to be acquired, or in the context of a series of transactions and/or arrangements, the assets acquired and/or to be acquired. In other words, a series of transactions and/or arrangements may include completed acquisition(s).
10. In assessing the principle based test, the Exchange will consider the six assessment factors and whether, taken together, the proposed acquisition (or series of acquisitions) would be considered an attempt to circumvent the new listing requirements and a means to achieve the listing of the acquisition targets.

***B. The six assessment factors***

***i) Size of acquisition relative to the issuer***

11. Where an issuer undertakes an acquisition of significant size, its existing principal business may become immaterial after the transaction, supporting a concern that the transaction may represent a means to achieve a listing of the target business.
12. The Exchange does not prescribe an absolute threshold in determining whether the size of an acquisition is significant<sup>28</sup>. In assessing the impact of the acquisition on the issuer, the Exchange will take into account other assessment factors such as the nature and scale of the issuer's existing business after the acquisition, and whether the acquisition would result in a fundamental change in the issuer's business.

***ii) Acquisition(s) resulting in a fundamental change in the issuer's principal business***

13. Where an issuer acquires a target business that is completely different from its existing business and that target business is substantially larger than its existing business, it may be viewed as a fundamental change in the issuer's principal business. This is more likely the case where the issuer's existing business is so immaterial that after the acquisition, the issuer would be substantially carrying on the target business.

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<sup>28</sup> It should be noted that under the Rules, an acquisition below the size of a very substantial acquisition may be a RTO. This would normally be the case if there are other factors resulting in specific concerns about circumvention of the RTO Rules.

14. For the avoidance of doubt, a “fundamental change in the issuer’s principal business” does not refer to acquisitions that are part of the issuer’s business strategies related to its existing business, including business expansion or diversification, or are consistent with the issuers’ size and resources. This may involve an issuer expanding upstream or downstream into new business segments, or an issuer acquiring businesses as part of the issuer’s expansion strategy as illustrated in the following examples:
- technology companies in the new economy sector making acquisitions of businesses in mature industries as part of their business strategies, where the acquisitions formed part of their expansion strategies.
  - a listed issuer engaging in financial advisory and other financial services proposing to acquire an app-based retail banking services business, where the acquisition is part of the issuer’s strategy to expand its business into the fintech sector.
15. Further, where an issuer operating a mature business seeks opportunities to diversify its operations (and income stream) and acquires a target business that is completely different from its existing business, absent other factors (for example, a change in control or de facto control in the issuer and/or an acquisition that is substantial in size), the RTO Rules would not normally apply to restrict an issuer from such business diversification.

***iii) Nature and scale of the issuer’s business before the acquisition***

16. A significant acquisition is more likely to be considered a RTO if the scale of the issuer’s existing business is small, as the existing business would likely be immaterial after the acquisition and the issuer would be in substance operating the target business.
17. The Exchange will consider the nature of the issuer’s existing business and its financial position. The RTO Rules address concerns about shell activities; accordingly, significant acquisitions by listed issuers with “shell” like characteristics are more likely to be RTO transactions. For example, an issuer that has wound down/disposed of its original business and moved into new businesses that can be easily discontinued (e.g. trading business or money lending business<sup>29</sup>) may suggest that the issuer is engaged in shell activities to facilitate backdoor listing. A newly listed issuer that conducted a series of arrangements (such as change in controlling shareholder, acquisitions and/or disposals) shortly after the lock-up period may also suggest shell activities.

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<sup>29</sup> See paragraph 10 of Guidance Letter GL96-18 on suitability.

**iv) Quality of the acquisition targets**

18. The Exchange would consider whether the target business can meet the eligibility and suitability criteria for new listing. In general, a substantial acquisition of a target business that is not suitable for listing will likely be considered circumvention of the new listing requirements, as that target business could not otherwise obtain a new listing. Examples include early exploration companies or a business that operates illegally. Similarly, acquisitions of new businesses or assets that have no track record or have yet to commence operations are more likely to raise questions. This is more so the case where the target business is completely different from that of the issuer. Examples include an acquisition of a patent for new technology or new business proposals where the infrastructure (e.g. production facilities) is under construction. See also LD96-2016 and LD95-2016 as examples<sup>30</sup>.

**v) Change in control (as defined in the Takeovers Code) or de facto control of the listed issuer**

19. Where a proposal does not fall under the bright line test, it may nevertheless be treated as a RTO under the principle based test. In assessing whether there has been any change in control or de facto control, the Exchange would consider:
- i) a change in the controlling shareholder of the issuer; or
  - ii) a change in the single largest substantial shareholder who is able to exercise effective control over the issuer as indicated by factors such as a substantial change to its board of directors and/or senior management. For the avoidance of doubt, these are non-exhaustive factors. There could be other factors that the Exchange may consider as indication of exercise of effective control by the single largest substantial shareholder.
20. The Exchange will consider changes to the personnel and changes to the executive functions of the existing directors when making an assessment. Examples of substantial change of board and/or senior management include change in a majority of the issuer's executive directors and/or senior management carrying executive functions; change in a majority of the directors and/or their executive functions; or change of the chief executive officer.

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<sup>30</sup> See Listing Decisions LD96-2016 and LD95-2016 for examples of acquisition targets that were considered not suitable for listing. In LD96-2016, the acquisition target's products relied on the vendor's supply of the major raw material. The target's plan to manufacture the material itself was preliminary and the impact of such change in the business model on its financial results was uncertain. In LD95-2016, the newly set up acquisition target was not licensed to manufacture the products but relied heavily on another licensed company for both the production and sale of its products.

21. The “change in control or de facto control” factor would not normally apply if (a) the new substantial (and not controlling) shareholder is a passive investor in the issuer; or (b) there are changes in the issuer’s board of directors and/or senior management but not its controlling or single largest substantial shareholder. However, where the issuer does not have a controlling or single largest substantial shareholder, a substantial change in its board of directors and/or senior management may raise questions about whether there is a change in de facto control in the issuer.
22. The Exchange normally applies this factor in conjunction with the “series of transactions and/or arrangements” factor. For example, an investor may acquire material shareholding interests in an issuer, appoints new directors to the board which oversees the operations and direction of the listed issuer, and subsequently acquires new businesses. The new directors have no experience in the issuer’s original business but have expertise in the new business acquired by the issuer. The Exchange may apply the RTO Rules if, taking into account other factors, it considers that such actions are a means to achieve a listing of the new business and to circumvent the new listing requirements.
23. As described in paragraph 5 above, in the Exchange’s experience a change of control together with a series of corporate actions (such as disposals of the issuer’s existing business and acquisitions of different lines of businesses)<sup>31</sup> are commonly associated with new investors attempting to achieve a listing of new businesses and circumventing the new listing requirements. In those circumstances the Exchange would more likely apply the RTO Rules.
24. We also clarify that this assessment factor is applied only in the RTO context to identify the circumstances where there may be a backdoor listing concern. It is not a determinant of whether an issuer has “changed control” under the Takeovers Code or for other Rules purposes.
25. ***Change in de facto control arising from issue of restricted convertible securities***<sup>32</sup> - in circumstances involving the issue of restricted convertible securities, the Exchange would consider whether in substance, the issuance serves to allow the vendor (who will hold the issuer’s convertible securities) to effectively “control” the issuer. For example, the vendor would become a controlling shareholder of the issuer assuming the convertible securities were fully converted and where i) the issuer has no controlling shareholder when it proposes the acquisition; or ii) the existing controlling shareholder would cease to be a controlling shareholder after the conversion.

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<sup>31</sup> An example involves an issuer engaged in garment business conducting a very substantial acquisition to acquire a property development business from a third party vendor, and shortly after that the issuer’s original controlling shareholder proposed to sell its entire interests in the issuer to the vendor, which would result in a change in control of the issuer. The close nexus between the change in control and the completed acquisition may raise concern about circumvention of the new listing requirement. The Exchange may consider these events as a series of arrangements in assessing whether the RTO Rules would apply to the completed acquisition.

<sup>32</sup> Restricted convertible securities are convertible securities with a conversion restriction mechanism to avoid triggering a change in control under the Takeovers Code.

**vi) Events and transactions which together with the acquisition form a series of transactions and/or arrangements to circumvent the RTO Rules**

26. As set out in paragraph 5 above, the amended RTO Rules address arrangements that are conducted as a series of transactions and/or arrangements over time to achieve a listing of new businesses and circumvention of the new listing requirements. Examples of such arrangements include a series of smaller acquisitions that result in the listing of a new business, or re-sequencing transactions to acquire a new business before disposing of the original business of the issuer, or a series of acquisitions and disposals. This is achieved by assessing a series of transactions and/or arrangements in totality when considering the application of the RTO Rules.
27. The “series of transactions and/or arrangements” factor is normally applied in conjunction with other assessment factors such as the relative size of the transactions to the issuer, and whether the series of transactions and/or arrangements would lead to a fundamental change in the issuer’s principal business.
- a) *A series of transactions or arrangements within 36 months or are otherwise related*
28. The Exchange may regard transactions and arrangements as a part of a series if they take place in reasonable proximity to each other (normally within a 36-month period) or are otherwise related. Transactions or arrangements may include change in control or de facto control, acquisitions or disposals of businesses.
29. The RTO Rules are not intended to unduly restrict business expansion or diversification by issuers that take place over a reasonable period where there would be more disclosure for shareholders and the public to assess the issuers’ business operations and developments. The Exchange would not normally consider a transaction or arrangement outside the 36-month period as part of the series, unless there is clear nexus between the transactions and/or arrangements, or where there are specific concerns about circumvention of the RTO Rules. For example:
- a transaction proposed shortly outside the 36-month period and which was likely under contemplation during the 36-month period;
  - where an issuer terminated a proposed acquisition of a target business (or downsized the acquisition) in response to the Exchange’s RTO ruling, the Exchange may treat any further acquisition(s) of the target business made outside the 36-month period as part of a series;

- where an issuer acquired a new business together with an option to acquire another target business and this option is exercised more than 3 years from the original acquisition, the Exchange may consider these acquisitions as a series.
30. Where an issuer acquires new business(es) over a period of time, the Exchange may aggregate the acquisitions when considering whether the acquired businesses together are substantial to the issuer and a means to achieve a listing of the acquired businesses. Acquisitions that are considered as part of a series would normally bear some relationship to each other, for example: (a) acquisitions that are part of a similar line of business<sup>33</sup>, or (b) acquisitions of interests in the same company or group of companies in stages; or (c) acquisitions of businesses from the same or related party.
  31. Absent indication of an attempt to achieve a listing of assets and a means to circumvent the new listing requirements, acquisitions of multiple businesses from different parties would not normally be aggregated in a RTO assessment. Circumstances indicating circumvention of the new listing requirements may include a change in control in the issuer followed by a disposal of its original business and acquisitions of multiple lines of new businesses from various parties.
  32. When considering whether the size of the acquisitions in a series is substantial, the Exchange would normally aggregate the financial figures/consideration of the acquisition targets (at the time of the respective acquisitions), compared to the size of the issuer, being the lower of (i) the issuer's latest published financial figure (i.e. revenue/profits/assets) or market capitalization before the first transaction in the series; and (ii) its latest published financial figure or market capitalization at the time of the last transaction in the series.
  33. When considering whether there is a fundamental change in business over the 36-month period, the Exchange will have regard to the size of the acquisition targets (at the time of their respective acquisitions), compared to the size of the original business (at the time of the last transaction in the series).
  34. In addition, where an issuer disposes the business it operated at the commencement of the series of transactions (the original business), it has the effect of reducing the size of the issuer and consequently, may have a bearing on the Exchange's assessment of other assessment factors, including whether there is a fundamental change of business of the issuer, whether the size of the acquisitions are substantial, and whether the issuer is a "shell"<sup>34</sup>.

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<sup>33</sup> In Listing Decision LD109-2017, the Exchange aggregated a proposed acquisition with an acquisition announced over a 20-month period which together, would lead to the issuer's substantial involvement in a new business.

<sup>34</sup> See footnote 5.

35. Where an issuer conducts shell activities through a series of transactions and/or arrangements involving greenfield operations, equity fundraisings, and/or termination of all or some of its original businesses and such activities are not within the scope of the RTO Rules, the Exchange may exercise its rights under Rule 2.04 to impose additional conditions, for example, requiring the issuer to comply with the RTO requirements<sup>35</sup>. The Exchange may also address shell maintenance concerns (e.g. an issuer operates multiple lines of new businesses or terminates its businesses) by applying Rule 6.01(4) (suitability for listing)<sup>36</sup> or Rule 13.24 (sufficiency of operations)<sup>37</sup>.

*b) Treating a series of transactions as one transaction*

36. When applying the RTO Rules, a series of transactions would be treated as if they were one transaction. Consequently, while an acquisition of the new business may have been completed at an earlier time within the period, by viewing the series of arrangements as one transaction, the RTO Rules would also apply to that completed acquisition.
37. Where the proposed series of transactions and/or arrangements involve a disposal that is preceded by an acquisition (or acquisitions) of a target business, both the RTO Rules and the continuing listing requirements (Rule 13.24) may apply. The target business (i.e. the issuer's remaining business after the proposed disposal) must meet the continuing listing requirement under Rule 13.24<sup>38</sup>, failing which the issuer may be subject to the delisting procedures under Rule 6.01(3). Additionally, the RTO Rules may apply to the target business (i.e. the acquisition(s)) that is part of the series of transactions and/or arrangements.

### **III. LARGE SCALE ISSUE OF SECURITIES**

38. Rule 14.06D describes circumstances involving an investor acquiring control or de facto control of a listed issuer through a large scale subscription of the issuer's securities, and the listed issuer using the proceeds to acquire or develop a new business unrelated to the original business of the listed issuer, achieving a listing of that new business and circumventing the new listing requirements. These arrangements involve a change in control or de facto control and acquisition of new business and/or greenfield operations as discussed in paragraph 5 above. Its application is set out in Guidance Letter GL105-19.

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<sup>35</sup> See Listing Decisions LD122-2019 and LD123-2019.

<sup>36</sup> See Guidance Letter GL96-18.

<sup>37</sup> See Listing Decision LD105-2017.

<sup>38</sup> Specifically, Rule 13.24 requires an issuer to carry on a sufficient level of operation and have sufficient asset to support its operations to warrant its continued listing.

#### IV. RESTRICTION ON DISPOSALS

39. Rule 14.06E<sup>39</sup> imposes restriction on a disposal or distribution in specie (or a series of disposals or distributions) that involves all or a material part of the issuer's existing business at the time of, or within 36 months from a change in control (as defined in the Takeovers Code) of the issuer, unless the remaining business or the assets acquired by the issuer can meet the requirements under Rule 8.05 (or Rule 8.05A or 8.05B).
40. This Rule complements the RTO bright line tests in Note 2 to Rule 14.06B to discourage investors from re-sequencing a RTO transaction by acquiring a new business before disposing its original business, thereby circumventing the bright line test (which involves acquisitions that are classified as very substantial acquisitions). The Rule may also apply where an issuer develops a new business through greenfield operation after a change in control, with a view to operating the new business through the listed issuers and circumventing the new listing requirements. As these arrangements do not involve acquisitions, they are not caught by Rule 14.06B.
41. The Note to Rule 14.06E provides the Exchange discretion to apply the same restriction to disposal(s) or distribution(s) by a listed issuer of all or a material part of its existing business at the time of, or within 36 months from a change in de facto control of the listed issuer (by reference to the "change in control or de facto control" factor in the principle based test), where the Exchange considers that the disposal(s) and/or distribution(s) form part of a series of transactions/arrangements to circumvent the new listing requirements. In making this assessment the Exchange would make reference to the six assessment factors under the principle based test. The Exchange would apply this Rule to a series of arrangements that involve an issuer developing a new business through greenfield operation after a change in control or de facto control<sup>40</sup>, with a view to operating the new business through the listed issuer and circumventing the new listing requirements (see paragraph 5).
42. Rule 14.06E is not intended to restrict issuers from disposing part of their businesses or assets for commercial reasons. For example, an investor may acquire control in the listed issuer and thereafter, conduct a series of business reorganizations to streamline the underlying business, including the disposal of certain non-performing segments of the issuer's business, provided that is not all or a material part of the issuer's business.

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<sup>39</sup> This rule incorporates former Rule 14.92.

<sup>40</sup> See paragraphs 19 to 25 for the factors set out in the "change in control or de facto control" factor.

## V. EXTREME TRANSACTION

43. The RTO Rules apply to acquisitions that constitute an attempt to achieve a listing of the assets to be acquired and a means to circumvent the new listing requirements under Chapter 8 of the Listing Rules. Where an acquisition or a series of acquisitions of assets, which individually or together with other transactions or arrangements, may, by reference to the factors under the principle based test have the effect of achieving a listing of the acquisition targets, but the issuer can demonstrate that it is not an attempt to circumvent the new listing requirements, the proposed acquisition (or series of acquisitions) may be classified as an “extreme transaction” under Rule 14.06C.
44. The extreme transaction classification would not be available where the listed issuer demonstrates “shell” like characteristics. This is because the RTO Rules discourage activities related to the trading of, or acquisitions of “listed shells” for backdoor listings. The Exchange will assess the application of the “extreme transaction” category case by case. For an acquisition (or series of acquisitions) to be qualified as an extreme transaction, the issuer has to satisfy the following additional requirements in addition to demonstrating that it is not an attempt to circumvent the new listing requirements:
- i) the issuer has been under the control or de facto control of the same person or group of persons for a long period (normally not less than 36 months) prior to the proposed transaction, and the transaction would not result in a change in control or de facto control of the issuer. The Exchange would make reference to the “change in control or de facto control” factor under the principle based test (see paragraphs 19 to 25) in making this assessment; or
  - ii) the issuer has been operating a principal business of substantial size, which will continue after the transaction.

As general guidance, this may include an issuer with annual revenue or total asset value of HK\$1 billion or more based on the latest published financial statements. When assessing the size of the issuer, the Exchange will also take into account the issuer’s financial position, the nature and operating model of the business and the issuer’s future business plans. For example, an issuer that meets the HK\$1 billion in revenue but has very small net asset value (or is in a net liability position) and operates an indent trading business may not meet this test.

### ***Procedural and compliance requirements for extreme transactions***

45. Rule 14.06C(2) requires that (i) the acquisition targets must meet the suitability for listing requirement (Rule 8.04) and the new listing track record requirements (Rule 8.05 or 8.05A or 8.05B); and (ii) the enlarged group must meet all the new listing requirements set out in Chapter 8 of the Rules (except Rule 8.05).

46. The issuer would be required to provide sufficient information to the Exchange to demonstrate that the acquisition target meets Rule 8.04 and Rule 8.05 (or Rule 8.05A or 8.05B). This may be in the form of a draft circular with material information, including, for example, draft accountants' report of the acquisition target for the track record period, detailed description of its business and its management, risk factors, legal compliance and any other information as requested by the Exchange. Failure to provide sufficient information for the Exchange to make a determination may result in a RTO ruling.
47. Rule 14.53A requires the issuer to appoint a financial adviser to perform due diligence on the acquisition targets and to provide the declaration in the form set out in Appendix 29. The Listing Committee may, in principle, allow the issuer to classify its proposed acquisition as an extreme transaction based on the information provided in its written submission and/or draft circular and any additional information requested by the Department. However, this classification is subject to the completion of the financial adviser's due diligence work on the target business and its submission of a declaration to support that the acquisition target can meet Rule 8.04 and Rule 8.05 (or Rule 8.05A or 8.05B).
48. The Exchange will require the issuer to reclassify the acquisition as a RTO if the financial adviser cannot provide the declaration, or where there is additional information indicating that the acquisition target cannot meet Rule 8.04 and Rule 8.05 (or Rule 8.05A or 8.05B), or where there are any other concerns about circumvention of the new listing requirements.

## **VI. COMPLIANCE REQUIREMENTS APPLICABLE TO RTO**

### ***Compliance with new listing requirements***

49. Where a transaction is ruled as a RTO, the issuer will be treated as if it were a new listing applicant. Rule 14.54(1) requires that (i) the acquisition targets must meet the suitability for listing requirement (Rule 8.04) and the new listing track record requirements (Rule 8.05 or Rule 8.05A or 8.05B); and (ii) the enlarged group must meet all the new listing requirements under Chapter 8 of the Rules (except Rule 8.05).
50. Under Rule 14.54(2), where the issuer has failed to comply with Rule 13.24(1), the acquisition targets must also meet Rule 8.07. The issuer and its sponsor must demonstrate that there is sufficient public interest in the business of the acquisition target and the enlarged group. This may be demonstrated by, for example, conducting a public offer or other analysis with evidence to demonstrate a sufficient level of public interest in the acquisition targets. For this purpose, it would not be sufficient to simply rely on the issuer's existing shareholder base to satisfy the requirements.

51. Note 1 to Rule 14.54 states that if the Exchange is aware of information suggesting that the RTO is to avoid any new listing requirements, the issuer will be required to demonstrate that the acquisition targets meet all the new listing requirements set out in Chapter 8 of the Rules.
52. Where the RTO transaction involves a series of acquisitions (including completed acquisitions), all the acquisition targets in the series of acquisitions must as a whole comply with the requirements in Rule 14.54.

## **VII. COMPLIANCE REQUIREMENTS RELATING TO RTOS OR EXTREME TRANSACTIONS THAT INVOLVE A SERIES OF TRANSACTIONS**

### ***Track record and due diligence requirements***

53. Where the Exchange considers a series of transactions and/or arrangements to constitute a RTO or an extreme transaction, the entire series of acquisitions should, as a whole, meet the new listing requirements of Rule 8.05.
54. The issuer is required to provide sufficient information to the Exchange to demonstrate that the acquisition targets can meet Rule 8.05, including financial information of the targets based on accountant's report or audited financial information<sup>41</sup>. For this propose the track record period for the completed acquisition(s) and the proposed acquisition(s) in the series shall be referenced to the latest proposed transaction and covers the three financial years immediately prior to the issue of circular for that transaction.
55. The due diligence requirements for RTOs or extreme transactions apply to the acquisition targets that form part of the series as mentioned above<sup>42</sup>.
56. As the RTO or extreme transaction Rules apply to i) acquisitions from various independent parties and ii) a series of acquisitions, including completed acquisitions, it is possible that the issuer may not meet the management and/or ownership continuity requirements in the eligibility criteria. The Exchange would consider granting waivers on a case by case basis.

### ***Shareholders' approval requirement***

57. Rules 14.53A and 14.55 require shareholders to approve a RTO or an extreme transaction. Where a RTO or extreme transaction involves a series of transactions, this approval requirement applies to the proposed transaction only. In other words, a listed issuer is not required to seek shareholders' approval for the completed transaction(s) that form part of the series.

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<sup>41</sup> Such approach is in line with our practice in requiring an issuer to provide to the Exchange financial results of its remaining group to demonstrate that the remaining group can meet Rule 8.05 in a spin-off under Practice Note 15.

<sup>42</sup> Where during the course of due diligence review the financial adviser identifies issues (e.g. legal non-compliance), the issuer is expected to take measures to resolve these issues.

## Part II

### HKEX GUIDANCE LETTER HKEX-GL[ ]-[ ] ([date])

|                      |   |
|----------------------|---|
| <b>Subject</b>       | <b>Guidance on Large Scale Issues of Securities</b>     |
| <b>Listing Rules</b> | <b>Main Board Rule 14.06D</b><br><b>GEM Rule 19.06D</b> |

**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.*

#### I. Background and Purpose

1. This letter provides guidance on the application of Rule 14.06D to large scale issues of securities by listed issuers.
2. In recent years the prevalence of backdoor listings has resulted in a substantial increase in the value of listing status, leading to extensive activities related to investors acquiring control of listed issuers for their listing platforms (rather than the underlying businesses) for backdoor listing. In particular, there were some issuers proposing large scale issues of securities to new investors with an intention to use the injected funds to start new businesses unrelated to the issuers' original businesses. The investors would be in effect listing, through the listed issuers, new businesses that would not have otherwise met the new listing requirements. In December 2015, the Exchange issued Guidance Letter GL84-15 on the application of the cash company Rules<sup>43</sup> to restrict these large scale issues of securities.
3. As part of the recent Rule amendments (effective on 1 October 2019) to address backdoor listings and shell activities, the Exchange codified the practices set out in Guidance Letter GL84-15 into Rule 14.06D. This guidance letter supersedes GL84-15.
4. All Rule references in this letter are to the Main Board Listing Rules. As GEM Rule 19.06D is the same as Main Board Rule 14.06D, the guidance set out in this letter also applies to GEM issuers.

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<sup>43</sup> Rules 14.82 to 14.84

## II. Relevant Rule

5. Rule 14.06D state that:

*“Where a listed issuer proposes a large scale issue of new securities (including any shares, warrants, options or convertible securities) for cash to acquire and/or develop a new business, which, in the opinion of the Exchange, is a means to circumvent the new listing requirements and to achieve a listing of that new business, the Exchange may refuse to grant listing approval for the shares to be issued.*

*Note: This rule is an anti-avoidance provision to prevent circumvention of the new listing requirements. It is intended to apply to a large scale issue of securities for cash proposed by a listed issuer where there is, or which will result in, a change in control or de facto control of the issuer (by reference to the factor set out in Note 1(e) to rule 14.06B), and the proceeds are to be used to acquire and/or develop a new business that is expected to be substantially larger than the issuer’s existing principal business. The effect of the proposal is to achieve a listing of the new business that would not have otherwise met the new listing requirements.”*

## III. Guidance

6. Rule 14.06D is an anti-avoidance provision designed to prevent circumvention of new listing requirements through large scale equity fundraisings. When applying this Rule, the Exchange’s approach is targeted towards large scale equity fundraisings that are made to facilitate investors in acquiring controls of the issuers for listing of new businesses that would not have otherwise met the new listing requirements.

### *Application of Rule 14.06D*

7. Rule 14.06D is a purposive test and is assessed based on all relevant facts and circumstances of the issuer. This assessment is not simply based on the size of the equity fundraising proposed by the issuer, but also other factors including the nature and scale of the issuer’s business and its financial position before the fundraising, its business plans and the intended use of proceeds, and whether there is, or will be, any change in control or de facto control of the issuer<sup>44</sup>.

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<sup>44</sup> In making the assessment, the Exchange will consider whether there is any change in the controlling shareholder of the issuer, or any change in the single largest substantial shareholder who is able to exercise effective control over the issuer as indicated by factors such as a substantial change in its board and/or senior management. Where the case involves an issue of restricted convertible securities to the investor, the Exchange will consider whether in substance, the issue serves to allow the investor to effectively “control” the issuer. Please refer to Note 1(e) to Rule 14.06B and paragraphs 19 to 25 of Guidance Letter GL104-19 for details.

8. In general, an equity fundraising with the following characteristics would normally be caught under Rule 14.06D:
- (a) The size of the fundraising would be very significant to the issuer and would bear little or no correlation with the needs of the issuer's existing principal business.
  - (b) Funds raised would be used largely in developing and/or acquiring a new business with little or no relation to the issuer's existing principal business. This would include circumstances where the issuer has started the new business shortly before the proposed fundraising (e.g. obtained a money lending license or acquired a small size money lending company).
  - (c) Employing the cash obtained from the fundraising, the issuer would proceed to operate the new business which is expected to be substantially larger than the original business.
  - (d) The investor would obtain control or de facto control of the issuer through the subscription of securities in the issuer. The effect is that the investor would obtain a listing platform for listing the new business. This is a circumvention of the new listing requirements as the lack of a track record would render such business unsuitable for listing.

Two examples are set out in Part IV below.

*Other points to note*

9. Rule 14.06D is not intended to restrict fundraising activities of issuers for legitimate business expansions or diversifications. As general guidance, the Rule will not normally apply to an issue of securities if, taking into account the proceeds from the issue<sup>45</sup>, less than half of the issuer's assets would consist of cash as a result of the fundraising. Nevertheless, if the Exchange considers that any fundraising, acquisition or other corporate action of the issuer in the future together with the current fundraising are a means to list a new business that is not suitable for listing or otherwise circumvent the new listing requirements, the Exchange may exercise its discretion under Rule 2.04 to impose additional requirements or conditions on such future arrangement(s).
10. Further, the Exchange acknowledges that issuers engaging in asset-light businesses (for example, technology companies in the new economy sector) may have a cash to asset ratio exceeding 50% after fundraising activities. As set out in paragraph 7 above, the Exchange will consider all factors in totality when determining whether an issuer's proposed equity fundraisings is an attempt to circumvent the new listing requirements. The assessment is not simply an analysis of the cash to asset ratio of the issuer.

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<sup>45</sup> These include any proceeds that are intended to be used for specific purposes (whether by way of legally binding agreements or other commitments)

11. For the avoidance of doubt, the Exchange may apply the RTO Rule 14.06B when issuers use the funds raised for acquisitions of new businesses. This may be the case where an equity fundraising was not caught under Rule 14.06D (e.g. there was no change in control or de facto control of the issuer as a result of the fundraising) but the subsequent acquisition using the funds raised constitutes an attempt to circumvent the new listing requirements under the principle based test of Rule 14.06B.

*Consultation with the Exchange*

12. Listed issuers who intend to undertake large scale equity fundraisings are encouraged to contact the Exchange at the earliest possible opportunity to seek guidance on the application of Rule 14.06D in individual cases.

#### **IV. Examples**

13. In each of the following two examples, the Exchange considers that Rule 14.06D would apply to the proposed issue of securities.

Example 1

14. Company A is principally engaged in the garment business. It recorded revenue of about HK\$60 million and a net loss of about HK\$20 million in the latest financial year, and its total assets value was about HK\$100 million.
15. *The proposed subscriptions:* Company A signed subscription agreements to raise a total of HK\$400 million by issuing restricted convertible bonds<sup>46</sup> to subscribers:
  - Upon completion, over 85% of the company's assets would consist of cash. The proceeds from the subscriptions would be mostly used to develop a new mobile game business.
  - Assuming full conversion of the bonds, the conversion shares would represent about 4 times of the company's existing issued shares, and the major subscriber would hold more than 60% of the company's shares as enlarged by the conversion shares.

The major subscriber is an entrepreneur.

16. Immediately after signing the subscription agreements, Company A completed an acquisition of a newly set up company engaged in distributing and marketing mobile games. Taking this into account, Company A's cash would represent 65% of its total assets upon completion of the subscriptions.

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<sup>46</sup> Convertible bonds with a restriction from conversion to avoid triggering a change in control under the Code on Takeovers and Mergers.

17. *The Exchange's analysis:* The Exchange considers that Rule 14.06D would apply to the proposed subscriptions for the following reasons:
- (a) Under the proposal, the subscription amount is significant to the company and the cash level would be 65% of the company's total assets upon completion. The company's assets would comprise substantially of cash.
  - (b) The subscriptions would be a means to list a new business which is unsuitable for listing:
    - The company has been engaging in the garment business since listing. It acquired a company engaged in the mobile game business only after it signed the subscription agreements.
    - The subscription amount is significant to the company. It has no correlation, and is completely disproportionate, to the company's existing garment business. The proceeds would be used to develop and operate a new mobile game business that would be significant relative to the existing business after the subscription.
    - The company would in effect be a listed vehicle for the subscriber (who would acquire a de facto control of the company using the restricted convertible bonds) to develop and operate a new mobile game business which has no track record and does not meet the new listing requirements.

#### Example 2

18. Company B is principally engaged in the business of manufacturing toys. It recorded revenue of about HK\$200 million and a loss of HK\$38 million in the latest financial year, and its total assets value was about HK\$500 million.
19. Two months earlier, Company B obtained a money lender licence in Hong Kong and commenced a money lending business.
20. *The proposed subscriptions:* Company B signed subscription agreements to raise HK\$1 billion by issuing shares to subscribers:
- Upon completion, about 75% of its total assets would consist of cash. The proceeds from the subscriptions would be mostly used to develop the money lending business. In particular, Company B signed loan agreements to provide financial assistance of a total amount of HK\$900 million to several independent third parties. These agreements were subject to completion of the subscriptions.
  - The subscribers would hold about 55% of Company B's shares as enlarged by the new shares.

The major subscriber is a money lending company.

21. *The Exchange's analysis:* The Exchange considers that Rule 14.06D would apply to the proposed subscriptions for the following reasons:
- (a) The subscription amount is significant to the company and the cash level would be 75% of the company's total assets upon completion. Company B's assets would comprise substantially of cash.
  - (b) The subscriptions would be a means to list a new business which is unsuitable for listing:
    - Company B has been engaging in manufacturing toys. The money lending business commenced shortly before the subscriptions were agreed and is a new business of Company B.
    - The subscription amount is significant to Company B. It has no correlation, and is completely disproportionate, to Company B's original toy business. The proceeds would be used to develop and operate the money lending business that would be significant relative to the existing business after the subscription.
    - Company B would in effect be a listed vehicle for the subscribers (who would become controlling shareholders of Company B) to develop and operate the new money lending business that has no track record and does not meet the new listing requirements.
22. Whilst Company B has signed legally binding agreements (i.e. the loan agreements) to ensure that a substantial part of the subscription proceeds would be used shortly after completion of the subscriptions, this does not address the concern about backdoor listing of a new business to circumvention of new listing requirements. These proceeds would be counted for the purpose of calculating the cash to assets ratio of the issuer under Rule 14.06D.

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## Part III

### HKEX GUIDANCE LETTER

HKEX-GL[ ]-[ ] ([date])

|                      |   |
|----------------------|---|
| <b>Subject</b>       | <b>Guidance on sufficiency of operations</b>          |
| <b>Listing Rules</b> | <b>Main Board Rule 13.24</b><br><b>GEM Rule 17.26</b> |

**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.*

#### I. BACKGROUND AND PURPOSE

1. On 1 October 2019, amendments to Rule 13.24 came into effect. The amended Rule 13.24 imposes a continuing listing obligation on a listed issuer to maintain a business with a sufficient level of operations and assets of sufficient value to support its operations to warrant its continued listing.
2. In recent years the prevalence of backdoor listings has resulted in a substantial increase in the value of a listing status, leading to extensive activities related to investors acquiring controls of listed issuers for their listing platforms (rather than the underlying business) for eventual backdoor listings, and listed issuers undertaking corporate actions (such as disposals of businesses) to facilitate the sale of their listing platforms. There were also cases where the listed issuers, after disposing of or otherwise winding down their principal businesses, established or acquired new businesses that have very low barriers of entry and/or can be easily established and discontinued without significant costs. These actions may leave listed issuers with minimal operations or businesses without substance. This, in turn, leads to speculative trading activities and opportunities for market manipulation, and undermines investors' confidence in our market. Where an issuer undertakes shell creation or maintenance activities, the Exchange would apply Rule 13.24(1). Where the Exchange considers that an issuer is not operating a business of substance, it may also question the issuer's suitability for continued listing under Rule 6.01(4) (see Guidance Letter on Listed Issuer's Suitability for Continued Listing (GL96-18)).

3. This letter provides guidance on the purpose behind and the general approach relating to the Exchange's application of Rule 13.24 after its amendments becoming effective. All Rule references in this letter are to the Main Board Listing Rules. As GEM Rule 17.26 is the same as Main Board Rule 13.24, the guidance set out in this letter also applies to GEM issuers.

## II. RULE 13.24

4. Rule 13.24 states:

“(1) An issuer must carry out, directly or indirectly, a business with a sufficient level of operations and assets of sufficient value to support its operations to warrant the continued listing of the issuer's securities.

*Note: Rule 13.24(1) is a qualitative test. The Exchange may consider an issuer to have failed to comply with the rule in situations where, for example, the Exchange considers that the issuer does not have a business that has substance and/or that is viable and sustainable.*

*The Exchange will make an assessment based on specific facts and circumstances of individual issuers. For example, when assessing whether a money lending business of a particular issuer is a business of substance, the Exchange may consider, among other factors, the business model, operating scale and history, source of funding, size and diversity of customer base and loan portfolio and internal control systems of the money lending business of that particular issuer, taking into account the norms and standards of the relevant industry.*

*Where the Exchange raises concerns with an issuer about its compliance with the rule, the onus is on the issuer to provide information to address the Exchange's concerns and demonstrate to the satisfaction of the Exchange its compliance with the rule.*

- (2) Proprietary trading and/or investment in securities by an issuer and its subsidiaries (other than an issuer which is an investment company listed under Chapter 21) are normally excluded when considering whether the issuer can meet rule 13.24(1).

*Note: This rule would not normally apply to proprietary securities trading and/or investment activities carried out in the ordinary and usual course of business by a member of an issuer's group that is:*

- (a) a banking company (as defined in rule 14A.88);*
- (b) an insurance company (as defined in rule 14.04); or*
- (c) a securities house (as defined in rule 14.04) that is mainly engaged in regulated activities under the SFO. It should be noted that proprietary securities trading and/or investment is not a regulated activity under the SFO and accordingly, this exemption is not available where proprietary securities trading and/or investment constitutes a significant part of the business of the securities house.”*

5. The objective of the amendments to Rule 13.24 is to address the issue of “shell companies” in a more effective manner. In particular,

- (a) Under Rule 13.24(1), an issuer must carry out a business with a sufficient level of operations to warrant its continued listing. An issuer that holds significant assets but does not carry out a sufficient level of operations is not compliant with the amended Rule.
- (b) Under Rule 13.24(2), an issuer's proprietary trading and/or investment in securities is normally excluded when examining its sufficiency of operations and assets under Rule 13.24(1)<sup>47</sup>.

The exception applies to proprietary securities trading and/or investment activities carried out in the ordinary and usual course of business by a member of an issuer's group that is a banking company, an insurance company or a securities house, provided that, in the case of a securities house, that member is mainly engaged in regulated activities under the SFO. It should be noted that proprietary securities trading and/or investment is not a regulated activity under the SFO and accordingly, this exemption is not available where proprietary securities trading and/or investment constitutes a significant part of the business of the securities house.

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<sup>47</sup> Before the amendments to Rule 13.24, there were cases where proprietary securities trading was employed to maintain listed shells and was not demonstrated to be a business of substance. Also see paragraphs 11 to 15 of this guidance letter.

6. Where an issuer fails to meet Rule 13.24(1), the Exchange would suspend trading in the issuer's securities under Rule 6.01(3). The issuer would generally be given a period to remedy the issue, failing which the Exchange may cancel the listing of the issuer's securities<sup>48</sup>.

### **III. GENERAL APPLICATION OF RULE 13.24(1)**

#### **(A) Listed issuers with minimal operations**

7. The Exchange notes a number of cases where the listed issuers completely or substantially ceased their operations or otherwise maintained only minimal operations. This might have resulted from (a) the issuers having gradually scaled down or discontinued their principal business (or a material part thereof), or (b) continual deterioration of the issuers' business due to, for example, decline in the demand for the relevant products or services or deterioration in the business condition of the specific industry. In these circumstances, they failed to maintain a viable and sustainable business to comply with Rule 13.24(1)<sup>49</sup>.
8. Among other situations, a listed issuer with the following characteristics would normally be considered not to have a viable and sustainable business that meets Rule 13.24(1):
  - (a) The issuer maintains a very low level of operating activities and revenue, raising an issue that the size and prospect of the issuer do not appear to justify the costs or purpose associated with a public listing. This may happen, for example, where the issuer's business does not generate sufficient revenue to cover corporate expense, resulting in net losses and negative operating cashflow.
  - (b) This current scale of operation does not represent a temporary downturn, as the issuer's business has been operating at a very small scale and incurring losses for years.

However, an issuer experiencing a temporary reduction or suspension of operations due to market conditions or business strategies would not be considered to have failed Rule 13.24(1) only because of the temporary circumstances. For example, a mining issuer with its mines being suspended on a temporary basis would not be considered to fail Rule 13.24(1).

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<sup>48</sup> See Rules 6.01A and 6.10 and Guidance Letter on Long Suspension and Delisting (GL95-18).

<sup>49</sup> See the note to Rule 13.24(1)

- (c) The issuer fails to demonstrate that it has sufficient assets to support an operation that generates sufficient revenue and profits to warrant a continued listing.

An assessment of sufficiency of assets is with reference to and commensurate with the particular nature, mode and scale of the issuer's operations. It is acknowledged that there are asset-light businesses which, compared to asset-heavy businesses, require assets of lesser value to support their viability and sustainability. Assets that are not used to support an issuer's operations are disregarded.

- 9. As examples, two issuers were considered not to comply with Rule 13.24(1):
  - (a) In Listing Decision LD115-2017, the issuer's businesses included coal exploration which never generated any revenue due to regulatory prohibitions and coal trading which generated about HK\$11 million only from a few customers with a segment loss for each of the last three years. The issuer had also fully impaired the values of its mining right licences. The size of such operations did not justify a continued listing.
  - (b) In Listing Decision LD118-2018, the revenue of the issuer's retail sales of second-hand motors dropped by 95% to less than HK\$5 million over the past five years, resulting in net losses and negative operating cashflows. The continued deterioration of such business resulted in the issuer maintaining only minimal operations that did not justify a continued listing.

Other examples of non-compliance include Listing Decisions LD105-2017 and LD116-2017.

- 10. Based on our experience, other circumstances that may lead to issuers having minimal operations and failing to comply with Rule 13.24(1) include:
  - (a) financial difficulties which seriously impair an issuer's ability to continue its business or which lead to the suspension of some or all of its operations;
  - (b) the issuer becoming insolvent, as may be evidenced by an uncontested petition for winding up, an order of winding up or the appointment of a liquidator (provisional or not); or
  - (c) the issuer losing its major operating subsidiaries.

## **(B) Business of no substance**

11. Where an issuer's business or a material part of its business is not demonstrated to have substance, the Exchange would also consider that the issuer does not have a viable and sustainable business to comply with Rule 13.24(1)<sup>50</sup>.
12. The Exchange notes that there were cases where the issuers, given their specific business models and the specific facts and circumstances, were not operating a business of substance. These issuers carried on their activities for the purpose of maintaining their listing status rather than genuinely developing their underlying businesses. Certain types of businesses, such as money lending and indent trading<sup>51</sup>, are commonly employed for such purpose.
13. In its assessment, the Exchange would examine the specific facts and circumstances of the issuer's business including the business model, operating scale and history, source of funding, size and diversity of customer base and internal control systems of the business of that particular issuer, taking into account the norms and standards of the relevant industry.
14. For example, subject to the specific facts and circumstances, a business of money lending or indent trading with the following business models would raise a concern that the business is operated to maintain the issuer's listing status rather than being operated commercially, hence a concern that the business does not have substance:
  - (a) Money lending business – the business is carried out without a clear business objective or strategy, a reliable source of funding, or an appropriate infrastructure of credit evaluation, risk management, collections and other functions that are typical of a publicly-listed money lending business. The business maintains a minimal scale of operation, with only a few employees, a high concentration of customers and a small loan portfolio which comprised mainly short term and unsecured loans.
  - (b) Indent trading business – the business involves only the issuer sourcing products from suppliers and selling them to a few customers on a back-to-back basis. The issuer provides limited value added services, and does not have demonstrable competitive advantages in procuring new sales orders or expanding customer base. The business is operated by a few employees and generates minimal revenue or gross profits.

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<sup>50</sup> See the note to Rule 13.24(1).

<sup>51</sup> There were also cases where proprietary securities trading was employed to purportedly maintain a listing status. Under the new Rule 13.24(2), subject to a few specific exceptions stated therein, such business is excluded when examining an issuer's compliance with Rule 13.24(1). See paragraph 5 of this Guidance Letter.

15. Based on our experience, other circumstances that may lead to a concern about the substance of a business include:
- (a) reliance on a limited number of transactions or customers, and/or a single source of business (for example, referrals by a connected person or a particular employee);
  - (b) the business in question being of a type which has a very low barrier of entry, can be easily established and discontinued without significant costs and/or is asset-light; and
  - (c) the basis for generating substantial fees/revenue from the relevant transactions being unclear or questionable.

#### **IV. APPLICATION OF RULE 13.24(1) TO SHELL ACTIVITIES**

16. As elaborated below, to facilitate sales of “listed shells”, some listed issuers conducted corporate actions such as disposals of businesses, leaving behind minimal operations. There were also cases where the listed issuers, after disposing of or otherwise winding down their principal businesses, established or acquired new businesses unrelated to their original businesses for purported compliance with Rule 13.24(1). Where an issuer undertakes shell creation or maintenance activities, the Exchange would apply Rule 13.24(1).

##### **(A) Corporate Action**

17. Based on our experience, some listed issuers structured their corporate actions to substantially scale down its operations through, for example, (i) disposing of the core business which generated the majority of revenue or profit, or (ii) artificially carving out a substantial part of the core business (see examples in subparagraphs (a) and (b) below). This caused a significant reduction in their assets, revenues and profits, leaving behind minimal operations which were loss making or generated minimal profits. An issuer conducting a corporate action involving a disposal of or having the effect of discontinuing its principal business (or a material part thereof) must satisfy the Exchange that after the corporate action, it would maintain a business which is viable and sustainable and has substance to comply with Rule 13.24(1). Otherwise, the Exchange will suspend trading in the issuers’ securities upon completion of their corporate actions (see Rule 6.01(3)).
- (a) In Listing Decision LD97-2016, the issuer proposed to dispose of its construction business accounting for a large majority of total revenue and assets since initial listing, leaving its property and trading businesses with a track record of less than one year and minimal revenue which did not cover corporate expenses. The proposed corporate action would result in the issuer becoming a listed shell without a business which was viable and sustainable to justify a continued listing.

- (b) In Listing Decision LD99-2016, the issuer manufactured communication products under different brands and proposed to sell the major brands, which constituted the bulk of its assets and operations and had been profitable, back to the controlling shareholder. While the issuer asserted its intention to continue the business, the proposed sale would result in the remaining business only consisting of minor brands that were historically loss making and would not generate sufficient revenue and profits to justify a listing. This proposed corporate action would also leave the issuer with a minimal operation that was not viable and sustainable to meet Rule 13.24.

Other examples include Listing Decisions LD35-2012, LD88-2015, LD98-2016 and LD112-2017.

**(B) Newly established or acquired business**

- 18. We have also noted cases where an issuer, after disposing of or otherwise substantially scaling down its business, established or acquired a new business to purportedly comply with Rule 13.24(1). Such business may be unrelated to its original business, may not be viable or sustainable and/or may not have substance, having regard to the specific facts and circumstances including, for example, such business being of a limited scale and operated only by a few employees, lacking management expertise (for example, the board of directors having no relevant experience), and/or falling within the situations described in paragraphs 12 to 15 above.
- 19. In such cases, the Exchange would consider that the issuers do not comply with Rule 13.24. For example,
  - (a) In Listing Decision LD105-2017, the issuer ceased its principal business and commenced a number of new trading businesses which were asset-light, had low entry barriers and relied on a few customers and suppliers to maintain a very low level of operations. Such businesses were not demonstrated to be viable and sustainable. The issuer was in effect a listed shell.
  - (b) In Listing Decision LD118-2018, the issuer sought to rely on its new business of wholesaling newly branded motor vehicles in the PRC to meet Rule 13.24(1). Without a track record of performance, a reliable customer base, a credible projection of revenue and profit or other supportive information, the new business was not demonstrated to be viable and sustainable.
  - (c) In Listing Decision LD112-2017, the issuer's newly acquired advisory business had a significant increase in revenue in recent months. However, the issuer failed to demonstrate the viability and sustainability of the business, having regard to the heavy reliance on connected person(s) or particular employee to generate business and questionable basis for the substantial fees/revenue generated from the relevant transactions.

Other examples include Listing Decisions LD115-2017 and LD116-2017.

## **V. General obligations of listed issuers and the Exchange's assessment process**

20. It is a listed issuer's continuing listing obligation under Rule 13.24 to maintain a business with a sufficient level of operations and assets of sufficient value to support its operations to warrant its continued listing. To demonstrate compliance, an issuer must ensure that it makes adequate disclosure of its business affairs, operation status and financial performance. In particular, an issuer is specifically required to publish financial results and reports in compliance with under Rules 13.46 to 13.49 and disclose inside information required to be disclosed under the Inside Information Provisions<sup>52</sup>. These disclosures provide transparency to the market and enable the Exchange to monitor its compliance with Rule 13.24.
21. As part of its regulatory supervision on listed issuers, the Exchange monitors issuers' activities and compliance with the Listing Rules primarily on the basis of their disclosures. Based on an issuer's periodic financial results and other disclosures, the Exchange makes a preliminary assessment of the issuer's compliance with Rule 13.24 on an ongoing basis.
22. If the Exchange is concerned with a particular issuer's compliance with Rule 13.24 upon such preliminary assessment, the Exchange may write a letter to the issuer setting out the observations giving rise to the concern and requesting the issuer to provide a written submission within a specified time period (normally three weeks) showing cause with reasons as to why, despite the matters set out in the letter, it still complies with Rule 13.24 and hence the Exchange should not commence the procedure to cancel its listing. The Exchange will make a ruling on the basis of the information available to it upon the expiry of the specified time period.
23. In response to the Exchange's request, the issuer must provide information to address the Exchange's observations and concerns set out in the letter. Without prejudice to the generality of such request, the issuer is also specifically expected to provide the following information (if not in the issuer's public documents) to demonstrate that it has a business which is viable and sustainable and has substance:
  - (a) the business objective, strategy and plan;
  - (b) the business model including how the business operates and generates revenue and profits, and the source of funding;
  - (c) the operating scale, management expertise and scale of staff or manpower;
  - (d) the size and diversity of customer base and source of supply;
  - (e) the role of and relationship with key business stakeholders;

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<sup>52</sup> Part XIVA of the Securities and Futures Ordinance

- (f) the infrastructure and other functions in support of the operation (e.g. internal systems or controls), together with a comparison with industry norms and standards if appropriate; and
  - (g) the board's views on the business prospect supported by a credible profitable forecast, if any, which is prepared on the basis of substantiated evidence.
24. Rule 13.24 is a qualitative test and is assessed based on the specific facts and circumstances of individual cases. Therefore, a numerical comparison with other listed issuers (for example, in terms of revenue, profit or assets) would not be an appropriate approach for an issuer to address the Exchange's concerns.

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## APPENDIX V : LIST OF RESPONDENTS

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### INSTITUTIONS

#### Listed Issuers

1. AIA Group Limited
2. Cathay Pacific Airways Limited (*note 2*)
3. CK Asset Holdings Limited
4. Grand Ocean Advanced Resources Company Limited
5. Hong Kong Aircraft Engineering Company Limited (*delisted on 29 November 2018; note 2*)
6. Kingston Financial Group Limited
7. Ping An Insurance (Group) Company of China, Ltd.
8. SHK Hong Kong Industries Limited
9. Swire Pacific Limited
10. Swire Properties Limited (*note 2*)
11. to 22. 12 issuers requested anonymity (*note 3*)

#### Professional Bodies / Industry Associations

23. ACCA Hong Kong
24. Hong Kong Institute of Certified Public Accountants
25. The Chamber of Hong Kong Listed Companies
26. The Hong Kong Institute of Chartered Secretaries
27. The Hong Kong Institute of Directors
28. The Law Society of Hong Kong
29. The Y. Elites Association

#### Accounting Firm

30. Ernst & Young

#### Law Firms

31. Cleary Gottlieb Steen & Hamilton (Hong Kong)
32. Harney Westwood & Riegels
33. Sherman & Sterling
34. Simmons & Simmons
35. Slaughter and May
36. Wellington Legal
37. 1 law firm requested anonymity

### **Corporate Finance Firms**

- 38. Anglo Chinese Corporate Finance, Limited
- 39. Asian Capital Limited
- 40. Baoqiao Partners Capital Limited, Donvex Capital Limited and Optima Capital Limited (joint response)
- 41. Central China International Capital Limited
- 42. HeungKong Capital Limited
- 43. Kingston Corporate Finance Limited (*note 4*)
- 44. Yu Ming Investment Management Limited
- 45. to 47. 3 corporate finance firms requested anonymity

### **Investment Management Firms**

- 48. BlackRock Asset Management North Asia Limited
- 49. Chartwell Capital Limited
- 50. Hermes Equity Ownership Services Limited

### **Other Entities**

- 51. China Securities (International) Financial Holding Company Limited
- 52. 1 other entity requested anonymity

### **INDIVIDUALS**

- 53. Chen Sze Hon Johnson
- 54. Christopher Cheung Wah-fung
- 55. Francesco Navarrini
- 56. Jacky Yeung
- 57. KC Mok
- 58. Liu Ka Lim
- 59. Terence Lau
- 60. Wong Kong Chi
- 61 to 121. 61 individuals requested anonymity (*note 5*)

#### *Notes:*

1. *The total number of responses is calculated according to the number of submissions received and not the underlying members that they represent.*
2. *Contents identical to Swire Pacific Limited, the controlling shareholder of Cathay Pacific Airways Limited, Hong Kong Aircraft Engineering Company Limited and Swire Properties Limited.*
3. *Among which 10 responses were entirely identical in content.*
4. *Contents identical to Kingston Financial Group Limited, the holding company of Kingston Corporate Finance Limited.*
5. *Among which 56 responses were entirely identical in content.*

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